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Options in Foreign Economic Relations for Central and Eastern Europe

Following the collapse of the CMEA, the foreign trade of the countries of Central and Eastern Europe declined drastically with dire consequences for output, incomes and employment in these countries. What options do the former CMEA members have for revitalizing their foreign trade? What impediments will have to be surmounted in each case?

In the past, the Central and Eastern European (CEE) countries did not show a very high degree of integration into the world economy. The share of foreign trade in their gross national products was significantly lower than it was in western industrial nations of comparable sizes. Up to 1990, the "Soviet-bloc" countries which were members of the CMEA ("Comecon") conducted most of that foreign trade with one another. More than two-thirds of the goods exported by CMEA members to other CMEA countries were absorbed by the Soviet Union (see Table 1).

The opposition movements of Central and Eastern Europe regarded the CMEA as an integral component of the Communist ruling system, and as such it had to go. Because the reform process in Moscow had not yet attained a position of irreversibility in 1990, Central Europeans had the additional concern of dissociating themselves from the USSR. As many of the reformers tended to be advocates of a liberal market economy, their preference was for as open an economy as possible and for their countries' integration into the world market. This was also regarded as a counter to the persisting power of government enterprises due to the monopolies they held in their respective domestic markets. Unless they were subjected to outside competition, they could readily abuse the release of price controls which would form a vital part of economic reform.

In cases in which opposition movements had national, or nationalistic, motivations – the former Yugoslavia and Soviet Union both provide several examples – their main interests lay in any case in breaking down established structures of integration and cooperation. Thus the CEE countries scaled down cooperative, integrative policies, while at times even aggravating new rifts by taking further protectionist measures.

It was chiefly for political reasons that the Council for Mutual Economic Aid (CMEA) was disbanded following the peaceful revolutions in Central and Eastern Europe. In the 1989-1992 period, there was a drastic decline in the region's trade (see Table 2). The fall in exports between 1989 and 1991, ranging between 40% and 75% depending on the country,[1] was on a scale comparable to the drop in world trade during the Great Depression of 1929-1933. This collapse in trade had a drastic, exacerbating effect on the falls in output, incomes and employment triggered by the reform process itself. The IMF has attributed more than 50% of the loss in output to the collapse in trading relations. D. Rodrik has estimated the cost of that collapse to be US$2.2 billion for Poland, $2 billion for Hungary and $3.4 billion for the former Czechoslovakia, which translates as 7-8% of GNP for Hungary and Czechoslovakia and 3% for Poland.[2]

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[1] Cf. Adalbert Winkler: Aussenhandel, Inflation und Konvertibilität – Ein Beitrag zur Diskussion über eine Osteuropäische Zahlungsunion, Discussion Paper 6/1992, Institut für Wirtschaftsgeschichte und Wirtschaftspolitik, Berlin, 1992.

[2] Cf. Dani Rodrik: Foreign Trade in Eastern Europe's Transition: Early Results, CEPR Discussion Papers No. 676, London, June 1992.

The introduction of world market prices and the switch to payment in convertible currencies brought about a fundamental change in the pattern of costs and earnings from trading and production. Raw material prices increased whereas those of manufactured goods fell. Thus a considerable proportion of manufacturing activity turned out to be value-subtracting, i.e. the end-product was worth less on the market than the total cost of its inputs. The CEE manufacturing countries could no longer afford to barter their finished goods to obtain raw materials, while the same exchanges were unprofitable for the raw material producers in the CIS. The former GDR's trade was additionally hit by the major revaluation of the "Ostmark" implicit in reunified Germany's monetary union.

The negative consequences of the CMEA's collapse mask the fact that the organization had not by any means provided the optimum foreign trading environment for the CEE countries. The demise of the CMEA also meant the end of the political ravaging of the Central European economies, which had often been forced by the Soviet Union into economically absurd specializations. In the old planned-economy system, reciprocal supplies of goods were notoriously unreliable, and this led enterpises to engage in considerable upstream activities to protect their positions. In the industrial sphere, the individual CMEA countries also tended to pursue foreign trade policies verging on autarky. The main types of exchanges in which the CEE countries engaged were to swap capital goods for raw materials from the USSR. Consumer durables constituted less than one fifth of each country's exports.[3] Forms of trade which had acted as a spur to growth in western countries, namely intra-industry trade and trade within multinational companies, did not play any part in the CMEA.

