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Problems of Economic and Social Transformation in Eastern Central Europe and the CIS States: Fields of Activity for the "Economic Dimension" of the OSCE?

On the Economic and Social Dimension of Security

Since the founding of the CSCE/OSCE the main traditional goals of the Organization, security and cooperation, have not been defined only in terms of foreign policy and armaments policy. They have always had a substantial economic dimension. The position and the importance of economic cooperation for guaranteeing peace and security was expressly emphasized in Basket II of the Helsinki Final Act, a number of fields of activity (trade, cooperation in industry, science and ecology) were identified, and the requirements for cooperative progress were set forth.¹ This approach was in line with the cooperative developments in East-West relations brought by detente policy but was not able to give much new or independent thrust to that process. Following the end of the East-West conflict the importance of economic and social factors for international security continued to grow. The collapse of the Soviet hegemonial system in Eastern Europe at the end of the eighties opened up new possibilities for various forms of cooperation, not least in the economic field, while at the same time the role of military security as a factor in international relations weakened, at least from a global perspective. On the other hand, the upheavals in Eastern Central Europe and the CIS states were accompanied by new security problems, many of them largely the result of discontinuities in economic and social development caused by the transformation.

There are a number of reasons why these discontinuities had such serious consequences. Of particular importance are the oppressive legacies of the collapsed communist system, the extraordinary complexity of the work involved in the transformation, and the comparatively low level of economic development in almost all of the countries undergoing this process. These factors were generally underestimated, both in the reform countries and in the West, and this led almost invariably to exaggerated hopes and false strategies - false because they were inadequate and inconsistent. For that reason we need to take a look at the conditions and the status of the transformation before we can investigate its security implications.

¹ Final Act of Helsinki, Helsinki, 1 August 1975, in: Arie Bloed (Ed.), *The Conference on Security and Co-operation in Europe. Analysis and Basic Documents, 1972-1993*, Dordrecht/Boston/London 1993, pp. 141-217, esp. pp. 156-181.

Burdensome Legacies and Complexities

Owing to the close relationship between economic and socio-political developments it is not only the economic but the political and social legacies of failed communism which impede the transformation of economic conditions: deficiencies of power and authority, weakly developed democratic forces, inability of social groups to organize themselves, and a lack of guiding social values and behavioral norms, all of which contribute to the spread of criminality. In a narrower economic sense, the old bureaucratic structures and interest groups go on functioning and thus burdening economic change. Central elements of the old system such as paternalism and "egalitarianism" left behind forms of economic behavior which do not exactly favor the transition to a market economy. Above all, the decades of Eastern European economies with an essentially negative character meant that any systemic change must inevitably lead to economic and social shocks. Nevertheless, a comparison of the systemic, behavioral and structural legacies of the individual transitional economies of Eastern Europe reveals that, despite many common elements, they differ substantially from one country to another and that the conditions under which the transformation process began were thus quite varied.

There are two aspects to the complexities of reform. For one thing, the transition to new economic conditions, in particular the shift to stable, socially accepted and efficient market systems, must take place at the same time as the change of the political system and the society into one with democratic and pluralistic structures. There are close relationships between political and economic transformation but many contradictions as well. And the restructuring of economic conditions is in itself an extraordinarily complicated process, made up of at least five different parts: the micro-economic liberalization of domestic and international economic relations, as the "essential point of entry" into a market economy; macro-economic stabilization with the vital objectives of overcoming transformational recession and fighting inflation; the institutional change, aiming at market economies; the transformation of existing economic structures and ensuring that that transformation is accompanied by adequate social flanking measures. Here, too, there are between the various reform objectives many contradictions which are difficult to overcome.²

² A more detailed discussion is in: Hans-Hermann Höhmann, *Marktwirtschaft ohne Alternative? Aspekte und Bewertungsmaßstäbe der osteuropäischen Wirtschaftstransformation* [Market Economy without Alternatives? Aspects of the Eastern European Economic Transformation and Standards for Evaluating it], in: BIOst (Ed.), *Zwischen Krise und Konsolidierung. Gefährdeter Systemwechsel im Osten Europas* [Between Crisis and Consolidation. Systemic Change at Risk in Eastern Europe], München 1995, pp. 189-195.

