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**Diskussionspapiere**  
**Discussion Papers**

Discussion Paper No. 121

**Countries in Transition and GATT/WTO**  
**= Issues, Expectations, Prospects =**

by  
Siegfried Schultz

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# **Deutsches Institut für Wirtschaftsforschung**

Discussion Paper No. 121

**Countries in Transition and GATT/WTO  
= Issues, Expectations, Prospects =**

by  
Siegfried Schultz

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## Table of Contents

<b>Abstract</b> .....	1
<b>Introduction</b> .....	2
<b>Relation of GATT to state trading countries</b> .....	3
<b>Member countries in transition</b> .....	5
<b>China and Russia in the offing</b> .....	8
<b>Substance of the Europe Agreements</b> .....	11
<b>The position of SU successor states</b> .....	16
<b>Mixed blessings of preferences</b> .....	18
<b>Conclusions</b> .....	19
<b>Bibliographical References</b> .....	25

## List of Tables

<b>Table 1</b>	<b>Relations of (former) state trading countries to the GATT/WTO</b> .....	22
<b>Table 2</b>	<b>Shares of sensitive products in EU imports from CEECs</b> .....	23
<b>Table 3</b>	<b>Significance of agriculture for Central and East European Countries</b> .....	24

**Abstract**

Applicant countries in transition wishing to revitalise or establish new ties with the GATT/WTO system will be able to achieve this neither in a rash nor uniform fashion. Undisputedly the necessary economic reforms in Central and Eastern Europe will take time. With respect to foreign trade, the economic reforms could be jeopardised without substantial improvement in the access to industrial country markets. However, the major remaining barriers to these markets are concentrated in sensitive areas, and protectionists' positions in favour of these barriers are generally stiff. To cushion detrimental effects of transformation and to prepare for ultimately joining the EU, particularly favourable conditions of market access have been extended in the framework of the Europe Agreements. This offer is open to a limited number of countries only. For the remaining majority of countries in transition there is some preferential treatment, the net effect of which is moderate. The alternative to regional schemes of preferences is the access to the world market as shaped by GATT/WTO provisions. Some of the applicants will have a long way to go before they qualify. For a realistic assessment of the chances of all of them, the WTO rules of accession should be clear, specified in advance, and the screening procedures transparent to avoid any impression of arbitrary decisions.

## Introduction

Liberal trade theory suggests that the main economic features of non-market economies (NMEs) are incompatible with the trade rules of the GATT due to the lack of market prices, non-convertible currencies, and a completely regulated foreign trade with a negligible role for private companies. In ideal terms, access to the import market should be a matter of price competitiveness determined by export prices, exchange rates, and tariffs - the latter being the main instrument of commercial policy and non-tariff barriers being considered as a temporary deviation of the system. To continue with this idealistic paradigm, the most-favoured-nation (m-f-n) clause, applied to the imports of all members of the "Club", is a guarantee of an even playing field, i.e. safeguards non-discrimination and equal terms for all players. Thus the key to comprehensive multilateral trade liberalisation is in the hands of GATT/WTO members ("Contracting Parties"), whose number should be as large as possible to bring trade-created welfare to a maximum.

Relations between countries in transition, in particular those in Central and Eastern Europe (CEECs)<sup>1</sup>, and the GATT/WTO system are not a new feature of the post-cold-war era. Some were even founder members of GATT, others were conceded access on very special terms. Initiated by the political landslide in 1989, the subsequent re-orientation of economic policies in the former socialist countries of Eastern Europe and the former USSR presented opportunities and challenges to incorporate these countries into the existing international trading system in order to widen its coverage and effectiveness. This gradual process means adjusting the CEECs and applicants with a non-market background to the existing contractual relations but also implies some restructuring of Western policies towards old-style Eastern trade partners formerly designed on the basis of political security considerations of the "containment" approach.

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<sup>1</sup> For this paper the CEECs include the four Visegrád countries: The Czech Republic, Hungary, Poland and the Slovak Republic; the three Baltic states: Estonia, Latvia and Lithuania; and the Balkan states of Bulgaria and Romania.

On the other hand, the CEECs played a subordinate role in the drawing up and further development of the GATT system due to political as well as economic reasons. If through political considerations of confrontation the USSR refrained in the immediate post-war years from taking part in the shaping of a world trade system which aimed at bringing about peaceful co-operation, then the GATT founding members Cuba and Czechoslovakia, as well as those countries which joined later, partly on very special terms - Yugoslavia (1966), Poland (1967), Romania (1971), and Hungary (1973) - were not in a position influential enough to effect a closer consideration of the interests of NMEs. Rather, more or less all of these states backed the wrong horse, with the former USSR and East Germany taking the lead, and endorsed the extension of UNCTAD to an all encompassing world trade organisation. Only after the failure of this approach became clear and the economic co-operation in the framework of the "Council for Mutual Economic Assistance" (CMEA) did not yield the desired results, did this group of countries draw closer to GATT (Machowski/Schultz 1989). [For a list of (former) state trading countries indicating their status in the GATT/WTO system see table 1.]

