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WORKING PAPER 37

REFORM, REINTEGRATION AND REGIONAL SECURITY

The Role of Western Assistance in Overcoming Insecurity in Central and Eastern Europe

by Jeanne Kirk Laux

October 1991

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PREFACE

Working Papers, the result of research work in progress or the summary of a conference, are often intended for later publication by the Institute or another publisher, and are regarded by the Institute to be of immediate value for distribution in limited numbers — mostly to specialists in the field. Unlike other Institute publications, *Working Papers* are published in their original language only.

Jeanne Kirk Laux is Professor of Political Science at the University of Ottawa. This *Working Paper* draws on the series of interviews the author conducted during 1991 thanks to funding from the Peace and Security Fund administered by CIIPS. Discussions about the terms and conditions of Western assistance to Central and East Europe took place with Canadian federal government officials, World Bank officers (Washington), and with senior officials at the OECD (Paris); CSCE (Prague); European Commission (Brussels) and the EBRD (London).

The opinions contained in this paper are those of the author and do not necessarily represent the views of the Institute and its Board of Directors.

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CONDENSÉ

Tous le comprennent maintenant, l'insécurité n'a pas disparu avec la Guerre froide; la fin de celle-ci a plutôt donné lieu à de nouvelles formes troublantes d'insécurité. Les pays occidentaux, notamment en Europe, craignent surtout qu'un échec de la transition économique et politique en Europe de l'Est vienne aussi compromettre la prospérité et la stabilité de l'Ouest.

L'inquiétude croît à un moment où l'on cherche à solidifier le Marché européen unique. Jacques Delors, président de la Commission européenne, explique pourquoi il faut fournir une aide plus grande aux pays de l'Europe centrale et orientale (PECO) : «Ces pays sont au bord de la faillite; si le pire se produit, les réformes démocratiques avorteront.»

Un autre motif d'insécurité plus alarmant découle d'une dissolution rapide des deux structures parrainées par l'URSS, à savoir le Pacte de Varsovie et le Comecon (les deux ont été dissoutes en juin 1991), et d'une vague de nationalisme. La nouvelle pensée du président Gorbatchev et les grands discours parlant d'une «seule et grande maison européenne», c'est bien joli, mais la désintégration de l'Union soviétique et la guerre en Yougoslavie laissent planer des doutes. Cette situation, peu rassurante disons-le, rend d'autant plus urgentes l'intégration et la protection des autres petits pays situés le long de la ligne de faille géopolitique de l'Europe.

L'unification allemande représente un cas étonnant et tout à fait exceptionnel, un processus qui a absorbé une somme imprévue de capitaux et d'énergie politique ouest-allemands. Le financier français Pierre Moussa, ne mâche pas ses mots : même si les marchés de l'Est déçoivent les investisseurs et même si les manifestations violentes des nationalismes affligent les peuples, les capitaux doivent «couler» vers l'Europe de l'Est, car ils représentent, sous une nouvelle forme, le budget consacré à la «défense».

Tout compte fait, la simple question de savoir «qui doit donner quoi à qui» paraît maintenant fort complexe : elle entraîne diverses implications non seulement pour le processus de réforme dans l'Est, mais aussi pour la sécurité à l'Ouest. Le présent *Document de travail* vise à familiariser le lecteur avec les thèmes se rapportant actuellement à l'aide occidentale, car ils pourraient bien déteindre sur des éléments plus vastes de la politique extérieure.

Quiconque veut évaluer les options du Canada doit tout d'abord reconnaître que l'aide occidentale consentie aux pays d'Europe centrale et orientale s'inscrit dans une démarche à trois volets : la réforme, la réintégration et la sécurité régionale. Sur le premier de ces plans, l'aide vise à faciliter, dans chaque pays d'Europe centrale et orientale, des changements qui étayeront l'infrastructure des économies de marché et les démocraties libérales. Que sommes-nous disposés à faire pour soutenir ces pays ? Quelles formes notre aide prendra-t-elle, quelle en sera l'ampleur et à quelles conditions l'accorderons-nous ?

Sur le deuxième plan, les réformes, conjuguées à la révision des régimes internationaux établis de commerce et de paiement, ont pour objet de réintégrer à l'économie mondiale les anciens pays communistes. Garderons-nous ces pays dans nos marchés et nos organisations multilatérales ? Quand, et à quelles conditions ?

Sur le dernier plan, la réintégration a pour but ultime de favoriser la réalisation d'un projet géopolitique d'une plus grande envergure : créer un nouvel ordre de sécurité dans la région européenne. À cet égard, les pays européens jouent du coude entre eux pour «se placer les pieds», tout comme le font l'Europe, l'Amérique du Nord et, dans une moindre mesure, le Japon, l'un par rapport à l'autre. L'aide économique favorisera les intérêts politiques et la sécurité de divers intervenants. D'accord, mais ceux de qui en particulier ?

L'auteure commence par présenter directement les intervenants clefs fournissant déjà une aide économique, puis elle précise sommairement la valeur quantitative de l'assistance accordée depuis 1989 et les formes que celle-ci prend. Elle met exclusivement l'accent sur les petits PECO (sauf l'Union soviétique). Dans ces pages, l'auteure annonce son analyse des trois grands volets susmentionnés des programmes d'aide.

L'auteure examine les politiques des principaux donateurs (le G-24) et des grandes institutions, notamment la Banque européenne de reconstruction et de développement (BERD), première organisation internationale d'après la Guerre froide. La notion maîtresse de cette évaluation est la «conditionnalité» : de quelles conditions l'aide occidentale s'assortit-elle ?

Dans la dernière partie, l'auteure montre comment les programmes d'aide ont des conséquences pour la sécurité régionale, alors que les dirigeants des États-Unis et des douze pays européens, en particulier, cherchent à redessiner l'architecture de l'Europe pour l'adapter aux besoins du Vieux Continent d'après la Guerre froide. Dans ses conclusions, l'auteure fait valoir que le Canada doit réitérer son engagement en faveur des réformes dans les PECO, en posant l'hypothèse fondamentale que l'assistance consentie à l'Est intéresse également les relations Ouest-Ouest et l'édification d'un nouveau régime de sécurité régionale en Europe.

I INTRODUCTION: THE TRIPLE R AGENDA

Now that euphoria at the end of the Cold War has dissolved into concern about the disintegration of the Soviet Union, civil war in Yugoslavia and the uneven progress of reforms in the rest of Central and Eastern Europe, many Western governments are reassessing their policy options. If all could still agree with US Secretary of State Baker just prior to the London Summit that these countries "need ongoing support to become lasting democracies," very little else is certain![1] Western policy choices have become more, not less, complex during the two eventful years since the 1989 Sommet de l'Arche where the seven leading industrial countries (G-7) first agreed to coordinate programmes to assist reform in Poland and Hungary. Not only have the forms of assistance multiplied, but so has the number of governments and institutions delivering or receiving them. Now twenty-four Western governments including Japan (G-24) coordinate assistance to all Central and Eastern European countries (CEEC). The cumulative value of their official bilateral commitments has reached more than $30 billion (US) and, when the value of debt reductions is included, this assistance surpasses the global lending of the World Bank in the same period.

Reconsideration of assistance to the CEEC is underway not only because other claimants for scarce resources have raised their voices, but because the transition away from command economies now appears to be a longer, more costly process than many bargained for. Academic debates over the sequencing of reforms — gradualism versus "big bang" shock therapy — have given way to a sober recognition that many economic and political problems inherited from the socialist regimes are intractable. The United Nations Economic Commission for Europe (ECE) exceptionally chose to update its annual report after six months because "the collapse of the Soviet-led Comecon trading bloc had plunged its former East European member states deeper into recession and cut trade among them far more than expected."[2] The reluctance of many private sector lenders and investors in the West to commit resources makes it obvious that the transition to market economies in the East will be neither short nor smooth. Indeed, the first analysis of capital flows — comparing needs to current trends — shows enormous shortfalls which would require either diversion from the Third World or increased interest rates in the industrial countries.[3] The abortive

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1 Secretary of State James A. Baker III, Address to the Aspen Institute, Press Transcript, Berlin, 19 June 1991, p.1.

2 As summarized in the *Globe and Mail*, 10 July 1991.

3 *The Economist*, 6 July 1991, p.61 drawing on GATT studies.

coup d'état in Moscow has raised the ante and brought new demands from the fledgling sovereign republics.

In these difficult circumstances, what may motivate policy-makers and public opinion in the West to divert resources to Central and Eastern Europe? The end of the Cold War, all now realize, is not the end of insecurity, but rather a source of disturbing new insecurities. The fundamental insecurity for Western donors, particularly in Europe, turns around the fear that failure of the economic and political transition in Eastern Europe could spill over and jeopardize Western prosperity and stability. Concern is heightened at a time when the European Single Market is being consolidated. For Jacques Delors, President of the European Commission, the main rationale for increasing aid to the CEEC rests on the fact that: "There is a grave risk that these countries will become bankrupt and the democratic reforms will be stifled."[4] By coordinating G-24 aid, the EC has necessarily become the "world leader of the 'salvation army'," recognizing "that if it does not do more to help Eastern Europeans stay at home and earn a living it might have to face the prospect of massive westward migration."[5]

Apprehension about Eastern European immigration is fuelled by social tensions and political debate in Europe over Third World immigrants. *The Economist* warned its readers last spring that:

> As unemployment sweeps through Eastern Europe and the Soviet Union disintegrates, the numbers may continue in the low millions in each year of the 1990s. The citizens of Western Europe, already suffering from rising unemployment, are deploying troops to keep out refugees along the old Iron Curtain.[6]

What may have sounded alarmist became a reality in front-page news photos of Italian troops holding back rioting Albanian refugees. Small wonder that the G-7 at the London Summit last July reaffirmed support for Central and East European reforms by underscoring the West's self-interest in their success.[7]

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4 "Europe Supports $2.4 Billion plan to assist Kremlin," *New York Times*, 15 December 1990.

5 This felicitous phrase is David Buchan's in the *Financial Times* (London), 4 February 1991.

6 *The Economist* editiorial "Poor Men at the Gates," 16 March 1991

7 G-7 Political Declaration as reprinted in *Le Monde*, 17 July 1991.

Another, more ominous sense of insecurity stems from the surprisingly rapid disintegration of both Soviet-sponsored organizations — the Warsaw Pact and the Comecon (each disbanded in June 1991) — and the explosion of nationalism. President Gorbachev's "new thinking" and the rhetoric of a "common European homeland" was all very well, but what if there should be a return to communist rule in the Ukraine or inter-republican military intervention? Such unpleasant scenarios give tremendous urgency to integrating and insulating the smaller countries located on Europe's geopolitical faultline. German unification is a dramatic but entirely exceptional solution, and one which has absorbed an unexpected amount of West German capital and political energy. France's outspoken financier, Pierre Moussa, put it bluntly: despite investors' disappointment with Eastern markets and despite humanitarians' distress over violent nationalism, capital must flow to Eastern Europe because it constitutes the new "defence spending."[8]

All in all, the simple question of who should give what to whom now appears to be a loaded question — loaded with implications not just for the reform process in the East, but for security in the West. This working paper is offered as initiation to the current issues surrounding Western assistance as they may affect broader foreign policy issues.

The starting-point for assessing Canada's choices is to recognize that Western assistance to Central and East European countries is part of a Triple R agenda: Reform, Reintegration and Regional Security. On the first, most obvious agenda, assistance is intended to facilitate change within each Central and Eastern European country which can buttress the infrastructure of market economies and liberal democracies. What are we willing to do to help them? What forms of assistance, how much, and under what conditions?

On the second agenda, the purpose of these reforms, together with revisions to established international trade and payments regimes, is to reintegrate the post-communist countries into the world economy. Will we let them into our markets and our multilateral organizations? When, and on what terms?

On the third agenda, the end purpose of such reintegration is to advance a larger geopolitical project — the creation of a new European regional security order. The dismal predictability of the Cold War has given way to open-ended uncertainty — even uncertainty over who speaks for the former Soviet superpower. A still polite jockeying for position is taking place among Europeans,

8 Cited in Jane Kramer, "Letter from Europe," *New Yorker*, 29 July 1991, p. 69.

and between Europe, North America and to a lesser extent Japan. Whose political-security interests will be favoured by economic assistance?

The paper begins with a straightforward Who's Who profile of the key players now giving economic assistance and a short What's What to clarify the amounts and forms of assistance extended from 1989 to date. Focus is exclusively on aid to the smaller CEEC (not the Soviet Union). These sections prepare the way for an analysis of the three agendas for assistance. We examine the policies of the major donors, regrouped as the G-24, and of the major institutions, in particular the European Bank for Reconstruction and Development (EBRD) as the first post-Cold War international organization.

The linchpin concept around which this evaluation turns is conditionality — what are the terms and conditions attached to Western assistance? Everyone knows the buzzwords: market and democracy, but what is their meaning in practice for donors and recipients? Increasingly, assistance programmes are centered on institutionalizing East-West relations — reintegrating the CEEC economies into organizations guided by Western liberal norms. Although there is broad compatibility among these institutions, the process of expanding programmes to encompass the CEEC is creating new rivalries as our illustrative case studies show.

The final section suggests how assistance programmes have implications for a regional security as leaders of the United States and the European twelve especially try to redesign European "architecture" to fit the needs of post-Cold War Europe. Our conclusions argue for renewing Canada's commitment to assist the CEEC reforms, based on the starting premise that assistance to the East equally concerns West-West relations and a new framework for regional security in Europe.

