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East European Integration and New Division of Labour in Europe

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Zusammenfassung

Die Beiträge in diesem Band sind das Ergebnis eines Workshops der unter dem Titel: "East European Integration and New Division of Labour in Europe" am 10. und 11. April 1997 am Institut Arbeit und Technik in Gelsenkirchen stattgefunden hat.

Zielsetzung war eine kritische Diskussion zu den institutionellen Rahmenbedingungen und politischen Strategien für die Integration von mittel- und osteuropäischen Ländern.

Mit Blick auf ein erweitertes Europa wurden neuere politische und ökonomische Entwicklungen einer näheren Betrachtung unterzogen. Zwei Thesen standen dabei im Zentrum der Diskussion.

1. Eine rasche Integration von zehn oder gar mehr Mitgliedern in ein zukünftiges Europa wie sie momentan diskutiert wird, erfordert erhebliche Veränderungen in den institutionellen Voraussetzungen der EU, aber auch der NATO.

2. Neben formalen Anpassungsprozessen wie z.B der Übernahme des "Acquis Communautaire" und anderen Erfordernissen für die Mitgliedschaft in EU und Nato, sind die Länder Mittel- und Osteuropas bereits durch Handelsbeziehungen und ausländische Direktinvestitionen in eine neue europäische Arbeitsteilung eingebunden. Ein Ausbau dieser Beziehungen ist für alle Seiten mit mehr Gewinnen verbunden als einseitige Transferleistungen, die in nächster Zeit ohnehin Veränderungen unterliegen müssen, da sie bei einer Erweiterung der Union nicht haltbar sind.

Die Beiträge in diesem Band beziehen sich, entsprechend diesen Thesen, zunächst auf generelle Fragen zur politischen Dynamik des Integrationsprozesses. Zukunftsszenarien zur Entwicklung des europäischen Raums sowie Probleme der NATO und der Europäischen Union ihr strategisches Denken und ihre Organisationsstrukturen auf die neuen Gegebenheiten auszurichten stehen am Beginn. Die folgenden Artikel lenken ihr Interesse auf neuere ökonomische und sozio-ökonomische Entwicklungen in ausgewählten Ländern. Dabei werden Fragen aufgegriffen, wie sich die Lasten und Vorteile einer Integration in Ost und West verteilen und wie die faktische Unterstützung, aber auch Handel und Investionen dazu beitragen, eine neue Arbeitsteilung in Europa entstehen zu lassen.

Sicher können die hier zusammengefassten Analysen nur Schlaglichter auf ein sehr komplexes Problem werfen. Dennoch zeigen sie Entwicklungen, die auf eine zunehmende Integration der Ökonomien in Mittel- und Osteuropa in die westeuropäischen Produktionsketten hinweisen. Gleichzeitig wird aber auch deutlich, daß die Unterschiede zwischen den einzelnen Ländern sich im Laufe einer Dekade eher vetieft haben. Was die Reformfähigkeit der Europäischen Union selbst angeht, sind viele der angesprochenen Probleme weiterhin ungelöst und es stellt sich die Frage, inwieweit eine verschobene Lösung nicht auch eine Verschiebung der europäischen Integration insgesamt bedeutet.

Wolfgang Potratz/Brigitta Widmaier

Introduction

The contributions in this volume are the result of the workshop "East European Integration and New Division of Labour in Europe" held on April 10/11, 1997 in the Institute for Work and Technology, Gelsenkirchen.

The workshop aimed at a critical discussion of the institutional framework and political strategies for the integration of Central and Eastern European (CEE) countries, and at the assessment of some of developments under way since the beginning of this decade. With view to a larger integrated Europe, we started out with two main theses:

1. Fast integration of ten or more new members of a larger Europe requires a quite substantial change in institutional preconditions, in particular of the European Union, but also from the side of NATO.

2. Apart from the formal adaptation of CEE countries to the "acquis communautaire" and other requirements of the EU, economic processes like trade relations and foreign direct investment have already incorporated CEE countries in a new division of labour.

With the selection of our topics and the invitation of contributions to this workshop, we tried to shed light on these problems. We now present the results which of course, can only be spotlights on a very complex situation.

European summits of recent years have proposed the enlargement of the European Union through the accession of some of the associated Central and Eastern European countries. Ten countries in this region have submitted applications for membership to the European Union. Although the time range and conditions are not specified yet, the Commission has undertaken steps to assist these countries in their endeavours to join the Union. It has been clear from the beginning, however, that the accession would raise problems and challenges to *both* sides, and consequently each strategy will have repercussions on all actors concerned. Without a long-term conception about the goals and means for the integration of these countries mutual expectations might be difficult to be satisfied.

We have been looking at such questions not only in connection with the European Union, but also with future integration of the CEE countries into NATO because, from the beginning, political and economic stability as well as military security have been the essentials of the European Communities and also today, NATO has vital interests in political and economic support for the transformation process.

The shape and functioning of these organizations which have developed under different historic constellations and their ability to reform in a way so that they are able to support socio-economic change in the reform countries will determine the future of the European landscape. Political stability and military security, however, will only be feasible if the CEE countries themselves become strong economic partners within a larger Europe because this is a necessary condition for growth and welfare of citizens.

These headings are represented by the topics in this volume. It starts out with general questions of the dynamics of the integration process and deals with the problems of NATO and European Union to redirect their strategic thinking and organizational structures. The following papers look for recent economic and socio-economic developments in selected accession countries; two contributions deal with developments in particular countries: the Czech Republic and Croatia. Finally, the eastern enlargement is seen under the aspect of what the European Union is doing to support the accession countries and who the potential winners of the integration process might be.

In the first paper of this volume Antoni Kukliński deals with the enlargement of the European Union under a dynamic and holistic perspective. Four scenarios are presented as a framework for the thinking about the future of Europe. Kuklinski argues that, even if in 2010 we have a Europe of 25, there will be considerable differentiations on political, economic and social dimensions which, however, should be considered under a common framework. He claims that the accession of the ten associated CEE-countries requires an active and prospective adaptation and that integration and transformation can have a strong mutual reinforcement effect.

The contribution of Ulrich Brandenburg points to the fact that NATO already has undertaken steps in order to integrate new cooperation partners from East and West by launching the "Partnership for Peace"-Programme. In doing this NATO abolishes the decade-long separation of the world in two opposing military blocks and re-defines its strategies towards cooperation in matters of military organisation and democratization and crisis management.

Potratz and Widmaier discuss the question how the institutionalized distribution systems and procedures of the European Union might run into problems if more countries are to participate. Among other things, it is argued that countries in CEE are badly advised if they only rely on financial support from the structural funds. Trade and direct investment, as they develop now, are a means for integration whose benefits are not deployed adequately yet by either side.

Christian Weise makes an assessment of the costs of integration under the given distribution rules of the EU-funds and stresses necessary reforms in order to make eastern enlargement financiable. Starting with an extrapolation from the present situation, he makes clear that even if only half of the estimated costs would come true, this would constitute an almost unbearable burden for the present member states. In contrast to the "status quo", he offers two scenarios which would keep these burdens within reasonable bounds. Necessary condition are reforms of EU-policies concerning structural and agricultural funds. Such reforms have been on the agenda already for many years and, even irrespective of the enlargement are vital for further development of the Union.

Roland Döhrn studies the impact of trade on the economic structure of the Central and Eastern European countries and their changing position in production chains with their new trade-partners. CEE countries have, within a remarkably short period of time, redirected their trade flows. Whereas re-orientation of trade towards the west has been remarkable, expansion of trade so far can scarcely be attributed to higher income. Beyond that, leaving the volume of trade aside, there are clear differences to be observed between the accession countries as to their involvement in intra-industry-trade, which is a yard-stick of integration.

The economic situation of the Czech Republic in particular in terms of investment behaviour is analysed by Pavel Mertlik and Ladislav Prokop. Though the development of investment activities and investment rates is quite encouraging in the recent past, it remains a question, whether it can trigger the necessary export-oriented restructuralization and modernization of the Czech economy. Still there seems to be more "adaptive adjustment" instead of "strategic restructuring".

Siegfried Lange discusses the procedure of the establishment of industry-related R&D in Croatia. He shows that western models can not be simply transferred and thereby he gives an account of what ‘institution building’ really means. In a very illustrative way he describes the differences between the views and perceptions of western consultants and eastern actors, e.g. concerning information behaviour, the exchange of information, or notions such as ‘cooperation’ or ‘competition’. Building bridges to cross these social and cultural barriers according to his observations ‘on the job’ are vital to microeconomic development of firms as well as to cooperation across borders.

David Ellison, finally, gives a comprehensive overview of EU-policies of integration and their shortcomings. His main argument is, that whatever strategy will be followed, it will primarily be the member states of the EU, who will profit from enlargement, and that the larger burden will primarily rest with the applicant countries. He criticizes the EU-Commission for largely ignoring these potential gains for the member states in their strategic concepts and arguments. On the other hand he makes clear that the longer it takes to integrate these countries, the longer it will take to assist them with the costs of transition and restructuring - without enjoying the benefits of more competitiveness and running the danger of losing internal cohesion instead. To fairly distribute the costs among those who benefit most, however, is an internal problem among the present EU member states, not the applicant countries.

As has been said in the beginning, the proceedings of a workshop can only cast a spotlight on the complex and dynamic situation in Europe. They can show developments under way like the increasing integration of CEE economies in European supply and production chains, though, at the same time differences in the progress of transformation between countries become more obvious. It also becomes clear, that some of the observations and criticisms articulated in the in the papers go on. The reforms in the European Union still proceed in a very slow pace. The issue of enlargement is and remains the test for the commitment to a larger Europe.

Antoni Kukliński*

The Enlargement of the European Union. The Accession of Central and Eastern European Countries. The Perspective of 2010

Introduction

The enlargement of the European Union is not an abstract and isolated process. It is a dynamic and comprehensive process deeply embedded in the changing global and European scene. So the acts of accession will not be performed in the framework of a static pattern but in the framework of the deep transformation of the whole European scene where different subjects and objects move at different velocities and very often in different directions.

This dynamic and holistic approach is the guide-line for the analytical composition of this paper; it will try to cover the basic aspects of Europe in the global perspective, the differentiated potential of the ten associated Central and Eastern European Countries and the necessary transformation of the countries before and after accession.

1. Europe 2010 in the Global Perspective

The past, the present and the future of Europe are not monolithic but deeply pluralistic.
At the turn of the XX to the XXI century Europe is facing a set of turning points. The internal logic of transformation and the global challenges are well expressed in the Four Scenarios of European Development.[1]

a. The Franciscan Scenario
b. The Darwinian Scenario
c. The Thurowian Scenario
d. The Singapurian Scenario

a. The Franciscan Scenario

The Welfare State was one of the greatest institutional innovations of the 20th century. It was an important instrument to eliminate the suicidal mechanism of social autodestruction incorporated in the philosophy of the 19th century laissez-faire capitalism. The welfare state was the response of the great western liberal democracies to the three challenges of the dramatic

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[1] In this part of the paper I use some materials presented in my earlier contribution The Future of Europe - Four Dilemmas and Five Scenarios, Liber Amicorum of Jos.G.M. Hilhorst, The Hague 1997.

experiences of the 20th century: the Great Depression of the early thirties, the experience of World War II, and to the challenge of the Soviet-socialist ideology and practice.

This is the background to the Franciscan Scenario. In this scenario, the European Union will transform itself into a federal welfare state - following the best traditions of the national welfare states of the 20th century.

Prima facie this scenario is totally unrealistic. The last quarter of the 20th century has generated a deep crisis of the welfare state which - according to neoliberal thinking - will lead to the total destruction of the welfare state in the beginning of the 21st century. It is true that the inefficient and degenerated versions of the welfare state will be rejected and eliminated. But it is also true that the question how to put "some humanity into efficiency" will remain as an important European question of the 21st century.

This means that the Franciscan scenario should not be eliminated from the scope of our attention, since this is the scenario of social justice, social cohesion and social solidarity.

b. The Darwinian Scenario

Europe must face the challenges of the global competition which will be stronger and more ruthless in the 21st century than it was in the 20th century. In this scenario, the European institutions will have no other choice than to support the development of the most efficient social and entrepreneurial actors, local, regional and national communities - in other words - the European institutions will promote "survival of the fittest" who will win in the competitive struggle on the global scene.

The Darwinian Scenario is not an abstract phenomenon, since it is supported by the fatalistic logic of globalization. It is also the surrender of the unique features of the European culture and civilization facing the challenges of the global scene. Nevertheless, this is a very important scenario - deserving a very serious attention in our studies.

c. The Thurowian Scenario

The well-known book "The Future of Capitalism" by Lester C. Thurow could be seen as a starting point of the third scenario - the Thurowian Scenario. It is dramatically exposing the weakness of contemporary capitalism and the necessity of a profound metamorphosis of this system. The weakness ironically is to be found in the "loss" of the former "competitor"; the necessary metamorphosis points into the direction of higher levels of learning skills and infrastructure.

In my view the Thurowian Scenario is probably the best scenario for the future of Europe, since it is the scenario of "long-run social investments in skills, education, knowledge and infrastructure". This scenario will create the long-term competitive advantages for the European economy, which is the crucial problem of the 21st century.

d. The Singapurian Scenario

The Thurowian Scenario is accepting the assumption that both the political system of democracy and the economic system of capitalism will successfully face the challenge of "deep metamorphosis". If, however, Europe will not demonstrate the capacity to face this challenge, then the only way out will remain for Europe to accept a "Singapurian Scenario" restricting individual freedom as a trade-off in relation to the improved collective order and growing economic efficiency. It is clear that the Singapurian model is a great contradiction to the fundamental values and principles of the European culture and civilization.

Naturally, these "Four Scenarios" should not be taken too seriously. However, a comparative evaluation of these scenarios may create a challenging framework for our thinking about the pluralistic future of Europe - and about the grand choices which will be made in Europe probably before 2010. These grand choices related to European reality will determine the trajectory of the European Union as the most important actor on the European scene.

2. The European Union of 2010

In the framework of this paper let us assume that in 2010 the European Union will be the Union of 25 countries - the 15 present members and the ten now associated Central and Eastern European Countries - Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic, and Slovenia. The scale of the enlargement of the Union and the relation between the old and new territory is presented in tables 1, 2 and 3 (see annex). These materials should be interpreted in a comprehensive historical perspective of the expansion of the European Union - seen in the context of the centre - periphery relations in Europe.

This "new map of Europe" is marked by several gaps. Each gap - the eastern, the northern, the atlantic and the mediterranean gap - has had a different scale, depth, quality, and has displayed rather different dynamics in the last 50 years – but above all, these gaps have widened, particularly between the European core and the Central and Eastern European periphery, but also between the Central and East European periphery and the other peripheral countries[2].

3. The Differentiated Potential of the Ten Associated CEECs

The definition - associated Central and Eastern European countries - is not quite correct. Inside this group, we have five definitely central European countries, namely the Czech Republic, Hungary, Slovenia, and Poland; three Baltic Republics which should be described as either central or northern European countries, and two Balkan countries, Romania and Bulgaria, which belong more to southern than to eastern Europe. The three really east European countries - Russia, Ukraine and Byelorussia are not included in the group of associated countries. The best approximation to a correct geographical definition of the group of ten associated countries would be: East-Central European Countries - located between West-Central Europe/Germany, Austria/ and Eastern Europe/Ukraine, Byelorussia and Russia.

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[2] W. M. Orlowski. Droga do Europy. Makroekonomia wstêpowania do Unii Europejskiej. The Road to Europe. The Macroeconomics of Entering the European Union. Warszawa 1996. GUS.

These geographical reflections are not 'ars gratia arte' considerations.[3] This is an important dimension in the explanation of the historical and geographical identity of the associated countries. These ten Countries are an important fragment of Europe - covering an area of about 1 Mio. sq. km and incorporating a population of about 100 million. And: this 'new territory' of the European Union in 2010 is not homogeneous but very deeply differentiated in geographical, historical, social, economic and political dimensions.

In the geographical dimension, we have to note the differentiation in terms of locations in relation to the European centre. Let us mention only the difference between the location of the Czech Republic and Bulgaria or the location of Hungary in relation to Vienna and the location of Poland in relation to the European Axis Paris-Berlin-Warsaw-Moscow.[4]

In the historical dimension, there are deep differences in the experience of long duration, expressed, inter alia, in the eastern boundary of the western civilization as analysed by S.P. Huntington.[5]

In the social dimension, there are deep differences in the mental, educational and professional structures of the societies and in their capacities to create and absorb innovations.[6] Economically, there are differences in the ability to promote the full cycle of economic transformation and to develop the deep rootes of the capitalistic economy. And in the political dimension, finally, there are differences in the ability to develop the institutions of the state which should be simultaneously strong, small, liberal, and efficient.

Keeping in mind these and other elements of differentiation, we have to remember that there are two common denominators, which, however, also stress the similarities in the past experiences of these ten countries and the prospects for their future: firstly, the common experiences of the 45 years of real socialism; and, secondly, the common target to join the European Union.

There is now a multitude of studies on the ten accession countries, commissioned and promoted by different units of the European Commission. I think, however, that there is a serious demand for holistic approaches trying to analyse the problem of these countries in toto[7]- taking into account all valid dimensions and especially the prospects for the next 10-20 years. Such holistic studies would contribute to explain the patterns of behaviour of the countries on the trajectory leading to the gates of the European Union.

If we imagine the ten countries as long-distance runners approaching the gates of the European Union - then three observations are appropriate:

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3 compare: Jerzy Kloczowski: East Central Europe - Historiographic Interpretations. in: A.Kukliński (ed.) op.cit. Part Two.

4 compare: Antoni Kukliński: The New European Space (N.E.S.). Experiences and Prospects. in: A. Kukliński. op.cit. Part One.

5 S.P. Huntington. The Clash of Civilization and the Remaking of World Order. Simon and Schuster. New York. 1996. p.158.

6 A. Kukliński. Transformation of Science. The Experiences and Prospects in Central and Eastern Europe. in: A.Kukliński (ed.) Production of Knowledge and the Dignity of Science. Warsaw 1996.

7 compare: Central and Eastern Europe 2000. Final Report. European Commission. Luxembourg 1995.

1. the gates are a moving target
2. at the present moment, each country has a different position in relation to this target
3. the differentiations in the capacity to reach the target among the ten countries have more chances to grow than to diminish.

This is a rather pessimistic interpretation of the collective capacity of the ten countries to reach the gates of the European Union. A more optimistic approach might reveal a more homogeneous performance of the ten countries. The optimistic versus pessimistic hypothesis could be tested via the findings of the Bertelsmann Stiftung report "Mittel und Osteuropa auf dem Weg in the Europäische Union"[8], which, however, would go beyond the scope of this paper. Yet even if some value judgements as they are indicated above would be totally wrong - they would generate academic and political discussions with a strong element of controversy. Such a discussion is necessary to start an open comparative evaluation of the progress of each country.

4. Accession, Membership and Adaptation

In the accession countries' present conventional thinking membership in the Union is a homogeneous legal category. This will be changed in the near future. It is now clear[9] that there will be a first and second wave of nations launching Europe's single currency in 1999. Even the present 15 members of the Union will be divided into two groups: the Euro-currency group and a remaining national currency group. This means that each of the ten accession countries will enter the Union also in two stages: first, they will move towards a general membership, and then, second, towards membership of the Euro-currency group. For Poland it is assumed that it will reach the first stage one around 2001 and the final stage around 2005.

There is still another field of the differentiation of the membership concept. In the strategy of negotiations with the European Union each of the ten countries will face the dilemma to accept the universal rules of the Union - or to get as many exceptions from these rules as possible. Prima facie - the 'exceptionalist' approach is better than the 'universalistic' approach. There is no doubt that some exceptions are - for a defined period of time – simply a political, economic and social necessity. If, however, a country will obtain too many exceptions - then, indirectly, this country is accepting a second-class membership in the Union, since there is a hard bargaining rule: those who do not accept the universal obligations will not obtain the universal rights and benefits. If we, the accession countries, or the Union, accept the "exceptionalist approach" on a broad scale, then we will observe a trend from homogeneous membership to differentiated membership. This reality will have to be faced by the ten countries in the next years.

The process of adaptation to the conditions and parameters prevailing within the European Union is a very important process, which has already started in the ten countries, albeit with different scale of success. But the adaptation process can be interpreted and implemented in different ways. Passive adaptation - the imitation of the present solutions now existing in the European Union - is the easiest and most simple choice. The Union is, however, a moving

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[8] W. Weidenfeld (ed.) Mittel und Osteuropa auf dem Weg in die Europische Union. Verlag Bartelsman. Stiftung 1995.