Deficiencies of Development and Transformational Recession

As for the level of economic development, four of the 26 OSCE countries in the region - which account for just half of all members of that Organization - belong, according to the UN classification³, to the "low income" (in 1994 up to US-Dollars 750 GNP per capita) group: Albania, Azerbaijan, Armenia and Georgia. Most of the others, including Russia, belong to the "lower middle income" group (up to US-Dollars 3,000 GNP per capita). Only three (the Czech Republic, Hungary and Slovenia) belong to the "upper middle income" group and none of the transformation countries is represented in the "high income" category. In addition to the low level of income in these countries, the negative trend in national income development has aggravated the situation. The "transformational recession" (J. Kornai)⁴, which began after 1989, was particularly serious in the successor states to the USSR and is still going on in many places. The national product of the Ukraine in 1995 was, for example, about 60 percent below the level of 1989 and in Russia about 50 percent below. The transformational recession in Eastern Central Europe was significantly smaller, however, which in turn led to the relatively early resumption of economic growth.

A low level of development of national economies, the rapid collapse of the communist system of rule and of economic management, and continuing burdensome legacies along with the transformational recession they have triggered are the main causes of other unfavorable socio-economic developments which - again with significant variations from one country to another - represent potential factors of internal destabilization. Worthy of mention are:

- the social security systems, which are so far only rudimentary;
- the unemployment which accompanies economic reform;
- the substantial growth of income and property differentials within the population;
- the growing impoverishment of those parts of the population which are incapable of adapting to the changed economic circumstances and conditions of work;
- medical care, which has deteriorated and is now often inadequate;
- environmental damage, often severe, and finally
- the high level of criminality, which continues to grow.

All of these negative economic, social and ecological factors make the transition to "normally functioning" civil societies more difficult and intensify the

³ The World Bank (Publ.), *From Plan to Market*. World Development Report 1996, Oxford/New York et al. 1996, pp. 188-189.

⁴ Janos Kornai, *Transformational Recession: The Main Causes*, in: *Journal of Comparative Economics* 19/1994, pp. 39-44.

danger of reactionary turns in domestic policy, whether of a communist or authoritarian and nationalistic kind; they could have international spill-over effects and they pose a potential risk to domestic and international security. The widespread, although not universal, return of post-communist groups to government responsibilities as a result of the second wave of parliamentary elections since 1989 shows that there is substantial dissatisfaction with economic and social progress. On the other hand, one can assume that these security risks would diminish if the systemic transformation to democracy and market economies proceeded successfully and if, accompanied by economic recovery and social consolidation, it were supported by a sufficient popular consensus.

A Transformation with Varying Degrees of Success

The variations between transformation countries have become manifest in all areas of the reform process.⁵ We see again and again that the countries which have made the most progress in transforming themselves are also the ones which have been most successful in overcoming the transformational recession. According to the level of politico-economic restructuring and economic recovery achieved, various zones of diminishing intensity in the transformation process can be discerned, although the lines between them are imprecise and there is also considerable differentiation within individual zones. The five Eastern Central European countries - the Czech Republic, Poland, Hungary, the Slovak Republic and Slovenia (ECE/5 states) are clearly at the head of the pack. It is equally easy to see which ones are bringing up the rear: all those countries affected by war or civil war in which decline and chaos prevail (former Yugoslavia, Trans-Caucasus, Tajikistan). All the other countries are to be found somewhere between these groups. Some are having a bit of success in trying to catch the leaders; in others, restructuring and efforts to overcome the transformational recession have at best produced unstable stagnation in which positive and negative factors balance each other out.

Favorable Prospects for Eastern Central Europe

Despite all difficulties the transformation has progressed substantially in the Eastern Central European countries and the economic situation has also clearly improved.⁶ Given favourable conditions at the start it was possible to begin the rebuilding of the system relatively fast and successfully. A whole

⁵ Cf. EBRD (Publ.), Transition Report 1995, London 1995, pp. 11-13.