Table 1
Trade among CMEA Countries

Country	CMEA trade in % of total foreign trade	The USSR's share in CMEA exports in %
Bulgaria	75.3	78.5
Romania	(45)	73.9
Hungary	44.5	70.2
Czechoslovakia	74.1	67.5
Poland	70.2	68.5
USSR	61.2	–
German Dem. Rep.	65.7	–

Sources: Trade shares with other CMEA countries (except for Romania's which is the author's estimate) taken from: Harald Zschiedrich: RGW: Ende oder Neubeginn?, in: Osteuropa-Wirtschaft, Vol. 35 (1990), No. 4; export share to USSR from: Peter B. Kenen: Transitional Arrangements for Trade and Payments among the CMEA Countries, IMF Working Paper 90/79.

Table 2
Decline in Exports to the Former CMEA Zone 1989-1992
(in %)

Country	Exports to ex-CMEA	Exports to ex-USSR
Bulgaria	–81.6	–84.0
Romania	–64.9	–62.2
Czechoslovakia	–50.7	–54.8
Poland	+ 1.9	– 7.8
Hungary	–26.2	–14.2
Former USSR	–43.9	–

Source: Handelsblatt, 18th February 1993 (cited in A. Inotai and J. Stankovsky: Transformation in Progress: The External Economic Factor, WIIW Research Reports, No. 200, Vienna 1993, p. 5).

Revitalizing Trade

From 1990-1992, the main focus of the economic policy debate was on the dire consequences of the collapse in trade. While liberal reformers advocated integration into the world market, reformed communists tended to favour returning to a revamped version of the CMEA, and the initial response of conservative nationalists was to see foreign competitors and investors as a threat to the domestic economy. A number of western experts[4] suggested that a payments union should be formed along the lines of the western European payments union of the post-war years. However, the proposal met with criticism even in the West,[5] and can now be considered to have been largely overtaken by events.

Ultimately, all of the participants in the debate do wish to revitalize trade, but the difference between them is that they concentrate upon different bottlenecks and inhibiting factors. The most important of these are:

☐ *Monetary constraints:* Now that payment in transferable roubles has been abandoned, exporters are generally only prepared to accept payment in hard currency. Because of both high and greatly differing inflation rates, and also because of their limited convertibility and the relatively underdeveloped foreign exchange markets, there was little confidence in individual countries' national currencies. At the same time, the system of export credit and insurance was also underdeveloped.

☐ *Protectionism:* The former CMEA countries faced the worst conditions of access to the markets of the OECD.

[3] Cf. Harald Zschiedrich: RGW: Ende oder Neubeginn?, in: Osteuropa-Wirtschaft, Vol. 35 (1990), No. 4, p. 287.

[4] The main proponents have been: Jozef M. van Brabant: A Central European Payments Union: Technical Aspects, Public Policy Paper 3, IEWSS, New York/Prague 1991; Adalbert Winkler, op. cit.

[5] E.g. Peter B. Kenen: Transitional Arrangements for Trade and Payments Among the CMEA Countries, IMF Working Paper 90/79.

This situation eased considerably after the collapse of the planned-economy system. The CEE countries themselves began by making pronounced cuts in their tariff levels. In the meantime, however, a number have begun to raise them again, particularly countries which were formerly part of Yugoslavia or the Soviet Union.

☐ *Lack of demand:* Quite apart from the problems of obtaining convertible currency, there was a general fall in demand in the CEE countries in line with the drop in national incomes. Beyond these aggregate, macroeconomic restraints, the microeconomic slumps in demand have been more serious still, as many products are simply no longer required (e.g. certain armaments) or are unable to match western competition.