[9] A. Friedman. Giscard on the Euro: Include Italy and Spain. I.H.T. Feb., 13.1997.

target - in this sense that the Union of 2010 will be quite different than the Union of 1997. Therefore, the ten countries must develop the processes of active and prospective adaptation to the conditions and parameters which will emerge in the first decades of the XXI century.

In the field of the long-term active and prospective adaptation there are two fields of decisive strategic importance:

- the field of education;
- the field of innovation, science and technology.

In a strategic perspective, the creation and development of the future-oriented system of education should be of highest priority in Central and Eastern Europe. The young generation, starting from the Kindergarten, should be prepared to live and work in the framework of the emerging, open and competitive European society. However, the reality of Central and Eastern Europe is rather problematic from these points of view. The art of long-term strategic thinking is almost totally absent, the transformation and development of the systems of national education have a very low priority in the de facto performance of the political elites in Central and Eastern Europe.[10] The same goes for the evaluation of the systems of innovation, science and technology. The effective performance of this system is a condition sine qua non for the development of the long-term competitive advantage on the European and global economic scene. In short, are the ten countries preparing themselves for the Thurowian Scenario of the future Europe? Unfortunately, at the present moment the answer is "no".

5. The Transformation of the Ten Countries Before Accession

In the last decade of the XX century, the transformation of Central and Eastern Europe is a phenomenon seen on a global scale.[11] There are different opinions related to the evaluation of the efficiency of this transformation process.[12] In other words, we have to answer the question, how the unique opportunity of the collapse of the Soviet Empire was used by the countries of Central and Eastern Europe. Looking at the performance of the ten countries in this field four observations can be presented:

1. the transformation is slower than originally anticipated;
2. the transformation scene is deeply differentiated in national, regional and local dimensions;
3. the transformation is both a spontaneous process generated by the movement of the market forces and a guided process promoted by the visible hand of the governments and international organizations;
4. the European Union performs an important role in the promotion of the transformation processes. However, it is not using fully its capacity to encourage the development of long-term strategic approaches in Central and Eastern Europe.

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[10] compare: Y. Dror. Science and Technology. Literacy for Politicians. in: A. Kukliński (ed.) The Production of Knowledge. op.cit.

[11] World Development report 1996. From Plan to Market. World Bank. Oxford University Press. 1996.

[12] compare: A.Kukliński. The Growth of Knowledge on the Transformation of Central and Eastern Europe. in: A. Kukliński (ed.) Baltic Europe in the Perspective of Global Change. Warsaw 1995.

6. The Transformation of the Ten Countries After Accession

There are two interpretations of the transformation process in Central and Eastern Europe. The optimistic interpretation represents the opinion that the future-oriented endogenous forces inside the ten countries are strong enough to determine the scale, the scope, the velocity and the goals of the transformation process.

In this optimistic interpretation, the exogenous forces including the international organizations, and especially the European Union, are performing an important but only a supplementary role in the transformation process. The pessimistic interpretation is related to the historical reflection that during the last 200 years, it is extremely difficult to find in the ten countries an example of a grand-scale successful transformation determined predominantly by the power of endogenous forces.

This historical experience would indicate that the great transformation of Central and Eastern Europe at the turn of the XX and XXI century will be not implemented in a comprehensive and fully successful way without very strong exogenous inducements. Full membership in the European Union, however, is creating a new situation in the field, a new pattern to integrate the activity and power of the endogenous and exogenous forces. Therefore, in my interpretation, accelerated development of the transformation processes in Central and Eastern Europe are basically to be expected after accession.[13]

In conclusion, in future we will have to more thoroughly observe the interrelations of the processes of transformation and integration. These two processes are consecutive in the sense that a given country has to conclude or at least to advance to a very high stage in the process of transformation in order to be ready for the process of the European integration; at the same time these two processes are parallel in this sense that both processes are being and will be developed simultaneously, producing a strong effect of mutual reinforcement, a 'sui generis' synergetic effect.

This distinction does not only have an academic dimension. In the recent discussions related to the Polish strategy of European integration, the Eurosceptics have already used this framework of thinking to argue in favour of the consecutive strategy. In contrast the mainstream of the Polish pragmatic and academic scene stands in for the parallel approach. In contrast to both these positions this paper has argued, in essence, to see the processes of enlargement of the European Union in a holistic, long-term and global perspective.

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[13] compare: M. Belka. J. Hausner and others. Polska w perspektywie integracji europejskiej. Poland in the Perspective of European Integration. Warszawa. 1996. F.-Ebert-Stiftung.

ANNEX

Table 1: European Union 1996

Country	**Surface** (Sq. km)	**Population** (Million)
Austria	83,9	8,1
Belgium	30,5	10,1
Denmark	43,1	5,2
Finland	338,1	5,1
France	551,5	58,0
Germany	357,0	81,6
Great Britain	244,1	58,3
Greece	132,0	10,5
Ireland	70,3	3,6
Italy	301,3	57,2
Luxembourg	2,6	0,4
Netherlands	40,8	15,4
Portugal	92,4	10,8
Spain	506,0	39,2
Sweden	450,0	8,8
Total	**3243,6**	**372,3**
Share in Europe	**30,8%**	**53,3%**

Source: UN Statistical Sources

Table 2: Associated Central and Eastern European Countries 1996

Country	**Surface** (Sq. km)	**Population** (Million)
Bulgaria	111,0	8,4
Czech Republic	78,9	10,3
Estonia	45,2	1,5
Hungary	93,0	10,2
Latvia	64,6	2,5
Lithuania	65,2	3,7
Poland	312,7	38,6
Romania	238,4	22,7
Slovakia	49,0	5,4
Slovenia	20,3	2,0
Total	**1078,3**	**105,3**
Share in Europe	**10,2%**	**15,1%**

Source: UN Statistical Sources

Table 3: Europe - Macrogeographical Balance

	Surface		Population	
Europe 15	3243,60	30,80	372,30	53,30
Europe 10	1078,30	10,20	105,30	15,10
Rest of Europe	6210,10	59,00	220,40	31,60
Europe	**10532,00**	**100,00**	**698,00**	**100,00**

Source: UN Statistical Sources

Table 4: The Development Gap in Europe. The Levels of GDP Per Capita

Country	**GDP per capita** (Poland=100)	
Year	**1950**	**1992**
Germany	167	422
France	204	393
Italy	106	363
UK	243	343
Spain	57	270
Ireland	134	247
Portugal	69	207
Greece	80	164
Czech Republic	141	147
Slovakia		115
Hungary	101	118
Poland	100	100

Source - W.M. Orlowski, op.cit., page 21.

Ulrich Brandenburg*

The Role of NATO in Shaping a Larger Europe

Under the overall heading of "European Integration" it may be useful, besides the economic issues, to reflect for a while on its security related aspects. In many countries interested in re-integration into Europe their accession to the NATO-Alliance is seen as an element of reassurance with stabilizing effects beyond security in a narrow, military sense. NATO, as opposed to other organizations, has the advantage of bringing in the Americans and their security guarantee. Also, NATO is seen as more easily accessible - easier than the European Union which is seen as more comprehensive and more complicated in its own decision-making and, for that matter, has already significantly extended the timeframe even for the first new accessions.

This short paper will try to highlight the role of the Alliance in shaping a larger Europe. It will start with the issue that remains politically most controversial: with NATO enlargement - or in NATO-language: the opening of the Alliance. Second, it will cast a glance on the format of the dialogue with the accession countries (which in some aspects may also shed a light on EU-procedures).

(1) Back in 1990 at its London Summit and through the new strategic concept adopted in 1991, NATO has closed a chapter of its history and entered a new one. Since then, its defence posture is no longer based on the assumption of a massive attack from the East, but oriented towards the prevention of instability emerging from local conflicts and crises, which can be categorized as "multi-faceted and multi-directional risks". In the same vein, the core function of collective defence has been complemented by a new type of mission: peace support operations under a OSCE or UN mandate. The Alliance has been reorganized and slimmed down. More than 80 per cent of the nuclear weapons on European NATO territory have been withdrawn (and to a large extent destroyed). Among them, for example, the whole category of ground launched nuclear weapons. 60 per cent of US troops in Europe have been withdrawn, the armed forces of e.g. Germany have been reduced from about 500,000 to slightly more than 300,000; other European Allies have made similar reductions. NATO's internal adaptation to its new missions continues through the reform of its command structure (among others, cutting down Headquarters to less than half of their present number), the promotion of a "European Security and Defence Identity" within the Alliance and a further development of concepts enabling NATO to react in a more flexible way to necessary crisis management operations such as in Bosnia.

The IFOR/SFOR operation in Bosnia is a good example, not only for the internal transformation of the Alliance, but also for its external adaptation. In addition to the 16 NATO Allies, 18 other countries are participating, 14 of which have already built up valuable experience in

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operating with each other and with NATO forces in the framework of the "Partnership-for-Peace-Programme (PfP). PfP has wrongly been described as a transitional stage or waiting room for NATO membership, or a programme exclusively directed towards countries of the former Warsaw Pact. 27 states up to now have joined the Partnership which was founded in January 1994, in the North Atlantic Cooperation Council (NACC) framework. The latest country to join was Switzerland on 11 December 1996. PfP provides the network for cooperation with NATO and with other countries: militarily to prepare for peace support, humanitarian and search rescue operations, but also in other fields such as civil emergency planing, defence planning, civilian and democratic control of armed forces. The external adaptation of the Alliance since 1990 is aimed at the same goal as its internal transformation: the provision of stability and security under changed circumstances. It helps to build cooperative security structures, fosters regional cooperation and transparency and supports operations in a collective security framework such as now in Bosnia.

Just as the internal adaptation of the Alliance, its external adaptation is not yet completed. Together with the European Union and other organizations, NATO contributes to cooperation and thus to the strengthening of security in the whole OSCE area. NACC and PfP are the structures the Alliance has created for this, along with the European Union, the WEU and the Council of Europe. However, NATO is also part of a process of increased integration in Europe. The Council of Europe, over the last years has taken in many Central and Eastern European states, including Russia. The European Union has offered 10 states in the same area the perspective of membership. The same states have become associate partners of the WEU. NATO, for its part, has confirmed in January 1994 (at the same Summit which created PfP, and not as an alternative to it) what is already stipulated by Article 10 of the Washington Treaty of 1949: the Alliance remains open for the accession of other states in Europe that share values and purposes, and that are able to contribute to security in the Euro-Atlantic area.

The opening of the Alliance under today’s circumstances of course differs from the accession of Turkey and Greece (1952), the Federal Republic of Germany (1955) and Spain (1982). Today we are dealing with candidates for membership who formerly were part of an opposed military alliance, and today we have the chance to create a European security space without new lines of division. This is why NATO has been pursuing its opening in an evolutionary, gradual and transparent way. The accession of Central and Eastern Europeans to the Alliance must have a stabilizing, not a destabilizing effect. It is not aimed at strategic gains, and it is not directed against anyone. It must avoid the creation of new dividing lines or the emergence of a new "Versailles complex". And it can only work as one of several elements of the new security structure we want to create.

(2) A major step in the enlargement process has been the publishing of NATO’s Enlargement Study in September 1995. On the basis of this study, an intensive dialogue was conducted through the whole year of 1996, with all partner countries interested in the enlargement issue, and based on discussion papers they provided. 13 countries took part in this dialogue, 12 of which are aiming at NATO membership. In the course of the dialogue they were invited to explain their security conceptions, expectations and possibilities, and to learn more about the Alliance and the way it functions.

To be very clear: the Enlargement Study is not a rigid list of criteria, at the end of which a country would automatically be invited to join. It covers elements that will be taken into account when it comes to the political decision on the invitation of a new member, and it is

meant to help the interested countries to prepare for membership. Is the democratic orientation of a country undisputed? How about civilian and democratic control of the military? Are there any unsolved border and minority issues? How does country X, Y or Z see its own security situation, what are its threat perceptions, and what are the consequences drawn for the country's own defence planning? How are the armed forces structured? To what extent are they able to operate together with the forces of the present Allies? What can the interested country contribute to the Alliance, including its new missions? Which legal procedures would have to be followed to prepare for accession, which laws might eventually have to be changed? Not least, the study is addressing two particularly controversial questions: the stationing of foreign troops and nuclear weapons on the territories of new member states.

It has been mentioned earlier to what extent the forces of NATO member states have been reduced and withdrawn from Europe over the last few years. Nearly all Allies have significantly lowered their defence expenditure. A permanent stationing of foreign troops by NATO Allies in new member states therefore appears very unlikely today. It would be the most expensive possible option to include new member countries into the military infrastructures of the Alliance, to pick up a term recently used by the Russian side. It would also be very difficult to justify politically. And therefore there is nothing revolutionary in the statement issued by the NATO Council a few weeks ago with regard to our conventional force posture.

The situation with regard to nuclear weapons is similar. We have always considered these as political weapons. The likelihood of having to use them is more distant today as it has ever been from a NATO point of view. Leaving aside this general consideration: it is sufficient to look at the map and to compare the present levels of conventional forces in Europe in order to understand why NATO countries - as the December Communiqué says - have no intention, no plan and no reason to deploy nuclear weapons on the territory of new members nor any need to change any aspect of NATO's nuclear posture or nuclear policy, and do not foresee any future need to do so.

Based on a report summarizing the individual dialogues on enlargement mentioned earlier, the Foreign Ministers of the Alliance decided last December (1996) to move forward the enlargement process, and they recommended to Heads of State and Government to invite, at the NATO Summit on 8 and 9 July, one or more countries which have participated in this dialogue, to start accession negotiations with the Alliance. Our goal is to welcome the new member or members by the time of NATO's 50th Anniversary in 1999. But also after that date the Alliance will remain open to the accession of further member - anything else would be in contradiction to Article 10 of the Washington Treaty. In the months leading up to the Summit, the Alliance will have to work on preparing comprehensive recommendations, for decisions to be taken on the "who". To that effect, the intensified dialogue with interested partners will be continued, including in a "16+1" format which will enable countries to make their case directly to the NATO Council. And, of course, all partners will be treated strictly at the same level, as decisions have not yet been taken.

The Alliance will also have to further analyse the relevant factors associated with the admission of potential new members, and to prepare a plan for conducting the accession talks. A few more words on the procedure: as a result of these talks, NATO and the potential new member would set up an accession protocol, which in turn would be submitted for ratification to the Parliaments of all NATO member states, while the acceding country initiates its own ratification procedure. The accession comes into force once the last ratification document, on the accession to the Washington Treaty, is deposited.

As already mentioned, it is wrong to see the Partnership for Peace Programme exclusively as a transitional stage towards membership. For some countries PfP will help to bring them closer to an Alliance they will eventually join. Enlargement, however, will make it even more important to preserve and enhance the present functions of the Partnership as a structure covering the whole OSCE area. Our Summit in July will bring about a substantial strengthening of PfP. It will bring all interested partner countries closer to the Alliance: through more operational activities, a strengthening of the political consultation element, the stronger involvement of partners in operations planning and decision making on programme issues.

The Alliance will also work for a greater coherence in its cooperation activities, and to this end is pushing on the initiative to establish an Atlantic Partnership Council (APC) as a single new co-operative mechanism. The modalities of the APC will be drawn up within the next few weeks. The APC will be a step forward towards more co-operative security in the whole OSCE area. There is no doubt of course, that the Atlantic Partnership Council will also be part of the answer given to those countries who want to joint the Alliance but will not yet be singled out as candidates at this summit. Nobody at NATO underestimates their concerns and it would not be host to pretend that the upcoming enlargement decisions do not carry a potential for disappointment. We have to honour our commitment that the enlargement of the Alliance will lead to more, and not to less stability.

A note on the role of Russia: there can be no doubt that in this respect, NATO's relations with Russia will be of crucial importance. There can be no lasting stability and security in Europe without Russia, and it would be very costly - in political and financial terms - to organize our security against it. Over the last few weeks, we have been able to engage in a more productive dialogue with Russia on the shape of this relationship. Since January 1997, NATO Secretary General Solana has had three rounds of talks on this issue with Minister Primakov. These talks have been businesslike, result-oriented, and the perspective is promising. The security partnership NATO aims at does not mean a condominium or a new Yalta as can be heard sometimes these days. It will not duplicate or replace other international institutions. There is no reason therefore for suspicion. NATO is definitely decided to create with Russia a stable structure for consultations and cooperation based on a comprehensive participation of Russia in PfP and beyond.

In relations with Russia, NATO builds upon the cooperation developed so far in the "16+1" format, on the political consultations, and on the successful cooperation between NATO and Russia in Bosnia. Russia has been instrumental in the process leading to the Dayton Peace Agreement. The participation of Russian troops in IFOR/SFOR is a consequence of our common political responsibility. At the same time, it has provided - on the ground as well at Headquarters level at SHAPE - an experience which, for political reasons, Russia has so far stayed away from in other areas. Russia's participation in Bosnia has brought Russian soldiers at all levels up to Colonel General Shetshov into daily contact with NATO troops and the NATO command structure, and thus helped to overcome some of the misperceptions still standing in our way.

Misperceptions and a desperate lack of information remain one of the biggest problems in the relationship between NATO and Russia. For decades, the Alliance had been perceived in Moscow as incarnation of the evil. It is still incredibly difficult to overcome the tradition of secrecy, mistrust and self-isolation in particular among the Russian military - a tradition which is not even typically Soviet, but dates back to the Russian empire. This deep-rooted reluctance and distrust, which in our own interest we must try to overcome, is part of the rea-

son why the opportunities for military operation and contacts under PfP have so far deliberately been left aside by the Russians.

There are other reasons as well, of course; financial, organisational and the whole posturing on enlargement. Russia has lost, in its relations with the Alliance, two and a half years, as rightly painted out by Former Security Advisor Lebed at the end of his visit to NATO last October. We hope that we can use the remaining months until the Summit to build upon the positive experiences of cooperation with Russia. A formalisation of our security partnership - its principles, areas for consultation and cooperation, a special NATO-Russia consultation mechanism, and a permanent military liaison - should be part of the package to be adopted as soon as possible. Relations between NATO and Russia have their own importance, and they will be developed on their own merits. The same is true for the distinctive and effective relationship between NATO and Ukraine, which we want to further formalise in time for the summit.

This summit, for sure, will not be a routine event. It will have to take decisions on the internal adaptation of the Alliance: the European security and defence identity, the CJTF concept, the new command structure. At the same time, it will decide an enhanced partnership programme (possibly within the framework of an Atlantic Partnership Council as suggested), and thus give new momentum to security cooperation in the whole of Europe. However, NATO must maintain its balanced approach. An opening without a strengthened partnership would be short-sighted and counterproductive.

The coming months will be a period of hard work and intensified political struggling at the Alliance, much of that with the active participation of the accession countries. Some issues might remain controversial and potentially divisive. Yet, even if this may sound provocative here: the opening is not NATO's most important concern. There are many reasons to avoid a narrow focus as this part of the menu, positively and negatively. All members and those interested in membership are called upon not to lose sight of the overall picture and to intensify cooperation, in whatever future form. We need it for the real security challenges we are facing today.

Wolfgang Potratz/Brigitta Widmaier*

European Integration: The Difficult Balance Between Traditional Institutions and New Demands

Introduction

Since the beginning of the transformation processes in Central and Eastern Europe (CEE) the enlargement of the European Union and NATO are on the political agenda. One of the main topics concerning the enlargement is, if these institutions, as they are shaped now, are also suited and capable to deal with the enormous task of integration. There are a number of reasons to be sceptical about this. It seems as if institutions with a long historically grown tradition sometimes miss flexibility and the necessary long-term strategic thinking to promote change. Another question is, in how far there are social and economic developments and mechanisms at work, which already contribute considerably to integration. This paper deals with the two questions of enlargement and integration and asks for the prospects of institutional change on the one hand and, on the other hand, for the role of economic mechanisms like mutual trade and investment for the intregration of a larger Europe.

1. New Challenges

The countries in East and West share the hope, that the enlargement of EU and NATO will guarantee stability and welfare for all. Beyond this hope, however, expectations and motivations are rather different, diverging and even contradictive. This relates to problems of inclusion/exclusion as well as to the time schedules and, even more so, to the mutual cost-benefit-calculations. There is unanimity about the all encompassing aim, but ways and means are far from clear.

