The Ability of the Associate Reform States of Central and Eastern Europe to Free Trade with the European Union

Seminar in Economy and State, IBL, International Trade,
“Globalization, European Integration,
Eastern Markets and Structural Change”

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Summer Term 1997

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Contents

List of illustrations page

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Preface

The young market economies of the states in Central and Eastern Europe (CEE) are knocking at the door of the European Union. This led public and economic discussion to a debate on the question, if, considering the relative economic underdevelopment of the reform countries compared with the EU-states, is free trade - with resulting accession to EU - between CEE countries and the EU possible, without destroying these inferior economies because of confrontation with the superior western competition or exposing them to high welfare losses. Often the competitiveness of these countries is doubted, recommendations for a protectionist trade instead of opening the market to the west follow these assessments.

The start point of this paper shows an approach against an eastern enlargement of the EU, the arguments are presented in political discussion as economic correlations. These arguments must be analysed. With the achieved results, the ability of the associate reform states to accede and perform economically will be examined, and either supported or rejected.

I. Introduction

1. The approach of the reform states to EU

After the breakdown of the communist Soviet empire with its economic alliance structures in Central and Eastern Europe (CEE) - integrated in the Council for Mutual Economic Aid (COMECON) - a lot of these countries approach the EU. The orientation to the West of the reform countries resp. CEE states[1] called Central and Eastern European countries has historical[2] and political reasons with regards to national security and economics. It is politically important to rescue, these countries from a difficult situation between Western Europe and Russia through a move towards NATO and EU. Due to the vacuum of power, entrance to these institutions is considered a guarantee of political development and an insurance against a return to old structures.

In the economic view, it is seen firstly as a free way to the EU-markets. The reform states look for new sales markets for their products and expect, through joining the EU, an influx of western capital, e.g. direct investments by private investors[3]. The CEE countries hope for support from the EU in their transformation process, so the EU-members have a role-model function and set a standard in transforming the CEE economic order[4].

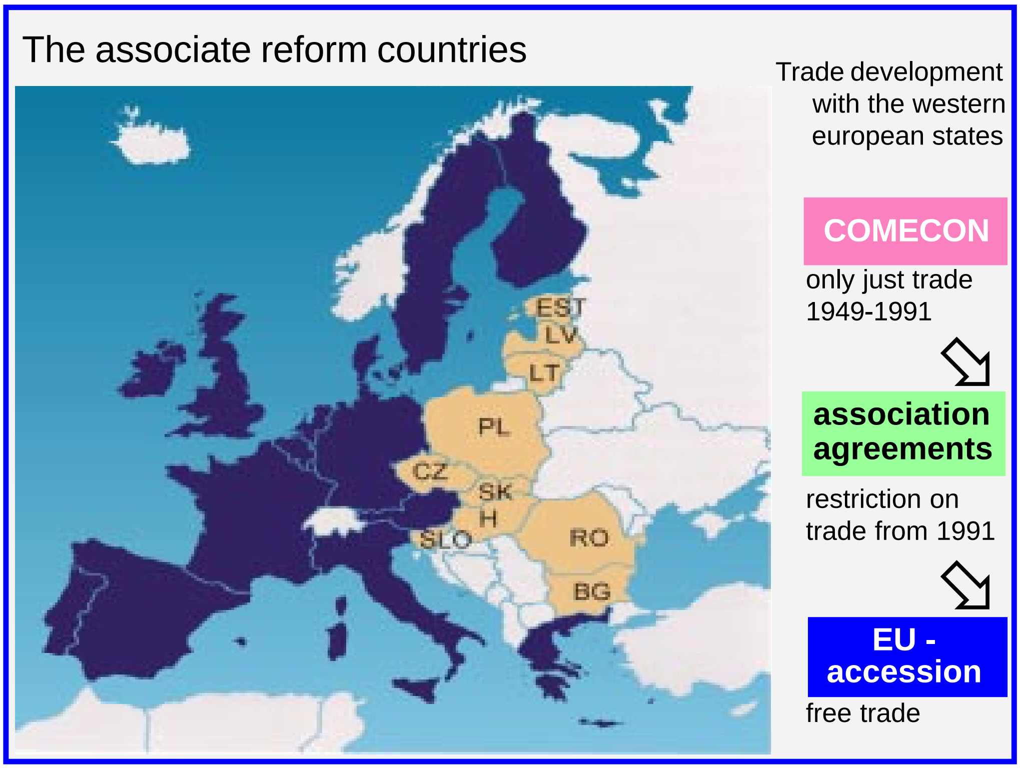
A first important step in the direction of opening the European internal market for the CEE-suppliers is the association agreement of the EU with the CEE-states[5]. The reason for these agreements is the creation of free trade for industrial products and parts of the services sector within ten years. The EU should open their markets faster than the CEE-countries[6], but the integration into the EU-markets makes delayed progress despite this clear target. The crucial points of exports of the reform states collide with the protectionist crucial points of the EU; in special rules coal, steel, textiles and certain chemical and agricultural products were related to a so called “sensitive sector”, to which only unimportant trade concessions are granted. These sensitive products represent a big part of the exports of the CEE-states into the EU[7]. Therefore one cannot speak of the creation of free trade between the CEE countries and the EU[8].

Only as a memberstate of the EU does a real trade liberalization seem possible, because membership guarantees the reform countries the economic freedom of the internal market both in their countries and outside, since restrictions on trade between the members of the Union are not allowed according to art. 9,12,30 Treaty on European Community.

