I Regional and Sub-Regional Integration in Central and Eastern Europe: An Overview

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I Introduction

The political events of 1989 in Central and East European countries (CEECs) brought along a number of important changes in these countries' external economic relations. One of the legacies of communism for these countries was that they had been isolated from world markets and become extremely insular. Trade policies were highly protectionist and autarchic. Inward foreign investments were practically forbidden, and industrial cooperation agreements were at best limited to joint ventures with foreigners holding a non-majority interest in the enterprise. Outward foreign investments were few in number, and again limited only to securing "essential" services or material inputs. It goes without saying that the integration of labour markets was even more restrictive since the communist regime hardly permitted any internal labour mobility let alone foreign migration.

The abolition of communism dramatically turned the attitudes in these countries. External economic policies were completely overhauled. Suddenly, the most important challenge was no longer whether these countries should open up to external competition and whether they should seek world markets more actively, but the real question has become how these general goals should be achieved. Theoretically, the countries could pursue two separate routes: they could join the multilateral "club" of countries through participation in the Bretton Woods system or they could seek strong alliances in the regional context. The third alternative was to pursue

1 The views expressed in this paper are personal and should not necessarily be attributed to the World Trade Organization or its members. The paper has been prepared for the conference on "Regional Economic Integration and Global Economic Cooperation: The Case of Central and Eastern Europe", Prague, 13-14 January 1997. I have benefitted from rich comments of the conference participants, especially Mark Allen, Franz-Lothar Altmann, Stephany Griffith-Jones, András Inotai, Ricardo Lago, Friedemann Müller, Joan Pearce, Barbara Stallings, Jan Joost Teunissen, Albrecht Von der Heyden and Per Magnus Wijkman. Statistical assistance of Maika Oshikawa and typing of Lidia Carlos-Silvetti are also most gratefully acknowledged.

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both options at the same time. As we shall see, most of the countries under consideration indeed pursued both routes.

The issue of seeking full participation in the multilateral trading system, on the one hand, or partnership in regional trading and other economic arrangements, on the other, has been studied extensively. The desirability of multilateral versus regional trading arrangements has been recently addressed, for example, in WTO (1995), de Melo and Panagariya (1993) and others. According to some authors, regionalism constitutes a danger for the multilateral system, while others (see, e.g. Mistry, 1996) argue that it helps to strengthen it. *Pari passu*, this issue obviously looms very heavily over the region of Central and Eastern Europe. The purpose of this paper is, therefore, to review the recent literature which evaluates the new regional arrangements in Central and Eastern Europe and identifies the constraints for further integration of these countries.

Evaluating regionalism is neither simple nor straightforward. Regional arrangements arenormally assessed on the basis of the Vinerian "trade diversion" and "trade creation" criterion (see Viner, 1950). More recently, researchers have begun to focus more on the extent to which regionalism affects the country's welfare (e.g. Baldwin *et al.*, 1996). In practice, however, the evaluations run into many difficulties. For example, there may be conflicting factors which determine the efficiency consequences of regional integration arrangements (de Melo, Panagariya and Rodrik, 1992). Moreover, empirical studies have been subject to a number of technical and data problems.[2] For a brief comment, see, for example, WTO (1994). As a result, many analysts believe that assessments of regional arrangements are basically an empirical problem (Laird, 1995).

We shall approach the assessment of the regional initiatives in Central and Eastern Europe from two different perspectives. Our *first approach* will be to assess the regional agreements as options faced by these countries in the light of various alternatives. Following the general literature on regionalism (e.g. Bhagwati, 1995), this can be done by ascertaining whether the regional agreements meet any or all of the four following criteria: (i) the extent to which the multilateral and regional agreements are consistent with domestic policy objectives; (ii) whether the regional agreements create incentives to reduce, minimise or eliminate trade diversion; (iii) whether the agreements have been leading to a deeper integration than what could have been achieved through the "multilateral option"; and (iv) whether the agreements have allowed a faster rate of integration with outside countries than what would have been possible under the multilateral

2 For a brief comment, see, for example, WTO (1994).

alternatives. In more concrete terms, we will raise questions such as: Do the regional initiatives in CEECs represent a protectionist trend or do they support the officially declared objective of liberalisation instead? Have the regional initiatives been concentrated only on trade arrangements or have they also been extended to other areas as well? Do the initiatives exceed the scope of measures and concessions negotiated in multilateral agreements? Have the measures negotiated in the regional arrangements been actually and fully implemented? If not, why? What is the time schedule for the completion of the negotiated trade measures and how does this compare with the multilateral agreement?

Our *second approach* will be to review the empirical literature which focuses on the quantitative assessment of regionalism in Central and Eastern Europe. The literature can be summarised under two separate headings. One route has been the attempt to estimate the nature and extent of trade diversion/creation. It includes studies based on "gravity models" and other methods to evaluate intra-regional trade, as well as studies which try to measure extra-regional trade effects. Another route has been to evaluate the impact of regional agreements on welfare in the EU and in the CEECs by looking at income, employment and the budget in the EU and income effects in the CEECs.

Due to limitations of space and time, we will concentrate on two agreements – the Europe Agreements and the Central and East European Free Trade Agreement (CEFTA). This means that we shall have to disregard a number of important bilateral agreements that have been concluded by the CEECs, such as the customs union between the Czech Republic and Slovakia, and various bilateral investment protection treaties. We shall focus on the "economics" of the regional arrangements although other issues may be equally important. For example, it would be interesting to address the broader question of the importance of global integration for transition of the CEECs but this would go beyond the scope of this study.[3] Non-economic factors, which also determine the success ofregional arrangements, will only be touched upon in this paper.[4] The paper will cover six CEECs – Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovakia. However, due to lack of information, Bulgaria and Romania will receive a relatively less rigorous treatment. Finally, the focus of the paper is trade, even though much more could and should be said about

3 The reader is referred to the World Bank's *World Development Report 1996* which addresses this question.

4 However, the reader may wish to consult Bofinger (1995) for more details and for a discussion of the broader political economy aspects of the EU enlargement. On the "eastern" view, see, for example, Richter (1996).

capital markets. This emphasis is arguably the weakest point of the study since the integration of capital markets has been quite successful, as will be shown in the text. But since it was the trade segment of the Europe Agreements and CEFTA that has been most controversial, our choice fell on trade rather than investment.

The paper is organised in the following way. Part Two describes the starting economic conditions for the CEECs to get more closely integrated into the world economy. The description is important because it helps us to understand the new opportunities created by the political changes. In addition, the description is necessary in order to evaluate various regional agreements in the rest of paper. Part Three reviews the main features of the Europe Agreements and CEFTA and discusses the main impediments to integration. Part Four reviews the empirical literature which focuses on quantitative assessments of these regional initiatives.

II The Initial Conditions: the Collapse of CMEA and the New Opportunities for Integrating the CEECs into the World Economy

The Collapse of CMEA

The collapse of communism in Central and Eastern Europe also resulted in the collapse of one of the "pillar" institutions of the former communist countries – the Council for Mutual Economic Assistance (CMEA, or COMECON). All six countries under consideration were a part of the CMEA, and all were, therefore, affected by its collapse. The collapse was sudden and abrupt. In CEECs, it resulted in the abolition of various domestic and foreign incentives, the conversion from rouble to dollar payments, the introduction of customs duties on imports from other CEECs, serious deterioration in terms of trade, adverse budgetary consequences, and the decline of domestic production (e.g. World Bank, 1991 and Oblath, 1995). The exact magnitude of the decline of trade is difficult to assess because of serious statistical problems and the differences in special trading arrangements in CMEA countries (Brada, 1995). In particular, the available statistical estimates vary greatly, with Hungary showing the lowest degree of inconsistency of data. I have reviewed six major sources which provide statistical data on trade of CEECs and these data are presented in Appendix Table 1. Unfortunately, we have no way of correcting these numbers nor are we in a position to identify the origins of these problems.

One consistent picture emerging from the literature is the sharp decline of total trade of all CEECs in the late 1980s (e.g. Csaba, 1992; Drábek,

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1992; Hrnčíř, 1992; Rosati, 1992; and Riditer, 1992). The fall started in 1989 and was relatively short-lived in Hungary and Poland. Trade continued to be depressed in the other countries until 1991 and in some countries even longer. Another common characteristic emerging from these studies is that trade recovery in Bulgaria, Hungary and Romania was very slow. It was not until mid-1990s that their total trade fully recovered. The recovery was much faster in the Czechand Slovak Republics and, especially, in Poland. Thus for the region as a whole, the recovery of trade was not in full swing until 1995. The collapse of sub-regional trade (i.e. trade between CEECs and other former CMEA countries) continued until 1992 in Poland and until 1994 in the Czech Republic and Slovakia.

The second conclusion that can be drawn from the data is that Bulgaria has been by far the most affected country in the region – with 50 to 70 per cent decline of trade between 1989 and 1994, depending on the source. The fall of trade in former Czechoslovakia was also steep – 20 to 30 per cent – while the other countries appear to have been affected considerably less. The reason for the decline of trade (and for the extreme situations in Bulgaria and Czechoslovakia) was the relative dependence of these countries on CMEA trade. As the same table shows, the decline of trade of each CEEC with the other CMEA countries – approximated in the table by a country grouping identified as "centrally planned economies" (CPE) – was extreme.[5] Since the share of CMEA in total trade of each CEEC was also high, the collapse of CMEA trade was mainly responsible for the decline in total trade of each country.

Notwithstanding these heavy economic losses, there was virtually nobody in CEECs who regretted the end of CMEA as a trade institution. There was also hardly anybody in these countries who wanted to revive sub-regional cooperation in any form. The CMEA was seen as an instrument of power politics of the former USSR, and in the minds of the people, it was synonymous with the inefficiencies of central planning. The collapse of communism and of CMEA coincided with other important changes which are described in the following section.

The Unilateral Liberalisation in the CEECs

Changing Incentives for Domestic Agents and the Domestic Market Opening

The political changes in Central and Eastern Europe brought along rad-

5 There were a few exceptions to this pattern, as always. For example, Polish exports to the centrally planned economies probably did not decline as steeply and as suddenly as in the other CEECs, as suggested by Riditer (1992).

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ical changes in trade policy and institutions. These changes had three important features: their scope was wide-ranging, the speed of the reform was fast and, last but not least, the changes were introduced unilaterally. The primary effect of these changes was a fundamental change of incentives for domestic economic agents and, as we shall see further below, a considerable market opening to foreign suppliers of goods and services in these countries.

Briefly speaking, the reforms included the following major steps.[6] (1) *De-monopolisation of foreign trade* has been actively pursued in every Central and East European country. (2) *Quotas* have been considerably reduced in all CEECs, and they have been virtually eliminated in the Czech Republic, Slovakia and Romania where they are only retained in exceptional and normally "sanctionable" circumstances. (3) *Tariffs* have been retained as the main instrument of trade policy. For a number of reasons, the average level of tariffs in the CEECs was set at a low level. (4) *Foreign exchange restrictions* have been greatly reduced, and the system of foreign exchange payments has been considerably liberalised. (5) *Exchange rate policy* has been completely overhauled leading to the elimination of highly overvalued exchange rates and of the system ofmultiple exchange rates. (6) *Internal and external subsidies* have been either considerably reduced or completely eliminated. (7) *The settlements mechanism* for payments on transactions with other formerly socialist countries has been changed, and the use of barter trade and the settlement system based on inconvertible currencies has been eliminated.

The scope of liberalisation was dramatic. Trade barriers were either completely eliminated or significantly reduced. Tariffs have been set – partly for historical reasons and partly by accident – at relatively low levels, as we shall see in the following section. As a result, the Czech Republic and Slovakia ended up with one of the lowest tariff levels in the world. Since unilateral liberalisation represents the first-best policy option among trade policy alternatives, one may question whether any regional arrangement should have been sought in such circumstances especially if one realises that international bargaining was not the driving force behind these countries' search for regional arrangements.[7] Since the liberalisations were unilateral, the ability of using international negotiations to obtain access to other markets has been weakened if not lost. The answer must, therefore,

6 The text of this section is based on Drábek and Smith (1995) where the reader is also referred for more details.

7 It is often argued that regional arrangements are a useful instrument for obtaining concessions from the country's trade partners in exchange for its own. This point was well elaborated, for example, by de Melo and Panagariya (1995).

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lie in areas other than the politics of international negotiations. One such area is the similarity of interests between the CEECs and the EU.

Aims and Objectives of the CEECs

Similarity of Interests with the European Union

The primary reasons for regional economic arrangements in Central and Eastern Europe are political, strategic and environmental as well as economic. The range of common interests between CEECs and the EU was fairly wide and has greatly facilitated or even stimulated regional integration. First, the introduction of a democratic system based on a multi-party political system, the respect of human and minority rights and the principles of a market economy was a commonly agreed *political* objective in both parts of Europe. The second common interest was *security*. While the collapse of CMEA and its military arm – the Warsaw Pact – was generally welcomed, Russia's retreat from Central Europe was seen by many in Central Europe as temporary (e.g. Richter and Tóth, 1994). A closer security tie to the West has, therefore, been an important objective of the CEECs, while the EU considered this an important foreign policy instrument for maintaining stability in the region. The third common interest concerns *environmental* issues. The EU has a strong interest in closer cooperation with Eastern Europe in resolving a variety of environmental problems that have plagued the CEECs for decades and that are unlikely to be resolved by the Central and East Europeans themselves with the speed that the West would consider desirable.[8]

It is, of course, arguable whether all these interests are as commonly or as deeply shared in both parts of Europe. For example, the CEECs' interest in closer security cooperation with the EU is normally associated with the CEECs' desire to join NATO, which in Eastern Europe is often seen, wrongly, as the military arm of the EU. All sixCEECs have begun their discussions with NATO representatives, and they have already taken steps towards closer military cooperation. On the European Union side the responses have usually been more cautious. The security motivations tend to be somewhat different with only some overlap with the interest of the CEECs.

Perhaps the most controversial issue in the commonality of interests

8 Even though environmental questions have become very important in the whole EU, several member countries such as the Scandinavian countries or Austria have become particularly vocal and active to pursue their environmental interests with some if not all of the CEECs.

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concerns *economic gains*. Many economists have argued that the creation of a regional economic arrangement between the EU and the CEECs will bring considerable economic benefits to both partners. Such opinions have usually been expressed in the CEECs or by observers on behalf of these countries, while the opinions in the EU have been much more cautious. This difference of opinion will be discussed in more detail below, but a few comments may be in order here. The caution in the EU originates in the fear that cheap labour in the CEECs represents a serious threat for the EU countries because of cheap imports or the relocation of industries from the EU to the CEECs. A less disputable and more objective reason for believing that the distribution of economic gains is very likely to favour the CEECs is that their economic dependence on the EU is much higher than in the reverse case. For instance, a large proportion of CEECs' trade is with the EU, and not the other way around. Foreign investment flows move predominantly in one direction only – from the EU to the CEECs. Central and Eastern European countries also hope to receive relatively large budgetary transfers either as a part of regional support programmes, infrastructural projects or as support for agriculture. Finally, CEECs will also obtain technological benefits as they acquire access to modern Western technology.

In sum, most writers agree that the costs and benefits of regional economic integration between the EU and the CEECs are not restricted to the economic realm of, for example, trade liberalisation measures (see Baldwin, 1992; Winters, 1992; and Brada, 1992). Bofinger (1995) even argues that benefits are much less important than the establishment of a rules-based system built on the Treaty of Rome.

GATT/WTO Membership

Five of the six countries covered in this paper were members of GATT at the time of the political changes. Their GATT membership also affected the countries' attitudes and policies towards regional arrangements. The countries included the Czech Republic and Slovakia as the successors to former Czechoslovakia, Hungary, Poland and Romania. The Czech Republic and Slovakia were the original Contracting Parties to GATT (1948) as the successors to former Czechoslovakia. Hungary became a Contracting Party in 1973, Poland in 1967 and Romania in 1971. Bulgaria applied for membership in 1986 and joined in 1996, and the Baltic countries joined in 1992. The latter obtained an observer status in GATT and, subsequently, in the WTO. Further details are provided in Table 1 below.

While being full members of GATT, the membership of the CEECs was more or less inactive during the time when these countries were cen-

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trally planned. Once these countries introduced market reforms, their membership could be fully activated but only after the countries "notified" and renegotiated the measures of the reforms in GATT including, in particular, their tariff schedules. Typically, the countries "inherited" a tariff schedule from the previous regime which had little economic rationale. For this reason alone, the countries thought it necessary to seek adjustments to their tariff schedules and negotiate them in GATT. The adjustments were accepted by the international community on the condition that the average tariff incidence remained more or less the same.