CEE countries put their stakes on new military security structures by means of NATO membership, and they expect economic growth and welfare from integration into the EU internal market. However, for some of them these positive expectations are already somewhat dampened by the fact, that integration into the new European structures also means new dependencies which restrict their newly gained sovereignty.

In turn the Western European countries nourish expectations about the newly arising markets in the East: after all, the new partners would bring in a market of about 105 million additional consumers. Their fear is, that with the accession of these new members also new rivals in the struggle for jobs and shares of the structural funds would come up.

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An unanimous view among EU-member-states is, that enlargement calls for a reform of institutions. How these new institutions should look like, and how their functions and functioning might be changed is subject to severe debate and controversy. Yet more than the necessary restructuring of political bodies and modes of decision-making it is the (re-)distributive mechanism of the agricultural and structural funds, which urgently need reform.

Taking this as the general background, we start out with two questions which relate to the immediate future:

- are the existing institutions in the European Union able to reorganize in such a way, that they are fit to welcome and integrate ten new members?

- what are alternative or complementary mechanisms to ease and speed up the integration process?

It would certainly go beyond this paper to answer these questions in detail and offer solutions. Therefore, we will take the problem of the structural funds, which is underlying so many debates, for a starting point to discuss in which direction reforms might be designed in order to ease accession of new members without putting too much strain on all sides. Following this, the main argumentation will be that the structural funds, even if revised, are by no means the only instrument to foster integration. In the past seven years the economic relations between the EU and the reform countries have been considerably extended. Therefore, we will try to follow up which actual integration processes have already taken place by means of trade and direct investments. For illustration data from Northrhine-Westphalia will be presented.

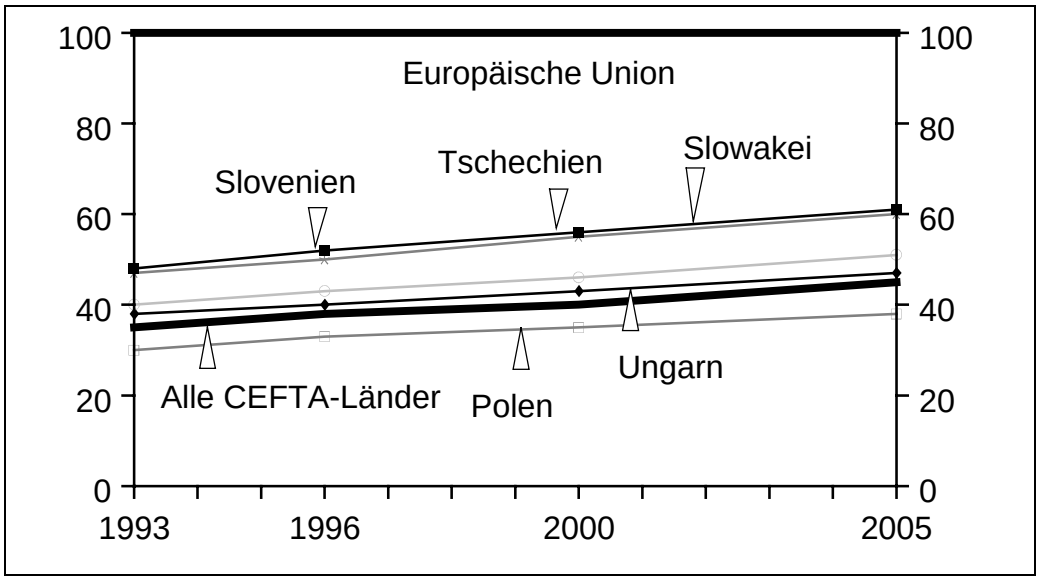
2. Old Institutions

Institutions and procedures of the EU have been subject of debate since many years, for they have virtually not changed since it was founded, although it has successively been enlarged from 6 to 15 member states. Besides a necessary revision of the basic institutions (commission, council, parliament) it is first of all the common agricultural policies (CAP) and the Structural Funds, the reform of which has gained top priority; the association of the Central- and East European countries has only underlined this fact.

It is in the political logic of the EU, that to maintain cohesion and further development of the union it is crucial to create comparable economic and living conditions in all member countries as far as possible. Therefore the Structural Funds have been created, which aim to assist certain countries and regions which are below the Union average in a given set of criteria, which are reflected in the system of programmatic "objectives". While the objective of "cohesion" as such is unquestioned, range and modes of distribution are at the core of controversy, and they stand for debate not only since the CEE countries have articulated their quest for accession. The main criticism is that economic incentives to mobilize endogenous potentials are distorted since there is a pay-off between performance and assistance. More than half of the EU-population lives in regions, covered by one or the other assistance programme; the latest accession of the Scandinavian countries even has led to the creation of an additional "Objective 6" for the subpolar regions. This has triggered innumerable single measures and has extended claims for assistance from the structural funds in such a way that member states during recent years have been confronted with rising contributions to the Union. Without

reforms and with maintaining the existing distribution schedules all associated countries would benefit from the best equipped "objective-1"-fund, since GNP in all these countries is below 75 per cent of the EU-average. Given these conditions estimations for transfer payments go up to additional 33 billion ECU per year.

Graph 1: GNP/Inhabitant in Selected CEE Countries 1993-2005 (EU = 100)



Source: European Commission - DIW calculations.

The political problem for the EU, however, is not only expressed in these sums which would flow towards the accession countries. The political problem rather is, as graph *1* shows, that these countries display a considerable dynamic, and so at least for some of them it may be expected, that within medium range they might grow beyond the GNP level of some of the present cohesion countries, e.g. Greece or Portugal, the GNP/inhabitant of which are at 63 per cent resp. 69 per cent (1996) of the EU-average. Thus a confrontation might come up both between the so far beneficiaries of the structural funds and their new ‘competitors’ in the East, and, what is even more probable, between the more and more burdened net-payers and the net-beneficiaries whoever they are. Simultaneously, following the experience so far of the structural funds and regional policies of the Union, a reduction of the distance between the cohesion countries and countries like e.g. Germany or France is not to be expected.

With respect to European competitiveness in general as well as to political-administrative experiences, for the time being it seems neither rational to load the net-payers with growing contributions nor to convey more financial means to the net-recipients. Even today, reserved funds are not used, since the demanded complementary means cannot be financed or since they exceed the absorptive capacities of the endowed countries.

The case of CEE countries is even aggravated by the fact that they sometimes do not command the necessary administrative infrastructure and management capacities to place useful projects and to manage them efficiently. Therefore one of the priorities of the "Agenda 2000" with respect to the applicant countries is institution-building to reinforce the administrative capacities and the functioning of the political system as a whole. Given these conditions the

inflow of financial means might rather enhance inflational pressures resulting from non-market-driven investments (as e.g. they are produced by wind-fall-investments) and thus lead to counter-productive allocation of resources. Because of these experiences suggestions for reformulations of distribution criteria are made e.g. to concentrate on fewer instruments (a concentration on objective-1-measures) and to enhance the efficiency of individual measures. This might lead to the consequence to connect the inflow of financial means to absorptive capacities, as e.g. measured in terms of GNP. Suggestions of this kind estimate roughly 3 per cent of GNP of a country as a reasonable upper limit for transfer payments.

There is no question that the problem of transfer payments must be settled before the associated countries become full members of the Union (although meanwhile negotiations have started without). The history of accession of the Southern European countries has shown that large transfer payments can also initiate processes conserving old structures. This obviously does not contribute neither to the cohesion objective nor to structural change. But it is not only by means of direct financial transfers that integration in terms of better living conditions can be achieved. Trade and direct investments offer an alternative, which, as market oriented mechanisms, have already contributed considerably to the integration process in CEE countries. These mechanisms correspond far better to the logic of the internal market, which aims at growth and integration of European value-added-chains by means of an extension of inter- and intra-industry trade. This is the subject of the following chapters.

3. Integration by Means of Markets?

Most CEE countries already orientate their institution building at the requirements of the EU, as they are laid down and specified in the "White Paper" and, more recently, in the "Agenda 2000". Also their new regulations for the process of transformation and the new mechanisms are geared towards integration into the EU. Aside from these institutional preconditions, one important motor of integration is trade with EU-countries and direct investments of EU-countries. It can be shown that they have contributed to a gradually growing integration of EU- and CEE-production chains.

3.1 Trade

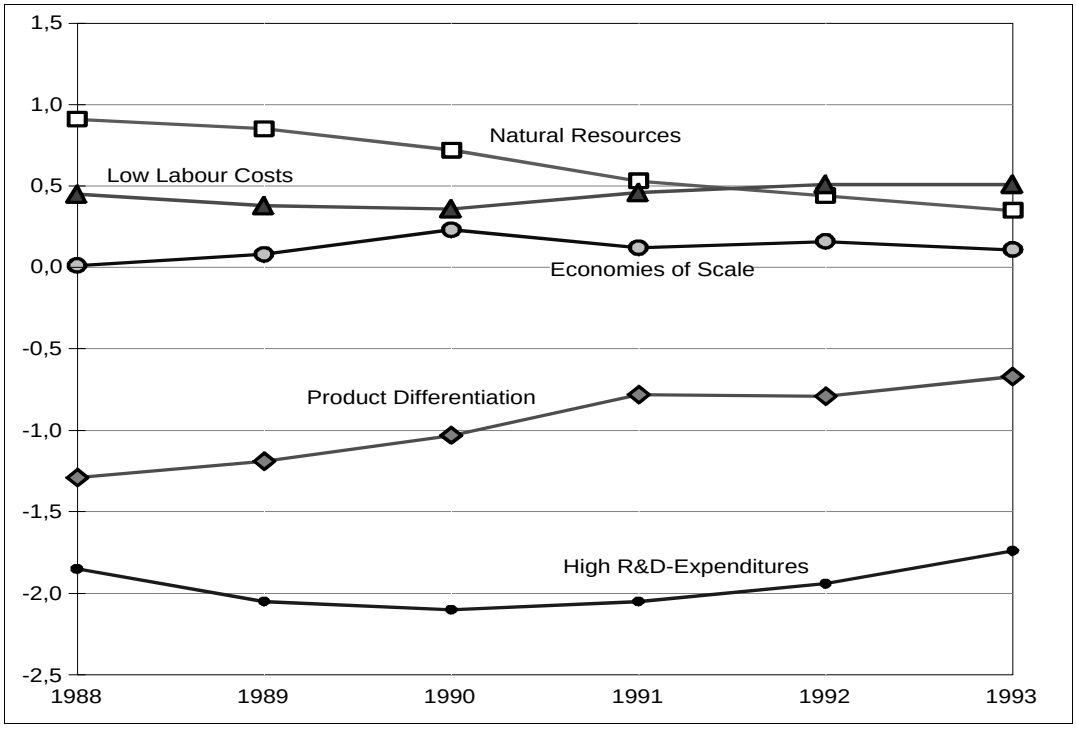
It is evident that the opening of CEE-markets has put these economies under an enormous strain of adaptation. Although macro-economic indicators have gained in stability in recent years, these economies have not yet reached the "break-even-point", since reconstruction on the enterprise level still displays many shortcomings, and infrastructure, too, is not yet in a state that would display clear locational advantages.

Already with the beginning of transformation processes ten years ago a quick reorientation of trade flows and trade relations has taken place. Due to the sudden break-up of the Council for Mutual Economic Assistance (CMEA)-markets and the CMEA-system as a whole these countries were forced to reorientate their trade and sales towards the West as quickly as possible. However, with the corresponding opening of their own markets they also were exposed to high import pressures, which rendered obsolete a number of products. Simultaneously rising prices for raw materials and intermediate goods so far supplied by CMEA-partner countries triggered off a breakdown of domestic industrial production chains. Because of this precarious situation at the beginning of the transformation processes in most CEE-countries

pointed the way for the level of exported goods, which because of the available resources primarily concentrated on labour-intensive and less on technology-intensive goods. This has changed meanwhile to a certain degree and is changing. Today we can observe that not only more than half of the foreign trade of CEE-countries is managed with the EU-countries, but also that the technological level is at least not decreasing any longer.

Applying the commonly used categories of goods for an assessment of comparative advantages, it is evident that CEE-countries still have their advantages in labour-, resource- and scale-intensive industries, although to varying degrees, and that their weaknesses still are to be found in the more knowledge-intensive industries.

Graph 2: Development of Comparative Advantages of the Visegrad-Countries[1)] Compared to the EU



1) Czechoslovakia, Hungary, Poland
Source: DIW-Außenhandelsdaten

Graph 2 shows the upward trend in the knowledge-based and more differentiated products, which indicates the accession to intra-industrial trade with EU-Europe, while the advantages in labour- and scale-intensive fields point downwards. This qualitative reorientation, which has taken place within a rather short period of time, has also been pushed by the fact that CEE-economies soon after the opening of their markets had to stand the labour-cost pressures of the Newly Industrializing Countries (NIC) in the Far-East. By this it became obvious that inter-industrial trade based on the present advantages in terms of factor costs would not lead to the aspired integration into western production- and value-added chains. In order to strengthen their position in intra-industrial trade and thus to integrate into European industrial structures, CEE-countries will have to satisfy so far unserved demand in investment goods and to close their technological gap. In so far, they are still under a high pressure for adapta-

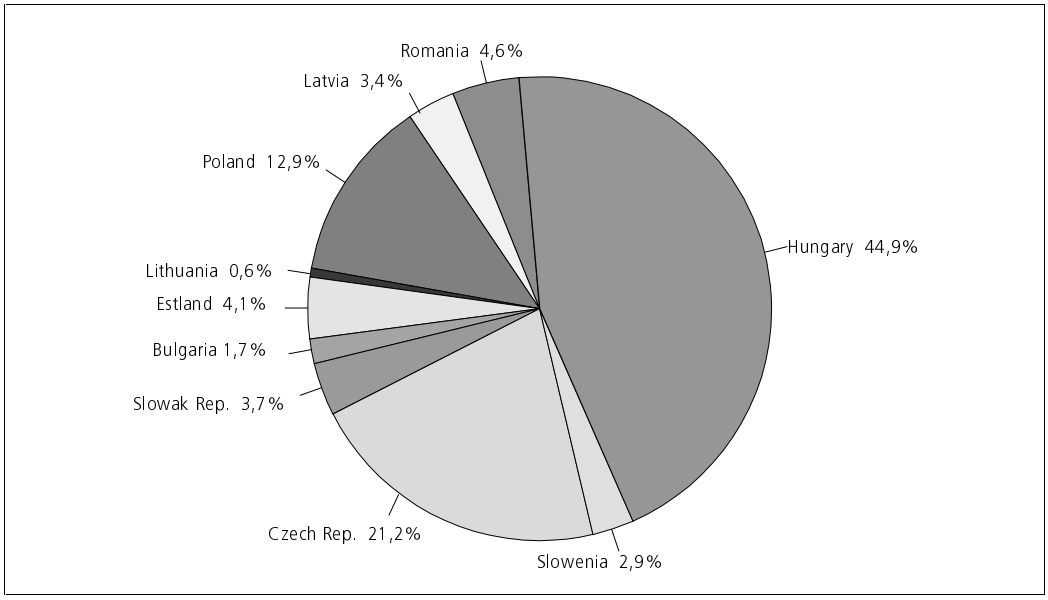
tion and will have to accept trade deficits, just as in turn the European economies will remain under pressure on the side of labour-intensive goods.

Based on these relationships, assessments of expected trade volumes show, that trade potentials are by far not exhausted yet. Partly this is due to the fact that low consumption power for the time being restricts the mobilisation of market potentials. However, the fact remains that trade has not only been redirected but also has new trade been created.

3.2 Direct Investments

The initially high expectations concerning the inflow of foreign direct investments have not been fulfilled. However, due to their low saving-rates they are indismissable for CEE economies. Besides the inflow of fresh capital the secondary effects of engagements of western firms in CEE are appreciated even higher. For example, the rather low qualifications in management and marketing at the beginning of transformation have considerably been upgraded in the course of direct investments and the qualification transfers coming along with it. Similarly in technological fields this effect can be observed. After a period of stagnation progressing privatisation especially in infrastructure has attracted a number of multinational enterprises and thus pushed new investments.

Graph 3: Flows of Direct Investments into CEE



Source: UN-ECE 1996; DIW calculations.

Contrary to public discussion, which often tries to focus replacements into low-labour-cost regions as a threat to west-European jobs, direct investments have mainly been placed in countries with rising labour costs, as e.g. in Hungary, Poland and the Czech Republic. Also, our own research as well as other recent studies clearly show that direct investments overwhelmingly have sales-accompanying functions and are aiming towards new markets, in a number of cases even towards east of CEE countries. Thus they display positive effects for

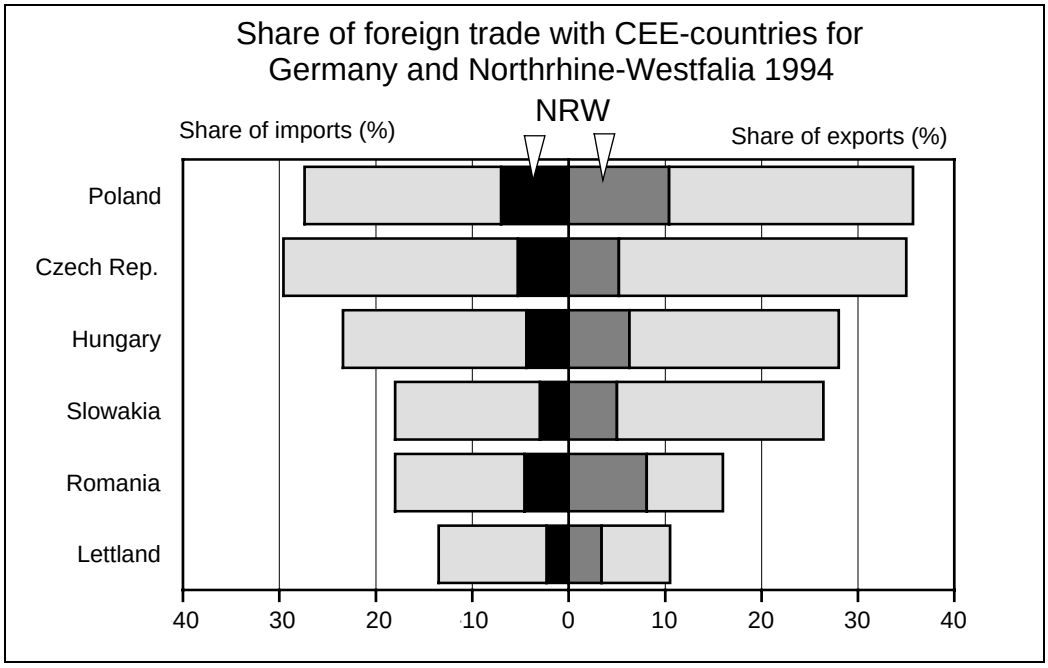
growth in EU-economies. Although negative effects in labour-intensive industries cannot be denied, on the whole, the EU, and particularly Germany, has been the winner of the opening and transformation of CEE-economies. For Germany the studies of the "Leading Economic Institutes" have shown, that those enterprises, which engage in foreign direct investments, also grow and offer new jobs at home. For 1993 the DIW had calculated a net job surplus of 60.000 jobs, which result from trade surpluses. Aside from that, replacements into CEE countries, e.g. of certain production sequences as well as of new investments, rather seldom are a substitute for domestic production; the strategy is rather a redirection of (parts of) productions and investments, which in the mid-term in Germany would not have been profitable anyway. Thus enterprises improve their cost structure and consequently their competitiveness. The relocation of enterprises and the "export" of jobs as it is maintained in public opinion and sometimes even in professional debate cannot be observed in a relevant quantity.

4. The Case of Northrhine-Westphalia: Regional Effects of Trade and Investment

Due to their geographical proximity Germany, and thus also Northrhine-Westphalia, have played an important role for CEE-economies already before the opening. A major stronghold in those times mainly was engineering and plant equipment, as e.g. the construction of the gas-pipeline-system in the 80ies, in which Northrhine-Westphalian enterprises played a major role. However, a recently published study of the IFO-Institute has found out, that the possibilities and potentials, which are offered now by the new markets, are used only hesitantly. A survey among enterprises that has been conducted in the context of this study indicates, that it is primarily access of new markets and cost advantages only as a secondary motivation for enterprises to engage in these countries; also investments in these countries is used as basis for activities reaching farther out to the East. Enterprises covered by this survey judge these activities positively, in terms of sales and profits as well as in terms of jobs stabilized in NRW.