1 In this paper the CEE states are: Poland, Hungary, The Czech Republic, Slovakia, Bulgaria, Romania, the Baltic States Estonia, Latvia, Lithuania and Slovenia.
2 Zschiedrich, Harald (1992), who explains extensively the “historical roots” of the reform countries in Europe, p. 201-214.
3 On the other side the CEE countries don’t make the incorporation in the EU transfer system a subject of discussion. So they avoid distribution conflicts in the east enlargement discussion.
4 The motivation of the Reform countries for an EU-entry is quoted by Schüller (1994) on p. 306-330.
5 These so called “Europe agreements” build a legal and political framework, in which the partner states will be led to the EU and prepared for the accession.
6 Nicolaysen, Gerd (1996); Kalbe, Peter and Bachmann, Ingrid (1996), p. 496-498.
7 The share of the sensitive products of the exports from Poland, Hungary, Romania, Bulgaria and the former CSFR varies in 1992/1993 between 40 and 70 %, according to Welfens (1995), p. 22-31.
8 Both sides have reserved the right in so called protection clauses to take measures in difficult situations for the domestic sectors, cf. art. 20 Europe agreement with Hungary, Abl. L 348 , 31.12.1993.

Only membership of the EU makes far-reaching, equal economic trade - the free trade - possible.

All the reform countries have filed an application for entry into the EU[9]. The European Commission proposed in June 1997 to start membership negotiations with a group of five states in the beginning of 1998[10]. The first accessions are expected - according to the president of the European Commission, Santer - between 2001 and 2003.



Estonia
Latvia
Lithuania
Poland
The Czech Republic
Slovakia
Hungary
Slovenia
Romania
Bulgaria

fig. 1 The associate CEE states approach to a fast EU-membership, which guarantees a free trade with western Europe. With the blue marked countries accession negotiations will start in 1998.

2. Free Trade as an entrance requirement

An important criterion for membership of the EU is the economic development of each candidate. The European Council said, at the Copenhagen summit in June 1993, that as a prerequisite for membership, the CEE states have to be able to resist the competition and the power of markets in the Union[11]. That means, that these countries have to be able to free trade with the present members of the EU.

The economic stage of development of the reform countries is estimated as too small by the opponents of a fast eastern enlargement. They reject an EU-entry in the next ten years[12].

9 They did it between 1994 and 1996 at the European commission.
10 These countries are Poland, Hungary, The Czech Republic, Slovenia and Estonia; cf. FAZ No. 163 (17.07.1997), p. 1 and 2.
11 European Council (1993) in Copenhagen in 25.06.1993. Additional conditions are institutional stability as a guarantee of law, democracy, the respect of human rights and functionable markets.
12 Weidenfeld, Werner (1993), p. 173-190; Stabenow, Michael (1997), p. 1.

The arguments of a supposed insufficient economic maturity can be summarised as follows:

- Free trade with the EU only gives advantages to the present memberstates of the EU.
- The CEE states must respond with protectionist measures against trade liberalization.
- The confrontation of the inferior economies with superior western competition leads to the ruination[13] of the reform countries.
- The CEE countries are not internationally competitive.

Therefore one must investigate,

- what the different maturities of CEE states and EU states mean in terms of free trade (II.).
- if protectionist measures are a better solution than market integration (III.).
- if such a fall-down scenario is a realistic possibility (IV.), and
- what is the meaning of the competitiveness of the reform countries (V.).

At the end we'll take a look at the real trade development between the CEE countries and the EU (VI). With the trade liberalization so far, which was possible with the European agreements, we should examine, if serious disadvantages for the reform countries exist until currently, are expected in the future.

II. Free trade and development differences

If the statement, that relatively underdeveloped countries fall down in competition with more developed countries is right, then reform countries should be excluded from trade with the EU for their own protection, until they achieve the welfare standard of the western EU states.

However free trade between economies does not that the trading countries to show an equal stage of development. An example with *A*- and *B*-production in the reform countries and in the EU can illustrate this.

If in one country it is only possible to produce all the goods at higher costs, this country has absolute cost disadvantages in comparison with the foreign country.

	product *A*	product *B*	
reform countries	**6**	**2**	EU shows absolute cost advantages
EU	**1**	**1**	

fig. 2 The production of A needs six service units (SU) in the reform countries; whereas in the EU one SU is enough. For the product B the reform states have to spend two SU, the EU only one again. So in both sectors the EU has absolute cost advantages.

13 Ruin of the reform countries means, that the economies are no longer productive, because all demand - including that for non - tradeable goods - will be satisfied by western suppliers. This leads to employment reduction, income losses and finally to the collapse of the economy as a whole.

Namely, in this constellation according to the theory of comparative cost advantages[14] the start of international trade is profitable for all partners, if the absolute cost difference for the single goods between the countries diverges and so comparative cost differences exist.

Reasons for comparative cost differences can be on one hand relative distinctions in the factor endowment, and on the other hand relative distinctions in the production efficiency.

	reform countries	EU		
relative costs of product *A*	$\frac{6}{2}$	$\frac{1}{1}$	In the reform states the renouncement of three *B*-products is necessary for production of one *A*-product; EU 1:1	The reform countries have comparative disadvantages in *A*-production
	reform countries	**EU**		
relative costs of product *B*	$\frac{2}{6}$	$\frac{1}{1}$	In the reform countries the renouncement of 1/3 *A*-product is necessary for production of one *B*-product; EU 1:1	The reform countries have comparative advantages in *B*-production

fig. 3 In *B*-production the reform countries have relative cost advantages, because they have to renounce for only 1/3 *A*-product to get one more *B*-product. The EU has to give up for one *A*-product to get one more *B*-product.

