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THE EUROPEAN COMMUNITY AND ITS EASTERN NEIGHBOURS

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A wind of change is blowing through Central and Eastern Europe. Alliances and infrastructures which have been in place for the past 45 years have collapsed and are in the course of being replaced. Most Central and East European countries wish to have close links with the European Community and eventually to join it.

This booklet explains what the European Community is doing to help its Eastern neighbours. Money has been made available to infuse new investment into the veins of industry and agriculture. New infrastructures are being set up to give them better access to the markets of the West and to stabilize and improve their food supply. Particular attention is being paid to the protection and improvement of their environment.

The booklet concludes with thumb-nail sketches of the European Community's 'future partners' and a description of its relations with the Soviet Union.

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A HISTORIC CHALLENGE

THE PEACEFUL REVOLUTION

The peaceful revolution which swept Eastern Europe in 1989 is probably the most significant event in global terms of the past 45 years. It is happening on the very doorstep of the European Community. It represents a challenge and an opportunity to which the EC has given an immediate response.

The Community and its Member States, thanks to shared traditions and background, are uniquely placed to help their Eastern neighbours on their way back to democracy. The Community, with more than 30 years of experience in bringing small and medium-sized nations together in an economic unit, also serves as a model for bringing market-driven economic policies to the eastern part of the continent.

Together, the revolution in Eastern Europe and the EC's programme to complete its single market by 1993 are changing the political and economic architecture of Europe. Germany is being united. A new set of relationships has been created between the Community and its European Free Trade Association (EFTA) partners as well as with its neighbours in Central and Eastern Europe.

Throughout the period of the cold war, and despite the limited ability of Eastern Europe to import western products, EC firms did more than their American or Japanese competitors in maintaining commercial flows between East and West. Over the years, the Community has kept a discreet but open-door attitude towards its Eastern neighbours who were part of Comecon, the Soviet-led economic grouping.

From modest roots, these contacts grew rapidly between 1988 and 1990 with the conclusion by the Community of trade and cooperation agreements with East Germany, Hungary, Czechoslovakia, Poland, Bulgaria, the Soviet Union and Romania. At the same time, the Community, and more especially the European Commission, has been at the centre of combined western efforts to support the economic liberalization process in Eastern Europe through the Phare programme.

The Phare programme was set up by the seven-nation Western Economic Summit (the so-called G-7) in July 1989. The initial aim was to coordinate Western aid to Hungary and Poland, the first East European countries to strike out on the reform road. In 1990 its scope was extended to cover the other countries of Central and Eastern Europe.

But these developments are only a beginning. The time when Europe was divided into three distinct regional economic groups — the Community, EFTA and Comecon — is now changing. The map is being redrawn with the Community firmly at the heart of the new Europe. This Europe is set to emerge as a new force in the balance of world power, a fact already recognized by the United States of America, Japan and the Soviet Union.

A COMMON HERITAGE

The emerging democracies in the East are part of the new Europe just as they were part of mainstream Europe until their former Communist rulers shut them off from their Western neighbours at the end of World War II. Traditional contacts were lost, turning Eastern Europe into unknown territory for two generations of EC citizens.

Until then, culture and commerce intermingled freely. Mitteleuropa, which covered parts of what were to become both East and West, was not just a geographic notion. It virtually came to mean a way of life. Czechoslovakia was among the most highly industrialized countries of the whole of Europe in the 1930s with a standard of living that was comparable to that of Switzerland.

The Eastern Europeans have played their part in the great cultural, scientific, political and economic movements that have shaped the history of Europe.

The Renaissance and the Reformation touched the whole continent. Copernicus is one of Europe's greatest scientists. East Europeans played a crucial role in the defence of Europe against outside invaders. They were part of the power struggles and patterns of alliances that marked much of Europe's history. Eastern Europe houses part of the continent's artistic and architectural heritage.

The desire of its peoples to return to the fundamental principles of freedom and democracy has always been present, rising irrepressibly to the surface at regular intervals, starting with the East Berlin uprising in 1953, followed by dramatic (and sometimes violent) events in Poland, Hungary and Czechoslovakia over the following 30 years, and culminating in the almost bloodless revolutions in one East European country after another in 1989.

The movement, begun in Poland and Hungary, accelerated during the year to reach Czechoslovakia, East Germany, Bulgaria and finally Romania by year's end. Each of the six countries has taken its own route towards pluralistic democracy and a market-driven economy.

East Germany is now part of the Federal Republic. The first free elections were held in the other countries during the first half of 1990. Each of the East European countries is grappling with its own set of economic, social, political and sometimes ethnic problems. Yugoslavia, with its own brand of communism, was never a part of Comecon. But it is going through the same revolutionary process as the others.

All the countries of Central and Eastern Europe share common characteristics. Their economies were in a state of near collapse; there had been virtually no investment in plant and equipment in recent years; infrastructure was suffering from similar neglect. Environmental pollution was out of control.

The model to which the peoples of Eastern Europe aspired in terms of freedom and living standards was that of the European Community. They saw how 12 countries of Western Europe had decided to form a fully integrated market, complemented by monetary and, eventually, political union.

A COMMON RESPONSIBILITY

'Each day in Central and Eastern Europe change is asserting itself more strongly. Everywhere a powerful aspiration toward freedom, democracy, respect of human rights, prosperity, social justice and peace is being expressed . . . The Community and its Member States are fully conscious of the common responsibility which devolves on them in this decisive phase in the history of Europe. They are prepared to develop with the USSR and the other countries of Central and Eastern Europe, and with Yugoslavia, in so far as they are committed to this path, closer and more substantive relations based upon an intensification of political dialogue and increased cooperation in all areas.'

Extract from the Declaration on Central and Eastern Europe by the European Council (of the Community's Heads of State or Government)
Strasbourg, 8 and 9 December 1989.

Moreover, the single market project, by putting Eastern Europe before the prospect of having to face a powerful and compact economic bloc, probably helped make several communist regimes aware of the near-bankrupt state of their economies. Just as the EFTA countries were concerned at losing market share and competitiveness once the EC internal market is achieved, many East European countries even before 1989 had begun looking at ways to break out of the further economic isolation they risked once the internal market becomes a reality.

The genesis of today's level of cooperation goes back a long way.

A COMMON HERITAGE AND CULTURE

'The European Council expressed its deep satisfaction at developments in Central and Eastern Europe. It applauds the continuing process of change in these countries with whose peoples we share a common heritage and culture. This process of change brings ever closer a Europe which, having overcome the unnatural divisions imposed on it by ideology and confrontation, stands united in its commitment to democracy, pluralism, the rule of law, full respect for human rights, and the principles of the market economy.'

Extract from the conclusions of the Presidency, meeting of the European Council,
Dublin 28 April 1990.

