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THE ARCHITECTURE OF E.C. RELATIONS WITH CENTRAL AND EASTERN EUROPE:

"COMMON HOUSE" OR JUST NEIGHBORHOOD IMPROVEMENT?

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THE ARCHITECTURE OF E.C. RELATIONS WITH CENTRAL AND EASTERN EUROPE: "COMMON HOUSE" OR JUST NEIGHBORHOOD IMPROVEMENT?

One would not have thought the EC capable of doing much to promote the integration of the Soviet-bloc countries into the EC at the time Gorbachev came to power in Moscow. This changed not only because of Gorbachev's Westpolitik. It was the EC's adoption of the Single European Act (SEA) which created a basis for deepening EC integration--not least by replacing unanimity by a qualified majority necessary for reaching decisions pertinent to those principal articles of the Treaty of Rome which regard the establishment of the interior market--which then became the basis for the broadening of cooperation (if not integration) now evident. The political climate for adoption of the SEA was conditioned by President Reagan's announcement in March 1983 of the American intention to pursue the SDI program. The SEA set EC cooperation on a firmer footing, without which it would have had no dynamic through which to take action following the democratic revolutions in Central and Eastern Europe in late 1989.

Before We Forget: The Renaissance of West European Cooperation

The first EC framework program for research and development was approved in 1983 to cover the period 1985-87. But SDI, by posing so clear an economic challenge, accelerated intergovernmental cooperation in Europe on technological development, both inside and outside the EEC. Within the EC in particular, the SDI program provided an impetus for closer cooperation on technology and security issues. The political challenge it represented added to the momentum for the Single European Act (SEA) adopted in 1986, which also included specific responsibilities for the Community in the fields of industrial research and technology. (However, the SEA represented more of an impetus to further integration than the foundation of a Community-wide technological development program. There is an appreciable technology gap among the very members of the Community itself.) Of course EC technology policy is itself a bit of a misnomer. Any technology "policy" is only an ensemble of many more specific policy issues, which are themselves moreover

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difficult to separate from other broader policy areas such as science and education. Moreover, governments are not always the most influential actors in making such a policy.

SDI soon came to be viewed by the principal West European governments as an American challenge to them. The nature of the challenge was defined by the two principal programmatic responses to the SDI announcement: the French-inspired Eureka program and the German-inspired European Defense Initiative (EDI). The former responded to SDI as an economic challenge from the U.S., by seeking to promote technological cooperation in Europe, in order to avoid losing markets created by SDI-related technology spin-offs and to avoid losing whole industries to American capital. The latter responded to SDI as a security challenge, since SDI would not have been able to protect Western Europe against Soviet medium- and short-range ballistic missiles, by seeking to extend air defenses in Western Europe.

President Mitterrand's emphasis on space technology in a Eureka framework created an impression that he wished to promote a European version of SDI. However, he probably wanted only to avoid a West European "brain drain" to the U.S. and to guarantee further development of French high technology. (In the same line was the emphasis by Paris on nuclear-powered submarines in 1984-85, as against enhancing conventional forces, which ran against NATO trends at the time.) There were great hopes that the May 1985 meeting between President Mitterrand and Chancellor Kohl could harmonize French and German responses to SDI, but this was not to be. The result was interpreted at the time as a difficult disagreement, but in retrospect it appears more as a decision to follow a two-track policy, each track responding to one of the two challenges that SDI represented to Western Europe. Thus Kohl embraced SDI while supporting Eureka as a civilian project that did not substitute for it. Meanwhile, Paris and Bonn began the process of deepening their defense cooperation in practical terms.[1]

Eureka was a French initiative outside the EC framework. It differed significantly from EC-sponsored cooperation: Eureka projects were to be market-oriented (not research-oriented), initiated freely by enterprises

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1. Joseph Fitchett, "France, in Strategy Shift, Takes on Defense of West Germany," International Herald Tribune, 6-7 July 1985, pp. 1, 5.

(without reference to defined research programs), and financed entirely by enterprises and governments (without 50% participation from Brussels). In the end a dozen and a half countries signed up to participate; priorities were set in the fields of computers and computerized telecommunications, robotics, lasers, and biotechnology.

The Japanese government at first felt that Europe was too far away to warrant their serious concern, and the Japanese public continue to think of divided Europe more as an integral aspect of U.S.-Soviet confrontation than as the result in Europe of U.S.-Soviet global conflict. Moreover, the affair over the Kurile Islands has not encouraged Japan to concern itself with distinctions among the small east European states. Nevertheless, over the past year Japan has promised substantial financial support to aid in the economic reconstruction of central and eastern Europe: and the U.S. has also done so, feeling that it cannot "give up" Europe. The hesitation of the U.S. and Japan reflects an emerging tendency in global economic affairs for the U.S. to look first to Latin America and Japan to look first to Asia, leaving the EC with Africa (under the CAP umbrella).

At the same time, the American government's pursuit of SDI guaranteed the aggravation of its budget deficit to the point where, by the end of the decade, it would be unrealistic to expect the U.S. to be able to give substantial financial assistance to the former members of the "Soviet bloc" to help them make the transition to pluralist democracy. Indeed, before the democratic revolutions that swept Central and Eastern Europe, President Bush, in his public declarations in mid-1989 repeated that the development of East-West relations in Europe was principally an intra-European matter. Events in Nicaragua and Panama underlined American preoccupations with their own hemisphere. Under the new administration, Washington felt that it should continue to have a role not only in Europe but also in Asia and Africa; yet in the near term its principal responsibility would be Latin America.

Washington supported democratization in Central and Eastern Europe with good rhetoric but felt that it was for Western Europe to provide financial support. When it became clear that democratization in Central and Eastern Europe was not only accelerating but also broadening to encompass all countries in the region, the U.S. government refined its position, underlining the continuing American interest in security arrangements in Europe. However, the idea that financial aid should be a West European matter was equally underlined; only domestic political pressure brought the Bush Administration to make any financial commitment at all.