Due to of specialization and exchange within the scope of foreign trade relations all countries can improve their endowments of goods in comparison with autarky, and profit from an improved allocation of national and international resources. The superior country specializes in production of goods with which it has comparative cost advantages against the inferior country. It exchanges these goods for those, which have comparative cost disadvantages. Analogously, the inferior country specializes in production of goods with relative small absolute cost disadvantages resp. comparative cost advantages against the superior country and trades the goods, which are comparatively more cost disadvantaged.

	additional ***A* - products**	additional ***B* - products**	
reform countries	**-1**	**+3**	reform countries and the EU profit from trade
EU	**+2**	**-2**	
reform countries & EU	**+1**	**+1**	

fig. 4 If the reform countries specialise in *B*-production and the EU in *A*-production, in the reform countries the output of *B*- production increases by three, which can be used for trade with the EU to get *A*-products. The EU is able to produce two more *A*-products, because they can renounce of the SU in the *B*- production.In the end both trade partners gain one product in each sector.

The example shows, that the clearer the differences of development between the countries, the larger the potential for specialization and so the larger the chances for welfare improving free trade. Therefore it is economically senseless to exclude inferior countries from trade with superior countries. International trade is an instrument to overcome international welfare differences and underdevelopment.

14 This theory by David Ricardo (1772-1823) is described in: Ethier, Wilfred J. (1994), p. 9 ff.; Siebert, Horst (1994), p. 24 ff.; Rose, Klaus / Sauernheimer, Karlhans (1995), p. 353 ff.

III. Protectionism instead of free trade

It must be expected, that the welfare gains of a protectionist foreign trade policy will exceed the welfare gains of a market opening policy, a fast eastern enlargement of the EU and more trade liberalization cannot therefore be recommended.

Instruments, which can be used as trade restrictions are the Optimum Tariff, the Infant Industry Tariff and the Strategic Trade Policy. They are explained and their practical relevance is examined below.

1. The Optimum Tariff

The bottom line of the Optimum Tariff argument is the consideration, that the possibility exists for a country, to improve its Terms of Trade and raise the welfare position to the debit of foreign countries by imposing a tariff. This country must have a monopolistic power to influence the international prices with its behaviour in supply and demand[15]. This means, that the country increases the tariff until the trade indifference curve reaches the highest welfare level. The welfare maximising tariff (Optimum Tariff) achieves equivalence of the marginal rate of substitution (trade indifference curve) of the home country and the marginal rate of exchange readiness abroad (offer curve abroad).

But the practical relevance of the Optimum Tariff is small. The nature of the Optimum Tariff is to take advantage of monopolistic power. If a country can influence the international prices, the citizens own monopolistic power; through reduction of a part from their export supply they can raise the price. Or one can say, they have the monopsonistic power on the import market to limit the demand and hold the price down. Only economically very big countries have this monopolistic power; none of the reform countries possesses this attribute[16].

In addition to the numerous conditions, which cannot be fulfilled the practical use of the Optimum Tariff fails. So even perfect information were available about all the relevant market conditions necessary to calculate the equivalent tariff. The tax revenue must be spent to increase the welfare of the home country, and perfect competition must dominate.

The tariff imposing country needs to worry about the possibilty of retaliation from abroad. The calculation of the Optimum Tariff takes the foreign export supply curve as fixed and therefore, assumes a fixed tariff policy for the rest of the world. However the home country can use commercial policy to improve the Terms of Trade, other countries can presumably do the same. The home tariff could be countered by a foreign tariff and a resultant tariff war. This reduces the appeal of an Optimum Tariff policy.

Therefore the Optimum Tariff is not a suitable instrument for protectionism of the reform countries and gives no argument against accession to the EU.

15 Cf. Ethier, Wilfred J. (1994), p. 266-270; Siebert, Horst (1994), p. 176-177.

16 The export share from the EU in the CEE states of the total EU exports was in 1995 10,2 %. The import share from the reform countries in the EU of the total EU imports was in 1995 8,6 %. This is not enough to determine the international prices with tariffs on imports resp. export taxes or quotas on exports; source: EUROSTAT-COMEXT, journal 12 from 1996, p. 15.

instrument of protection	purpose of use	assumptions
Optimum Tariff	improvement of Terms of Trade	- economically large country - perfect information - perfect competition in the home country - the foreign countries do not retaliate

fig. 5 Although the Optimum Tariff argument is used by those demanding protectionist trade policy, it is still not relevant in practice. It fails by the turn over of a country to improve the Terms of Trade through imposing a tariff and by the unrealistic assumption, that the foreign countries will behave calmly, faced with such policy.

2. The Infant Industry Tariff

The Infant Industry argument[17] centres on the idea, of giving the domestic industrial sector the opportunity to recover cost disadvantages incurred during production due to lack of experience compared to foreign countries through a periodical limited trade protection. So competitive sectors can be established[18]. Growth and existence of infant industries in domestic markets is defended against competition abroad. The reform countries have conceded in the European agreements to the imposition of Infant Industry Tariffs.

The strict conditions, under which a infant industry protection theoretically can - but need not - be successful, give rise to doubt about the efficency of this protection method.