II WHO'S WHO: DONORS AND RECIPIENTS

No one was apparently more surprised than Jacques Delors, President of the European Commission, when the G-7 governments, at the 1989 economic summit in Paris, requested Brussels to take on the task of coordinating emergency assistance to Poland and Hungary. Rumour has it that Germany proposed and President Bush was well disposed after his trip to Poland where the scale of demands for aid had startled him. Canada was asked to float the idea so that France, not overly inclined to give political initiatives to the Commission, could concur. Whatever the real story, here was the beginning of coordinated rather than purely bilateral assistance, aimed self-consciously at political as well as economic transformation. The heads of government of the leading industrial nations had determined to consolidate these two countries' move toward "freedom and democracy." The communique stated that "to these ends, we ask the Commission of the European Communities to take the necessary initiatives in agreement with other Member States of the Community, and to associate, beside the Summit participants, all interested countries."

The first emergency programme, known as PHARE or "Poland and Hungary: Assistance for Restructuring Economies" was immediately supported by all twenty-four member states of the OECD. Their senior experts met three times over the summer and fall of 1989, organized into five working groups (e.g., food aid; investment; access to Western markets) to assess means and coordinate national commitments. By the time their work was enshrined in December 1989 by the first ministerial meeting of the "G-24" (so-called to distinguish the governments from the OECD as an institution), a number of multilateral organizations were brought in as observers. In addition to the Commission of the EC, these were: the OECD, the IMF, the World Bank, the European Investment Bank (EIB), and the Paris Club. The EBRD, which officially opened its doors in April 1991, is now a regular observer while other organizations are invited in depending on the projects under discussion. For example, the BIS (Bank for International Settlements) and the International Energy Agency were both observers at the January 1991 meeting when a working group on energy was set up.[9]

Who coordinates whom? In Brussels, the European Commission's Directorate-General of External Relations (DG 1) set up a Task Force to oversee both G-24 and Community (EC) assistance. Therein, a G-24 Coordination Unit is in place "to provide information on G-24 programmes to

9 Other donors join in on the assistance activities of other institutions — for example, five developing countries are EBRD members and the Gulf Cooperation Council has contributed to balance of payments lending to Czechoslovakia.

Commission services, donor and beneficiary countries; to strengthen complementarity and coherence of G-24 assistance; and to promote joint actions and new initiatives."[10] Bureaucrats from the Commission, along with five experts seconded for two years from the twelve non-EC governments, monitor assistance and prepare background reports on reforming economies. Among the donor countries, the process of consultation and coordination takes place at three levels. First, a "Brussels network", made up of those in national government missions to the EC, meets regularly, dividing up into the G-24 working-group subject areas. Second, "Senior Officials" or delegates from the national capitals, usually some four to six people at the level of a Canadian director general, meet to exchange views and put into place the agenda for ministers. They have met ten times thus far.

This coordination process appears as elaborate as that of the OECD Development Assistance Committee (DAC) for Third World aid donors. In fact, although the G-24 Unit prepares situation reports for the senior experts, its real function is to act as a "scorekeeper." The consultations in the Brussels network and among the Senior Experts do give each government a sense of how others assess the issues. It is, however, primarily at the third and highest level, the G-24 "ministerials" convened once a year, where broad policy guidelines are set. Here, whatever consensual view of the CEEC reform progress emerges, it is announced in a communique indicating intent either to increase commitments or to wait and see in dubious cases (Romania 1990; Yugoslavia and Albania 1991).

Bilateral assistance, which is then "counted" as G-24 assistance, naturally varies by country — as some donors are more committed than others — and also by type of assistance and by recipient. An ECE study (see Appendices I and II) shows the distribution by donor to the original PHARE programme. Germany was clearly in the lead and even Japan's share of assistance was initially greater than that of the United States. Japan, however, overwhelmingly contributes export credits and loans rather than hands-on grants or technical assistance programmes. For these forms of aid a small country, Austria, with its proximity and close business ties to central Europe, gives a great deal more than Japan.

The latest scoreboard published by the G-24 (Appendix III) confirms the early pattern. According to the share of total assistance committed in all forms, Germany accounts for 32 percent, the EC members taken together 45 percent, the United States and Japan 6.7 percent and 6.5 percent

10 Commission of the European Communities, Directorate General, External Relations, "G-24 Coordination Unit", Brussels, 12 March 1991.

respectively. Canada ranked 20 out of 24 with its 0.5 percent contribution (although the accuracy of these figures is questioned by External Affairs officials). Overall, however, it is not any single national government's programme, but the collective effort made through multilateral institutions, first among them the European Communities which account for the major contribution to CEEC reforms. As Appendix II shows, multilateral organizations provided 38 percent of all PHARE assistance. The EC gave 33 percent of this total, followed by the World Bank (29 percent).

Who benefits from Western assistance? The changing scope of assistance mirrors the changes in post-Cold War politics. PHARE initially concerned only Poland and Hungary, the first countries to embrace market reforms and multiparty elections. The basic direction of Western decision-making since has been to expand the aid programme to the other CEEC as soon as reform governments are elected to power. Very quickly, in February 1990, the senior experts considered the request of five other CEEC anxious to benefit from the battery of programmes already offered to Poland and Hungary. The European Commission then launched fact-finding missions to assess whether commitment to reform justified extending PHARE to the GDR, Czechoslovakia (now the Czech and Slovak Federal Republic), Bulgaria, Romania and Yugoslavia. Meanwhile, other Western organizations went ahead to include Czechoslovakia. For example, NATO's Coordinating Committee (COCOM) liberalized its strategic export controls, and the European Free Trade Area (EFTA) negotiated cooperation agreements with Poland, Hungary and Czechoslovakia. Finally, the G-24 Foreign Ministers officially extended PHARE programmes to the five other CEEC at the July 1990 summit.

In fact, not all former communist party states have been equally favoured. The G-24 first offered assistance to Romania in principle but not in practice — its government was in bad odour after allowing violent repression of civilian demonstrations. All aid would be withheld until Western concerns about political liberties could be allayed. Only in January 1991 was Romania given the benefit of the doubt. After receiving reports from two parliamentary groups, the G-24 senior officials "noted progress in the reform process in Romania and therefore agreed to extend economic assistance to this country."[11] For quite other reasons, the GDR received only limited G-24 aid. Once the two Germanys were slated for unification, the donor governments agreed to continue some project lending to the GDR, but to cancel its eligibility as at year-end 1991. Albania, despite radical political change, still waits at the gates, having received only emergency humanitarian aid.

11 Commission of the European Communities, Press Release, Brussels, 20 January 1991.

Meanwhile, the civil war in Yugoslavia has provoked Western governments to cancel promised assistance.

Although Western assistance through the G-24 will envelope every one of the former communist party states, including Albania by 1992,[12] the differential pace of reforms and thus the staggered timing of assistance has created a sharp disparity between those first off-the-mark (Poland and Hungary) and the others. As Appendix IV reveals, by early 1991, Poland had received 34 percent of the total G-24 assistance actually allocated and Hungary another 26 percent. The other former Comecon countries received minuscule shares: Czech and Slovak Federal Republic (8 percent), Romania (5 percent), and Bulgaria (5 percent). The CSFR may be expected to catch up rapidly now that negotiations with the IMF and the EC have put that country in line for macroeconomic lending and special association status with the European Economic Community. As well, the large-scale Czech privatization programme has attracted some major buy-ins by Western multinational corporations.

A striking disparity will likely remain between Europe's northern and southern tiers as most Western officials simply dismiss the possibility for Bulgaria and especially Romania to make a fully democratic transition. This attitude raises the worrisome question of history repeating itself. The cultural/religious affinity and geopolitical self-interest which bonds Western Europe to the three northernmost countries could, if aid disparities persist, make stagnation and alienation in the Balkans a self-fulfilling prophecy.

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12 In July 1991, EC Vice-President Andriessen asked the Council of Ministers to consider including Albania in the G-24 process, after the Brussels Network of all 24 officials had so recommended. EC, Directorate General for External Relations, G-24 Coordination Unit, *G-24 Update* no. 5 (6 August 1991). The USSR has never been included in the G-24 coordinated assistance programme, although both the G-7 and the EC twelve try to reach consensus on whether and how to assist the USSR and/or the republics. The three Baltic states were brought into the G-24 assistance programme in September 1991.

III WHAT'S WHAT: THE SIZE AND SCOPE OF ASSISTANCE

What exactly is meant by "assistance"? Once the reform movement in Central and Eastern Europe snowballed into a full transition away from the command economies and Leninist party states — a process that can be dated from the Polish elections in June 1989 — virtually all West-East economic relations have been rebaptized as assistance. The G-24 Coordination Unit in Brussels monitors both multilateral assistance and official bilateral aid in the form of grants or loans and credits. The bi-annual scoreboard then breaks out each category by type of assistance and its end-use — such as projects to enhance Social/Administrative Infrastructure (e.g., Education) or Economic Infrastructure (e.g., Energy; Environment); projects in the Productive sector (e.g., Agriculture or Industry, Mining, Construction). There are also Non-project uses, including Programme Assistance such as a Currency Stabilization or Debt Relief; Emergency Aid (e.g., Food and Medical) and Official Support for private agents (e.g., Export Credits or Private Investment Incentives).

How does it all add up? After two years, the cumulative figure for assistance committed by Western governments or international institutions to the six CEEC came to US $40 billion according the G-24 scorekeepers (See Appendix V). Of this total, $10b was in the form of grants and $10b in commercial credits. Another $5b had gone to macroeconomic stabilization loans for Hungary and Poland. A further $5b represents balance of payments lending by the IMF and the G-24 while $850 million was for one time only emergency food aid to Romania and Bulgaria. The G-24 also promised $10b to capitalize the EBRD. To these figures can be added the indirect cost of foregone interest when the Paris Club reduced the Polish debt ($16.5 billion).[13]

Western governments and multilateral organizations are engaged in impressive transfers of funds to support a complex package of programmes meant, in the first instance, to advance the economic transition in Central and Eastern Europe. Impressive, but when scrutinized, this assistance, like overseas development aid before it, comes under critical fire. There is conflation and inflation of the figures. To call interest bearing loans and, more so, marketing and investment incentives to Western enterprises, "assistance" stretches the imagination. A senior official in the Hungarian Ministry of Foreign Economic Relations rightly complains that much of the counting to

13 Commission of the European Communities, Directorate-General External Relations, "G-24 Coordinated Economic Assistance, an initial stocktaking," prepared for the the Meeting of the Group of 24 at Senior Officials level, Brussels, 13 June 1991. The G-24 updates its scoreboards twice a year (See Appendices III, IV and V).

reach G-24 scoreboard tallies overstates the commitment.[14] Loan guarantees, for example, are not out of pocket monies unless in fact a recipient country cannot meet its obligations. Project lending is on a multi-year basis and yet the total is registered in Brussels when promised in Year One, rather than when actually disbursed.[15]

The UN ECE's assessment of PHARE funding supports the criticism that nominal totals of aid to the East are "misleading," mainly because "the lion's share of commitments do not represent cash available for spending as the recipient government may wish" and "there is some unavoidable double counting." Moreover, "practically all credits are offered on commercial bases." Its report concludes that "the commitments for financial support made so far all address critical needs, but the bulk is debt-creating."[16]

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14 Dr. Peter Balazs, Director, Ministry of Foreign Trade, Hungary, Presentation to the International Colloquium on "Coopération politique et économique: Europe centrale et Europe de l'Ouest," Paris, 22 May 1991.

15 The G-24 has now clarified its figures to reveal that by mid-1991 only 35 percent of the commitments to any CEEC recipient had been disbursed. Commission of the European Communities, "Scoreboard of G-24 Assistance," Brussels, 13 June 1991, Table V.

16 Peter Mihalyi (UN ECE), "Eastern European Investment and Prospective Inward Resource Flow," Paper presented to the NATO Advanced Research Workshop, St Anthony's College, Oxford, 16-19 December 1990.

IV CANADA'S CONTRIBUTION

These caveats aside, every Western government has mobilized new financial resources and redirected bureaucratic resources to support the G-24 programmes. A quick survey of the assistance package put together by Canada for the CEEC will give some idea of our multifaceted involvement in the transition in Central and East Europe.[17]

In response to the G-24 initiative, Canada set up a $72 million emergency programme for Poland and Hungary in 1989. This included emergency food aid, short-term insurance for exports, $10 million for economic development projects and a $30 million contribution to the Polish Stabilization Fund. The federal government then formalized its assistance by setting up a Task Force on Central and Eastern Europe under External Affairs/International Trade auspices with a $40 million budget spread over three years. The responsible ministers were clear about the purpose: The Task Force "brings together public and private resources in Canada in support of what is an irrepressible push towards democracy and private enterprise in Central and Eastern Europe and the Soviet Union."[18]

Just what can Canada's Task Force do? Most of its funds ($30m) go to economic projects, which should be "aimed at market-oriented reforms." Overwhelmingly, such projects involve technical assistance, training or feasibility studies. Some $10 million was, however, budgeted for a "Political Cooperation Fund" intended to "encourage democracy, political pluralism, the rule of law, and respect for human rights."[19] Here training is key and a typical project brings in non-governmental organizations. For example, a legal internship programme was co-funded by the Canadian Bar Association to bring Hungarian lawyers to Canada. Task Force initiatives are supplemented by the Parliament of Canada whose speaker has used the cooperation fund to invite parliamentarians from the CEEC to observe Canadian practices.