### **Relation of GATT to state trading countries**

Almost all of GATT's founder members were of a market economy type.<sup>2</sup> Therefore, essentially rules concerning only the exchange of goods among privately organised trading partners were fixed.<sup>3</sup> This is expressed in the basic principles and type of individual rules of the Agreement.<sup>4</sup> The major problem of trade with state trading

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<sup>2</sup> Exceptions: China, Cuba and Myanmar (formerly: Burma). In the international discussion about the basic elements of the world economic order in the post-war period, initially also the Soviet Union took part. In the originally planned, comprehensive International Trade Organisation (ITO) - still-born in 1949 - the Soviet Union was to have a seat and vote. However, the Soviet Union did not take part in the GATT Treaty which ran parallel to the ITO negotiations.

<sup>3</sup> The ITO was drafted differently to the GATT: specific rules for the integration of centrally planned economies into the international economic system were foreseen. These regulations were also included in the final draft of the Havana Charta; they could not, however, be realised due to the failure of the Charta and the ITO.

<sup>4</sup> The only regulation that refers to state trading relates to public monopolies, which are forbidden to settle their transactions in a discriminatory manner (article XVII).



countries is price formation. It took place essentially at an administrative level and reflected, therefore, neither the cost of production nor the scarcity of resources. The difference in price formation in market and planned economies did not permit direct price comparison and excluded, for instance, the application of classic anti-dumping measures.

Problems arose from two closely connected principles determining relationships between members. One of these is the principle of non-discrimination among trading parties or the m-f-n clause - one of the cornerstones of the Agreement. The other is the principle of reciprocity, i.e. the granting of trade concessions *mutually*. Though this reciprocity condition was not spelled out explicitly, it has nevertheless been of fundamental significance for how the Agreement was viewed by its signatories and how it functioned in practice.

In NMEs, as a rule trade was guided predominantly by the plan and executed by state foreign trade enterprises, the level and pattern of imports being mainly a mirror of the physical demand of domestic enterprises and the current account situation. Exports take place on the basis of production possibilities and foreign currency requirements. Export prices are fixed with an eye on the world market level, because the exchange rate does not directly reflect the relationship between international and domestic prices. Finally, import duties, if existent, do not exert a major influence, and above all do not affect the level of administratively fixed prices. Export levies, occasionally raised primarily to give relief to the budget, could add a distortive element to the picture.

With the accession of countries in transition systemic frictions emerged because the Agreement worked on the assumption that quantitative import restrictions were prohibited (with exceptions only in the case of serious balance of payments problems). Also, according to the m-f-n principle, new members were able to export to others at prevailing m-f-n tariff rates. With regard to NMEs, the problem was that these countries did not have truly comparable tariff systems. As a result, the principle of reciprocity could not be applied since the applicant country was unable to offer proper tariff reductions as an equivalent to the tariff level granted within the system (Pissulla 1992).

### Member countries in transition

There was fairly broad consensus right from the beginning that trade liberalisation should be implemented early in the reform process. An accelerated pace of trade liberalisation in reforming post-socialist economies was considered essential because, compared with market economies, relative prices were highly distorted, factor markets functioned poorly, state ownership was overwhelming, and trade had been distorted by government arrangements among former CMEA members<sup>5</sup>. In these circumstances, liberalisation of the trade and payments system in order to establish a realistic set of relative prices for traded goods and to prevent distortions due to monopolistic pricing and loss of productive efficiency was almost automatically one of the central demands of potential creditors. In addition, access to imports and foreign investment was considered as assistance in the acquisition of foreign technology (IMF 1992).

Historically, the policy move to differentiate among NMEs - the ultimate goal of which was to reduce Soviet power in the region - was the common base for the admission of Poland, Romania and Hungary - Yugoslavia may also be included in this group. The formal status in the GATT was not identical among these acceding countries. The most visible difference between them was the way they managed to get along with the principle of reciprocity. They had a few general rules in common (reduction of trade impediments, reservation of protective measures, mutual consultation, dispute settlement) as well as country-specific solutions. The arrangements were shaped as follows:

- **Czechoslovakia** was a participant at the first GATT meeting and a founder member, becoming a state trading country in 1948 with the coming to power of the Communist Party and the integration into the Soviet sphere of interest. Despite previous East-West political and trade tensions its formal status in the GATT was not substantially changed. The USA used the implied changes in the

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<sup>5</sup> The dominant elements of their trade related economic regimes were central planning, foreign trade monopoly, controlled prices, subsidies and unfavourable terms for foreign investment. Until the termination of CMEA all CEECs maintained a separate set of trade instruments for trade with CMEA partner countries (Naray 1993).

constitution of the economy as an opportunity not to apply some of the GATT rules. Above all, m-f-n treatment was suspended. Czechoslovakia did not make a stand against the quantitative import restrictions which several countries had erected. As of April 1993, both the Czech and the Slovak Republic became member countries, continuing the status of former Czechoslovakia.

- **Yugoslavia** became a full member in 1966 (provisional since 1962) after it had decentralised the economy. At that time, price controls were relaxed, tariffs were introduced, and multiple exchange rates abolished. Becoming a GATT member Yugoslavia granted normal tariff concessions.
  
- **Poland** joined the GATT in 1967, but under different conditions as the process of decentralisation of the economy was much more sluggish. Poland was obliged at admission, after long-term negotiations, to increase its imports annually - initially by 7% and later by 6% in nominal terms. As a reciprocal move, GATT member states initially did not strengthen their import restrictions against Polish goods and subsequently scaled them down. M-f-n status was, however, not granted unconditionally; this applies particularly to the USA. Since 1977 Poland was, due to frequent social and economic crises, not in a position to fulfil the agreed obligations with respect to import commitments.
  