So infant industry protection is only legitimised to animate the production of goods with dynamical savings because of external learn-effects[19]. The process of learning leads to external effects, then other producers are able to gain the experience without cost, which won another enterprise. In such cases the social revenue of investments exceeds the private profit. Since the resultant advantages - the gained experience resp. knowledge - are gained not only by the pioneer enterprise, but by other producers, these producers are able to produce with the same low costs as the pioneer enterprise, but without the starting-load costs.

Predictions, of how and why a growing industry leads to external effects, are difficult to make, and they must be examined in each individual case. Most enterprises are able to prevent the spread of gained experience for a certain period, to keep their competitive advantages over the other producers.

17 Cf. Siebert, Horst (1994), p. 169; Ethier, Wilfred J. (1994), p. 276-278; Rose, Klaus / Sauernheimer, Karlhans (1995), p. 605-610.

18 Touched upon is the protection effect of a tariff; how the imposition of a tariff on imported goods raises the domestic price opposite the international price and leads to reduction of imports (foreign trade effect), a reduction of the domestic consumption (consumption effect) and an increasing home production of the equivalent import goods (protection effect). Cf. Rose, Klaus / Sauernheimer, Karlhans (1995), p. 565 ff.

19 Cf. Rose, Klaus / Sauernheimer, Karlhans (1995), p. 609.

Naturally the enterprises don't want to invest in non-cost-recovered production and so give away their gained knowledge to other firms, which are able to enter the market without costs. So it is possible to protect domestic industries with price rises and to compensate losses at the beginning of production, but other producers take over the foreign experience without any costs and can avoid start losses.

Furthermore, an Infant Industry is justified, only if the benefit because of the savings - based on the external learn effects - exceeds the welfare losses for the consumers because of the price rise - based on the protection-. These welfare effects of the protection work against each other and are difficult to measure.

Since it is difficult to spot the point in time, when the protected branches become the target - become "an adult" - the time limited building-up of an industrial sector could mutate into an inefficient permanent conservational protection. The protected sectors not wanting to give away their protection. It is easy to impose a tariff, but the abolition of a tariff is almost impossible, if the protected industry is afraid of failing in the international competition[20].

The existence of very special basic requirements for welfare increasing infant industry protection and the uncertainty of the desired effects occuring makes this instrument unsuitable for supporting the needs of protection of the reform countries.

instrument of protection	purpose of use	assumptions
Infant Industry Tariff	protection of young, domestic industrial sectors	- economies of scale - external effects - international competitiveness - welfare gains as a compensation for higher prices

fig. 6 The Infant Industrial argument is subject to criticism. It causes distortions and welfare losses of its own, which must be weighed against any benefits. Only if the later welfare gains exceed, is the instrument useful. A political objection is, that it is hard to abolish the time limited protection of an industry against this resisting sector, when the international competitiveness is reached.

3. Strategic Trade Policy

Besides the Optimum Tariff and the Infant Industry Tariff the Strategic Trade Policy shows a further restriction of the free trade postulate of classical and neo-classical international trade theory. Contrary to the Optimum Tariff it is possible for an economically small country, to reach welfare gains with this new instrument.

Therefore the arguments for this new protectionism to justify trade restrictions are popular[21].

20 „Die Erfahrung mit dem Erziehungszoll für junge Industrien ist durchweg negativ; in aller Regel sind die Zölle geblieben, und die geschützten Wirtschaftszweige waren nicht dem Wettbewerb ausgesetzt. So hat die Protektionspolitik in Lateinamerika während der letzten 40 Jahre im wesentlichen versagt, während die bewußte Außenorientierung der asiatischen Staaten mit hohen realen Wachstumsraten erfolgreich war." quoted from *Siebert, Horst* (1994), p. 169.

21 Cf. the case study: "Does Japan play fair?" in: Ethier, Wilfred J. (1994), p. 332-336.

One can show, that a country with Strategic Trade Policy on imperfect markets in monopolistic or oligopolistic market structures is able through sector specific, protectionist interventions in the form of import restrictions or export subsidies, to shift market shares and rents in favour of domestic industries and charge the other countries. In comparison with the free trade situation the welfare could rise[22].

The proof of possibilities of welfare improvement through protectionist measures in the framework of Strategic Trade Policy is only valid if oligipolistic models are assumed.

These models react very sensitively to each alteration. So it is not possible to give clear recommendations in favour of protectionist instruments, if the market participants change their assumptions of behaviour, if the entry to the market is possible for new suppliers or the foreign countries take measures of retaliation resp. of Strategic Policy[23].

Apart from the absence of strength in the theoretical models there are also near impossible information problems, which include the identification of the suitable branches, the choice and dosage of the political tools, the reaction of the market participants, the reactions on other sectors of the economy and finally the quantification and weighing of welfare gains and welfare losses[24].

In the presence of these deficiencies Strategic Trade Policy cannot be used as basis for a complete protectionist regime. The reform countries cannot be recommended these instruments of trade restriction.

instrument of protection	purpose of use	assumptions
Strategic Trade Policy	rent-shifting of market-shares in favour of domestic industries	- oligopolistic structure - entry of market for new suppliers should not be possible - external advantages - foreign countries do not retaliate

fig. 7 As with the other forms of protectionism, the Strategic Policy shows an example of a “beggar my neighbour policy” and can bring measures of retaliation from the rest of the world. It is hard to realize which industry is worthy of protection. One has to avoid such sectors giving up resources, which in the long term represent low comparative costs.

4. Conclusion

The instruments of protectionism discussed offer no justification for trade restrictions instead of trade liberalization of the reform countries, with the exception of special cases for hardly recognizable single sectors of the economy.