EC RELATIONS WITH EASTERN EUROPE

Contacts between the Community and Eastern Europe began in the early 1970s but, at Russian insistence, these were initially channelled through Comecon. The Communtiy made a first offer in 1974 to conclude a series of trade agreements with individual Comecon countries and repeatedly restated this willingness.

Only Romania responded and an agreement was signed in 1980, although limited accords on steel and textiles were signed with a number of others.

The main obstacle to normal trade relations between the Community and Eastern Europe was Comecon's insistence that it deal with the Community on behalf of its members. The Community was prepared to establish a limited working relationship with Comecon but insisted that in parallel there should be trade agreements with any of its members who wanted one.

The Community resisted the Comecon approach for several reasons. Comecon was clearly seeking to reinforce its international legitimacy through creating formal links with the EC.

But more importantly, the Community considered that Comecon did not have the structure or authority to be an equal partner. The organization was dominated by the Soviet Union. The degree of economic integration and shared decision-taking was more limited than that in the Community. Comecon had no authority to negotiate on trade and other issues on behalf of its members.

Exploratory meetings did take place between the European Commission and the

Comecon secretariat from 1978 onwards, but little progress was made. If formal contacts were restricted during this period, trade relations were also limited. By 1986, exports from the EC to Comecon still accounted for a mere 7% of the EC's external trade, the bulk of it with the Soviet Union.

It was in 1986 after Mikhail Gorbachev came to power that Comecon signalled its readiness to accept the Community's double approach, agreeing to the principle of a framework agreement with the Community but leaving trade matters to be negotiated by its individual members. Thereafter the pace accelerated.

The agreement between the Community and Comecon, signed in Luxembourg on 25 June 1988, took the form of a Joint Declaration under which formal relations between the two were established. The two sides undertook to cooperate in areas where they were competent and where there is a common interest.

The declaration opened the way for the negotiation of the individual trade agreements. These have been concluded with the Soviet Union and with all the East European countries.

The first to sign an agreement was Hungary in September 1988 to be followed by Czechoslovakia (December 1988), Poland (September 1989) the Soviet Union (December 1989) and East Germany and Bulgaria (both May 1990). The initial, limited agreement with Czechoslovakia was updated in May 1990.

But the rapid pace of events in Eastern Europe has also forced the EC to develop additional, new responses. These so-called first-generation trade agreements are modest instruments with which to meet the challenge of helping the emergence of democracy and a market economy in Poland and Hungary and the rest of Eastern Europe.

RECENT DEVELOPMENTS IN EC-EAST EUROPEAN RELATIONS

Here is a brief summary of the most significant recent developments in relations between the Community and Eastern Europe:

1. June 1988: a delegation of Comecon countries signs a Joint Declaration in Luxembourg with the EC agreeing on mutual recognition of the two organizations.

2. September 1988: a cooperation agreement is signed between the EC and Hungary.

3. December 1988: a trade agreement is signed with Czechoslovakia.

4. July 1989: the G-7 summit in Paris gives the EC the task of coordinating Western aid to Poland and Hungary. The so-called Group of 24 is created.

5. September 1989: the EC signs a trade and cooperation agreement with Poland.

6. November 1989: the EC Heads of Government hold a special Summit in Paris to discuss aid to Eastern Europe. On the eve of this summit, EC Foreign Ministers agree a common strategy for easing Comecon restrictions on high-technology exports to Eastern Europe.

7. December 1989: the EC Summit in Strasbourg agrees the creation of a European Bank for Reconstruction and Development for loans to Eastern Europe.

8. December 1989: the Group of 24 meet in Brussels to define their aid programme for Poland and Hungary and to express willingness to help other East Europeans 'once the necessary political and economic reforms' have been put in place.

9. December 1989: the EC and the Soviet Union sign a trade and economic cooperation agreement.

10. April 1990: a special EC Summit agrees arrangements for incorporating the German Democratic Republic into the Community. Community leaders also decide to offer a new type of association agreement to individual East European countries.

11. May 1990: the German Democratic Republic and Bulgaria sign trade agreements with the Community. The 1988 agreement with Czechoslovakia, which was limited in scope, is updated.

12. May 1990: the Group of 24 agree to extend the Phare programme to other Central and East European countries.

13. July 1990: the German Democratic Republic enters a monetary and social union with the Federal Republic.

14. October 1990: The two parts of Germany are united within the Federal Republic.

THE ROLE MODEL OF THE EC

LEGITIMATE ASPIRATIONS

Immediately after its victory at the polls in April 1990, Hungary's Democratic Forum, which headed the winning coalition, said that membership of the European Community would be the new government's principal foreign policy priority. Leaders of other Central and East European countries have made similar statements.

The European Community is a magnet for East European reformers. This is principally because of the Community's record of democracy and balanced economic growth. Their aspirations to belong to such an order are legitimate. But there is also a necessary element of self-interest. East European countries are concerned lest the creation of the post-1992 single market will make it more difficult for them to export to the Community.

The Community is aware of the aspirations and concerns of its Eastern neighbours. But early membership of the Community is excluded for a number of reasons, both political and economic. For one thing, the countries of Eastern Europe need to consolidate their commitment to pluralist democracy and to a market-driven economic system.

In strictly technical terms, the economies of the countries of Central and Eastern Europe are in no condition to withstand the shock of free market competition. Despite their keenness to join the EC, even Czechoslovak leaders — whose country is the most developed of the region — know they will have to wait.

Prague: Czech youth in a historical setting (Photo: Marc Riboud, Magnum)

Several years of deep-going reform and restructuring are clearly required first.

Another major reason for putting off membership is the Community's own decision not to consider a further enlargement until the single market process is completed. This means that even current applications already submitted by Austria, Turkey, Cyprus and Malta will not be considered until after 1992.

EFFECTIVE AND IMMEDIATE AID

In the light of these constraints, the Community has focused on short- and medium-term support for the reform processes which are under way. It has taken steps to open its markets to East European exports, and has put in place a range of actions and programmes both on its own initiative and in cooperation with other Western countries. Many of these are already operational.

The Phare programme, which the Commission is coordinating on behalf of the 24 donor countries, is the most wide-ranging. The Community's project to conclude special association agreements with individual Central and East European countries is the most ambitious.

In each case, the Community has made the continuation or extension of its aid conditional on the consolidation of democracy and progress towards a market economy by the recipient country.

The States of Central and Eastern Europe have met the challenge. Democratic multiparty elections have been held in all of them except Yugoslavia (at least at federal level). The results of the votes have varied from country to country. All have begun implementing programmes to liberalize and privatize their economies, although none of the others has gone as far as the radical reforms being implemented in Poland.

The Community has taken immediate action to support efforts to develop market-oriented policies, to grant these countries better access to Western markets, to provide financial aid, to offer technical assistance and training, to facilitate foreign investment, and to help clean up the environment.

