Working Paper

Western Assistance to Central and Eastern European Countries in Their Transition to Market Systems

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WP-94-006
February 1994

IIASA

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Introduction

In November 1993, more than forty participants gathered at the International Institute for Applied Systems Analysis (IIASA) in Laxenburg, Austria, to discuss the challenges, opportunities, and failures of Western assistance for economic transformation in Russia. The participants, who responded to a call by the Economic Transition and Integration (ETI) Project at IIASA, consisted of international experts and policy-makers representing institutions such as the International Monetary Fund (IMF), the European Bank for Reconstruction and Development (EBRD), Ministries of Economy and Finance of several countries, and the Bank of Russia, as well as other key figures in the world of multilateral aid and academia. This seminar was one in a series organized by the ETI Project dealing with the transition from centrally planned to a market economy in Russia. The Ford Foundation and the Pew Charitable Trusts have generously provided financial support for the seminar series.

The particular topic of Western assistance was considered as a high priority item. We have now had enough experience with Western assistance that we can not only look back, but also look forward. The issues of primary concern include a lack of understanding on the part of both Eastern European nations and the West for the other side with respect to the prerequisites, regulations, and requirements governing the process on the one hand and the scope and character of the aid and assistance required on the other. Furthermore, while there is some belief that the West could offer more and especially more timely assistance, Russia and other East European states do not, in fact, exhaust all the potential sources of assistance, especially in terms of efficiency, for a variety of reasons.

In many ways, this report exposes the complexities associated with Western assistance to East Europe. Few points can boast universal agreement: all donors (whether international organizations, financial multilaterals, or advisors from academia West or East) and recipients view the issues from slightly different perspectives. Each begins with a different understanding of what was and a different goal for what ought to be. The report also attempts to convey the most promising aspect of the seminar: the willingness of experts to discuss sensitive issues in an effort to improve the procedures and requirements for giving and receiving foreign assistance.

The expository form of presentation has been chosen for this report in order to present a succinct, cohesive, and objective account of the information, pertinent arguments, personal experiences, and discussions offered at the meeting. The author of this report and the organizers of the seminar, all members of the ETI Project, wish to thank the participants for their valuable contributions. A full list of names and affiliations is given in the appendix, as well as the agenda of the seminar.

General Characteristics of Foreign Assistance

The following provides some background against which current foreign assistance has been given, partly to show that some of the frustrations experienced on both sides are not new, going back to the time of Ancient Greece, and perhaps setting the backdrop for the discussion identifying those issues that are distinctively new.

Foreign aid has a long history. Over the centuries, most aid was closely associated with national security, buying allies or neutralizing adversaries. Nevertheless, there is a generally novel component to foreign assistance as it has come to the forefront of international policy in the post-World War II era. In the United States, a leading nation in this activity, foreign assistance has become an integral ongoing part of US foreign policy, no longer specifically related to security, since President Truman came to office in 1949 and may have influenced this modern style. Before this new era, foreign aid was of a sporadic and fixed temporary nature, like the Marshall Plan. More recently, foreign aid programs have become a part of OECD governments' structures and they give aid on a routine, regular basis. The novelty of the last few decades is that the giving of foreign assistance has become an integral part of the international behavior of rich countries and has now become institutionalized.

The IMF and the International Bank for Reconstruction and Development (World Bank) were established in 1944 but neither was designed to give what we now call "concessional aid" (offering capital on very preferable terms). Both were designed to assist countries in difficulty: in the case of the IMF short term difficulty and in the case of the World Bank to mediate between private capital markets and countries reconstructing first and subsequently developing. The increase in concessional aid can be attributed to the imperfect nature of international capital markets and the lack of access to capital and to capital markets for countries that are most in need of it, as in the case of the republics of the former Soviet Union. Many international financial institutions as the World Bank, IMF, EBRD, and others are working with a contradiction embedded in their charters: they are to lend aid on essentially a non-market basis (i.e., when commercial banks would not lend), but are simultaneously required to act like sound bankers. For some extremely difficult and sensitive lending issues, as in the case of Russia, some international financing agencies (like the IMF) are peculiarly illadapted to the circumstances and to dealing with the arising problems. For instance, it is not within the Fund's practice to initiate the provision of aid. Someone else or group must thus take the initiative: in the case of Russia, for example, it should be the recipient itself and the G7.[1]

Donors and recipients of foreign assistance are motivated by numerous but different interests. The fundamental interest of recipients is fairly obvious: to obtain additional resources (at as reasonable a cost as possible) to compensate their scarcity in that particular nation. The motivation of donors is much more complicated. Historically security has been a key factor, and it continues to be so even today. In addition, aid has been seen as a vehicle of export promotion and a channel for extending influence (culture, language, etc.) of the donor country. Straight-forward altruism also plays an increasing role in aid programs: important

[1] The G7 countries are: Canada, France, Germany, Great Britain, Italy, Japan, and the United States.

vocal segments of the population feel that rich countries have a duty and obligation to help countries less well off. The latter is something that has primarily arisen in the post-WWII era when aid has become ongoing government policy as a kind of global redistribution and not just available in emergency situations.