22 The Strategic Trade Policy uses the knowledge of the New International Trade Theory. There are respected in opposite to the unreal assumptions in the classical and neo-classical theory especially economies of scale and unpure markets; Rose, Klaus / Sauernheimer, Karlhans (1995), p. 619 ff.
23 Ethier, Wilfred J. (1994), p. 322 ff.
23 Rose, Klaus / Sauernheimer, Karlhans (1995), p. 623.
24 Cf. Siebert, Horst (1988), p. 574 ff.

Such measures signify a fundamental deviation from free-market principles in favour of more governmental interventionism[25]. On the contrary the arguments from the classical and neo-classical theory - even in consideration of an imperfect market - retain validity in favour of free trade. Foreign trade liberalization effects an enlargement of sales markets and leads to an increase of production, which guarantees a better use of economies of scale. More intensive world market integration and subsequent harder international competition clear monopolistic structures away.

An increase of the national welfare in the reform countries cannot be based on protectionist methods. Therefore the theory of international trade is not able to give a recommendation for such measures or against a fast trade liberalization in the framework of a EU-accession.

IV. Free trade and the danger of "death" of economies in competition

The scenario sketched by those opposed to the accession shows enormous imports from the EU countries to the CEE states, because the products of high quality from Western Europe would be strongly desired. But these imports are not balanced by exports from Central and Eastern Europe to Western Europe, because the products of low quality produced in the CEE would not bought in the EU. The result of this permanent one-sided foreign trade would be the standstill of production in the reform countries, which would lead to the downfall of these economies.

By means of two considerations - the correlation of current account and the exchange rate mechanism - one can show, that permanent one-sided foreign trade as prerequisite for the downfall of the economies in eastern europe is not practicable.

1. The correlation of current account

The correlation of current account states, that a country can permanently import in terms of value only as much as it can export on the other side, because only by the exports can the foreign currency be purchased, which is required to pay for the imports[26].

25 When looking at the credibility of the transformation process it is important to show the western european countries a clear free-market orientation. Cf. Achten, Peter (1996), p 39.

26 "The products of a country are exchanged for the products of other countries with the values, which are necessary to have a correspondence between the total exports and the equivalent amount of the whole imports", John Stuart Mill (1806-1873), quoted from Ethier, Wilfred J. (1994), p. 360; Siebert, Horst (1994), p. 205: "Die Zahlungsbilanz ist eine Budgetrestriktion in dem Sinne, daß man nicht mehr Devisen ausgeben kann als man einnimmt"; Busch, Berthold / Fröhlich, Hans-Peter (1993), p. 42.

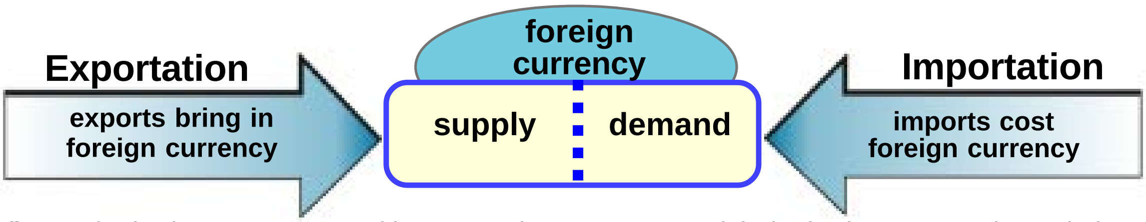


fig. 8 The foreign currency earned by exports is necessary to satisfy the foreign currency demand of the foreign importers.

If the reform countries could not supply any products for exportation - this is the assumption made by those opposed to an eastern enlargement - , the quid pro quo for the imports from the EU states would remain practically worthless. The foreign currency earned by these imports - provided the reform countries pay in their own currency - could neither be used by the EU countries to buy products from Eastern Europe nor exchanged for other currencies.

The EU countries would stop their export activities with the CEE countries. The permanent one-sided foreign trade could not exist and the downfall of the economies couldn't take place.

fig. 9 If exports of a country do not take place, there is a lack of foreign currency, with which imports could be payed. The foreign importers would stop their deliveries and the consumers would have to buy the domestic products.

2. Exchange rate mechanism

The mechanism of balance of payments adjustment shows how the floating exchange rate leads to a settlement of foreign currency supply and demand after a disturbance. It describes, that inequalities between the foreign exchange account cause currency movements, which compensate for the balance of payments adjustment by adapting the exports and imports[27]. These exchange rate movements prevent the presented scenario of the opposition.

The reform countries are not able to export their products, so they cannot place a supply of foreign currency at disposal for financing the imports. The difference between the foreign currency supply and demand for purposes of import would increase. The rising demand of foreign currency would lead to a fast increasing exchange rate of the reform countries. This means a currency devaluation of these economies.

27 Jarchow, Hans-Joachim / Rühmann, Peter (1994), p. 69; Siebert, Horst (1994), p. 219.

Therefore the imported goods become more expensive compared with the domestic goods, which are in competition with the imported goods. The domestic goods would be more demanded and one-sided, enormous imports from the EU-states would be prevented by the exchange rate mechanism.