- The conditions for **Romania's** accession (1971) had some resemblance. Instead of a fixed percentage increase, imports from GATT partner countries were to increase at least to the same extent as total imports, foreseen in the five-year-plans. Thus, there was no firm obligation with respect to the size of annual import increases - in fact an extensively flexible formula.
  
- **Hungary** became a member on the basis of 'classical' terms. This was made possible by the decentralisation of the Hungarian economy after 1968 and was supplemented by a commitment to gradually reduce relatively high tariffs. Hungary was able to point to the market economy elements of its trade regime as it applied for membership in 1973. The "new economic mechanism" was

supposed to bring domestic and foreign trade prices closer together by means of a multilevel tariff system. In contrast to other Western countries, the USA granted Hungary m-f-n status initially for 12 months only. Since more thorough political and economic reforms were undertaken, this period was extended subsequently.

In the protocols of accession for Poland, Romania and Hungary some preventive measures were foreseen. These special provisions aimed at facilitating the introduction of anti-dumping and countervailing measures and enabling discriminatory import restrictions in the case of market disruptions in the economies of member countries. The weak relationship between domestic and world prices constituted a formal rationale for these specific regulations.

The agreed device in the case of anti-dumping was to use - as the 'normal' value of an imported good - either the price level of the importing country or a constructed value. The other specific clauses referred to quantitative restrictions (maintained inconsistently with article XIII of the GATT), a selective safeguard and the stipulation of periodic review of the implementation of the agreed provisions. Past experience of these three member countries was not exactly a clear demonstration of successfully bridging the gap between market economies and former state trading countries.<sup>6</sup> The most promising approach was the Hungarian example. However, also there full integration into the multilateral trading system was hampered by inconsistencies in the reform process (Naray 1993).

All in all, the GATT was and the WTO system is attractive for economies in transition because of its landmark function by giving them "a fixed point of orientation" (ibid.) in their reforms and ultimately a world-wide outlet for exports on m-f-n terms.

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<sup>6</sup> All three countries are in the process of or intend to re-negotiate their protocols of accession. In particular Poland wanted to get rid of the "entrance fee" of rigid import commitments; the other two are waiting to see the outcome of the respective Working Group for the Polish case.

## **China and Russia in the offing**

Among the countries seeking membership at present are various NMEs - some of them hard core NMEs and some with a respective past which has left its mark on the present economic system: The **People's Republic of China**, one of the initial founder members, left GATT in 1950 and has been wanting to return since 1986. The case is, technically speaking, quite controversial, and the question arises as to whether it is a matter of re-integration or a new entrance. In material terms, it is a matter of testing in detail how compatible the Chinese foreign trade system is with the relevant GATT/WTO regulations. The People's Republic claims that since the beginning of economic reform in 1979 a change on the foreign trade front has also occurred: Firstly, with the decentralisation of economic jurisdiction regarding economic contacts - extending to a certain extent even to the company level - a comprehensive liberalisation has been initiated. Secondly, with the special economic zones in the Chinese coastal areas, clear market economy elements have allegedly been introduced. The autonomous room for manoeuvre of individual economic units has been strengthened thereby, and a decisive step towards a suitable market framework has been taken. In addition, tariff schedules were thoroughly revised and the old process of setting prices centrally for foreign trade goods was replaced by various pricing mechanisms.

China's request is considered a special case by the GATT/WTO. By early summer in 1989 the majority's opinion was essentially in favour of accession, as the People's Republic was ready to bring market economic elements to the centre of its foreign trade system. Following the massacre in Tienanmen Square in June 1989 and continuing human rights violations with bloody repression of the democratic movement, however, the Chinese application was not negotiated any further.

After lengthy discussions China's request to join the WTO as a founder member failed in December 1994 after the United States and the EU unequivocally refused to concede China the long transition period for bringing down tariff barriers which is associated with the status of a developing country. The next obstacle was the dispute between the USA and China on the spread of copyright piracy in the video, audio and computer

software sector. Since March 1995 this impediment seems to be overcome, and negotiations have been resumed but educated guesses assume that further necessary discussions will not come to an end within the foreseeable future.

Other countries in transition stand in line for membership. Most prominent among them, the **Russian Federation** filed an application in 1993, renewed and re-addressed to the WTO in late 1994. The approach of its predecessor - the former Soviet Union - was somewhat cumbersome. After first taking up contact with the GATT in 1982, the former Soviet Union probed again in 1986 about the possibility of receiving observer status in the framework of the Uruguay Round. This attempt failed as it came up against the clear resistance of some Western countries. Above all, America brought political, strategic and security considerations into play. There was no clear refusal; rather an invitation from the Council of Ministers responsible for the initiation of the Uruguay Round only went to members of GATT and most Third World countries.

However, one can also blame partially the failure of the attempt to come closer to GATT on the fact that the former Soviet Union made tactical errors beforehand. The Secretariat had signaled (Brabant 1988) to the Soviet emissaries at their first meeting that - according to the more informal discussion process in GATT - it would be advisable to consult important member countries before formal application was to be initiated or public announcements made.