☐ *Structural bottlenecks:* Both transport and communications infrastructures are often in poor condition, which interferes with attempts to re-orient the regional pattern of trade flows. Also lacking is a suitable information system, in the form of trade fairs etc., to allow suppliers and customers to learn more of each other's potential or needs.

In addition to their immediate aim of revitalizing trade, the reforming countries have a number of other objectives for their foreign trade policies, some of which depend on the former. Trade revitalization, for example, would have the immediate effect of increasing output, employment and incomes. At the microeconomic level, Central and Eastern Europe expects trade to induce modernisation. However, that modernization can only come from structural change which takes a long time to work through. During the transitional period, there are some sectors in which price stability could be jeopardized by foreign demand. As far as imports are concerned, apart from improving the supply situation, the countries also expect them to provide the competitive spur needed to combat inflation when prices are liberalized, and to introduce a price structure compatible with the world market.

Although the various trade policy proposals and strategies are often not mutually exclusive, they do differ in their emphasis:

☐ Advocates of a Central and Eastern European *payments union* regarded monetary constraints as the chief problem. They were indeed the main cause of the collapse in trade among the former CMEA member states. Because trade among the countries concerned was so slight, a payments union confined to Central Europe would only have required a relatively small amount of foreign exchange in 1990/91. However, apart from political problems the crux was the inclusion of the USSR which would have multiplied the funding requirement by a factor of ten.[6] As far as the Central European countries are concerned, the issue has been sidelined by the switch to partial convertibility undertaken for trading purposes. In the former USSR, though, there remains an urgent need for a mechanism to finance regional trade (see below).

☐ The payments union proposal has frequently coincided with a *strategic preference for regional trade* rather than orientation to the world market. It is felt that traditional suppliers may have better chances if they trade regionally. As far as the exporters' economies are concerned, demand from elsewhere in the region will encounter elastic supply conditions. The fact that major investment is not needed may allow supply to increase without endangering overall stability.[7] Conversely, goods supplied from other countries in the region will exert less competitive and adjustment pressures upon the importing economies, whereas goods from the West may be unmatchable in their superior quality in the short term. The advocates of regional cooperation demand reductions in any tariffs which are higher for imports from elsewhere in the region than for those from western countries. They are also aware of the danger that if imports from the West continue to grow while the CEE countries' own exports to the West stagnate by comparison, the ensuing current account deficits will trigger off a debt crisis which will inevitably act as a brake on growth in Central and Eastern Europe.

☐ Liberal reformers believe that a *world market orientation* holds a great deal of promise by way of just the same developments so much feared by the regionalists, namely: intensified pressure upon local suppliers to adjust to the new situation and an accelerated process of modernization; increased foreign exchange earnings providing the resources to import capital goods; more open markets, and trading partners with markedly different patterns of supply. The CEE countries' integration into the world market vitally depends on the liberalization of trade in general. Though market access has been substantially eased thanks to the various GATT rounds since the 1950s, to association agreements with the EU and to the application of the Generalised System of Preferences, market controls and other special arrangements are still particularly prevalent in a number

[6] Cf. the results obtained from econometric models by Jozef M. van Brabant, op. cit., pp. 42 ff.

[7] This argument is stressed by Adalbert Winkler: Regionale Kooperation in Mittel- und Osteuropa, unpublished paper prepared for a Friedrich Ebert Foundation workshop of the same name, 9th September 1993.

of sensitive sectors such as agriculture, coal and steel, textiles and clothing (the Multi-Fibre Arrangement).

The debate on foreign economic policy is frequently a reflection of general foreign policy and other political conflicts. Any form of relatively close economic cooperation entails some restriction of national sovereignty. If a country has only just managed to shake off its bonds with Moscow, Belgrade or Prague, it will be difficult for it to accept new restraints from outside. And if it does, it is more likely to accept them from Brussels or Washington than from its neighbours. On the other hand, countries in the region are indeed intensifying their economic relations wherever there is also a wish to strengthen political links.