The reorientation of trade towards hard-currency markets is a top priority for each of them, hitherto restricted by their Comecon commitments to doing a large part of their trade with each other. Central and Eastern Europe (including the Soviet Union) account for only 6% of the Community's external trade. The comparable figure for the much smaller EFTA countries is 25%.

East European countries are already taking steps to reduce their soft-currency trade with Comecon. During 1990, the Community replaced Comecon as Hungary's principal trading partner, while Comecon's share in Czechoslovakia's trade dropped from 60 to 50% in the course of the year. To help its access to EC markets, Czechoslovakia announced that it would be manufacturing to West European norms and standards by the end of 1992.

There has also been a structural imbalance in their trade with the Community. Their biggest export items have been raw materials, fuels and basic products like steel and plastics. The main products imported from the Community have been products of considerably more added value: engineering products and transport equipment followed by other manufactured goods and chemicals.

Details of Community trade with individual East European countries are given on the table below. The Community has a trade surplus with Hungary and Bulgaria and a deficit with the others.

COMMUNITY (EUR 12) TRADE WITH EAST EUROPEAN COUNTRIES, 1986-88

(million ECU)

	Imports			Exports			Trade balance		
	1986	1987	1988	1986	1987	1988	1986	1987	1988
USSR	13 158	13 128	12 988	9 874	9 189	10 113	–3 284	–3 939	–2 875
GDR	1 626	1 390	1 400	1 072	1 086	1 264	–554	–304	–136
Poland	2 947	2 907	3 359	2 388	2 332	2 755	–559	–575	–604
Czechoslovakia	2 108	2 055	2 211	1 944	2 078	2 170	–164	23	–41
Hungary	1 888	1 996	2 158	2 450	2 372	2 354	562	376	196
Romania	2 483	2 429	2 234	987	651	614	–1 496	–1 778	–1 620
Bulgaria	549	517	461	1 472	1 453	1 406	923	936	945
Albania	125	56	72	65	56	67	–60	0	–5
Total	24 884	24 478	24 883	20 252	19 217	20 743	–4 632	–5 261	–4 140

Source: Eurostat.

SPECIAL ASSOCIATION AGREEMENTS

Although the first generation trade and cooperation agreements lift quotas and other quantitative restrictions on exports from the EC's East European partners, they do not contain any element of tariff preference to facilitate their access to the Community market. Nor do they provide for statutory financial aid.

But they can be built on. They are the starting point for the second-generation of association agreements or 'European agreements' of a totally new kind. These agreements would even go beyond the free-trade accords which the Community has forged with the individual countries of EFTA.

Although the Community has a first-generation agreement with the Soviet Union, it does not intend to include the USSR in the network of association agreements. The size of the Soviet economy and its particular problems require a different cooperation framework.

The association agreements are to consist of four essential elements:

(i) free trade between the country concerned and the European Community;
(ii) industrial, technical and scientific cooperation;
(iii) a pluriannual programme of financial assistance;
(iv) the creation of a mechanism for political dialogue.

The agreements would constitute an end in themselves. They are not a transitional phase on the road to membership of the Community; neither do they exclude the possibility of an 'associated' country applying subsequently to join the EC.

Their implementation would 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.

Free trade

The aim of the agreements is to bring about the phased introduction of two-way free trade. The step-by-step approach will take account of the specific reforms under way in each country as they concern prices, subsidies, taxation, monetary policy, currency convertibility and its system of foreign trade. The aim of the reforms is to align their national systems with the open system of multilateral trade and global competition.

In moving towards the free-trade objective, the Community will reduce its tariff and other import barriers more rapidly than partner countries. Associated countries would open their markets for Community goods according to a flexible timetable and one which reflects their specific situation.

Once the economies of the associated countries have succeeded in bringing themselves close to the level of the Community, negotiations can begin on the free movement of persons, services and capital. Their economic legislation could also be harmonized with that of the Community.

Economic and technical cooperation

This cooperation will reinforce the structural changes undertaken by the associated countries, contributing to their integration into the world trading system. Prime focus will be on measures to facilitate technology transfer and direct foreign investment.

Actual cooperation projects will cover areas such as professional training, the environment, the modernization of agriculture and of agri-industries, the renovation of industrial structures, science and research, energy, mining, transport, tourism and other services, telecommunications, health and medical equipment, standards and norms.

Financial assistance

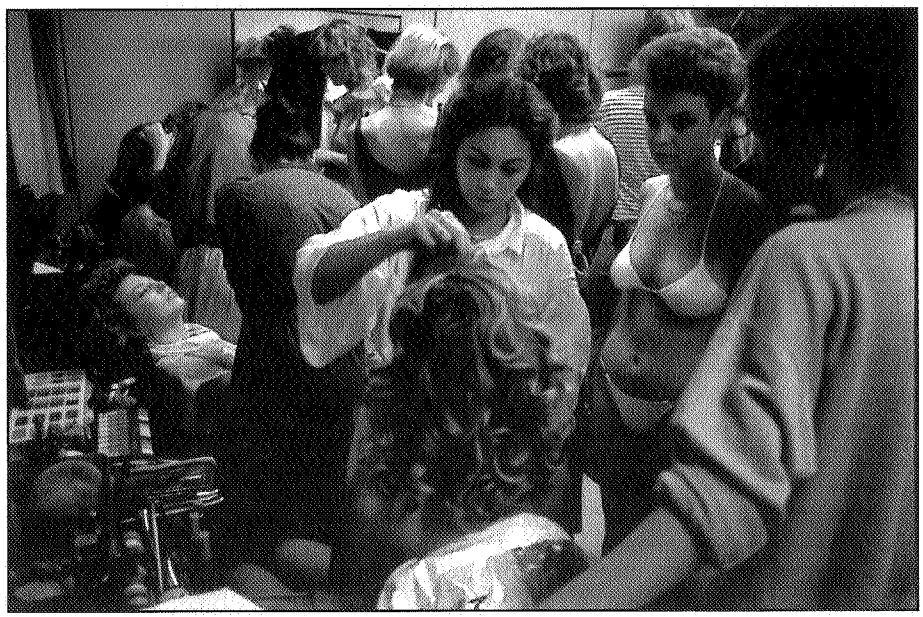
The Community will offer a set amount of credits for each associated country to finance cooperation and technical assistance. The Community is already committed to spending ECU 2 billion in assistance to Central and East European countries in the 1990-92 period.

The financing of projects which promote investments in the private sector will benefit from a particular priority. Financial assistance may take the form of subsidies (technical assistance, interest-rate rebates) or loans (European Investment Bank, the European Coal and Steel Community, Euratom) or risk capital and other instruments.

Community Member States should also increase their cooperation with associated countries in the area of export credits or export insurance guarantees.

Political dialogue

The association agreements will provide the institutional framework for a political dialogue between the Community and each of its partners. It will enable views to be exchanged on urgent bilateral and multilateral issues and thereby greatly facilitate information flows. These exchanges will become increasingly important when new forms of integration and cooperation in Europe (such as the strengthening of the CSCE framework)[1] are put in place.