As for the volume of trade, both exports from NRW to CEE as well as imports from CEE have steadily increased since 1989. Graph 4 shows the volume of trade of Germany and of NRW with CEE countries. Since Germany stands for roughly half of EU-trade with CEE economies (as well as for foreign direct investments flowing into CEE), the figures show very clearly the role of this state with this region. On the other hand, if we cut out the trade with CEE countries between 1990 and 1995 from the NRW trade balance, exports would not have gone up but down - in other words: also for NRW these countries have gained weight and have become an important partner.

Graph 4: Exports and Imports of Selected CEE Countries 1994



Source: IFO Institut - 1993

Analyses of comparative advantages today still paint a picture of CEE-economies as marked by resource-, labour- and scale-intensive goods, while NRW primarily exports research- and labour-intensive goods. A stronghold of exports is in metal engineering and automobiles. These structures meet the actual need and demand of CEE-economies for investment goods as well as the specialisation of NRW and its industrial branches. This, however, also highlights the degree to which trade is still dominated by inter-industry-trade. The reasons for the presently still lower level of technology in CEE products have been mentioned, and there is no doubt that the capital stock of these countries needs renewal. However, as has also been shown in the case of FDI, the problem of economic restructuring is not only made up by the capital stock. It is at least of the same importance to renew the "knowledge stock" of industry and to promote basic knowledge as well as applied knowledge and experience by promoting training, research and development. In rebuilding the ‘knowledge stock’ there are perspectives that CEE economies will also catch up with research- and technology-intensive goods - which in medium term will certainly lead to an increase in intra-industrial trade and thus to a structure of trade that is typical of developed industrial countries.

It is not only in the context of trade relations with CEE countries that it seems important for NRW to strengthen and extend its own comparative advantages through new product developments. In following a tendency to serve primarily mass markets and to stick to old product strategies, as it has occurred after 1989, both sides have already given away many chances for structural change. Enhancing R&D in fields of comparative advantages and building co-operative structures with CEE economies would certainly make for more dynamics in trade relations. But the further development of these market potentials will bring about profits only if the new market economies in CEE are included and integrated into production- and supply-structures and intra-industry-trade as they exist between EU-economies.

5. Integration by markets instead of transfer payments!

Whatever strategy will be followed, the countries of Central and Eastern Europe will have a long way to go before they catch up to the present level of economic development in the EU. Even though they have gained a certain importance for some regions, as has been shown with the example of NRW, for the time being they are still only a marginal competitor on the world markets. Despite "globalisation" world trade is concentrated on relatively few and technologically almost equivalent countries, whose production chains are integrated by intra-industrial exchange. The path to more competitiveness and welfare in CEE countries therefore will certainly not be paved by transfers from the structural funds of the European Union. This, by the way, also holds for the present member states, especially for the countries presently benefiting from the "cohesion funds". It is not only the vested interests of the present members, which stand against such a policy, but also the debatable economic sustainability and nature of this transfer system. Contrary to the initial intention more and more it comes to the fore that contribution of the structural funds to an approximation of living conditions has been rather limited. The short outline of the flows of trade and direct investments given in this paper, however, has shown the impact of "classical" market mechanisms on structural change in CEE countries. Thus it can be expected that market-led exchange relations will contribute more to further and sustainable development and structural change of industries and services than administrated transfer payments, as well as to the integration of CEE economies into European division of labour. This way the question for winners and losers will take care of itself.

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Reforms Necessary if Eastern Enlargement of the EU is to be Financed

So far, ten eastern central European countries[1] have reached association agreements with the EU and have formally applied for membership. At the behest of the Federal Ministry of Economics the DIW has analysed the external and domestic consequences of an intensified division of labour between these countries and the EU, and the consequences of eastern enlargement of the Union on policies exerting a major impact on the EU budget.[2]

Already the integration process is generating positive effects on growth and employment in both groups of countries; these effects would intensify if the accession candidates were to actually join the EU. The impact on the EU budget, on the other hand, is uncertain. It depends on whether the EU is prepared to undertake reforms that, irrespective of enlargement, have been on the political agenda for many years now. In order to sketch out the framework for such reform measures, model calculations were conducted for enlargement at different points in time and given various policy scenarios. These models are described in this paper. Solutions are available for the problems revealed here - solutions that would raise the efficiency of internal EU policies. Whether or not they are implemented, however, will be a test of the EU's reform capability.

Eastern enlargement of the EU is the logical continuation of European integration to date. Previous accession rounds have shown that economic ties are intensified significantly and that this is associated with mutual welfare gains. Thus the accession of new members from eastern central Europe is not only desirable in political terms, but also advantageous in economic terms. Yet the extension of internal EU policies to the new members raises economic policy problems. From the perspective of the EU, it is the impact on the Union's budget that is a particularly explosive issue. In two policy areas in particular - the Common Agricultural Policy (CAP) and structural policy - eastern enlargement is expected to result in a massive increase in community spending. In the case of agricultural policy the driving forces behind the increase are a subsidy system in the EU that is still oriented primarily towards production, and the importance of the agricultural sector to the Polish and Hungarian economies. In the case of structural policy it is the generally underdeveloped state of the eastern central European countries that will inevitably lead to an acceleration of spending, at least to the extent that these countries are treated on an equal basis with the poorest current EU members.

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1 Poland, the Czech and Slovak Republics, Hungary, Slovenia, Bulgaria, Romania, Estonia, Latvia and Lithuania.

2 The full report has been published 1997 under the title "Ostmitteleuropa auf dem Weg in die EU – Transformation, Verflechtung, Reformbedarf der EU". In: Beiträge zur Strukturforschung des DIW, Duncker &-Humblot, Berlin.

The scenarios are based on the following assumptions:

- The date of accession is uncertain.[3] Consequently the entire period 2000 to 2010 was considered.

- It is unlikely that all ten candidates will be admitted together. The results presented here are those of a "small-scale" enlargement incorporating the five members of the Central European Free Trade Area CEFTA (5).[4]

- An important influencing factor is the real rate of GDP growth in the participating countries. For the EU (15) this was assumed to be 2 per cent p.a., i.e. slightly lower than the average for the past 25 years. For eastern central Europe it was assumed that the development gap vis-à-vis the EU will steadily close, whereby growth rates there will gradually decline. In the scenarios this translates into average annual growth of just under 4 per cent to the year 2010.

The Budgetary Impact of Eastern Enlargement Under Status Quo Conditions

Firstly the case that the internal policies of the EU (15) remain unchanged in the face of eastern enlargement was considered. The budget is assumed to expand in line with the rate of GDP growth. The distribution across the various spending items remains unchanged.

Agricultural Policy

It is difficult to estimate the additional spending on the new members, particularly that by agricultural policy. The additional, agriculture-related costs of eastern enlargement are influenced decisively by the expected differences between EU and world market prices, gross value added in the agricultural sector and the demand for agricultural products in the eastern central European countries at the time of accession; it is difficult to forecast such developments in view of the many imponderables and the diverse sources of error. Earlier studies have suggested additional costs ranging between ECU 5 and 38 billion. Some of the results obtained at the upper end appear exaggerated, however. This is because, firstly, the need for further reforms occasioned by agreements reached within the World Trade Organisation (WTO) have not been allowed for; secondly, it is to be assumed that it will only be possible to exploit in full the natural productive potential of eastern central Europe in the longer term, so substantial oversupply is not initially expected. Previous EU enlargements lend support to this view.

This analysis initially refers to the case of complete assumption of the CAP by the acceding countries. It is posited that the budget costs change in a stable proportion to gross value added in the agricultural sector measured in EU-internal prices. In 1994 the level of agricultural prices was between 30 per cent and 40 per cent below that in the EU. Clearly the difference

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[3] The year 2005 would, however, appear more realistic than the year 2000, a date frequently mentioned. Cf. Poland's Path to the European Union, in: Economic Bulletin, vol. 32, no. 12, December 1995.

[4] Poland, the Czech and Slovak Republics, Hungary and Slovenia. The results for an enlargement encompassing all ten of the associated countries of eastern central European can be found in the German report, the details of which are given in footnote 2.

in price level cannot be done away with in one fell swoop on admission, but must steadily be closed within a transition period. Until this has been accomplished there can be no single EU market for agricultural products.

Decisive parameters for the share of gross value added generated in the agricultural sector are both macroeconomic and sectorally specific developments. It is generally accepted that, in the longer term, agricultural output growth will lag significantly behind macroeconomic growth in the eastern central European countries, i.e. agriculture will contribute less to GDP. For the estimates it is assumed that the agricultural sector grows about half as rapidly as the economy as a whole. For most countries this is broadly in line with the expectations held by the European Commission.

Under the status quo conditions assumed here, the additional enlargement-induced budgetary costs associated with agricultural policy for the CEFTA (5) would amount to in excess of ECU 7 billion in 2005 and just under ECU 8 billion in 2010 (cf. table 1).

Structural Policy

Spending on structural policy measures is the second largest expenditure item in the EU budget after agricultural policy. The central aim of EU structural policy is to mitigate regional income differentials within the Union. Over recent years a wide-ranging catalogue of specific measures has been developed for this purpose, the most important of which has been the promotion of particularly underdeveloped regions - regions whose income is less than 75 per cent of the union average are defined as objective 1 regions. All the candidates for admission from eastern central Europe will remain below this ceiling for the foreseeable future.

Per capita payments from the structural funds to new members are determined by their national wealth level compared with the EU average.[5] In 1993 average per capita income in the CEFTA (5) countries as a whole amounted to 35 per cent of the EU average. The support given to the poorest current EU members (Greece, Portugal and Spain) was used as a basis for determining the per capita level of support for the eastern central European countries within the framework of the status quo scenario. In 1999 these countries are to receive per capita support of ECU 325, 340 and 235 respectively. Given the significant income gap even to these poorest EU Member States, the CEFTA (5) countries would, on this basis, have to receive per capita support of around ECU 500 in the year 2000; this represents a total of around ECU 33 billion. Between then and 2010 there would be only a slight increase in these transfers due to the assumed growth trajectory in eastern central Europe. If growth were stronger - a possible outcome of accession - the volume of transfers would be reduced; nevertheless so they would remain at a high level for the foreseeable future.

[5] According to the directive on the implementation of structural policy, the Commission takes account of the following criteria in dividing the resources among the regions entitled to support: "national wealth, regional wealth, regional population and the relative incidence of structural problems" (Article 12 (4) of Directive No. 2052/88 in the amended version of 20.7.1993). As it is the transfers to the newly admitted countries that are to be estimated here, we can abstract from the regional wealth of specific support regions.

Other Effects on the Budget

Besides the - predominant - budgetary items, agriculture and structural policy, are a number of other types of spending that need to be considered as part of the costs of eastern enlargement. These affect the external policy areas, the internal policy areas - education policy, spending on the transeuropean networks (TEN), research, the single market, environmental policy etc. and administrative costs. Spending on the external policy areas would decline, to be replaced by transfers from the structural fund. On top of this comes higher expenditure on the internal policy areas and on administration. Overall the effect is likely to be a slight easing of the burden on the budget from the "other policy areas" (cf. table 1).

Table 1: EU Accession by the CEFTA (5): Financial Perspective, 1993 to 2010 in ECU millions at 1992 prices Scenario A: status quo

	1993	1999	2009	2003	2005	2008	2010
GDP EU (15) at purchasing power parities PPP	5881582	6623616	6756088	7169615	7459268	7915834	8235634
GDP CEFTA (5) at PPP	373410	477.100	495.800	554.800	596.400	662.200	708.600
GDP CEFTA (5), annual growth in %		4.0	3.9	3.8	3.7	3.5	3.4
Gross value added by agriculture CEFTA (5)			30.407	32.261	33.416	34.997	35.947
EU (15) budget							
Common Agricultural Policy	37688	39.327	4.014	42.569	44.289	46.999	48.898
Structural policy	22761	30.945	31.564	33.496	34.849	36.982	38.476
of which: Cohesion Fund		2.600	2.652	2.814	2.928	3.107	3.233
of which: objective 1	12688	19.887	20.285	21.527	22.396	23.767	24.727
External activities	4226	5.953	6.072	6.444	6.704	7.114	7.402
R&D, TEN, other	5820	6.634	6.767	7.181	7.471	7.928	8.249
Administration	3509	4.093	4.175	4.430	4.609	4.892	5.089
Total expenditure	74003	86.952	88.691	94.120	97.922	103.916	108.114
EU budget CEFTA (5)							
Common Agricultural Policy			6.687	7.094	7.348	7.696	7.905
Structural policy			33.027	33.206	33.418	33.871	34.249
Transfers as % of GDP at PPP			6.7	6.0	5.6	5.1	4.8
External activities			-1.020	-1.082	-1.126	-1.195	-1.243
R&D, TEN, other			496	555	596	662	709
Administration			301	319	332	352	367
Total expenditure			39.490	40.092	40.569	41387	41.986
Contributors CEFTA (5)			6.509	7.283	7.829	8.693	9.302
Results							
Net accession costs CEFTA (5)			32.981	32.809	32.739	32.694	32.683
EU (20) Budget			128.181	134.212	138.491	145.302	150.099
of which: to be provided by EU (15)			121.672	126.929	130.662	136.609	140.797
Net accession costs of CEFTA (5) as % of total expenditure of the EU (15)			37.2	34.9	33.4	31.5	30.2

Source: DIW estimations and calculations.

On accession the new members must make a contribution to financing the EU budget. They are required to make the same payments - relative to GDP - as the existing 15 members. For the year 2000 the CEFTA (5) countries can be expected to have to contribute ECU 6.5 billion; by the year 2010 the level of contributions will have increased to ECU 9.3 billion.

Net Costs

The net burden on the current EU Member States resulting from an eastern enlargement would be considerable were the *acquis communitaire* - the prevailing system of regulations, norms and standards - applied without substantial changes to the candidate countries.

The net costs of the accession of the CEFTA (5) in the year 2000 would amount to ECU 33 billion. Accession in the year 2010 would involve costs of a similar order of magnitude (cf. table 1). These costs amount to 37 per cent of the EU (15) budget in the case of rapid accession and 30 per cent if accession were postponed.

Under status quo conditions, financing eastern enlargement would require an expansion of the EU budget. Even allowing for the possibility of transitional arrangements, the heavy costs involved would sorely test the willingness to pay of the 15 present Member States. This is all the more the case given the fiscal constraints resulting from the errors made by fiscal policy makers in the past and the preparations by the Member States for monetary union. On top of this comes the pressure on government budgets resulting from mass unemployment, which can be expected to remain with us for the foreseeable future. Germany, in particular, also needs to reduce its heavy tax burden over the medium term. The figures just mentioned would need to be found every year. It is unlikely that the necessary majorities for such a strategy can be found. This means that reforms of EU-internal policies are inevitable if the Union wishes to achieve the goal of eastern enlargement.

Proposals for Reforming EU Internal Policies

Agricultural Policy

The agricultural policy reform implemented in 1992 was the inevitable result of the high costs to the budget, the trade distortions and the, in some respects, unsatisfactory income trends and distribution in the agricultural sector; it nevertheless remained uncompleted. It referred to the market organisation of only certain products (e.g. cereals, beef), ignoring a number of important commodities. Overall the 1992 reform proved unable to ease the burden on the EU budget; on the contrary, even now, four years after the reform, annual spending on agriculture is still rising markedly. Although reduced spending was not a direct aim of the reform, the EU can have no interest in allowing expenditure on agricultural policy - which in 1996 is expected to amount to ECU 41 billion, or 51 per cent of the entire budget - to rise further. Further critical points are the high subsidies paid for land taken out of use, the distributive justice of these transfers and the costs of regulation and control.

Given unchanged agricultural policies, accession by the ten associated countries would place a heavy burden on the EU budget. An additional factor is that, at the WTO negotiations, eastern central Europe and the EU have committed themselves to reducing subsidised exports based on the level of protection in a reference period. Given that the eastern central European

countries did not subsidise agricultural exports during the reference period to any significant extent, they are entitled to only very limited export quotas. If these countries were to achieve more than 100 per cent self-sufficiency following accession, the EU as a whole would be confronted with substantial excess production without having additional scope for subsidised exports. Reforms will then become unavoidable, all the more so given that the reduction of agricultural protection already under way is to be continued in the context of the evaluation of the implementation of WTO agreements to begin in 1999.

Irrespective of this it must be doubted whether the transposition of the instruments of support to eastern central European agriculture is good, not to mention necessary, policy. If the CAP were retained, the EU, in addition to purchasing surplus products and reimbursing exports, would also have to apply the compensation regulations. At first sight this does not appear necessary, as farmers in the eastern central European countries do not face price cuts as a result of accession, so that one might fairly ask what they are to be compensated for. However, compensation payments within the EU (15) are tied to cultivated land area and the number of animals. This means that, while the quantity produced is not subsidised, as is the case with direct price support, factor input is subsidised. Thus the payments still distort competition. Yet in political terms it can scarcely be argued that, in the longer term, the poorest farmers in the enlarged EU, of all people, should be excluded from such payments, while at the same time uniform market prices are applied to all producers.[6] On the other hand it is likely to prove difficult - irrespective of the fiscal burden - to adjust the instruments of price intervention to the specific conditions prevailing in eastern central Europe.

Comprehensive reform of the CAP could limit the enlargement-induced costs and at the same time render the agricultural policy of the EU (15) more efficient. A central element in any further development would be to extend the 1992 reforms to cover the market organizations excluded so far, in particular the sugar and milk markets. It is vital in macroeconomic terms that the nascent market-orientation of price policies is rigorously pursued, i.e. further price cuts for all goods to world market levels are imposed. At the same time instruments of quantitative restriction should be abolished and government intervention limited to the original aim of mitigating or removing market disequilibria arising in the short term. A central goal should be to reform all the market regimes on the same pattern. It is only then that the competitive distortions between the various products within the EU can be removed. Price reductions, such as currently being imposed on cereals and beef, for all agricultural products would also serve to reduce the danger that in future the EU will be confronted with surplus output in the new members from eastern central Europe for which it would have no WTO export quotas.

The second important area of reform would be a decouple, in strictly production-neutral fashion, price support payments from the factors of production. The only direct income transfers, in the narrower sense of the term, that would then be acceptable would be those set irrespective of past or future yields or the factors of production deployed. Income transfers tied to person would enable the eastern central European countries to enter the EU without price intervention payments having to be made in order to ensure equal competitive conditions. For the current Member States a staged return of the transfers to national budgets and the staged reduction in the volume of transfers - a necessary step in macro-economic terms - must be

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[6] Cf. Stefan Tangermann, Timothy E. Josling, Wolfgang Münch, Preaccession Agricultural Policies for Central Europe and the European Commission. Study commissioned by DG 1 of the European Commission, Final Report 1994.

considered. If this proposal were followed the budgetary costs incurred due to enlargement would be restricted to the classical instruments of market regulation systems - that is the costs of market intervention, storage and export reimbursement. No price intervention payments would then be required for the eastern central European countries.

Given that these reforms can be expected to meet with stiff political opposition, two reform scenarios, in addition to the status quo scenario A, were considered. The first reform scenario models a compromise (scenario B): on the one hand price support instruments are replaced by person-related transfers; on the other, the costs remain the responsibility of community institutions and their level is not reduced. This means that the fiscal costs of EU (15) agricultural policy are the same as in the status quo scenario. If such a compromise proposal were actually implemented, the costs to the budget would be certain to decline, as the distribution of person-related transfers would be more efficient. It was not possible to model this effect in the scenario, however. The second reform scenario models a complete, albeit staged, renationalisation of the compensation payments (scenario C). Following implementation of this reform proposal in ten annual steps from 2000 to 2010, the only costs met from the EU (15) budget would be traditional market organisation costs, as apply in both the reform scenarios to the eastern central European countries as well. It may well be that some form of compensation would be required for the poorer EU countries in which agriculture still plays an important role, but this could not be incorporated into the simulation.

The costs to the budget given the reform measures proposed above can then be estimated on the basis of the financial flows of the guarantee fund for the financial year 1996, the year that the agricultural policy reform of 1992 first took full effect. For the market regimes already reformed, spending by the guarantee fund is divided at a ratio of 85:15 between the costs of price intervention and the costs of traditional market regulation.[7] The figure of 15 per cent for the costs of traditional market regulation is extrapolated to total annual guarantee spending in the two reform scenarios. It is virtually impossible to forecast the precise ratio following an extension of the reform to all regulated markets; for the purposes of the scenarios the cost ratio of 85:15 is assumed to apply to the CAP as a whole.

