

# foreign policy *in focus*



Interhemispheric Resource Center  
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## Restructuring East-Central European Economies

In 1990, after the collapse of its communist governments, East-Central Europe confronted a daunting challenge: to transform its stagnant economies as quickly as possible, with few resources and little experience. Although differing in many respects, the countries in the region suffered from many of the same problems. They carried (or would soon carry) large foreign debts, supported a huge number of unproductive state enterprises, could no longer rely on the trade network of the Council for Mutual Economic Assistance (Comecon),

### Key Points

- Structural adjustment has been pitched as the only acceptable economic reform model.
- This unpopular reform has created political and economic instability.
- In promoting structural adjustment, the U.S. has concentrated on short-term profits for businesses and narrow diplomatic gain.

and faced serious health and environmental problems. The U.S.—along with key international funders such as the World Bank, International Monetary Fund (IMF), and the European Bank for Reconstruction and Development (EBRD)—offered a firmly stated and well-articulated panacea: structural adjustment.

Based largely on economic-reform models exported to third world countries in the 1980s, this brand of structural adjustment involved

three basic components: liberalization, stabilization, and privatization. In other words, the new governments in East-Central Europe were advised to:

- Stabilize the economy by cutting government expenditures, restricting the money supply, raising interest rates, and lowering inflation.
- Liberalize prices by removing state subsidies and price controls.
- Sell off state-owned businesses and encourage the growth of a private sector.

The U.S. and its economic allies not only insisted on this reform outcome but also pressed for a rapid rather than a moderate pace of change. In return for compliance with these strictures, the international financial community would then provide the desperately needed

loans to begin the transition and help integrate these countries into the Western trading system.

With money contingent on the adoption of structural adjustment, government opinion in the region soon coalesced around this single path to the market. Riding a crest of postrevolutionary support, these first governments could count on substantial political capital to enact reform. On the advice of the West, they spent that political capital on a highly unpopular economic reform, which was all the more unpopular because it came after at least a decade of austerity communism.

Workers went out on strike and other social movements filled the streets with protests. But the governing elites, desperate for outside capital, continued to hold to the structural-adjustment line, even as the fast-track market reforms led to the collapse, one after another, of the reform governments. And when reform socialists won elections in Poland, Hungary, Romania, and Bulgaria, they, too, quickly notified international funders that, campaign propaganda to the contrary, they had no intention of deviating from the economic model pushed by the West.

Initially, expectations ran high in the region that the U.S. would sweeten the pill of structural adjustment with a large outpouring of aid, a second Marshall Plan. The largesse never materialized (except in the case of German unification). Instead, the U.S. and its allies used the model of structural adjustment to drive a permanent trade wedge between East-Central Europe and Russia and open up the entire region to U.S. businesses. The U.S. also saw an opportunity to weaken the European Union's Common Agricultural Policy (which the U.S. has opposed in world-trade negotiations) by making agricultural subsidies to potential EU members in the East unsupportable.

In other words, instead of mandating policies to stabilize the region, the U.S. has cloaked its strategy of narrow and short-term self-interest in the rhetoric of the universal values of liberty, freedom, and prosperity.

Six years into the transition from communism to capitalism in East-Central Europe, U.S. economists, consultants, and businesses have portrayed their experiment as a resounding success. Despite this triumphalism, structural adjustment has produced a set of ills familiar to those who have experienced the model elsewhere in the world: depression, unemployment, a growing divide between rich and poor, and increased social unrest.

In East-Central Europe, the model has also encouraged corruption, irreparably damaged the regional trading network and, even at a time of deindustrialization, further degraded an already poisoned environment. The rapid pace of reform has intensified these negative consequences and accentuated tensions along the lines of class, gender, and ethnicity.

The recessions in East-Central Europe have stimulated a lively debate among economists. In the first years of transition, 1990-92, the economic statistics were clear. Every economy in the region bottomed out, with the gross domestic product (GDP) falling between 7 and 15 percent a year and with both industrial and agricultural production dipping dramatically. According to the World Bank, the GDP in the region fell on average by 16% from 1989 to 1994, a collapse comparable to the Great Depression in the U.S. during the 1930s.

By 1995, however, most economists proclaimed a dramatic turnaround. True, Bulgaria and Romania were still in dreadful economic shape (not to mention the virtual collapse of war-torn former Yugoslavia). But Poland posted real GDP growth of 7%, Slovakia 7.4%, and Albania an astounding 11%. And these figures, optimists argued, did not accurately capture all the private-sector growth, much of it in the informal economy.

These impressive growth rates, however, conceal that the economies of East-Central Europe have not recovered to their 1989 levels, which in turn were not impressive. Moreover, the economies will probably not recover fully until at least the year 2000. To reach the 1994 EU average at present growth rates, East-Central Europe will need at least forty years, according to the World Bank.

Meanwhile, the social consequences have been dire. In 1996, unemployment figures varied widely in the region, from only 3% in the Czech Republic to 12.5% in Slovakia, 10% in Bulgaria, 11% in Hungary, and 15% in Poland. While many unemployed supplement their government benefits with unreported income, the living is still harsh. Even for the formally employed, the fall in real wages has been severe (33.6% in Poland from

1990 to 1992, 21.5% for the Czech Republic over the same period). Women, usually the first to be fired, have suffered disproportionately from the layoffs.