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17 For a more complete picture of Canadian policy see C.H. McMillan, "Canada's Response to the 'New Détente' in East-West Relations," in M.A. Molot and Fen Hampson, ed., *Canada Among Nations* (Ottawa: Carleton University Press, 1990), pp. 59-78 and his "The Collapse of the Regional System in Eastern Europe: implications for Europe and North America," in C. Maule and F. Hampson, eds., *Canada Among Nations: after the Cold War* (Ottawa: Carleton University Press, 1991).

18 Joe Clark and John Crosbie. "Joint Message on the Task Force on Central and Eastern Europe," Ottawa, External Affairs and International Trade Canada, 1990. Of this $40m, $10m was to be carried over from the initial pledge.

19 External Affairs and International Trade Canada, Task Force on Central and Eastern Europe, *Newsletter*, vol. 1, no. 1, 1990. For a complete listing of the 164 projects funded by the task force see *Ibid.*, "Bilateral Technical Assistance Projects," (21 August 1991).

In addition to its own funds, the Task Force allocates monies from the so-called "counterpart fund" which now amounts to $8 million Polish *zloty* equivalent. These monies come from food aid (i.e. food sold on concessional terms) shipped to Poland and sold to consumers there on the open market. The Polish government thereby receives emergency supplies, pays for the imported food in local currency, and the receipts are then redirected into Canadian sponsored projects which focus on Poland's agricultural needs. The Task Force is also authorized by the Department of Finance to use the interest earned on Canada's contribution to the Polish Stabilization Fund (which sits in New York at the Federal Reserve) to fund other assistance projects.

Such creative financing techniques for assistance to the CEEC may have enabled External Affairs to avoid putting in supplementary budget requests to the Treasury Board for a time. As CEEC needs expanded and G-24 programmes multiplied, new monies were needed. The 1991 federal budget created an "International Assistance Initiatives" reserve within the overall International Development Assistance Envelope containing $57 million for urgent projects. This money was made available to External Affairs (Task Force) or CIDA — forcing the three responsible ministers (External, Finance and CIDA) to see the trade-offs between assistance to the CEEC and to Third World countries. Now virtually exhausted, most of the sub-envelope went to Eastern Europe to cover guarantees on balance of payments lending. More recent humanitarian aid initiatives — wheat for Albania or milk powder for Bulgaria — are being donated from surplus stocks by the Department of Agriculture.

Canada has also made new funding available for the CEEC by way of multilateral organizations. For example, Parliament in 1990 approved membership in the EBRD which entailed a $120 million entry fee. Officials justified this commitment in terms of the historical transformation in Europe, the desire to take part in coordinated programmes to maximize effectiveness, the appeal to those Canadians of East or Central European origin, and the longer term potential for Canadian businesses to get involved in joint ventures.[20] When the EBRD officially opened last spring, the first tranche of this pledge was made with the rest to be contributed over the next five years to the Bank's Capitalization Fund.

In the area of "policy aid" (which may or may not entail direct financial costs), Canada is involved with the G-24 governments in working out balance of payments lending to the CEEC.

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20 Canada, Parliament, House of Commons, Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-88, An Act to provide for the membership of Canada in the European Bank for Reconstruction and Development, Issues no. 1 and 2 (12 and 13 December 1990).

Linked to the IMF's willingness to approve standby arrangements, such collective commitments of support entice commercial bank lenders to come in as well. Canada agreed in April this year to make US $25 million available to the CSFR and $12.5m to Hungary as guarantees for loans to be provided by Canadian commercial banks. This has been followed by similar commitments to Bulgaria ($10m) and Romania ($25 million) always with the proviso that they are "exceptional" (Third World borrowers beware) and reflect "our determination to assist these countries at this critical juncture in their transition to democratic governments and market economies."[21]

Another ostensibly exceptional gesture in the financial area came recently when the Canadian government, after the meeting of the Paris Club governments, announced that service charges will be lowered on the outstanding debt owed by Poland. Half the interest owed, or $1.6 billion, was forgiven. These debts derive mainly from credits advanced to permit purchases from the Canadian Wheat Board well before the current reforms. Finally, in the trade area, Canada has followed the trend to liberalization with Central and Eastern Europe, offering a General Preferential Tariff deal to Poland and Hungary. Ottawa also went along with the 1990 NATO Coordinating Committee (COCOM) decision to liberalize export restrictions for several high-tech industry products.

Clearly, Canada's assistance to the CEEC, most of which is part of coordinated Western programmes, involves new commitments of funds and human resources. Among the G-24, although Canada's share is relatively small, our record for delivering what was promised is excellent as Canada's disbursement record is among the highest. To stay the course, however, given the expanding number of recipients and the prospect that the G-7 will augment assistance for the USSR, Canada will have to dig deeper into the public purse.[22] Government here as elsewhere is already confronting objections from those concerned about underfunding of domestic social programmes

21 Secretary of State for External Affairs, News Release no. 103 (30 April 1991) and no. 145 (19 June 1991). The provision (50 percent) for these loan guarantees goes from the International Assistance envelope back into the Consolidated Revenue Fund. The government tenders the loans to Canadian commercial banks which then make a virtually risk-free loan to the CEEC borrowers.

22 Prime Minister Mulroney has made dramatic promises for more "cheque book diplomacy" to assist the new Soviet republics. He recommends doubling the commitments to the EBRD. ("Throw Soviets a 'lifeline' Mulroney says", *Globe and Mail*, 30 September 1991). Canada had already pledged $150 million in food credits and $25 million for technical assistance to the USSR after the July 1991 G-7 summit. Following the abortive August 1991 coup, France called for the G-7 and the EC to organize a "Marshall Plan" mechanism to reconstruct the Soviet economy. Meanwhile the USSR had dramatically raised its demands for food aid and import credits. See "Massive aid plan for Soviets proposed by France, *Toronto Star*, 8 September 1991; "Soviets double request for aid to $14.7 billion" *Globe and Mail*, 20 September 1991.

or diversion of overseas development assistance away from the Third World. Can a policy consensus born of "exceptional" circumstances withstand such pressures for alternative uses? On what terms and conditions should assistance to Central and Eastern Europe be sustained?

V COORDINATING WESTERN ASSISTANCE - THE PRINCIPLES

"Western assistance cannot be unconditional" — thus spoke the senior experts assembled last year by the Canadian Institute for International Peace and Security. The group concluded that the West should do all it could to assist the reform process in Central and Eastern Europe, so long as economic aid were "linked, as it should be, to the progress made towards democratization and a market system."[23] In fact every G-24 donor government and multilateral organization expresses the official conviction that aid to the CEEC must be conditional, that is, overtly tied to both political and economic change imitative of Western liberal democracies and market economies.

The British Treasury's report on assistance stipulated a close connection between economic reform and democracy to recommend that: "Help should be targeted at those countries that are undertaking political as well as economic reforms."[24] The US Congress continued its long tradition of linkage last year when the Senate foreign relations committee approved a $535 million aid programme to Eastern Europe and not to the USSR, insisting that funds could only go to countries fully committed to "move from communism by strengthening free-market practices."[25] After Canada decided to expand assistance programmes beyond Hungary and Poland in May 1990, External Affairs Minister Joe Clark warned that "Our efforts must be governed by the behaviour of the governments of the regions" — therefore no assistance would go to Romania until that government "reaffirmed its commitment to a course of reform."[26]

The multinational organizations, through which much Western assistance to the East is channelled, have also made it crystal clear that their objectives are as much political as economic. Michel Camdessus, Managing Director of the IMF states the premise of aid to the East: "Attempts to find a 'third way' intermediate between central planning and a market economy have not been successful."[27] The World Bank endorsed early on in the reform process the report by its economist Manual Hinds who in dismissing all previous reform attempts under state planning, argued that successful reforms depended on a full commitment to "the introduction of market forces...centered

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23 Canadian Institute for International Peace and Security. *East West Relations in Transition: Towards a New European Order*, Working Paper no. 27, Ottawa (July 1990).

24 As quoted in the *Globe and Mail*, 19 July 1990.

25 "Senate panel votes to aid Eastern bloc," *Globe and Mail*, 20 July 1990.

26 "Canada widens aid to Eastern Europe," *Ottawa Citizen*, 5 July 1990.

27 Cited in "Eastern Europe must not waffle on needed reforms," *Globe and Mail*, 23 March 1990.

on large-scale privatization of means of production."[28] These financial institutions have not hesitated to transfer their practice of placing policy conditions on Third World lending to a new setting. In approving Structural Adjustment Loans (SALs) to Poland and Hungary, the Bank's Executive Directors specified among their conditions that a certain share of state-owned enterprises be privatized. The Vice President responsible for Eastern Europe went so far as to chide the Hungarian government for not having the political courage to get on with it![29]

This coincidence of views among Western donors that liberal norms shall define the conditions for assistance has been transformed into a policy consensus through the G-24 coordination process. When the European Commission Vice-President submitted his first annual "Report on G-24 Coordinated Assistance" to the Foreign Ministers, he reaffirmed the "pertinence of the decision taken at our meeting last December to subject the granting of coordinated assistance to five basic political and economic conditions. We shall be deciding this afternoon on the extent to which these conditions have been satisfied." Overall, Mr. Adriessen judged that "giant steps have been taken by the central and east European countries towards political and economic systems founded on the values which we around this table share " (although the situation in Romania "cast doubt"). He based his report on an Action Plan submitted by the EC to all G-24 governments which in turn relied on fact finding missions sent out to each country. The Plan had concluded that "most of the countries concerned will have put in place the basic legislation needed to move towards democracy and competitive market oriented economic systems."[30]

Conditionality does not appear merely pious but has become integral to the West's inter-governmental consultation process. At each subsequent meeting of the G-24 Senior Experts, programmes have been considered in light of developments within the CEEC. Thus, for example, at the January 1991 session, it was decided to organize new assistance to the energy sector in the CEEC, "provided that they carry out the requisite political and economic reforms." And, most recently, at the June 1991 session, the communique gave a consensual overview and also singled out specific countries for comment:

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28 Manual Hinds, "Issues in the Introduction of Market Forces in Eastern European Socialist Economies," The World Bank, Internal Discussion Paper, April 1990, report no. IDP-0057, 150p.

29 "World Bank criticises Hungary," *Financial Times* (London) 10 September 1990.

30 Mr. Frans Andriessen, Vice-President of the Comission, "Report on G-24 Coordinated Assistance, G-24 Ministerial Meeting, Brussels, 4 July 1990, Speaking Notes, 5p. and Commission of the European Communities, "Action Plan — Coordinated assistance from the Group of 24 to Bulgaria, Czechoslovakia, The German Democratic Republic, Romania and Yugoslavia", Brussels, SEC (90) 843 final, 2 May 1990.

> The 24 exchanged views on the political situation in the various CEEC.They felt that democratic reform was in general developing well. They agreed, however, that the situation in Yugoslavia is causing serious concern. The 24 considered that at this stage it would be premature to extend their economic assistance to Albania, but agreed to continue humanitarian aid as necessary.[31]

In this collective conviction that conditions could and should be imposed on assistance, the 1990s could not be more different from the 1970s when the concept of political conditionality was highly contested, and most Western capitals regarded President Carter's campaign to link human rights (as interpreted in Washington) to aid or trade concessions, with utmost scepticism. Today, in contrast, a US Secretary of State can speak for all at the G-24 Foreign Ministers summit in saying that they had agreed "to base economic assistance on continued political liberalization," according to five criteria: (i) adherence to the rule of law (ii) respect for human rights (iii) introduction of multiparty systems (iv) holding free and fair elections and (v) progress towards the development of market-oriented economies."[32] Western consensus has been possible because these conditions are not imposed by the donors, but subscribed to by the recipient countries themselves. The new leaderships in Central and East Europe affirm the same teleology of reform, seeing their end purposes to be market and democracy. Even where, as in Bucharest, some doubts may be permitted, this teleological rhetoric is used in an effort to co-opt Western donors into committing larger infusions of aid.

The extent of East-West ideological convergence on the ultimate purposes of reform comes very clear in those pan-European organizations where the CEEC are full members. It is here, in the CSCE and the EBRD for example, that governments both East and West have gone the furthest in calling for liberal norms to govern economic relations. The concluding document of the Conference on Economic Cooperation in Europe (April 1990) is a striking example. Convened in Bonn by the thirty-four CSCE members (Albania and the three Baltic states joined only in 1991), the conference sought consensus on ground rules for economic relations following the dramatic political change in the East. Among the principles which all signatory states pledged to "endeavor to achieve or maintain," were these:

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31 "Draft Conclusions of the Group of 24 on Economic Assistance to the Central and Eastern European Countries," Brussels, June 13 1991; "Co-ordinated Assistance in the Energy Sector," G-24 High Level Meeting, 30 January 1991.

32 Peter Mihalyi (UN ECE), "Eastern European Investment and Prospective Inward Resource Flow," Paper presented to the NATO Advanced Research Workshop, St Anthony's College, Oxford, 16-19 December 1990.

- Recognize that democratic institutions and economic freedom foster economic and social progress;

- Consider that the process of economic reform and structural adjustment, with increased reliance on market forces, will enhance economic performance;

- Recognize that the performance of market-based economies relies primarily on the freedom of individual enterprise;

- Believe that economic freedom for the individual includes the right freely to own, buy, sell and otherwise utilize property.