Agricultural policy reform on these lines means that the fiscal costs of accession by the associated countries are substantially lower than in the status quo scenario, and, indeed, that in scenario C a reduction in the EU (15) agricultural policy budget is to be expected. For the CEFTA (5), accession costs of just over ECU 1 billion would be expected in the year 2005 or 2010 as a result of the agricultural policy reform (cf. tables 2 and 3). The mode of financing proposed in the second reform scenario significantly reduces the burden on the EU (15) agriculture budget. Assuming that the new financing concept was applied from the year 2000 onwards, CAP spending on non-traditional market regulation would be reduced to zero in ten annual steps and transferred to national budgets. Spending by the guarantee fund on agriculture would as a consequence decline from ECU 40 to around 8 billion (cf. table 3). In the status quo scenario A and reform scenario B ("compromise") agricultural policy would require almost ECU 49 billion for the EU (15) by the year 2010. The difference would have to be borne by the Member States themselves if the retransfer of financing responsibilities is not accompanied by expenditure-reducing reforms.

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[7] Cf. the EC budget plan for 1996, in: *Official Journal of the EC L 22/1996.*

Structural Policy

Full transposition of the prevailing structural policy regulations to the eastern central European countries would place a heavy burden on eastern enlargement of the EU; indeed, it might render it impossible. Yet at heart the community structural policy is an indispensable element of European integration. This is true not only for economic reasons; urgent political considerations also support this view, as all the current Member States, i.e. including those currently in receipt of the lion's share of transfers from the structural funds, must agree to eastern enlargement. Ongoing development of EU structural policy must be oriented towards the principles of functional and regional concentration and towards convincing economic arguments for government transfers.

In principle this means that objective 1 regional support should be retained. The activities pursued with respect to the other objectives of EU structural policy, on the other hand, lack adequate justification; they largely benefit the more affluent members. If a certain scope for regional policy activity were reassigned to national governments, they would be in a position to solve their problems themselves: action by the EU is therefore unnecessary. The inappropriateness of the policy approach in this area is shown by the high proportion of the population living in supported areas: more than 50 per cent (in objective 1 areas around 25 per cent). Abandoning the less well-justified elements of structural policy would save around one-third of total expenditure in this policy area. In addition, steps must be taken to improve the provision of support in the objective 1 areas. In particular, it is important that the resources available be deployed more efficiently, notably by reducing the excessive contribution rates and improved control involving effective sanction mechanisms.

Table 2: EU Accession by the CEFTA (5): Financial Perspective, 1993 to 2010, in ECU millions at 1992 prices
Scenario B: EU reform (compromise)

	1993	1999	2000	2003	2005	2008	2010
GOP EU (15) at purchasing power parities PPP	5881582	6623616	6756088	7169615	7459268	7915834	8235634
GDP CEFTA (5) at PPP	373410	477.100	495.800	554.800	596.400	662.200	708.600
GDP CEFTA (5), annual growth in %		4.0	3.9	3.8	3.7	3.5	3.4
Gross value added by agriculture CEFTA (5)			30.407	32.261	33.416	34.997	35.947
EU (15) budget							
Common Agricultural Policy	37688	39.327	40.114	42.569	44.289	46.999	48.898
Structural policy	22761	30.945	3189	31.348	31.164	31066	31.128
Objective 1 + Cohesion Fund	12688	22.487	23162	25.310	26.851	29.341	31.128
Structural policy - (Objective 1 + Cohes.)		8.458	8.627	6.039	4.313	1.725	0
External activities	4226	5.953	6.072	6.444	6.704	7.114	7.402
R&D, TEN, other	5820	6.634	6.767	7.181	7.471	7.928	8.249
Administration	3509	4.093	4.175	4.430	4.609	4.892	5.089
Total expenditure	74003	8.652	88.916	91.972	94.237	98.000	100.765
memo item: Transferred to Member States:							
structural policy			0	3.116	5.211	8.382	10.516
EU budget CEF7A (5)							
Common Agricultural Policy			1.003	1.064	1.102	1.154	1.186
Structural policy			14.874	16.644	17.892	19.866	21258
Transfers as % of GDP at PPP			3.0	3.0	3.0	3.0	3.0
External activities			-1.020	-1.082	-1.126	-1.195	-1243
R&D, TEN, other			496	555	596	662	709
Administration			301	319	332	352	367
Total expenditure			15.654	17.500	18.796	20.840	22.276
Contributions CEFTA (5)			6.525	7.117	7.535	8.198	8.670
Results							
Net accession costs CEFTA (5)			9.128	10.383	11.262	12.642	13.606
EU (20) Budget			104.569	109.472	113.034	118.840	123.041
of which: to be provided by EU (15)			98.044	102.355	105.499	110.641	114.371
Net accession costs of CEFTA (5)							
as % of total expenditure of the EU (15)			10.3	11.3	12.0	12.9	13.5

Source: DIW estimations and calculations.

An additional decisive modification would be to take account of the absorption capacity of the national economy in question. In the so-called "cohesion countries" transfers from the structural funds have already risen to a substantial share of GDP at purchasing power parities (Greece: 2.8 per cent, Portugal: 2.7 per cent, Ireland: 2.5 per cent, Spain: 1.4 per cent; in each case estimated for 1999). The reports by the European Court of Auditors indicate that, even now, it is not always possible to administer funds in accordance with the regulations and ensure that they are spent in economically sensible projects. At 6.7 per cent in the year 2000, the proportion of GDP at purchasing power parities derived from the structural funds would be much higher for the five CEFTA countries. This would certainly far exceed their capaci-

ties for a sensible deployment of resources, and would inevitably lead to inefficiencies and inflation. Clearly, though, it is not possible objectively to determine a transfer volume that does not exceed a country's capacity to absorb it. Here it is proposed that the highest figure for the current cohesion countries be taken as a guideline, and that a figure of 3 per cent of GDP at purchasing power parities be set as a ceiling for support.

Table 3: EU Accession by the CEFTA (5): Financial Perspective, 1993 to 2010 in ECU millions at 1992 prices Scenario C: EU reform (extreme)

	1993	**1999**	**2000**	**2003**	**2005**	**2008**	**2010**
GDP EU (15) at purchasing power parities PPP	5881582	6623616	6756088	7169615	7459268	7915834	8235634
GDP CEFTA (5) at PPP	373410	477.100	495.800	554.800	596.400	662.200	708.600
GDP CEFTA (5), annual growth in %		4.0	3.9	3.8	3.7	3.5	3.4
Gross value added by agriculture CEFTA (5)			30.407	32.261	33.416	34.997	35.947
EU (15) budget							
Common Agricultural Policy	37688	39.327	4.014	30.253	23.692	13.869	7.335
15% of CAP		5.899	6.017	6.385	6.643	7.050	7.335
85% of CAP		33.428	34.097	23.868	17.048	6.819	0
Structural policy	22761	30.945	31.789	31.348	31.164	31.066	31.128
Objective 1 + Cohesion Fund	12688	22.487	23.162	25.310	26.851	29.341	31.128
Structural policy - (Objective 1	Cohes.)		8458	8.627	6.039	4.313	1.725
External activities	4226	5953	6.072	6.444	6.704	7.114	7.402
R&D, TEN, other	5820	6634	6.767	7.181	7.471	7.928	8.249
Administration	3509	4093	4.175	4.430	4.609	4.892	5.089
Total expenditure	74003	86952	88.916	79.656	73.640	64.870	59.202
memo item: Transferred to Member States;							
structural policy			0	3.116	5.211	8.382	10.516
agricultural policy			0	12.316	20.597	33.130	41.563
EU budget CEF7A (5)							
Common Agricultural Policy			1.003	1.064	1.102	1.154	1.186
Structural policy			14.874	16.644	17.892	19.866	21.258
Transfers as % of GDP at PPP			3.0	3.0	3.0	3.0	3.0
External activities			-1.020	-1.082	-1.126	-1.195	-1.243
R&D, TEN, other			496	555	596	662	709
Administration			301	319	332	352	367
Total expenditure			15.654	17.500	18.796	20.840	22.276
Contributions CEFTA (5)			6.525	6.164	5.888	5.427	5.094
Results							
Net accession costs CEFTA (5)			9.128	11.336	12.909	15.413	17.182
EU (20) Budget			104.569	97.156	92.437	85.709	81.477
of which: to be provided by EU (15)			98.044	90.992	86.549	80.283	76.384
Net accession costs of CEFTA (5) as % of total expenditure of the EU (15)			10.3	14.2	17.5	23.8	29.0

Source: DIW estimations and calculations.

In the status quo scenario objective 1 support and the resources for the cohesion funds expand proportionately to the overall budget at 2 per cent p.a.; i.e. their share of GDP remains constant. There are no differences in this respect between the two reform scenarios. In contrast to the status quo scenario, however, a more than proportional growth should be envisaged, as the poorest regions in the EU might be affected negatively by more intensive competition from eastern central European firms. For this reason it is assumed in the model calculations that objective 1 support in the EU (15) expands by 3 per cent p.a. The other structural policy measures are gradually wound down over the duration of two support periods - from 2000 to 2010. Under these conditions structural policy expenditure in the EU (15) would stabilise at around ECU 31 billion over the period under consideration.

Transfers to the eastern central European countries are limited to 3 per cent of GDP. In the year 2000 this would be ECU 224 per capita for the CEFTA (5) countries. Support would total ECU 15 billion in the year 2000, rising to ECU 21 billion by the year 2010. In these countries support rises not in spite of, but rather because of, GDP growth in these years, as transfers are restricted to a fixed proportion of GDP which serves as a ceiling throughout the period under consideration.

Implications of the Reform Scenarios

The estimated net costs of eastern enlargement are substantially lower in both reform scenarios B and C than in the status quo scenario A (cf. tables 2 and 3). In the "compromise" scenario B, EU structural policy is reformed for the EU (15) (concentration on objective 1 and cohesion funds, return of remaining measures to national budgets in ten steps by the year 2010), while the agricultural budget, in volume terms, remains unchanged. In substantive terms, however, the CAP is changed in such a way that support consists primarily of direct income support. This is one prerequisite for its not being fully, transposed - as is assumed here - on to the new members. The structural policy, transfers to the new members, too, are lower in both reform scenarios than in the status quo scenario due to the imposition of a ceiling. At heart the two reform scenarios differ from one another in that in the "extreme" case of scenario C income support under the CAP is also transferred back to national budgets; the remaining elements of the CAP are applied to the new members in full. In scenario C the EU (15) budget is smaller due to the agricultural policy reform, and the contributions paid by all Member States are consequently smaller. As a result the net costs of enlargement are slightly higher than in scenario B.

In the reform scenarios the economic growth induced by early accession means that, after a transitional phase, the costs will be lower than indicated in the tables. Unlike in the status quo scenario negative effects are not to be expected in the medium term due to an expanding agricultural sector (as a result of distorted incentive structures), as the CAP is transposed only to a very limited extent. The transfers to the new members then required are certainly substantial, but they can undoubtedly, be financed.

The characteristic difference between the two reform scenarios lies in the volume of the EU (15) budget. The "compromise" scenario B differs from the status quo scenario only in the reduction in structural policy spending outside the objective 1 areas. In this scenario 85 per cent of the agricultural policy budget is paid each year to farmers, in the form of direct income transfers. This form of subsidy would be highly transparent, and in the longer term

could not be justified to other occupational groups. Sooner or later these subsidies would have to be reduced.

In the reform scenarios the EU (15) budget contracts compared with status quo conditions - in one case significantly. It cannot be concluded from this that national budgets will benefit from a windfall reduction in the burden of contributions, however. Although there is some saving in contributions, fewer functions - and thus payments - are made by the Union. Member States will have to provide more resources for farmers - in scenario *C* - and for certain problem regions; the expectation is, though, that in sum less will be spent. This expectation is based, firstly, on the reduced transaction costs as less administration is required due to the "loss" of one administrative level, and the fact that the reforms proposed allow more highly focused and efficient instruments to be deployed. Secondly, the subsidisation system and its opportunity costs will be rendered more transparent if they, are solely a national responsibility. On balance this can be expected to lead to a declining volume of subsidies. Whatever the means, spending cuts are unavoidable, even if they involve political difficulties. Abandoning certain policies could lead to additional adjustment difficulties in the Member States and be conceived as a step backwards in the process of European integration. Yet a functional concentration of community activities is the price to be paid for an enlargement that marks a new quality of European integration.

Conclusion

The scenarios delineate a framework within which the financial consequences of eastern enlargement move against the background of more or less far-reaching reforms of internal EU policies. They clearly indicate that enlargement need not come to grief on the costs associated with it. The burden imposed on the budget can be kept within reasonable bounds given changes in internal EU policies that should be implemented in any case. If these policies are not modified, the analysis shows that structural policy is a more serious obstacle to accession than agricultural policy. If the capability of a national economy to absorb transfers efficiently is taken into account by introducing a fixed ceiling on EU support as a proportion of GDP, it would make a decisive contribution towards facilitating eastern enlargement. Irrespective of enlargement it is vital that further progress is made with agricultural policy reform. Agricultural policy remains the most important item of spending in the EU (15) budget. It is only here that the inevitably substantial - resources required for eastern enlargement can be freed up.

Roland Döhrn*

The New Trade Structure Between East and West: Is Integration Already a Matter of Fact?

Volume, directions, and product structure of a country's foreign trade, i.e. the way it is integrated into the world economy, mirrors quite well its state of development. Economic theory gives quite a number of reasons to suppose that. As the traditional Heckscher-Ohlin theorem suggests that the structure of trade depends on the endowment with factors, countries at a lower stage of development will export products that are low-skill-labour intensive, as this seems to be the abundant factor in those countries whereas capital or high-skill-labour are scarce. Accordingly, economies at a high stage of development will export capital or skills intensive products. Therefore, trade between two countries that have large differences in the stage of development will be of a more complementary nature, i.e. it will be dominated by inter-industry-trade. The Linder hypothesis, on the other hand, points out that trade between two countries will show an increasingly substitutional pattern the higher the income level of both partners is. Having in mind these basics, state and development of trade between the transforming economies in Central and Eastern Europe and the traditional industrialised countries can be seen as an important indicator of the state and success of transformation.

However, the change of trade relations of the transforming economies does not only reflect economic transformation but is also a consequence of the elimination of enormous distortions that dominated external exchange during the central planning era. Before the fall of the iron curtain, trade of the former CMEA states was smaller than one could have expected looking only at their state of development and economic power. Within the CMEA trade was relatively intensive, though primarily organised on a bilateral basis and hampered by the lack of a convertible currency accepted by all partners which would have encouraged them to build up claims or debts between the countries. Curiously enough, when looking closer at the composition of trade, one detects that division of labour between the economic and political centre of the CMEA - the Soviet Union - and its rim worked just the opposite way than centre-periphery relations between market economies do: The centre exported raw materials and imported, often relatively skills intensive manufactured goods[1].

Trade with the 'Rest of the World' was only poorly developed in the CMEA countries. In part this was inherent in the logic of central planning: One could not expose a large part of the economy to the uncertainties of a free market. In part it also followed reservations on the western side. Imports from the CMEA often were restricted with reference to dumping and the same was true for exports due to strategic considerations. Again, the composition of trade is atypical for exchange between industrialised countries: Exports of the CMEA to western

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1 Cf. A. Brüstle, R. Döhrn und A.-R. Milton, Die Einbindung der DDR in den Rat für Gegenseitige Wirtschaftshilfe. "RWI-Mitteilungen", vol. 41 (1990), pp. 53ff.

economies were raw materials and highly standardised products by large, whereas western exports above all consisted of capital goods. Thus, trade was mainly inter-industry-trade, typical for relations between developed and developing countries.

These distortions vanished in a relatively short span of time and simultaneously patterns of trade emerged adequate to factor proportions and state of development. This paper will describe the development of East-West-trade and thus the integration of the transforming countries into the European division of labour since the start of transformation. In doing so, it pays attention to three aspects of integration: A first chapter focuses on the volume of trade. A second chapter is dedicated to an examination of the composition of exports and imports. In a third chapter the analysis goes deeper and looks at the position of Eastern European producers in the production chain. As usual, a summary of the basic findings concludes this paper.

1. Volume of Trade

Trade between the Eastern European transforming countries and the industrialised economies has, as already said, been traditionally rather small. Before the start of transformation their share e.g. in extra EU exports and imports rarely exceeded 7 per cent except for some years in the 70s and in the early 80s. This situation before 1990 must be considered as 'abnormal'. The Eastern European countries are the EU's neighbours to the East and having in mind the impact of geography on trade, intensive trade-relations should be expected. Let alone relations to industrialised countries in a greater distances, such as the U.S. and Japan; trade with them was nearly neglectable.

In recent years several attempts have been made to quantify the distortions inherent in these trade figures. One of the first analyses in this direction was made by Collins and Rodrik[2]. They base their estimations on historically observed trade-patterns from the interwar period and on assumptions about the 'openness', i.e. the share of exports in GDP. For 1988 they estimate the hypothetical volume of trade between the EU12 and Eastern Europe including Yugoslavia and the Soviet Union to be $ 147 bn in the case of Eastern European imports and $ 144 bn in the case of exports. Both figures mean a triplication of actually observed trade in 1988. Alike in all calculations to follow, their prediction of the long run effect depends highly on their assumption on the development of income in Eastern Europe. Assuming that per capita income in the transforming economies will reach the EU average, they predict exports as well as imports of $ 380 bn[3].

Several other calculations employ gravity models to estimate 'normal' trade relations and to forecast future trade. To compare their results is a difficult task. Firstly, they base their estimates on different years and different samples of reference countries. Secondly, the definition of 'Eastern Europe' varies across the papers. Some include Yugoslavia and the GDR, others exclude the Soviet Union as will be indicated in the survey to follow.

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[2] Cf. S. Collins and D. Rodrik, Eastern Europe and the Soviet Union in the World Economy,. (Policy Analyses in International Economics, No. 32.) Washington D.C. 1991.

[3] Cf. S. Collins and D. Rodrik, pp. 45ff.

One of the first analyses in this direction was made by Havrylyshyn and Pritchett[4]. They give no estimate of hypothetical trade under market conditions as they normalise their results to actual trade. Furthermore they restrict their analysis to non-oil trade. However, their calculations give an impression of the redirection of trade that can be expected after transformation. In 1986/87 more than 51 per cent of Eastern Europe's (including Yugoslavia, excluding the Soviet Union) imports and 62 per cent of its exports were intra-CMEA trade. The authors' prediction is that this share will decline to 11 per cent (imports) and 17 per cent (exports) at the same time while Western Europe's share will rise from 39 per cent to 83 per cent (imports) resp. from 26 to 80 per cent (exports)[5]. One interesting aspect of Havrylyshyn and Pritchett's results is that Western Europe will also gain importance to the debit of America and Asia. A prediction of trade is not given in this article.

Hamilton and Winters base their analysis on a gravity model using 1985 data[6]. They state even a wider gap between actual and potential trade than Collins and Rodrik do. They predict Eastern European export (including the GDR and the Soviet Union, excluding Yugoslavia) to EU12 of $ 133 bn in 1985 compared to actual trade of $ 27 bn. For the import side the relation is even more dramatic: potential trade of $ 142 bn compares to an actual value of $ 22 bn. In this paper also a judgement for individual western countries is given: The gap between actual and potential trade is relatively small in the case of Japan and Germany and it is the widest in the case of the US. Anyway, even for Japan potential trade makes three times the actual, for Germany this factor comes near to 5. Döhrn and Milton use a gravity model based on the network of trade among 26 industrialised and newly industrialising countries[7]. The stability of the coefficient of this model is tested for the period 1983 to 1989, the estimations for Eastern Europe use 1988 coefficients. Using World Bank income data, this study comes to a much more moderate judgement of the distortion of trade: Whereas actual 1988 exports of the transforming countries (excluding Yugoslavia) into industrialised countries and the NICs amounted $ 36.6 bn, hypothetical exports of $ 52.6 bn are calculated. Breaking down this result to individual market economies, they come to the result that German and Japanese trade even is above its hypothetical value, whereas the distortion is relatively high in the case of most other EU countries. On the Eastern side they furthermore state a bias in favour of the Soviet Union, where the gap between actual and predicted trade is relatively small. Döhrn and Milton also try to quantify long term effects. For this purpose they assume a doubling of per-capita income in Eastern Europe within 10 years. This would imply that in 1998 trade between industrialised and transforming economies will be - expressed in 1988 prices - four times as large as 1988 values, which also means a moderate growth compared to the projections of Collins and Rodrik. Trade between the transforming economies, however, will not grow in that period: After an initial sharp decline it will at its best come back to the 1988 level.