Table 1 Foreign Trade Agreements and Trade Regimes of Countries in Transition: Eastern Europe and the Baltic States

Countries	Foreign Trade Arrangements	Trade Regimes
Bulgaria	• joined WTO in Dec. 1996. • EU Europe Agreement in force since Feb. 1995, Interim Agreement covering trade components in force since Jan. 1994. • EFTA Free Trade Agreement in force since July 1993.	• All other OECD countries have granted MFN and/or GSP status. • Free Trade Agreements in force with Czech Republic and Slovak Republic since Jan. 1996.
Czech Republic	• GATT original contracting party as successor to CSFR (1948), WTO member. • EU Europe Agreement signed with CSFR in Dec. 1991, renegotiated with Czech Republic Oct. 1993, entered into force Feb. 1995. Interim Agreement covering trade components in force since March 1992. • EFTA Free Trade Agreement in force since July 1992 for CSFR, protocol on succession of CSFR agreement signed April 1993.	• All other OECD countries have granted MFN and/or GSP status. • CEFTA in force since March 1993. • Customs Union with Slovak Republic in force since Jan. 1993. • Free Trade Agreements in force with Bulgaria (Jan. 96), Estonia (July 96), Latvia (July 96), Romania (Jan. 95) and Slovenia (Jan. 94).
Estonia	• WTO observer status (June 1992), working party on accession (March 1994). • EC Trade and Cooperation Agreement in force since March 1993, EU Free Trade Agreement in force since Jan. 1995. Exploratory talks on Association Agreement. • EFTA Declaration on Co-opera tion Dec. 1991; bilateral Free	• All other OECD countries have granted MFN and/or GSP. • Baltic Free Trade Agreement in force since April 1994, Free Trade Agreement in Agricultural Products signed June 1996, (Baltic Customs Union intended by Jan. 1998). • Free Trade Agreements in force with Czech Republic (July 96), Slovak Republic (July 96) and

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Table 1 (continued)

Countries	Foreign Trade Arrangements	Trade Regimes
	Trade Agreements in force with Finland (Dec. 92), Norway (June 92), Sweden (July 92) and Switzerland (Apr.93). EFTA Free Trade Agreement in force since June 1996 in replacement to the bilateral agreements with Norway and Switzerland.	Ukraine (March 96). • MFN agreements on trade in force with Australia, Canada, China, Moldova, Poland, Romania, Turkey and Turkmenistan.
Hungary	• WTO member (1973); working party on re-negotiation of accession terms formed. • EU Europe Agreement in force since Feb. 1994, Interim Agreements covering trade component in force since March 1992. • EFTA Free Trade agreement in force since Oct. 1993.	• All other OECD countries have granted MFN and/or GSP status. • CEFTA in force since March 1993. • Free Trade Agreement with Slovenia in force since Jan. 1995 (tariffs phased out by 2001).
Latvia	• WTO observer status (Oct. 1992), working party on accession (1993). • EC Trade and Cooperation Agreement in force since Feb. 1993. EU Free Trade Agreement in force since Jan. 1995. Exploratory talks on Association Agreement. • EFTA Declaration on Cooperation Dec. 1991, bilateral Free Trade Agreements in force with Finland (July 93), Norway (June 92), Sweden (July 92) and Switzerland (Apr. 93). EFTA Free Trade Agreement in force since June 1996 in replacement to the bilateral agreements with Norway and Switzerland.	• All other OECD countries have granted MFN and/or GSP. • Baltic Free Trade Agreement in force since April 1994, Free Trade Agreement in Agricultural Products signed June 1996, (Baltic Customs Union intended by Jan. 1998). • Free Trade Agreements with Czech Republic and Slovak Republic in force since July 1996. • MFN agreements on trade in force with Armenia, Australia, Azerbaijian, Hungary, India, Moldova, Poland, Russian Federation, Tadjikistan, Turkmenistan, Ukraine, United States and Uzbekistan.
Lithuania	• WTO observer status (Oct. 1992); working party on accession (1993). • EC Trade and Cooperation Agreement in force since Feb. 1993. EU Free Trade Agreement in force since Jan. 1995. Exploratory talks on Association Agreement.	• All other OECD countries have granted MFN and/or GSP status. • Baltic Free Trade Agreement in force since April 1994, Free Trade Agreement in Agricultural Products signed June 1996, (Baltic Customs Union intended by Jan. 1998).

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Table 1 (continued)

Countries	Foreign Trade Arrangements	Trade Regimes
	• EFTA Declaration on Co-operation Dec. 1991, bilateral Free Trade Agreement in force with Finland (July. 93), Norway (June 92), Sweden (July 92) Free Trade Agreement with EFTA signed Dec. 1995 in replacement to the bilateral agreements with Norway and Switzerland.	• Free Trade Agreement in force with Ukraine. • MFN agreements on trade in force with Australia, Belarus, Bulgaria, Canada, China, Cyprus, Czech Republic, Cuba, Hungary, Iceland, India, Japan, Kazakhstan, Romania, Russian Federation, Slovak Republic, Slovenia, South Korea, Turkey and Uzbekistan.
Poland	• WTO member (1967), working party on re-negotiation of accession terms. • EU Europe Agreement in force since Feb. 1994. Interim Agreements covering trade components in force since March 1992.	• EFTA Free Trade Agreement in force since Nov. 1993. • All other OECD countries have granted MFN/GSP status. • CEFTA in force since March 1993.
Romania	• WTO member (1971), working party on re-negotiation of accession terms. • EU Europe Agreement in force since Jan. 1995. Interim Agreement covering trade components in force since May 1993. • EFTA Free Trade Agreement in force since May 1993.	• All other OECD countries have granted MFN and/or GSP status. • Free Trade Agreements in force with Czech Republic and Slovak Republic since Jan 1995.
Slovak Republic	• GATT original contracting party as successor to CSFR (1948). • EU Europe Agreement with CSFR signed Dec. 1991, renegotiated for Slovak Republic October 1993, entered into force Feb. 1995. Interim Agreement covering trade components in force since March 1992. • EFTA Free Trade Agreement in force since July 1992 for CSFR, protocol on succession of that treaty signed April 1993.	• All other OECD countries have granted MFN and/or GSP status. • CEFTA in force since March 1993. • Customs Union with Czech Republic since Jan. 1993. • Free Trade Agreements in force with Bulgaria (Jan. 96), Estonia (July 96), Latvia (July 96), Romania (Jan. 95) and Slovenia (Jan. 94).

Source: Based on EBRD, Transition Report (1994) and WTO Working Party Reports.

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The Importance of Speed

Another policy consideration of CEECs governments was the speed of reforms. All the policy changes that were taking place in the aftermath of the revolutions were very fast. They took everybody by surprise, as the internal events moved considerably faster than anybody – abroad or at home – was able to comprehend or predict. Even domestic policymakers were often only responding to actual events. Whether these countries would be able to establish stable and transparent economic relations with their foreign partners became, therefore, a legitimate question.

Under these circumstances it became obvious that regional economic arrangements could become more practical and effective than multilateral initiatives. What some of these countries needed was a signed legitimacy since some of them were "brand new" countries. What all of these countries needed was credibility of their economic policies since they had no track record of policymaking in a market environment. An international agreement –regional or multilateral– was clearly an important step towards the country's credibility. Since regional agreements tend to be easier to negotiate than multilateral agreements because of the smaller number of actors involved in negotiations, they could provide a faster resolution to the problem of legitimacy and credibility of the countries' policies. Membership of GATT was important but was regarded as less adequate for these purposes.[9]

The Europe Agreements as an Instrument for Restructuring Foreign Trade

The signing of the Europe Agreements (see next section) was expected to have a major impact on trade incentives in CEECs. The policy measures were expected to lead to an improvement of profitability of exports to the West and, in general, of production of tradables (see e.g. Rosati, 1990). They were also expected to lead to a significant change in relative prices due to the elimination of differences between domestic and foreign prices, to the abolition of special pricing arrangements in the CMEA and other peculiarities of the CMEA and of centrally planned foreign trade. In Poland, for example, the policy liberalisation initially led to the deterioration in the Polish-Soviet terms of trade which, in turn, reflected the fact that Polish export prices tended to be higher than Polish import prices prior to the introduction of market-based pricing rules. The former affect-

9 Many of these points are based on my personal experience as the Czechoslovak chief international negotiator. Unfortunately, these points have not yet been well documented in the literature to my knowledge.

ed mainly foodstuffs, chemicals and other manufactures – hard goods – while the latter covered predominantly non-ferrous metals, iron and steel – soft goods. Prices of Polish industrial goods tended to be higher than world prices while the prices of Polish crude materials and food tended to be closer to world market prices. The reverse was true for Soviet exports to Poland (Rosati, 1990).

Even though it was well understood at the time that these policy changes would most likely lead to strong inflationary pressures and would call for major real adjustments indomestic economies,[10] Central and Eastern European governments strongly supported this policy reform. The higher import prices resulting from the domestic price realignment contributed to as much as 10 to 20 per cent of the initial inflation in Poland (Rosati, 1990). The driving force behind the change in trade incentives was the desire to re-establish what may be considered *natural* trade ties between the CEECs and Western Europe (Collins and Rodrik, 1991). The pursuit of this objective had a strong empirical support from economists. Using typically the "gravity" models, relevant studies indicated that the trade of the CEECs with the EU was artificially suppressed until 1990 while trade with other – then formerly socialist – countries was artificially encouraged.[11] The only disagreement that exists among experts is the magnitude of "under-trading" with the EU and the extent of "over-trading" with other Central and East European countries including the former Soviet Union. While the ratios between the potential and actual trade obtained from these models tend to be in the range of 2 to 3 for trade with the EU in the case of Baldwin (1994, p. 90), Collins and Rodrik's somewhat different methodology leads to ratios that are in the range of 3 to 5. Wang and Winters' results are broadly similar with those of Collins and Rodrik.[13] The results are summarised in the following Tables 2A and 2B. Moreover, the gravity models also show that the potential of trade expansion is not limited to a few EU countries. For example, Faini and Portes (1995) show that even the "Southern Wing" countries such as Greece and Spain have a potential for a significant increase of trade with the CEECs.

A Summary of Regional and Multilateral Initiatives

The unilateral liberalisation noted above was the most important step in

10 These issues have also been discussed, for example, by Brada (1992), Havlik (1991), or World Bank (1991).

11 There is a long history of writing on this subject. For more recent examples, see Baldwin (1994), Wang and Winters (1991), and Hamilton and Winters (1994).

12 Baldwin (1994) also reviews other studies based on the "gravity" model which reach similar conclusions.

Table 2A CEECs-EU Trade: Actual and Potential Trade at the End of 1980s
(billions of dollars)

Baldwin (1994)	CEECs-EU12 Trade (1989)			CEECs-EFTA Trade (1989)		
	Actual	Potential	Ratio	Actual	Potential	Ratio
Bulgaria	0.5	2.9	5.8	0.1	0.5	7.3
CSFR	2.6	12.5	4.8	0.8	4.6	5.5
Hungary	2.6	4.5	1.7	0.9	1.5	1.7
Poland	4.0	8.5	2.1	1.0	1.9	2.0
Romania	2.5	3.0	1.2	0.2	0.6	3.2

Collins & Rodrik (1991)	CEECs-EC Trade (1988)			CEECs-EFTA Trade (1988)		
	Actual	Potential	Ratio	Actual	Potential	Ratio
Bulgaria	1.3	6.7	5.2	0.2	1.1	5.5
CSFR	3.8	12.6	3.3	1.1	2.9	2.6
Hungary	2.4	5.9	2.5	0.9	2.6	2.9
Poland	4.3	20.1	4.7	1.4	4.1	2.9
Romania	2.2	9.0	4.1	0.2	1.4	7.0

Wang & Winters (1991)	CEECs-EC Trade (1985)			CEECs-EFTA Trade (1985)		
	Actual	Potential	Ratio	Actual	Potential	Ratio
Bulgaria	0.4	2.5	6.3	0.06	0.6	10.0
CSFR	1.5	15.0	10.0	0.5	2.1	4.2
Hungary	1.3	6.5	5.0	0.7	0.9	1.3
Poland	2.5	12.5	5.0	0.6	2.6	4.3
Romania	2.5	5.2	2.1	0.3	1.2	4.0

Source: Based on Baldwin (1994), Collins and Rodrik (1991) and Wang and Winters (1991).

Table 2B Intra-CEECs Trade
(billions of dollars)

	Baldwin (1994)			**Collins &Rodrik (1991)**			**Wang & Winters (1991)**		
	1989			1988			1985		
	Actual	Potential	Ratio	Actual	Potential	Ratio	Actual	Potential	Ratio
Bulgaria				2.7	0.9	0.3	9.8	2.6	0.3
CSFR	2.7	2.8	1.0	3.1	2.9	0.9	12.5	7.4	0.6
Hungary	1.8	1.4	0.8	1.0	2.4	2.2	4.4	4.1	0.9
Poland	2.2	1.8	0.8	1.6	3.7	2.3	5.9	9.1	1.5
Romania	1.8	0.8	0.4	1.0	2.1	2.0	4.0	4.3	1.1

Source: Based on Baldwin (1994), Collins and Rodrik (1991) and Wang and Winters (1991).

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the CEECs' move away from their traditional isolationism. The other step was their attempt to join or activate their membership in the multilateral economic institutions as well as to encourage various regional initiatives. Participation in both multilateral and regional initiatives was pursued simultaneously, but the regional arrangement with the European Union had a special attractiveness, as noted above. We have already reviewed the countries' relations with the GATT/WTO. It only remains to list their bilateral and other regional initiatives.[13] All of the bilateral and regional initiatives are summarised in Table 1 above.

The CEECs pursued a number of regional and sub-regional arrangements. Among these,the most important was arguably the agreement with the European Union. The six Central and East European countries signed Associate Agreements (later transformed into the "Europe Agreements") in the course of 1992-1993. The Baltic countries signed a relatively less comprehensive Trade and Cooperation Agreement with the EU in February and March 1993. In addition, all CEECs have signed an agreement with the remaining countries in EFTA while the Baltic countries have signed a relatively less comprehensive Declaration on Cooperation with EFTA. Furthermore, the Czech Republic, Hungary, Poland and Slovakia agreed to establish their own sub-regional trade initiative – the Central European Free Trade Arrangement (CEFTA) – in March 1993 and they have since invited Bulgaria, Romania and Slovenia to join. The Baltic countries established a free trade area following their agreement signed in April 1994. Moreover, there was a proliferation of bilateral free trade agreements, which are also summarised in Table1. As a special case, the list of bilateral initiatives also includes the establishment of a customs union between the Czech Republic and Slovakia following the separation of these countries from former Czechoslovakia. In addition to the elimination of all internal barriers and the establishment of a common external tariff, the main feature of this customs union was the establishment of a payment clearing system which was in place in parallel with the payments mechanism operating with other countries. The clearing system was eliminated at the end of September 1995.

Several CEECs have concluded bilateral free trade agreements. In particular, Czech Prime Minister V. Klaus has been actively seeking support for bilateral agreements not only in the region but also in other parts of the world. However, the number of bilateral agreements that the Czech Government has so far been able to sign is still relatively small (see Table 1

13 The participation in the other Bretton Woods institutions – the World Bank and the International Monetary Fund – is not discussed in this overview paper. The reader may wish to refer to Schonfeld *et al.* (1995) for more details of this aspect.

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above). In total, the Czech government signed six agreements before the end of 1995. These are the Europe Agreement, CEFTA, and the bilateral agreements with Slovenia, Latvia, Estonia and Romania. Slovakia, Hungary and Poland have also signed bilateral free trade agreements. All of these agreements concern countries with relatively small mutual trade. No bilateral trade of any of these countries exceeds 1 per cent of the respective country's total trade– with the sole exception of trade between the Czech Republic and Slovakia (see Appendix Table 3).

The above list of regional initiatives is not exhaustive. The countries in the region have pursued other regional initiatives. These include, for example, the "Central European Initiative", "The Danube Valley Cooperation", "South-East European Cooperation", "Border Cooperation of Poland and the Czech Republic" and attempts to develop military cooperation between Poland and the Czech Republic. These initiatives are typically either highly specific or they have not really got off the ground.

III The New Regionalism in the CEECs

We have seen in the previous section that the initial conditions were highly favourable for the pursuit of regional initiatives. The CEECs and the EU had a broad range of similar objectives to provide the basis for the Europe Agreements. The discussion in this section is about the other three important criteria of successful regional arrangements mentioned in the introduction: (1) the establishment of incentives to stimulate trade creation; (2) the depth of the agreement; and (3) the speed of integration.

The Main Features of the Europe Agreements

The dramatic liberalisation of economic policies in the CEECs has opened up newopportunities for other countries in this region, and for closer integration of the CEECs into the world economy. The most rapid response came from the European Union, which answered the calls of the CEECs for a closer integration by offering these countries the status of associate membership. The first three of these association agreements (later transformed into "Europe Agreements" covering all ten CEECs) were signed with the so-called Visegrad countries – Czechoslovakia, Hungary and Poland – in 1993, and they had several important features.