As the basic idea of the Russian economic reform is to strongly dissuade state intervention in production and foreign trade to the benefit of decentralised and macro-orientated decisions, it is a matter of changes in the basic setting of macroeconomic policy which had been demanded by GATT members from state-trading countries earlier. However, Russia has only made moderate progress in implementing the reform concept. The most important refraining factors responsible for this were inflation, political instability and the evident shortage of foreign exchange.

Presently, Russia still faces reservations among WTO members while the EU is going ahead with substantial offers in the field of trade policy. From a Russian point of view,

membership of the WTO should help to push ahead with economic reforms. In particular, pressure from outside may be pertinent to consolidating and stabilising the process of reforms and stepping up the rate of economic growth. Furthermore, this step should support a liberalisation policy helping to integrate the economy into the world economy on a long-term basis. Of course, Moscow also wanted to gain influence in the drawing up of new multilateral rules for the world-wide exchange of goods, services and capital - subjects which, for the time being, have been finalised in the Uruguay Round.

In July 1995, talks for membership were re-started in Geneva after some political isolation at the international table sparked off by the war in Chechnya has obviously been overcome. The stepped-up activity of the Russian government in the context of trade talks may have its explanation in the desire for political goodwill and the necessity to add to the complex reform process an element of 'success' at the external flank. The obligatory report on trade policy and the instruments employed as of March 1994 must be supplemented by extra information on at least two new WTO subjects, i.e. services and the treatment of trade-related aspects of intellectual property rights. Clearly, the Russian side has a keen interest in the swift integration into the multilateral trading system. However, despite a basically favourable attitude among major trading nations, the rapid change of various elements of economic reform will require intense reviewing of facts and figures, the quality of which is also a matter of concern. Further negotiations will be lengthy and may last years rather than months<sup>7</sup>.

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<sup>7</sup> **Bulgaria's** request for accession (1986), connected with the attempt to be recognised as a developing country (and granted respective preferences and concessions) has long been in the political shade of the Soviet Union's request. There was the fear in the eyes of some Western officials of creating a precedent for such larger NMEs as Russia and China. In a cat-and-mouse game between the US and the EC, it was discussed on whether standard or non-standard terms of reference should be employed. It became clear that it was not the alleged "systemic economic differences" which mattered (Haus 1992); rather it was no particularly ingenious way of prolonging talks. Ultimately the country will be allowed to join, but procedures will drag on as do economic reforms.

### Substance of the Europe Agreements

As the CEECs reform their economies, the expansion of their foreign trade and changing trade pattern deserves access mainly to industrial markets. The 'natural' export outlets of Eastern Europe are the advanced industrial countries of Europe, i.e. the EU and the few remaining non-member countries in Western Europe while total amounts of Eastern European trade with dynamic Asian economies remain *relatively* small (Collins/Rodrik 1991). Expanding trade relationships with the EU are of central importance in the process of strengthening CEEC economies. This is why the EU has been considered to be "the trade anchor of the transformation process in Central and Eastern Europe" (Inotai 1994).

The EU liberalisation programme vis-à-vis the CEECs in terms of market access for industrial products has made substantial progress. After agreements on trade and general economic co-operation, *quantitative restrictions* (QR) - with important exceptions<sup>8</sup> - have been suspended. Also, these countries were deemed fit for inclusion in the group of beneficiaries of the Generalised System of Preferences (GSP) - with reference to the similarity of basic economic conditions of countries in transition with those of developing countries. Beneath the envisaged full EU membership, the highest degree of market opening has been achieved by the Europe Agreements (EA) which came into effect in March 1992 for the Visegrád countries, in May 1993 for Romania, and in December 1993 for Bulgaria<sup>9</sup>. The Baltic states signed EA in June 1995; the next candidate will be Slovenia.

The decisive improvement in trade relations with the EU was the autonomous suspension and subsequent abolition of discriminating QR for CEECs in the early phase of their transformation, when stepped-up export sales potential was the more desired the more

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<sup>8</sup> As to the 'weight' of sensitive products in EU-CEEC trade see table 2.

<sup>9</sup> The trade policy sections came into operation in advance of the entire arrangement by means of interim agreements. The full Agreements for Hungary and Poland entered into force on Febr. 1, 1994 and those for Bulgaria, the Czech Rep., Romania and the Slovak Rep. on Febr. 1, 1995.



traditional trade ties were breaking down (Möbius 1993). In fact, in the sensitive sectors of iron and steel as well as textiles - both of quite some significance for CEECs - it was the EA that brought about a breakthrough: Iron and steel products ceased to face QR when the interim agreements became effective<sup>10</sup>; with textiles, liberalisation is progressing more slowly and differentiated: as a rule, the less utilised the quotas, the faster the liberalisation.

Moreover, the EA brought about the immediate abolition of *tariffs* for the majority of industrial goods. In accordance with previous GSP proceedings,<sup>11</sup> the duty-free quantities of imported goods initially remained restricted in the case of sensitive products. This was flanked by annual increases in tariff quotas and ceilings whilst tariff levels for quantities overshooting these limits were reduced. In detail, the size of tariff cuts varied between countries and product groups. As a result of the acceleration of the liberalisation schedule agreed at the Copenhagen Summit in June 1993, the EU had lifted almost all tariffs and quantitative restrictions on industrial imports from associated countries by January 1, 1995. The only exceptions were certain steel as well as textiles and clothing products. For steel products, all quantitative restrictions on imports from the associated countries were immediately abolished, and tariffs should be completely phased out by the end of 1995. For textiles and clothing products, some of the associated countries' quotas have been abolished, the remaining ones substantially augmented (Schumacher/Möbius 1995); tariffs are scheduled to disappear by the end of 1996/97, and quantitative measures should be eliminated in 1998, i.e. several years before the deadline envisaged in the Uruguay Round (WTO 1995).