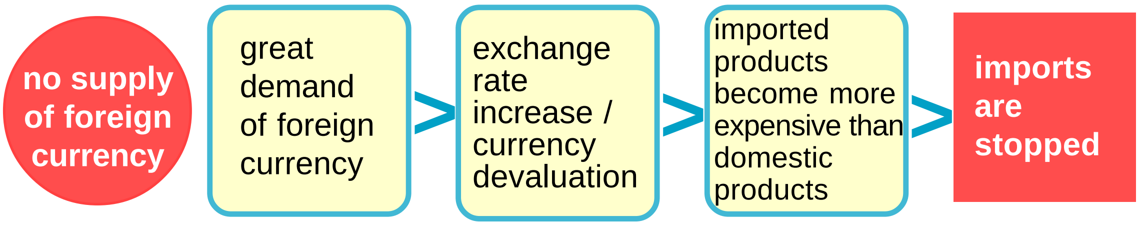


fig. 10 The great demand for foreign currency leads to an increase of the exchange rate. The currency devaluation is followed by a price increase of the imported goods, which cannot be bought by the consumers. So the imports stop and the consumers are dependent on the domestic production again.

V. Free trade and the "competitiveness of the reform states"

Often in the political argumentation an accusation of a lack of international competitiveness is levelled against the CEE states[28]. However the question is, what is the meaning of this term, when used to describe the whole economy of a country or even a group of countries[29]?

As soon as the international competitiveness of single enterprise or branches is aggregated to the whole economy of a country, the term loses its meaning, because the summarizing general assessment displaces the really interesting evaluation. This concept of international competitiveness, mayority be meaningfully applied to single enterprises or branches.

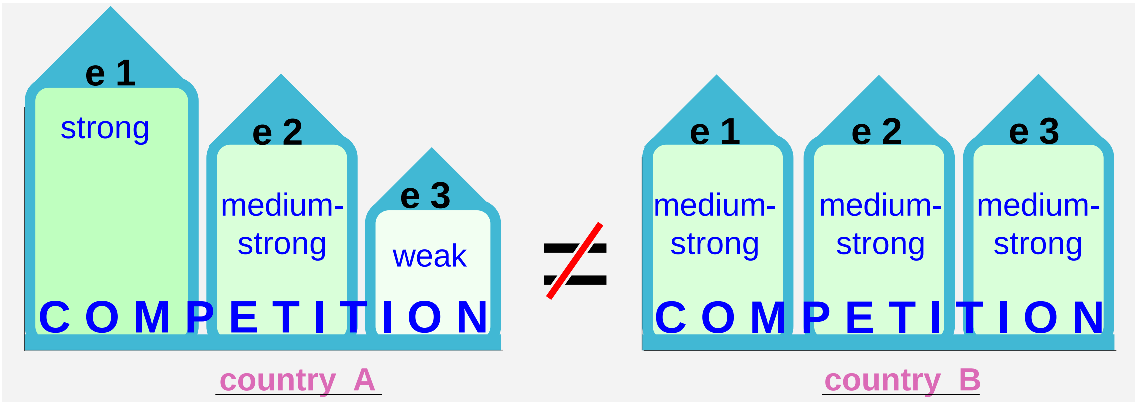


fig. 11 The term international competitiveness of a country can only be used concerning single enterprises or branches. Considering the competitiveness of the countries A and B (showed and quantified by the areas in the single enterprise/branch), both countries reach the same result, because the added areas have the same size. But actually the international competitiveness of the single enterprises is different. E.g. e1 and e3 in each country are different in a direct international comparison.

28 Competitiveness means the ability to distribute the products to the existing demand, i.e. the "ability to sell".

29 Contrary to the microeconomic conception of competitiveness there is no comprehensive and common accepted theory of the competitiveness of nations so far, cf. recently: Berg, Nicola / Holtbrügge, Dirk (1997), p. 199-201.

It must also be noted, that the international division of labour involved economies are subject to permanent structural shifts. On one hand some enterprises and branches are under pressure in competition and in correspondance with the changes of comparative advantages in the country they shrink. On the other hand enterprises and branches can expand and improve their individual positions.

Loss of competitiveness of an enterprise resp. branch goes hand in hand with an improved competitiveness of another participant in the market according to the shift of the comparative advantages. Because of this process a country is only able to have only a limited number of enterprises or branches, which reach a high position in competition. Not all branches of one country can lead the competition worldwide. So the international competitiveness can only qualify specific branches and enterprises.

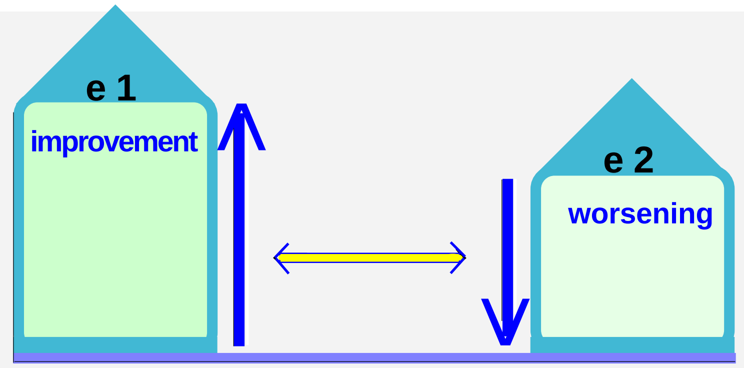


fig. 12 Example:
The competitiveness of an enterprise increases because of a costsinking innovation of production.
The wages increase. But at the same time the competitiveness of other firms gets worse, because they can only pay such wages, if they raise the prices of their products; and this leads to a decrease in sales volume.

But even when using such a meaningless term, one question remains open: Which level must the reform countries reach to get the capability for free trade with the EU without great welfare losses[30]?

To summarize, the argument of insufficient international competitiveness of the reform countries has no economic meaning and cannot be used against an eastern enlargement of EU.