Aid is almost always conditional. The major exception is where the principle motivation is promoting exports, although this is tied in its own way. Otherwise, the donor country wants to be sure that the aid is being used plausibly to serve its objectives which may not be entirely well-articulated and may be diverse or even conflicting. Particularly in democratic countries, an argument has to be put to the parliaments and to the publics that the aid is serving its purpose and is conditional on policies. This is intrinsically a source of tension between the donor and recipient countries. Nevertheless, the positive part of conditionality is that when it works it creates a new form of coalition between the outside advisors and the recipient governments which are then to more likely have a longer term devotion to the policy implementations as part of the conditionality. The credibility of the recipients generated in this manner is also more likely to secure the continuous flow nature of foreign assistance.

The recipients must make the political judgements with respect to what is achievable and what is not in the country in question; these nations should not allow themselves to be badgered by foreign advisors into taking actions which may be politically unwise. Foreigners just do not have the feeling that is necessary for making refined judgements about the behavioral responses and the political reactions to policies. But the countries can certainly benefit from the information that foreign advisors give on what has worked or not worked in other countries and why, and they should feel free not to accept the foreign aid as there is no obligation to do so. It is in the nature of democracy, the style of government adopted by the new recipient countries of Eastern Europe, that policy decisions take time and this can delay the granting of conditional assistance, causing conflicts regarding the timeliness of aid.

There are different kinds of conditionality, though conventional macroeconomic conditionality to do with fiscal and monetary policies can result in considerable economic damage. For example in Eastern Europe, the way in which some of the interpretation of fiscal as opposed to monetary conditionality deters the transforming economies from undertaking certain types of desirable financial reforms and restructuring. In particular, those that are involved in the recognition of the bad assets on the balance sheets of the banks which should be replaced by explicit claims, probably in the form of a bond issued by the government. This then causes a subsequent series of problems that involve the retention of the soft budget constraint for enterprises and banks in these countries and just further delays the imposition of financial discipline.

The history of foreign aid over the last 30-40 years has resulted in many failures in the sense that no possible case can be made ex-post that the aid has served the interest of the donor countries and has secured the consequences expected ex-ante. As long as a recipient country had one particular project which was of funding character, it was very difficult to determine whether the foreign aid actually went in full to the designated activity. However, there were clearly some outstanding successes such as the Marshall Plan and the Aid Program for South Korea. Yet even with respect to the Marshall aid, there were great difficulties in getting the recipient European countries to cooperate with the donor and among themselves (i.e., opening their markets to one another). American objectives for the aid did not always coincide with the objectives of the recipient countries, notably in Britain and France. This situation required bilateral agreements between the USA, the donor country, and each of the recipient nations, and all were conditional.

In essence, there are two types of foreign assistance, one is financial aid and the other is technical advice. The role of financial aid is two-fold: firstly, to make it attractive for a country to undertake actions that are known to be difficult for one reason or another -- that is, bribing those elements of the population that are reluctant to undertake the changes and acquiesce to the new situation, and secondly, to ease the transition. Considerable positive evidence has been found for the second point. For example, those countries that had some foreign assistance to cushion the compression of imports performed better than those that did not have assistance in the right policy context.

There are also numerous roles for foreign technical advice, and certain things that they should not do. Firstly, the foreign advisor can make a valuable intellectual contribution utilizing his or her specialized knowledge as well as experiences and judgements about why something has succeeded or failed in other countries attempting similar reforms in the past or simultaneously. Secondly, foreign advisors can also provide a good house-keeping seal of approval on the polices that a country has decided to undertake by making a detached judgement -- lending credibility to the actions of a country. Thirdly, depending on the setting these advisors can steer the internal dialogue or debate within a nation in a way that possibly does not exclude other things but at a minimum includes the things that should be included. It is well known that in debates over policy, different groups are looking out for their own best interests and there is a high risk that the general interest gets neglected all together. The outsiders, who are not perceived to have a personal stake in the domestic outcome, can make sure that the main issues are at least addressed; whether the most desirable results are achieved will be beyond the foreign advisors control.

Foreign assistance does not only have to be a simple transfer of resources. It could well be a mutually advantageous arrangement between donor and recipient. Foreign assistance can create employment and growth in both, particularly when it is conditional and more likely when the development and opening of the established markets to the new nations (aid recipients) is part of the overall picture.