The International Organization of Economic Relations in Europe

EEC-EFTA-CMEA: The Not-so-eternal Triangle

Since the creation of an EC-EFTA "European economic area" (EEA) was agreed as a common objective in 1984,[2] it had become evident that this would take much detailed work. However, three fundamental problems arose from the basic difference between the EC as a supranational institution with political aspirations and the EFTA as a free-trade organization without central decision-making institutions. First, the EEA was fundamentally distinct from the EC internal market. The EC gave priority to establishing the latter, in which latter only its own members could participate. Second, EFTA wanted not only full participation in the EEA but also the creation of EEA institutions giving them equality of participation in decision-making, particularly regarding regulation of public-sector activities. But in both these respects, the EC has always privileged its political autonomy. In addition EFTA had proposed its industrial development fund for Portugal, created in 1977 and maintained despite Portugal's accession to the Rome Treaty, as a model for regional assistance that could be available to countries such as Spain and Greece which (with the UK) run a deficit in their trade with EFTA. But the EC would have found it difficult to swallow an absence of control over how such funds are spent within its member countries. Third, there would be huge problems even if the EFTA countries were to modify their product standards in consonance with those of the EC internal market: the resources necessary to verify the consonance between the six EFTA countries and the internal market could approach those necessary to negotiate an accession; whereas the EC has always sought to assure a balance between political and economic costs and benefits. Moreover, once those standards were harmonized, it would have remained to be determined whether EC law could be altered unilaterally at a

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2. Originally called the "European economic space," but altered in response to British criticisms that the word "space" was vague and indefinite.

subsequent date (thus touching again the issue of EC autonomy). Furthermore, EFTA has no institutions equivalent to the European Court which could restrain its members if the rules were infringed, and did not wish to compromise its members sovereignty through binding adjudication by EC instances: this represented a potential advantage for the EFTA members, as they would not have been obliged, for instance, to apply EC import quotas. On the other hand, for the EFTA members to accept all of the EC conditions and provisions would leave them in a situation worse than if they simply became EC members: they would be nothing but agenda-takers.

Like EFTA, CMEA as an organization lacked central institutions that could exercise authority on a regular basis in the name of its members. Like the members of the EFTA, the CMEA countries were also worried about the EC internal market. They were unhappy in particular about trade preferences given to EC members and about the uniform application of EC-wide regulations. The EC internal market raised the further possibility, for the CMEA countries, that EC-wide social policy would create demands for protection against their own less expensive imports by raising labor costs in the EC's poorer members.

Before the fall of the communist-party regimes in Central and Eastern Europe, it was conceivable that EFTA could be a halfway-house to full EC membership for the small CMEA countries, particularly if it provided free access to the EC market, free-trade arrangements for manufactures, and the free movement of capital and labor. The CMEA countries would have further required assurances that EFTA membership did not disadvantage them by subjecting their national economies to additional restraints in their dealings with the EEC. Such a development would have necessitated EC recognition of EFTA national standards rather than harmonization; a promise to extend such recognition to all future EFTA members; and the establishment by EFTA of requirements for economic reform that Soviet-bloc countries would have to meet to obtain EFTA membership.[3] However, the CMEA countries were not necessarily counting on EFTA to provide it entrée to the EC. Indeed, EEC-CMEA relations began to thaw not long after Gorbachev's election as CPSU general secretary.

3. See, for example: Holger Schmieding, "The Efta Option For Eastern Europe: Comecon And The Community," Financial Times, 2 August 1989, p. 17.

In autumn 1985 the CMEA's general secretary Sychev opined that an EEC-CMEA joint declaration could open the way for bilateral negotiations between the EC and individual CMEA members. This amounted to an admission that the two organizations were unequal. The EC was still cautious. In a letter to each of the seven CMEA governments, with a copy to the CMEA secretariat in Moscow, EC Vice President Willy de Clercq invited them to accredit some of their diplomats in Brussels to the EC. This so-called "parallel approach" sought to extract a precise Soviet grant of autonomy to the East European countries in bilateral trade negotiations with the EC.

The outlook for a positive response was not impressive at first. Hungary had been insisting since 1982, in informal talks with the EC, that quantitative restrictions on her exports to the Community were illegal under the GATT (which Hungary had joined in the early 1970s) and so should be entirely lifted; in return, the EC insisted that not all GATT rules could really apply to Hungary, which was still a state-trading country. The USSR and GDR had no reason to negotiate: most Soviet exports, mainly energy and raw materials, are not subject to EC restrictions; the GDR's trade with the FRG was considered internal EC trade. Poland and Bulgaria seemed satisfied to renegotiate agreements for the period 1980-85 which covered agricultural products, and Czechoslovakia went only so far as to suggest replacing EC quotas on industrial imports by voluntary restraint agreements.

Following Soviet approval of closer bilateral relations, linked to some kind of EC-CMEA agreement, however, hopes grew. Huge increases in subsidized agricultural sales by the EC to the CMEA countries reflected that development. The EC adopted measures permitting sale of over 200,000 tons of surplus beef to the USSR and Eastern Europe in autumn 1985 and announced cuts in beef prices to promote further sales in early 1986. Also in early 1986, the EC Commission adopted a new system of export subsidies to melt a million-ton butter mountain: the Soviets bought 100,000 tons that April, followed by another 280,000 in early 1987. The USSR also used EC export subsidies to buy at least 700,000 tons of wheat and barley during 1986.

This was not occurring in a vacuum. In May 1986, after the Chernobyl accident, the EEC introduced a temporary ban on food imports from Eastern Europe and the Soviet Union. This exacerbated Hungary's trade deficit with the EC and led to a deficit in its overall trade with the West during this period. Along with the fall in world oil prices, which decreased Hungarian revenues for Soviet oil reexported to the West and oil products, it made the economic outlook worse for the next year or two.