⁶ Cf. ECE (Publ.), Economic Survey of Europe in 1995-1996, New York/Geneva 1996, pp. 53-57.

set of transformational measures was introduced and some of them have been completed. There has been positive growth in all ECE/5 states since 1994, in Poland for the fourth year in a row. The transformational recession was less severe in these countries; overall, the decrease in GDP after 1990 came to only about 15 percent. It appears that the ECE/5 states are in the process of catching up with the weakest EU countries, becoming "normal European problem children" in the economic sense and preparing themselves for membership in the European Union. Positive elements, in addition to the growth in GDP that has been achieved, are the investment growth which is once again under way and the moderate development of annual inflation rates which ranged from nine percent (Czech Republic) to 28 percent (Hungary) in 1995 and can, all in all, be described as "transformationally appropriate". But there are also several negative economic developments in the ECE/5 states which must be pointed out: the unemployment rates, ranging between 15 percent in Poland and ten percent in Hungary (both figures for 1995), are relatively high (the Czech Republic is an exception with the very low rate of 2.9 percent); average real wages have been declining since 1990; gaps between social groups are getting larger; an effective system of social security has yet to be established; and some portions of the population are threatened by poverty, especially because the governments, as in Hungary in 1995, have occasionally had to resort to strict austerity measures.

The three Baltic states, Estonia, Latvia and Lithuania, are trying, with varying success, to catch up with the leading transformation countries.⁷ But they still have substantial economic and social problems, not least because they have had to overcome a much deeper transformational recession. Despite numerous problems of adaptation, however - and contrary to many predictions (including ones from the West) -, the process of removing themselves from the old Soviet economic association has had positive results for the Baltic states, mainly owing to the additional leeway they have gained for pursuing an economic policy in accordance with their own capacities and needs and the reorientation of their international economic relations more toward the North and West.

The transformation in the countries of Southeastern Europe - Albania, Bulgaria and Romania⁸ - has been characterized by instability and susceptibility to disruptions in macro-economic consolidation and systemic change, but it has not been without favorable prospects. Albania has had high economic growth rates since 1993 but the population remains extraordinarily poor owing to the very low level of development. Romania, too, has achieved a growth rate of about five percent while Bulgaria, with regard to growth and

⁷ Cf. Länderanalysen der FAZ, Baltikum [Country Analyses of the Frankfurter Allgemeine Zeitung (FAZ), the Baltic States], April 1996, p. 3.

⁸ Cf. FAZ (Publ.), Osteuropa-Perspektiven. Jahrbuch 1995/96 [Eastern European Perspectives. Yearbook 1995/96], pp. 95-114, 203-218.

stability, is having great difficulty keeping up. The low level of economic development aggravates problems in both of these countries.

Continuing Problems in Russia and Other CIS Countries

Russia is a special case because of its size and its geo-political importance. It is certainly the most advanced of the transformation countries in the CIS but its path toward democracy and a market economy is still plagued by many problems. Among them:

- the especially burdensome legacies in Russia, not least with respect to sectoral and regional economic structure;
- contradictory political concepts together with uncertain power relationships and regional efforts to achieve autonomy, with the result that even after Yeltsin's reelection the central government remains weak;
- the continuing negative consequences, both internally and externally, of the war in Chechnya; and finally
- the persistently unsatisfactory economic situation.

The speed of GDP decline has been slowed but once again in 1995 there was a drop of four percent which, in this case, particularly affected private consumption. A real economic structural transformation has begun, unfortunately under conditions of insufficient adaptability and willingness to react on the part of firms, accompanied by completely inadequate capital formation. Progress has been made in monetary and fiscal stabilization but this is once again being put at risk by electoral promises which now must be redeemed. A beginning has been made in the process of systemic transformation leading to a market economy and the course is being held to despite many difficulties. But obstacles and false starts abound, making clear that institutional change is either inadequate or is not taking hold. The old social system of Russia has, after all, come off its hinges; the distribution of property and income has become very uneven and poverty has increased, more or less mitigated by traditional or spontaneously developing new networks for self-help whose potential durability is, however, difficult to judge. All in all, the transformation process in Russia, in comparison with Eastern Central Europe, is still far from being consolidated. But the continuation of Yeltsin's Presidency, democratically legitimated, at least gives Russia a chance to avoid the turbulence and instability that would have attended the possible alternatives - his staying in office without an electoral mandate or a victory

for Zyuganov; it allows cautious hope that the political and economic transformation can go on, even if not entirely free of tensions.⁹