Especially in situations where economic transition is associated with a sincere stabilization program, foreign assistance does not work when it is back-loaded rather than front-loaded. In addition, foreign assistance fails to fulfill its actual objective of helping a recipient in need if the aid arrives only then when it is not or no longer needed for the purpose it was to originally serve, when it does not serve the purpose of coalition-building, and when it does not help to get things started during the time of crisis. The way to build positive momentum is to use front-loading, something that is systematically often lacking when giving foreign assistance. Additional problems inhibiting the potential success of foreign assistance arise when international institutions neglect the crucial tactical and timing aspects of providing aid. Usually non-unified governments in chaotic situations and huge factional interests already make it difficult for the recipients to justify risky actions of accepting conditional assistance. Thus, when these issues are resolved, the international institutions should already have the aid ready rather than only begin their selection procedure. A further constraint limiting the success and disrupting the schedule of assistance provided is the need for the recipient to continue to servicing external debt during the negotiations for aid, a time when the particular country (for instance, Poland, Russia, or Bulgaria) is already essentially bankrupt and despite the fact that liquidity is necessary to survive. Under private bankruptcy law in the United States, all debt servicing is halted (without having to fear any legal repercussions on the part of the creditors) immediately at the time a firm files for bankruptcy. Although the desirability to apply such conditions in the international economic community seems almost unquestionable, guaranteeing the compliance would nonetheless be difficult in the context of sovereign nations.

Bold policies backed by considerable sums of foreign aid have been most successful in initiating economic stabilization in troubled nations. Therefore, in order to make foreign aid effective and the program successful, recipient countries must do much more than they think that they should do and the outside world should lend much more than it thinks it should lend. It is this combination of both sides stretching beyond what may be deemed as ''politically feasible'' that leads to real stabilization in real prices. Today, and particularly in Eastern Europe, foreign aid can go a long way in helping establish the reform element in a government and the West can demonstrate that democracy can indeed work. Foreign aid will more likely have a positive effect if there is a willingness on the part of international institutions and more well-off nations to provide a substantial up-front investment, putting some money at risk, to build a political, social and economic consensus early in the transition process.

<u>Some comments on recent Western aid to Russia</u>

The Western aid to Russia over the two years ending in late 1993 was not markedly significant and substantial in an economic sense. However, politically it was of paramount importance. The pledge to give Russia 24 billion US dollars at the beginning of 1992 was one of the crucial factors that helped the Gaidar government survive the Congress of Peoples Deputies in April 1992. The fact that the greater part of these pledges did not materialize during that year[2] was one of the pivotal weapons of the political opposition to reform in Russia during the Congress of Peoples Deputies in December 1992, which resulted in the call for Gaidar's resignation at the time and a replacement of 30-50% of the highest level members of the government. Aid that has been pledged but does not arrive puts the targeted recipient governments (in Eastern Europe primarily reformers that can only rely on skeptical support at the very most) in a uncomfortable predicament. Furthermore, this puts the credibility and integrity of the entire international lending system in jeopardy, particularly when the reformist governments have taken on the political risk of introducing various painful changes that are prerequisites for obtaining aid.

The leading international lending institutions were extremely inflexible and slow in providing aid when it was most crucially needed in the delicate early stages of reform and transition in Russia. After the collapse of the Soviet Union, for example, it took Russia 18 months to become a member and receive the first funds from the IMF, though this was not solely the

[2] Of the aid that finally arrived in 1992: the World Bank ended up only lending 670 million US dollars, which was not disbursed until 1993; the IMF at least approved to lend one billion US dollars, but it took until August and only on the condition that the money be held in reserves -- that is, not spent.

fault of the international lending agency. Countless teams of foreign experts were sent on fact finding missions utilizing valuable time and resources of both sides that could be implemented in a much more efficient fashion. There is also difficulty for international organizations and the West in general to accept proposals from Russia due to the incompatibility of terms and definitions of economic factors, not to mention practices and accounting. In addition, the international financial institutions favor or neglect recipient nations to differing degrees. In this regard, Russia actually has a fairly preferable position. The issue becomes more dramatic when recognizing that Russia, previously a major donor of assistance to other republics within the FSU, has essentially halted aid to these new states, leaving them at the mercy of the slow and cumbersome international aid apparatus. Therefore, the possibility of missing further opportunities to help create and support the productive coalitions necessary for reform continues to persevere.

Certainly, political instability was one of the important obstacles to receiving foreign aid in Russia. With greater political certainty, a strong commitment to fiscal and monetary reform, including strict discipline, should form the appropriate basis for the effective use of foreign assistance. Conditionality is seen as important for many reasons, though some suggestions have been made to target aid at the project and regional levels to ensure efficiency and success, and reduce the possibilities for waste and abuse. Numerous Russian experts believe that foreign aid today should form the basis for creating the appropriate economic climate that will attract domestic and foreign private investment in the future.