It need not be mentioned that this significantly affected the hard currency earnings of the CMEA countries. Of course there was a little internal EEC politicking going on too. The EEC's inability to agree on safe levels of radioactivity in food was due mainly to the FRG's desire to protect its dairy exports and Italy its vegetable exports. Any such agreed levels would have governed intra-EEC commerce as well as imports from the Soviet bloc; the CMEA-related level was subsequently extended to at least October 1987. It seemed to some observers, including in Western Europe, that all this was merely a camouflage for promoting EC commercial interests.

Only after agreeing the budget reform package of February 1988 was the EC truly able to organize its attention to external relations, including such issues as monetary reform and lifting trade barriers as well as relations with the EFTA countries. Indeed in early 1988, the EC was more concerned with EFTA than with the CMEA. In late June, the EC and CMEA initialed a joint declaration (not tantamount to mutual recognition) that left intact the status of West Berlin as part of the EC as well as Quadripartite responsibility for the city. Czechoslovakia, Bulgaria, the USSR, and the GDR requested accreditation for missions to the EC even before the declaration was signed. Following the joint declaration, the FRG publicly gave Delors firm support for an extension of his mandate as president of the EC Commission.

This did not occur without differences of opinion inside the EC itself. Greece, which assumed the presidency for the second half of 1988, had suggested, even before the signature of the EC-CMEA joint declaration, that special consideration be given Soviet interests; however, most other members of the Community did not want to treat the Soviets better than the smaller CMEA members. Further differences of approach emerged during the last three months of the year. The twelve foreign ministers agreed to try to formulate a document to serve as framework in defining the EC's position toward the Soviet bloc, to be discussed at the December 1988 summit in Rhodes. At the same time, the presidency (Greece) was instructed to prepare an analogous text to present in Vienna at the CSCE conference, and the EC Commission began to draft yet another document on the EC's economic relations with the CMEA. Through this process it emerged that one tendency in the EC, represented by the United Kingdom and Portugal, preferred to take a favorable but wait-and-see attitude toward the developments in Central and Eastern Europe which had then begun and were soon to lead to the overthrow of one-party rule. An opposing tendency argued that Gorbachev's policies deserved more active support because they were in the West's interest.

EC-CMEA cooperation in exchanges of information and statistics, and standardization and environmental protection got quickly under way in early 1989, and were thought extendable to fields such as developing passenger and freight transport facilities, and in science and technology, where both economic groupings have comparable long-term programmes. The USSR was clearly frustrated at the EC's regarding scientific cooperation as a possible threat to Western security. This was particularly so in the field of energy generation, especially nuclear power. Neither the EC nor the CMEA proposed a comprehensive program of common action: Soviet economists tended to recognize the problems of learning EC technicalities, and vice versa, but maintained that an integrated CMEA market was the inevitable result of the economic reforms and restructuring in Eastern Europe and the USSR.

Phare and the EBRD: The Phototropic Hypothesis

At the G-7 "Summit of the Arch" in summer 1989, before the explosion of the anti-authoritarian revolution throughout Central and Eastern Europe, Poland and Hungary were at the center of discussion. These were the two countries that were making the swiftest progress toward institutionalizing political pluralism. A major result of the so-called Summit of the Arch in summer 1989 was the creation of the Poland/Hungary Aid to Restructure Economies program (known as Phare and sometimes in English called the Lighthouse program, a translation of the French acronym).[4] Phare was financed by the EC in the amount of 300 million ecus, of which Poland received two-thirds and Hungary the remainder. Also at the Summit of the Arch, the EC was asked to take on the role of coordinating programs the aid program of its

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4. As explained below, the Phare program has since been expanded to other countries of Central and Eastern Europe. One is tempted to suggest that the expanded Phare be called in English the Rainbow program, after the French Arc-en-ciel, for Aide à la Restructuration de Certaines Economies Non-Communistes pour Intégrer l'Europe Lentement.

member states and of the twelve non-EC members of OECD, an idea that the U.S. strongly supported. This was the first time that the EC had ever been asked to coordinate the activities of governments other than those of its member-states. (Thus after the Summit of the Arch the G-7 for Poland and Hungary became the G-24, or G-25 if one includes the EC itself.)

The EC did not originally intend to take the measures incorporated into Phare until the mid-1990s. Phare itself was largely an emergency program. Thus the first stage of Phare in winter 1989-90 included emergency food aid to see Poland through the winter. Phare's second stage provided for input programs for food production so that such aid would not have to be permanent. The EC's strategy appears to have been to "build out" from these agreements: the Phare assistance can be conceptually integrated into the progression from trade agreement to cooperation agreement to financial protocol to association agreement. In particular, the evolving EC relationship with Central and Eastern Europe can be integrated into the framework of a trade and cooperation agreement. For the majority of former East-bloc countries, the trade-and-cooperation agreement is the first generation of agreement, including, for state-trading countries: de facto MFN status and the lifting of any existing quantitative restrictions (QRs); plus, in the case of non-GATT members such as the USSR counterconcessions on trade, the allocation of hard currency for imports, and the easier provision of import licenses. (For GATT members, it is necessary only to refer to the requisite articles of the Havana Charter, so special provisions do not have to be introduced.)

Phare's third stage is analogous to the cooperation provisions of a trade-and-cooperation agreement: the EC granted trade concessions, created export possibilities for Central and Eastern Europe, and lowered some tariffs and quantitative restrictions. At the end of 1989, the EC decided to accelerate building-down of nontariff barriers (i.e., quantitative restrictions and tariff concessions on products of special interest particularly in agriculture on such items as geese, lamb, mushrooms, and small fruits and berries) and a more rigorous application of the Generalized System of Preferences to qualifying former East-bloc countries.