And there is more: All states agreed in "Recognizing the relationship between political pluralism and market economies, and being committed to the principles concerning":

- multiparty democracy based on free, periodic and genuine elections;

- the rule of law and equal protection under the law for all, based on respect for human rights;

- the rights of workers freely to establish or join independent trade unions;

- free and competitive market economies where prices are based on supply and demand.[33]

The ease of reaching this final consensus is remarkable considering the years of diplomatic wrangling over every syllable used to define essential freedoms at the protracted CSCE review conferences which followed the Helsinki accords in 1975. In Bonn, the Soviet Union did attempt to water down some of the assertions about free flows of capital and succeeded in adding the principle of promoting of social justice.[34] The main bargaining, however, took place among Western, not Eastern, delegations as the US started from a more tough-minded draft. Thanks to adroit Canadian mediation, the final document basically merged the EC and US drafts. It is true that it is easier to affirm principles than to put them into practice, and of course, the CSCE is a conference, not an institution, one without concrete resources to transfer to the East. The EBRD thus provides an even more telling testimonial of the willingness of the former communist countries to accept Western norms of market and democracy as conditions for assistance.

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33 CSCE, Document of the Bonn Conference on Economic Cooperation in Europe. (April 1990).

34 "West wins eastern converts at CSCE economics talks," *Financial Times* (London), 10 April 1990.

The EBRD, or the European Bank, calls itself "the first international financial institution of the Post-Cold War Period." The Bank's literature explains that the EBRD was created as a "collective response" to change in Eastern Europe and the challenge of moving "from centrally-planned command economies to free democratic institutions and market economies." France's President Mitterrand proposed the idea for a European development bank in a speech to the EC's Council (the twelve heads of state) in Strasbourg in December 1989. Meetings held in Paris that winter to work out a plan on the basis of a French draft brought together officials from the G-24, eight Central and Eastern European countries, the EC, the EIB, as well as Malta and Cyprus. Once it was decided that membership would be open to non-European countries outside the G-24, a half dozen others such as Israel and Mexico joined in. Considering the scale of financing and the innovative nature of the institution, agreement came with astonishing speed, thanks to a shared sense of historical opportunity and to the French government's diplomatic drive.

The EBRD's Articles of Agreement were signed by forty countries (then including the GDR) and two international organizations (EC and EIB) in Paris in May 1990.[35] The Bank began its operations, headquartered in London, in April 1991. Subscribed capital amounts to 10 billion ECU (US $14 billion) with 30 percent of this paid in by annual instalments over five years (and the rest callable). The full membership list and the relative shares of capital stock, which also dictate weighted voting shares, are given in Appendix VI. The EBRD's task assignment is multiform, combining "development and merchant banking." It can offer loans directly, participate in co-lending with other institutions or commercial banks, proffer policy advice or technical assistance, make equity investments in private or state-owned enterprises and foster capital markets in the East by underwriting securities offerings.

Considering the crowd of multilateral institutions, commercial banks, private firms and the twenty-four governments already involved in transfers of resources to post-communist Eastern Europe, what exactly is new here? The EBRD is novel in several ways. In the first place, it is the only financial institution *exclusively* devoted to targeting funds to Central and Eastern Europe. The list of recipient countries is limited to the USSR, the five former Comecon European members (including projects in the East of Germany) and Yugoslavia. In the second place, the EBRD is the only international financial institution where the USSR and every CEEC (except Albania which has observer status) is a full member. They subscribe capital and therefore vote on the policies affecting

35 The facts and citations in this section are from: Agreement Establishing the European Bank for Reconstruction and Development (29 May 1990) and its appended Chairman's Report on the Agreement Establishing the European Bank for Reconstruction and Development.

them. Indeed four of the twenty-three directors must be from "Central and Eastern European countries eligible for assistance from the Bank." And most importantly, the EBRD, as an institution created, rather than being adapted, to meet reform needs in the East, puts explicit policy conditions on its lending and investment — a practice, but never an enshrined principle, for other international lenders.[36]

How do the EBRD member countries understand conditionality? The governments which founded the Bank, including the CEEC and USSR, placed a set of principles in the preamble to the Articles of Agreement which echo the Bonn CSCE principles. They declared themselves "committed to the fundamental principles of multiparty democracy, the rule of law, respect for human rights and market economics." They then recalled the CSCE Helsinki Final Act and welcomed "the intent of Central and Eastern European countries to further the practical implementation" of these principles. In this new political climate, EBRD member states were ready "to help their economies become more internationally competitive and assist them in their reconstruction and development." Unlike the CSCE, the European Bank is a formal, permanent institution with resources committed to back up its principles.

36 The EBRD is also the first international financial organization to have explicit environmental safeguards (Articles 2 and 35).

VI CONDITIONALITY IN PRACTICE

Can a consensus on the conditions of assistance among Western governments and within multilateral institutions be maintained? The collective will exemplified by the EBRD must now be translated into project approvals, involving opportunity costs for some. As for bilateral assistance, now that governments have begun to disburse aid, criticism of G-24 coordination has picked up. Indeed, assistance can be said to have entered Phase II, a phase characterized in the West by financing fatigue. With appeals from competing claimants and hard evidence that economic transition in the East will be very costly, national governments complain that Brussels overstates needs, acts as a tithing agency, is not transparent in presenting aid data and that the whole operation serves the European Commission rather than Western interests overall.

Looking East, Phase II is characterized by the fall from grace as the new governments try to move from rhetoric to realization of reforms. The capacity to "absorb" aid is questioned. Most Western economists and policy advisors preferred to ignore Eastern realities in 1989-90 and focus instead on the promise of post-communism. Now all have been forced to recognize that political will alone cannot work miracles. Recipients and donors alike express their disillusionment. Poland's President Walesa, in his recent interview with *Le Monde*, bluntly refers to the "error" of having believed in a Western myth of instant capitalism and finding instead production decline and high unemployment. The OECD finds the eastern region of Germany to be a "collapsing" economy despite having had every imaginable financial and institutional support. This judgement has increased Western qualms about the transition in less-favoured CEEC economies.[37]

In this second more sober phase, compatibility among Western donors on the conditions for assistance cannot be assumed. There are, however, reasons to believe that a broad consensus on conditionality will prevail, whether or not coordination continues to take place through the G-24 as such. First, the idealized goals — market economy and democracy — are understood to be *a priori* shared objectives and not standards used to blackmail recipients on a project by project basis. Second, the criteria used to assess CEEC reforms are elastic. The one institution, the EBRD, which was precise in stipulating just what constituted market oriented reforms, has stretched its definition to suit the circumstances (see discussion below). Third, when national interests diverge, the G-24, as a very loose coordination mechanism, tolerates diversity. The European Commission acts

37 "East Germany collapsing", *Globe and Mail*, 26 July 1991 summarizes the OECD report; *Le Monde*, September 9 1991, p. 1. See also Peter Cook's column, "The disputed prognosis for Poland," *Globe and Mail*, 27 September 1991.

primarily as a catalyst and each government remains free to subscribe or not to a given programme. Altogether, as some examples will now suggest, the flexible implementation of conditionality should enable Western donors to maintain the principle and thereby weather rougher times ahead.

On the first notion of *a priori* conditionality, interviews confirm that all those carrying out Western assistance programmes agree that their programmes have been put in place on the understanding that donors and recipients share the objectives of transition to market economies and liberal democracies. In this perspective, conditionality is imagined as a green light. It does have an on-off switch, but one which should be used only by heads of state for overarching geopolitical reasons and even then only in the case of egregious violations — shooting in the streets or a return to dictatorship. As a Canadian official put it, "conditionality should be understood as 'positive incentives,' not 'punishments.' "

This wording is echoed by a French official who refers to a "prime à la démocratie" — those Central and Eastern European countries which move fastest in liberalizing can expect to attract greater contributions from Western governments and private business. EC officials explain that the Commission considered and rejected the initial British request for a sort of "report card" on aid where the eastern countries would have had to meet "X" preconditions before they received more assistance. Instead it is up to governments, i.e., the Council of Ministers meeting annually, to give a general assessment of policy. Once a CEEC is accepted into the EC's aid programme, those actually running PHARE give it the benefit of the doubt ("une présomption favorable.") In administering day-to-day programmes therefore, absolutely no reference is made to political conditionality.[38]

The European Bank for Reconstruction and Development

Where Western assistance is more precisely bound by conditions, however, as in the EBRD, maintaining agreement among donors with different national perceptions of the geopolitical stakes is more delicate. The EBRD, as we have seen, has openly endorsed a linkage between assistance and political/economic developments in the recipient countries. Article 1 states that: "The purpose of the Bank shall be to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics." With this

38 Personal Interviews, European Commission, Brussels, April 1991.

article, principles stated in a preamble become restrictions — only those countries which indeed apply them shall be eligible for assistance.

Will such stipulations remain "up-front" conditions — shared objectives — or might they become negative sanctions in the sense of legitimizing decisions by Western governments holding the majority of votes to withdraw project funding should they disagree with domestic policies in the East? Article 8 suggests the potential for sanctions by restating the connection between Article 1 and all transfers of resources. Operations can only be conducted in those Central and Eastern European countries "which are *proceeding steadily* in the transition towards market-oriented economies" [emphasis added]. If a member government's policies are deemed "inconsistent with Article 1" the Board of Directors may recommend to the Board of Governors that assistance "be suspended or otherwise modified." A vote of two-thirds of the Governors (representing three-fourths of the total voting power of the members) is required. To ensure attention to these criteria, the Board of Directors is charged with reviewing Bank operations at least once a year to determine compatibility with Article 1.

Conditionality can be broken down into two broad types — economic and political. The exact meaning of *(micro)economic conditionality* was agreed upon by the EBRD's founding members. To ensure that funding went to those working towards a market-oriented economy, Article 11 stipulates that "not more than forty percent of the amount of the Bank's total committed loans, guarantees and equity investment...shall be provided to the state sector" nor in any one country "can more than forty percent of committed funds go to the state sector." The state sector covers not just governments, but also government owned or controlled enterprises. Even within the 40 percent of activity permitted in the state sector, EBRD can deal only with those state enterprises deemed competitive, i.e., operating in competitive markets and subject to bankruptcy laws.

According to the press accounts, these stiff restrictions on lending to the state sector were American conditions for entry, resisted by the French, among others. To allow EBRD to launch projects in economies where the private sector was as yet missing in action, except for small-scale operations, the founders worked out some exceptions to the rule. For the Bank's start up, this quota would apply over a two-year period (and thereafter in each year). As well, any state enterprise implementing a privatization programme could qualify under the 60 percent ceiling for private sector loans or investment. In practice, the new Board of Directors appears ready to adopt a flexible approach, noting that "while the initiative for restructuring *should* be left to the emerging private sector and to foreign investors...at the enterprise level a more *gradualist* approach will be needed to ensure that the productive sector does not completely break down."[39]

The exact meaning of *political* conditionality — i.e., applying principles of multi-party democracy and pluralism — for Bank operations is much more contentious.[40] The senior staff involved in doing country reviews are seeking to develop indicators of democracy, an attempt deemed futile in other lending institutions, like the World Bank, after long experience. For the moment, EBRD directors seem inclined to assume that once a country study is approved, no project-by-project judgements will need be made. Yet they appear somewhat nervous about possible political crises in recipient countries and foresee that the decision-making situation could become "tricky." At the same time, realism reigns at the Advisory Council to the EBRD — after all, these senior economists insist, the Bank has a profit-making mandate and if investments were in place, would the Board really risk losing all by pulling its money out? Clearly such questions will only be answered once the Bank engages in a series of projects, but a quick look at decision-making structures will give an idea of which member states might prevail.

At the level of the Board of Governors, where such strategic decisions as capitalization and membership are made, voting is by members (one governor, one vote) and retabulated by share of capital stock voted. The United States has the largest weighted vote — 10 percent — which is, however, only half its shares in the IMF or the World Bank. The combined EC countries and institutions have 51 percent. Although there has been much complaining in the American and British press about the European Bank serving as a tool for French foreign policy, the distribution of votes at the board of directors gives the European governments and institutions eleven of the twenty-three seats, whereas any decision to recommend sanctions requires a majority of two-thirds of the Directors.

The EBRD is clearly a very politicized financial institution. Contention among its members and between the Board and the President is well publicized. Just how to ensure fair distribution of funding across the CEEC and avoid crowding out by the USSR are two disputed issues. The United States and Japan have prevailed in their opposition to changing the initial limit on Soviet borrowing

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39 EBRD. "Operational Challenges and Priorities: Initial Orientations," April 1991. This document was "produced by the Staff of the EBRD and endorsed by its Board of Directors."

40 For an article by article legal analysis of the Bank's Agreement see: Ibrahim Shihata, *The European Bank for Reconstruction and Development: a comparative analysis of the constituent agreement*, (London/Boston: Graham & Trotman, 1990).

from the EBRD despite repeated efforts, led by Germany at the 1991 G-7 summit, to lift the ceiling.[41] All this is prologue. Once the Bank is truly operational, as *The Economist* warns, "A lot more drama and intrigue lie ahead, not least because the bank will have to wrestle with 'political conditionality' — that is, lending is meant to promote political as well as economic freedom."[42]

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41 Canada also supported lifting this restriction. The Agreement places a temporary (three year) ceiling on funding projets in the Soviet Union to match its 6 percent subscription share — change would require an 85 percent majority vote. For more details on debates over these issues see for example "US Role in aid bank draws ire," *New York Times*, 12 April 1990; "Plans for European Bank run into trouble," *Financial Times* (London), 12 March 1990; and "M. Attali veut faire de la BERD une 'institution rapide et souple,'" *Le Monde*, 26 October 1990.