Debt and Other Issues with respect to the Role of International Organizations

International decision-making with respect to the foreign debt issue is a good example of the degree of efficiency of the international mechanism for aiding or solving financial crisis of countries in need. The distribution of a particular Eastern European country's debt is said to reflect to a certain extent the dynamics of that country's relations with the West. In the Russian case before 1991, for example, the absolute majority of funds were obtained from non-official sources as the former Soviet Union (FSU) and its President Gorbachev were considered reliable and trustworthy partners by commercial banks. During 1991 this picture changed dramatically: commercial banks severely restricted lending and official creditors like Germany began to provide substantial funding. While 65% of loans to the FSU were from non-official sources pre-1991, over 90% of all borrowed money came from official creditors in 1992.

The cause for Russian debt goes back to Gorbachev policies. From 1988 to 1991, the debt rose by 50 billion US dollars and by another 20 billion in 1991 alone. There were numerous causes for this drastic expansion including a crucial decline of exports (especially oil), acceleration of economic growth was based on expensive import oriented policies (particularly of technologies), an unwillingness to restrict the import of consumer products due to political pressures, and a sharp decline in export revenue balances due to external and domestic borrowing. Thus, when the first Russian government took office in late 1991, there were no funds in the accounts to service the exploding debt (only USD 60 million which was equal to about 10 hours of imports).

As a result, immediate negotiations were initiated with the Paris and London Clubs to redefine the debt servicing schedule. In fact, the Russian reform team had three main goals: to deal with the issue of food credits, to pay as little as possible in financing the debt burden, and to attempt to maintain normal political relations with the West and the international financial institutions. The two Clubs were indeed wary of their own balance sheets and expressed the need for political stability in Russia and the other republics of the FSU and Russian economic recovery and growth. Much to the disappointment of the Russian reform team, the last of these three terms conditional for lending was most insignificant for the Clubs and international institutions.

Since it is apparent that Eastern European countries (like Russia, Poland, Bulgaria, and others) can no longer service their outstanding debt, the international financial institutions and the Paris and London Clubs have made multiple agreements with these nations suspending and rescheduling principal and interest payments, as well as conceding on the request for total debt reduction or debt write-offs. Nevertheless, there are limits to how obliging these organizations can be and the debtor nations are generally asking for considerable concessions. As in debtor countries, creditor countries also have budgets and budgetary rules. Of course, budgetary discipline is at least as important in the creditors countries and one has to continually be concerned about its maintenance.

Real debt relief is very difficult in the existing international framework: it is people making decisions with someone else's money. For example, the management of banks do not have the money -- they are making decisions on behalf of their stockholders; or, government officials who do not have the money -- they are making decisions on behalf of their taxpayers. Every time a decision for debt relief is made, someone is giving up an asset or having to spend more. It is not easy to transfer debt burdens from one group of countries, called debtors, to another group of countries, called creditors, because many of the latter have very heavy debt burdens themselves already today.

In addition, a critical free-rider problem has become almost typical in the international lending and rescheduling dialogue. Namely, since the rescheduling negotiations are handled *seriatim* (in a series, one after another) rather than in one common framework, the case arises where the commercial banks free-ride on the concessions of the official creditors. Furthermore, as the commercial banks see the official creditors expand their concessions, the remaining outstanding debt naturally increases in value and the banks, whose share of which has consequently increased, are even less willing to concede on their terms.

One of the most important elements of debt management in the broader sense of the term (i.e., external and internal public debt) is the fiscal aspect -- its significance continues to increase during the transition to market economies in the East European countries. Two key points of the fiscal discussion are the leveling-off or decline of exports since 1991 and the increasing fiscal tension due to the social cost of transition and the long delays in implementing sweeping changes in fiscal policies. Therefore, the present dynamic of public debt accumulation is quite rapid in all these countries. Further issues of concern that threaten to cause still greater increases in the public debt are the accumulation of budget deficits and the short to medium term prospect of recapitalization of banks, which means that all the non-preforming loans to the commercial banks will sooner or later have to be taken over by some kind of public funds.

More broadly then, with this accumulation of both internal and external public debt the whole process of transition could fall into some kind of a so-called *'debt-trap'*. The room for fiscal maneuverability will become even more restricted, making it more difficult to reduce the public budget deficit. This situation is inevitably translatable into an enduring *crowding-out effect* on the enterprise sector, especially the private one. Consequently, economies with low potential for growth and high vulnerability to foreign shocks are created.