The Speed of Establishing the Free Trade Area

The trade component of the Europe Agreements provides for the estab-

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lishment of a free trade area between the EU and the CEECs over a period of ten years. The one major exception is agriculture, which remains subject to restrictive trade measures throughout the whole period. The Agreements also provide for the elimination of all quantitative restrictions on the date of entry of the Agreement into force except in the case of coal, steel, textiles and clothing. The Agreement provides, therefore, for completely free access of all industrial products, including textiles and steel, by the end of the ten-year transition period. The preferential treatment of industrial products has been phased in accordance with the following categories: (1) the "one-year delayed" free trade group; (2) the "four-year delayed" free trade group; (3) the "quota/five-year delayed" free trade group; (4) steel and coal schedules, leading to free trade by the end of the fifth and second year respectively and subject to some differences among the beneficiaries; (5) the Multi-Fibre Arrangement to be negotiated bilaterally and in the context of the Uruguay Round Agreement; and (6) the "immediately" free trade group.[14]

By deciding on a free trade area rather than other forms of integration, the CEECs did not intend to discriminate against third countries. This would probably have been the case if the Europe Agreements had led to the establishment of a customs union which, in turn, would have called for an agreement on a common external tariff. Since the existing external tariffs differed among the CEECs, the establishment of a customs union would have probably resulted in a higher level of external tariff for most of the member countries. The non-discriminatory nature of the Europe Agreements was further supported by two additional factors – the unilateral liberalisation pursued by these countries and the fact that of the six CEECs under review only Bulgaria was not a GATT/WTO member country. The GATT membership meant that the CEECs could not raise the level of protection above the commitments already made in GATT.[15]

The Depth of the Agreement

The aim and scope of the Europe Agreements extends beyond a simple free trade agreement. It covers not only merchandise trade but also trade in services, foreign investment, payments systems, various aspects of economic cooperation (such as customs procedures and administration, control of drug trafficking etc.). In addition, the Agreements provide for a virtually complete integration of capital markets. Particularly important are

14 This classification is based on Kaminski (1995), p. 20.

15 All of these countries have, however, restructured their tariffs, as noted above, while retaining the average tariff incidence more or less unchanged.

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the measures to liberalise inward foreign investment together with protection to be provided to foreign firms. Foreign firms are to be treated not only on the mostfavoured nation basis but they also receive "national treatment". Liberalisation of payments restrictions has become another important element of stimulating both foreign trade and inward foreign investment. Labour markets are affected significantly less,[16] but the Agreements provide for an extensive cultural and political cooperation.

Linking of Europe Agreements to GATT/WTO

Regional trading arrangements are often looked upon with concern in the WTO because of fears that they may violate ArticleXXIV of GATT and thus undermine the multilateral trading system. These concerns have also emerged during the negotiations and implementation of the Europe Agreements. Three major concerns were expressed. The first concern is about the *regional* mechanism for dispute settlement which is seen as a potential threat to the dispute settlement mechanism in the WTO. The second relates to competition policies and safeguard measures, and the third to the level of protection against third countries.

On the first count, the Europe Agreements clearly pose no danger for the WTO system since the Agreements do not provide any effective mechanism of dispute settlement.[17] On the second account, the situation is somewhat different but not entirely. The Agreements seems to provide for "own" definition of dumping and other safeguard measures that constitute a danger to local industries. In general, such provisions do not usually respect the national treatment obligation of the GATT, and this is also the case of the Europe Agreements. However, the problem can be solved by harmonising the markets through stronger competition enforcement and the parallel phasing out of anti-dumping measures.[18] Both of these steps are foreseen in the Europe Agreements because the CEECs will adopt EU competition policies. A number of steps still need to be taken but, as pointed out by independent observers, the Europe Agreements already contain the necessary provisions to accelerate the countries' integration into the EU.[19]

On the third account, the evidence is scarce. Nevertheless, given the rel-

16 See also discussion in the next section.

17 The Agreements enable consultations and specify procedure for lodging complaints. These procedures, however, do not offer any effective room for negotiating disputes. For more details see Drábek (1994).

18 For more details, see Marceau (1995), p. 38.

19 See, for example, Marceau (1995), p. 50.

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atively low level of tariff before the liberalisation, the commitment of those CEECs that were GATT members to maintain the existing level of tariff unchanged, and the fact that each CEEC has radically liberalised the domestic institutions of international trade, we can only surmise that the level of protection against third countries has not increased. As the evidence provided in the next section shows, the opposite is in fact more likely to be the case.

It is also fairly clear that the Agreements provide for at least two major policy changes in the CEECs which are essential for stimulating dynamic gains: the liberalisation of inward foreign investment and the liberalisation of the payment settlement mechanism. These are two crucial measures which create the condition for a welfare-improving regional integration between the EU and the CEECs. The other important policy measure is the liberalisation of mutual trade to which we shall now turn.

Market Access to the EU: "A Glass Half-Full or Half-Empty?"

The first crucial and frequently discussed question is the extent to which the Europe Agreements represent a modest or a radical step towards closer integration with the EU. Another equally important question is whether the Agreements are an effective instrument for opening up markets. The usual response to the first question is that, because of their depth, the Europe Agreements represent an important instrument for closer integration of the CEECs and the EU. Nevertheless, the second question still remains unanswered in the minds of many people, that is whether the Europe Agreements have been "a glass that is half-full or half-empty", rather than a clear move towards a real market opening.

More specifically, there is considerable disagreement about the extent of concessions provided in the Europe Agreements by the EU. The traditional perception of the Agreements was that they significantly opened up opportunities for the CEECs (e.g. Castile, 1996; Bucker, *et al.*, 1994; and Drábek and Smith, 1995). Notwithstanding these concessions, however, many observers have been quite critical. The main point of criticism has been the relatively restrictive treatment of "sensitive" products – textiles, steel and coal and other agricultural products. Access to service sectors also remains relatively restricted.[20] Moreover, several observers have pointed out that the concessions granted in the Agreements did not substantially differentiate among the CEECs, especially in the light of concessions

20 See Winters (1992), Messerlin (1992), and European Commission (1994). Other critical studies are briefly reviewed in Drábek and Smith (1995).

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already offered to these countries under the generalised system of preferences (GSP) and similar treatments.

In order to evaluate the concessions negotiated under the Europe Agreements, it is necessary to compare various barriers to trade *before* and *after* the signing of the agreements. Their real importance is also dependent on the initial level of trade barriers, on the initial shares of mutual trade, the size of countries, and the level of diversification of their economies. Unfortunately, the literature has not so far covered all these elements which are necessary for a more thorough evaluation of the concessions. Nevertheless, several interesting conclusions can be drawn from the analysis of tariff concessions as reported in Table 3. The table shows that prior to the European Agreements, the CEECs faced barriers against their industrial exports to the EU that were neither prohibitive nor excessively high. The average EU industrial tariff on exports from Bulgaria and Czechoslovakia was about 7 per cent, even though these exports were probably more restricted by non-tariff barriers (NTB) than by tariffs. The other countries – Hungary, Poland and Romania – faced an even lower tariff in the EU as all three countries benefitted from the GSP rates. The level of protection was much higher on non-industrial goods, partly due to the agricultural policies of the EU and partly due to the fact that the GSP status did not apply to non-industrial products. In the case of industrial products, as the figures in the last column of Table 4 suggest, the share of CEECs exports subject to immediate free access was less than 40 per cent in Romania and less than 50 per cent in the other CEECs.

Table 3 CEECs – Pre-Agreement Market Access to the EU: Industrial Products Versus Other Goods

	Index, 1991 1988 = 100		NTB coverage ratio (in %)		Simple average tariff rate (in %)	
	industrial	other	industrial	other	industrial	other
Bulgaria	162	165	22.5	48.3	6.9	11.6
Czechoslovakia	196	163	24.0	52.5	7.0	11.7
Hungary	188	156	24.2	57.7	0.1	9.4
Poland	202	165	23.6	48.6	0.1	10.5
Romania	68	85	28.4	59.8	0.0	8.6

Source: Kaminski (1995), p. 19.

Table 4 CEECs – Composition of Industrial Exports to the EC by ITA Groups, 1988-92

	"One-year-delayed"	"Four-year-delayed"	"Quota/five-year-delayed"	"Multi-Fibre Arrangement"	"Steel"	"Coal" (excluding Germany and Spain)	"Coal" (Germany and Spain)	"Free Trade Residnal"
Bulgaria								
1988	2.5	0.2	10.9	14.9	9.6	0.1	0.0	61.7
1989	2.1	0.4	12.6	15.7	14.2	0.0	0.0	55.0
1990	1.4	0.3	13.6	19.1	17.3	0.3	0.0	47.9
1991	1.4	0.1	16.3	20.9	11.4	0.1	0.0	49.6
1992	0.9	0.0	14.0	29.5	8.0	0.2	0.0	47.4
Czechoslovakia								
1988	0.6	0.0	24.4	13.2	12.6	0.1	2.8	46.4
1989	0.7	0.0	25.3	12.3	13.6	0.1	2.7	45.3
1990	0.5	0.1	24.2	13.5	14.2	0.0	3.0	44.4
1991	1.1	0.1	26.5	13.6	10.5	0.0	3.0	45.2
1992	1.3	0.0	25.9	13.7	10.4	0.0	2.3	46.4
Hungary								
1988	1.0	0.9	26.1	22.9	6.9	0.1	0.0	42.1
1989	1.5	1.0	25.7	21.5	6.5	0.2	0.0	43.6
1990	1.0	0.9	24.9	21.5	6.7	0.1	0.1	44.7
1991	0.7	0.5	24.3	21.4	4.2	0.1	0.0	48.9
1992	0.5	0.3	23.7	21.8	3.6	0.0	0.0	50.1
Poland								
1988	0.2	0.3	22.4	13.8	4.2	9.5	3.5	46.2
1989	0.3	0.2	22.9	13.7	6.0	8.7	3.2	45.0
1990	0.5	0.4	23.7	15.2	5.4	6.0	3.9	44.9
1991	0.4	0.8	23.6	17.6	4.5	4.3	4.6	44.2
1992	0.7	0.7	24.4	19.0	4.3	3.7	3.5	43.6
Romania								
1988	0.1	5.1	25.7	19.9	4.2	0.0	0.0	45.1
1989	0.2	5.2	23.1	19.3	4.0	0.0	0.0	48.2
1990	0.1	2.7	28.0	26.4	4.4	0.0	0.0	38.5
1991	0.0	1.6	31.4	28.2	3.6	0.0	0.0	35.3
1992	0.0	0.4	30.4	39.0	6.7	0.0	0.0	23.5

Note: ITA stands for "Interim Trade Agreement" between the EU and the CEECs prior to the coming into force of the Europe Agreements.
Source: Kaminski (1995), p. 36.

Most other export concessions tended to be delayed if not "end-loaded". Perhaps even more importantly, exports of considerable interest to the CEECs – textiles and clothing (the "multi-fibre" commodities), steel, coal and agricultural products – were treated as "sensitive" products by the EU and thus were subject to specific liberalisation schedules, as noted above. Excluding agriculture, these products accounted for at least 25 per cent of industrial exports. In the case of Romania, the share was more than 45 per cent. More importantly, the "sensitive" products included not only commodities that have been historically subject to international regulations such as to the Multi-Fibre Arrangement, but also products for which import restrictions were much more unusual and therefore controversial. For example, the products on the list of Czech exports to the EU covered such commodities as passenger cars, cement, furniture, glassware, trucks, tractors and many other commodities of considerable interest to the Czech Republic (Mobius and Schumacher, 1994). However, a substantial improvement in EU market access should take place in the beginning of the sixth year of the Agreements when a large proportion of industrial goods will be liberalised (see Table 5). In sum, the Europe Agreements have improved market access, and the improvement has been relatively fast, but it was limited to a relatively small share of these countries' exports and excluded important and highly competitive products.

Table 5 CEECs – Share of Duty-Free Goods in Industrial and Total Exports to the EU, 1992-98

	1992	1993	1994	1995	1996	1997	1998
Share in industrial imports							
Bulgaria	54	54	57	58	59	60	61
Czechoslovakia	59	63	65	67	71	86	86
Hungary	62	64	66	67	68	78	78
Poland	56	63	65	66	72	81	81
Romania	39	39	42	44	46	48	61
CEE-5	58	69	70	70	71	74	80
Share in total imports							
Bulgaria	43	43	45	45	46	47	56
Czechoslovakia	55	59	61	62	66	80	80
Hungary	48	50	51	52	53	60	60
Poland	47	53	55	56	61	69	69
Romania	36	36	39	41	43	45	57
CEE-5	44	59	60	60	61	63	69

Note: In computing the duty-free shares, the commodity composition of flows in 1992 was applied to the anticipated customs status of each item in all subsequent years.
Source: Kaminski (1995), p. 37.

The extent of concessions on *agricultural products* has been even more limited.[21] Overall, only modest concessions, mostly in the form of increased tariff quotas, were granted for cereals, sugar, beef and dairy products, somewhat better concessions were offered for pork, poultry, beef, game, fruit, vegetables and wine. In addition, the concessions granted by the EU to the CEECs did not cover all agricultural exports. In the case of Poland, they excluded, for example, ten agricultural products representing an export value of 150 million ECU, or 14 per cent of Polish agricultural exports to the EU in 1991. Moreover, non-tariff barriers such as health requirements, consumer protection standards and other specific import restrictions under the Common Agricultural Policy have remained in force. Mainly due to the use of a "reference period" and to other factors such as negotiating skills, the concessions appear to have differed among the CEECs. The concessions granted to former Czechoslovakia, for example, appear to be less favourable than those granted to Hungary and Poland. The coverage of trade concessions has been the widest in Bulgaria's Agreement and the narrowest in the Agreement with Poland and Czechoslovakia. In sum, the market openings provided by the Europe Agreements for the CEECs are estimated to be relatively small primarily during the first five years of the Agreement with some improvements in the sixth year and, mainly, thereafter.

Other Trade Policy Impediments in the European Union

The Europe Agreements retain a number of elements that are often seen as serious shortcomings. We have already discussed one issue, the continued protection of "sensitive" products, but there are other trade barriers as well which have their origins in various safeguard measures. These are known as technical barriers or non-tariff barriers to trade. They have been quite high in the EU as can be seen from Table 6.

Contingent Protection

Measures of contingent protection are seen by many observers as potentially the most serious instrument for trade protection. In the Europe Agreements, the measures are treated under the heading of safeguards and anti-dumping, and they have generated considerable controversy. As with any provision for contingent protection, the controversy has revolved around two basic issues – whether the Europe Agreements' provision for

21 The following text is based on a detailed study by Tracy (1994).

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Table 6 CEECs – Non-tariff Barriers Faced by CEECs Exports to OECD Markets, 1992

ISIC*	Sector	USA(a)	EU	Austria	Sweden	Japan
100	Agriculture	33.1	79.8	83.6	71.6	159.3
311	Food manufacturing	(b)	(b)	(b)	(b)	(b)
321	Textiles	21.8	10.0	–	–	–
322	Apparel	28.3	18.0	–	–	–
323	Leather	–	(b)	(b)	(b)	(b)
351	Basic chemicals	(b)	16.0	–	–	–
352	Other chemicals	(b)	16.0	–	–	–
371	Iron and steel	–	22.0	(b)	(b)	(b)
	Other sectors	(b)	(b)	(b)	(b)	(b)
	Whole economy(a)	–	13.8	–	–	–

* ISIC: International Standard Industrial Classification.

Notes:
(a) NTB ad valorem equivalent rates: NTB ad valorem equivalent rates estimated by US ITC (CBO, 1991). These rates of protection concern all exporters to the US and thus cannot be directly compared to the estimates for the EC which concern only CEECs exports.
(b) Industries with few or non-binding NTBs for which combined MFN-GSP rates are considered as reflecting the level of protection.

Source: Aghion *et al.* (1992), Table 8.1, p. 178.

safeguards and anti-dumping is consistent with the GATT rules, and whether the existence of these provisions has any effect on trade. In one of the first studies, Winters concluded that while the safeguards and anti-dumping provisions in the Europe Agreements are probably GATT-consistent, their very existence is a threat to exporters.[22] He also points out that the adoption of competition laws by CEECs is clearly not sufficient to protect the CEECs' interests since EU maintains anti-dumping (Winters, 1992, p. 26). By implication, the recently adopted commitment at Essen Council to dismantle the contingent protection is, therefore, questionable.

22 See Winters (1992), pp. 20-21. The insistence and reliance on anti-dumping measures is somewhat surprising since the Agreements include provisions for competition policies, and since the competition policies of at least some of the CEECs probably fully conform to international standards. For example, Winters' view of the legal status of safeguards is consistent with later studies such as Marceau (1995) which find that, for example, the provision for competition policy in the Polish-EU Europe Agreement is consistent with the corresponding provision of the European Union. Hoekman and Mavroidis (1995) have also found that the domestic competition policy in the Czech Republic is on par with the corresponding policy in the EU even though the other CEECs have policies that deviate more or less from the blueprint of the European Union.