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4 Cf. O. Havrylyshyn and L. Pritchett, European Trade Patterns after the Transition. (World Bank Working Papers, WPS 748.) Washington D.C. 1991.

5 Cf. O. Havrylyshyn and L. Pritchett, p.11.

6 Cf. C Hamilton and A. Winters, Opening up trade with Eastern Europe, "Economic Policy", vol. 14 (1992).

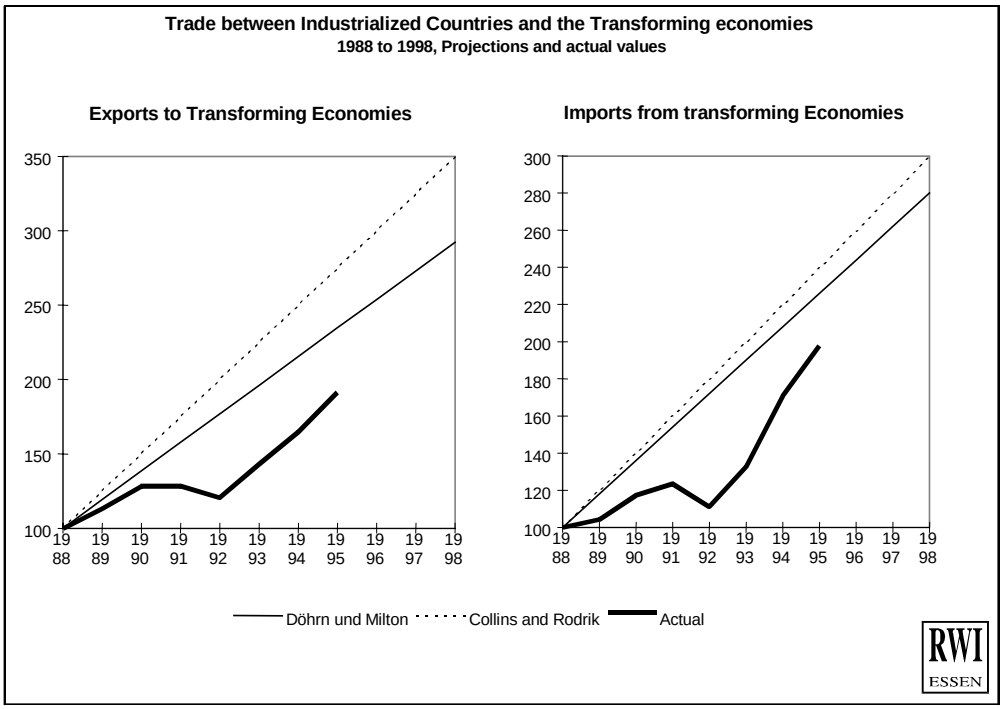
7 Cf. R. Döhrn and A.-R. Milton, Zur zukünftigen Einbindung der osteuropäischen Reformländer in die Weltwirtschaft, "RWI-Mitteilungen", vol. 43 (1992), pp. 19ff.

A recent study by Festoc, finally, comes to results that are quite in line with the above mentioned[8]. For 1992, after four years of adjustment, it states that EU exports to Poland, Hungary and Czechoslovakia are on average 60 percent below trade potential. For EU imports from these countries the gap has narrowed to 30 percent on average. Concerning imports, Germany, again, is the only country that has fully utilised its potential, in the case of exports its degree of utilisation is highest.

Summing up, all studies predicted a remarkable expansion of trade between the transforming and the industrialised economies. They also are quite in line that Germany will experience a slower expansion of its trade with eastern Europe because it has exhausted its potential trade to a much higher degree than other countries in the past.

The first part of this projection seems to come true: Looking at the real development of trade, one can see that after a stagnation during the first years after transformation trade seems on his track towards the development predicted (chart 1). Anyhow, driving force up to now has mainly been the reorientation of trade towards Western Europe, whereas rise in incomes has contributed to the expansion only to the smaller part[9].

Chart 1



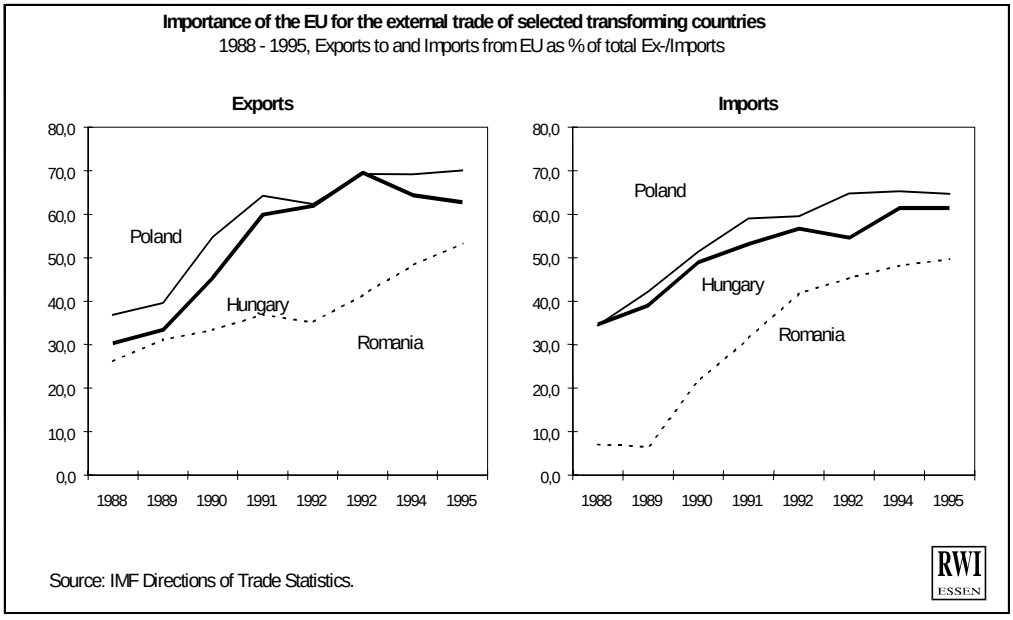
8 Cf. F. Festoc, Quel potentiel d'échanges entre les pays d'Europe Centrale et l'Union Européenne? (Journées AFSE Intégration Économique Européenne, Recceuil des contribution, Vol. I.), Nantes 1995.

9 Nevertheless, it is difficult to assess the 'right' development of incomes suitable for such calculations. Expressed in US-$-terms, e.g., per-capita income in Poland doubled between 1990 and 1995, it rose about 50 per cent in Hungary. In real-term national currencies, Polish per capita income was in 1995 on pre-transformation level, whereas Hungarian was clearly below.

Indeed, reorientation of trade has been remarkable. Nearly all countries have experienced a turn-around. Before 1990 about half of all imports came from the CMEA members and roughly speaking the same share of all exports went there. Today trade relations of some Central European countries are oriented more intensive towards the EU than those of some EU-members themselves (Chart 2). Accordingly, the use of a more sophisticated method, the cluster analysis, unveils how close Poland, Hungary, the Czech and the Slovak Republic have moved towards the EU. Contrary to the situation before the start of transformation, in 1994 they entered the "European cluster" already at a relatively low level, even at a lower level than the EU-member Greece[10]

The second prediction mentioned above, however, can at present not be verified very clearly. Germany did not loose much of its importance as partner of the transforming economies and the catch-up of the other EU countries was not as strong as expected. Anyway, that might also be a consequence of German unification, as Germany in the short run benefited much from East German connections within the CMEA, especially from contracts that were signed by the GDR and now fulfilled by united Germany. Thus, one should not emphasise this developments too much.

Chart 2



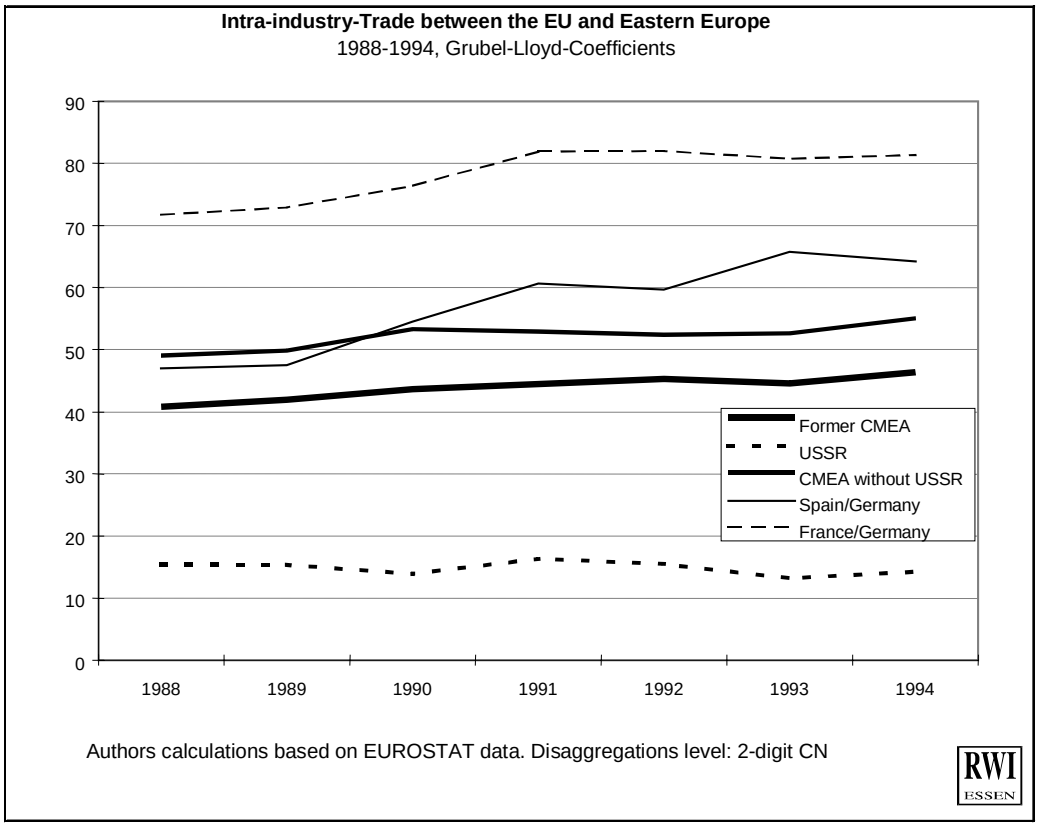
2. Structures of Trade

At CMEA times composition of trade of the transforming economies was - as mentioned above - atypical for relatively high industrialised countries. As well intra- as well as extra-CMEA trade was mainly inter-industry-trade. Structures of intra-CMEA trade were widely determined by specialisation agreements that intended to create a ‘socialist division of labour’. Extra-CMEA trade covered only a very limited number of products. Raw materials and

[10] Cf. D. Piazolo, Trade integration between eastern Europe and Western Europe: Politic follows the market. (Kiel Working papers No. 745.) Kiel 1996, p.9.

highly standardised low-tech goods dominated CMEA exports, because they could easily be sold abroad using price as the only marketing instrument, and offered the opportunity - according to the logic of central planning - to allow the quantities of exports to be fixed. Eastern imports concentrated on investment and intermediate goods that were scarce or could not be produced with the technologies available in their countries. Consumer goods were imported in very rare cases, e.g. to avoid social unrest in situations were some basic goods were extremely scarce.

Chart 3



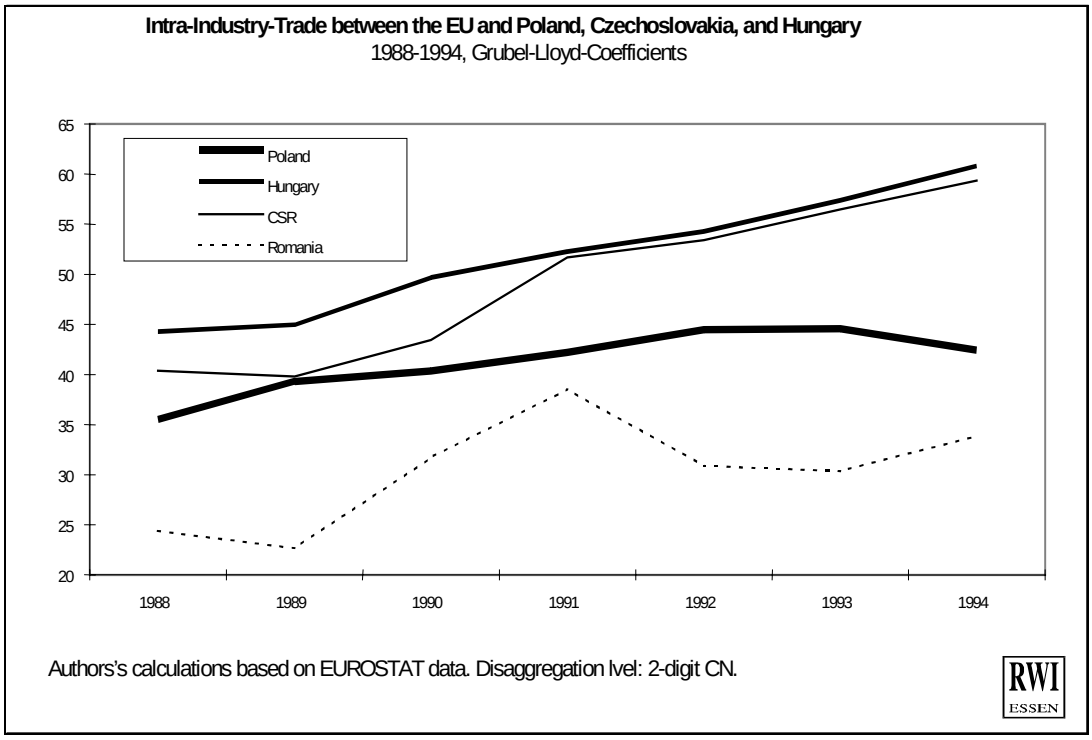
Starting from this situation, traditional foreign trade theory suggests, that a more intensive integration of the Eastern European countries into the European division of labour would mean an increase of intra-industry-trade (IIT)[11]. Again, this shift in the composition of trade will be driven by two forces: First, a 'normalisation' of trade relations will lead to trade structures more typical for relatively high industrialised economies than those existing under the central planning regime. Second, access to western products and a rise in income will result in an assimilation of consumer behaviour and, thus, in trade structures. However, in the light of more recent approaches in the analysis of the location of industries, the link between integration and trade structures is not as clear as conventional theory suggests[12]. Alike in earlier periods of history, the Eastern European countries are 'follower countries' again, com-

[11] Cf. A. Bucher, M. Hayden, and E. Toledano Laredo, Economic evaluation of EC-CEEC trade. (European Economy, Reports and Studies, no. 6/1994) Brussels 1995, p.77ff, esp. P. 104.

[12] Vgl. P. Krugman, Geography and Trade.

peting with well established producers from industrialised countries or the NICs[13]. Under these conditions the location of production and, thus, the consequences for the structure of trade are less predictable than in a situation, where trade relations steadily developed over long time.

Chart 4



Anyway, figures make evident, that IIT has gained importance since the start of transformation (chart 3). Leaving aside all methodological problems that are linked to the calculation of intra-industry-trade coefficients[14], IIT-coefficients for total CMEA-EU-trade were relatively low at the end of the eighties, lower e.g. than for the trade between Germany and Spain, to quote an EU-country with an income level at the lower end of the EU income range. Nevertheless, chart 3 also exhibits a clear differentiation: Trade with the USSR and its successor states was complementary by far and remained so during the course of transformation, reflecting the importance of raw materials for the exports of the CIS-states. On the other hand, IIT with the Central European transformation-states was considerably higher - the level was even slightly above the Spanish value in 1988 - , and it shows a moderate but clear upward trend. Insofar, development of IIT suggests that the Central European transformation states are increasingly integrated with the EU. However, one should look closer at these developments, as the results are deducted from a relatively high level of aggregation of regions as well as of products.

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[13] R. Döhrn and U. Heilemann, Structural Change in Eastern Europe. In: L. Waverman and B. Heitger (Eds.), German Unification and the World Economy. London und New York 1993., pp. 83ff.

[14] To measure IIT the standard Grubel-Lloyd-Index is used. For a review if the methodological problems e.g. cf. R. Pomfret, Intra-Industry-Trade in Intraregional and International Trade. In: H. Giersch (ed.), On the Economics of Intra-Industry-Trade. Tübingen 1979, pp. 115ff.

At a more detailed regional level, clear differences appear linked to the income levels in the different countries (chart 4)[15]. EU-trade with Hungary and Czechoslovakia[16], that have relatively high incomes per capita among the Eastern European countries, is much more coined by IIT than trade with Poland whose per capita income is considerably lower. Trade with Romania, the country with the lowest per capita income in the sample, consists only to a relatively small extent of IIT. Furthermore, in the two former cases importance of IIT has been rising considerably, whereas its share in trade with Poland and also with Romania is even falling slightly since 1992 resp. 1991.

Table 1

Intra-industry trade with electronic products[1]
1988-1994

	1988	1989	1990	1991	1992	1993	1994
	Grubel-Lloyd-Indices						
CSR	32,0	30,7	31,1	44,3	50,4	57,9	65,1
Hungary	36,3	40,9	46,5	56,6	51,2	56,6	57,9
Poland	48,0	48,7	32,0	38,4	40,6	45,7	47,2
Romania	20,4	21,9	26,7	31,7	22,9	32,6	42,8
	Adjusted Aquino-Indices						
CSR	29,1	29,0	32,8	47,4	53,3	62,5	68,7
Hungary	39,2	41,8	46,6	57,0	72,1	78,0	75,2
Poland	47,5	46,6	30,0	40,8	42,7	44,3	51,2
Romania	20,0	28,4	27,4	29,0	29,1	41,7	49,5

Author's calculation from EUROSTAT sources. - [1]45 products on 4-digit CN-level.

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At a more disaggregated product level, again, the above findings are confirmed. As an example, trade with electronic products is taken[17]. Because on a sectoral level trade imbalances can be large, Grubel-Lloyd indices may underestimate the extent of IIT considerably. Therefore, as an additional indicator, Aquino's index of IIT has been calculated that eleminates this bias[18]. The figures calculated make evident that EU-trade of electronic products especially with Hungary, Czechoslovakia, and Romania is increasingly showing an intra-industry pattern (table 1). In the case of Poland, the index rose only to a relatively small extent, when 1988 and 1994 are compared. However, from 1988 to 1990 it declined and it increases since then. Differences between the countries, again, reflect differences in per capita income and state of development: IIT coefficients are higher in the case of Hungary and Czechoslovakia and lower with respect to Poland and Romania. This, of course, is an example only. However,

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[15] Insofar this analysis comes to similar results as M. Landesmann, The Pattern of East-West European Integration: Catching Up or Falling Behind? (WIIW Research reports No. 212.) Vienna 1995.

[16] To get an appropriate time series for Czechoslovakia, data for the Czech and the Slovak Republic have been aggregated after 1992.

[17] According to the Combines Nomenclature of Products (CN) electronic products in this study are defined as CN 85.