While a small elite has profited handsomely in this new economic environment, a new mass of poor is growing on the other end of the spectrum. In Bulgaria, for instance, the percentage of people below the poverty line rose from 2% in 1987 to 33% in 1994-5. In Poland, the ranks of the poor swelled from 6% to 12% over the same period. With the IMF insisting on reduced budget deficits, governments have cut back on social services such as health care, child care, and pensions. A shrinking social safety net is paradoxically expected to support an ever-increasing burden.

A key policy fueling conflict between the transition's winners and losers has been privatization. A cornerstone of Western policy, the rapid sell-off of state properties has also been enormously attractive to the governments in the region.

Privatization is a narcotic. It provides a large infusion of capital that can help balance budgets and pay off debts. But it is a one-time shot in the arm that unloads the profitable and unprofitable alike and is even beginning to fragment "natural monopolies," such as utilities and railways. Because of its accelerated pace, privatization also resembles less an orderly transfer of state assets to the population (through the distribution of vouchers or the sale of stocks) than a wholesale looting, with Western businesses given extremely favorable terms and government officials using their connections to line their own pockets or the pockets of their cronies.

Finally, the West has done little to improve the environment in the region. Deindustrialization—and the closing of hundreds of unprofitable polluters—could have been a great opportunity. But without Western pressure, the governments in the region did not take advantage of this window of opportunity.

The structural-adjustment model has placed profit and efficiency above the value of a clean environment. Energy lobbies, backed by their Western partners, have tightened the region's dependency on fossil fuels and nuclear power. Many privatization contracts have included environmental escape clauses. Bankruptcies often have left the question of cleanup unanswered since the governments simply have not had the requisite funds.

### Key Problems

- Economic growth has been inconsistent.
- The social and environmental consequences have been dire.
- Privatization has widened the gap between rich and poor.

Structural adjustment is well underway in East-Central Europe. It has survived changes in government, waves of strikes, reductions in foreign aid, and refugee pressures from the east and south. But it has not produced stable, equitable, or healthy economies. The governments in the region can still do a great deal to ensure a future of equitable and sustainable growth. And the U.S. can, in the following ways, alter its pattern of carrots and sticks to encourage this result.

## Industrial policy.

It is unlikely that in today's climate the U.S. would actively promote a full-scale industrial policy in which the governments in the region pick and subsidize winners in the economy. But the U.S.

must recognize that the state can play an important stabilizing role in shaping markets, directing public investment into high-technology and projects that require high costs of entry, and promoting strong health and educational policies that stimulate economic growth. The U.S. should also stop encouraging rapid privatization

and provide more space for the countries of East-Central Europe to choose their own mix of public and private ownership. Debt forgiveness is key to enabling governments to play a constructive economic role (the steep reduction of Polish debt contributed largely to that country's rebounding growth rate).

## Social policy

The World Bank's answer to escalating poverty is growth, understood to be a rising tide that raises all boats. But growth alone will not alleviate social ills, particularly when the growth is uneven and the redistribution mechanisms are weak (the experience of the U.S., where growth has not eliminated poverty, should be sufficient proof). When the governments in East-Central Europe have stepped in to ease the pain of transition, the results have been significant. In 1990, the Czech government instituted a comprehensive job-information system and a strong job-creation program that have contributed to keeping unemployment there extremely low. In Hungary the rise in poverty has been relatively small because Constitutional Court decisions forced the government to retain welfare policies that offset rising inequality.

## Environmental policy.

It will take, according to analyst Roger Manser, as much as \$600 billion over two decades for economic restructuring in the region to meet environmental standards. But in the early 1990s, only \$2-3 billion made it to East-Central Europe. The U.S. should be a leader in providing funds for environmental cleanup in the region. It could provide start-up capital, for instance, for a regional "superfund" that would finance the cleanups for which neither governments nor businesses in the region have the money. As importantly, the U.S. should help train people in the region to run such programs and not simply pay U.S. consultants to do the work. Finally, the U.S. should encourage the growth of environmentally responsible businesses in the region that produce energy-efficient boilers, battery-driven buses, filters, and pollution-monitoring equipment.

## Trade policy.

The growth of the successful economies of East Asia were largely fueled by exports. But to build up domestic industries, these countries not only adopted industrial policies but also protected indigenous business behind trade barriers. The U.S. should recognize the critical nature of transition and permit East-Central Europe an exemption from trade liberalization. It should also encourage the strengthening of trade links within the region and between the region and the former Soviet Union. This part of the world is still riven with many conflicts—economic, political, and ethnic. Competition for trade with the West will only sharpen such divides.

These new policies will cost money but the price tag will not be high compared with the costs of NATO expansion or the expense of current U.S. military commitment to Europe. Instead of pouring money into security band-aids, the U.S. should ensure that the region does not descend into a morass of economic inequity, political instability, and cross-border tensions that will eventually trigger military conflict. Moreover, by linking such reforms to the future stability of Russia rather than pitting the two regions against one another, the U.S. can guarantee that East-Central Europe is a bridge between East and West and not merely a dangerous and endangered buffer zone.

*Written by John Feffer, National Writers Union, Philadelphia. Author of Shock waves: Eastern Europe after the Revolutions. Co-editor of Europe's New Nationalism.*

### Key Recommendations

- Support stronger social programs such as education and health.
- Encourage greater public investment and step back from rapid privatization.
- Provide funds for environmental cleanup and facilitate the growth of environmentally responsible businesses.

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