Examples of countries reaching the critical level of debt burdens are Poland, Bulgaria, Hungary, and Russia. Polish total domestic and foreign debt (that is, all debt that must be served from fiscal sources) has already reached close to 85% of GDP in 1993 -- closing in on what is considered a catastrophic level -- and servicing the debt will cost at least 4.3% of GDP and that is after a 40% debt reduction negotiated with the London Club. Poland is still much better off than a country like Bulgaria where interest payments on total public debt are growing and already around 14% of GDP, making up almost all of the nation's budget deficit. The Hungarian economy has also been under the shroud of a considerable debt burden: in 1990 already, total external debt was closing in on 70% of GDP, total debt servicing was almost 15% of GDP, just the interest payments were 5% of GDP and 40% of export earnings. In 1991, Gorbachev had to spend 36% of export revenues to service the Soviet debt and that was already 10% of GNP at that time.

For countries in extreme crisis at one time or another during the transition process (like Bulgaria, Poland, or Russia), the failure to implement a standstill on debt collections is a major systemic fault in the international financing system, particularly if based on economic merit. In a precarious time for a country's economy, there should be a way to prevent the creditors from making a run on the debtor to get as much as they can before the debtor becomes insolvent. There is no established mechanism in place to achieve this in the global community because no international bankruptcy proceedings exist. As a result, countries are typically forced to pay down their reserves to next to nothing before it is acknowledged that they have a payments problem, and then still considerable time elapses before there is a *de jure* settlement. Yet during this time, a nation can be harassed with law suits, it fails in procuring working capital, it is not able to get suppliers' credits, and all the other factors needed for normal operation. Russia is a case in point: in addition, five days after the new government was formed in late 1991, the Western debt collectors turned up in Moscow and took up valuable time of the reform team while it was attempting to plan the first phase of reform. So, the situation for nations in this type of predicament goes from bad to worse. Indeed, the IMF would have the authority to put up a standstill umbrella by certain mechanisms allowed in the IMF articles which allow countries to exercise various types of exchange control including debt service payments that are then an enforceable barrier against other kinds of debtor claims in the courts of the member countries of the IMF. But the Fund has not taken such action and it has come at a high cost, especially in the first year or so of these crisis situations.

With respect to the issue of a nation's ability to pay, there are both conceptual and procedural problems in the way how the debt is typically managed. The conceptual problem is that foreign debt is almost always accumulated loans taken by governments (referred to here as official debt) and, therefore, the transfer problem involves both the foreign transfer problem and the fiscal problem. As a consequence, the ability to repay a debt becomes a balance of payments problem, a burden on the state, and a stabilization problem. As it happens, the

Paris Club treats this matter almost exclusively as a balance of payments problem, neglecting the considerations regarding the fiscal burden of the debt. Thus, an excessive amount of time is spent on balance of payments (BOP) projections in these situations despite the complications with the BOP concept the way it is calculated to define the ability to pay. However, a country will almost always be able to pay the debt if its government is prepared to squeeze imports enough; but, there is no accepted normative scale as to how much import compression is enough or too much.

However, there are arguments that defend the reasoning of the Paris Club to base lending on BOP rather than link it to fiscal issues. Some experts will testify that fiscal problems, above all, are the responsibility of citizens of that particular country. The international community should not have much to say about them, one way or the other, unless they have an impact on international relations; that is, on international transactions. The Paris Club was never set up to deal with all the economic problems of the debtor country. The Club was created to provide temporary relief on a particular crucial fund, not to provide a comprehensive solution. The Paris Club is the wrong forum for dealing with the kind of comprehensive approach needed to resolve the fiscal difficulties of all the countries coming forward for foreign assistance.

Although debt is directly and intrinsically a part of the fiscal problem as well as the BOP problem in the Eastern European countries in transition, there are many other sources of the fiscal problem. In fact, the other sources of the fiscal problem are usually a large multiple of the debt share. Internationally, it is the role of the IMF, among all multilateral financial institutions, to take the whole spectrum of economic issues and criteria into account that will determine the necessary stability which is a desirable goal and often a prerequisite for foreign aid.

Possibly due to this extensive assignment in which delays are certainly not unheard of, the IMF is frequently blamed for not providing timely aid. However, some experts indicate that immediate aid for economic fine-tuning and emergencies is essentially only appropriate when the economic fundamentals in the recipient country are sufficiently well-evolved, stable, and meeting some set standards and prerequisites. As this has generally not been the case during the early phases of reform in the East European nations and those in the FSU in particular, there should be more understanding for the IMF's procedure and timing. Besides, considerable resources are at stake for the creditors of the IMF so there is no room for impulsive decisions and, at any rate, the IMF is not here, and never was, to provide money on demand.