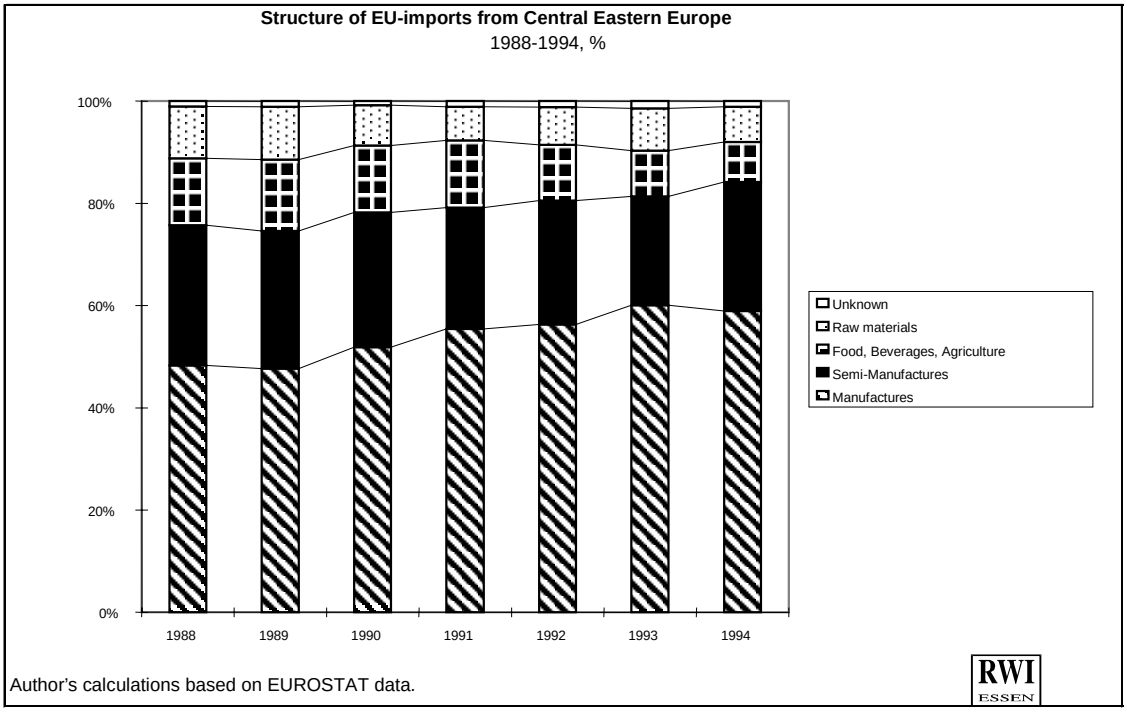
[18] Cf. N. Grimwade, International Trade. London and New York 1989, p. 96ff.

the picture also appears when looking at the structure of imports from Eastern Europe (chart 5). Taking into account the Central Eastern European Economies only, as trade with the CIS-states is a special case, the share of manufactures in EU-imports from this region has grown since the start of transformation. Furthermore, there is some indication, that high-tech- and high-skill industries are gaining ground among these sectors[19]. At the same time raw materials and agricultural products lost importance, the latter may be also a result of trade policy, as agricultural products are regarded as 'sensitive' and are, therefore, subject of special treatment under the Europe agreement.

3. Position in the Production Chain

So far, changes in the volume of trade as well as in its structure suggest that integration of Eastern Europe into the international division of labour has already become a matter of fact. Hence, there should be virtuous conditions for an increase of income in the transforming economies. Some doubts about this quite optimistic assessment, however, arise when looking at Eastern Europe's position in the product chain. Trade between the EU and the transforming economies was stimulated to a large extent by outward processing trade (OPT). Before 1990 outward processing was of little importance for the Eastern European states. Only in the former Yugoslavia and in Romania it was a relevant part of total trade. After 1990 it gained increasingly importance, the value more than doubled till 1994 (table 2). Its share in total EU-imports from Eastern Europe rose from 6 per cent in 1988 to more than 10 per cent in 1994.

Chart 5



[19] Cf. B. Andreosso-O'Callaghan and C. Noonan, European Intra-Industry-Trade. Emerging Industrial Specialisation in Central and Eastern Europe. "Journal of World Trade", vol. 30 (1996), no. 6, pp. 139ff

At the same time a remarkable shift in the geographic pattern took place. Yugoslavia, initially the place where a good deal of outward processing took place, lost importance not at least due to the conflicts arising after the dissolution of the state. Much of the outward processing was shifted to other Central European states, namely to Poland, Hungary, the Czech Republic, and Romania. On an average, in 1994 about 17 per cent of all imports stemming from this region originated in outward processing compared to only about 9 per cent in 1988. The differences between the various countries are large. In former Czechoslovakia the share is about 10 per cent, in Romania, that is at the upper end of the range, almost a quarter of all trade is linked to outward processing. One should notice in this context that EU exports to Eastern Europe are influenced by these developments in like manner. It is in the nature of outward processing that each import after processing has an export for processing as a prerequisite.

Table 2

EU-Imports after Outward Processing from Eastern Europe
1988-1994

	1988	1989	1990	1991	1992	1993	1994
	ECU bn						
Central Eastern Europe	1048	1268	1557	2190	3004	3622	4472
former USSR	65	111	98	146	134	296	484
former Yugoslavia	805	934	1110	1164	886	765	759
Total	1918	2313	2765	3501	4024	4683	5715
	% of total imports						
Central Eastern Europe	8,8	9,2	10,9	13,5	15,8	17,9	17,0
former USSR	0,5	0,7	0,6	0,8	0,8	1,5	2,1
former Yugoslavia	14	13	14	16	15	15	13
Total	6,2	6,4	7,3	8,3	9,5	10,5	10,4

Source: EUROSTAT

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Since 1992 there seems to be a new tendency in this field: Outward processing obviously is ‘moving east’. Traditionally it was of almost no importance for the former Soviet Union. But in 1994 it covered already 2 per cent of the EU imports from this region. In 1995 and 1996 this share seemed to have continued to rise, at least provisional data from Germany do suggest this. In the first half of 1996 almost 30 per cent of German imports from the Ukraine and more than 25 per cent of those from Belarus consisted of OPT[20].

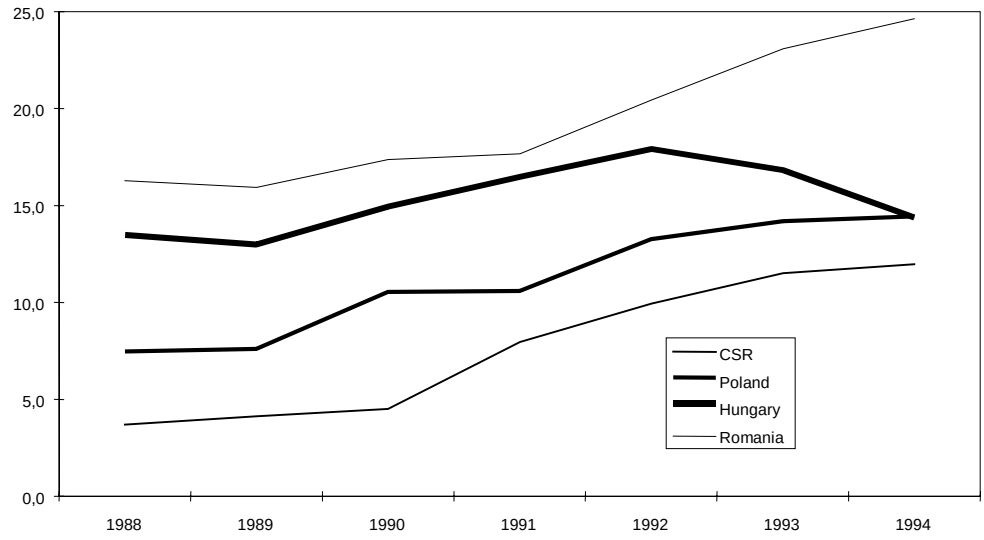
From a western perspective these new possibilities to use outward processing offer advantages in international trade. Due to the iron curtain Western Europe, especially Germany, was cut off from its traditional hinterland. Economically speaking, it was situated at the rim of the ‘market economy area’. Whereas the US benefited from of a quite intensive division of labour with low wage countries in Central and South America, and Japan took the same

[20] Even within the former Yugoslavia there seems to be a shift from the western rim (Slovenia) to the eastern (Macedonia).

chances in South East Asia, Western Europe sadly felt the lack of such opportunities. Therefore, OPT was, contrary to the situation in the US, of little importance for Europe. To be even more general, European industry imported significantly less inputs of semi manufactures from low wage countries than the US or Japan[21]. This was a disadvantage in international competition that vanished by and by as the Eastern European countries opened their economies.

Chart 6

Share of Outward Processing in the Trade Volume of selcted countries
1988-1994,%



Author's calculations based on EUROSTAT data.

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From an eastern perspective the feelings about this development are more mixed[22]. On one hand outward processing may have offered the chance to practise trade with market economies, to adopt new technologies, and, finally, to secure jobs and maintain qualifications in the short run in sectors that were not competitive with their own products after the opening of the markets. On the other hand outward processing must be considered as second best, because often those steps in production that are decisive for market success such as product development, design, and marketing remain in the hand of the Western European partner. Furthermore, outward processing seems to be partially footloose, i.e. western partners may move to locations with even lower costs after the end of their contracts. The 'move east' of German OPT described above seems to affirm that such fears might come true.

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[21] Cf. K. Löbbe, R. Budde, R. Döhrn et.al., Der Wirtschaftsstandort Deutschland vor dem Hintergrund regionaler Entwicklungen in Europa. (Untersuchungen des RWI 22). Essen 1997.

[22] Concerning the ambivalence of OPT-trade with respect to the creation of competitive industries in the Eastern-European countries cf. E. Synowiecz, Der Außenhandel mit Textilien und Bekleidung zwischen Polen und der Europäischen Union. In: R. Döhrn (ed.), Ost-Erweiterung der EU - Neue Chancen für Europa?!. (RWI-Schriftenreihe), forthcoming.

4. Conclusions

As it had been expected by most experts, trade between the Central and Eastern European transforming economies and the European Union considerably increased since 1990. Up to now, this is almost exclusively a consequence of a redirection of trade, whereas income does not contribute much to this development. Moreover, the composition of trade suggests that the transforming economies and the EU have become increasingly integrated. Imports and exports more and more show an intra-industry pattern. This observation also holds when trade is examined at a relatively detailed level of disaggregation.

Comparing the various economies in Eastern Europe, a clear differentiation of trade patterns with respect to income level and, thus, state of development can be detected. Large shares of intra-industry-trade (IIT) of the EU with Hungary and Czechoslovakia make evident that integration with these two countries has been intensified considerably. IIT-coefficients calculated for them come already quite close to those observed between Germany and Spain, to quote an EU-member at the lower end of the community's income range. Concerning Poland and Romania IIT is less developed, but on the rise. On the other hand, trade with Russia and the other countries of the CIS still shows an inter-industry pattern, as EU imports are still dominated by raw materials.

However, dynamics of EU-Eastern European trade are in large part a consequence of the expansion of outward processing, that covered 17 per cent of EU imports from the transforming economies (except the former USSR) in 1994. From a statistical point of view, a large share of outward processing overstates the trade relations as OPT goods appear as exports as well as imports. From an economic point of view, there is the danger that outward processing does not stimulate integration, because it may create little spill overs and production for OPT-purpose can be considered as footloose to a certain extent.

Hence, integration of Eastern Europe into the European division of labour proceeded considerably since the start of transformation and, thus, is already a matter of fact. However, a more detailed look at the position in the production chain unveils, that integration might not have proceeded yet as far as gross figures suggest.

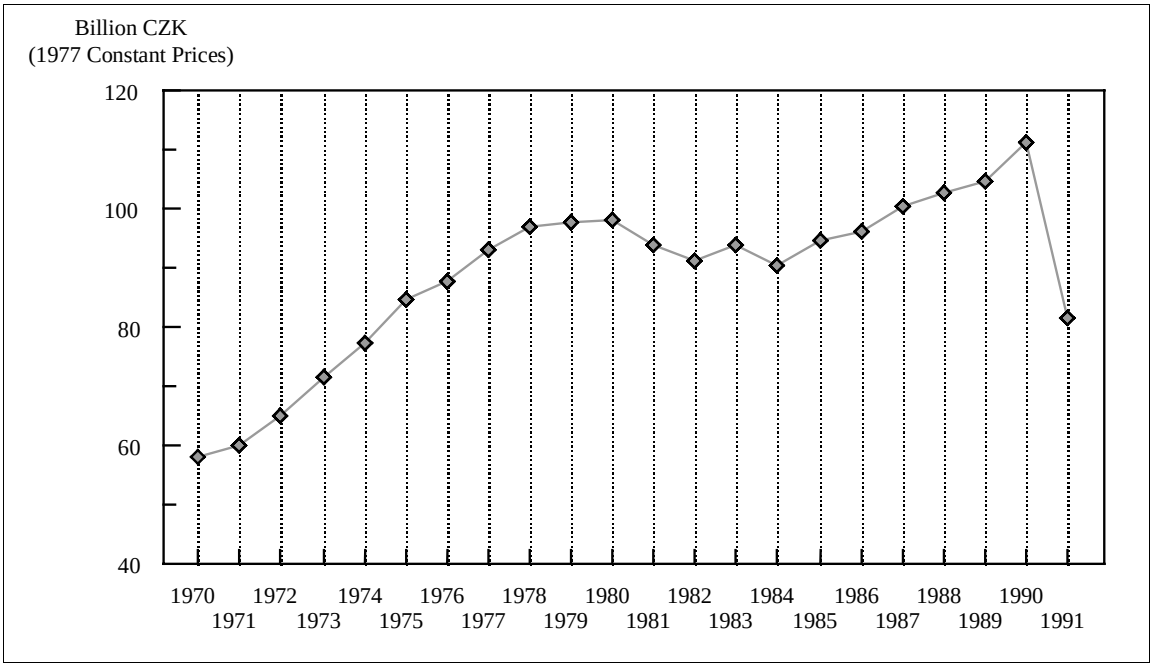
Pavel Mertlík/Ladislav Prokop*

Investment Pattern of the Czech Economy since 1989[1]

1. Czech Investment Development in 1970s and 1980s

The investment pattern of the Czech economy had traditionally been characterised by comparatively high investment levels. At the same time, investment fluctuations (cycles) had typically been present in the Czech economy, at least from the 1960s (see classical works of Goldmann)[2]. The Table 1 and Chart 1 and 2 describing the situation in the 1970s and 1980s clearly indicate two investment cycles in the last two decades of central planning, the second one reaching its peak only in 1990. In 1991 we could observe a sharp decline of investment activity.

Chart 1: Tangible Capital Investments



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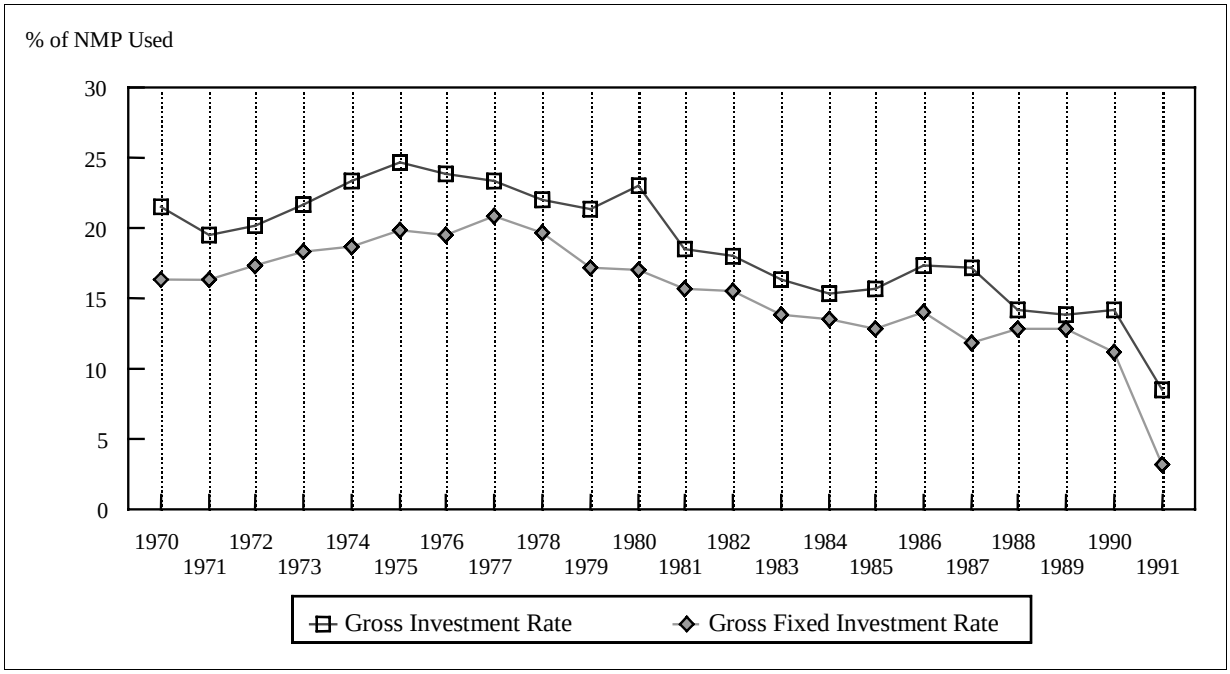
1 The preparation of the paper was co-supported by the Phare ACE Programme 1995, Research Project No. P95-2226-R Industrial Investments: Cornerstones in the Next Stage of Central European Transformation.

2 Namely Goldmann 1964, Goldmann and Flek 1967, Goldmann and Kouba 1969.

Also, we may observe an important difference between the investment cycles of the seventies and of the eighties. While Chart 1 suggests that the economic development in the country in terms of real tangible capital investments in the eighties was less impressive than during the decade before, Chart 2 shows that not only the growth rates of real tangible capital investments in the eighties comparatively declined but that the propensity to invest significantly decreased: while in the 1970s the rate of gross investment (gross capital formation over net material product used ratio) fluctuated well above 20 per cent, in the 1980s its fluctuation was located in average by about 6 percentage points lower and the trend of its motion indicates an apparent decline. Similar moves are observable in the case of the rate of gross fixed investment, i.e. gross capital formation over net material product used ratio. Thus, the statistics suggests that the Czech economy despite its traditionally high investment figures started the transformation period due to the downswing and the following stagnation of the "bad eighties" in a situation of a quite significant investment need.[3]

Chart 2: Investment Rates



[3] The data presented here are defined in terms of the system of balance of national economy (material product system) - official statistical data produced in the system of national accounts are available in Czech statistics only since 1992. Nevertheless, the best available estimates of Czechoslovak GDP between 1961-1988 made via complex matrix calculations by Vladimír Nachtigal in the Economic Institute of the Czechoslovak Academy of Sciences in the late eighties (see Nachtigal 1989, 1990a, 1990b, 1991) also give a picture of high national propensity to invest, in fact even more impressive. Nachtigal's GDP data display - mainly due to the different method of treating of the tertiary sector in the national accounts system - significantly higher investment rates, and also the estimated trends of capital formation differ, being for the eighties significantly more positive: Nachtigal's estimates of the average share of the gross capital formation in GDP used are 26.9%-29.9% in the fifteen-year period 1961-1975 and 28.9%-30.9% in the thirteen-year period 1976-1988 (respective period averages; the spread between the values is the result of the experimental use by Nachtigal of three different recalculation and rectification methods). For the share of gross fixed capital formation in GDP used, the respective average figures are according to Nachtigal 23.7%-26.2% (1961-1975 average) and 25.7%-28.2% (1976-1988 average) respectively (cf. Nachtigal 1991).

2. The Macroeconomic Situation in the Czech Economy Since 1990

The economic reform in the Czech economy started on 1 January 1991 with an extensive price liberalization and deregulation that followed after several important institutional and macroeconomic preparatory steps accomplished during 1990 (dismantling of the system of central planning, enterprise reform, currency devaluation, tax reform). Later on, some other prices and markets were liberalized (most notably the labour market), the turnover tax was substituted with the value added tax (1 January 1993), the current account operations of the balance of payments were fully liberalized and the currency was made convertible according to Article VIII of the Statute of the International Monetary Fund (1995), and so forth. Summed up, in the first half of the 1990s there had been turbulent times in the Czech economy and in the country as such. The disestablishing of the Czech and Slovak Federation by 31 December 1992 and the resulting state sovereignty of the Czech Republic since 1 January 1993 are parts of the story; their economic impact also should not be omitted.

Table 2 gives the overview of the major macroeconomic indicators of the Czech economy in the 1990s that reflect the rapid and dramatic process of institutional and economic change. The table shows several interesting features which are specific for the Czech economy compared to other economies in transition, namely within CEFTA.

First of all, while the GDP slump was not only deep but also long (since 1989 up to mid-1993), and the period of decline of the industrial output was even one year longer (the recovery of industry had started only in late 1994), the slump of investment activity was concentrated only within one year, 1991. Since 1992, investment have been growing rather quickly. On the other hand, one has to remember that the real GDP of the country is still well below its 1989 level and not far from its 1980 level. Consequently, from the long-run point of view, the whole period since 1980 so far (lasting now over seventeen years) may be interpreted as a period of a long-term economic stagnation of the country.

Secondly, the real "economic miracle" of the Czech transformation, the low unemployment rate, has been persistent during the whole period, including the "black" year 1991. Some foreign economists tend to give an "easy" explanation of this phenomenon assuming that it is a manifestation of the low degree of industrial restructuralization within Czech economy; Czech economists studying the domestic labour market usually give a more complex poly-causal explanation in which the process of the accelerated tertiarization of the economy (when services typically are labour intensive) and the flexibility of the domestic human resources plays an important role.