New Approaches to Regional Cooperation

Since 1990, various groups of countries in Central and Eastern Europe have been adopting new approaches to regional cooperation. Two large regions, namely Central Europe with its Visegrad Group and the former Soviet Union with the Commonwealth of Independent States, have declared extensive ambitions, though their future remains uncertain. Other groupings, such as the Black Sea group, the "Hexagonale" Central European Initiative, and the Baltic countries are cooperating regionally on a less ambitious basis.

The Visegrad Group

The Visegrad Group, consisting of Poland, Hungary, the Czech Republic and Slovakia, has developed the most extensive programme of cooperation and integration. In February 1991, they signed a mutual agreement to cooperate more closely, and in December 1992 they set up the Central European Free Trade Area (CEFTA). The background to these agreements was provided by

- cooperation among dissident groups during the period of Communist rule;
- the common approach of going for rapid reform, coupled with the wish to distinguish themselves from the former USSR and the Balkan countries which were reforming more slowly;
- their common aim of gaining membership of the European Union, their associate status with the EU and the gentle pressure that entailed;
- the incentives to trade generated by the non-discriminatory country-of-origin rules for exports to the EU;
- the relative unimportance of raw material exports for the Visegrad signatories.

The free trade agreement initially signed in Krakow in December 1992 has not yet come into force, as Poland's parliament had not ratified it before the general election was held in September 1993. In other respects, too, cooperation among the Visegrad signatories is hampered by a lack of enthusiasm among the member states. The partition of Czechoslovakia encouraged disintegrational tendencies within the group; neither their signing of the association agreement in December 1991 nor their shared desire to join the European Union (hence also the monetary union from 1999 onwards) prevented Czechia and Slovakia from introducing their own currencies and from scaling down their mutual trade. Slovakia even imposed a 20% duty on imports.

Revitalizing regional trade is not among the Visegrad Group's priorities. For one thing, trade with one another had never constituted more than a small proportion of these countries' total foreign trade. For another, all of the signatory countries have now switched to current account convertibility and are not seeking to establish any kind of regional payments union.

Politically, cooperation is hampered by Slovakia's tense relations with Hungary (over the Danube dam and the position of minorities) and with the Czech Republic (apportionment of assets, and migration, trade and monetary issues). Poland, too, introduced an import duty in the spring of 1993. Hungary and the Czech Republic frequently stress their preference for rapid entry to the EU and NATO above any regional arrangements. President Walesa of Poland was given a cool response when he proposed the institutional reinforcement of the Visegrad cooperation on a recent visit to Prague.[8]

Now that Bulgaria and Romania have concluded association agreements with the EU, it would really seem appropriate to admit those countries to CEFTA. However, the Visegrad countries have not so far shown any great inclination to do so, but instead stress the differences which exist in the countries' level of economic development, economic policies and use of protectionist policies.

The growing nationalism in the region means there is little tolerance for even the minor concessions of sovereignty which regional cooperation would call for in the first instance. Privatization has so far led to hardly any break up of the old monopolies. Competition policy considerations would suggest to open up markets to allow in companies from regional rival countries with similar productivity levels. But at such a time of general recession

[8] Cf. Deutsche Welle Monitor Dienst, 26th October 1993, General Section, pp.4 f.

this is a tremendous political hurdle to overcome on the road towards liberalization.

Chaotic Cooperation in the Former USSR

The trade ties within the former Soviet Union had a pattern similar to those of the CMEA, but were considerably more intensive. Indeed, the degree of integration measured in terms of internal trade as a proportion of gross national product was greater than that of the European Community in 1988, at 21% as against 13%.[9] Traditionally, Russia ran an internal trade surplus, along with the Ukraine, Byelorussia and Azerbaijan. Once the CIS was formed, however, Russia was the only country left with a surplus.[10]

It should be noted that, so far, Russia has been generous in funding its CIS trade, i.e. its exports to the newly independent states (NIS). However, this policy has had the effect of pushing up the stock of roubles and heating up inflation. It will have to come to an end as part of the stabilization programme. In July 1992, Russia switched to a bilateral payment system. Observers estimate that the decline in "intra-Soviet" trade between 1990 and 1992 was approximately 50%, part of which was attributable to the overall fall in output (approximately 10% in 1991 and 20% in 1992).[11]

On the one hand, the NIS have been severely hit because of their high dependence on trade (regional trade is approximately 50% of GNP in the new Baltic countries), while on the other they show a fluctuating and mixed interest in engaging in close cooperation with Russia.