The World Bank (WB) has also had a very important role, though its influence has sometimes been two-sided and resulting in criticism. On the positive side, the World Bank has worked well in providing technical assistance for the privatization process in, say, Russia. However, on the more perplexing side, there is a systemic feature of Bank policy -- the import rehabilitation loans for all of the countries of the FSU. Rather than having this be general balance of payments support to back the market exchange rate or to promote the free market for foreign exchange, the World Bank has instead pushed for a very bureaucratic structure of Gosplan-style import targeting. The problem with this procedure is that when such institutions do not exist in some of the recipient countries, they are created. In countries like Kyrgyzstan or Kazakhstan, both of which are beneficiaries of WB import rehabilitation loans, the Bank has only allowed one-third to be dispersed through the free market, while two-thirds had to go for *"identified import needs"*. In order to identify these needs, the Bank established an agency which consequently controlled about 50% of the recorded import licensing in each country by late 1993. The World Bank states that its role is not to loan money to the enterprises: in fact, the enterprises must use local currency to buy the foreign exchange. Yet, this entire program can be seen as an example that is completely opposite to the philosophy of the reform.

The countries of Eastern Europe were, in fact, not in mind when the rules for international financial agencies were drafted. The rules were laid down for ordinary market-oriented countries that got themselves in some financial difficulty for either internal or external reasons resulting in the need for more capital. The rules were not conceived to deal with nations undergoing the colossal and extraordinary task of massive economic reform. The Paris Club, the IMF, and others should in fact only be considered as only a small part of managing this special process, while what is required is a framework to take an overview of the whole process. Unfortunately, this is still absent. The countries of Eastern Europe present an entire new set of problems that might actually require an adaptation of the established rules in most of the international agencies. However, this may not be favorable and it may be more desirable still, to develop a new special set of rules for these situations. Eastern Europe presents a situation unlike those customarily dealt with by the international funding institutions in places like Columbia, Nigeria, Chile, and so forth.

There is an inherent paradox in how an international system providing foreign assistance should operate: on the one hand, it should be demand driven and fast disbursing, and, on the other, it should be cost effective and not corrupt. Viewed from this perspective, it is clear that the role of international organizations is certainly not an easy one. The whole activity of international organizations providing foreign assistance to the East European countries in their unprecedented transition efforts, radically reforming previously centrally planned into market economies in very short time frames, has thus far been characterized by a sort of learning period for both sides.

Some Eastern European government officials have expressed dissatisfaction with the treatment of certain issues by the international organizations, in particular the IMF. The complaints include such points that the approach of the Fund in Hungary, for example, has recently focussed too narrowly on finding ways to cut budget deficit and expenditure, neglecting such issues as supporting a fixed exchange rate as, for example, a nominal anchor. This distracted from the need to undertake many other moves that were crucial to continuing the overall reform efforts. In fact, there appears to be a real omission of qualitative targets and an obsession with quantitative targets.

Over the years and founded on their respective guidelines, a type of division of labor between certain international organizations, like the IMF and the World Bank, has evolved. The World Bank seems to be more preoccupied with structural reforms while the IMF is more concerned with macroeconomic reforms. This division has developed some flaws and resulted in inconsistencies. The concentration of one organization or another on the need of the recipient country to fulfill a particular measure (i.e., like the IMF on the budget deficit) has frequently caused recipient nation authorities to feel pressured into following a policy path that they may actually perceive as not the most appropriate means conducive to a successful end. Also, the procedure to determine eligibility for and amount of foreign aid available to a potential recipient country based on economic forecasts made with uncertain data in an economic environment where the underlying behavior and determinant factors are changing incredibly rapidly, widely, and often unpredictably, necessitates the donor or creditor to be very flexible on the conditionality and targets tied to the aid. Yet, exactly those international organizations that use economic forecasts, have been very rigid with respect to their terms and timing of the aid they have given directly or managed in some other manner.

International assistance organizations have many people working on Russia and Eastern Europe but too few on site. There is a need to set up more in the way of permanent missions, though the international organizations argue availability of experts is more important than continuous residence of experts (more details in the next section). In order to achieve their goal of aiding countries with economic difficulties that impede future growth, lead to social hardship, and eventually to political collapse, the international organizations must clarify their internal priorities. Fact finding missions are useful, but must be efficient. More should be done with resident experts, giving them greater freedoms and responsibilities. Greater consistency on the one hand, and increased cognizance, sensitivity, and sympathy for differences on the other, as well as higher flexibility are all characteristics that could use improvement in the international aid framework. Considerable care is required in applying a particular recipe-type solution, not to mention stereo-typing nations, regions, or situations. Only after sufficient on-site effort to understand the situation, problems, measures and instruments used to deal with them, and the differences to customary and traditional practices and definitions common in long-established Western industrialized market economies, will the aid giving process become more effective and timely, not to mention more accepted by the recipient populations.

Technical Assistance and Policy Advice: The Role of International Agencies (including associated organizations), Academic Advisors, and Consultants

Certain fundamental characteristics of a recipient government and its ways have been identified by practitioners on both sides to, by and large, be the major determinants of the effective use and success of foreign technical assistance and policy advice in achieving at least the expectations set ex-ante. That is to say, as long as the assistance and advice is, of course, of sound quality in its own right.