42 *The Economist*, "All Europe's a Stage," 16 March 1991. Some of the current controversies at the EBRD are discussed in *Ibid.*, "Jacquerie at the bank," 10 August 1991. At the time of writing just one project, a $50 million loan to a Polish bank co-financed with the World Bank, had been finalized.

VII BEYOND REFORM TO REINTEGRATION: THE ROLE OF MULTILATERAL ORGANIZATIONS

The question of who should give what to whom, and under what conditions, is by no means a question of internal reform in Central or Eastern Europe alone, but increasingly a question of building a new European order wherein the smaller CEEC can be safe from either internal collapse or external pressures which could once again destabilize European security. Western economic assistance is a means to achieving the triple R agenda of reform, reintegration and regional security. In the view of G-24 donor governments, after reassessing their assistance in June 1991, the new emphasis must be "to further the integration of these countries in the open international economic system."[43] To bring about this reintegration of the CEEC into the world economy and into institutions based on Western liberal norms, not any one government, but a panoply of multilateral organizations is moving into the breach left by the collapse of Soviet empire.

The critical role of the multilateral organizations has been reinforced by the outcome of the G-7 debates last summer over whether and how to assist Gorbachev. The compromise reached in London between those wishing to put in money (Germany, Italy and France) and those insisting on reform first (US, Britain and Japan) takes the form of a Six-Point Plan. It centres on technical assistance to bring the USSR into the world economy by way of associate membership in the IMF and formal cooperation with the OECD, World Bank, and EBRD. Reactions to the failed coup and the subsequent declarations of sovereignty by many republics accelerated this process.[44] How have the multilateral organizations met the challenge of encompassing the former planned economies in Central and Eastern Europe?

The institutional actors able to transfer resources or set the rules for economic transition in the CEEC are many. It is easiest to distinguish them, by way of introduction, according to the scope of membership. They range from the universal — e.g., IMF and World Bank which in principle are open to all and already had some East European members in 1989; to the pan-European organizations where the East Europeans are founding members and which normally include the US and Canada: — e.g., CSCE, EBRD, ECE; to the all "Western" organizations, some of which include

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43 "Draft Conclusions of the Group of 24 on Economic Assistance to the Central and Eastern European Countries," Brussels, 13 June 1991.

44 The USSR gained special associate status in the IMF at the October 1991 Board of Governors meeting in Thailand. Moscow has agreed to open its financial data to the IMF (see the forthcoming December issue of *International Financial Statistics*) in exchange for technical assistance; all republics in the State Council will report through the USSR. See *IMF Survey* (14 October 1991) for the terms of the agreement.

Japan — e.g., OECD; to the strictly West European institutions — e.g., Council of Europe and, more narrow yet, the EC or EFTA.

The capacity of each multilateral organization to influence change in Central and Eastern Europe varies widely in function of its mandate and resources. Some are charged with setting the agenda for East-West relations by reaching consensus on principles, but as yet have no independent resources and only limited institutional continuity — e.g., the CSCE. Some have very significant financial resources to transfer as well as policy influence in monitoring the conditions of their loan agreements — e.g., the IMF, World Bank, EBRD and the European Investment Bank. Figure 1 highlights the institutional actors which have contributed real resources to assist the reform process in Central and Eastern Europe since 1989, be it grants, loans or human resources for technical assistance. Those institutions which influence the norms and rules for CEEC, whether in trade or security regimes, are included in parentheses. Canada, it may be noted, is a member of all but five of the Figure 1 organizations.

It would, however, be too static simply to assert that the capacity of these multilateral institutions to affect CEEC reform and reintegration varies in function of membership, mandate, and monies since these factors are themselves variable. In the fervour of hope for democratic transition in Central and Eastern Europe, most Western institutions have revised mandates, allocated new resources and considered opening their membership to the CEEC. Certainly the organizations that can offer membership have a special power in the short term.

Acceptance into the IMF and the World Bank, already a *fait accompli* for the Central and Eastern European countries, brings eligibility for loans and implies co-optation into the well-established rules of the global capitalist game.[45] Acceptance into the EC would mean, more significantly, absorption into a complex economic, monetary and eventual political union. Hungary, for one, has counted on this option from the outset of its democratic transition when Forum president Antall baldly announced that "to us, the European Community is the most important target. We would like to join as soon as possible."[46] A look at the World Bank, the OECD and the European Communities as examples of longstanding universal, Western and West European

45 Bulgaria and Czechoslovakia joined the Fund and the Bank in September 1990 making all six CEEC members. Albania applied for membership in January 1991.

46 "Hungary's elected leaders to seek EC membership," *Financial Post*, 10 April 1990.

Figure 1

MULTILATERAL ORGANIZATIONS ASSISTING THE TRANSITION IN CENTRAL AND EASTERN EUROPE

UNIVERSAL MEMBERSHIP ORGANIZATIONS AND THEIR AFFILIATES	WESTERN MEMBERSHIP ORGANIZATIONS AND THEIR AFFILIATES
INTERNATIONAL MONETARY FUND (IMF)[E]	COUNCIL OF EUROPE[E]
WORLD BANK (IBRD)[E] International Finance Corporation (IFC) Multilateral Investment Guarantee Agency (MIGA)[**]	EUROPEAN COMMUNITY (EC) European Investment Bank (EIB) European Coal and Steel Community (ECSC)
BANK FOR INTERNATIONAL SETTLEMENTS (BIS)[E+]	EUROPEAN FREE TRADE AREA (EFTA)
GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)[E **]	NORTH ATLANTIC TREATY ORGANIZATION (NATO)[c]
	ORGANIZATIONS FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD)[b]

PAN EUROPEAN ORGANIZATIONS[d]
EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)[E+ b]
CONFERENCE ON SECURITY AND COOPERATION IN EUROPE (CSCE)[E+ b **]
UNITED NATIONS ECONOMIC COMMISSION FOR EUROPE (ECE)[E+]

KEY

E	**Includes Central and Eastern European states as members.**
E+	**Includes all Central and Eastern European states and the USSR.**
******	**Carries out studies or sets rules.**
b	**Includes United States, Canada, Japan and some other OECD member states.**
c	**Includes United States and Canada.**
d	**Includes the USSR and the Central and Eastern European states as founding members**

These are the principal organizations transferring real financial resources or technical assistance as well as those which carry out studies or set rules influencing the CEEC transition. It should be noted that may other international organizations, for example UNESCO or UNDP, have tailored some of their activities at the Central and Eastern European countries' needs.

In addition to these formal organizations, intergovernmental consultation on assistance policy takes place in three main fora:

G-24 The twenty-four member states of the OECD coordinating aid and consulting on policy to Central and Eastern Europe since 1989 under the direction of the European Commission with regular meetings of their Senior Experts and (annually) Foreign Ministers.

G-7 Heads of government of the seven industrial countries (Britain, Canada, France, Germany, Italy, Japan and the United States) meeting at annual summits to set economic policy guidelines - including the issue of aid to CEEC and/or the USSR.

G-10 Finance Ministers (and central bankers) of the G-7 plus Sweden, Switzerland, Benelux consulting on international financial policy and form 1991 making occasional policy statements on assistance to the CEEC.

institutional actors may illustrate how they are reallocating resources and positioning themselves to influence the CEEC transition.[47]

The World Bank

The World Bank provides a clear example of a universal institution stretching its mandate and resources to meet the post-Cold War challenge. Once limited to project lending, the Bank already reinterpreted its mandate in the 1980s to take on an IMF-like role and offer structural adjustment loans (SALs) in response to the critical needs in debt-ridden Third World countries. By 1991, the Bank had signed SAL agreements with Poland, Hungary and Yugoslavia and was negotiating SALs with Czechoslovakia and Bulgaria. It also stepped up project lending to the same countries and its private sector investment affiliate, the International Finance Corporation, has begun to provide both advice and financing to Hungarian and Polish companies.

Before the USSR even applied for membership in the Bank or the IMF, both institutions took part in the major "needs assessment" mission to Moscow in late 1990, together with the OECD and the President-designate of the EBRD, as requested by the G-7 and the EC.[48] The challenge of change in Eastern Europe was seen to be so urgent that the Board of Governors voted an additional US $5 billion over the next three years for CEEC borrowers, prompting angry opposition from Third World member governments who saw this decision as a diversion of resources away from the more needy South. Whereas the Bank lent only $543 million or 3 percent of its total lending to

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47 Another venerable financial institution, the Bank for International Settlements (BIS), has responded to post-communism by intensifying its relations with the CEEC. Although some CEEC central banks have remained pro forma members since the BIS was founded in 1930, now all are invited to the monthly meetings in Basel where international monetary cooperation is worked out. The BIS handles 9 percent of the world's foreign exchange reserves for its twenty-nine central bank shareholders. It has created a special service to undertake research and provide technical assistance (training, seminars, advice on banking legislation) to the CEEC. Should the European Community's project for a new central bank go forward, however, the BIS could become irrelevant. Survival may thus be one reason for promoting its role in the CEEC transition according to the *Financial Times* (London), 16 April 1991. See Bank for International Settlements, Service for CEEC, "Financial and Technical Assistance provided by the BIS to the Central Banks of the Central and Eastern European Countries," (12 June 1991). 3p.

48 International Monetary Fund, IBRD, OECD, EBRD, *The Economy of the USSR*, Summary and Recommendations (December 1990). The IMF has advanced US $8 billion to the CEEC according to its 1991 *Annual Report*.

support projects in CEEC economies in 1989, its 1990 books showed $3 billion disbursed to the East or nearly 20 percent of its total lending.[49]

The Organization for Economic Cooperation and Development

The Organization for Economic Cooperation and Development (OECD), which regroups twenty-four Western (including Japan) industrial countries, has assiduously expanded its activities in support of the transition to market economies in Central and Eastern Europe, albeit within the rather narrow confines of its mandate. The OECD is neither a bank nor an operational agency with funds to transfer, but it can offer the intangible investment in human resources. Its new orientation towards the East was in some sense forced when five CEEC asked for membership during 1989-90 and the USSR sent delegates looking for advisors to help prepare privatization. Following an investigative mission by its Secretary-General, the executive Council of the OECD decided to set up a new unit, the Centre for Cooperation with Economies in Transition (CCEET).

The OECD's new Centre now channels all requests from the CEEC and coordinates projects by various OECD directorates related to the reforming economies. Once the choice was made to have this unit be administrative rather than operational, new personnel and budget resources were invested in the existing directorates — some thirty new posts have been created since mid-1990 for work on the transition and a new division for Central Europe established in the key directorate dealing with economics and statistics.

A major revised programme of OECD activities relating to the CEEC for 1991 reveals a wealth of workshops, seminars, study missions and publications dealing with such issues as "Integration of CEEC into the International Trading System," "Financing of Enterprise Investment in CEEC" or "Double Taxation Agreements between OECD Countries and CEEC." As well, the much-cited OECD "country reviews" which evaluate members' industrial performance are being extended to cover the CEEC. Finally, in order to focus its resources more effectively, the OECD has put two countries on a fast track to membership by breaking out a new "Partners in Transition" programme. It allows the select (Hungary and Poland) to have high-level exchanges with the OECD

49 Willi Wapenhans, [Vice-President, The World Bank], "The Challenge of Economic Reforms in Eastern Europe," *Finance and Development* (December 1990), p. 2-5. Recent data are from IBRD, "The World Bank Group's Support for Economic Transformation in Central and Eastern Europe," 5 June 1991 (submission to the G-24).

through a liaison committee and to participate in some OECD Committee work, all with the express purpose of preparing them to meet the conditions of membership.[50]

The European Community

The European Community (EC), and more particularly its Commission is, however, without any doubt the international body having the pivotal role in Western assistance to Central and East Europe in terms of (i) its coordination role within the G-24; (ii) its direct assistance (above that of individual member states); and (iii) its mandate to integrate the CEEC into a West European future by liberalizing trade relations and possibly by opening its doors to them as new members.[51]

The EC itself, we saw, is the largest multilateral donor with contributions matching those of the largest national donor, Germany. This contribution has steadily expanded since a vote from the European Parliament in 1990 raised the EC's budgetary commitment to assist Central and Eastern Europe. Further increases have since been authorized by the twelve EC Economic and Finance Ministers, bringing the PHARE programme to its current level of over one billion dollars (US). EC officials are keen to point out that Community assistance has the largest grant component of any donor (some 34 percent) of which a good deal goes to new training and educational programmes such as TEMPUS, the programme for academic exchanges. The EC also contributes 30 million ECU annually to capitalize the EBRD. The European Investment Bank (EIB), responsible to the EC Commission, and the European Coal and Steel Community (ECSC) have both been cleared to lend to Eastern Europe. Late in 1990, the Commission also decided to raise the EIB's loan ceiling so that it could offer credits for development projects in Czechoslovakia as well as Poland and Hungary.[52]

The EC's central role in integrating the CEEC into the world economy is now acknowledged by all since market access is seen to be the key for these economies to finance their transition over

50 Documentation provided by OECD delegations and CCEET officials.

51 For a good summary in English of the EC's role see Pierre Jacquet and Pascal Lorot. "Economic Reform in the East and the Role of Western Europe," *Tokyo Club Papers*, no. 4 Part 1 (1990), pp. 106-126.