The political, economic, trading and monetary interrelationships on the territory of the CIS do not coincide with one another:

- In political terms, the CIS as its successor organization does not in any case take in all the territory of the former USSR. The Baltic states, Georgia, Moldova and Azerbaijan all either did not join in the first place, failed to ratify their accession, or else joined initially and subsequently left the CIS. At a later stage, Azerbaijan and Georgia did join in order to obtain Russian support in the wars they were fighting against Armenia and the Abkhasians respectively.

- In economic terms, supply links continue to exist between all of the countries, though the extent to which they depend on monopoly suppliers is usually overestimated. For although it may well be true that there is one single enterprise devoted exclusively to manufacturing a particular product, that does not mean to say that other enterprises elsewhere may not produce it, perhaps as an intermediate product. Simultaneously, the decline of the armaments industry and conversion to civilian production have meant a reduction in associated supplier relationships and intra-regional trade flows.

- Not all of the CIS member states have also joined the customs union, but in view of the high and widely differing inflation rates prevailing, the new currencies in operation and the relative or even complete lack of administrative capacity, the ensuing customs duties are just one relatively marginal barrier to trade among many.

- Subject to approval by their respective parliaments, the countries initially joining the rouble zone were Armenia, Byelorussia, Kazakhstan, Tajikistan and Uzbekistan. Their decisions can be assumed to have been based largely on political rather than economic considerations. Most of the republics are now in the process of introducing their own currencies (see Table 3), and that gives rise to an additional monetary impediment to trade. Because of difficulties in maintaining a sufficient level of gold backing, Kazakhstan has had to suspend its membership of the rouble zone.

Any trade revitalization would need to begin by tackling the monetary problems. A payments union would suffer from the facts that

- Russia would be the only creditor nation,

- inflation rates are markedly divergent, and

Table 3
New Currencies in the Former USSR

Country	Currency	Year of introduction
Estonia	Krone	1992
Latvia	Latvian Rouble/Lat	1992/1993
Lithuania	Talonas/Litas	1992/1993
Moldova	Lei	1993
Byelorussia	Saichik	1993
Ukraine	Karbovanez	1992
Georgia	Kupons	1993
Azerbaijan	Manat	1993
Kirghizstan	Som	1993
Turkmenistan	Manat	1993
Russia	Recall of the Soviet Rouble	1993

[9] Cf. Gijsbertus van Selm and Hans-Jürgen Wagener: Former Soviet Republics' Economic Interdependence, in: Osteuropa-Wirtschaft, Vol. 38 (1993), No. 1, pp. 28 ff.

[10] In the first half of 1992 alone, the other 14 republics chalked up a combined deficit of 320 billion roubles, then equivalent to US$2.8 billion (figures taken from The Economist, 19th September 1992, p. 92).

[11] Cf. Barry Eichengreen: A payments mechanism for the former Soviet Union: is the EPU a relevant precedent?, in: Economic Policy, 17th October 1993, p. 310.

☐ the credit lines made available would soon be exhausted.

The approaches to cooperation in the former Soviet Union are dominated by domestic and foreign policy considerations. Those countries in which former party officials have maintained control over the government tend to favour cooperation with Russia. The Central Asian countries are endeavouring to cooperate more closely with their Islamic neighbours. The Baltic states have directed their attention towards Scandinavia, and are developing their own free trade area. The Ukraine, Moldova and Russia are all parties to the Black Sea Conference, but this is hardly in any position to develop substantial influence in view of the many conflicts between the countries involved. Although the Black Sea group has been discussing the establishment of a joint development bank,[12] a front of mutual mistrust cross-cuts the group, between the Turko-Islamic countries on the one hand and the traditionally anti-Turkish states on the other (chiefly Bulgaria, Greece and Armenia). Trading and economic relations are thus subordinate to political relations. Russia, for example, uses its supplies of oil and natural gas as a lever for exerting political pressure.