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The dangers to the CEE exporters from the provisions of contingent protection are serious, as most economists agree despite some attempts to mitigate the impact of the provisions (Castillo, 1996). In the course of 1990-1995, the European Union notified in GATT (WTO) 24 cases of anti-dumping against the CEECs. These measures mostly affected the Czech Republic and Slovakia which jointly faced twelve of such cases (three cases during the period of former Czechoslovakia, five cases against the Czech Republic and four cases against Slovakia after the split between 1993 and 1995), nine cases against Poland and three cases against Hungary. The actions affected mainly chemical and allied industries (9) and iron and steel (10). Other affected sectors were wood and paper (1), minerals (3), and other metals (1). Full information about the potential economic impact is not available nor are we aware of any other independent study to asses the implications. However, many of these cases affected imports which had an extremely small share in domestic consumption in the "injured" party's country. In five cases, the share of the relevant imports was less than 5 per cent, in two cases the share was 5 to 10 per cent and only in 3 cases was the share more than 10 per cent. The corresponding shares in the remaining 14 cases are not known.

The resolution of the problem was also interesting. In six cases, the actions have resulted in the imposition of duties, in two cases the protection was provided in the form of a tariff quota. In six cases, the relevant exporting firm had to take an appropriate measure. In two cases no injury was established, and the complaints were withdrawn. The remaining eight cases are still unresolved.

Rules of Origin

A major problem of free trade agreements (FTA) is usually the provision for rules of origin (e.g. Kruger, 1993). These rules protect member countries of the FTA against competition from third countries due to uneven rates of external tariff levied on imports from the third countries by individual member countries. The Europe Agreements are no exception in this respect since they provide strict conditions on rules of origin. The local content of products for exports within the boundaries of the EU and the CEECs has been set at 60 per cent. This "performance" requirement is quite clearly distortionary since it discourages the CEECs to seek cheaper, i.e. non-EU or non-CEECs sources of supply. The impact of this trade restriction may vary depending on the share of the non-EU country in total trade of the CEECs and/or the EU in question and on the commodity composition of trade, but the provisions concerning the rules of origin, or the "local content" as they are alternatively called, always lead to a pro-

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tection of domestic producers. It is, therefore, clear that these provisions not only distort trade but also adversely affect welfare in the countries concerned.[23]

Asymmetry of Trade Concessions

Another factor that has been quoted in the literature as a possible barrier to future trade is an asymmetry of concessions granted in the Agreements. Successful agreements should provide for a symmetry of concessions in order to make the agreements viable. Asymmetry of concessions or a perception of an involuntary asymmetry will jeopardise the willingness to fully endorse the agreement by the party that sees itself disadvantaged by it. The more asymmetrical the concessions, the less likely will it be to maintain normal trade relations and to enforce the provisions of the agreement. The reason is that asymmetrical trade concessions may provoke nationalistic sentiments, and these are often highly protectionist. The perception of asymmetry is also likely to increase the pressures of lobbies to increase the protection of their interests. In the Europe Agreements, the "balance" of interests was based on the principle of asymmetry in that the trade concessions granted by the EU were to be provided on more generous terms than the concessions offered in exchange by the CEECs.

In practice, the asymmetrical concessions by the EU did not work out as foreseen. The unilateral trade liberalisation adopted by the CEECs prior to the conclusion of the Agreements had resulted in the reduction of trade barriers to such an extent that at leastsome countries in the region could hardly benefit from the declared asymmetry (Aghion *et al.*, 1992). Given the timing, the speed and the scope of liberalisation, it is self-evident that the CEECs had used up their bargaining positions before the negotiations. Nevertheless, the European Commission has tried hard to preserve its face and to show that the concessions provided by the EU in the Agreements were indeed higher than those offered by the CEECs. For example, according to one of the recent European Commission reports on agriculture,[24] the CEECs liberalised their agricultural imports from the EU relatively less in comparison to the concessions offered to them by the EU. However, as Inotai points out, this asymmetry evolved contrary to the expectations of the CEECs. "The asymmetry in agriculture often meant

23 The point has been strongly made by Inotai (1995, p. 128) who also tries to estimate the values of various subcontracting deals that are affected by the regulation.

24 The European Union has commissioned three studies on the agricultural sector in the CEECs to examine its adjustment needs and the adjustment implications for the agricultural sector in the EU. The study referred to here is Tracy (1994).

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that imports by the associated countries reached the 'sensitivity threshold' earlier than the Community expected, which triggered a halt to tariff reductions. Also, different levels of agricultural subsidisation created an inverse asymmetry in favour of the Community." (Inotai, 1994, p. 160) Inotai is also very critical of the aggressive subcontracting by the EU clothing industry in the CEECs made possible by preferential "rules of origin" as already noted above. Furthermore, he asserts that the EU erected a "highly sophisticated wall of non-tariff trade protection".

Supply Constraints in the CEECs and the Role of the Europe Agreements

Brief Account of Supply Constraints

Trade between the CEECs and the EU has also been constrained by a number of impediments which have nothing to do with trade policy but originate on the supply side (Cekota, 1995). While most economists agree that supply constraints exist on both sides, it is clear that they are more serious in the CEECs.[25] At the same time, it is unclear how serious these constraints are since the empirical evidence is relatively limited. We have, for example, some indications of the presence of supply constraints from the inability of the CEECs to fully utilise their export quotas (e.g. Nagarajan, 1994). However, these and other similar indicators are imprecise and may be even misleading.[26] for the sake of clarity, let me therefore start with a brief account of supply constraints which are of relevance in analysing the role of the Europe Agreements.

Supply impediments include infrastructural and institutional constraints as well as constraints originating in various areas of macroeconomic and structural polices. The problems of *physical infrastructure* are numerous and wide-ranging, and they are relatively well-known. They include such prob-

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25 In the EU, institutional reforms, for example, are quoted as a serious candidate for the most urgent changes. The problems are well known, and they concern the budgetary rules and the voting procedures. The budgetary rules will have to be modified in order to avoid an explosion in the EU structural and agricultural budget. The estimates of costs are discussed in more detail in Part IV below. For more discussions, see also Baldwin et al. (1996). Similarly, most observers agree that the voting procedures will also have to be changed in order to improve the effectiveness of the decision-making process within the EU.

26 For example, some of the quotas have been allocated to countries even if the countries had no or only a limited production capacity to fill them. In addition, some EU quotas were substantially increased, especially to allow for a rapid growth of outward processing trade. Low quota utilisation may also reflect inefficiencies in the administration of quotas. High transaction costs and lack of competition have been also used as arguments to explain low quota utilisation.

lems as poorly integrated transport systemsand energy networks, different and problematic environmental standards or inadequate border crossings, a poor system and quality of telecommunication services and many others.

With regard to *institutional constraints*, most observers usually identify two areas for reforms. The first area involves the need to adjust the legal provisions in each country in order to ensure consistency with corresponding legal provisions of the EU. The task ahead is truly daunting. It implies that the approximation of national laws in the CEECs to the laws of the EU must be based on the *acquis communautaire*[27] According to van Brabant, quoting a study of Reinicke, the CEECs will have to change about 10,000 laws and regulations in order to ensure legal consistency. In addition, the institutions for law enforcement will have to be established or strengthened.

Apart from legal and administrative constraints, there are other important institutional barriers to the integration of the CEECs into the EU. The most frequently quoted impediments include weak financial sectors, and poor functioning of labour markets (e.g. van Brabant, 1996, p. 16). The problems of the *financial sector* in these countries are both problems of weak banking and non-banking institutions and deficiencies in the regulatory framework (Griffith-Jones and Drábek, 1996). The poor functioning of *labour markets* is related to a number of factors. In particular, wage settlements in some countries have been subject to incomes policy. Labour mobility has been severely constrained by considerable housing shortages, housing subsidies and rent controls, uneven distribution of economic activities in different regions and government policies towards unemployment (Svejnar *et al.*, 1995).

Finally, the integration into the EU may be also affected by *macroeconomic instability* in the CEECs.[28] A stable macroeconomic situation is extremely important for regional integration. Unstable macroeconomic conditions create unstable trade policy and may even threaten the country's international trade commitments. In spite of the considerable progress made by CEECs, it is evident that none of these countries has been able to achieve full macroeconomic stability. Symptoms of instability

27 The legal and regulatory framework of the European Union.

28 The discussion of macroeconomic instability is relevant for one specific aspect of regional integration – monetary integration. While the discussion of this aspect may seem premature at this stage, it is not entirely out of place. The EU seems to be moving with a determination towards its own full monetary integration with a single currency. It is, therefore, only appropriate to ask what kind of a European Union the CEECs will be attempting to join when they actually sit down with the EU to negotiate their accession. In addition, there are some politicians in the CEECs region who argue that their countries are ready to join the "single currency" arrangement. In discussing these issues I am sure that the reader does not need to be reminded that impediments to monetary integration also exist on the EU side. These are well known as they are widely discussed at the present time.

are present in every country of the region.[29] External balances in these countries are either weak, as reflected in large current account deficits, low international reserves, and slow growth of exports (Hungary, Poland, Slovakia and Bulgaria), and/or vulnerable due to potentially destabilising capital inflows (Czech Republic). Inflation has been running in every country at much higher rates than in the EU and unless significantly reduced within the transition period, it will either necessitate further tightening of macroeconomic policies, and thus risk an even greater unemployment, or it will increase the gap between the inflation rates of the CEECs and those of the EU countries and thus impair their ability to achieve full monetary integration. Income differentials are also rising extremely fast partly due to thesharp fall of output in the aftermath of the political changes and partly as a legacy of communism.[30] For Brada (1992), macroeconomic instability remains perhaps the most serious constraint on any regional effort in the region. These concerns are also echoed in CEPR (1992).

The Role of the Europe Agreements

Many observers believe that the Europe Agreements have played a positive role in easing the supply constraints on integration of the CEECs into the EU identified above. This has been done either directly or indirectly. The direct effect came from the relevant provisions of the Agreements. Other forms of assistance came as initiatives that have been separate from the actual Agreements or even came as an "after-thought". An example of these initiatives has been the support of the IMF-sponsored stabilisation programmes in the CEECs. These programmes were not a part of the actual Europe Agreements, but it was widely understood that there could be no associate membership or full membership of the CEECs unless the countries eliminated the inflationary pressures in their economies, for which they needed the IMF support and the support of Western governments. An example of "targeted" assistance was the assistance to the CEECs for specific projects such as those in infrastructure, even though no concrete steps were agreed in the original Agreements. The Agreements identify various areas for *infrastructural support*. These are (A) Transport, (B) Energy, (C) Border Crossing, (D) Road networks, (E) Nuclear safety, (F) Environment, (G) Social policy, (I) Science and technology.[31] Other infrastructural pro-

29 See, for example, Daianu (1994) on Romania; Maroudas and Rizopoulos (1995) on Bulgaria; and Drábek (1996b) on the remaining CEECs.

30 These issues are discussed in greater detail in Drábek (1996) and van Brabant (1996) who examine the relationship between macroeconomic stability and the stability of trade policy.

31 See the proposal made by the Corfu Council of June 1994 on Pre-accession strategy for CEECs (cf. van Brabant, 1996, p. 6).

grammes that have been identified and targeted for possible assistance from the EU to the CEECs are the establishment of export insurance and guarantee systems and credit facilities for exporters.[32]

Financial Assistance. The articles of the Agreements provide for direct assistance of the EU to the CEECs in three broad areas. One type of support is technical assistance which is provided in the form of fully-funded technical expertise and as financial grants for technical assistance. As noted above, outside the Agreement but strongly in the spirit of the cooperation with these countries was the provision by the EU of major balance of payments support to accompany the IMF-sponsored stabilisation programmes. Between 1990 and 1994, the equivalent of approximately ECU74.7 billion in total assistance was committed by G-24 to the twelve Central and East European countries – Albania, Bulgaria, Czech Republic, Estonia, Hungary, the former Yugoslav Republic of Macedonia, Poland, Romania, Slovakia and Slovenia. The largest part of this assistance was balance of payments support, but it also included assistance to sectors such as transport, energy, environment, investment promotion and democratic institution building.[33] Within the G-24 process, the European Union and its member states accounted for 45 per cent of total assistance over this period, with the total contribution amounting to ECU33.8 billion. Further details of G-24 assistance are provided in the following Table 7. The massive financial support for balance of payments purposes is nowadays fully recognised in the literature and among policymakers as having played a crucial role in the initial transition phase of the CEECs (e.g. Drábek, 1995 and Schönfeld *et al.*, 1995).

The other important form of financial assistance was PHARE. Together with loans provided by the European Investment Bank, PHARE was one of the two sources of finance explicitly mentioned in the Europe Agreements. Its main objective was to finance technical assistance to the CEECs and help achieve the objectives of the Europe Agreement. In other words, the financial support provided in the form of technical assistance was specifically covered in the Agreements in contrast to the above-mentioned forms of financial assistance for macroeconomic stabilisation and for specific projects. In its first five years, the total commitments to these countries under the PHARE umbrella amounted to ECU4.248 billion

32 Ibid., p. 17.

33 The figure comes from Verrue (1995). Unfortunately, the author does not disaggregate the figures between the general balance of payments support and other forms of assistance. Partial indicators of BOP assistance can be found in Dixon et al. (1995).

(Table 8). Despite many difficulties that have surrounded various stages of the "project cycle", there is no doubt that the funding of PHARE has been large, and that the PHARE programme itself has been the largest programme of technical assistance to these countries.[34]

Table 7 G-24 Assistance by Recipient Country, 1990-94 (excluding assistance to the former Yugoslavia and multi-recipient programmes)

	Total Assistance (ECU million)	of which grants (ECU million)	Share of grants in total assistance (%)
Albania	1,346.73	847.86	63
Bulgaria	3,440.77	655.15	19
Czechoslovakia (1990-92)	5,992.56	496.31	8
Czech Republic (1993+)	2,398.44	223.89	9
Slovak Republic (1993+)	1,030.55	146.56	14
Estonia	711.57	277.25	39
Hungary	11,709.34	904.54	8
Latvia	799.37	198.50	25
Lithuania	1,049.44	302.97	29
Poland	27,473.36[1]	11,246.53	41
Romania	6,749.91	1,023.38	15
Slovenia	668.91	81.59	12

[1] of which ECU 8.3 billion in debt reduction.

Source: Verrue (1995), p. A2.

Table 8 PHARE Commitments by Partner Country, 1990-94
(millions of ECU)

Country	Commitments	Country	Commitments
Albania	244.00	Lithuania	84.00
Bulgaria	393.50	Poland	1,011.55
Ex-Czechoslovakia (1990-92)	233.00	Romania	541.72
Czech Republic	120.00	Slovenia	44.00
Slovak Republic	80.00	ex-GDR	35.00
Estonia	44.50	ex-Yugoslavia	141.12
Hungary	490.80	Regional programmes	475.14
Latvia	62.50	Other programmes	247.64
		Total	4,248.47

Source: Verrue (1995), p.164.

34 Foreign assistance to the CEECs has been reviewed at length in a number of studies, such as IEWS (1995). The assistance has been seen with mixed views. Some people have been very critical such as Inotai (1994), but their criticism is in my view exaggerated. See, for example, Portes' response to Inotai (1994) who puts the criticism in a good perspective.

Non-Financial Assistance. The Europe Agreements also include non-financial assistance to help the CEECs in developing and standardising their statistical reporting systems, customs declarations, and for an exchange of customs officers. Assistance should be provided in other areas as well such as industrial cooperation, investment promotion and protection, cooperation in science and technology, education and training, energy, nuclear safety, transport, regional development and social cooperation. This form of assistance usually calls for technical assistance, and specific projects are already under way.

Relaxation of Restrictions on Labour Mobility. The labour market arrangements provided for under the Agreements are very modest and, as far the CEECs are concerned, they represent a highly disappointing step towards integration of labour markets. The CEECs expected great concessions and assistance from the EU to enable them to take advantage of their cheap labour, but labour issues turned out to be politically highly sensitive. The Agreements make only marginal concessions to liberalise these important markets, and no fundamental change was foreseen for the whole duration of the transition period. As expected, the reason for this cautious approach was the fear of mass migration from the CEECs to the EU and of its impact on employment in the latter countries (Winters, 1992, and Layard *et al.*, 1992). The limited liberalisation measures that have been adopted refer to the movement of highly skilled labour, mostly executive-type, middle-management personnel and workers with specialised skills. In addition, several EU member countries have agreed to negotiate bilateral agreements with individual CEECs on the movement of labour, but, again, with a relatively small impact.

The Sub-Regional Arrangement: CEFTA

The re-establishment of sub-regional cooperation in Central and Eastern Europe was a slow and painful process. Following the unhappy experience of the CEECs with the Council for Mutual Economic Assistance (CMEA),[35] the countries were only too happy to dismantle their agreement, and they were in no mood to replace it with another. For logical and economically rational reasons, however, they had to change their negative posture, and eventually agreed to establish the new sub-regional trading arrangement Central European Free Trade Agreement (CEFTA). As noted above, the agreement was signed on 21 December 1992 between the Czech

35 For a detailed account of the CMEA demise see, for example, Lavigne (1992).

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Republic, Slovakia, Hungary and Poland. Since then, CEFTA has been joined by Slovenia (1 January 1996). Bulgaria and Romania have also expressed their interest to join. Czech Premier Klaus has set as conditions for all prospective applicants that they have concluded their EU associated agreements, are members of the WTO and have concluded free trade agreements with each CEFTA member.[36]

The main objective of the original CEFTA was to create a free trade zone by the year 2001 at the latest. The original agreement was soon found to be highly unsatisfactory due to a limited coverage of concessions and slow speed of liberalisation. The document was, therefore, supplemented with additional agreements resulting in further reduction in the tariffs for industrial products and the expansion of customs concessions in the exchange of farm and food products. The Supplementary Protocol No. 2 shortened by one year the schedule of the gradual reduction or elimination of duties on industrial products – except the so-called "sensitive" products – while The Supplementary Agreement of the Central European Free Trade Agreement provided for an opening of CEFTA to other countries. The Agreement on the Admission of Slovenia and Supplementary Protocol No. 3 provided for the accession of Slovenia and for the expansion of concessions on farm and food products, starting from 1 January 1996, respectively. All these agreements were signed in the course of 1995.