Several EC members had resisted Delors's calls for coordinating export credit terms to Eastern Europe (this was already regulated by the OECD), but the rapidity of events persuaded countries such as the UK and France of the need for better co-ordination, even at the expense of arrogating to the EC some aspects of East-West political relations usually reserved to sovereign states. In April 1989, EC foreign ministers decided that events in Eastern Europe were coming so fast that they recognized the inseparability of EC commercial policy (which they do not usually concern themselves with) and political cooperation. Seeking to maintain a "differentiated approach" to the countries of the region, they suspended talks on economic cooperation with Romania because of the country's failure to meet CSCE obligations on human rights (suppression of dissent and forced relocation of peasants) but were very promising toward Poland following the "round-table" agreements in Warsaw between the government and opposition. In particular, the ministers sought a rapid conclusion to the trade-and-cooperation agreement between the EC and Poland. Both the UK and France specifically suggested training in EC countries for Polish managers.

The European Bank for Reconstruction and Development (EBRD), an investment bank with subscribed capital of roughly $10,000 million, was an initiative of the French government, not of the EC. France's motives in proposing to create the EBRD were to prevent the U.S. from dominating Western political initiatives, and to prevent Germany from dominating EC economic initiatives, toward Central and Eastern Europe. However, neither Germany nor the United Kingdom saw the wisdom in making the EBRD an exclusive Community institution. Early anticipations in Brussels that internal EC political reasons would lead to the EBRD's finding a home within Community structures, and that it would have competence to lend to EC members, turn out to have been mistaken.

France, supported by Italy, has argued that so massive a problem as the reconstruction and development of Central and Eastern Europe requires a massive response that necessitates a multifunctional institution, and they see the EBRD in this role. Article 2 of the EBRD statutes refers to "cooperation" with other institutions (meaning IMF and the World Bank in particular). One possibility, then, is that EBRD would seek the suggest appropriate microeconomic policies for Central and Eastern Europe, for example, reform of the taxation structure. However, this would require research personnel that EBRD will not have. Indeed, the real scope of the EBRD's functions remain to be determined in practice, and part (but only part) of the reason for this is staffing levels. With its headquarters established in London, and with the ratification of its charter expected before spring 1991, the EBRD should be operating by 15 April 1991 with a maximum staff of 200 which will double by 1992. This level of personnel does not leave much scope for activity beyond administrative and treasury functions.

The EBRD is not to be confused with the European Investment Bank (EIB), which is the EC's own credit-granting bank and operates only within the Community itself. A non-EC institution such as the EBRD was also necessary due to a longstanding difference of bureaucratic interests between the EC Commission and the EIB: the EIB traditionally grants credit on good terms and then goes to the EC Commission to ask them to cover the risk. Moreover, the EBRD was needed because the EIB's authority to lend to EC non-members is decided on a case-by-case basis. The EIB was involved in the earliest stages of the Phare program but, given institutional restrictions, clearly could not manage the magnitude the loans foreseen for Central and Eastern Europe. However, both the EIB and the EC Commission have subscribed capital to the EBRD and both are both represented in EBRD decision making.

The members of the EBRD are the G-24 plus the European CMEA members (including the USSR) and Yugoslavia. At the Paris meeting in 1989, a good deal of time was devoted to discussing whether and how the USSR would participate. Since it was the French who invited the Soviets, and since the USSR did not ask to be coupled to the expanded Phare program, the idea was raised that the Soviets should be a shareholder in EBRD and not a client. Naturally, the Soviets were not happy with this. The matter was further discussed at the official founding meeting of EBRD in January 1990, and in March it was decided that the USSR would be accepted as a member of its council, and as a possible debtor, with its capital subscription fixed at six per cent of the total.

The relationship between the EBRD and the EC's Phare program remains to be clarified. The EBRD-Phare relationship is problematic. The EBRD's head Jacques Attali thought the bank would take over Phare, whereas EC sees EBRD as an element of Phare. Phare will eventually be phased out as a separate program as the Association Agreements to be negotiated with Central and Eastern Europe enter into force. Those agreements will frame EC assistance to the region. (U.S. aid is still on a yearly basis only and may well trickle out or be concentrated on macroeconomic aid limited by IMF conditionality. The EC is taking the initiative through IMF for macroeconomic aid to Central and Eastern Europe, and the IMF may become a leader in this later, although the EC is now coordinating it although not in the context of the Association Agreements.)

The Emerging Framework of EC Relations with Central and Eastern Europe

Phare Becomes a Big Bang: The Short Term Broadens and Deepens

The pattern of EC relations with third parties usually begins with a trade agreement and follows with a cooperation agreement (usually integrated into a trade-and-cooperation agreement that also creates a framework around the previously existing trade agreement). Subsequently, a financial protocol may be signed that leads later to an association agreement. Finally, the association agreement itself may pave the way for full membership. Greece and Spain, for example, followed basically this pattern. However, there is no automatic progression, and even the signature of an association agreement does not guarantee eventual full membership. (Turkey is a case in point.) Nevertheless, even if history does not always repeat itself, this pattern does provide a useful framework for interpreting the recent evolution of the EC's relations with the former East-bloc countries.[5]

Although the Phare program originally provided largely for emergency aid, still that assistance can be conceptually integrated into the progression from trade agreement to cooperation agreement to financial protocol to association agreement. Indeed, the EC originally did not expect to take the measures

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5. "Central and Eastern Europe" is newly consecrated term for referring to these countries. It became current before the GDR became part of the FRG. Originally (at the EC) one spoke of the "CMEA countries" or the "east bloc." The Hungarians began bruiting the term "East European countries" to replace this, then the FRG proposed to the EPC group the term "Central and Eastern Europe" (without thinking about the reference to Mitteleuropa), and the EC adopted the terminologically officially. What this rubric includes the USSR is a matter of taste. Some people in the West speak of "the Soviet Union and Central and Eastern Europe" (much as they used to speak of "The Soviet Union and Eastern Europe"), whereas an increasing number of specialists even in Moscow insist that the USSR is not an East European country. (If it is not East European, it certainly is not West European.)

incorporated in Phare until the mid-1990s. The creation of Phare was relatively easy as a political decision, but putting it into practice has been more difficult. Before the democratic revolutions in Central and Eastern Europe in the second half of 1989, the EC had "differentiated" among the countries there on case-by-case basis. That is why Poland and Hungary were included in the program and others were excluded. At the time, the EC's chosen instrument to promote reforms was the trade and cooperation agreements.