Limited Revitalization Attempts

The heavily reduced trade still occurring between Central Europe and the CIS (chiefly Russia) primarily consists in exchanging manufactured goods for raw materials. Up to a point, both parties still have an interest in upholding this exchange, which is underlined by a number of barter deals.[13] Even today, the former Soviet Union is a major trading partner: in Hungary, for example, it ranks second after Germany both for exports and for imports. Boris Yeltsin's visit to Poland in the summer of 1993 also signified a mutual interest in upholding economic relations. Similarly, the Czech Republic and Russia engaged in economic talks in October 1993.

The main obstacle to intensified trade between the CIS and Central Europe is likely to stem from monetary problems. The CIS republics have very small foreign exchange reserves and hard currency earnings. At the same time, Russia is still a long way from achieving rouble convertibility. Central Europe has no interest in continuing to accumulate claims which are unlikely to be collectable. A private clearing house has been in existence since the end of 1992, with support from the EBRD and nine participating banks from Russia, Hungary, Poland, the Czech Republic and Bulgaria.[14]

A more western-oriented group is the "Hexagonale" Central European Initiative, which set about deepening cooperation in Central Europe in 1989. The original participants were Hungary, Yugoslavia, Austria and Italy, with Czechoslovakia joining in 1990, and Poland in 1991. The disintegration or partition of two of its member countries has weakened the group's cohesion. In addition, 60% of the group's trade is in any case conducted between Italy and Austria.[15] The group has not concentrated any particular effort on trade or financial cooperation, but is more concerned with other collaborative fields such as infrastructure.

World Market Orientation

The CEE countries' expectations are greatest with regard to the European and world markets. For foreign policy reasons in themselves, the West took an accommodating stance towards Central and Eastern Europe. The reforming countries were allowed market access by application of the "most favoured nation" clause and the Generalised System of Preferences, while the COCOM list of export restrictions was also relaxed. The various European agreements concluded all contained major relaxations in trade policy, though they often still left protectionist escape routes open. EFTA, too, entered into free trade agreements with many CEE countries. In practice, of course, Europe often behaves in a protectionist manner, particularly in sensitive sectors such as agriculture, steel, cement etc.

The relative opening of western markets, the devaluation of CEE currencies, low labour costs and the availability of productive capacity all facilitated a

Table 4
Increase in Exports to the West from CEE Countries, 1989-1992

Country	To OECD (%)	To the EC (%)
Czechoslovakia	40.6	62.0
Hungary	56.0	87.0
Poland	55.7	86.1
Bulgaria	58.1	72.4
Romania	–56.5	–47.9
Former USSR	19.0	

Source: As for Table 2.

[12] Cf. Werner Gumpel: The Black Sea Economic Cooperation Zone. Outline of a New Community of States, in: INTERECONOMICS, Vol. 28, No. 4, July/August 1993, pp. 178 ff.

[13] Cf. the list set out in: Wolfgang H. Reinicke: Building a New Europe. The Challenge of System Transformation and Systemic Reform, Brookings Occasional Papers, Washington, D.C. 1992, pp. 58 f.

[14] Cf. Barry Eichengreen, op. cit., p. 344.

[15] Cf. Andreas Inotai: Economic Cooperation and Development in Central Europe, lecture given to the international study meeting on "The reciprocal relations between the 'Hexagonale' and the Alpine-Adriatic region in a changing Europe" in Trieste on 14th January 1992, pp. 3f.

substantial growth in exports to the West between 1989 and 1992 (see Table 4), though the starting level was very low.