52 For EC assistance broken down by projects see Commission of the European Communities, *First Annual Report from Commission to the Council and the European Parliament on the implementation of economic aid to the countries of East and Central Europe as of 31 December 1990* (issued in July 1991). The 1991 Budget for PHARE, including Romania, is 785 million ECU. The TEMPUS programme this year involved 452 joint academic projects — most in the areas of engineering, applied sciences or business. A recent EIB credit (July 1991) makes 75 million ECU available to Polish enterprises to encourage EC Polish joint ventures. Information from *G-24 Update* Nos. 5 and 6 (July and August 1991).

the long term and become partners in an international division of labour rather than supplicants in a Europe divided by a new "wall of welfare." As the *Washington Post* editorial after the London Summit asserted, "The Western countries are desperately anxious to see the Eastern Europeans prosper" and thus "it was contradictory to send aid to promote market economies in Eastern Europe...while at the same time keeping products from these countries out of the world's biggest markets."[53] Even the not so European *The Economist* argued after the summit that the EC must dismantle the Common Agricultural policy's protectionism, do away with textile quotas, and allow visa-free entry to CEEC workers since "The most useful thing the West can offer is not money. It is markets."[54]

Within the European Commission, officials interviewed differ in their assessment of the EC's commitment to trade liberalization for the CEEC. Some emphasize the extraordinary progress since 1989 — from the elimination of most quantitative restrictions (QRs) to application of the generalized tariff preferences (GSP) originally intended for Third World countries only. Yet they also admit that the East Europeans do not see it this way as the product areas still restricted (e.g., steel, textiles, agriculture) affect them most. Other EC officials are impatient with what they see as tokenism, noting for example, that enlarged quotas are based on prior market shares which had been held artificially low due to the former restrictions on the state trading countries. New tensions developed in autumn 1991 between the Commission and the member governments, as the issues of trade liberalization became part of the new negotiating package to give three of the CEEC association status with the European Community.

Of all forms of "assistance" to the East, the most contentious within the Community and the most consequential for the former Comecon countries is association with, and possible membership in, the EC itself. Initially, after democratic reforms snowballed across Eastern Europe in 1989, the EC assumed that negotiating enhanced trade and cooperation agreements would suffice to encourage the East at a low cost to the EC itself — not so.[55] Events quickly overtook them: the collapse of Comecon, the pace of economic change in the CEEC and the direct demands of several

53 *Washington Post*, 18 July 1991, p. A16 and p. A27 "Leaders Gloss over Rifts."

54 *The Economist*, "Open Up," 3 August 1991, p. 17.

55 An umbrella Declaration between EC and Comecon in June 1988, whereby each organization finally recognized the other, made bilateral agreements with Comecon member countries possible for the EC. A new generation of trade and cooperation accords were signed with Hungary (1988), Poland and the USSR (1989); GDR, Bulgaria and Czechoslovakia (1990). These accords both liberalized quantitative restrictions imposed on state trading countries and set up consultation mechanisms to encourage economic cooperation.

countries to be admitted as members of the EC provoked a whole new strategy. At a special EC Summit in Dublin in April 1990, where the twelve governments incorporated the GDR into Germany and thus into the Communities, they also approved proposals from the Commission to devise new, more elaborate "Association Agreements" for the most rapidly reforming countries. By the end of 1990, detailed directives had been submitted to the European Parliament and the European Council so that negotiations could begin with Czechoslovakia, Hungary and, shortly thereafter, Poland.

These Association Agreements, now known as "European Accords," were in the first instance pure politics. The requests for membership from CEEC came at a delicate time of transition within *Western* Europe after all. The debates over Europe 1992 had been highly charged, especially concerning monetary union (EMU); applications for membership by EFTA members like Austria and then Sweden complicated the agenda while the complex issues of German unification had to be dealt with immediately.[56] To orient EC strategy, Commission President Jacques Delors, had hit upon the image of "concentric circles." The EC twelve constituted the centre, which would negotiate with the second circle of EFTA member countries to create a single market, but not common political institutions. This new "European Economic Area" would extend a supportive policy net to encompass a third circle of the reforming CEEC. At the far margins were found those few countries which needed EC assistance but were never expected to become members — e.g., the USSR.[57] By proposing association, the EC sought on the one hand to forestall the need to face difficult decisions about widening its membership and on the other hand to offer a West European future to the post-communist governments.

The common framework policy worked out over 1990-91 in Brussels for the new "European Accords" clearly expresses the political end purposes of the EC's relationship to the CEEC. The preamble to each accord will reiterate the common goal — "political and economic freedoms" — which is to be promoted by institutionalizing a "political dialogue." On a bilateral basis, the EC will set up the following institutional mechanisms: a ministerial level council; permanent working committees of experts; and periodic consultation between parliamentary delegations. Among the

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56 Austria's application is now being considered; Sweden formally applied in July 1991.

57 Commission of the European Communities, Address by Jacques Delors, President of the Commission, to the European Parliament, *Bulletin of the European Communities*, supplement 1/89. It was agreed in principle (22 October 1991) that the EEA will have a common "ministerial conference" of the 19 states to set broad policy.

six stated purposes of the European Accords, just one concerns classic East-West trade and investment cooperation.[58]

Whether or not association will lead to eventual EC membership is very unclear. European Documentation literature has been ambivalent: "The agreements would constitute an end in themselves. They are not a transitional phase on the road to membership of the Community; [but then again...] neither do they exclude the possibility of an 'associated' country applying subsequently to join the EC."[59] The negotiations leading to association have proven extremely tough and on the eve of agreement, France stunned its partners by refusing to accept beef imports from the CEEC in the face of farmers' protests at home. Once compromise permits the signing of accords (expected before year-end 1991), real concessions will be subject to EC conditionality. According to the Community, implementation will be "conditional on internal progress by the partner country concerned in the area of the rule of law, the respect for human rights, the maintenance of a pluralist democracy and the degree of economic liberalization."[60] Already Hungary has refused having a review of its reforms be the precondition for renewing the association accord after five years.[61] With the dismantling of the Soviet Union in process, however, where are the alternatives? Now Hungary's Prime Minister calls membership a matter "of life or death." And in Brussels, the Commission asks its Council of Ministers for a new mandate to begin negotiating association agreements with Romania and Bulgaria.[62]

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58 Citations from Europe Documents no.1646/47 (7 September 1990), *Cadre général des accords d'associations (accords européens) entre la CEE et les pays d'Europe centrale et orientale, defini par la Commission européenne.* A very significant area of cooperation in the Association Agreements is the gradual harmonization of CEEC legislation with Communities' law to permit these countries to benefit from the European Single Market. For some observers, harmonization will also have the effect of "bilateralizing" East-West economic relations by making EC, rather than North American, regulations and standards the norm.

59 European Community, *The European Community and Its Eastern Neighbours*, Luxembourg: Office for Official Publications 1990, p. 13. The legal basis for the Association Agreements is Article 238 of the Treaty of Rome.

60 *Ibid.* The bitter debate around agricultural quotas and France's policy can be followed in Europe, e.g., no. 5563 (9/10 September 1991), p. 9. Resolution by avoidance involves having the USSR use EC food credits to buy CEEC beef for an interim adjustment period.

61 *Financial Times* (London), "Hungary at impasse on Brussels Farm Trade," 9 April 1991. The expected format is nonetheless a two-stage, ten-year plan with access to EC markets for the CEEC preceding full market integration in the second stage.

62 *Europe* no. 5568 (16/17 September 1991), p.7 for Prime Minister Antall's statement made to the European Parliament's Bureau. *Ibid*, no. 5561 (6 September 1991), p.1 for the new EC Commission initiatives.

These three examples of organizational adaptation to change in Central and Eastern Europe are part of an emerging institutional framework for Western assistance to the CEEC which will not only affect ongoing reforms in the East, but will reshape the arena for Western foreign policymaking. The challenge of reintegrating the CEEC into the world economy entails moving the tectonic plates of Cold War institutions — as they reposition, expand membership and rejig with new institutions.

VIII REGIONAL SECURITY: DESIGNING THE NEW EUROPEAN ARCHITECTURE

At the moment of Western triumph at the CSCE Paris Summit when President Bush heralded the End of the Cold War, a more sagacious President Mitterrand foresaw the real challenge: "Tout est à repenser. Aucune institution n'échappera à cet examen critique."[63] The current jockeying for position among old and new institutions participating in assistance programmes to the CEEC is part of the process of reconstructing "European architecture." Depending upon which institutional fora are favoured, each Western government will have different opportunity costs in terms of gaining or losing national influence.

In the movement to recast the role of various institutions, the central role of the G-24 and within it the central role of the European Commission in coordinating assistance to the East may well be eliminated. Some national governments and rival institutions perceive the EC to have "hijacked" assistance programmes in order to set the agenda for East-West European cooperation.[64] One alternative has been proposed by the Group of Ten. This consultative grouping is composed of the G-7 Finance Ministers plus those from Sweden, Switzerland and the Benelux along with their central bankers. Its seeks to coordinate international financial policies. At its spring 1991 meeting, also attended by the heads of the OECD, BIS and the Vice-President of the EC, the G-10 reviewed a report on "Issues raised by the transition in Central and Eastern Europe." The communique set out a preferred hierarchy of institutional responsibilities for assisting the CEEC.

The Group of Ten's fundamental message was that the EC/G-24 is no longer the body best suited to assessing needs and devising policies to bring the CEEC back into the world economy. "Ministers and Governors agreed that the G-24 has been created as a temporary mechanism designed chiefly to provide emergency support and to ensure that political considerations were taken into adequate account in providing assistance to the CEEC."[65] Instead, direct involvement of financial authorities in the coordination of Western assistance was called for — the G-10 ministers

63 Cited in *Le Monde*, 22 November 1990, p.1.

64 Somewhat on the defensive, the latest meeting of G-24 Senior Experts "welcomed the suggestion of the EC to strengthen coordination with the international institutions and with beneficiary countries' authorities." Rather than having the European Commission provide all information on CEEC needs, "it was agreed that Senior Officials of the CEEC would be invited to meetings of the 24 on a permanent basis" and their experts would be included in sectoral working groups. "Draft Conclusions of the Group of 24 on Economic Assistance to the Central and Eastern European Countries," Brussels, 13 June 1991.

65 Communique of the Ministers and Governors of the Group of Ten, Washington, 29 April 1991, 4p.

and central bankers gave the principal responsibility for strategy to themselves; for macroeconomic policies to the IMF; for structural reform to the World Bank; for micropolicies and especially privatization to the EBRD; and for technical assistance to the OECD. Consultation should take place at an early stage among the IFIs, national contributors, and the EC Commission rather than continuing the present EC/G-24 system.

Regardless of how these particular proposals shake out over time, all governments now see that the organization of Western assistance to the CEEC goes well beyond finance and economics to high politics, and here financial institutions are not the suitable fora for policy coordination. Who then will design the new European order? The process began formally at the first meeting of the CSCE "Council" of Foreign Ministers in Berlin (June 1991). Now scheduled to meet annually, the Council started "political consultations on the European architecture and the strengthening of security in Europe." In unexpectedly rapid fashion, the thirty-five states managed to set up a Dispute Settlement Mechanism, invoked immediately thereafter to legitimize the EC mission to Yugoslavia.[66] The quick acceptance of the three Baltic states as members suggests that CSCE will be the first forum to welcome other former Soviet republics.

This new manifestation of political will within the CSCE came as a surprise to many who expected its glory at the moment of the Paris Summit (November 1990) to fade away. There, the heads of state piously declared that "the era of confrontation and division in European has ended" and enshrined liberal principles in the "Charter of Paris."[67] They also strengthened the CSCE's institutional capacity by authorizing a Free Elections office in Warsaw, a Conflict Prevention Centre in Vienna and a permanent political office in Prague. Now the Berlin meeting has revealed the potential of these fledgling centres. Ministers also laid plans for the CSCE secretariat to become involved in exchanges of information among "the main European and transatlantic institutions" notably the EC, ECE, NATO and Council of Europe.[68] Meanwhile, decision-making at the CSCE's Parliamentary Assembly (Madrid, April 1991) has moved from the cumbersome unanimity principle to majority voting. With imaginative leadership, the CSCE could well expand its role in the process of European reintegration.

66 Berlin Meeting of the CSCE Council, "Summary of Conclusions," 19-20 June 1991, 10p.

67 "Charter of Paris for a New Europe," Paris 1990. To appreciate Canada's role in the evolving CSCE process see Robert Spencer, ed., *Canada and the Conference on Security and Co-operation in Europe* (Toronto: Centre for International Studies, 1984).

68 Berlin Meeting...*op cit.*

There are at present numerous contending visions of the appropriate architecture for post-Cold War Europe. Some are extremely modest, such as the "Pentagonal" cooperation grouping invented by Austria, Hungary the CSFR, Italy and Yugoslavia. Created at a meeting in Budapest in 1989, these five governments now caucus within CSCE meetings and have also set up a series of cooperative projects in such areas as telecommunications, environment or parliamentary consultations. Their not so hidden intent is to avoid overweening German influence in the CEEC transition. Poland has now joined the group. It is, however, the fate of much more ambitious projects favoured by the United States on the one hand and the European Community on the other which will likely fix the future security order in Europe.