A peculiarity of CEFTA is that the countries negotiated separate bilateral protocols concerning the speed and the coverage of concessions. While the Agreement calls for a complete elimination of trade barriers in industrial products by the year 2001, the countries negotiated separate protocols for the transition periods. The protocols were negotiated between former Czechoslovakia and Hungary, between Czechoslovakia and Poland and between Poland and Hungary. After the split of Czechoslovakia, the relevant Czechoslovak agreements became agreements with the Czech Republic and Slovakia.

Rationale for CEFTA

There were several powerful arguments why the CEECs should consider sub-regional integration, but there were also several strong arguments against such integration.[37] The establishment of CEFTA was based on several considerations. Since the CEECs are bound by a close geographical

36 As reported in Financial Times, 12 September 1995.

37 See Inotai and Sass (1994) and also Richter and Tóth (1994). Several of their arguments are reproduced here, others I have found more dubious and vague and they are not considered.

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proximity, some, albeit probably small amount of their trade can be viewed as "natural". In other words, there are "natural" incentives for these countries to trade with each other, and trade policies which obstruct the operations of these "natural" forces are distortionary. The importance of letting the "natural" (market) forces to operate freely has become even more acute after the conclusion of the Europe Agreements, because the Agreements have created conditions in which CEFTA countries discriminated against each other due to the rapid liberalisation of trade between the CEECs and the EU. Another argument in favour of the establishment of CEFTA is that these countries have similar cultural and historical experiences, thereby creating a basis for an economic and possibly also political and cultural unity. The experience obviously also includes their communist past and the transformation of their countries into market economies.[38] The provisions made in the Europe Agreements for rules of origin have also created incentives for the CEECs to work more closely together in order to intensify their sub-contracting work for the EU as discussed above. A strong case could also be made for a closer coordination of policies towards foreign direct investments to avoid heavy fiscal costs of investment incentives. Last but not least, to the extent that EU will treat the countries uniformly, common issues and positions are bound to emerge among the CEECs. Coordination of national approaches may be, therefore, beneficial in order to increase their negotiating power and to increase regional stability. Ironically, the establishment of CEFTA was particularly popular with many EU politicians since, in their view, it demonstrated to the outside world the civic and diplomatic maturity of the CEECs.

Impediments to Closer Integration

Despite the conclusion of CEFTA and the genuine attempts to establish close sub-regional cooperation, the cooperation among the CEECs remains difficult. The impediments to mutual cooperation and integration of the CEECs can be grouped under four separate headings: the shortcomings of the Agreement; the political, sociological and other non-economic factors; the differences in economic structures and conditions; and the implementation of the Agreement.

Main Shortcomings of the Agreement. The scope of the Agreement is very limited – it only covers trade and not even those economic activities

38 See Inotai and Sass (1994). Needless to say, however, one could also argue the opposite: that the countries' negative experience of communism would push them to seek alliances elsewhere.

that are additionally covered by the Europe Agreements. The trade component itself provides for liberalisation of trade but, again, is subject to exceptions including the so-called "sensitive" products and agriculture. The Agreement also includes other exceptions of industrial products that are subject to specific schedules. Within two years of its existence, the Agreement has been under severe strains. Facing balance of payments difficulties, Hungary, Poland andSlovakia imposed additional protective measures (import surcharges) on all imports and these remain in force even at the present time. Paraphrasing some observers from the region, (1) "sensitive" products are in CEFTA even more "sensitive" than in the Europe Agreements, (2) liberalisation of industrial products is slower and (3) very little has been achieved in the Agreement in the area of agriculture. Finally, (4) the coverage of "tradables" is also less comprehensive than in the Europe Agreements. Moreover, the Agreement only covers merchandise and not trade in services.[39]

Non-Economic Impediments. Closer economic ties have been also constrained by various other impediments. Fear of competition, delay of company restructuring, ethnic tensions primarily involving Hungarian minorities in Slovakia and Romania, and the rise of nationalism have all contributed to an atmosphere of suspicion and a lack of trust. No serious attempt has been made to coordinate the countries' institutional reforms even in the most fundamental trade-related areas such as customs evaluation and procedures or the establishment of dispute settlement mechanisms. Moreover, countries' intentions and future strategy towards sub-regional integration remain unclear and often obscure. In countries such as Hungary and Slovakia, the authorities have been preoccupied with the loss of revenues from import duties as a result of trade liberalisation.

Different Economic Structures and Conditions. Another impediment that has often been quoted in the literature is the relative differences in economic conditions in these countries. For example, Brada (1992) argues that different rates of inflation and differences in purchasing power will make the integration among these countries difficult. Similarly, significant differences in inflation could jeopardise integration as countries export their inflation and put strain on their macroeconomic polices. According to Brada and other analysts, close sub-regional integration is not even desirable because it would provide a ready market for poor quality products and would slow down restructuring (Brada, 1992; Sorsa, 1994). A similar posi-

39 For details see Inotai and Sass (1994) and Rudka and Miszei (1994).

tion is also taken by those who argue that the trade regimes of these countries are still fundamentally unstable (Drábek, 1996). As a result, CEFTA-like arrangements would help to "freeze" the highly distorted and inefficient production structures of the CEECs and thus lead to trade diversion.

Implementation Problems. The implementation of CEFTA has run into several problems. In November 1992, Poland imposed import surcharge on all imports except alcoholic beverages, tobacco products, fuel and automobiles at the rate of 5 per cent, which was lowered to 3 per cent in January 1996. Hungary also introduced import surcharges on all products except primary energy carriers and machinery for investment at the rate of 8 per cent in March 1995. In the same year, the Hungarian government took the decision to prohibit imports of used automobiles for four years. In Slovakia, the government imposed import surcharge for a broad range of consumer products and foodstuffs at the rate of 10 per cent, which was later reduced to 7.5 per cent (July 1996). Czech exporters complained about additional non-tariff measures introduced in Slovakia with the effect of discriminating against their exports. Attempts to increase tariffs in Romania have also been reported by the EBRD.

The most serious situation turned out to be in Bulgaria. The first import surcharge was introduced in August 1993, and it affected all products except energy and basic raw materials. The rate was 3 per cent, which was reduced to 2 per cent in 1995 and eliminated in January 1996. However, at about the same time the government introduced tariff quotas on certain commodities (mainly agricultural and some pharmaceutical products). In June, the government re-introduced the import surcharge on all imports except energy products and basic raw materials at the rate of 5 per cent. In the same year it introduced an import tax on automobiles at the rate of 10 per cent.[40]

All these cases represent examples of a highly unstable macroeconomic situation in these countries. As a result, balance of payments have been under severe pressure and so were the countries' trade policies. Under the circumstances, the governments resorted to trade policy in addition to other measures to restrict imports to somewhat relieve the balance of payments pressures. The measures have, of course, also put additional strains on the relations among the CEFTA countries and, to some extent, also on their relations with the EU and other trade partners.

40 The information comes from WTO and from publications of the US Trade Representative.

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IV Quantitative Assessments

Quantitative assessments of the regional and sub-regional arrangements in Central and Eastern Europe have been subject to a variety of problems. In addition to the usual difficulties of measuring trade "creation" and "diversion" and of evaluating the dynamic effects of regional trading arrangements, which are common to all studies of regionalism, an assessment of the regional initiatives in Central and Eastern Europe is subject to specific problems. First, the assessment is still in some sense premature. The Europe Agreements have only been in force for a few years, and their effects may not yet be fully felt. This shortcoming is even more evident in the case of CEFTA, which is more recent. Second, it is difficult to distinguish between the effects of the regional Agreements and those the of various unilateral initiatives of the CEECs described above. Thus, the initial contribution of the Europe Agreements may have been small due to the unilateral liberalisation of the CEECs and due to the relatively favourable trade treatment of the region by the European Union prior to the Agreements coming into force. This would imply that market forces were more powerful than the Europe Agreements. This point has been strongly made by Inotai (1995) and Piazolo (1996). In addition, many of the important trade concessions have been "end-loaded" in the Europe Agreements as noted above, and their impact will, therefore, only be felt later. These specific problems should be kept in mind when reading the following sections. Finally, quantitative assessments can only be useful if the data are good. This, unfortunately, is not the case in the CEECs. The quality of the data is poor, particularly if one wishes to do cross-country comparisons. As we have seen above, the differences among different sources can be substantial. Therefore, the numbers discussed below must be treated with extreme caution and, in certain cases, conclusions must be avoided.

Geographical Trade Reorientation

There is no doubt that one important effect of the Europe Agreements has been to encourage or at least support the geographical reorientation of foreign trade of the CEECs. The immediate impact of the collapse of the CMEA and the liberalisation of trade policy in the CEECs was a radical re-orientation of trade from the Eastern markets to the EU (e.g. Inotai, 1995; Maroudas and Rizopoulos, 1995; Piazolo, 1996; Drábek and Smith, 1995). The liberalisation of trade with the EU had obviously greatly facilitated this tradereorientation. In order to assess the extent of the trade reorientation, we shall again review several sources. These data differ a great deal, as we already observed above when we examined the decline of trade

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Table 9 CEECs – Geographical Distribution of Trade (Total = 100)

	1985	1989	1990	1991	1992	1993	1994	1995
I. Exports								
Bulgaria								
EU	18.9	19.5	34.5	40.4	42.3	43.3	45.5	51.4
CEFTA	23.0	17.4	12.5	7.5	2.6	2.2	2.2	1.8
Rest of the World	58.1	63.1	53.0	52.1	55.1	54.5	52.3	46.8
Of which: FSU	–	–	–	–	–	9.6	11.3	11.6
Czechoslovakia								
EU	28.3	25.7	32.1	40.7	49.5	–	–	–
CEFTA	9.5	12.8	10.6	11.6	8.9	–	–	–
Rest of the World	62.2	61.5	57.3	47.7	41.6	–	–	–
Of which: FSU	33.4	31.3	25.9	19.4	10.6	–	–	–
Czech Republic								
EU	–	–	–	–	–	49.6	50.9	59.5
CEFTA	–	–	–	–	–	23.7	23.6	24.1
Rest of the World	–	–	–	–	–	26.7	25.5	16.4
Of which: FSU	–	–	–	–	–	5.3	5.3	5.0
Slovakia								
EU	–	–	–	–	–	33.8	39.9	44.1
CEFTA	–	–	–	–	–	–	–	46.1
Rest of the World	–	–	–	–	–	–	–	9.8
Of which: FSU	–	–	–	–	–	4.2	4.2	3.8
Hungary								
EU	22.7	24.7	35.4	46.7	49.4	45.8	48.9	62.6
CEFTA	9.5	8.2	5.8	3.9	4.0	5.3	5.2	5.9
Rest of the World	67.8	67.1	58.8	49.4	46.6	48.9	45.9	31.5
Of which: FSU	33.5	25.0	20.2	12.0	13.1	14.0	15.0	10.0
Poland								
EU	28.1	32.1	46.8	55.6	57.9	63.3	62.7	70.1
CEFTA	7.5	7.1	5.1	5.4	5.1	4.8	4.8	5.4
Rest of the World	64.4	60.8	48.1	39.0	37.0	31.9	32.5	24.5
Of which: FSU	24.6	20.8	15.3	11.0	7.1	6.2	7.4	11.4
Romania								
EU	26.2	29.0	31.5	33.7	32.1	39.4	46.0	53.2
CEFTA	8.5	8.4	7.3	5.7	3.7	3.1	4.2	3.1
Rest of the World	65.3	62.6	61.2	60.6	64.2	57.5	49.8	43.7
Of which: FSU	21.4	21.4	25.2	23.0	13.9	9.1	6.6	5.8

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Table 9 (continued)

	1985	1989	1990	1991	1992	1993	1994	1995
II. Imports								
Bulgaria								
EU	39.5	35.0	46.7	48.4	32.5	36.6	41.3	46.0
CEFTA	16.4	13.2	9.7	5.0	3.3	2.3	2.8	2.9
Rest of the World	44.1	51.8	43.6	46.6	64.2	61.1	55.9	51.1
Of which: FSU	–	–	–	–	–	32.6	24.7	26.4
Czechoslovakia								
EU	28.0	28.7	34.3	35.3	46.2	–	–	–
CEFTA	10.8	14.9	17.2	7.3	5.7	–	–	–
Rest of the World	61.2	56.4	48.5	57.4	48.1	–	–	–
Of which: FSU	36.2	33.0	23.0	34.1	26.9	–	–	–
Czech Republic								
EU	–	–	–	–	–	47.4	54.3	65.5
CEFTA	–	–	–	–	–	19.6	17.1	16.0
Rest of the World	–	–	–	–	–	33.0	28.6	18.5
Of which: FSU	–	–	–	–	–	11.1	10.4	11.1
Slovakia								
EU	–	–	–	–	–	28.8	35.1	41.4
CEFTA	–	–	–	–	–	–	–	42.3
Rest of the World	–	–	–	–	–	–	–	16.3
Of which: FSU	–	–	–	–	–	18.6	12.6	12.9
Hungary								
EU	29.7	28.5	36.8	40.4	42.2	40.1	42.8	60.7
CEFTA	9.6	8.4	7.1	5.3	5.8	5.2	4.2	6.3
Rest of the World	60.7	63.1	56.1	54.3	52.0	54.7	53.0	33.0
Of which: FSU	30.0	22.1	19.1	14.3	16.8	20.9	23.1	14.4
Poland								
EU	24.2	33.8	42.5	49.9	50.7	57.3	57.5	65.4
CEFTA	8.1	7.3	4.5	4.2	4.1	3.6	4.3	5.6
Rest of the World	67.7	58.9	53.0	45.9	45.2	39.1	38.2	29.0
Of which: FSU	29.8	18.1	19.8	14.1	10.0	8.3	8.3	9.6
Romania								
EU	11.4	5.7	19.7	27.1	37.5	22.3	35.2	49.7
CEFTA	11.6	11.8	9.9	5.1	5.4	3.8	4.0	5.2
Rest of the World	77.0	82.5	70.4	67.8	57.1	73.9	60.8	45.1
Of which: FSU	22.4	31.5	23.6	17.0	14.5	21.8	17.9	18.3

Note: European Union consists of the current 15 member states throughout the period. FSU stands for former Soviet Union.
Source: Based on Direction of Trade Statistics (IMF) and national statistics.

since the end of the 1980s. The data are summarised in Appendix Table 1 and Table 9 above.

We have already seen in Part Two that trade recovery has been slow in the CEECs, and this has been particularly the case of the sub-regional trade which only began to recover in 1994-1995. The overall trade recovery depended, therefore, a great deal on the revival of trade with the European Union. This trade component expanded dramatically in all CEECs though at a different speed. As a result, the trade shares of the EU also increased very strongly (see also Table 9 above and Crane and Sagers, 1995, Tables 1-5).

Nevertheless, there have also been negative effects of the Europe Agreements. We have identified the main impediments in Part Three above, and here we shall only report the findings of three empirical studies – two by the same authors – that analyse the impact of these impediments on trade flows in some of the "sensitive" sectors. The first study is Wang and Winters (1993), who argue that the import measures employed by the EU in the footwear industry have been extremely restrictive. Perhaps even more important is that they find both the CEECs and the EU would gain significantly even in the absence of any preferential arrangement. Exports of footwear to the EU would continue even if the EU trade measures in the footwear market were fully liberalised on the MFN principle. Both authors reached the same conclusions when they separately studied the impact of quantitative restrictions in the EU against the CEECs exports of steel and iron. Inotai (1994) argues that the attractiveness of the Europe Agreements "was exhausted" by the end of 1992, by which time the growth of the CEECs exports had virtually stopped. However, his argument has been overtaken by events as the export performance of the CEECs considerably improved in late 1994 and 1995.

The Impact on Extra-Regional Trade

The interpretation of findings in the literature about the impact of regionalism on *intra*-regional trade may be relatively easier in comparison to the interpretation of empirical studies of the impact of regionalism on *extra*-regional trade. As Bhagwati (1995) has pointed out, the interpretation of figures on extra-regional trade is subject to serious analytical difficulties and can hardly be used in an unambiguous fashion for this purpose. Second, the data problems are particularly serious in the case of extra-regional trade flows. The following findings must, therefore, be treated as tentative.