Imports from western countries have also increased markedly, but have more or less kept pace with the export side. There are no signs yet of dramatic deficits in western trade, although the EC/EU has recorded a growing export surplus since 1991 (ECU 1.4 billion in 1991, and ECU 2.5 billion in 1992).[16]

The extent to which CEE countries are able to score further successes in exporting to the West will be less dependent on the trade policy assistance they receive than on the exchange rates of their currencies and the pace of modernization in their economies. Competitive producers have, after all, always managed to penetrate into OECD markets.

All countries of Central and Eastern Europe have devalued sharply against western hard currencies. This was a necessary step before they could make the transition to partial convertibility for trading purposes. When viewed in terms of purchasing power, the CEE currencies are heavily undervalued (by approximately 40% in Hungary and Poland's cases, and by as much as 60% in the Czech Republic or Bulgaria).[17] These exchange rate policies have markedly improved price competitiveness. Wages are extremely low when compared internationally, thus acting as a magnet to investors.

Direct investment and a solid economic policy environment ease the process of modernizing (export-oriented) production, with which the CEE countries are only just beginning. Most of them have opened up entry to foreign investors. The countries of Central Europe have been more liberal in their approach to this than the CIS countries. Poland occupies a semi-liberal position somewhere between the two. The number of investment projects increased from 2,500 in 1989 to approximately 60,000 in 1993, but only a fraction of these are actually in operation. The inflow of funds had reached a total of approximately $9 billion by the beginning of 1993, with almost half of that sum going to Hungary alone.[18]

These transfers of capital are roughly in the same order of magnitude as Central Europe's trade deficit with the EU (though the regional distribution is different). In addition, western countries are virtually falling over themselves to provide export credit at least to the creditworthy CEE countries. That allows those of them in Central Europe to fund the imports of capital needed for the modernization process. However, the CEE countries' substantial long-term investment requirements and the need to service old debts mean that they will still have to tap additional exporting and funding opportunities.

The stronger a country's own exports and the greater its reforming efforts, the lower the proportion of its capital requirement will normally be which cannot be met from direct investment and export credit, and which needs to be made up by means of "political" borrowing from the EBRD, IMF, World Bank and other lending institutions. It is interesting to note that Vaclav Klaus, the Czech prime minister, is generally dismissive of these types of loans, whereas Russia is continually calling for more of them.

Problems and Prospects

The upheavals in Central and Eastern Europe have inevitably affected foreign economic relations, and indeed if anything this has been the area where the upheaval has been greatest. Foreign trade will continue to play a key role in the transformation process. The CEE countries urgently need imports, especially from the West, in order to modernize their economies. Conversely, they need exporting opportunities in order to safeguard output levels and incomes, and to finance those imports.

The expansion of trade is inhibited by factors which vary from one region to another. Table 5 endeavours to outline the inhibiting factors in simplified form.

Especially in the CIS, the continuing process of reducing these impediments to trade will not be an easy one. Some help is on hand from the West in removing infrastructural and other trade barriers. To facilitate regional cooperation, the West can

☐ help to break down the structural and institutional barriers to trade (by setting up a currency stabilization

Table 5
Inhibiting Factors for International Trade in Europe

Importing region / Exporting region	EU	CE	CIS
Western Europe (EU)	–	T, S	M, T, S
Central Europe (CE)	M, T, S	M, T, SS	MM
Eastern Europe (CIS)	M, T, S	MM	MM

M = Monetary impediments (trade finance, convertibility)
T = Trade policy impediments (protectionism)
S = Structural impediments (infrastructure, market knowledge, etc.)
Wherever the code letter appears double, this signifies particularly severe difficulties, while a single code letter indicates that the factor concerned plays a lesser part when compared inter-regionally.

[16] Cf. euro-east, No. 13, 27th July 1993, p. 24.

[17] Cf. The Economist, 20th June 1992, which cites a study by Jan Vanous (PlanEcon), entitled "The Role of Exchange Rates in Western Investment Decisions in Eastern Europe" (May 1992).