Transformation in most of the other CIS countries is lagging even more than in Russia. Here too there are some areas in which substantial transformation projects have made a certain amount of progress (e.g. in the Ukraine) but there are also enormous realization problems which, in extreme case, threaten to paralyze any reform plan. What these countries have in common with Russia, however, is the impossibility of completely abandoning the reform course; there is no promising alternative to the policy of systemic change that has been more or less clearly undertaken. For one thing, it is clear that increased interventionism - extensive price controls, for example, or subsidies for unprofitable factories or administrative interference - would lead to mixed economies that would not be particularly efficient and might well be counter-productive. And a complete return to the old conditions of a planned socialist economy looks even less feasible. The lack of any fundamental alternatives to reform policy does not, of course, completely rule out administrative interference with the transformation process or changes of course and zig-zag movements in economic policy, whether they result from economic desperation or from continuous blockades, initiated by reactionary forces.

Transformation and the "Economic Dimension" of the OSCE

Since the beginning of the transformation process the CSCE has paid a lot of attention to the economic dimension of security and stability and to the necessity of successful systemic transformation. The main stages of conceptual development can here only be indicated with a few key terms: while the old formula about promotion of "stable and equitable international economic relations in the interest of all States" was still presented as the main objective of economic cooperation in the Concluding Document of the Follow-up Meeting of Vienna of 15 January 1989¹⁰, then, beginning with the Bonn Conference on Economic Co-operation in Europe in April 1990, it was the development of market economies, political pluralism and the rule of law which took over the central position in the CSCE's catalogue of economic objectives.¹¹ In the "Prague Document on Further Development of CSCE

⁹ Cf. Hans-Hermann Höhmann/Christian Meier, Zwischen Hoffen und Abwarten: Jelzins Wahlsieg, der Westen und der G7-Gipfel von Lyon [Between Hope and Patience: Yeltsin's Electoral Victory, the West and the G7 Summit in Lyon], Aktuelle Analysen [Contemporary Analyses] of BIOst, Köln 45/1996.

¹⁰ Concluding Document of Vienna, Vienna, 15 January 1989, in: Bloed, cited above (Note 1), pp. 327-411, here: p. 343.

¹¹ Cf. Document of the Bonn Conference on Economic Co-operation in Europe, Bonn, 11 April 1990, in: Ibid., pp. 425-438.

Institutions and Structures" of January 1992, the focus on "the transition to and development of free market economies" was again put in the foreground of economic cooperation. In addition, it was decided to establish an Economic Forum in order to promote a dialogue on issues of market economy reform and to encourage related activities and proposals by European and trans-Atlantic organizations such as the OECD, the European Investment Bank, EBRD and ECE.¹² Finally, the Document of the CSCE/OSCE Budapest Summit (5/6 December 1994) emphasized support for the economic reform process and the development of market economies and environmentally friendly policies as indispensable elements of security and stability in the OSCE region.¹³

As reasonable and necessary as it may be to discuss economic and social development problems in Eastern Central Europe and the CIS states with a view to their importance for security and stability and, hence, as a part of the OSCE's economic dimension, we should not entertain exaggerated hopes for clear analytical results and unambiguous conclusions regarding an interdependent relationship between socio-economic development and questions of internal stability and security. For one thing, the data are often too imperfect to give a precise enough picture of the structure and explosiveness of socio-economic problems; there are serious problems of measurement and evaluation, particularly when it comes to international comparisons. Moreover, the risks to security and stability in the OSCE region that lie in bad economic and social circumstances usually come less from the situation itself than from the way they are perceived and evaluated by the people and from their fluctuating usefulness in political debates and power struggles. Extensive case studies and the development of sensitive indicators would be needed to establish a dependable basis for judgement and decision.

