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UPDATE

THE EASTERN EUROPE DEVELOPMENT BANK: TURNING THE EAST BLOC INTO LATIN AMERICA

(Updating *Backgrounder* No. 759, "For Eastern Europe, An Agenda for Economic Growth," March 13, 1990.)

Now that the long-suffering East Europeans have ousted their communist rulers and are on the road to democratic elections, their next great challenge is reversing four decades of economic destitution caused by their socialist systems. The West, understandably, is eager to help. Yet one of the means by which the West ostensibly intends to help will be useless at best and, more likely, will impede Eastern Europe's growth. The culprit is the proposal for a European Bank for Reconstruction and Development, modeled on the World Bank. This will inflict on Eastern Europe the same flawed policies that, for example, in Latin America are failing to solve the debt crisis there and around the world promote economic sclerosis. The United States, at least, should learn the lessons of what has and has not worked in helping backward economies develop. Guided by these lessons, Washington should refuse financial support for this proposed European Bank for Reconstruction and Development and instead promote growth-oriented free market policies in Eastern Europe.

Conceived by Western European governments, led by France, the Eastern European Bank would receive between 8 percent and 10 percent of its \$25 billion capital from the U.S. Eastern European countries would be members and eligible for loans. The Western Europeans would have effective control over who receives loans and for what purposes. Some 60 percent of the Bank's funds would be earmarked for the newly emerging private sector in Eastern Europe; 40 percent would go to governments.

Alarming Record. Economic growth in these newly free countries requires the abandonment of socialist economics and granting people the maximum freedom to produce and prosper from their actions. A Bank controlled by West European countries with mixed socialist-market economies cannot be expected to promote free enterprise. Over the past decade, the policies of these West European countries have led to unemployment rates on the average twice as high as in the U.S. Almost no new jobs, on net, have been created in these countries, while some 19 million have been created in the U.S. in the past decade. Even the integration of the European Community planned for 1992 testifies to Western Europe's economic problems: the integration is motivated in large part by the loss of competitiveness to the U.S. and Japan. East Europeans should be particularly alarmed by Western Europe's record as the principal provider of aid and advice to Africa. Overall, Africa has stagnated and declined economically.

With this record, it makes no sense for the U.S. to turn its money over to a Bank controlled by the West Europeans. Even worse, of course, the West Europeans are likely to use loans from the new Bank to promote their own economic and commercial interests at the expense of the U.S.

Problems from Moscow. The prospect of Soviet membership in the new Bank also causes serious problems. First, while the U.S.S.R. will not have to contribute hard currency, it might be able to receive loans. Yet since the Soviets send billions of dollars overseas to their own allies each year, including some \$6 billion to Cuba, they hardly deserve a bailout from U.S. taxpayers. Second, Soviet capital assets and labor are tremendously underutilized. Western loans or handouts simply would allow Moscow to continue its wasteful policies. Soviet membership on the Board of the new Bank would cause problems for the Eastern European countries. The U.S.S.R., for example, could delay or derail loans to these countries if they offended Moscow. The U.S.S.R. also could block membership of the Baltic Republics as they seek to reestablish in fact their independence.

If the history of the World Bank or the InterAmerican Development Bank (IDB) is any indication, this new Bank could ensure the Latin Americanization of Eastern Europe. In Latin America, the massive loans generally have delayed economic change and helped the politicians responsible for their country's economic problems hang onto power. In the 1980s, for example, the World Bank and the IDB poured billions of dollars into Argentina, Brazil, and Mexico to cover the continuing costs of money-losing state enterprises and bloated state payrolls. In Eastern Europe, with Communist Party apparatchiks still running the governments, the situation promises to be just as bad.

Presumably the governments in Eastern Europe will decide where the 40 percent of the new Bank's public sector funds are allocated. This is a prescription for the same sort of corruption found in Third World countries when governments make such decisions. The complete failure of government economic planning in Eastern Europe and the billions of dollars wasted by Western European governments subsidizing their own industries shows that these governments, just like governments anywhere, cannot pick economic winners and losers among competing firms. These governments are hardly the doctors best suited to treat the economic illnesses of Eastern Europe.

Simpler Approach. If a special source of funds is needed for rebuilding Eastern Europe, a simpler approach, requiring little new bureaucracy or overhead costs, currently is being planned by the World Bank. A special "window" or facility is proposed at the World Bank specifically for Eastern Europe. Only if this window fails to serve the needs of Eastern Europe might a more expensive and cumbersome new Bank be required.

Secretary of State James Baker says the U.S. must participate in this new Bank to demonstrate U.S. leadership. Here he is wrong and is being poorly advised. Leadership does not mean that America must follow the failed economic formulas of the past, even when they are prescribed by America's European friends. Instead, leadership means going beyond equating cash payments with caring. It means facing directly the real problems and addressing them on their merits.

East Europeans have struggled bravely to reestablish their political freedom. They admirably specifically are not clamoring for international welfare. Rather, they are asking for markets opened to their exports and direct foreign investment by Western businesses in their countries. As a sign of respect to them, and in an attempt to spur real economic change, the West should not inflict on them the same policies that have locked into poverty other less developed countries. The U.S. should not participate in the new Bank.

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