US Secretary of State James Baker, envisages a new "Euro-Atlantic architecture extending from North America across Europe to the Soviet Union" wherein the "essential structures" are NATO, the EC and the CSCE. Not surprisingly, he sees NATO as the core element. NATO will move beyond its defence role through outreach programmes of cooperation with the CEEC, such as the exchanges now underway with security officials and military authorities from the former Warsaw Pact countries.[69] Baker's blueprint relegates the EC to the economic function of opening markets and eventually expanding membership to the CEEC. The broader framework institution should be the more inclusive CSCE which, he claims, can best ensure "the political, economic and security conditions that may defuse conflict." It should be supported by programmes emanating from the EC, the Council of Europe and the OECD.[70]

Crucial to whether or not this American vision materializes is the outcome of the controversial EC project for political union with its possible military security component. The President of the European Commission naturally regards the US imagery as "ambiguous." Instead he evokes "the emergence of a multipolar world" after the Cold War and calls for "strengthening of political cooperation" so that the Community can take on "continent-wide

69 Secretary of State James A. Baker III, Address to the Aspen Institute, Press Transcript, Berlin, 19 June 1991, p.1. Canada, among others, is channelling some of its "assistance" via NATO — $150,000 has gone to support seminars and fellowships on "democracy" for CEEC applicants. Secretary of State for External Affairs, *News Release* no. 174, 21 March 1991.

70 The Council of Europe, established in 1949 to promote democracy and human rights, first invited the CEEC to attend its meetings in 1990. Two countries, Hungary and Poland, have since become members. The Council also voted to increase activities in the CEEC and to be represented formally at future CSCE meetings. Its role is to a degree contentious in that neither Canada or the United States is a member, although Canada has observer status.

responsibilities."[71] Revisions to the Treaty of Rome made as part of Europe 1992 foresaw a Political Union alongside the Economic and Monetary Union. France and Germany jointly took the initiative in 1990 to promote a draft treaty which the twelve Heads of State agreed to work out through an Intergovernmental Conference on Political Union. All Foreign Ministers met in March this year to find consensus on a common foreign policy and common security policy (known as CFSP). Differences, however, required a compromise draft to be tabled at the heads of state meeting this past April in Luxembourg. There Britain first of all, but also Ireland and the Netherlands, objected to any references to defence, and in particular to the French desire to see the West European Union revived to act as a potential military arm for the EC. Clearly a European alternative to NATO is not for tomorrow.[72] Competing views on how to organize regional security beyond the Cold War — NATO, CSCE or a EC centered arrangement — have different implications for the Central and East European countries. The crisis in Yugoslavia makes the risks of leaving Central and Eastern Europe outside any collective security regime frighteningly clear.

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71 Commission of European Communities, "Commission's programme for 1990" and "Address by Jacques Delors, President of the Commission to the European Parliament," in *Bulletin of the European Communities*, supplement 1/90.

72 See "Les Douze à la recherche d'une diplomatie commune," *Le Monde*, April 7-8 1991 and "Britain Rejects EC Treaty with a Federal Goal," *Financial Times* (London), 18 June 1991. In October 1991, revived Franco-German initiatives for a European army were again attacked by Britain as weakening NATO. A broader review of the "European pillar" and Atlantic security is provided by David Haglund, "Being There: North America and the variable geometry of European security," *International Journal* (Winter 1990-91), pp. 81-112.

IX CONCLUSIONS: CANADA'S AGENDA

The Triple R agenda of assistance to Central and Eastern Europe, intended to promote reform, reintegration and regional security, has evolved over the two years since radical political changes motivated the twenty-four Western governments to coordinate their aid. Both new insecurities and new opportunities have revised initial expectations. On the one hand, the first agenda is well advanced as direct transfers of aid to reform programmes through the G-24 have expanded to encompass all CEEC and now finance a multitude of activities including the operations of a brand new financial institution, the European Bank for Reconstruction and Development. On the other hand, over the winter of 1990-91, financial fatigue and sobering recognition that a transition to market economies in the CEEC will be costly and lengthy have pushed each government to reconsider assistance programmes.[73]

Central and Eastern European countries are experiencing losses in output and employment; private capital cannot yet be counted on. Thus the IMF regards "the financial and technical support provided by national governments and international institutions as essential at this stage."[74] And yet, as Canada's Department of Finance explains, all OECD governments are concerned that "global savings may not be adequate at a time when the demand for financing in Eastern Europe and developing countries is very strong"[75] Emphasis has therefore shifted to the multilateral institutions in order to promote the second agenda of reintegrating the CEEC within the world economy — through trade liberalization, balance of payments support and technical assistance leading to eventual incorporation into an enlarged European Common Market.

This reordering of the agenda for assistance and the elbowing for position among the many multilateral actors has consequences for the third agenda aimed at building a new architecture for regional security in Europe. The institutions engaged in assistance programmes are redefining their membership and activities and looking to entrench their role in the new East-West relations. Here

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73 The recently released special issue of *European Economy*, commissioned by the EC, opens by acknowledging that "In little over a year, the prevailing mood among East Europeans themselves as well as the Western analytical and policy community has shifted from optimism and enthusiasm for the transformation to a pessimism that is most depressing in its scope and depth." Special issue no. 2, "The Path of Reform in Central and Eastern Europe," Brussels, 1991, p.3.

74 International Monetary Fund, *Press Release*, no. 91/23, "Communique of the Interim Committee of the Board of Governors of the International Monetary Fund," 30 April 1991.

75 Canada, Parliament, House of Commons, Minutes of Proceedings and Evidence of the Standing Committee on Finance...Consideration of the International Monetary Fund, issue no. 3, 17 June 1991, p.9.

the overarching geopolitics of West-West relations prevail. Longstanding issues, in particular the fit between intra-European and Euro-Atlantic strategies, have not ended with the Cold War, but are simply up for renegotiation. Europe's institutional future remains open-ended and for this reason, our review and analysis of Western assistance to Central and Eastern Europe suggests the need to reopen debate on Canada's role in post Cold War Europe.

Canada, like every Western government, has a growing network of officials and diplomats involved in assisting the CEEC transition. At a higher level, however, policy will have to be continually adapted not only to fit the evolving circumstances in Eastern Europe, but also to respond to the initiatives taken by other Western governments, all seeking to shape the Triple R agenda. A very clear view of the national interests underlying assistance policy is required in order to focus both funding and ministerial attention. Others already have visions for us — the US Secretary of State imagines "a Euro-Atlantic community that extends east from Vancouver to Vladivostok."[76] The usual amorphous "policy" of getting a seat at every table will not serve. NATO, for example, is an alliance whose time has passed. It will not be dismantled, but rather diluted as it widens both functions and membership to the point when it can be superceded by the CSCE.[77] Canada should follow this trajectory now, promoting a CSCE with enhanced conflict prevention mechanisms to complement the role of the UN Security Council in other regions.

The travail of Central and East European reforms and the unstable situation in the former USSR make a renewed commitment by Canada and the other G-24 urgent. Canada should not salute at every G-7 call to financial arms. Grandious schemes to reconstruct the Soviet economy, if they are at all feasible, will be guided by IMF, World Bank and to a lesser degree EBRD stewardship. Better to refinance the Task Force and ask it to target assistance to those CEEC where ties of language and family give us an edge in offering technical assistance or training. Most CEEC, and the Baltic states as well, have small economies and evince the policy commitment to reform which makes it possible for Canadian assistance to have a real impact.

The case for renewed commitment to assist the CEEC cannot be made on the narrow basis of business opportunities for the rather reluctant Canadian bankers and investors. Nor should the

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76 Secretary of State James A. Baker III, Address to the Aspen Institute, Press Transcript, Berlin, 19 June 1991, p.1.

77 Statements by NATO's Secretary General made before the November 1991 summit already ceded terrain as he emphasized the alliance's political role and its likely cooperation with the CSCE, the UN and the WEU. See "NATO forging a new political role," and the accompanying interview in the *Globe and Mail*, 8 October 1991.

case against aid to the CEEC be based on a zero-sum calculation of Third World needs (particularly as some former Comecon countries are themselves both traders and investors in the Third World.) The CEEC look very much like the Newly Industrializing Economies. Both seek to expand their share of global markets and achieve sustainable development. More than direct financial transfers, policy initiatives are needed if the welfare gap is ever to be closed. It is by opening markets, reducing existing debt and avoiding the cheap route of more debt-creating "assistance" that Western governments can do the most — acting through GATT, the Paris Club, the OECD and within regional trading blocs.

Although many in Ottawa wonder aloud whether Europe, as a market or a security arena, is not an anachronism for Canada which would do better to look to North America and the Pacific Rim, this is not our conclusion. As European governments recognize, assistance to the CEEC is not an issue simply of tradeoffs in "cheque book diplomacy." The issues at stake involve reconstructing the institutions of Bretton Woods to knit a global economy, reopening the security options foreclosed some forty years ago, and refocussing diplomacy in an era when American hegemony is encroached upon by Europe and Japan. Strategic choices must guide policy-makers as they reassess Canada's role in Western assistance to Central and Eastern Europe. If the right choices are made, it will be money well spent.

ERRATUM

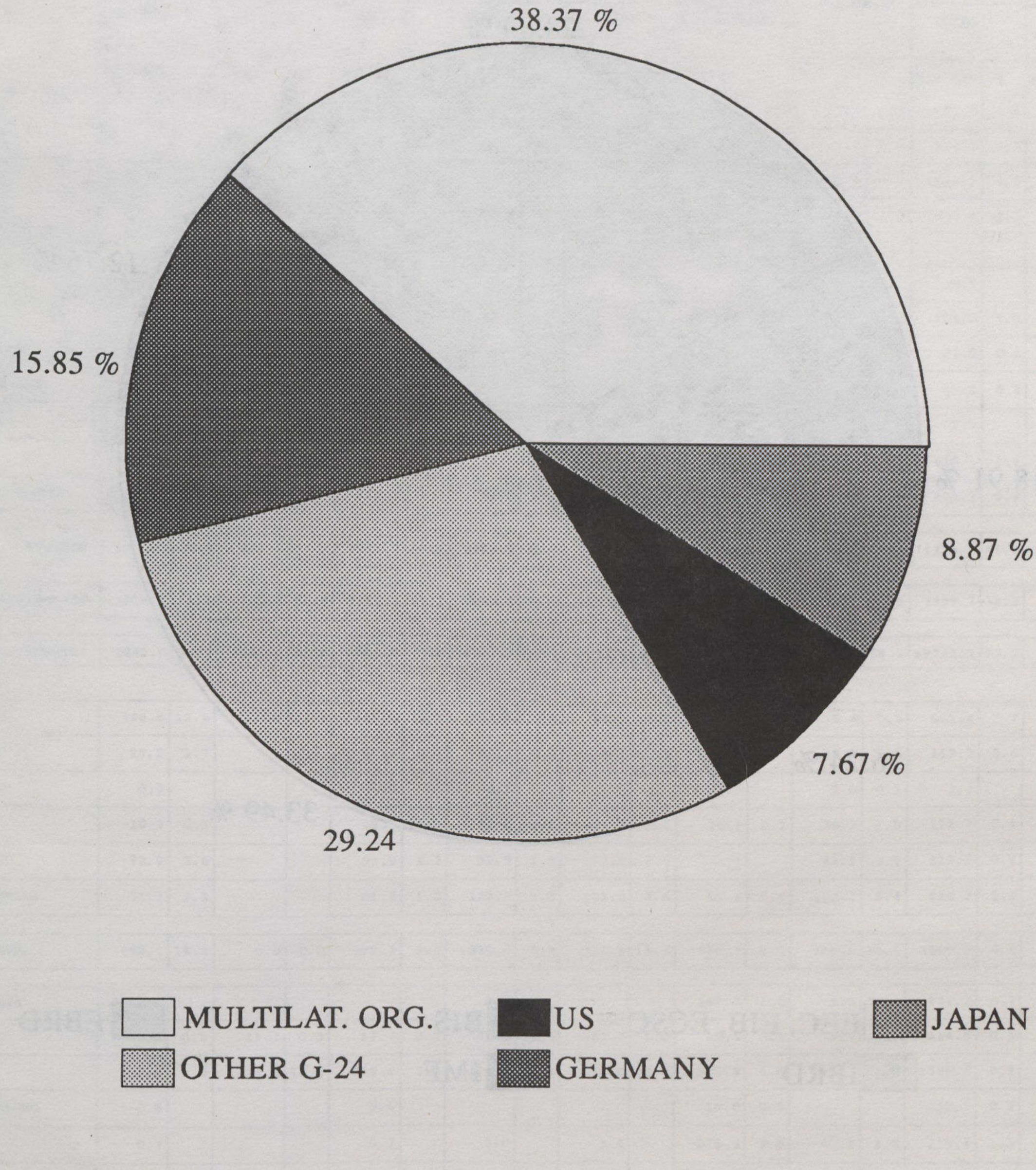
The source for Appendices I and II is:

Peter Mihalyi (UN ECE), "Eastern European Investment and Prospective Inward Resource Flow," Paper presented to the NATO Advanced Research Workshop, St. Anthony's College, Oxford, 16-19 December 1990.