Summarising, it can be stated that undoubtedly the lowering of barriers for CEECs' exports has had a significant positive impact on their trade prospects. Here, the lifting of QR, or increase in quotas respectively, was more important than tariff cuts - partially offset by changing relations between internal prices and exchange rates. Disproportionate

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<sup>10</sup> Except coal from Poland and the Czech and Slovak Republic in Germany and Spain. These two EU countries must lift their QR by the end of 1995.

<sup>11</sup> Under the present regime, in operation since Jan. 1, 1995, quantitative restrictions of duty-free treatment have been lifted.

liberalisation on either side may be justified if the weaker partner is only in a position to proceed more slowly by taking smaller steps. However, as the openness of an economy also in Western Europe is related to its pace of economic development, there is at present a built-in propensity in favour of protectionism. What is the point of bringing down tariff barriers for certain import volumes if the exceeding amounts are not exposed to m-f-n treatment but rather to penalty tariffs of 25-30% as in the case of certain steel products from the Czech and Slovak Republic? The same applies to textiles: on the one hand, thanks to the rules of the Single Market, bilaterally agreed contracts apply to the entire territory of the EU but on the other, safeguards and stipulations referring to good conduct serve as a deterrent to dampen export enthusiasm - traditional trade relations should not be ruined by export surges from newcomers. This is an expression of the notion that established trade channels ought to be defended (Möbius 1993). Part of this game among unequals is the intention to provoke some kind of preventive response in exporting countries which translates in reality into 'voluntary' restraints once it deems fit for the importing country. In this game, only strong players like Japan have the opportunity to compensate their 'voluntary' export reduction by extra investment in the market region.

Of course, the "anchor function" of trade with the EU is also valid with respect to agricultural products. The EA consolidated preferences granted under the GSP, with certain improvements. However, here too some of the sectors in the CEECs that are most capable of exporting and earning much needed foreign exchange are the ones that are the most "sensitive" and therefore highly regulated within the EU. The political resistance to liberalizing these sectors within the EU is in direct conflict to foreign policy and security objectives of stabilising the emerging market economies in Central and Eastern Europe<sup>12</sup>. "Agriculture is a prime example of a sector where the CEECs seek and need better access to the EU market, but where the EU finds it politically difficult to be more liberal" (Tangermann/Josling 1994).

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<sup>12</sup> With regard to the importance of the agricultural sector in CEECs' economies see table 3.

Because of its sensitive nature and the mechanisms of the EU Common Agricultural Policy, agricultural trade was considered separately in the EA. In general, the concessions were less favourable than in other sectors. They cover a ten-year period and were to be "asymmetric" in favour of the CEECs. Special arrangements limit the degree of EU agricultural market access for the CEECs. For most agricultural products the import duties and levies were reduced, but this reduction applies only to limited quantities of exports. In general, the concessions entailed a 10% increase in quota each year for the first 5 years, the levy or tariff reduction being -20%, -40% and -60% in the first three years, with a subsequent freeze. The base periods for the determination of the reduced levy quotas (for most countries the years 1988-90 were taken as reference period) turned out to be periods of depressed EC-CEEC trade. Average imports during this time were taken as the basic quantity for assessing quotas. Consequently, substantial increases in percentage terms of these quotas over time do not correspond to the true export potential in the CEECs. Furthermore, increased exports of the products which are most severely restricted in terms of EU market access (beef, dairy, cereals, sugar) are the ones which would greatly benefit the CEEC. In this view, a revision of the EA in accordance with the alleged liberal spirit of these agreements might be the most suitable form of assistance for the ongoing economic reforms in Central and Eastern Europe (ibid.).

In a preliminary assessment of the EA (Kawecka-Wyrzykowska 1995), the following can be listed among the *positive* effects:

- gradual exposure of enterprises to foreign competition thus pressing for constant monitoring of the costs of production,
- provision of a platform for economies of scale in wider markets for those companies fit for competition, and the
- virtue of a banister to stabilise the CEECs' economic and trade policies.

Experiences have been *negative* due to the following reasons:

- liberalisation has been slowest for those products which constitute the main items in the scale of exportable goods - thus reducing the scope of immediate export increases,

- disappointment because of rising protectionist tendencies in Western Europe since the EA have been concluded, and
- dissatisfaction with the development of the trade balance as import growth was higher than the hoped-for increase in exports.