The next component would be financial protocols, but these will not be signed with Central and Eastern Europe, with the possible exception of Yugoslavia if it still exists. Existing elements of the Phare and expanded Phare programs could be integrated at least conceptually into the framework of a financial protocol. The EC may for example provide counterpart funds to Poland in zlotys to restructure agriculture; the G-24 may make GSP-type unilateral concessions; Poland has a stabilization program while Hungary has a balance-of-payments aid program. However, any protocols that there may be would likely not be negotiated with the former East-bloc countries but would be unilateral gifts on the part of the EC in the Phare context of "activities assisting economic reform." The G-24 considers all former East-bloc countries except the USSR to be eligible for this. The June 1990 ministerial meeting of the 24 will probably decide to extend Phare (following on meetings of December 1989 and February 1990). The fourth component would be association agreements. (Note that technically there is no legal status such as "associate membership"; there are only association agreements.) An association agreement may be considered as the sum of trade and trade-and-cooperation agreements, plus a financial protocol, plus the prospect that preferential trade treatment by the EC would be reciprocated into bilateral free trade.

Following the upheaval in Central and Eastern Europe in fall 1989 and winter 1989-90, the G-24 approved in mid-February 1990 an outline of conditions for extending Phare beyond Poland and Hungary. These conditions emphasized the need to move toward democracy, including the respect for law and human rights, and toward a liberal economy. The Central and East European countries soon returned memoranda to the EC in which they spelt out as best they could their specific economic needs. At the request of Poland and Hungary, training and education were a big part of Phare and will no doubt remain important sectors of the expanded program, including language training, training in how to be a businessman in a market economy, training of local government administrators, and so forth.

Before the March 1990 elections in the GDR, it was generally assumed that the expanded Phare would include it. The GDR established diplomatic relations with the EC in August 1988 and opened its mission in Brussels the following March. The first framework agreement to emerge was a trade-and-cooperation agreement that granted most-favored-nation status and gradually reduced quantitative restrictions to eliminate them by 1995 except in some sensitive areas such as agriculture. At the time both the EC and the GDR thought it better to start bilateral relations with an agreement in hand than to wait for the question of unification to be settled. However, at the Dublin meeting of the EC prime ministers in late April 1990, Chancellor Kohl opposed the extension of EC aid to the GDR. Such a program would have been beyond Bonn's direct control, and Kohl did not want the Community to have this means for influencing German unification.

The use of vigilantes by the Iliescu regime in Bucharest to put down anti-government protests in June 1990 led to an EC decision to freeze such aid to Romania. Although Romania signed a cooperation agreement with the EC in the late 1970s, the political situation there is still too fluid, and there is uncertainty whether the two conditions of the G-24 will be met there. Yugoslavia, which has made great progress since the beginning of 1990 in controlling its inflation and has taken steps toward reducing its foreign debt, is also be in the expanded Phare. The expanded Phare program was predicated on progress toward the institutionalization of political pluralism, the adoption of guarantees of the freedom of assembly and of the press, etc. Indeed, Romania and Czechoslovakia were told that they would have to show evidence of reforming their political systems and introducing political democracy before they were granted EC aid, and the repression of demonstrations in Bucharest in June brought swift EC criticism accompanied by the suspension of aid.

The expanded Phare is budgeted at the level of 500 million ecus this year, scheduled to rise to 800 million next year. The G-24 suspended, as of 1 January 1990, all restrictions specifically applicable to state-trading restrictions such as quantitative restrictions. The GSP is also being applied. QRs on state-trading countries are being dismantled through trade-and-cooperation agreements. Such restrictions will disappear probably by 1995 at the latest for Bulgaria and the USSR and earlier for other countries, with the possible exception of some "sensitive" products (in the sense of being politically sensitive within the EC).

Romania received urgent medical aid and food aid but were promised nothing more unless they put into action promises for political liberalization. Czechoslovakia needed neither food nor a fund for stabilizing their balance of payments. However, it did seek special credits for industrial restructuring. Yugoslavia already had a financial protocol and wanted an extra billion to "sanitize" is banks. The problem was that the combinats in Yugoslavia owned their own banks, from which they could force bad loans. So out of $10 billion in loans, almost three-quarters were bad: in Kosovo, nearly all were bad; in Serbia, some were bad; and in Slovenia, almost none were bad. The Yugoslav Prime Minister Markovic had developed a system of buying bad debts from banks in the form of bonds, which the banks would buy back after ten years; but the center needed funds to put the scheme into practice. They started with $250 million and asked the G-24 for another billion.

A number of training and education programs have been housed in the EC bureaucracy, where it performs the same coordinating function on behalf of the G-24. The Tempus programs aims to develop higher education, and elements of the institutional development may include transfer of persons. It is set up according to Central and Eastern Europe country needs that are identified by them: engineering, applied sciences, management, languages, law, environment, and agriculture. The Tempus program, and other training programs, were intended to be housed in Berlin at the European Training Foundation (ETF), but the ETF has so far been blocked for this reason (even though its institutional structure and procedures are already decided), by those who want the European Parliament to stay in Strasbourg rather than move to Brussels and who therefore are delaying implementation of any decision to establish any EC offices outside Brussels. If the Berlin Center is not established soon, it may simply go by the boards.