VI. Stage of trade development

In the first half of the nineties, a new orientation of trade from the further COMECON-markets towards west - focusing on EU -.

In 1989 only 25 % of exports of The Czech Republic, Slovakia, Hungary and Romania were directed towards the EU-market[31]. With a share of 32 % of the export market Poland was the biggest EU-partner, the smallest was Bulgaria (5,5 %). However in 1995 almost 62 % of the Polish exports reached the EU.

30 Achten, Peter (1996), p. 26/27, the author underlines additionally, that empirical studies of the international competitiveness don't reach useful results.
31 Following values are taken from a survey of the European Commission resp. are calculated from myself; Europäische Kommission (1997), p. 115-130. The Baltic States are not represented.

The EU-export share from Hungary, The Czech Republic, Slovakia, Romania and Bulgaria amounted to 30 - 50 %. Similar developments took place on the imports of the reform states. The imports from the EU in 1989 came to 32,4 % of the total imports. The EU-import share varied in the single countries between 5,7 % in Romania and 56,9 % in Slovenia. In 1995 54 % of all imports came from the EU. Again Slovenia was on top with 74,2 % import share from the EU, and Slovakia imported only 34,7 % of all imported goods from the EU.

Now the EU is the number one trade partner for all CEE countries. After the accession of Austria, Finland and Sweden to the EU the reform countries trade between 40 and 80 % of their export and import with the EU.

The value of trade movements with the EU in the single reform countries is very varied. Whereas the exports from Poland in the EU almost tripled in the observed period (1989-1995) and reached a value of 16 027 million US-dollars in 1995, Bulgaria improved its export value from 972 million US-dollars to 1901,5 million US-dollars. This represents a near doubling of the figure six years previously.

With the imports from the EU again Poland is in the lead with an increase from 4337 million US-dollars import value to 18766,6 million US-dollars. The value of the import goods was more than quadrupled from 1989 until 1995. Against this, in Bulgaria there was a relatively small increase from 1896,3 million US-dollars to 1925,2 million US-dollars.

One can transfer the export values of the reform countries on to a diagram. The abcissa shows the period from 1989 until 1995 and the ordinate presents the export value in US-dollars. Poland, The Czech Republic, Hungary and Slovenia have the greatest rate of expansion in foreign trade with the EU. With these reform countries (and Estonia) the European Commission will enter accession negotiations in spring of 1998; therefore they are the first candidates for an EU-membership.

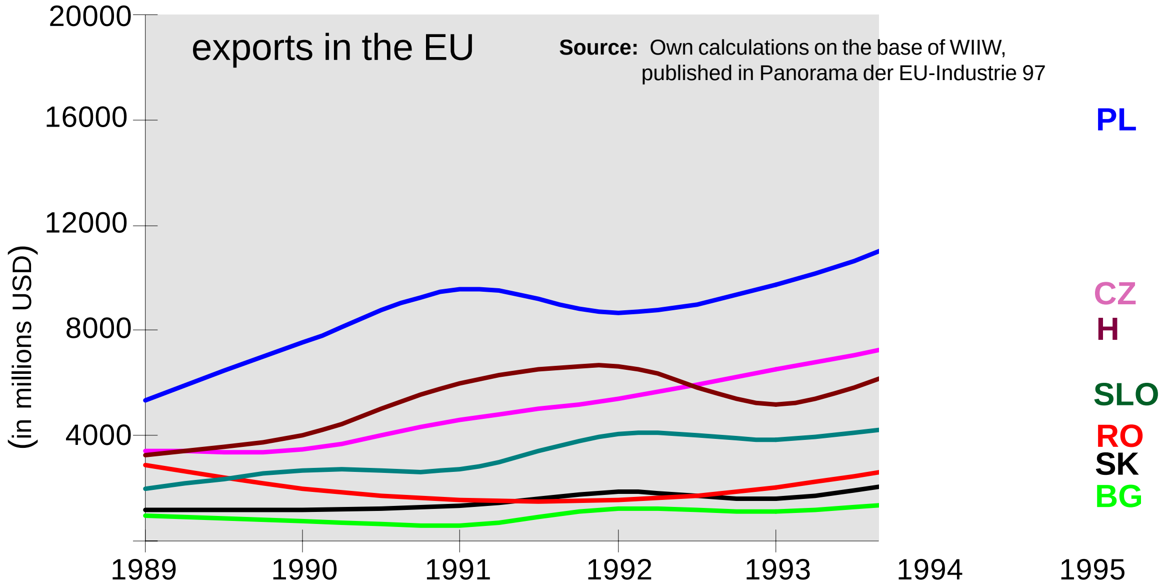


Abb.13 Against the thesis of the accession antagonists, one can see, that the exports from the reform countries into the EU have clearly increased. The importance of the trade development between the single Eastern European states and the EU to the accession ability can be deduced from the fact, that the four strongest export countries will probably acquire the EU-membership soonest.

The second graph shows the flow of trade between the EU and the associate reform countries based on US-dollars; it shows that the EU-imports into the CEE states as well as their exports to the EU were more than doubled in the period from 1989 until 1995. Therefore the European Commission rates these countries no longer as low-performance but as the most dynamic trade partners[32].