On the other hand, the range of instruments available to the OSCE for meeting its responsibilities in the economic dimension as defined in its documents is also extremely limited.¹⁴ In working out and implementing economic, ecological and social support programs for the transformation countries - these generally include untied credits, project-related transfers of funds, technical assistance and consultation, support for training and advanced training programs, help in developing labor markets and establishing social security systems and support for the protection of the environment - it is

¹² Prague Document on Further Development of CSCE Institutions and Structures, Prague, 30 January 1992, in: *Ibid.*, pp. 830-838, here: p. 833.

¹³ CSCE Budapest Document 1994, Towards a Genuine Partnership in a New Era, in: *Helsinki Monitor* 1/1995, pp. 79-106, esp. pp. 101-104.

¹⁴ Cf. Ivan Majercin, Die wirtschaftliche Dimension der OSZE: Neue Herausforderungen [The Economic Dimension of the OSCE: New Challenges], in: *Institut für Friedensforschung und Sicherheitspolitik und der Universität Hamburg/IFSH [Institute for Peace Research and Security Policy at the University of Hamburg/IFSH] (Ed.), OSZE-Jahrbuch [OSCE Yearbook] 1995, Baden-Baden 1995, pp. 365-371, here: p. 368.*

clearly other organizations than the OSCE which have the lead. Among the most important are the big international economic and finance organizations (OECD, World Bank, IMF, European Investment Bank, European Bank for Reconstruction and Development). The European Union also plays a big role, both as a cooperation partner and future anchoring ground for the Eastern Central European reform countries and as an organizer of assistance programs (PHARE and TACIS *inter alia*). There are, in addition, the multi-lateral and bilateral activities of the G-7 countries, support measures from other countries, and the efforts of new regional associations (CEFTA and the Central European Initiative *inter alia*). Finally, there are also smaller participants - the Federal States in Germany, for example, as well as many associations and foundations - which concern themselves with support for the transformation countries. The OSCE, in contrast to these, has no similar network of institutions and no noteworthy financial resources of its own that would permit it to take on responsibility for adequately ensuring security and stability in economic, ecological and social terms. Thus the very brief section on the economic dimension in the 1995 Annual Report of the OSCE Secretary General was limited to the observation that the Economic Forum had discussed "various aspects of regional economic co-operation in the fields of trade, investment and infrastructure and, in particular, their relevance for security and made specific proposals on improved integration of the economic dimension into the work of the OSCE".¹⁵

Even though the OSCE's work in the economic and social fields is very limited its value should not be underrated. It consists, first, in the fact that the OSCE is the largest institutionalized forum, focused on but at the same time transcending Europe, for the discussion of relations between economic, ecological and social developments, on the one hand, and the entire complex of security issues on the other. At the same time it is a forum in which developed industrial countries and less developed transitional countries have almost equal shares of the overall membership. This not only opens up the possibility of an East-West dialogue but offers an opportunity for intensive communication amongst Eastern participating States - badly needed to discuss regional cooperation which is still too weakly developed as a result of the attractive force of the EU, and to forestall further disintegration of the economic space in Eastern Europe. In addition - an aspect which is of particular importance for CIS members - the OSCE is the most important pan-European organization which includes countries that never have an opportunity to become real economic partners, let alone become full members of the EU. Still, there should be a review of how the existing institutions of the economic dimension of the OSCE can be given broader effectiveness. Finally, there is the question whether, beyond simply doing better what has already

¹⁵ OSCE, The Secretary General, Annual Report 1995 on OSCE Activities, reprinted in this volume, pp. XXX-XXX, here: p. XXX.

been done, the economic functions of the OSCE could not be expanded and given a more secure institutional form. What is at issue, in the final analysis, is to develop suitable forms and methods for international cooperation in the entire OSCE area so as to halt the trend, which can already be seen, toward a new division of Europe between the established market economies and the successful reform countries in Western and Central Europe, on the one hand, and the transformation countries in the CIS area which are threatened by stagnation on the other, and thus to counter the dangers for stability and security in Europe which this trend entails.