Election of Miss Hungary: sex-appeal recognizes no frontiers (Photo: Leonard Freed, Magnum)

A Council of Association will be created for each agreement in which the Community and individual partners will discuss and decide on issues of mutual interest. A structure will be created for cooperation between the European Parliament and the national parliament of each associated country.

A STIMULUS TO SELF-HELP

These association agreements will form the nucleus of the Community's efforts in favour

1 *The Conference on Security and Cooperation in Europe which brings together the countries of Western and Eastern Europe (including the Soviet Union) plus the United States of America and Canada.*

of the countries of Central and Eastern Europe. But they fit into a broader perspective.

For one thing, as Commission Vice-President Frans Andriessen has said:

'The European Community is willing to accept its co-responsibility for what is going on in these countries. But it should also be made clear that our assistance cannot fully replace the responsibilities to be assumed by the individual countries themselves. To put it another way: we can do no more than help them to help themselves.'[1]

In addition, the touchstone for the negotiation and implementation of such agreements will be the degree of progress on political and economic liberalization achieved by the individual countries. Such considerations have already applied in the decisions the Community has taken to accelerate the elimination of import quotas on Polish and Hungarian goods in the first-generation agreements with these countries and to update the very limited 1988 agreement with Czechoslovakia.

To quote Mr Andriessen again:

'In the view of the European Community, there should be irreversible trends for real democracy and an opening to a market economy in the particular country concerned before an association agreement can be put into place.'

THE MULTILATERAL FRAMEWORK

The Community has taken a key role in coordinating the overall Western aid efforts for Central and Eastern Europe. These efforts are centred on the Phare programme and the creation of a European Bank for Reconstruction and Development (EBRD). The initial success of the Phare initiative in support of reform and restructuring in Poland and Hungary has led to its extension to the rest of Central and Eastern Europe.

Bucharest: the novelty of parking meters (Photo: Martine Franck, Magnum)

The Phare programme

The Phare programme was set up by the Group of Seven (G-7) summit in Paris in July 1989. The summit charged the European Commission with coordinating assistance from the Group of 24 Western industrialized countries taking part in the programme.[2]

This function enabled the Commission to take on a new and important international political role. For, besides coordinating Western aid, it has increasingly taken the lead in framing Phare policy and strategy. The initial aims of Phare were to sustain the political and economic reform process in Poland and Hungary and in particular to strengthen the private sector.

The priority areas identified by the Commission, in consultation with the IMF, the World Bank and the OECD, are now the object of substantial programmes. These areas are agriculture and rural development, enterprise restructuring, banking and finance, in-

1 *'Europe at the crossroads: the EC in a changing political and economic environment', speech delivered in Brussels, 8 June 1990.*

2 *The G-24 consists of the 12 EC countries plus Australia, Austria, Canada, Finland, Iceland, Japan, New Zealand, Norway, Sweden, Switzerland, Turkey and the United States of America.*

vestment, the environment and professional training and technical assistance.

In addition, the G-24 countries have taken action to facilitate access to Western markets for Polish and Hungarian exports. They have removed quantitative restrictions on Polish and Hungarian products, extended most-favoured nation status (where this was not already granted) and extended to them their system of generalized preferences (SGP).

The Community and its G-24 partners have also provided financial safety nets for Poland and Hungary in the form of the Polish Stabilization Fund and the Community's medium-term loan of USD 1 billion to Hungary. The stabilization fund has helped underpin Poland's radical reform programme which might have otherwise proved too risky. This programme has reduced inflation, strengthened the zloty and improved the balance of payments.

The medium-term loan has helped maintain Hungary's access to international capital markets and encouraged other institutions to provide finance for economic restructuring.

The Community has invited the other G-24 members to participate in the Tempus programme for student exchanges and in the European Foundation for Training. Tempus was formally established by the Community in May 1990.

With funding of ECU 117 million, Tempus is a three-year programme whose main purpose is to finance academic exchanges to enable students and teachers from Eastern Europe to spend up to a year at an EC university or in a company or administration. A smaller number of teachers and students from EC universities would spend equivalent time in Eastern Europe. Tempus also promotes exchanges between Eastern universities and universities or private businesses in the EC.

In May 1990, the Commission produced an action plan to extend the operations of the Phare programme to cover Bulgaria, Czechoslovakia, the German Democratic Republic (to the extent necessary prior to German unification), Romania and Yugoslavia. This proposal was subsequently adopted by the rest of the G-24. Romania's participation was temporarily withheld because of internal events there.

Priorities identified by fact-finding missions sent to these countries by the Commission were similar to those in Hungary and Poland:

(i) improved access to Western markets;
(ii) stabilizing and improving food supply;
(iii) professional training;
(iv) environmental protection;
(v) investment and economic restructuring.

In May 1990 the Commission announced a set of projects for Poland and Hungary worth ECU 86.5 million as part of its contribution to Phare projects. More than half the amount will go on environmental protection, a sector where the Community has taken the lead in supporting major control efforts.

The list of projects includes:

1. Poland: Environmental protection programme
2. Hungary: Environmental protection programme
3. Poland/Hungary: Participation in Budapest Regional Environment Centre
4. Poland: Basic technical assistance for privatization programme
5. Hungary: Support for modernizing the financial system
6. Poland/Hungary: Cooperation in the field of economics
7. Poland: Sectoral import programme for animal feed and feed-additives
8. Poland/Hungary: Technical assistance for implementing the Trans-European mobility programme for university studies (Tempus)

Specific emphasis varies from country to country. The Commission's initial assessment of national priorities for each country are as follows:

Bulgaria

agriculture and the agri-foodstuffs industry,
the environment,
investment (transport and telecommunications),
training (management, financial services, scientific and technical),
restructuring (chemical and light industries),
tourism,
improved access to markets.

Czechoslovakia

industrial restructuring,
the environment (pollution control, industrial waste, nuclear safety),
energy,
training and youth exchange,
investment (transport and telecommunications),
scientific and technical cooperation,
improved access to markets.

German Democratic Republic

food supplies (restructuring of slaughterhouses, dairy sector and sugar production),
the environment (water, air and industrial pollution, protection of the cultural heritage),
investment (transport and telecommunications),
training (management, higher education, scientific and technical),
improved access to markets.

Romania

agriculture and food supply (research, production technology, joint ventures),
the environment,
investment (transport, tourism, smaller enterprises),
training (management, banking, tourism, communications, agri-foodstuffs industry),
improved access to markets.

Yugoslavia

agriculture,
the environment (notably pollution of the Danube and Sava basins and of the Adriatic coast),
investment,
restructuring of the banking sector and the industrial sector,
training (banking, management, taxation systems),
structural adjustment, including the social aspects,
improved access to markets.