APPENDIX I

Western assistance to Hungary and Poland

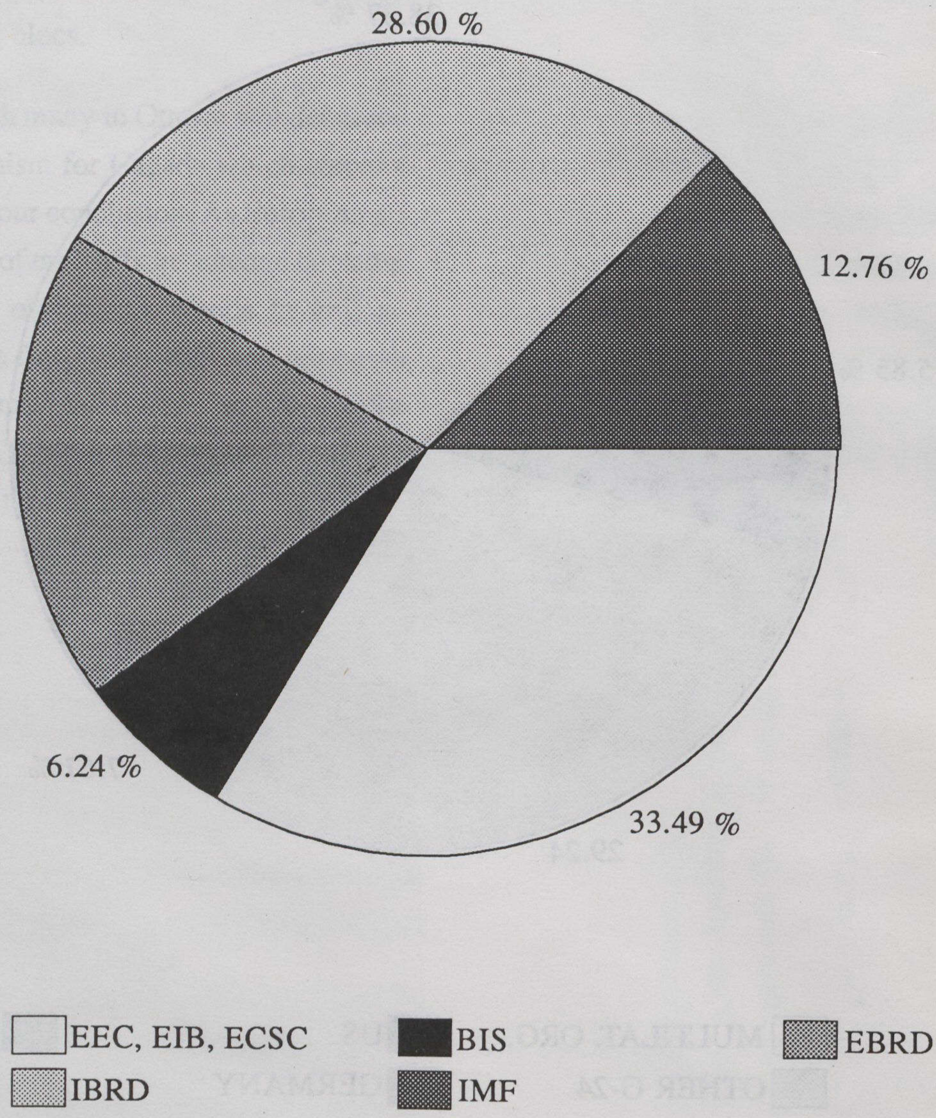
(Total commitments: $21 bn.)



APPENDIX II

Western assistance to Hungary and Poland by multilateral organizations

(Total commitments: $8 bn.)



APPENDIX III

01/06/91

T A B L E II

Distribution of assistance pledged to the central and eastern European countries (CEEC)

(cumulative pledges and commitments since beginning of the coordinated assitance programme)

	ECONOMIC RESTRUCTURING ASS. (PROJECTS)						MACRO FINANCIAL ASS.				TRADE CREDITS /INVESTMENTS GUARANTIES		OTHER(2)		TOTAL ASSISTANCE			
	GRANTS		CREDITS		TOTAL		TOTAL (1)		of which macro-econ. (3)						TOTAL		of wich grants	
	Mln Ecu	%	Mln Ecu	%	Mln Ecu	%	Mln Ecu	%	Mln Ecu	%	Mln Ecu	%	Mln Ecu	%	Mln Ecu	%	Mln Ecu	%
BELGIUM	2.7				2.7						138.9	1.5	19.4	0.8	161.0	0.6	22.1	0.3
DENMARK	84.8	2.4	20.4	0.5	105.2	1.4	6.2	0.1			190.5	2.1	12.7	0.5	314.6	1.3	288.0	3.9
FRANCE	14.4	0.4			14.4	0.2	82.0	1.5			926.2	10.2	105.5	4.1	1128.1	4.6	119.9	1.6
GERMANY	737.6	20.9	24.4	0.6	762.0	9.9	2093.5	38.2			5055.3	55.8	45.2	1.8	7956.0	32.2	1830.1	25.0
GREECE	0.04				0.04								1.0		1.0		1.0	
IRELAND	0.7				0.7								0.2		0.9		0.9	
ITALY	41.6	1.2	114.7	2.8	156.3	2.0	82.0	1.5			515.6	5.7	200.1	7.9	954.0	3.9	241.7	3.3
LUXEMBURG	0.1				0.1		0.7				19.0	0.2	2.0	0.1	21.8	0.1	2.1	
NETHERLANDS	21.0	0.6			21.0	0.3					9.2	0.1	10.6	0.4	40.8	0.2	40.8	0.5
PORTUGAL							2.0								2.0			
SPAIN	1.0		21.7	0.5	22.7	0.3	11.4	0.2			382.0	4.2	2.0	0.1	418.1	1.7	3.0	
UNITED KINGDOM	127.6	3.6			127.6	1.7	82.0	1.5					15.6	0.6	225.2	0.9	225.2	3.0
TOTAL EC MEMBERS	1031.5	29.5	181.2	4.4	1212.7	15.8	2359.8	43.0			7236.7	79.9	414.3	16.3	11223.5	45.4	2774.8	37.8
EC(Incl.EIB+CSCE)	1014.1	28.7	3380.0	81.4	4394.1	57.2	2097.5	38.3	2097.5	75.4	36.0	0.4	1472.1	57.9	7999.7	32.3	2522.2	34.4
TOTAL EC+MEMBERS	2045.6	58.0	3561.2	85.8	5606.8	73.0	4457.3	81.3	2097.5	75.4	7272.7	80.3	1886.4	74.2	19223.2	77.8	5297.0	72.2
AUSTRIA	446.4	12.6			446.4	5.8	103.1	1.9	88.6	3.2	106.3	1.2	5.6	0.2	661.4	2.7	466.5	6.4
FINLAND	59.8	1.7			59.8	0.8	22.2	0.4	18.1	0.6			70.2	2.8	152.2	0.6	72.9	1.0
ICELAND	0.3				0.3		0.2						2.8	0.1	3.3		3.1	
NORWAY	18.3	0.5			18.3	0.2	49.0	0.9	44.6	1.6	19.1	0.2	26.3	1.0	112.7	0.4	72.4	1.0
SWEDEN	92.9	2.6			92.9	1.2	80.8	1.5	72.2	2.6			41.5	1.6	215.2	0.9	134.4	1.8
SWITZERLAND	81.4	2.3			81.4	1.0	123.3	2.2	101.6	3.6	57.3	0.6	162.2	6.4	424.2	1.7	91.9	1.2
TOTAL EFTA	699.1	19.8	0.0	0.0	699.1	9.1	378.6	6.9	325.1	11.7	182.7	2.0	308.6	12.1	1569.0	6.3	841.2	11.5
AUSTRALIA							0.6				167.1	1.8	3.5	0.1	171.2	0.7	4.1	
CANADA	6.0	0.2	11.7	0.3	17.7	0.2	45.3	0.8	27.2	1.0	12.6	0.1	38.9	1.5	114.5	0.5	44.0	0.6
JAPAN	36.8	1.0	579.6	13.9	616.4	8.0	412.0	7.5	290.0	10.4	543.5	6.0	24.7	1.0	1596.6	6.5	61.5	0.8
NEW ZEALAND	0.6				0.6						50.0	0.5			50.6	0.2	0.6	
TURKEY	0.7				0.7		2.0		1.4		276.5	3.0	40.2	1.6	319.4	1.3	4.0	
USA	737.3	20.9			737.3	9.6	184.8	3.4	39.8	1.4	490.4	5.4	241.2	9.5	1653.7	6.7	1078.6	14.7
GRAND TOTAL G-24	3526.1	100	4152.5	100	7678.6	100	5480.6	100	2760.9	100	8995.5	100	2543.5	100	24698.2	100	7331.0	100

1) Includes contributions to the Polish Stabilisation Fund and debt relief.
2) Includes Food aid and other humanitarian assistance.
3) Medium term macro-economic assistance.

APPENDIX IV

23/05/91

DISTRIBUTION OF ASSISTANCE PLEDGED BY THE G-24 (bln ECU,cumulative) TO THE CENTRAL AND EASTERN EUROPEAN COUNTRIES (CEEC)

	ECONOMIC RESTRUCTURING ASSISTANCE(PROJECTS)			MACRO FINANCIAL ASSISTANCE		TRADE CREDITS /INVESTMENT GUARANTEES	OTHER	TOTAL ASSISTANCE	
	GRANTS	CREDITS	TOTAL	TOTAL	(1)			TOTAL	(2)
POLAND	0.67	0.75	1.42	1.46	-	3.19	0.12	6.49	2.24
HUNGARY	0.26	0.62	0.88	2.53	1.29	1.55	0.01	4.97	0.39
CZECHOSLOVAKIA	0.19	0.004	0.19	0.65	0.65	0.80	0.01	1.65	0.21
BULGARIA	0.10	–	0.10	0.38	0.38	0.50	0.11	1.09	0.17
ROMANIA	0.26	–	0.26	0.46	0.46	0.17	0.30	1.19	0.55
YUGOSLAVIA	0.15	1.28	1.48	-	-	2.15	0.01	3.59	0.27
NOT ALLOCATED	1.90	1.49	3.39	-	-	0.64	1.69	5.72	3.50
TOTAL	3.53	4.14	7.67	5.48	2.78	9.00	2.25	24.70	7.33

(1) of which medium term macro-economic assistance
(2) of which grants

APPENDIX V

21 May 1991

Assistance to the Central and Eastern European countries (CEEC)
(Global cumulative pledges and commitments)

	Total Assistance		Of Which Grants	
	bln ECU	bln US$	bln Ecu	bln US$
A. G-24				
1. Economic Restructuring Assistance	7.7	9.6	3.5	4.1
of which:				
- G-24 Member States	3.3	4.1	2.5	2.8
- EC	1.0	1.3	1.0	1.3
- EIB	3.0	3.8	-	-
- ECSC	0.4	0.5	-	-
2. Macro-Financial Assistance	5.5	6.9	1.1	1.4
of which:				
- Polish Stabilisation Fund	0.8	1.0	0.5	0.6
- Medium-term Loan to Hungary	0.8	1.0	-	-
- Complementary (to IMF) Loans to:				
Czechoslovakia	0.8	1.0	0.01	0.01
Hungary	0.3	0.4	0.01	0.01
Bulgaria	0.4	0.5	-	-
Romania	0.5	0.6	-	-
3. Emergency Assistance	0.8	1.0	0.7	0.9
of which:				
- Food Aid	0.7	0.9	0.6	0.8
- Other Emergency Aid	0.1	0.1	0.1	0.1
4. Export Credits and Investment Guarantees	9.1	11.4	0.5	0.6
of which:				
- Export	8.2	10.3	0.06	0.07
- Investment	0.9	1.1	0.4	0.5
5. Non-Specified Assistance	1.6	2.1	1.5	2.1
TOTAL G-24	24.7*	31.0	7.3	9.1
B. Bretton Woods Institutions				
1. IMF (net)	3.3	4.1	-	-
2. World Bank	4.2	5.3	-	-
of which: Structural Adjustment Support	0.7	0.9	-	-
C. EBRD				
So far no outflow from the EBRD				
GRAND TOTAL	32.2	40.4	7.3	9.1
D. Paris Club				
- Poland	(13.2)	(16.5)**		
- Bulgaria	(1.4)	(1.8)***		

Exchange rate used 1 ECU = US$ 1.25.

* Total G-24 including capital subscription to EBRD: 32.9 bln ECU.
** Cancellation.
*** Rescheduling over 10 years with a 6-year-grace period.

APPENDIX VI

Members of the European Bank for Reconstruction and Development (EBRD)

EBRD MEMBER'S PERCENTAGE SHARE OF THE BANK'S CAPITAL STOCK			
Australia	1.00	Mexico	0.30
Austria	2.28	Morocco	0.10
Belgium	2.28	Netherlands	2.48
Bulgaria	0.79	New Zealand	0.10
Canada	3.40	Norway	1.25
Cyprus	0.10	Poland	1.28
Czech and Slovak Federative Republic	1.28	Portugal	0.42
Denmark	1.20	Romania	0.48
Egypt	0.10	Spain	3.40
Finland	1.25	Sweden	2.28
France	8.52	Switzerland	2.28
Germany	8.52	Turkey	1.15
Greece	0.65	United Kingdom	8.52
Hungary	0.79	USA	10.00
Iceland	0.10	USSR	6.00
Ireland	0.30	Yugoslavia	1.28
Israel	0.65		
Italy	8.52		
Japan	8.52	EC	3.00
Korea	0.65	EIB	3.00
Lichtenstein	0.02		
Luxembourg	0.20		
Malta	0.01	Unallocated shares	1.56