Referring again to Table 9, we can see that the share of the "Rest of the World" declined in all CEECs. The speed and the extent of the fall differs from country to country, but the picture is generally consistent across the

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board and for exports and imports. Perhaps the only exceptions are Bulgaria (both exports and imports) and Romania (exports). By far the most important factor in this decline has been the dramatic fall of the former Soviet Union, which was the dominant trade partner of these countries. However, the bulk of this trade was economically inefficient, so the collapse of this kind of trade was highly desirable. Furthermore, the collapse of trade with the former Soviet Union was partially due to the collapse of export supply in the former Soviet Union, and cannot, therefore, be attributed to the effects of trade policy in the CEECs.

The Effects of CEFTA

Quantitative assessments of the impact of CEFTA on the member countries' trade are rare. The experience is still too short to draw any meaningful conclusions. The data in Table 9 and Appendix Table 1 show that CEFTA trade dropped to a bare minimum after 1990, that the fall has continued until recently, and that the recovery is still modest. The small weight of CEFTA trade is consistent with the historical patterns prevailing in the inter-war period when trade between these countries was also very small, with exceptions such as the former Czechoslovakia (Drábek, 1985). Nevertheless, some expansion of mutual trade can be expected in the short and medium run. Recent estimates of Richter and Tóth (1996a,b) and those of Guzek *et al.* (1994) show a fairly significant trade recovery within the CEECs for Hungary and Poland, while sub-regional trade has also expanded recently in the Czech Republic and Slovakia. Even though historical evidence from the inter-war period may not be fully relevant in view of considerable distortions in world markets at the time, it is generally believed that geography and the existing factor endowments would suggest that the CEECs would normally trade with Western Europe rather than with each other.[41] Some doubt the political commitment of the CEFTA member countries to promote mutual trade and others emphasise macroeconomic instability as the major impediment to further integration (Margolis, 1994).

"Normalisation" of Commodity Trade

Prior to the collapse of intra-CMEA trade, the *total* trade of the CEECs was dominated by the commodity composition of trade within the region.

41 The same point is made by Sorsa (1994) when she examines the prospects for a closer integration of the Baltic countries.

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The composition was very different from the commodity composition of these countries' trade with developed countries, and, therefore, also from the composition of their trade with the EU (e.g. Drábek and Smith, 1995, p. 12 and Table 10). The reasons for the difference were several, but the usual explanation has traditionally been the lack of competitiveness of manufacturing products in the world markets (Drábek and Olechowski, 1989), the pricing policy in individual CEECs and in the CMEA (Marrese and Vanous, 1983) and the absence of currency convertibility (Lavigne, 1992). One of the effects of these factors was that the share of manufactures was much lower in CEECs' total exports than in CEECs' exports to the other CEECs and to the former Soviet Union. In contrast, the CEECs tended to export to the West "excessive" quantities of energy – and other natural resources – and labour intensive products.

Table 10 Poland – Similarity Indices: Comparisons of Commodity Composition of Trade, 1989-1990

Poland	Similarity indices	
	CMEA-EU	CMEA-DC
Exports		
1989	43.6	46.3
1990	44.4	44.8
Imports		
1989	52.7	56.3
1990	49.1	50.5

Note: CMEA stands for Council for Mutual Economic Assistance, EU for the European Union and DC for Developed Countries.
Source: Drábek and Smith (1995).

The opening of trade with the EU together with the collapse of the intra-CMEA trade have dramatically changed the countries' commodity trade structures. For example, the share of machinery, equipment and means of transport in total exports declined from 60 per cent in 1990 to 29 per cent in 1991 in Bulgaria, from 52 per cent to 28 per cent in Czechoslovakia, from 18 per cent to 12 per cent in Hungary, and from 29 per cent to 22 per cent in Poland. More aggregate and rigorous comparisons of commodity structures of trade using "similarity tests" give the same conclusions that the commodity structure of trade of the CEECs has substantially changed if one compares the pre- and post-1989/90 periods. The changes have led to the elimination of "trading excesses" and to trade "normalisation". These changes are consistent with predictions of many economists who have argued that the bulk of the manufacturing industry in these countries is highly inefficient and will have difficulties to compete in world markets (e.g. McKinnon, 1991). The empirical evidence of these trends has been collected in various country studies in all CEECs – for example, Dobrinsky (1994) for Bulgaria, Jackson and Biesbrouck (1994) for Romania, and the European Commission (1994) for other countries.

Trade Creation or Trade Diversion?

The changes in the geographical composition of trade and in the commodity structure noted above have been brought about by five broad factors. Three of these factors were already noted above, and they included the impact of the elimination of special trading arrangements within the CMEA. In particular, the elimination of the highly arbitrary price policies and the clearing payments system has discouraged exports of high-value added manufacturing products and natural resource-based commodities into the former CMEA markets.[42] The other two factors, also noted above, were (a) poor competitiveness of the CEECs manufactured exports and (b) the absence of currency convertibility prior to 1990.

The change in commodity structure was induced by two additional factors. The first factor was the sharp decline in domestic output, which itself led to further changes in the commodity structure of trade due to different speed in the domestic inter-sectoral adjustment. The relative impact of these forces is now well understood in the literature (e.g. Holzman *et al.*, 1995). The second factor has been the continued presence of trade restrictions in the EU (and other countries) in "sensitive" markets. As pointed out by Inotai (1995), the so-called "sensitive" products did not play the role of an export engine in the CEECs as expected.

Gravity Models

The most important issue is the extent to which the new regional arrangements have been conducive to a more rational pattern of trade

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42 The original policies were what was known as the policy of "subsidisation" of Eastern Europe by the former Soviet Union. This has been treated in a large number of articles and was the subject of a well-known public discussion. See, for example, Marrese and Vanous (1983).

43 In the literature in general, the trade diversion and trade creation have been typically measured with the help of "gravity" models. However, the use of these models has run into a number of difficulties which have been discussed at length, for example, by Baldwin (1994) and Bayoumi and Eichengreen (1995).

reflected in a more efficient allocation of resources. Here the empirical evidence is provided from four sources. Following the traditional approach, a number of analysts applied the "gravity model" despite the somewhat controversial nature of this technique.[43] The results of the gravity model-based studies have been already reported earlier in this overview. It may suffice to remind the reader that all of the studies have shown a considerable degree of "undertrading" with the countries of the EU, a substantial potential for expansion between the CEECs and the EU and a somewhat smaller one in the case of sub-regional trade among the CEECs. The only matter of dispute today might only be the degree of the "undertrading".

Comparative Advantages

A second group of studies has looked at the extent to which the regional arrangements have stimulated growth of trade and specialisation according to the countries' comparative advantages. A serious effort has been made by a number of researchers to identify the pattern of comparative advantages in the CEECs and, by juxtaposing them against the pattern of concessions agreed in the Europe Agreements and in CEFTA, one may draw some conclusions about the nature of the concessions.

It appears, however, that there are no easy answers. According to Neven (1994), for example, the CEECs have a comparative advantage in industries that use capital and *unskilled labour* relatively intensively. In contrast, Hamilton and Winters (1994) argue that the CEECs have a high proportion of labour with secondary education – an important condition for tilting the structure of the labour force and the comparative advantage towards skilled labour. A different argument was presented in a review of the relevant literature by Halpern (1995). Discussing papers by Gács, Rosati and Landesmann, he concludes that the empirical evidence provided by these studies points to natural resources and unskilled labour as the factor determining the comparative advantage of all CEECs, including the resource-poor countries such as the Czech Republic.[44] Echoing the view of Hamilton and Winters, several writers suggested that the region is already more than challenging the industrial West in markets requiring *skilled labour*.[45] McKinnon (1991) is more pessimistic when he argues, "the cascading system of implicit tariffs in socialist economies raised the level of

44 The explanation for this apparent paradox is that the Czech Republic imported relatively cheaply natural resource-based products which were subsequently processed into higher-value added commodities.

45 Similar arguments have been put forward even for the least industrial countries of the region such as Bulgaria. See Novicki (1994).

effective protection in finished goods to the point where most manufacturing exhibits negative (or very low) value added at world market prices." A detailed study by Hughes and Hare (1991) reached a similar conclusion when the authors identified a number of specific sectors in greater detail.[46] Even though this view is neither shared ad *extremis* by the rest of the profession nor fully backed up by empirical evidence (Havlik, 1995), the signs are clearly present that the CEECs will face major difficulties in finding markets for their manufacturing exports. This can be seen from the sharp decline in the share of machinery and equipment in total exports of these countries, especially in the Czech Republic, as noted above.[47]

The evidence obtained from studies of adjustment costs in the EU leads to rather different and more clear conclusions. The literature looks at the degree of similarity between both parts of Europe and demonstrates that there are sufficient differences between the EU and the CEECs (e.g. Faini and Portes, 1995).[48] This would suggest a high degree of mutual complementarity between both parts of Europe. For the bulk of the commodities, therefore, the conclusion will probably be that the Europe Agreements have been conducive to trade based on differences in factor endowments. This, in turn, would suggest that the total trade of the CEECs reflects the current comparative advantages of these countries better than in the past and leads, therefore, to a better resource allocation in the CEECs. This conclusion seems also to be shared by economists from the European Commission who found that the CEECs' exports "are clearly concentrated in highly protected sectors of the EU" (Bucher *et al.*, 1994, p. 89).

In sum, there is only indirect evidence in the studies of comparative advantages to suggest that the Europe Agreements have been unequivocally conducive to a "better" trade, one that leads to a more rational allocation of resources in that it is consistent with the existing factor endowments. The basic problem of most of the studies is their methodology and the fact that both technological conditions and capacity utilisation may dif-

46 The study has been heavily criticised in a number of studies such as Holmes *et al.* (1993). The shortcomings notwithstanding, the Hughes and Hare study does show at least that the cost structure differs widely in the countries under consideration.

47 According to a recent report by Bohata (1996), who draws on the data base of the Czech Ministry of Foreign Affairs, exports of machinery in 1994 were 30 per cent below the level of 1988 in US dollar terms. The comparison was made for the Czech Republic only. The share of this commodity group in total exports declined from 40.1 per cent in 1989 to 27.1 per cent in 1994. These findings are, however, contradicted by the performance of manufactured exports from Hungary, as pointed out by Inotai and as reported above. It seems, therefore, necessary to make a distinction between machinery and equipment on the one hand and manufactured products as a whole on the other.

48 See also the discussion of unemployment effects below.

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fer among countries and over time too significantly to allow precise measurements. Moreover, as Holmes *et al.* (1993) pointed out, the presence of X-inefficiencies makes a rigorous analysis extremely difficult since their bias cannot be ascertained *a priori.* Furthermore, the techniques of ascertaining "comparative advantages" – whether they were based on "domestic resource costs" or "revealed comparative advantages" or similar methods – have intrinsic deficiencies which become particularly apparent when applied to transition countries. These economies are rapidly changing as reflected in changes in production methods, technology and product mix – and the quality of data in these countries is often dubious. All this, in turn, makes it difficult to resolve even the basic controversies about the impact of the Europe Agreements, such as those concerning evaluations of "sensitive" sectors.

Intra-Industry Trade

The third group of studies includes studies of intra-industry trade. The Europe Agreements have opened up not only inter-industry trade, i.e. trade based on differences in factor endowments, but also intra-industry trade which is driven by other forces such as scale economies or differences in taste. Even though the evidence is scarce, there are reasons to believe that these opportunities are already well understood and exploited by firms in the EU and the CEECs. The evidence can be found in studies of *subcontracting* which has been taking place on a large scale, especially by German, Italian, Austrian and French companies (e.g. Graziani, 1994, p. 470). Further evidence comes from sector-specific studies such as Faini and Portes (1995), who find a great deal of intra-industry activities in trade between Greece and Spain, on the one hand, and the CEECs, on the other. Neven (1995) has found that the EU now has at least as much intra-industry trade with the CEECs as it has with Northern Europe. Their findings are consistent with those of Cado and de Melo (1996) who find little penetration from the CEECs, especially in the "sensitive" industries, but they also find a fairly high level of intra-industry trade,using the case of France. Moreover, Drábek and Smith (1995) show that the role of intra-industry trade between the EU and the CEECs has been increasing (Table11).[49] A similar conclusion has been reached by Graziani (1994) and in the country studies by the European Commission (1994). In sum, intra-industry trade is beginning to play a significant role in trade between the EU and the CEECs, and the role has substantially increased over time.

49 Compare also with Drábek and Greenaway (1984).

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Table 11 CEECs – Intra-industry Trade with the EU, 1988-1993

	1988	1989	1990	1991	1992	1993
Poland	0.38	0.42	0.39	0.40	0.42	0.45
Czechoslovakia	0.46	0.46	0.47	0.50	0.53	0.59
Hungary	0.48	0.49	0.50	0.52	0.52	0.55
Singapore	0.38	0.38	0.40	0.41	0.39	0.36
South Korea	0.27	0.28	0.30	0.29	0.34	0.34
Taiwan	0.32	0.35	0.38	0.38	0.37	0.37

Source: Drábek and Smith (1995).

Trade Distortions?

Even though positive, "trade-creating" effects can be clearly discerned from the pattern of trade between the EU and the CEECs, contrary evidence has also been shown in the literature. One area of "perverse" effects of the Europe Agreements on the EU-CEECs trade has been the impact of the Common Agricultural Policy (CAP) in the EU. The CAP, which has allowed the build-up of substantial agricultural surpluses in the EU, has encouraged the growth of agricultural exports from the EU to the CEECs. Most writers on this subject argue that these exports not only damage the agricultural sectors in the CEECs but also contribute to the existing distortions in the allocation of resources in the EU. In brief, these trade flows are examples of "trade diversion".[50] There is clearly no doubt that the trade liberalisation in the CEECs combined with the agricultural policy in the EU has permitted a rapid expansion of agricultural exports from the EU to the CEECs. In 1992, for example, EU agricultural exports accounted for 50 per cent of total Polish imports of agricultural and food products. The corresponding numbers were 44 per cent in Czechoslovakia, 34 per cent in Hungary, 42 per cent in Romania and 40 per cent in Bulgaria.

It is not clear, however, whether the expansion of agricultural imports was due to the agricultural subsidies in the EU or to domestic factors in the CEECs. Some writers, such as Inotai, have complained that subsidised exports of agricultural products from the EU have been primarily responsible for the emergence of a deficit in CEECs in their agricultural trade with the EU (Inotai, 1995, p. 127). But the point is disputed by Tangermann and Josling (1994) who argue that "export subsidisation has

50 This position is taken even in studies prepared for the European Commission by a number of external advisers such as Tangermann and Josling (1994) and Buckwell *et al.* (1994).

probably had less influence on rising CEECs agricultural and food imports than is sometimes assumed". They argue that the depression of the agricultural sector in these countries was caused by bad policies in these countries rather than cheap imports.

There are other examples of trade distortions. The evidence comes from studies of effects of import restrictions in other "sensitive" sectors such as footwear (e.g. Wang and Winters, 1992). However, these distortions would point to trade distortions arising from other arrangements such as the Multi-Fibre Agreement or from special bilateral arrangements concerning "sensitive" products such as footwear rather than to the distorting effects of the Europe Agreements *per se.* Unfortunately, the Europe Agreements did not undo these restrictive arrangements. It is not yet clear how serious these examples oftrade distortions are. My rough guess is that the magnitude of losses due to the distortions attributable to the Europe Agreement may be important at the margin but probably not on the aggregate level.

Effects of the EU Enlargement on Economic Welfare

Even though there has been much talk about "who gains from the Europe Agreements and who does not", there is, once again, very little hard evidence. Typically, one should distinguish between two kinds of welfare effects of regionalism – allocative effects and the effect on capital accumulation and economic growth. The empirical literature – as limited as it is – typically focuses on the latter by estimating the budgetary costs of integration and the overall adjustment costs for the countries concerned following the signing of a regional agreement.

Limited Economic Gains for the West

The prevailing view among observers is that economic gains for the EU will be relatively small in the short run and limited in the medium run while the costs may be high. The basis for this assertion is the relatively small role of the CEECs in the economies of the EU. To make their argument, the sceptics usually point to the small share of the CEECs in total trade of the EU. In 1994, for example, the share of the CEECs in total imports of the EU was only 2.2 per cent and 2.6 per cent in the case of total exports (Schumacher and Weise, 1996). Moreover, the low levels of GDP per capita in the CEECs as well as the low combined level of GDP relative to that of the EU will also limit the dynamic effects in the short and medium run. All this would suggest that the current economic gains from integration must be relatively small, and that even the prospects for

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the gains to become really significant in the short or medium run are rather remote.[51] At the same time, the critics also point out that the costs of integrating the CEECs into the EU will be large partly because of heavy budgetary implications and partly due to the adverse impact of industrial relocation from the EU to the CEECs as a result of cheap labour in the latter. We shall now look at these arguments in some detail.

The prevailing view has recently received empirical support from Baldwin, Francois and Portes (1996) who quantify the net economic gains to the EU. Using a calibrated general equilibrium model of global trade, they estimate the long-run economic benefits of the CEECs enlargement under two scenarios – a conservative and a more optimistic one. They find that the income effects will add to growth of GDP in the EU by only 0.2 per cent per annum. Moreover, it makes no difference whether they make optimistic or pessimistic assumptions about the model structure – the impact on GDP growth is virtually insignificant. Somewhat more significant are their estimates of the impact on growth of exports of the EU. The enlargement will add more to the EU's growth rate of exports – about 1.5 per cent, which is not negligible but hardly dramatic.

