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Special Analysis

EASTERN EUROPE: **Long Road Ahead to Economic Well-Being**

Once the eupnoria of political change begins to wane, the daunting task of recovering from four decades of economic mismanagement will face the new reform governments in Eastern Europe. Not only are expectations of rapid improvement unrealistic, but people generally do not appreciate that a wrenching drop in living standards will accompany economic restructuring. A timely, sustained program of Western financial and technical aid will be a key factor in the ability of the new leaderships to sell reform. [redacted] 6.2(d)

In recent months, Poland and Hungary have passed a series of unprecedented constitutional amendments and other legislation in support of economic reform. Many ideological barriers have been overcome, and progress, probably irreversible, has been made toward reducing administrative controls on the economy, opening it up to market forces, and rewarding individual initiative. [redacted] 6.2(d)

Implementation, however, particularly of reforms dealing with the politically sensitive issues of bankruptcy, unemployment, and privatization, has not kept pace with legislation. The hybrid governments in Warsaw and Budapest, inexperienced with market mechanisms and increasingly answerable to the electorate, have been slow to translate economic priorities into tough reform initiatives. [redacted] 6.2(d)

Popular Consensus for Reform Uncertain

The public's tolerance for austerity, which is key to further reforms, is largely untested. Most of the legislation enacted thus far—broadening foreign and private investment rights, liberalizing trade and foreign exchange activity, creating stock and bond markets—does not add to the burden on a population already struggling to make ends meet. Moreover, a steady stream of wage increases and an accompanying upswing in real wages have helped cushion the potentially more negative effects of recent price hikes. [redacted] 6.2(d)

Despite the bandwagon for economic change, no electorate has yet endorsed an austerity program. To many workers, economic reform simply means greater access to material goods and a higher standard of living without attendant hardships: unemployment, relocation, and higher prices. In Poland, for example, only 15 to 20 percent of the youngest voters—the most frustrated economically and the most active in protesting against austerity measures—participated in the election that eventually brought Solidarity to power. [redacted] 6.2(d)

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A crunch may come when reform leaders tackle the issue of consumer subsidies and spiraling wages. In Poland, where food and fuel costs have risen rapidly since August, it may happen as early as this month when the wage indexation law protecting worker income expires. [redacted] 6.2(d)

Unfavorable Environment

A strong popular consensus behind reform would not by itself move the regions' highly distorted economies closer to a market orientation. In Poland, for example, much of the local Communist bureaucracy opposed to rapid change remains entrenched. The deteriorating economic situation in most of the region—characterized by inflationary pressure, declining industrial output, growing budget deficits, and deteriorating balance-of-payments problems—will add to the adjustments people must make. [redacted] 6.2(d)

Currency devaluations; more market-determined prices, wages, and interest and exchange rates; and a reduction in government expenditures—all prerequisites for IMF standby programs and desperately needed Western aid—will mean higher unemployment, a surge in inflation, falling output and consumption, and widening income disparities, at least in the short run. [redacted] 6.2(d)

Expectations Dangerously High

With expectations so high, the risk of failure, perceived or real, is great. Warsaw and Budapest have made Western economic support the centerpiece of reform efforts and seem ready to accept large doses of nasty medicine in exchange for sizable amounts of Western financial and technical assistance. Failure to secure such help or to meet ambitious targets could undercut reform efforts to win public support and to hold the confidence of Western creditors. [redacted] 6.2(d)

Because the benefits of economic restructuring are long term and the short-term costs are high, progress toward market reform will be uneven for both the new coalition governments and the West. If aggressive implementation coincides with consumer shortages and a prolonged decline in real incomes, workers may take to the streets. In these circumstances, the US and other Western donors would be likely to encounter pressure for additional aid and a high degree of public criticism if none were made available. [redacted] 6.2(d)

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