The other three programs of note are Lingua, Erasmus, and Comet. The Lingua program provides language training at all levels. It started in 1990-

91 at the level of higher education, and other levels will be added in 1991-92. It is probably the most difficult of these programs to administer because of the variation across recipient countries of the particular needs, and across the donor countries of the resources available. It is currently funded at a level of 200 million ecu over five years.

The Erasmus program provides for travel to study. The problems of this program comes from its overwhelming acceptance and the interest it evokes. It is funded at the level of 192 million ecu over three years, but the EC cannot bear this cost; the host countries must do so. It has funded 1700 projects benefit 40,000 students and expects to quadruple its size.

The Comet program seeks to establish and reinforce the links between industry and higher education. This program has had start-up problems because establishing such links is especially problematic for such countries as Poland and Hungary, where the functions of teaching and research have traditionally been divorced within whole system of higher education. It is funded at the level of 200 million ecus over five years and, like Lingua and Erasmus, is scheduled to expire in 1994.

Association Agreements: The Medium Term Accelerates

As of spring 1990 the G-24/EC were negotiating trade-and-cooperation agreements with most or all former East-bloc states. They were negotiated in parallel with determinations of aid required and amount to "expanded Phare" programs. Longer term relations with the EC and the former East-bloc states will fall into the framework of "association agreements," as provided in Article 238 of the Treaty of Rome. However, the Treaty of Rome specifies neither the content nor the context of association agreements. Countries having association agreements with the EC are sometimes referred to as "associate members" of the organization, but this is erroneous. There is no legal standing such as associate membership. Rather, an association agreement implies an institutional relationship assuming a stage-by-stage progression of relations on the basis of joint institutions that are something more than mixed commissions.

The next step in EC relations with East and Central Europe will not be a financial protocol but an association agreement. The EC members want to avoid financial protocols because these entail definite financial commitments even for specific projects, which may be very costly and inappropriate. (The Association Agreements will not constitute a customs union because Central and Eastern Europe will not be adopting the ACP regime in their trade with developing countries.) Probably some of the terms that would usually be included in a financial protocol will be integrated into association agreements, but without separate financial protocols beforehand. Association agreements are nonpreferential free-trade arrangements as the EC has with EFTA. (Customs tariffs, for example, are not touched by a bilateral agreement, but a two-way building-down can be begun first by the EC as has already been happening the case of Yugoslavia. Bilateral agreements create mixed commissions but association agreements create standing commissions.) An association agreement would not by itself exclude eventual EC membership but the EC would seek to avoid very rapid and loose association.

The summer and fall of 1990 saw a great deal of movement. On the basis of meetings in late October, the EC Commission proposed in late October 1990 to the Council of Ministers ideas outlining general shape of the Association Agreements and was mandated to proceed in late November with negotiations to sign Association Agreements with Poland, Hungary, and Czechoslovakia. In mid-December the negotiations themselves were authorized by the Council of Ministers and the first meetings were held the weekend before Christmas to open negotiations formally before the end of the year, to be taken up substantively beginning in mid-January. These negotiations are projected to conclude by summer 1991. Although there is no doubt of the political will on any side, this timetable may be slightly optimistic, since the agreements will be complicated in content also for legal reasons.

The Association Agreements with Central and Eastern Europe will be of a different kind, although still coming under Article 238 of the Rome Treaty. They are in the context of the new European architecture covering everything that may be linked to eventual political and economic integration. Article 239 permits associated countries to apply eventually for membership, but as regards Central and Eastern Europe there are neither commitments nor exclusions in this respect. The Association Agreements will include clauses on political cooperation and dialogue with these countries, with which dialogue is already ongoing through the European Political Cooperation structures.

This text dates from 11 January 1991.

These Agreements will be of a mixed nature, in the sense that they will contain provisions falling into EC competence as well as provisions that do not (e.g., free movement and political cooperation). When the Agreements are ratified by the EC Council the provisions falling under EC competence will enter immediately into force. The other sections will enter into force following ratification of the Agreements by the various national parliaments. During all this type, political cooperation will continue under way in one form or another. The EC deliberations on Economic and Monetary Union and on Economic and Political Union will not affect the Association Agreements. Negotiations on the latter are projected to be concluded in summer 1991, and to enter into force at the beginning of 1992, whereas amendments to the Rome Treaty dealing with EMU and EPU may require as many as three years to be drawn up and approved.

There is consensus in Brussels on the outline of these eventual Association Agreements with Poland, Czechoslovakia, and Hungary. They will not be modelled on the agreements with Greece and Turkey. Rather, they will be tailor-made political umbrellas for the present trade-and-cooperation agreements, creating a framework to encompass the manifold cooperation which until now has been ongoing on ad hoc bases. The Association Agreements will do five things:

1. Establish free trade in industrial products with a period of transition to give East Central European industry time to prepare for competition. Provisions accompanying such a commercial free trade area (e.g., anti-dumping, state aid, competition, safeguards) and including the 278 regulations necessary for establishing the Single Market will be elaborated, including specific solutions to trade in agricultural products and also assuring compatibility with GATT textile regulations.

2. Give additional impetus to the economic reforms including but not limited to privatization.

3. Include conditionality on the progression of the steps of reform. For example, monetary and fiscal reforms are necessary to permit the free movement of services.

4. Provide for free movement of persons, capital, and services. Barriers to the latter two will be dismantled relatively quickly. These countries know

they need the services and need to have them up to Western standards. As it is in their interest to make their legislation compatible with EC law (so as not to have to change it in, say, ten years), ministries in these countries have received directives from their governments to check compatibility of their regulations with EC law before promulgating the former. The Association Agreements will also provide these countries with access to Western legal expertise necessary to introduce such compatible legislation on banking, insurance, and company law, and on accounting: these constituting the legal structure permitting companies to establish themselves on the national territory.

5. Provide a continuing financial accommodation under the Phare program until 1992. This accommodation is with the EIB and European Coal and Steel Community, coordinated with the policies of international financial institutions (IMF, EBRD, World Bank, and G-24).