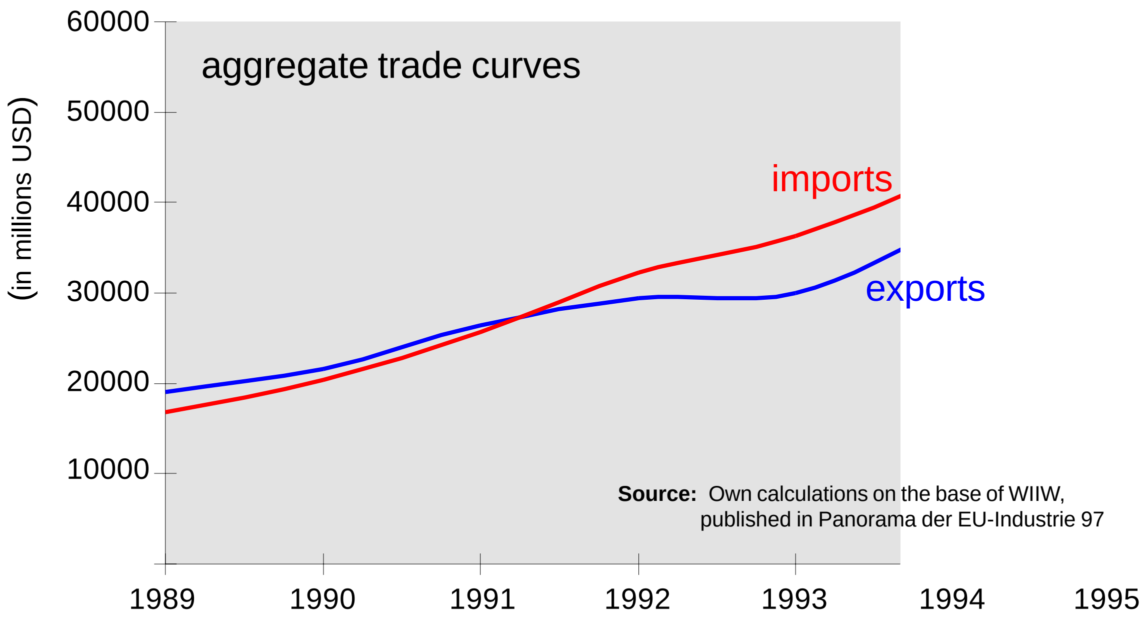


Abb.14 With nearly equal rates of growth, imports from the EU into the reform countries increase, as well as their exports to the EU. The capability of the CEE states to free trade with the EU-members also can be illustrated empirically.

The viewing of the trade development between the reform countries and the EU shows, that contrary to the thesis of those against a fast eastern enlargement the trade liberalization so far has not lead to a one-sided increase of only the imports from EU in the CEE states with stagnation or even decrease of the exports to the EU[33]. It is clear, that these countries managed to increase their exports to the EU. There cannot be talk of a lack in capability of the reform countries to free trade with Western Europe.

VII. Results

The exposition above recommends a liberalized trade regime between the reform countries in Central and Eastern Europe and the EU with reference to international trade theoretical knowledge. It is economically useful, to make free trade possible for the underdeveloped CEE states with the higher developed EU-members. Starting from the theory of comparative advantages, one can see, that differences in development between the participant countries open potentials of specialization and subsequently chances for welfare increasing intensified trade relations. This international trade is the instrument to get over international welfare differences and development backlogs.

32 Europäische Kommission (1997), p. 115.

33 The aggregate trade curves shows a trade deficit of the reform countries with the EU. But this development takes place in a time, when the reform countries just begin to recover from the transformation recession and the imports grow faster than the exports. Obviously the EU-measures of trade liberalization and the laid down in the Europe agreements steps (faster abolition of tariffs by the EU) are not enough to compensate the supply gap in the CEE economies.

Protectionist interventions can be justified for some single industrial sectors, but they do not improve the welfare of the larger part of an economy. As a rule, the gains from protection do not exceed the welfare losses caused for the whole economy. Additionally, the position of the foreign countries often gets worse, and they answer with retaliation, which compensates potential gains from protection. Not least because of the unrealistic assumptions in the theoretical considerations this instruments of trade restriction fails. So these are not suitable political measures for the reform countries.

Owing to the correlation of current account and the exchange rate mechanism, imported goods cannot flood the reform countries until their economies fall down. Both considerations make clear, that a permanent one-sided foreign trade is stopped by supply and demand of imported goods and therefore not possible.

It is wrong to argue in terms of the international competitiveness of countries in a discussion about capability to free trade. Krugman formulate: *Wettbewerbsfähigkeit ist ein Wort ohne jede Bedeutung, wenn man es nur auf die Wirtschaft eines einzelnen Landes anwendet"*[34]. Studies of international competitiveness should be undertaken only regarding single enterprises or branches, otherwise the term is meaningless.

A view on the trade development between the reform countries and the EU makes clear, that the CEE states because of trade liberalization so far, are able to participate in foreign trade with their own exports. They managed an enormous increase of exports to the EU. Therefore the capability of the reform countries to free trade is empirically verified.

The prospects of the Central and Eastern Europe countries in free trade relations with Western Europe in the framework of an EU-membership must be assessed positively. More good reasons for free trade can only be touched upon: comparative advantages of the reform countries in the production of labour intensive goods[35], the attraction of foreign direct investments[36] and the high qualification level of manpower[37].

Therefore a fast eastern enlargement of the EU must be used as a chance for economical progress on all sides.

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34 Krugman, Paul (1994), p. 34.
35 Cf. Institut der deutschen Wirtschaft Köln (1995), p. 58 ff.
36 Cf. Europäische Kommission (1997), p. 122 ff.
37 Cf. Klodt (1993), p. 428 ff.