In particular the agricultural provisions of the EA have come under severe criticism, especially with the conversion of an EU agricultural trade deficit into a surplus. It is maintained that the asymmetry is in the opposite direction from that intended. The criticisms include the following (Tarditi/Senior-Nello/Marsh 1994):

- The pattern of trade during the base period is said to reflect the legacy of the state-trading system and the upheavals of the transition period rather than any longer term comparative advantage. By excluding important products from liberalisation, the product coverage is felt to be too limited and the degree of concessions too modest.
- Quotas have not been designed in a meaningful way (unless they are interpreted as the outcome of skillful planning on the importer's side) because some have been exceeded by large margins and others were not used at all.
- In a situation where domestic CEEC products were already having difficulties in competing, the EU continued to apply export refunds on its agricultural exports.
- The Agreements failed to remove many barriers. Proof of this is, e.g., minimum import prices on imported soft fruit (used in 1992 and 1993 to suspend imports from Poland) and 'voluntary' export restraints on sheep and sheepmeat.
- The EU regulations for issuing quotas require that licenses, necessary up until the quota level is reached, are granted to firms based in the EU with at least one year's experience in trading that product.
- The consequences of tight health regulations and veterinary standards on trade volume were not made clear in advance but may in practice lead to severe import impediments.

Summarising, evidence suggests quite strongly that the EA have played an overall positive role for the CEECs in opening up the EU market to their industrial exports but

substantial reservations remain with respect to the way the provisions regarding agricultural trade have been fixed.

### **The position of SU successor states**

When the former Soviet Union ceased to exist, foreign trade for most of the fifteen successor states was a subject in which they had very little experience, due to the previous dominance of state-trading organisations in Moscow. In fact, not only "third country" but also "interstate" trade literally collapsed. Though the supply side problems bear most of the responsibility for the decline in trade, there also are tariff and non-tariff barriers in Western markets that matter. While energy and raw materials, which account for a significant portion of total exports, encounter few problems of market access, barriers on traditional industrial goods are substantial. As they address their supply side problems, these countries may realise that problems of market access will constrain their future export expansion.

Following independence, the new states faced the trade barriers that had been applied to the former Soviet Union. They were high and discriminatory for political reasons to counter state-trading practices. Moreover, since these new countries, like the Soviet Union before them, are not members of the GATT/WTO, they are subject to rules decided by each importing country or regional integration group.

Though the average *tariffs* facing the new independent states in most Western countries were only about 5 to 7 percent, the tariff preferences, extended to developing countries and to each other in free trade areas or economic unions, constituted a serious competitive disadvantage to exports. There is considerable tariff escalation as well, with effective tariffs exceeding nominal tariffs by a wide margin.

*Non-tariff barriers*, mostly QR, have also been a significant impediment to trade, especially in agriculture, food products, leather, textiles, and ferrous metals. Anti-dumping actions have been a particular problem for several countries. The new independent states 'inherited' anti-dumping actions started against the Soviet Union and

were also subject to new ones. Belarus, Georgia, Kazakhstan, Russia, Tadjikistan, and Ukraine have all been the object of some sort of anti-dumping action on a variety of products from aluminium to ferro-silicon and uranium (Michalopoulos/Tarr 1994). The EU has alleged that since transport and energy prices are below world market levels, sectors making extensive use of these inputs are artificially competitive.

In the course of 1992, most OECD countries started to grant m-f-n treatment and eligibility for the GSP to countries of the former Soviet Union, beginning with the Baltics. Most new independent states had applied for and been granted observer status at the GATT, though none has become a member yet [cf. table 1]. Thus there was no relevant reduction of trade barriers for these countries. Moreover, non-tariff barriers seem to have increased rather than decreased, as evidenced by the growing number of anti-dumping actions. Remaining barriers, together with the preferences extended to other countries, the lack of membership in GATT/WTO, and the heritage of state-trading countries, means that the majority of the new independent states are severely affected.

What are the main options for this group of countries to improve access to Western (European) markets? First, there is generally the demand for wider market access and in this context all GSP schemes might be extended to all successor states of the Soviet Union, with equal treatment for all partners. This would at least create a level playing field for them compared to exporters from countries at similar stages of development (Kaminski 1994). Second, retaliatory measures should be modest with allegedly "disruptive" imports originating in countries undergoing sustainable stabilisation and structural adjustment programmes endorsed and supported by the IMF and the World Bank. Because of inherited distortions, former NMEs cannot be expected to carry out painful reforms internally and observe all restrictions in foreign trade simultaneously. Third, accession to the WTO should be expedited. The discipline of the "Club's" rules, committing members to binding tariffs and, in turn, obtaining greater market potential would ultimately allow them to benefit from the welfare gains associated with a more predictable framework of foreign trade and with trade expansion. Fourth, as the chances for making use of the potential for mutual trade with Western partners cannot fully be grasped because of the exceptionally high transaction costs in trade with most SU

successor states, it is indispensable to tackle problems like poor communication, low discipline of contracts as well as uncertainty on deliveries and payments (UN-ECE 1994) in the very near future.

### **Mixed blessings of preferences**

At this point, a few reservations may be added with respect to expectations associated with preferences in favour of countries in transition. As there is experience with previous efforts to bring another group of countries to the fore in terms of world market integration, it may be appropriate to draw on empirical evidence of how preferences worked in practice after they were designed to foster trade integration of developing countries. In this context, the following features of preferences should be recalled (Langhammer 1987, 1995b):

- preferential treatment cannot compensate for bottlenecks on the supply side,
- preferences tend to compartmentalise markets and require a number of costly and partially protectionist monitoring procedures (e.g. rules of origin, direct shipping) or considerable administrative work to keep abuse in check,
- preferences are being installed by their providers in a trade diverting manner
  - instead of trade creating, and
- even if they were of a trade creating nature, the benefits tend to go to the wrong recipient.