The Commission also suggests that a more formal mechanism for a financial safety net be put in place for the five countries. Memoranda submitted by them to the G-24 strongly suggest that requests for facilities like the Polish Stabilization Fund or the medium-term loan for Hungary will be forthcoming.

Czechoslovakia has said it is seeking a large stand-by facility while Bulgaria and Yugoslavia are seeking other forms of financial support. The Commission believes the time is ready for the G-24 to consider a general facility to which its members would contribute. Individual reforming countries in Central and Eastern Europe could draw on the facility as and when necessary. The G-24 would tailor the credits or loans to the needs and absorptive capacity of the beneficiary.

To ensure the soundness of restructuring measures financed through the facility, it would be essential for the country concerned to belong to the IMF and to accept commitments as to the macroeconomic strategy it should follow. As can be seen from the following table, the countries of Central and Eastern Europe are members, or have applied for membership, of the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), i.e. the World Bank and the General Agreement on Tariffs and Trade (GATT).

EASTERN EUROPE'S MEMBERSHIP OF INTERNATIONAL FINANCIAL ORGANIZATIONS

	IMF	IBRD	GATT
Poland	Member	Member	Member
Hungary	Member	Member	Member
Czechoslovakia	Applied	Applied	Member
Bulgaria	Applied	Applied	Applied
Romania	Member	Member	Member
Yugoslavia	Member	Member	Member

The European Bank for Reconstruction and Development

The proposed facility would be additional to the specific project-related activities of the European Bank for Reconstruction and Development (EBRD). The creation of the EBRD is the Community's main multilateral initiative for Central and Eastern Europe. It was first proposed by President François Mitterrand in a speech to the European Parliament in September 1989 and endorsed at the EC's Strasbourg Summit in December of that year.

It has been extended to the G-24 Phare network and beyond to include the Central and East European countries and the Soviet Union as well as other members of the IMF.

The Community and its Member States have a majority stake in the EBRD which has a share capital of ECU 10 billion. In all, there are 42 members — 40 countries plus the Community and the European Investment Bank. The bank will play an important role in supporting productive investment in the private sector and in related infrastructure.

According to the first article of the EBRD's statutes,

'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 East European countries committed to and applying the principles of multiparty democracy, pluralism and market economics.'

The seat of the bank is London. Its President is Jacques Attali, former adviser to President François Mitterrand.

COMMUNITY ATTITUDES TO CENTRAL AND EASTERN EUROPE

In a survey conducted in the 12 Member States in the spring of 1990, 70% of those interviewed felt that the European Community should speed up the pace of economic, political and monetary integration to enable it to participate more effectively in the construction of a wider, democratic Europe.

Eurobarometer No 33, June 1990

PROFILE OF FUTURE PARTNERS

UNKNOWN NEIGHBOURS

'Following the bold decisions of the authorities in Poland and Hungary to adopt far-reaching reform programmes... the entire international community has welcomed the extension of reform to other countries in Central and Eastern Europe. It is now up to the industrialized countries to rise to the challenge posed by the courage and determination of the peoples most directly concerned.'[1]

Despite geographic proximity, the EC's Eastern neighbours were relatively unknown before the revolutions of 1989. They were perceived by public opinion in the EC as monolithic satellites of Russia with little separate identity of their own.

Their rigid communist political structures and uniformly lower standards of living did little to stimulate Western interest in them. Their lack of hard currency made them poor markets for EC exports, while their own shoddy goods — with the slight exception of bottom-of-the-range cars like Skodas, Wartburgs and Polski Fiats — made little inroads on Community markets.

The table on the following page sets out some basic indicators for the Comecon countries of Eastern Europe.

The table shows that on a broad range of economic and social indicators, the countries of Eastern Europe lag behind their Western neighbours. Others could be added to confirm the gap.

Life expectancy in Central and Eastern Europe varies between 70 years (Romania and Hungary) and 72 years (Bulgaria). In the Community it ranges from a low of 73 years in Portugal to 77 in France, Italy, Spain and the Netherlands.

Romania, the poorest country of Eastern Europe, has a per capita GDP which is scarcely one third of the OECD average. The figures in the table should be considered with some caution; they are regarded by some Western economists as on the high side. Other estimates would actually mark

[1] *This quotation is from the conclusions of the European Commission's action plan of May 1990 for extending G-24 assistance to Bulgaria, Czechoslovakia, the German Democratic Republic, Romania and Yugoslavia, SEC(90) 843 final.*

	Foreign debt	
	Total (billion USD)	Per capita (USD)
Poland	40.4	1 078
Hungary	19.7	1 873
Czechoslovakia	6.9	431
Bulgaria	9.5	1 056
Romania	1.0	44
Yugoslavia	17.6	733

Sources: World Bank, IMF.

BASIC INDICATORS FOR EASTERN EUROPEAN COUNTRIES

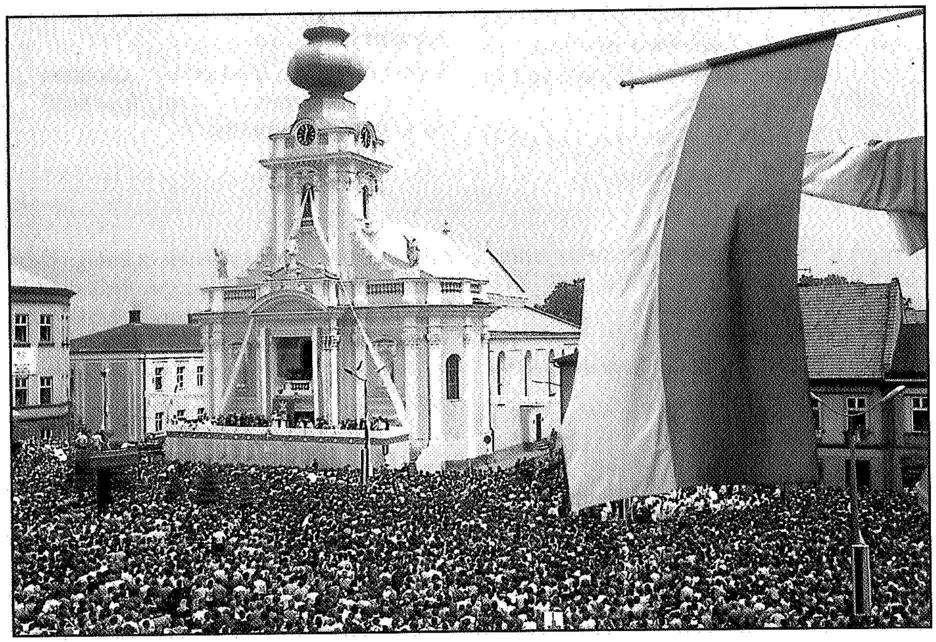
Indicators	Soviet Union	Bulgaria	Czecho-slovakia	German Democratic Republic	Hungary	Poland	Romania	OECD
Population (million, 1988)	286.4	9.0	15.6	16.6	10.6	38.0	23.0	824.8
GDP (billion USD, 1988)	1 590.0	50.7	118.6	155.4	68.8	207.2	94.7	12 073.0
GDP per capita (USD)	5 552.0	5 633.0	7 603.0	9 361.0	6 491.0	5 453.0	4 117.0	14 637.0
Annual growth of GDP (%):								
1981-85	1.7	0.8	1.2	1.9	0.7	0.6	— 0.1	2.5
1986-88	2.3	1.9	1.5	1.7	1.5	1.0	0.1	3.5
Living standards (1987):								
Cars per 1 000 inhabitants	50.0	127.0	182.0	206.0	153.0	74.0	11.0	385.0
Telephones per 1 000 inhabitants	124.0	248.0	246.0	233.0	152.0	122.0	111.0	542.0
Share of workforce in agriculture (%)	21.7	19.5	12.1	10.2	18.4	28.2	28.5	8.0
Gross domestic investment/GDP (%)	33.2	32.7	24.7	29.2	28.5	36.5	37.1	20.6
Share of private enterprise in GDP (%)	2.5	8.9	3.1	3.5	14.6	14.7	2.5	70-80
Workers with secondary education (%)	27.3	n.a.	29.4	n.a.	33.8	28.9	n.a.	61.0
Exports of goods as % of GDP (1988)	6.8	23.0	19.7	13.7	14.7	6.4	11.2	14.4
Exports of manufactured goods as share of exports to non-socialist countries	63.0	59.3	72.4	77.3	79.6	63.4	50.6	81.8
Change of share of OECD markets (%, 1978-89)	— 26.0	— 18.5	— 44.0	— 25.2	— 7.8	— 32.3	— 46.3	—