The recipient government must specifically express the need for foreign help -- it must be the initiator. It is unacceptable for the process of providing foreign assistance that the demand is just an alibi to appease the international aid-giving organizations or the domestic population. The recipient government should not only clarify what assistance is desired and how it should be transmitted to be best received, but should also be undisputedly determined and politically willing to implement the results of cooperation. In this way, the sincere effort on behalf of both parties will not be in vain, and there should be no dramatic surprises for either side.

A further key technical and organizational factor is the need for foreign advisors to be permitted to participate in the normal everyday work of the recipient country's executive staff and experts. Even in response to a request, it is unfortunately not always easy to give assistance for lack of access to the critical departments (i.e., invitations into ministries, etc.), insufficient time and exchanges with decision-makers of influence and knowledgeability, and inadequate or incomplete information. Technical support of foreign advisors is also on the list of pivotal points for ensuring the relevance and subsequent success of advice and assistance. Also, seniority and authority of the domestic counterparts to the foreigners in the recipient country is crucial to the success of aid programs (i.e., their ability to be involved in program design rather than simply in reporting functions). The IMF, for example, does not operate without an invitation from the recipient government. Thus, there are limitations on the Fund's ability to place talent and react to perceived potential needs.

The role and visibility of the foreign advisor can be extremely beneficial for the recipient government as long as there is no abuse. For the sake of public acceptance, it will be more beneficial if the advisor works behind the scenes rather than spreading views in an aggressive public relations campaign. Particularly in the countries of Eastern Europe, the people are leery about foreign meddling in domestic policy. Once the advisors have arrived, the resident experts and decision-makers must make a point of working with them and making the investment payoff in a mutually beneficial manner. It will be counterproductive for both the host country and the foreign advisor should this person, group, or organization be used as an instrument of political maneuvering between domestic parties concerning political disputes. The advisory body should only be used in its designated professional capacity. This is important for the integrity of the entire assistance process.

Most Eastern European policy-makers agree that full-time, resident foreign advisors are the most productive. Regular part-time foreign advisors (i.e., one visit for several days each month) with resident assistants and consequently still permanent access to necessary data and other information are a second-best solution. The experts offering their assistance should certainly have some previous general knowledge regarding the host country's culture, history, ethnic composition, and the recent political and economic situation in order to be most effective in their set task. To this end, there is obviously great value in taking the time and making the effort to conduct a detailed and in depth diagnosis of the situation in the recipient nation. This can be seen as a sort of insurance for the applicability and relevance of the foreign expert's advice.

Occasional expert visits with little advance preparation have rarely proven to be significantly useful; in fact, more often than not these were deleterious, especially considering the time and money they consumed. Too much of the little valuable time available is used to instruct foreigners on basic characteristics of the host country; so, essentially no discussion concerning specific important policy issues occurs. However, it is important to make a distinction between the foreign experts involved in the aid process for the sake of providing assistance and those involved to monitor how the aid provided is used. The responsibility of the latter group is to help the tax-payer in the donor country or the nation holding a stake in the particular multilateral financial institution to control whether all the conditions tied to the aid are met and not abused by the recipient country. They are also there to report and review the conditions determining the eligibility of a recipient country for aid. The premier objective of these experts is not to go there in order to provide assistance and they should not be expected to do so.

Although theoretical knowledge is an important part of any expert's professional skills, practical experience in the art of policy-making or policy-advising can significantly enhance a foreign advisor's productivity and ability to engage in amiable collaboration. The effect of an advisor will be further enhanced should this person or group be able to conduct their assisting activities in the domestic language, reducing the transaction costs, frictional costs and misunderstandings. Yet, even if an advisor possesses such favorable traits which allow him to get intimately close to the action (i.e., as far as taking an active part in elaborating government programs, drafting legislation and budgets, etc.), he, she or they must clearly refrain from acting as a decision-maker in the applied sense. This role is reserved for the domestic politicians and civil servants whom the advisors are providing with their services. As a consequence, the policy finally introduced by the recipient government may well differ from the advisors original proposals, and as long as this does not conflict with any conditionality requirements tied to donated funds, such decisions can only be accepted by the foreign advisors. Simultaneously, the recipient nation must then avoid making the advisors scapegoats for any policy failures.

Technical assistance is, in fact, more than just policy advice at the highest political level. Technical assistance is a broader concept and exists in many forms including: awareness creation (regarding investment technologies, business practices, functioning of a market economy, or the public sector or government ministry in a market environment); human resource development (training, development, placement, and so forth); policy formulation (i.e., guidelines for cooperation between industrial organizations and/or chambers of commerce and political decision-makers on issues of institution-building, sub-contracting, investment promotion, etc.); and direct support at the enterprise level. As economic transition towards a more market system progresses, a shift in the type of technical assistance can be expected, most probably from the macro to the enterprise level.