Central and Eastern Europe want positive developments from EC for themselves, but EC may be unwilling or unable to deliver: then Phare will go on for longer, perhaps beyond even five years, though with Czechoslovakia, e.g., there may be a fast agreement, but with others no. The Agreements will be adopted to the specificities of each country: Poland, for example, may continue "shock therapy" whereas Hungary may require a more cautious approach. From the EC standpoint, however, two major issues in the eyes of Central and Eastern Europe are problematic: free movement of workers and free access for agricultural products. Formally speaking, the expanded Phare program has no rationale for continued existence after the Association Agreements, which will regularize the assistance they provide, come into force. In practical terms, however, such programs as Tempus will survive the formal demise of Phare as an element of Association Agreement.

The International Re-organization of Economic Relations in Europe

EFTA: To Be or Not To Be?

EC-EFTA negotiations will probably be finished before summer 1991, and they will not lead to type of agreement EFTA desired. The EFTA countries will therefore probably continue to apply individually. EFTA will not get its desired full participation in the European Economic Space, because of its insistence on such provisions as a joint EEC-EFTA council with equal participation in decision making by the two organizations. It is doubtful whether such a council and such participation would make a concrete difference to EFTA: about two-thirds of the 1992 legislation--the 278 bills on standards and regulations that the EC members must adopt for the single market to enter into force--have already been approved by the respective national parliaments. Such decisionmaking could therefore only refer to so-called "flanking" issues such issues as monetary policy, educational policy, and regional development. (Regional development is especially nettlesome, since the EC has wanted EFTA to accept the notion of "cohesion"--on model of the EC's Mediterranean program--meaning assistance to the poorer areas of the EC such as Ireland, Greece, and Portugal. EC regional and social funds for this purpose will have amounted to 14 billion ecus by 1992.)

Before it became too late (which it now is), EFTA found that it could negotiate with the EC so as to harmonize its national systems with those of the EC. This opened to the EFTA countries the possibility of closer economic ties with the EC, but without the political obligations of membership. As recently as fall 1989, for example, it seems that procedures could be constructed to resolve EC-EFTA problems at the interorganizational level, such as a free-trade arrangement covering goods and services produced in the "European economic area." This would have been in the interest of EFTA countries since they generally have stricter requirements--in consumer safety for example--than do the EC countries. In response, the Finns were prepared to loosen their own restrictions on foreign ownership of land and securities.

Some of the EFTA countries may have problems in accession to the EC. Swedish foreign policy neutrality may be a question, for example, even though the Swedish parliament voted in December 1990 to submit an application for membership in 1991. Pro-EC Swedish opinion is split over the question whether they should join as soon as possible, the better to dilute the EC's supranationality, or wait and see. Because of the EC attitude toward Sweden, the second will prevail. The preservation of the Sweden's social system from pressure by external requirements will be a sensitive issue. Austria has an application pending, even though such neutrality is enshrined in its state treaty; it had hoped to use multilateral (EFTA-wide) approaches to the EC to preserve this. Norway and Finland will be the next to apply. Finnish public opinion is strongly pro-EC, but polls reveal that nearly a quarter of the Finnish population believe the country is already a member. Norway does not have the neutrality problem--it is a NATO member--but has as strong isolationist strand in its public opinion that led its voters to vote against joining the Community in a plebiscite in the early 1970s. Its principal concerns are shipping and the energy market. Swiss foreign policy also conforms to neutral lines, although if Sweden asks for membership it is hard to see how this argument against EC accession can be used in Switzerland, where the financial institutions (to name only one sector) are de facto more integrated into the EC than those of some of its member countries. The EC might wish Iceland then to join for the sake of completeness, since Iceland only real concern appears to be fisheries policy, with the exception of labor mobility, a concern that the Swiss share.

In mid-December 1990, Jacques Delors publicly acknowledged for the first time, speaking in Strasbourg, the EC will have to accept an increase in its membership. Whether he had EFTA members or the former CMEA members in mind is not clear. Poland, Czechoslovakia, and Hungary may soon enjoy greater advantages in their relations with the EC, than the EFTA countries would have enjoyed under the umbrella of a joint EC-EFTA "European economic area."

The EFTA countries cooperate by and large with the EC countries in providing assistance to Central and Eastern Europe, because they are members of the OECD and therefore fall under the G-24 umbrella coordinated by the EC from Brussels. The EFTA countries are in the Comet and Tempus programs, and negotiations are under way to include them in the Erasmus program by 1992. The EFTA countries, in their bilateral trade relations with Central and Eastern Europe, will align their policies and regulations with the content of the Association Agreements now under bilateral negotiation between the EC and Poland, Czechoslovakia, and Hungary. The EFTA countries, particularly in Scandinavia, have been providing important assistance to the Baltic republics of the Soviet Union, although EC will not have bilateral contact with the Balts unless Moscow gives a green light.

This text dates from 11 January 1991.

CMEA: Où sont les ménages d'antan?

In early 1990 the CMEA created an expert committee to make proposals for transforming the organization, but events overtook them. Czechoslovakia presided the working group that examined the possibilities for reform. With Hungary and Poland, it constituted a lobby for profound reform, also not excluding regional cooperation but with indefinite ideas in this regard. Delors believes that intra-East European coordination should be enhanced, but this depends upon the countries concerned. In a certain sense, organized economic cooperation among Poland, Hungary, and Czechoslovakia would be advantageous to them all--there is a certain complementarity to their industrial structures--but the EC is not making any real effort to promote such cooperation. For some in those countries, such cooperation is only reminiscent of the CMEA, and they are intent to be treated as individual countries by th EC rather than as a bloc. Some non-industrial cooperation is motivated by external actors (Japan bought food from Hungary to give to Poland under Phare), but it is not very much in absolute terms. As early as spring 1989, Hungary and Poland were leaning westward; Italy lobbies for Yugoslavia, and France for Romania; Bulgaria has no real lobby in the EC for its interests. As of 1 January 1991, CMEA will trade on a market basis using convertible currencies. This will permit price comparisons with Western countries, allowing for an increase in productivity. Problems of bilateral clearing with the transferable ruble will be replaced by problems of credits and payment conditions.