Source: OECD.
n.a. = not available.

down the dollar equivalent of the GDP figures for most of these countries.

But a closer examination of the figures show that far from being two-dimensional copies of each other, there are considerable differences in the situation of the individual countries. This is also evident from the table on their debt position (see page 19).

It is worth, therefore, looking more closely at each in turn to give a brief political profile and assess their capacity to integrate more or less rapidly into the international market economy system.



Wadowice, Poland: Pope John Paul II visits his home town (Photo: Bruno Barbey, Magnum)

Poland

Poland was the first of the Central and Eastern European countries to embark on its 1989 revolution. The events of 1989 were the follow-on to the concessions won by the Solidarity trade union in 1980. But the liberalization movement was abruptly checked by the imposition of martial law by the Communist government in December of that year.

However, the manifest incapacity of the government to cope with the economic and social situation led it to turn to Solidarity in late 1988 to help solve the crisis. An agreement was reached the following April to legalize Solidarity once more and to hold multiparty elections. The diary of events in 1989 is given below.

But paradoxically, Poland's election was less free than those subsequently held in other East European countries. Elections were for the 460-seat lower house and the 100-seat senate or upper house.

In the free elections for the senate, Solidarity won 99 seats. In the lower house, Solidarity was allowed to contest only 35% of the seats

POLAND — EVENTS IN 1989

February 6: Round table discussions involving the government, Solidarity and the Catholic Church.

April 7: Agreement on legalization of Solidarity and elections.

May 17: Catholic Church recognized.

June 4: Solidarity wins overwhelming victory in parliamentary elections (all 161 allotted seats in lower house and 99 out of 100 in Senate).

July 19: General Wojciech Jaruzelski elected president.

July 25: Solidarity invited into coalition government.

August 7: Lech Walesa suggests Solidarity allies itself with two minor parties to form government.

August 24: Tadeusz Mazowiecki becomes first non-communist Prime Minister in 40 years.

September 12: 24-member coalition government confirmed. Only four seats go to the Communitsts.

all of which it won. The target date for a new constitution is May 1991. New, fully free elections would then follow.
Poland is a member of the IMF, the World Bank and GATT. It has applied to join the Council of Europe.
It has one of the highest levels of foreign debt of Central and Eastern Europe. This debt is the biggest in absolute terms at USD 40.4 billion, while on a per capita basis it amounts to USD 1 078 — a figure surpassed only by Hungary.

Gdansk, Poland: hotel waitresses taking a break from work (Photo: Bruno Barbey, Magnum)

Poland is the country of Central and Eastern Europe which is most dependent on Western financial support. It was first in line to obtain it: through the Phare programme and the bilateral assistance from the Community, the EC Member States, the other G-24 participants and the international financial institutions.

At the beginning of 1990, the zloty was made partly convertible as part of the introduction of a new economic reform programme. To support this, the Polish Stabilization Fund of USD 1 billion was set up by Western governments to bolster foreign exchange reserves.

As a result of these combined efforts by the Polish authorities and the international community, food supplies have improved, the external account is in surplus and inflation has fallen significantly.

In addition to its first-generation trade agreement with the Community, Poland — like Hungary and Czechoslovakia — has signed a cooperation agreement with EFTA. Besides investigating the possibilities of free trade, the agreements cover trade promotion as well as economic, scientific, industrial and technical cooperation.

Hungary

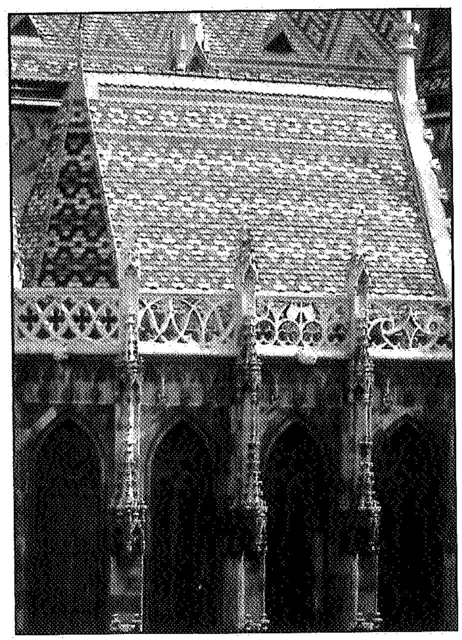
Hungary has been the most persistent economic reformer of Eastern Europe. The Communist government which took over after the brutal repression of the 1956 uprising made a conscious choice to give priority to improving living standards.

Its first major effort to open its economy dates from 1968. But this and subsequent efforts have been frustrated partly because the reform measures were inadequate and partly because of external payments constraints.

Hungary has the highest per capita level of debt in Eastern Europe. At USD 1 873 for every man, woman and child it is nearly double that of second-placed Poland.

But the result of earlier liberalization efforts meant that the post-1989 economic reform process has been less turbulent in Hungary than elsewhere in Eastern Europe. Foreign investors already have a certain access to the Hungarian market. General Electric of the United States bought a controlling interest in the Tungsram lightbulb company. Another American group, General Motors, has signed a deal with the Raba truck group. Budapest has a fledgling stock exchange.