The results of a recent conference organized by the United Nations Industrial Development Organization (UNIDO) revealed various key areas requiring technical assistance in the transforming countries of Central and Eastern Europe. At the policy level assistance is required on the conceptualization and design of policy (including industrial restructuring, privatization, and investment), the creation of the necessary institutional infrastructure for executing the policies (encompassing everything from organization of market information to public/private sector coordination and promotion of the private sector), the integration of environmental aspects into industrial policy, and the development and extension of a wide range of training programs. Further assistance at the enterprise level should focus on financial, production, operations, and physical restructuring, programs for conversion of military to civilian production, promotion of domestic and foreign investment, identification of and penetration techniques for export markets, provision of appropriate technologies, and training programs in market-based management techniques and tools. Each of the many aid agencies and international financial institutions like the IMF, World Bank, EBRD, OECD, CEC, UN, UNIDO, International Labor Organization, UNCTAD, UNEP, WHO, and others could concentrate their assistance in their special area of expertise.

Competition between foreign advisors or advising organizations may easily lead to confusion, withholding of information on the part of the advisors to maintain some of their monopoly position in providing policy advice, and a severe lack of communication undermining the purpose of the assistance-giving process, reducing the productivity of international cooperation, and eventually creating distrust on the part of the recipients. Coordination and openness between the agents providing the help is critical to the success of aid, as is the speedy response to requests from the recipient countries. Both these issues are improved with the permanent presence of a resident base of advisors and assistants in the nation in need.

Conclusion

Foreign aid can exert two main influences on the recipient country. The conditions of aid provide incentive to induce change, and the aid itself acts as a shock-absorber to cushion the social impact of reforms. Once the decision to aid has been taken, it is important to have a coalition of economic experts and technocrats from both donor and recipient countries to work closely together to decide on policy. Knowledge, information, coordination, speed, willingness, and openness on both sides of the aid, as well as more decentralized decision-making on the part of the multilateral organizations will determine the measure of success. In future, more care should be taken by the donors of categorizing the types of recipients (i.e., Russia should not be considered within the same framework as Nigeria, Chile and others) and the guidelines, conditions, regulations, and flexibility governing the provision of aid must be altered to better reflect and thus accommodate the changing situation in national economies throughout the world, more specifically the transforming economies of Central and Eastern Europe. Personal and written exchange are compliments in setting the stage for foreign assistance. Productive two-way communication is the essential prerequisite and basis for aid negotiations and disbursion.

<u>Appendix</u>

Program for the Seminar

Western Assistance to Central and Eastern European Economies in Their Transition to Market Systems

Seminar Room, IIASA, 4–6 November 1993

Thursday, 4 November

13:30 REGISTRATION
14:00 OPENING REMARKS
Peter de Jánosi, Director, IIASA
14:15 INTRODUCTION
Merton J. Peck, Leader, Economic Transition and Integration Project

14:30 **SESSION I: General Characteristics of Foreign Assistance**
Chair: Petr Aven

- Role of individual countries and multilateral aid
- Export credits, trade aid and concessions, aid in kind
- Gains of donor countries from aid
- Role of conditionality and the timing of aid
- Political and economic factors in donor decisions on aid
- The absorptive capacity of recipients and the local distribution of aid

Presentations by: Richard Cooper, John Flemming, Andrei Nechaev, and Jeffrey Sachs

Friday, 5 November

9:00 **SESSION II: Debt Issues**
Chair: Marek Dabrowski

- Options on the serve and repayment of debt
- The role of London and Paris Clubs
- Winners and losers from debt decisions -- institutions and countries

Presentations by: Petr Aven, Álmos Kovács, Richard Portes, and Jérôme Sgard

14:00 SESSION III: The Role of International Organizations
Chair: Richard Cooper

- Pattern of decision-making in international organizations
- Relevance of their experience and policies in transition in other nations such as Latin America
- Role of international organizations in formulating and supervising conditionality and provisions

Presentations by: Marek Dabrowski, Álmos Kovács, and Andrei Vernikov

17:30 Close of session

Saturday, 6 November

9:00 SESSION IV: Technical Assistance and Policy Advice: The Role of International Agencies (including associated organizations) Academic Advisors, and Consultants
Chair: János Gács

- The benefits and drawbacks of different types of technical assistance
- Role of technical assistance in the decisions of the recipients government
- Divergence in the advice from different kinds of consultants
- Long-run role of technical assistance

Presentations by: Jitka Cenková, Bengt Karlsson, Viacheslav Shironin, Molly Meacher, Tiit Naber, and Olga Radzyner

12:00 Close of Seminar

Final List of Participants for the Seminar

Western Assistance to Central and Eastern European Economies in Their Transition to Market Systems

Seminar Room, IIASA, 4–6 November 1993

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