[18] Cf. Rolf Alter and Frédéric Wehrlé: Foreign Direct Investment in Central and Eastern Europe. An Assessment of the Current Situation, in: INTERECONOMICS, Vol. 28, No. 3, May/June 1993, pp. 126 ff.

fund, by providing loans and guarantees, and giving technical assistance),

☐ use the aid it gives to boost trade directly, e.g. by purchasing aid shipments destined, say, for Russia in another country such as Hungary (this has already been done),

☐ liberalize regional trade by including country-of-origin rules in the EU's association agreements which would compel CEE importers to treat products from other CEE countries equally to those from the EU, and

☐ define quotas – if they really cannot be avoided – in regional rather than national terms.

However, many Eastern Europeans fear that when western countries stress regional cooperation they are only trying to distract attention from their own protectionism. Particularly the reform-oriented elites in Central and Eastern Europe are looking to a European, or Western European, perspective. The best means of fulfilling their wishes would be to provide a firm acceptance that their countries can join the European Union.

It cannot be in Eastern Europe's interests, either politically or economically, to model foreign economic relations artificially on purely regional lines. In almost every respect, it is more lucrative to trade with the more developed countries. Such global opening of markets is also in Western Europe's long-term interests. In the short term though, and especially at a time of deep recession, western companies and employees are chiefly concerned with the threat posed by new competition from Central and Eastern Europe. Neither protectionism nor political pressure to halt the relocation of production are possibilities which should be ruled out. If Western Europe refuses to make the necessary adjustments and shelters behind protective barriers, the CEE countries will be forced to seek alternative courses of action. In such a case, the regional market would at least offer some substitute opportunities and the chance to prepare before facing tougher competition on the world market.

The risk that the West will only go half way towards opening its markets is quite considerable. The EU is severely preoccupied with its own economic and political problems, and this calls its willingness to embrace new members into question.[19] On the one hand, the advocates of extending the Union eastwards are demanding that this should take priority over deepening integration, and that the reforming countries should be given a firm date for entry, as an immediate spur to the necessary adjustment processes. A medium-term alternative would be for the CEE countries to join EFTA.

On the other hand, doubts persist as to the reforming countries' ability to meet these challenges. The case of Greece illustrates the economic and social setbacks which can result if a full member of the European Community, or Union, finds the stress of integration too great to cope with. Even the more successful recent new members, Portugal and Spain, are going through a period of huge trade deficits relative to the core group of EU countries, which they need to finance by inflows of capital from EU funds, by inward direct investment, etc.

On the crucial matter of structural adjustment the CEE countries have the greatest upheavals still ahead of them. Even the most advanced reforming countries such as the Czech Republic have only reached the stage of establishing the mechanisms of the market system, and are only just beginning to build an economy which can hold its own in the marketplace, with truly competitive companies. Even privatization is only one part of that process.

During the course of the adjustment crisis, with all its consequences for social security and employment, nationalist and/or neo-interventionist tendencies have been growing in Central and Eastern Europe. Both of these pose a threat to the political will to progress towards a more open economy. These tendencies frequently aggravate conflicts among the CEE countries themselves, where there are often more sore points than in their relations with western countries. For its own part, the West is likely to take a more guarded approach if nationalists rise to power or Communists return to it (witness Lithuania, Poland, and perhaps Hungary soon?). In such situations, liberals and western-oriented experts who have previously acted as points of contact between CEE and western countries may refuse to continue (as did Poland's representative at the EBRD in November 1993). Western investors, too, may stay away.

The countries of Central and Eastern Europe have to try to establish the right policy mix of regional cooperation, attachment to the EU and orientation to world markets so as to build up external economic safeguards for the reform process. Inevitably, the best anchor available to Central Europe remains the European Union. Russia, on the other hand, can afford to consider global options. The Caucasus and Central Asian countries will probably only gradually be able to ease themselves away from Russian hegemony, both politically and economically. In as far as they do succeed in diversifying, Asia will presumably offer them better prospects than Europe.

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[19] Cf. Michael Dauderstädt: EG und Osteuropa: Im Leuchtturm geht das Feuer aus, "Eurokolleg" series, No. 23/1993, Friedrich Ebert Foundation, Bonn.