At the political level, the Hungarian Communist party took the lead in the reform process, effectively programming its own demise. It abandoned its so-called leading role in 1989 and began Round table discussions with opposition groups in September that year.

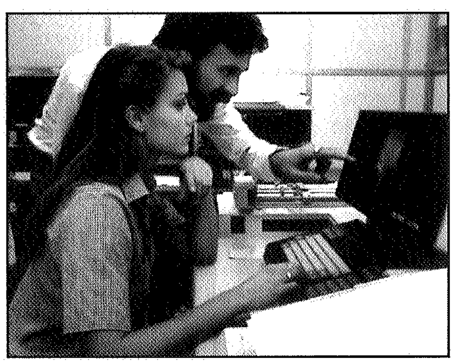


Budapest, the Cathedral (Photo: Leonard Freed, Magnum)

These prepared a transition to elections in March/April 1990 for a single-chamber 386-seat parliament. The outcome of the vote is given below. It led to the creation of a coalition government led by Democratic Forum with the support of the Smallholders Party and the Christian Democrats.

ELECTIONS IN HUNGARY, MARCH/APRIL 1990

	% of vote	Seats
Democratic Forum (centre-right)	25	165
Free Democrats (centre-liberal)	21	92
Independent Smallholders (farmers)	12	43
Socialists (reformed Communists)	11	33
Young Democrats (centre-liberal)	9	21
Christian Democrats	7	21
Hungarian Socialists Workers (unreformed Communists)	4	0
Social Democrats	4	0
Other	7	11



Nadudvar, Hungary: trying out computer techniques at a cooperative farm (Photo: Leonard Freed, Magnum)

To help Hungary continue to implement the reform programme in the face of a worsening of its payments position in 1989, the Community agreed to put together a five-year loan of ECU 870 million (USD 1 billion). The payment of the first tranche of this loan was conditional on agreement between Hungary and the IMF on the precise terms of an IMF stand-by credit. These were agreed in March 1990 and the Community subsequently disbursed the first tranche of ECU 350 million.

Hungary is a long-standing member of the IMF, World Bank and GATT. In addition to its first-generation trade agreement with the Community, Hungary signed a cooperation agreement with EFTA in June 1990. Of the countries of Central and Eastern Europe, Hungary is the one which has most clearly expressed its intention to apply to join the EC as soon as possible.

Czechoslovakia

Czechoslovakia is the industrially most-advanced of the Community's Eastern neighbours. It is also the one which had — in pre-Communist days — the strongest democratic tradition. In the 1930s, the standard of living of its citizens was on a par with that of Switzerland.

Czechoslovakia has a relatively low level of foreign debt (USD 6.9 billion). This will allow it access to international capital markets at relatively keen rates of interest. It has applied for membership of the IMF and the World Bank, although credits from this source will take some time to organize.

Even more so than in Hungary, the Czechoslovak Communist party opted out of the reform process. After a series of popular demonstrations in November 1989 the party effectively handed over power to Civic Forum, although keeping some government portfolios until the elections of June 1990.

Vaclav Havel, the most prominent figure in Civic Forum and a member of Charter 77, the dissident group set up after the brutal repression of the 1968 Prague Spring by Warsaw Pact troops, was elected President.

Prague: Vive la liberté! (Photo: Ian Berry, Magnum)

Civic Forum, with its Slovak sister group, won a comfortable majority in the 1990 elections (see below).

The elections were for a 150-seat lower house (101 from the Czech republic and 49 from Slovakia) and a 150-seat upper house or House of the Nations (75 members from each). The two houses must together write a new constitution by 1992.

Because of the harmonious way it has carried through democratic reforms, while maintaining a high degree of political consensus, and because of its industrial traditions, Czechoslovakia is considered to be one of the countries of Central and Eastern Europe which is best placed to make the leap to a market economy.

It has a favourable geographic position, a highly educated workforce and an infrastructure which, although neglected, is less devastated than in other countries of the region. It has viable firms in the automobile, engineering, glass and footwear sectors.

ELECTIONS IN CZECHOSLOVAKIA, 1990

	% of vote	Seats
Civic Forum/Public against violence (Czech/Slovak anti-Communist alliance)	47	87
Communists	14	23
Christian Democrats	12	20
Moravian and Silesian Autonomists	5	9
Slovak National Party	4	6
Coalition of other minorities	3	5

In terms of economic reforms the new Czechoslovak government has shown bold intentions but remains cautious in practice. The reform programme provides for private enterprise and private property, the opening of the country to foreign investment, the reduction of government subsidies and the dismantling of State planning.

Bulgaria

Bulgaria is one of the East European countries whose economy was most closely integrated with the Soviet Union and its Comecon partners. More than 75% of its foreign trade was with Comecon. It will therefore need to undertake major efforts to reorient its economy to free market forces.

Bulgaria's foreign debt at USD 1 056 per capita is well above the level of Czechoslovakia but below that of Poland and Hungary.

The poor state of the Bulgarian economy is a major drawback to reform. The new government, elected in June 1990, has to contend with inefficiency, shortages and corruption as well as an absence of reliable statistics on which to base reforms.

Sofia: a mass demonstration (Photo: F. Zecchin, Magnum)

Therefore, the reform process is likely to be slower in Bulgaria than in Poland, Hungary and Czechoslovakia. This could lead to a gap widening between the pace of its integration into the free-market European economy and that of the others. Bulgaria will need actively to woo Western aid and investment; otherwise Western partners will concentrate their efforts on more fast-track candidates.

Bulgaria is the only country where the reformed Communist party — now called the Bulgarian Socialist Party — emerged the clear winner of the first free elections since

ELECTIONS IN BULGARIA, JUNE 1990

	% of vote	Seats
Bulgarian Socialist Party (formerly Communists)	47	211
Union of Democratic Forces (anti-Communist alliance)	36	144
Agrarian Union (farmers)	8	16
Movement for Rights and Freedom (ethnic Turks)	6	23
Other	3	6

World War II (see below). These elections took place in June 1990.

This election-result is because the party itself took the lead in the political reform process when it forced the resignation of Todor Zhivkov, the long-serving party leader, in November 1989. It is also due to the fact that the opposition groups are less well organized than in other Central and East European countries.

Another reason is the country's relatively weak political culture and the difference between conservative rural areas, which supported the reformed Communists, and the urban population — particularly in Sofia — who backed the Union of Democratic Forces.

Romania

Events in Romania have confirmed predictions that it will be the country of Central and Eastern Europe that will experience most difficulty in restoring democratic institutions and political and economic stability. No other country of the region experienced the degree of totalitarianism imposed by the Ceausescu regime.