Employment Effects of the Europe Agreements. Cheap labour in the CEECscould make a large number of EU firms relocate into the CEECs, and this could lead to a loss of jobs in the EU. High wage costs and taxation combined with overblown payments for social benefits and rigid labour markets have been quoted as the most powerful force for Western companies to relocate into the CEECs (Schultz, 1996). While the relocation is making the companies more competitive in world markets, it has raised fears in the EU about the adverse impact of these changes. In this respect, the Europe Agreements might play an important role at the margin since the market penetration in a number of specific activities has been very large (Havlik, 1995, p.151). Moreover, the provisions in the Europe Agreements for some, albeit limited labour mobility has added to these fears. How important these effects are has been the subject of a number of studies.

These studies reach the fairly uniform conclusion that the competitive threats of the CEECs have been greatly exaggerated. A pioneering CEPR

51 In contrast, political gains could be very large indeed for the EU. These are not, however, considered in this review. The reader may wish to consult, for example, Bofinger (1995) for details. It must be said, however, that a minority of observers, for example, Inotai, suggest that economic gains of the EU have already been large, pointing at large trade surpluses with the CEECs as evidence of such gains. However, without going into detail, trade surpluses can hardly be considered the appropriate indicators in such a case.

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study of 1992 argued that the fears of the CEECs competition can be discounted provided that the market access in the EU improved for the CEECs, and credible promises of full membership for CEECs have been given to these countries. A number of subsequent studies have also found that the employment costs of the Europe Agreements for the EU member countries will be relatively small. The main reason is that the CEECs and the EU member countries tend to be dissimilar, as noted above. This dissimilarity has further increased in recent years even in those countries in which economic structures where probably more similar to those of the CEECs in the past (Faini and Portes, 1995). The most controversial and sensitive areas include industries such as steel, coal mining, textiles, footwear and clothing – the so-called "sensitive" industries. But even for these industries, the evidence suggests that the adjustment costs resulting from East European competition are likely to be relatively minor. Thus, Cadot and de Melo (1995) analysed the impact on French industries, Dimelis and Gatsios (1995) on Greek industries, and Gual and Martin (1995) and Martin (1995) on Spanish industries. Relatively minor adjustment costs can be expected in specific sectors such as steel (Winters, 1995) and textiles (Corrado, 1995).

The EU countries have protected their labour markets by means of restrictive labour migration policies. The logic of these restrictions was to limit the outward migration from the CEECs to the EU. The costs and benefits of these policies for the EU are difficult to ascertain since the issue has hardly been studied. Although the existing large wage differences have stimulated some outward migration from the CEECs to the EU countries, two studies indicate that the negative impact on Western employment is greatly exaggerated (Layard *et al.*, 1992 and Winters, 1992).

Budgetary Costs of Integration. We have seen that the possibility of financial assistance has remained by and large outside the actual Europe Agreements. It became evident early during the negotiations that the EU's ability to help the CEECs to provide financial resources other than for technical assistance was very limited for *budgetary reasons* in the EU itself (Brada, 1992 and CEPR, 1992). As a result, the Agreements have not enabled the CEECs to access regional and structural funds of the EU even though the access to these funds has been regarded by many observers as crucial to the whole process of regional integration (Baldwin, 1992).

At present, there is a debate in academic and political circles about the importance of these budgetary constraints. These discussions are translated into discussions of costs of enlargement. The estimates of budgetary costs of full membership vary a great deal. The crux of the problem and the basis for the differences in the estimated costs of full membership lie main-

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ly in the assessment of the so-called cohesion costs, the countries' contributions and the costs of agricultural adjustment. The latter, in turn, reflects differentassumptions about the Common Agricultural Policy (CAP) and about the capacity in the CEECs to absorb foreign funds. Assuming no change in the CAP and no constraints on the capacity of the CEECs, the costs of enlargement would indeed be enormous. For example, Baldwin (1994) estimated the costs to be about 64 billion ECU. The CAP alone would result under "no-change" policy in 47 billion ECU. In contrast, Buckwell *et al.* (1994) have estimated that the costs would be considerably lower – 22 to 37 billion ECU, even though their estimates only cover the costs of enlargement under the present CAP. According to another estimate, the overall costs of enlargement would not exceed 20 to 25 billion ECU which most experts consider an acceptable burden for the existing member countries (Schumacher and Weise, 1996). A more recent estimate by Inotai puts the figure of enlargement costs even lower – at between 12 billion and 20 billion ECU.[52] Most writers and many politicians argue that the CAP will have to be significantly changed in order to reduce the level of protection for Western agriculture and decrease the large budgetary support.

Several writers have made useful summaries of the literature on the budgetary costs of the EU enlargement (e.g. Baldwin, 1996) and there is no need to repeat it in this paper. It may suffice to say that all the recent reviews of budgetary estimates and the estimates themselves confirm that the budgetary implications of the enlargement are likely to be significantly smaller than was previously believed. Baldwin (1996) himself has re-estimated the budgetary costs for the EU and found that "only" 17 billion ECU would be needed in year 2000 – a much lower figure than what he estimated a few years earlier. The differences lie primarily in the availability of better data, the assumptions about the agricultural productivity in the CEECs, about the future course of the CAP, about the absorptive capacity of the CEECs and the growth of the EU economies.

Significant Economic Gains for the CEECs

In contrast to rather small economic gains for the EU, economic gains for the CEECs from the Europe Agreements and from full EU membership could be very large indeed. These gains would result from improved allocative efficiency as well as from faster economic growth. Even though the associate or full membership will imply adjustment costs in the

52 As reported in the Wall Street Journal Europe, 23 July 1996.

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CEECs, the overwhelming majority of observers believe that the economic benefits will significantly exceed the economic costs. Most of the arguments are presented by Brown *et al.* (1995), who also review some of the empirical studies.

Effects on Growth. Notwithstanding the recent general findings of de Melo and Panagariya (1992) that membership in integration schemes has no effect on economic growth, there seems to be a general agreement among experts that the Europe Agreements have had a positive impact on economic growth in the CEECs.[53] The Agreements have clearly contributed to economic recovery in the CEECs after the collapse of the CMEA. Exports to the EU have been growing, and, for some of the CEECs, they have represented the only growing component of aggregate demand during the time of recession. In most of these countries, exports to the EU have been growing even faster than domestic output. In the future, with full membership of the EU, such exports will continue to make an important contribution to GDP growth in the CEECs. In a recent study, Baldwin, Francois and Portes (1996) have estimated the net benefits in terms of the contribution of trade to GDP growth that will result from the accession to the EU. In their conservative scenario, they estimate that the accession will add 15per cent to the GDP of the CEECs. In their more optimistic scenario, in which they allow for additional growth of capital investment as a result of the enlargement, they estimate that the corresponding contribution will be almost 19 per cent.

The Contribution of CEFTA. While recovering relatively fast, mutual trade of CEFTA countries remains small. This reflects the absence of not only strong market forces but also government policies to discriminate in favour of CEFTA trade. Given the relatively small size of their mutual trade and of other economic relations, the current contribution of CEFTA to welfare of member countries is small, and in the medium run the net economic gains are likely to remain modest. The gains are much smaller than the economic gains from their trade with the EU, as Brown *et al.* (1995) have pointed out. Similar conclusions are reached by Guzek *et al.* (1994). Using an input-output model Guzek and his collaborators simulated the impact of CEFTA on price changes in Poland. In addition, they calculated the impact of CEFTA on government revenues. Their conclusion

53 The following discussion obviously covers only that part of the literature that has addressed the relevant problems of the CEECs. Nevertheless, similar conclusions have also been reached by analysts looking at the impact of regional arrangements in the CIS region. See Michalopoulos and Tarr (1996).

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is that the total losses due to reduction in government revenues and to the reduction of incomes in affected industries are roughly equal to total gains. Once they allow for further dynamic effects of growth, they find that net gains would be positive but still relatively small.

Similarly, Bakos, quoted in Rudka and Miszei (1994), argues that former Czechoslovakia, Hungary and Poland have always been attracted to the West, and that their trade with other CEECs could never reach levels of real significance. Rudka and Miszei (1994) themselves take a similar view – which is strongly supported by empirical evidence of historical trade flows (Drábek 1985). In brief, the history makes these arguments quite convincing since none of the CEECs have ever traded intensively with one another, with perhaps the Czech Republic and Slovakia as the only exception.

Effects of the Europe Agreements on Foreign Direct Investment and Capital Flows

The Europe Agreements have had an impact not only on trade but also on other economic activities. Among the latter, the most important activity has arguably been foreign investment, representing an important step towards integrating the capital markets of the countries concerned. Here again, researchers face a general problem of distinguishing between the impact of the Europe Agreements and the unilateral liberalisations which the CEECs adopted in the early 1990s.[54] What matters, however, is that the Europe Agreements have provided the necessary set of measures to protect foreign direct investment in the CEECs, thus creating an "international" protection for foreign firms in the CEECs.[55] This has been well recognised in the literature, even by those observers who have been otherwise more critical of the Agreements (e.g. Winters, 1992, p. 23).

With these reservations in mind, there seems to be no doubt that the EuropeAgreements have actually played a highly positive role in encouraging foreign direct investment (FDI) in the CEECs. Starting from virtually zero, the total cumulative investment in the CEECs region is currently high, especially if compared to the late 1980s and to many developing countries. According to EBRD's *Transition Report*, the total cumulative

54 By the time the Europe Agreements were negotiated, the CEECs had already liberalised foreign exchange transactions and had provided for a range of guarantees to foreign investors.

55 The protection was, in fact, provided not only for foreign direct investors but also for portfolio investors. The Europe Agreements do not make a distinction between these two types of investors.

FDI amounted for the period 1989-1994 to (in millions of dollars) 6,913 in Hungary, 2,981 in the Czech Republic, 1,523 in Poland and 1,600 in Slovakia (EBRD, 1995, p. 87). In per capita terms, Hungary is already a country with one of the highest levels of FDI in the world. FDI in the Czech Republic and Poland accelerated in 1995 after additional measures taken to attract foreign capital.[56] By far the greatest share in total FDI has been held by firms from the EU, mainly Germany, Austria and France (see Drábek, 1996b). The combined contribution of the EU to the stock of foreign direct investment was about 60 per cent in 1994 in the case of Poland, and almost 67 per cent in the case of Hungary. In 1995, the corresponding shares in the case of Slovakia and the Czech Republic were 48 per cent and more than 70 per cent respectively.[57] Romania and, in particular, Bulgaria have so far received modest amounts of FDI because other factors have clearly discouraged foreign investors.

The size of markets is normally an important determinant of foreign investment. Many companies have, therefore, invested in the CEECs with the view of establishing a "hub" for the rest of the area. The successful implementation of CEFTA will create a market of 65 million consumers. *Pari passu*, many writers and, of course, individual investors still consider the markets of individual countries to be too small to warrant FDI in each of the markets individually. Thus the slow progress of integrating the economies of the CEECs has undoubtedly been a disincentive for foreign investors (Rudka and Miszei, 1994). Several analysts have even argued that the lack of closer integration of the CEECs has encouraged highly speculative and short-term foreign investors rather than investors with long-term horizons (Maroudas and Rizopoulos, 1995).[58]

V Conclusions

The *first conclusion* that can be drawn from the literature is that trade, investment and other economic relations between the EU and the CEECs have been driven by market forces. The unilateral liberalisation of the CEECs has provided a strong impetus to trade re-orientation from the

56 These measures mainly included several privatisation deals in the Czech Republic and the conclusion of Paris and London Club Agreements with foreign creditors in the case of Poland.

57 The figures come from Drábek (1996b). The Czech figure includes only four EU countries – Germany, Austria, France and Belgium. The figure is greatly affected by the extraordinary high share of Germany – 48.4 per cent.

58 This sentiment was also strongly echoed at the seminar at which this paper was presented. The position was taken particularly strongly by Joan Pearce.

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"Eastern" markets to the markets of Central Europe and mainly to Western Europe and to other developed countries. Some of this re-orientation began to materialise before the conclusion of the Europe Agreements, which suggests that both trade and foreign investment have been positively stimulated by existing market conditions. The presence of these forces has been well documented in a number of empirical studies based on "gravity" models which show a large scope for trade expansion between the CEECs and the EU. In addition, the Agreements have provided a strong impetus towards the integration of capital markets. While the process has not yet been concluded, the growth of FDI and, most recently, of portfolio investment has already beenimpressive in some CEECs.

The *second conclusion* refers to the actual Europe Agreements. By general accounts and on three out of the four criteria mentioned in the introduction, the Europe Agreements have been so far very useful. Both parties to the Agreements have a broad range of common interests which is the basis for an effective completion of the integration process. The EU countries have a strong political interest to absorb the CEECs as members and an economic interest, that will perhaps only be realised in the long run. The CEECs have an immediate economic interest in addition to strong political expediency. The regional agreements became more practical and effective than multilateral initiatives even though the latter were approached by the CEECs simultaneously. The question of speed was crucial for these countries to provide legitimacy for new governments, policies and, indeed, even for new states. The Agreements have provided a legal "umbrella" for economic cooperation in that they "locked-in" the existing concessions by the EU to the CEECs and provided some new, additional concessions. The Agreements have been, therefore, useful in improving the market access for the CEECs and thus in stimulating mutual trade and foreign investment. In addition, the Agreements go beyond free trade agreements in that they have been an important instruments of deepening the integration of the CEECs into the EU. They have opened up room for foreign assistance – both financial and technical – and for the establishment of economic institutions in the CEECs. As a result, the Agreements have played a positive role in helping the CEECs shift their trade from the "Eastern" markets after the collapse of the CMEA, in helping to absorb the shock of the collapse of Eastern markets, and in helping to reduce the adjustment costs of transition. In contrast, the economic gains of the EU are relatively small. Their trade exposure to the CEECs is small at present, and is unlikely to dramatically increase in the medium run. At the same time, economic costs could become relatively high, especially if one considers the impact of investment relocated from the EU to the CEECs without an

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appropriate adjustment mechanisms in the EU, and if one assumes that the present budgetary policies of the EU remain unchanged.

The *third conclusion* concerns the future of the relationships between the EU and the CEECs, on the one hand, and among the CEECs, on the other. The former is crucial for the CEECs in view of their economic dependence on the EU, which is unlikely to be reduced in the future. Unfortunately, the future of the EU-CEECs relationship looks less promising today than before. The main reason is that the Agreements have not been entirely successful in eliminating all of the trade restrictions against the CEECs exports. Thus the Agreements do not pass with "flying colours" on our fourth criterion –to create incentives for the elimination of trade diversion. The presence of restrictions on the so-called "sensitive" products is a primary example of the problems at hand. This could prove to be particularly painful in the next few years when the CEECs will have to expand their exports beyond their existing market shares.

The *fourth conclusion* concerns the CEECs trade and economic relations with Russia and other CIS countries and with other CEECs. The question is often asked among experts, policymakers and the general public: How much integration or cooperation with Russia is possible or indeed rational? The answer that can be obtained from the literature is: not much. There are several reasons why this is the case. (1) External tariffs in Russia are much higher and non-uniform than in the CEECs. Unless Russia is prepared to reduce its tariffs, the CEECs cannot increase their exports to Russia. (2) Russia is even more unstable than the CEECs, hence closer links would destabilise the CEECs. (3) There are good reasons to believe that trade with Russia would lead to a great deal of trade diversion. Russia is a vast market. However, even with low tariffs it would not bedesirable to export to Russia on a preferential basis since the market is less competitive than that of the EU. (4) Unresolved problems of Russian debt to the Czech Republic and some other CEECs make it very difficult to bring these countries closer together. (5) Various payment restrictions exist in Russia, and it has not yet established a credible payment system (Drábek, 1992).

A similar question has been raised with regard to the prospects of mutual trade of the CEECs. Is CEFTA a good instrument to expand the mutual trade of the CEECs? Would such an expansion be desirable? The answer is no. Most writers believe that mutual trade of CEFTA countries would lead more to trade diversion than to trade creation. While this is probably an exaggerated view, the potential for future trade expansion is slim for economic reasons. Moreover, there is widespread agreement that CEFTA alone will not be sufficient to increase the level of cooperation of these countries significantly; other measures will be required in order to expand their mutual trade. However, CEFTA can play an extremely important role in helping the individual CEEC to strengthen their negotiation power.

The *fifth conclusion* is that neither the Europe Agreements nor CEFTA are instruments of protection against third countries. As free trade agreements, these regional and sub-regional arrangements do not coordinate the external tariff (and trade policy in general) towards third countries. Moreover, with the exception of Bulgaria, until recently the CEECs have been members of the WTO and could not, therefore, change their external tariffs unilaterally. The trade regimes have been liberalised in all of the CEECs unilaterally, and the agreements have provided an additional impetus for liberalisation; in the case of the Europe Agreements, they have provided a legal framework for other trade and investment-supporting measures. Indeed, both the Europe Agreements and CEFTA exceed the scope of liberalisation measures negotiated by these countries in international agreements so far. However, the implementation of the measures has been less than satisfactory. As we have shown above, several of the CEFTA countries have introduced a number of new protective measures indicating some policy slippage.