Also, there is one truth which is easily forgotten when preferences seem to be the prime solution: Expectations with regard to export increases on the basis of preferences - in general grossly overestimated - implicitly assume that (a) supplier countries do not adjust prices if border levies shrink, (b) market supply is completely elastic, (c) extra demand will be unhampered by customs quotas or QR, and (d) tariff cuts will be passed on to consumers (Möbius 1992). All of these assumptions are highly questionable. Both with developing countries in the past and transition countries now, trade concessions by main importers (OECD countries) were concentrated in non-sensitive manufacturing sectors where export growth has been weaker. In other words, trade in agriculture, iron and

steel, chemicals and textiles remained subject to numerous protective devices (UN-ECE 1994).

EU trade policy in particular has been characterised from the very beginning by two components incoherent with a truly liberal stance, i.e. a policy being discriminatory in nature by "special and differential treatment" and demanding compliance with rules having strong elements of "managed trade" ('voluntary' export restraints, anti-dumping proceedings, import monitoring, safeguard provisions). It has been rightly stated (Langhammer 1995a) that the main characteristics of EU trade policy is "contingent" protection (contrasting with "surgical" policies) imposing a strong random element by using "short-term yardsticks for market entry subject to internal policies rather than setting stable and predictable conditions and applying clear instruments such as tariffs, quotas, or tariff quotas" (ibid.).

The argument in favour of trade on a preferential basis as an external contribution to adjustment policy is an extension of the argument for moderate support of domestic industry. In the long run, however, there is need for thorough restructuring of production. Thus, in order not to hamper the long-run integration of these economies into the global trading network, preferences should be temporary and decline on a pre-announced schedule. In reality, it is difficult to gauge how long such a temporary arrangement should last. However, the longer the exception lasts, the more entrenched protected interests of sluggish adjusters become and the more difficult the transition will turn out to be (Michalopoulos/Tarr 1994).

### **Conclusions**

More advanced than other countries in transition, the CEECs were able to make even more headway after becoming EU associates with the EA status. However, built-in dampening effects - more market access only if there is no import-competing interest to be protected - have brought about some disenchantment as to the opportunities of speedy economic integration with Western Europe. As may be learned from the experience of developing countries, preferential trading terms granted by major importers - with the



EU as the most prominent among them - are mostly *ex ante* overvalued in their impact on extra trade volumes. In particular, the distribution of resulting benefits, quite frequently, turns out to be lopsided in the opposite direction than intended by the preference-seeker; as licenses are issued to established companies in the importing country, these enterprises are in a strong position to capture much of the economic rent arising from preferences.

However, as there is demand for preferential treatment, there obviously is some net benefit. Nevertheless, the smaller it tends to be in regional schemes, the higher the inclination to strive for participation in a multilaterally shaped set-up for foreign trade, carried out on a world-wide scale. In fact, both things can be done: taking advantage of preferences, where possible, and trying to reap the benefits of special tariff rates and non-discriminatory treatment associated with m-f-n status. This is why the list of applicants to GATT/WTO is long. Yet here, it is a matter of lengthy discussion before admission is granted - this process being not only dragged on by some 'Western' countries but also by a number of developing countries which are economically in a fairly equal position as countries standing in line.

To avoid disappointment it should be borne in mind that the old GATT has not only been a multilateral activity with widespread country coverage for bringing down customs barriers, but also it has been a pact against discrimination, i.e. a high level of protection agreed upon in a non-discriminatory manner would not have violated GATT rules. WTO is different because it offers stronger trade remedy rules. These will have to be employed; as yet there is little experience in this area to draw on. Notwithstanding the new organisational set-up, liberalisation will remain an offspring of favourable general economic circumstances. Successive liberalisation steps, in a predetermined time frame, may be argued for but cannot be enforced in practice. Moreover, of course, multilaterally agreed rules do not necessarily control power-orientated national trade policies.

The CEECs and the SU successor states seem to agree on the *de-facto* rules of the game. What is needed presently is the streamlining of the entire procedure of admission. Admittedly, there does exist the established formal framework for submitting a

memorandum on the foreign trade regime, the subsequent round(s) of questions and answers, the report of the Secretariat on the economic situation of the candidate, and the (multilateral) negotiations of the accession protocol - not to speak of (bilateral) consultations. However, there seems to be the need for a more rigorous methodology as to what is going to be under review altogether and what changes in institutions and policies have to be effected before the respective Working Group comes to its final recommendation for the Council of Ministers. Somewhat arbitrary procedures, like the present endeavour of applicants to present their case, in several successive stages, to the members may be supplemented in order to come to a transparent monitoring system which will give more indication of how long the entire screening procedure will last. There can, of course, be no formal guarantee as to the nature of the final decision. Nevertheless, more predictability with regard to the length of the proceedings would be essential for meaningful domestic decisions during transition.