The rebuilding of political and economic structures will take time and could lead to considerable instability. Because of the totalitarian past, few individuals have any legitimacy or credibility to lead the country forward. These problems have certainly visited the ruling National Salvation Front.

Although the Front won the country's first free election for 40 years in May 1990 (see below), suspicion and doubt have lingered about its commitment to democracy among opposition groups.

Externally, Romania's trading partners and potential suppliers of financial assistance have also had problems in coming to terms with the country's reform process. The signature of Romania's trade agreement with the Community, concluded in May 1990, was delayed because of the way the government handled post-election demonstrations. This was reminiscent of earlier problems over human rights in Romania which periodically marred the application of the 1980 EC-Romania cooperation agreement.

ELECTIONS IN ROMANIA, MAY 1990

	% of vote	Seats
National Salvation Front (ex-and not-so-ex-Communists, military officers, former dissidents)	66	233
Democratic Hungarian Union	7	29
Liberals (centre-right)	6	29
Greens	3	12
National Peasants (farmers)	3	12
Others	15	81

Bucharest: Quiet, please ... Action! (Photo: Dennis Stock, Magnum)

The one bright spot is the country's negligible foreign debt. It could have access to multilateral or bilateral credits at an early date. It is a member of the IMF, the World Bank and GATT. But it is short of trained people with the necessary skills to put a reform programme in place.

Yugoslavia

Yugoslavia is the only country of Central and Eastern Europe not to have held multiparty elections since the wave of political and economic reforms swept through the region. The main reason is that the reform process is handicapped by the difficult relations between the country's six constituent republics.

The European Community and the West in general have traditionally treated Yugoslavia as a case apart. Its particular brand of economic self-management was seen at one stage as a potential 'third way' between rigidly-planned Communism and the market economy. Its refusal to become part of the Soviet economic or military sphere of influence gave it a special relationship as a Communist State with the EC.

Relations go back to 1970 when the first non-preferential trade agreement was signed. This was upgraded to a special cooperation agreement in 1980 under which Yugoslav exports got preferential access to the Community market. Yugoslavia also qualified for loans from the European Investment Bank.

If political reform is proving difficult because of ethnic considerations, some economic reforms have been propelled forward by the depth of the country's economic crisis. Severe internal difficulties coupled with four-digit inflation in 1989 led to the introduction at the start of 1990 of a wide-ranging economic reform programme, introducing tight monetary and budget controls and the convertibility of the dinar.

The European Commission proposed a three-level improvement in the Community's support for Yugoslavia in a paper submitted to the Council of Ministers in May 1990. One of the ideas — the extension of the Phare programme to cover Yugoslavia and the rest of Central and Eastern Europe — has already gone through.

The Commission's other two proposals are for the near-doubling of the amount of EIB loans to Yugoslavia from ECU 550 million (1986-90) to ECU 900 million for the five years 1991-96 and for the negotiation of a new Association agreement.

Yugoslavia is thus the first country to be offered this new type of agreement with the Community. Its terms go beyond free trade to cover additional financial support, industrial and technical cooperation, a political dialogue and the possibility of subsequent moves to free movement of people, services and capital.

Zagreb: Square of the Republic (Photo: Ian Berry, Magnum)

THE EC'S RELATIONS WITH THE SOVIET UNION

As a superpower, albeit a diminished one, the Soviet Union's relations with the Community are developing differently from those of other East European countries. Because of the sheer size of the Soviet economy, the Community has decided it cannot offer the USSR the same kind of special association agreements proposed for the others.

Present trade relations between the Community and Moscow are based on the Trade and Economic Cooperation Agreement signed in December 1989 and which came into effect on 1 April 1990. Under its terms, each side grants the other most-favoured-nation (MFN) status for their exports. The Community is committed to removing all quota restrictions on its imports from the Soviet Union by 1995.

The Soviet Union has agreed to improve its market's transparency to ensure better access for EC goods and has given guarantees on the repatriation of dividends and profits generated by firms set up in the Soviet Union. The economic cooperation section of the agreement covers a wide range of sectors from standardization, energy and the environment to financial cooperation and farming.

The second major element in EC-Soviet relations is the Community's efforts to prepare a financial aid and structural support programme for the USSR. These were launched at the Dublin Summit of the European Council on 26 June 1990.

The programme is divided into two parts — short-term credits and medium-term struc-

Mr Shevardnadze, the Soviet Foreign Minister, visiting the European Parliament in December 1989 tural assistance. The Commission's leading role was confirmed when its president, Mr Jacques Delors, visited Moscow in July 1990.

The Community's willingness to give financial and other support for economic reform in the Soviet Union is conditioned *inter alia* by a recognition of the central role played by President Mikhail Gorbachev in allowing the rest of Eastern Europe to free itself from Soviet and Communist dominance. Having created the division of Europe in the first place, the Russians have been instrumental in breaking down the barriers again.

At the same time, they have tried through *glasnost* and *perestroika* to bring about a certain level of economic and political reforms at home. But in so doing, they have reawakened some powerful sleeping forces and given birth to some new ones.

The process of economic reform — *perestroika* — and the introduction of a market-related economy is advancing slowly in the face of considerable resistance. Politically, the authorities are confronted with a double challenge: the huge nationalities problem and the need to create more democratic and pluralist structures. All three issues are inextricably intertwined.

Moscow now faces secessionist pressures from most of its constituent republics. The movement began in the small rebellious Baltic States and spread rapidly to the Muslim south and then to the biggest republics, the Ukraine and the Russian Federation itself.

The authorities are drafting a new constitution that will grant greater autonomy to the republics in the hope of keeping most of them within the current union. A new economic reform programme was published in September 1990.

In the mean time, secessionists vie with federalists, political conservatives with radical reformers and economic innovators with entrenched Communist-vested interests. It is against this background that the Community's task in seeking to help the economic and political liberalization of the Soviet Union should be seen.

CENTRAL AND EASTERN EUROPEAN PERCEPTIONS OF THE EUROPEAN COMMUNITY

The European Community has what might be termed a mystical attraction and is seen as an ideal by the people of Central and Eastern Europe. This is revealed by opinion polls carried out in Czechoslovakia, in Moscow and in the European territory of the Soviet Union, and by a survey conducted in Lithuania by Gallup UK and the Sociological Laboratory of the University of Vilnius. All these surveys were conducted in 1990.

Three Muscovites in five, two Soviet citizens in four and 86% of East Germans had heard of the European Community. All the Czechs and Slovaks questioned claimed to have heard of it.

More than a third of Soviet interviewees were aware of President Mitterrand's proposal for a Pan-European Confederation grouping all European States with more than one political party, free elections freedom of speech and freedom of the media.

Eurobarometer No 33, June 1990

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European Communities — Commission

THE EUROPEAN COMMUNITY AND ITS EASTERN NEIGHBOURS

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The booklet reviews relations between the European Community and the East European countries and explains what the Community is doing to help its Eastern neighbours.