The structure and competitiveness of the CMEA as an institution remain unclear. It could end up as a secretariat perhaps similar to OECD and in this way develop its own functions and structures. (For example, the International Investment Bank might be useful in the future as financial instrument, including financial obligations to members, to change the system of work to promote not investments according to bilateral or multilateral agreements, but rather to finance commercial banks and enterprises in Central and Eastern Europe: whereas at present it is involved only in big projects under governmental agreements; it could finance joint or multilateral projects of a commercial (i.e., not state-trading) nature. Alternatively, it could work with state banks to give credits to help restructure national economies. The CMEA's IBEC could conceivably play a similar role. The decision to use old

CMEA structures will have to be political decision for political reasons because there is probably little they can do that can't be done in other ways.

When the CMEA members begin financing their foreign trade with convertible currencies, this will permit comparison with Western countries and so lead eventually perhaps to increasing their productivity. Instead of bilateral clearing with the use of the transferable ruble, there will be the problem of fixing the conditions of credits and payments. The CMEA should retain some of its functions as a conversation partner for the EC, and some of its institutions could facilitate mutually beneficial economic cooperation among its member states.

The CMEA Executive Council in January 1991 dissolved the organization and created a follow-on Organization for International Economic Cooperation.[6] The new statute and concept of this organization, still to be finalized, will still have important barter elements and a strong bilateral touch with multilateralism still missing. More than half of Central and Eastern Europe's trade is still with the USSR. Central and Eastern Europe are looking at the West and at increasing EC trade but are still energy dependent on SU and will still have to sell some products to Soviet Union for several years. Principles for the new trade system are to include market prices, hard currency, etc., but not revised intra-CMEA trade. The quickness with which German unification was achieved may in fact complicate the process of making all East-bloc currencies convertible. The Ostmark could have served as a kind of bridge during a more gradual process of German unification.

Deals have already begun to be struck with economic sub-units of the Soviet Union: trade between Poland and the Ukraine, for example; or an agreement between Czechoslovakia and the Tiumen oblast to supply transport vehicles in return for oil deliveries. A series of bilateral interstate agreements were also concluded in fall 1990. The new CMEA statute will probably involve the organization in OECD-type analyses. More important than the CMEA follow-on is what will happen in foreign trade matters among CMEA members. This will be outside CMEA institutional framework: e.g., Association Agreements with Poland, Hungary and Czechoslovakia can include

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6. See also Christian Meier, "COMECON: A Follow-on Organization is Planned," NATO Review (October 1990), for details.

free trade but will not work if there are trade barriers among them. The CMEA or its follow-on organization will remain useful to EC as diplomatic courier, transmitting documents and so on, and should remain a confederal organization permitting the ensemble of members of CMEA to treat general questions, especially the environment.

Conclusion

EC relations with the states of Central and Eastern Europe are somewhat in the same category as with EFTA members: in Brussels people think that the Twelve should be strengthened before any more major steps are taken toward admitting more members, and all the non-members are agenda-takers. The EC will give development aid to Central and Eastern Europe but is not looking to be a pole of attraction, although it inevitably will be one. The problems of the two groups of countries are in some ways incomparable: the EC is still trying to decide what mechanism to use for collecting value-added taxes, and in Central and Eastern Europe it is difficult to determine the value of anything due to the absence of price systems.

Politicians and other public figures in the West sometimes seem convinced that what the region needs is a good investment insurance scheme. However, the establishment of the aforementioned legal regimes are prerequisites, because insurance insures against risk, whereas the present situation is one of certainty: certainty that the legal foundations for foreign investment have not been laid. The pressing problem in EC relations with Central and Eastern Europe (and with Poland, Hungary, and Czechoslovakia in particular) is not only providing technical advice but also persuading national parliaments to give time to the questions and adopt necessary laws: not to mention finding East European civil servants who understand the problems from a Western cultural perspective. For example, many economists in the region lack the necessary analytical techniques and consequently speak in grand terms of overarching changes, thus avoiding specificity. It is, then, for Central and Eastern Europe, a question of national will and resources. Political elites and civil servants in the region do not have the necessary skills and training.

This text dates from 11 January 1991.

The example of Poland is instructive because it enjoys one of the better situations and more favorable prospects. Poland has a fairly stable currency and pre-war commercial law inspired by German standards. If she could sort out the question of land ownership, things could slowly be set right. But, like all Central and Eastern Europe countries, she needs a system of property law: and not only property law, but also accounting law, contract law, and inheritance law. There are whole bodies of law that don't exist in Central and Eastern Europe. EBRD can publicize the existing situation but one needs to know what the situation is on the ground there. The problem is not advice or access to it but rather persuading the adoption of changes and getting people there to do something. (There may be a danger of the systems' being re-created becoming fragmented and chopped up by the intrusion of foreign trade regimes.) The Association Agreements will include provisions for West European specialists to assist Poland, Hungary, and Czechoslovakia in setting up these legal regimes, but this assistance is very expensive and the EC will have to find a way to pay for it.

It would be dangerous if Poland, Hungary, and Czechoslovakia considered that Association Agreements with the EC were a panacea for all their problems; they are not. What is most important to them is for Western companies to establish themselves in those countries, which they are not doing now. For example, land ownership is unresolved; so who will build a factory when the land might go to the old owner following a legal decision three years from now. To solve these problems, not just technical and legal expertise are needed from the West. Cadre have to formed also in the East. So the EC will train trainers and teach teachers (on condition that they stay at home after for a fixed period of time, say three to six years, otherwise they will jump to the West to get a high-paying job), in coordination with the World Bank and others.

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