Table 1

## Relations of (former) state trading countries to the GATT/WTO

Country	GATT				WTO	
	Contracting Party	Application filed	Observer	No contractual relations	Membership	Accession request <sup>a</sup>
					as of end of July 1995	
Albania		1992				X
Armenia		1993	1992			X
Azerbaijan			1993			-
Belarus		1993	1992			X
Bulgaria		1986	1967			X
China, PR <sup>b</sup>		1987				X <sup>c</sup>
Croatia		1993				X
Cuba	1948 <sup>d</sup>				Apr. 20, '95	
Czech Rep.	1948 <sup>e</sup>				Jan. 1, 1995	
Estonia		1994				X
Georgia				X		-
Hungary <sup>f</sup>	1973		(1966)		Jan. 1, 1995	
Kazakhstan			1992			-
Korea, DPR				X		-
Kyrgyzstan						-
Laos				X		(X) <sup>g</sup>
Latvia		1993				X
Lithuania		1994				X
Macedonia		1994				X
Moldova			1993			X <sup>h</sup>
Mongolia		1991				X
Poland <sup>i</sup>	1967		(1957)		July 1, 1995	
Romania	1971		(1957)		Jan. 1, 1995	
Russian Fed.		1993	1990/91 <sup>j</sup>			X
Slovak Rep.	1948 <sup>e</sup>				Jan. 1, 1995	
Slovenia	1994				July 30, '95	
Tadjikistan				X		-
Turkmenistan			1992			-
Ukraine		1993	1993			X
Uzbekistan		1994				X
Vietnam				X		X
Yugoslavia	1966 <sup>k</sup>		(1950)			

(a) Countries having filed an application with GATT were allowed to transfer it to the WTO.- (b) Founder member, withdrawal 1950.- (c) Observer to the WTO Council since July 11, 1995.- (d) Founder member.- (e) Czechoslovakia founder member, after separation both states acceded in April 1993.- (f) Member of Cairns Group (involved in agricultural negotiations in the Uruguay Round). Intention to re-negotiate its protocol of accession as an emerging market-orientated economy.- (g) In suspense.- (h) In accession proceedings; formal request pending.- (i) Re-negotiation of its protocol of accession.- (j) Observer to GATT Council since 1990, and on the Committees on Import Licensing and Anti-Dumping since 1991.- (k) Preliminary accession 1962; Serbia-Montenegro is not a member.

Sources: Machowski/Schultz 1989.- Extended and updated on the basis of GATT, International Trade (Trends and Statistics) 1994; WTO, GW/13 (04.01.95), PRESS/14 (31.05.95), PRESS/17 (04.07.95), and WT/L/51/Rev. 2 and 3 (05.07.95), communication of the WTO Secretariat as well as press reports.

Table 2

## Shares of sensitive products in EU imports from CEECs

		1988	1989	1990	1991	1992	1993	
<b>Czecho- slovakia</b>	A:	42.4	42.8	44.1	41.8	41.0	38.5	Czech Rep. 36.3 31.0 26.4 Slovak Rep. 47.8 42.9 39.6
	B:	33.6	34.8	36.5	34.2	34.8	33.3	
	C:	26.5	26.2	28.6	28.1	29.8	28.9	
<b>Hungary</b>	A:	62.1	61.4	58.6	56.7	53.5	51.0	
	B:	54.5	54.2	51.9	50.5	48.0	45.7	
	C:	26.0	24.9	27.7	25.3	27.2	27.6	
<b>Poland</b>	A:	43.9	48.9	50.3	48.8	46.2	42.7	
	B:	39.2	43.9	43.7	41.7	40.6	38.6	
	C:	19.1	20.7	22.3	24.4	27.1	27.8	
<b>CEE-5*</b>	A:	46.2	47.3	49.9	49.0	47.9	45.3	
	B:	39.5	41.2	43.4	42.2	42.2	40.5	
	C:	23.7	23.8	26.4	26.7	30.0	30.4	
<p>Note: Figures indicate sensitive products in per cent of total trade.  (A) Includes chemical products among the sensitive sectors.- (B) Excludes chemicals.-  (C) Excludes chemicals, agriculture and food (but includes iron and steel, textiles, apparel and footwear).  (*) Bulgaria, CSFR, Hungary, Poland, Romania.  Source: Drábek/Smith 1995, on the basis of Eurostat COMEXT data.</p>								

Table 3

## Significance of agriculture for Central and East European Countries

	Share of agriculture in GDP			Share of agriculture in employment			Number of people employed in agriculture		
	in per cent						in 1.000		
	1989	1993	1994	1989	1993	1994	1989	1993	1994
Bulgaria	11	9.6 <sup>a</sup>	11	18.1	17.4	21.7	909	698	684
Czech Rep.	6.3	6.1	5.6	9.4	6.7	6.4	906 <sup>b</sup>	233	215
Hungary	15.6	5.6	..	17.9	9.9	..	752	431	..
Poland	8.2	6.8 <sup>c</sup>	5.2	26.4	25.2	(25) <sup>d</sup>	4 676	3 700	(2 700) <sup>d</sup>
Romania	14.4	23.7	..	28.2 <sup>e</sup>	32.2	..	2 839	2 053	..
Slovak Rep.	9.4	5.9	6.0	12.2	10.3	9.9	..	225	216

(a) Forestry excluded in 1993.- (b) Czechoslovakia.- (c) Figure for 1992.- (d) Rough estimates.- (e) Figure for 1985. - "...": Not yet available.

Sources: Buckwell/Haynes/Danidova/Kwiecinski 1994, p. 22; updated by DIW on the basis of national data.

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