While the Europe Agreements and CEFTA represent a major change in the conduct of trade policy in the CEECs, both agreements also raise new questions. Unfortunately, there are still no definite answers to many of these questions. One such unresolved question concerns the *speed of integration* between the CEECs and the EU. At present, the question is not "whether" but when. For reasons discussed above, most writers agree, and the empirical literature presented in this review supports it, that the integration of the CEECs into the EU will be economically beneficial and rational. Most writers probably also agree that full integration (and membership) of the CEECs into the EU will take time and that the negotiations of accession will be much longer than was originally assumed. How long the process will last depends on the depth and nature of the problems perceived. The economic problems alone are substantial, and they could lead to long delays and difficult negotiations. As Baldwin has pointed out, "as a matter of self-defence, coalitions of farmers and poor regions are likely to veto the eastern enlargement until CEECs get much richer and the CAP is reformed" (Baldwin, 1994). But the issues are broader and include considerations of a political nature. For example, how long will it take the CEECs to adopt the EU environmental standards or to carry out full institutional reforms?

The other unresolved issue is the question of the *depth of integration*. So far, the integration with the EU has mainly taken the form of a free trade area with some additional measures in other areas. Nevertheless, the question is currently asked in the EU whether the EU should be deepened or

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widened or both at the same time. The answer to this question will obviously have serious implications for the CEECs which will have to make the necessary policy and institutional adjustments. The deeper the integration the bigger the adjustments that will be required. The question of which countries would or should be integrated first and which later also remains unresolved. If some countries are left behind, how should they be treated by the EU and the other CEECs? The more general unresolved question is that the full integration of any CEEC into the EU still remains a bit of a mystery. Nobody knows for certain what the EU will look like at the time of the accession. The CEECs themselves have not yet shown much interest in addressing this question and have stuck to their general statement that they want to become full members irrespective of the type of EU they will be facing.

Appendix

Appendix Table 1 CEECs Imports and Exports, 1988-1991

		Imports					Exports				
		Percentage change (%)				Indices (1988=100)	Percentage change (%)				Indices (1988=100)
		1988	1989	1990	1991	1991	1988	1989	1990	1991	1991
Bulgaria											
Crane/PlanEcon	*World*	*10.5*	*0.3*	*-14.5*	*-71.1*	*24.8*	*5.0*	*-9.9*	*-15.4*	*-50.1*	*38.1*
	CPEs	5.0	2.5	-10.0	-77.5	20.8	6.3	-7.9	-21.7	-52.8	34.0
	DMEs	4.2	0.6	-25.6	-55.4	33.3	2.9	17.2	-10.8	-31.9	71.3
Rosati/ECE	*World*	*3.4*	*-9.9*	*-23.7*	*-51.5*	*33.3*	*9.1*	*-12.0*	*-21.3*	*-34.2*	*45.6*
	CPEs	-5.4	-16.7	-23.8	-43.1	36.1	6.5	-10.6	-32.0	-27.8	43.9
	DMEs	4.4	0.6	-25.9	-59.8	29.9	3.3	17.2	-11.1	-36.3	66.4
	DEVs	81.3	-8.7	-19.0	54.4	114.2	-3.5	-35.8	9.7	-47.6	36.9
IMF	*World*	*9.9*	*-10.6*	*-32.8*	*-19.7*	*48.2*	*8.1*	*-5.7*	*-25.4*	*1.2*	*71.2*
	CPEs	9.3	-15.4	-67.5	-34.2	18.1	9.4	-10.9	-55.6	-30.0	27.7
	DMEs	1.9	1.1	-21.5	-15.5	67.0	-6.6	9.1	25.2	14.6	156.5
World Bank	*Total*	*0.2*	*-12.6*	*-28.3*	*-49.0*	*32.0*	*-0.1*	*-14.0*	*-27.5*	*-31.9*	*42.5*
	CPEs	-10.9	-19.7	-30.7	–	49.6[b]	0.2	-13.8	-37.4	–	54.1[b]
	DMEs	4.5	0.7	-26.8	–	77.0[b]	4.0	16.6	-12.4	–	106.1[b]
	Others	81.2	-8.6	-22.7	–	128.0[b]	-3.5	-35.7	4.5	–	64.8[b]
Czechoslovakia											
Crane/PlanEcon	*World*	*3.7*	*8.2*	*9.0*	*-39.9*	*70.9*	*2.9*	*1.0*	*-6.0*	*-12.2*	*83.4*
	CPEs	6.2	12.0	3.5	-61.6	44.5	-0.9	-3.7	-15.9	-35.9	51.9
	DMEs	9.8	-1.6	27.5	-2.8	122.0	13.6	10.8	12.8	15.4	144.3
Rosati/ECE	*World*	*5.8*	*-2.4*	*0.3*	*-7.2*	*90.9*	*9.2*	*-3.2*	*-10.5*	*5.6*	*91.5*
	CPEs	1.5	-6.9	-17.1	0.3	77.4	5.9	-11.7	-27.4	6.8	68.5
	DMEs	9.8	-1.6	24.6	-13.7	105.8	13.6	10.9	13.4	6.9	134.5
	DEVs	–	17.0	-12.0	4.4	107.5	-2.5	0.1	-10.9	-6.0	83.8
Rodrik	*World*	–	–	*-7.0*	*-23.6a*	*71.1c*	–	–	*-17.0*	*-13.3a*	*72.9c*
	CPEs	–	–	-7.3	-70.6[a]	27.3[c]	–	–	-18.9	-76.4[a]	19.1[c]
	DMEs	–	–	20.5	-24.9[a]	90.5[c]	–	–	7.9	-1.2[a]	106.6[c]
IMF	*World*	*-1.9*	*-2.9*	*-3.0*	*-25.3*	*70.5*	*0.4*	*-3.6*	*-17.4*	*-6.5*	*74.4*
	CPEs	-4.4	-3.9	-19.4	-31.3	53.2	2.8	-10.5	-31.5	-20.1	48.9
	DMEs	2.2	-3.7	21.6	-26.6	86.0	2.5	3.5	3.2	7.6	115.0
World Bank	*Total*	*-0.1*	*-6.0*	*-5.7*	*-12.3*	*77.7*	*3.0*	*-6.5*	*-15.9*	*-5.0*	*74.7*
	CPEs	-4.4	-10.3	-23.6	–	65.5[b]	-0.3	-14.8	-33.1	–	56.8[b]
	DMEs	9.8	-1.6	28.1	–	138.5[b]	13.6	10.9	13.4	–	142.8[b]
	Others	0.0	17.0	-12.0	–	103.0[b]	-2.5	0.2	-10.9	–	87.0[b]
EU	*World*	–	–	–	*44.9*	–	–	–	–	*22.7*	–
	EU	–	9.8	9.3	46.4	175.7	–	15.7	5.1	51.0	183.6
Hungary											
Crane/PlanEcon	*World*	*8.9*	*1.7*	*2.7*	*-10.9*	*93.1*	*10.8*	*0.4*	*0.7*	*-7.3*	*93.7*
	CPEs	12.1	-1.4	-3.0	-62.6	35.8	5.5	-4.6	-14.3	-52.2	39.1
	DMEs	1.4	10.5	5.0	64.7	191.1	20.3	8.9	22.4	33.6	178.1
Rosati/ECE	*World*	*-4.9*	*-5.4*	*-2.7*	*30.2*	*119.8*	*4.3*	*-3.3*	*-1.3*	*5.1*	*100.4*
	CPEs	0.2	-14.4	-19.1	2.8	71.2	7.9	-9.5	-21.4	-26.8	52.0
	DMEs	0.4	7.7	3.8	44.3	161.3	14.9	5.6	20.6	21.4	154.7
	DEVs	7.5	-22.0	60.9	29.0	161.9	11.8	-6.8	-0.2	21.8	113.3
Rodrik	*World*	–	–	*-0.1*	*34.3a*	*134.2a*	–	–	*0.8*	*0.4a*	*101.2c*
	CPEs	–	–	-9.8	-51.0[a]	44.2[a]	–	–	-17.3	-74.4[a]	21.2[c]
	DMEs	–	–	14.6	38.4[a]	158.6[c]	–	–	19.3	11.3[a]	132.8[c]
IMF	*World*	*-5.1*	*-4.9*	*-2.9*	*24.3*	*114.7*	*4.1*	*-2.7*	*-0.8*	*4.0*	*100.3*
	CPEs	-10.0	-14.2	-34.6	-8.2	51.5	-4.9	-10.9	-28.6	-34.1	41.9
	DMEs	-0.6	6.6	19.4	40.9	179.4	16.1	5.7	29.4	33.1	182.0

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Appendix Table 1 (continued)

		Imports					Exports				
		Percentage change (%)				Indices (1988=100)	Percentage change (%)				Indices (1988=100)
		1988	1989	1990	1991	1991	1988	1989	1990	1991	1991
World Bank	*Total*	-2.7	-8.3	-7.6	26.3	107.0	6.7	-6.0	-6.7	1.7	89.2
	CPEs	-5.7	-17.5	-25.4	–	58.0[b]	1.6	-12.7	-27.6	–	64.2[b]
	DMEs	0.4	7.7	3.8	–	112.2[b]	14.9	5.6	20.6	–	146.4[b]
	Others	7.5	-22.1	61.0	–	134.9[b]	11.7	-6.8	-0.2	–	103.9[b]
EU	*World*	–	–	–	27.3	–	–	–	–	8.9	–
	EU	–	26.9	-3.7	21.2	148.1	–	19.9	13.4	23.5	168.0
Poland											
Crane/PlanEcon	*World*	16.8	4.8	-11.5	1.9	94.5	11.2	0.5	17.1	-18.6	95.8
	CPEs	9.4	4.7	-22.8	-59.2	32.9	3.5	-2.3	-7.2	-62.8	33.7
	DMEs	33.3	7.1	11.3	60.9	191.9	21.9	5.3	53.2	13.2	182.7
Rosati/ECE	*World*	12.8	-1.1	-2.5	24.3	119.8	13.3	0.6	24.7	-18.5	102.2
	CPEs	-3.9	-5.7	1.8	-42.8	54.9	3.2	-2.5	14.9	-62.0	42.5
	DMEs	30.1	7.1	-4.7	71.7	175.3	18.5	5.3	40.0	13.7	167.6
	DEVs	12.9	-8.8	-17.1	151.0	189.8	14.0	-3.6	3.2	-15.5	84.1
Rodrik	*World*	–	–	-2.5	64.7[a]	160.6[c]	–	–	11.8	-1.8[a]	109.8[c]
	CPEs	–	–	-25.6	-75.9[a]	17.9[c]	–	–	-0.4	-87.5[a]	12.5[c]
	DMEs	–	–	6.3	73.9[a]	184.9[c]	–	–	40.9	6.7[a]	150.3[c]
IMF	*World*	16.0	-17.9	-21.0	90.4	123.5	11.0	-0.1	0.7	9.5	110.1
	CPEs	20.7	-41.9	-35.0	34.6	50.9	27.2	-23.6	-30.2	-19.9	42.7
	DMEs	40.4	-1.7	-4.1	105.1	193.4	27.4	6.9	36.2	23.9	180.3
World Bank	*Total*	4.1	-9.9	0.0	5.0	94.6	7.6	4.1	8.5	-25.4	84.3
	CPEs	-8.6	-14.1	-4.1	–	75.3[b]	0.3	1.4	-6.1	–	95.5[b]
	DMEs	30.2	-2.5	2.5	–	130.2[b]	19.6	9.4	32.5	–	173.2[b]
	Others	12.9	-16.9	-10.8	–	83.7[b]	15.1	0.1	-2.4	–	112.5[b]
EU	*World*	–	–	–	95.6	–	–	–	–	12.5	–
	EU	–	43.1	11.4	79.2	285.7	–	31.0	18.0	77.7	274.7
Romania											
Crane/PlanEcon	*World*	–	–	–	-41.8	–	–	–	–	-27.3	–
	CPEs	–	–	–	-53.4	–	–	–	–	-35.3	–
	DMEs	-10.6	-8.0	172.5	-28.1	–	6.9	-6.2	-37.8	-25.7	–
Rosati/ECE	*World*	-8.1	8.8	18.1	-17.6	105.9	8.6	-10.0	-43.4	-7.1	47.3
	CPEs	0.3	-2.3	-13.7	-8.9	76.8	9.0	-14.7	-45.5	29.2	60.1
	DMEs	-12.6	1.7	116.7	-9.4	199.7	4.6	-3.9	-38.4	-22.8	45.7
	DEVs	-23.4	29.0	10.1	-32.7	95.6	15.5	-15.2	-51.0	-11.9	36.7
IMF	*World*	-6.3	-2.1	11.7	-45.0	60.1	10.7	-16.6	-43.4	-30.4	32.8
	CPEs	2.3	0.8	-30.3	-60.7	27.7	11.4	-18.4	-48.0	-37.2	26.7
	DMEs	-11.2	-5.9	176.6	-29.8	182.8	6.7	-7.7	-36.6	-28.7	41.7
World Bank	*Total*	-12.6	5.5	11.5	-22.7	91.0	6.1	-11.5	-45.0	-13.7	42.0
	CPEs	-5.6	-5.8	-20.4	–	70.8[b]	2.6	-17.8	-49.8	–	42.4[b]
	DMEs	-12.6	1.7	116.7	–	192.7[b]	4.6	-3.8	-38.4	–	61.9[b]
	Others	-23.4	29.0	10.2	–	108.9[b]	15.5	-15.2	-51.0	–	48.0[b]

Notes: [a] January-September.
[b] 1990.
[c] 1989=100.

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Appendix Table 2 CEECs – Free Trade Agreement Notified in the WTO

	Signed	Notified	Working Party
EC + Bulgaria	1993	23.12.94 L/7617 + Add.1 15.2.95 WT/REG1/1	20.2.95 G/C/M/1
Latvia + EC	1995	WT/REG7/N/1 30.6.95	26.9.95 G/C/M/6
Estonia + EC	1995	WT/REG8/N/1 30.6.95	26.9.95 G/C/M/6
Lithuania + EC	1995	WT/REG9/N/1 30.6.95	26.9.95
EC + Rep. Of Slovenia		WT/REG10/N/1 1.8.95	*
Rep. Of Hungary + Rep. Of Slovenia	1994	WT/REG19/N/1 15.8.95	26.9.95 G/C/M/6
EFTA + Slovenia		WT/REG20/N/1	1.12.95 G/C/M/7
Czech Rep. + Bulgaria			
Slovak Rep. + Bulgaria			
EC – Czech + Slovak + Hungary + Poland	1991	3.4.92 L/6992	30.4.92 C/M/256
EFTA + Romania	1992	3.6.93 L/7215 + Add.1	16.6.93 C/M/264
EFTA + Bulgaria	1993	7.7.93 L/7257 + Add.1	27.10.93 C/M/267
EFTA + Poland	1992	21.1.94 L/7372 + Corr.1 + Add.1	25.1.94 SR.49/1
EFTA + Hungary	1993	21.1.94 L/7360/Rev.1 + Add.1	25.1.94 SR.49/1
Czech + Hungary + Poland + Slovak	1992	30.6.94 L/7498 + Add.1	20.7.94 C/M/274
Czech + Slovenia	1993	4.5.94 L/7447 + Add.1	21.6.94 C/M/273

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Appendix Table 2 (continued)

	Signed	Notified	Working Party
Slovak + Slovenia	1993	4.5.94 L/7448 + Add.1	21.6.94 C/M/273
EC + Romania	1993	23.12.94 L/7618 + Add.1 15.2.95 WT/REG2/1	20.2.95 G/C/M/1

* No Working Party established as the Agreement has been superseded by a "Europe Agreement".

Appendix Table 3 Share of the Bilateral Free Trade Agreements in Total Exports

	FTA Partner country	1994	1995
Bulgaria	Czech Republic	0.40	0.50
	Slovakia	–	–
Czech Republic	Bulgaria	0.36	0.34
	Estonia	0.08	0.10
	Latvia	0.05	–
	Romania	0.36	0.25
	Slovenia	–	–
Estonia	Czech Republic	0.23	0.27
	Slovakia	0.09	0.17
	Slovenia	–	–
Hungary	Slovenia	1.59	1.99
Latvia	Czech Republic	0.30	0.53
	Slovakia	0.10	0.19
Romania	Czech Republic	1.23	0.26
	Slovakia	0.13	0.20
Slovakia	Bulgaria	–	–
	Estonia	–	0.03
	Latvia	0.04	0.07
	Romania	0.59	0.42
	Slovenia	–	–
Slovenia	Czech Rep. and Slovakia	1.66	1.67
	Estonia	–	–
	Hungary	1.45	1.00

Source: Based on Direction of Trade (IMF).

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