The economy has a permanent and persisting problem with its low and rather decreasing international competitiveness and export performance and this situation is rather worsening. The triple devaluation of the crown in 1990 had brought a significantly high ERDI (well over 3, and vis-a-vis some major currencies including Deutschmark over 4 or even 5; in Table 2 this is reflected by the sharp decrease of the nominal unit labour costs in early 1990s). This definitely assisted the economy in its export reorientation from CMEA to EU economies in 1991-1992, but the volume of exports in real terms had been more or less stagnant throughout the nineties. Due to the policy of stable nominal exchange rate conducted since 1991 ERDI decreased by time to the area of about 2 and in early 1997 was already approaching 1. At the same time, no significant comparative improvement of labour productivity, quality of tradable goods etc. is observable. Nowadays the problem of insufficient international competitiveness of the Czech economy has brought a high and quickly growing foreign trade deficit

(between 7-8 per cent of GDP in 1996, i.e. one of the highest foreign trade deficit / GDP ratios in the world in 1996). This development sharply contrasts with significant improvements in this area observable recently in Hungary and namely Poland.

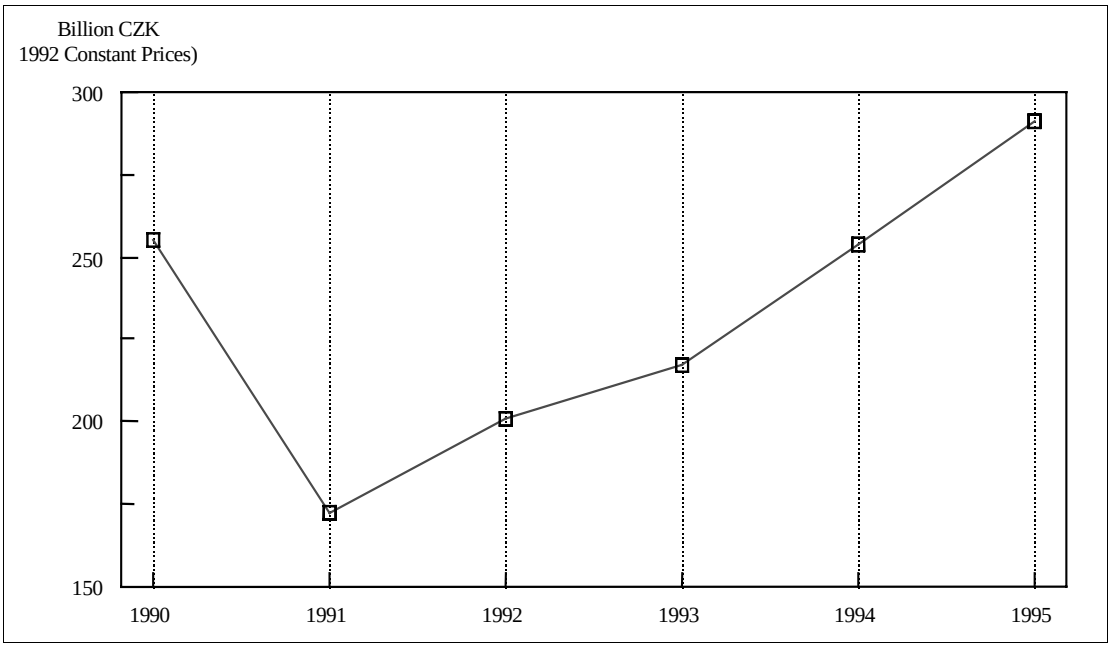
The budget has so far operated with surplus; its internal structure and the trends, particularly on the expenditure side (where necessary expenditures are rapidly growing, in some areas out of government's control, while appropriate increases in the tax revenues cannot be envisaged) are, however, dangerous and a warning sign; for the future we can expect huge deficit problems. Thus, it seems that at least in this respect the Czech economic development does not substantially differ from that of other countries - the only difference is a time delay of several years caused by some specificities of the Czech economic policies and, not least, by a better (i.e. macroeconomically much more balanced) "starting position" in 1990.

3. Investment Process in 1990s - Basic Macroeconomic Characteristics

The peak of the last Czech "socialist" investment cycle of the 1980s coincides with the beginning of the economic reform. The start of the reform in 1991 came just following the year with the highest investment level in terms of real tangible capital investments in the Czech economic history until 1995. Of course a matter of interest may be what the investment development would have been like if the reform of 1991 and the consequent "transformation recession" had not arrived but answers to such questions lie in the reign of speculations. On the other hand, the notoriously known fact of frequent technological obsoleteness and low economic efficiency of tangible capital investments in the late centrally planned economies should be mentioned here. This significantly deteriorates the meaning of the above quoted, relatively high levels of investment activity in statistical terms.

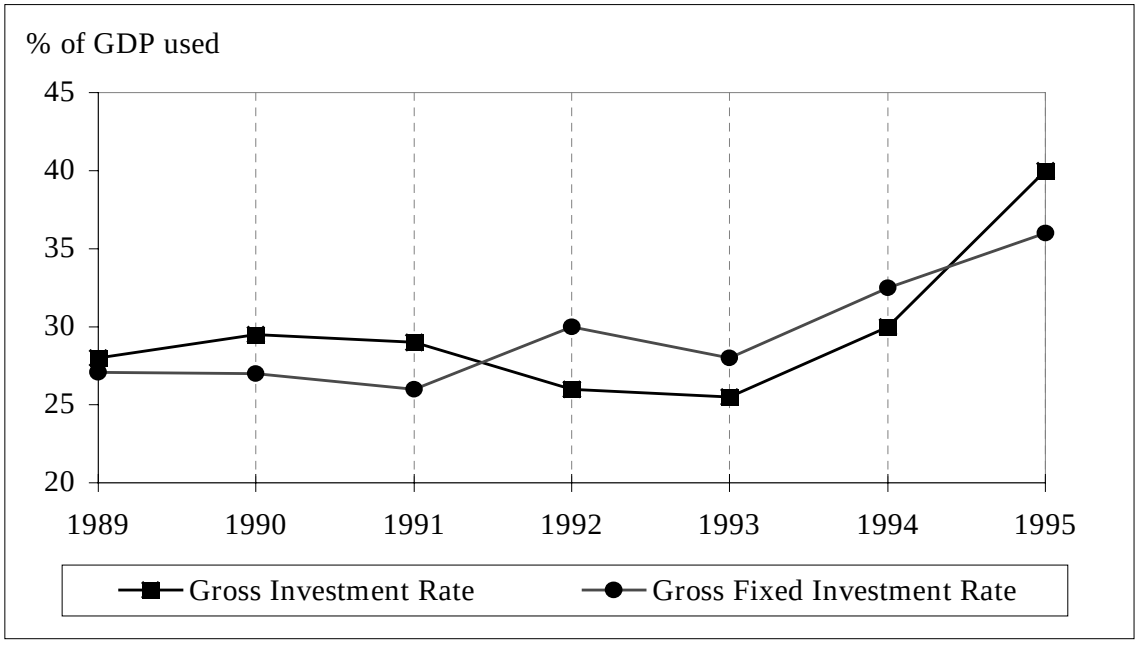
In any case, 1991 was the year of the most rapid decline of investment activity within the Czech economy in the post-war period. Then, as Table 3 and Chart 3 document, the investment activity displayed a revival, accelerated in 1994 and namely in 1995 together with the comeback of GDP growth.

Chart 3: Tangible Capital Investments



Regarding the investment activity as a fraction in GDP consumption, the relevant indicators, i.e. the rate of gross investment and the rate of gross fixed (all in real terms) fluctuate in 1990, due to uneven concurrence in investment and GDP variations. The picture of these fluctuations, is illustrated in Chart 4.

Chart 4: Investment Rates



These data clearly indicate that despite the total decrease of tangible capital investment in absolute real terms in the first half of the 1990s, the investment propensity of the economy in the same period rather increased in comparison with the 1980s. Namely the figure representing the level of the rate of gross fixed investment is impressive as it was very high during the whole period, with the only more significant slump in 1991 - but even that year it was quite high from the point of view of international comparison. The development of both investment rates was also importantly determined by the fluctuation of inventories (rapid and long-lasting decline1992-1994, rapid growth 1995).

From the macroeconomic point of view, a very problematic moment of this blooming investment activity in the Czech economy during the 1990s is its financing: as the national savings rates are now very low, an important part of the investments must be financed from abroad. As documented in Table 4, domestic bank deposits now cover less than one third of new tangible capital investments (in nominal terms); in 1993, the year of establishing of the independent Czech Republic it was roughly one half (which itself is an inappropriately small figure). The change of deposits over GDP ratio calculated in Table 4 is of course only a tentative indicator. It does not take into account time lags, the size of past savings and their consumption in the current investment processes, other forms of savings than bank deposits, the fact that part of the domestic bank deposits may represent savings of foreign bodies (private or corporate) while some domestic savings may be deposited abroad, etc. Anyway, the figure is warning, and similarly as the other two ratios presented in Table 4 it indicates the depth of the dependency of the Czech investment process on foreign sources.

4. The Structure of Tangible Capital Investments in the 1990s[4]

4.1 Sectoral Structure of Tangible Capital Investments

During the first half of the 1990s the sectoral structure of the Czech economy, changed considerably, compared to the end of the 1980s. Mainly, however, this was due to "adaptive adjustment", characterized by downsizing of industrial output in numerous branches and de-industrialization rather than by investment-driven "strategic restructuring". The latter is, nevertheless, also present in the Czech economy, in bigger extent namely in the last two to three years. Table 5 gives a picture of the contemporary sectoral structure of the Czech economy (NACE- classification)) and of the impact of tangible capital investments.

Table 5 shows that in the period 1993-1994 for which standard GDP data are now available. The share of the manufacturing industry in the national economy is about constant and the existing level of tangible capital investments into this sector promises that it will remain about the same in the coming years. The progress of tertiarization of the economy compensates for the relative decrease of the primary sector. A remarkably steady growth of its share in GDP is observable in construction.

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[4] The most comprehensive analytical surveys of the development of the tangible and intangible capital investments in the Czech Republic were in recent years done in the Institute of Economics of the Czech National Bank (published namely in Prokop 1995a, 1995b,1996a, 1996b, Hájek et al. 1993, 1995, 1996, 1997).

4.1.1 Industrial Structure of Tangible Capital Investments in Manufacturing Industry

There are, however, important structural changes inside the sector of manufacturing industry itself. This is documented in Tables 6 and 7.

Data in Tables 6 and 7 of course are not fully comparable as they are based on different industrial classifications (we are here limited by what the national statistics supplies) but they roughly indicate the main current structural changes within manufacturing industry. Thus, we may expect the most dynamic growth in chemical and related industries, the share of which in the manufacturing industrial output of 1994 was 6.3 per cent - and 8.6 per cent, if the production of rubber and plastics is added; the share of tangible capital investments into these industries in 1992-1994 (cumulatively) was 15.4 per cent. Other dynamic industries are production from non-metal minerals, printing and production of means of transport. Also the other traditional Czech engineering industries, i.e. mechanical and electrical engineering, as well as metal-working, do exhibit higher investment than output shares; the last such industry is production from wood. Finally, tangible capital investments into the tobacco industry are also (thanks to FDI) very dynamic. The structurally downsizing industries are - according to what we may conclude from Tables 6 and 7 - numerous branches of the traditional light industry (food-processing, textile, clothing, leather and footwear production, paper production) on the one hand and also some branches of the heavy industry (metallurgy, oil refineries et sim.) on the other. Also, there are comparatively low tangible capital investments into the production of instruments.

Generally, from the above quoted figures it seems that the traditional Czech specialization in engineering and in some branches of the light industry (glass production, porcelain and ceramics production etc.) continues, corrected by a rapid boom in chemical industry (including production of pharmaceuticals). Compared with most other industrialized economies, however, the industrial structure of the Czech economy during last two decades was characterized by an extraordinary role of the chemical industry anyway. To sum up: the Czech Republic's basic position in the international division of labour, characterized by the dominance of the above mentioned traditional manufacturing industries, remained unchanged despite the relative de-industrialization and tertiarization of the economy during the transformation processes in the first half of the 1990s.

On the other hand, we also have to state here clearly that the last suggestion doesn't say anything about the changes in the degree of sophistication of Czech products, or, to put it differently, about the microstructural changes inside individual industries of the Czech economy. The process of structural decrease of which many Czech economists are warning (see e.g. Pick 1994, as an eminent example of the analysis of the trend of structural decrease and of the decrease of the international competitiveness of the Czech economy) may well continue in spite of the, at first glance, rather optimistic figures quoted above.

4.2 The Technological Structure of Tangible Capital Investments

The technological structure of the new real tangible capital investments[5] is characterized by a rapidly increasing role of investments into machinery and equipment and the relative decrease of the role of construction work (Table 8). Regarding other new real tangible capital investments, the role thereof also seems to be quickly increasing, though it naturally is limited in extent.

Other recently made calculations(in Prokop 1996b) based upon internal materials and data of the Czech Statistical Office provide information about real tangible capital investments into machinery and equipment by industrial sectors defined according to NACE classification. The results reproduced in Table 9 do not cover all industrial sectors of the national economy - some NACE groups are skipped (not the standard NACE group data available). Still, the breakdown covers from 81.0 to 86.9 per cent of all real tangible capital investments into machinery and equipment each year.

4.3 Ownership Structure and the Role of General Government, Corporate Sector, Financial Sector and Households in Tangible Capital Investments

The last two important breakdowns of the total tangible capital investments are breakdowns according to the economic sector in which the investment has been accomplished and according to the ownership sector. They are given in Table 10 and Table 11.

They show that while the role of the corporate sector and the sector of households in tangible capital investments had been about stable in the given period, the share of the financial sector had slightly increased while, on the contrary, the share of the general government had slightly decreased. These changes, however, are of marginal size and importance only. Regarding the ownership structure of tangible capital investments, there had been dramatic changes in the role of two ownership sectors during the given period: in the sector of the state (central government) ownership and in the sector of the "other" ownership. The latter includes all forms of mixed ownership plus all forms of foreign ownership or foreign ownership participation. The figures in Table 11 thus reflect the specificities of the Czech privatization process, namely the importance of the mixed public-private (domestic or foreign) ownership that had emerged as the consequence of the Large Privatization programme including the voucher scheme, and naturally, the decreasing role of "pure" state ownership (for detailed analysis see e.g. Mertlík 1995).

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[5] The new tangible capital investments are by definition investment outlays for non-trade acquisitions of investment goods newly entering the national economy. They consist of newly produced domestic investment goods, and of imported investment goods, acquired for inland tangible capital investment (i.e. non-trade) purposes. The difference between the (total) tangible capital investments and the new tangible capital investments consists of the reinvestments within the national economy, i.e. of investment outlays for second-hand investment goods acquired for inland tangible capital investment (non-trade) purposes from another inland user. The Czech Statistical Office doesn't normally monitor the new tangible capital investments. According to calculations accomplished in Prokop 1996b, the share of new tangible capital investments in (total) tangible capital investments in 1993, 1994 and 1995 was 93.0, 91.8 and 93.2% (measured in 1992 constant prices) respectively.

5. The Role of Imports in the Investment Process During Transformation

5.1 The Share of Imports in New Tangible Capital Investments

The import of foreign investment goods for domestic tangible capital investment purposes is an important economic variable for two reasons. Obviously, the import of progressive technologies from top world producers is a *conditio sine qua non* of the modernization process of the national economy and for the desirable improvement of its performance - namely of the improvement of its international competitiveness. On the other hand, the import of standard technologies that are as well produced locally with similar technical characteristics, price and quality may be a sign of the decreasing competitiveness of the domestic producers vis-a-vis their international rivals and result in crowding them out from the market. Besides, some part of the imports of investment goods may rather represent a luxury consumption than a tangible capital investment though formally (from the statistical point of view) it is assumed as investment - the import of cars may to a certain degree be assumed as a typical category of this kind. Thus, the growth or decrease of the imports of foreign investment goods per se does not necessarily have an unambiguously positive or negative effect on the national economy. Rather, the analyst has to investigate the structure of such imports and the role they really play in the investment and reproduction process.

Regarding the role of imports in the investment process in the Czech economy, first of all, it is necessary to say that in the period 1993-1995 the share of imported new real tangible capital investments was about one quarter of all new real tangible capital investments. This is shown in Table 12 (the sector of households not included). Simultaneously, the share of the new real tangible capital investments in the total real tangible capital investments had been 93.0, 91.8 and 93.2 for the respective years of the same period (calculated in 1992 constant prices). Regarding the area of the new real tangible investments into machinery and equipment, however, the role of imports had been much more significant. As Table 13 documents, about 40 per cent (the figure slowly decreasing during the given period) of all new real tangible capital investments into machinery and equipment consisted of imported investment goods. This fact allows us to believe that the penetration of new modern technology originating in developed market economies into the technological base of the Czech economy is comparable to the situation in other CEFTA countries.

5.2 The Industrial Structure of Investment Imports

The available data about the industrial structure of the total imported tangible capital investments (Table 14) are unfortunately only nominal, as well as the available data about the industrial structure of the imported tangible capital investments into machinery and equipment (Table 15). These data, however, confirm the already above documented position of the manufacturing industry as the most important absorber of new tangible capital investments, as well as the importance of the infrastructural industries, namely the energy industry (electricity, gas and water supply). The difference between the data for all imports of nominal tangible capital investments and for imported tangible capital investments into machinery and equipment is very small.

5.3 The Physical Structure of Nominal Imported Tangible Capital Investments

The Czech tangible fixed capital statistics (the tangible capital investments statistics being part thereof) does not provide more detailed information about the physical structure of imported investment goods used as tangible capital investments other than the above given statistical breakdown into the categories of machinery and equipment and construction work. This means that the reader of the official publications of the Czech Statistical Office doesn't have any information about the commodity structure of tangible capital investments into machinery and equipment and about the investment utilization of imports of specific categories of investment goods within individual industries of the national economy. The only available statistical background reporting about the physical structure of imports is the foreign trade (import) statistics. The use of the foreign trade statistics for the analysis of the physical structure of the imported tangible capital investments is, however, methodologically very complicated and to a certain degree necessarily arbitrary. The work accomplished recently in this field in the Institute of Economics of the Czech National Bank (Prokop 1996b) basically consists of the attempt to adjust and digest the existing detailed primary foreign trade statistical data. Thus it can be identified which part of imports of investment goods consists of investment goods with possible domestic tangible capital investment utilization that hence really could enlarge the stock of the tangible fixed capital accumulated in the country. On this basis it is possible, with some likelihood, to make assessments of the microstructural changes in the physical structure of the accumulated tangible fixed capital. The result of this work is contained in the following tables which give a tentative account of the size and structure of imports of investment goods and their share in total imports.

First of all, based on the recalculation of import data on the basis of the SITC-5 Rev. 3 trade classification, the share of nominal imports of investment goods in total nominal imports had been 24,4, 24,6 and 24,1 per cent in years 1993, 1994 and 1995 respectively. Regarding the technological structure thereof contained in Table 16 the imports of machinery and equipment were playing a decisive (albeit slightly decreasing) role.

The most interesting result of this recalculation work is no doubt the physical structure of imports of machinery and equipment as it is presented in Table 17. The data show that the traditional significance of the manufacturing industry in the Czech economy is reflected also in the structure of imports of machinery and equipment - nearly 20 per cent share of imports of manufacturing technology in all machinery and equipment imports represents a rather high level in the international comparison. Also, the same level of imports of the machinery and equipment for production (group I in Table 17) as of imports of precious technology, vehicles and transport equipment, etc. (group II in Table 17) is the result of this traditional place of the Czech economy in the international division of labour. Czech economists and industrialists mostly tend to attribute to these facts positive value judgements. On the other hand, the quickly growing imports of road vehicles - far the most dynamic category in our breakdown at all - hardly can be assessed as a sign of a positive change in the structure of imports and investment.

As concerns the interpretation of the figures from Table 17, we must, however, be very careful. If we compare the nominal figures about imports of machinery and equipment with nominal figures about tangible capital investments into machinery and equipment according to the tangible capital investments statistics, we get the following ratios: 202.9 per cent for 1993, 203,1 per cent for 1994, and 196,4 for 1995 or, reciprocally, 49,3, 49,2 and 50,9 per cent. This means that only about one half of imported machinery and equipment (in current prices)

had been really used in the process of the gross fixed capital formation, i.e. they had been accumulated as tangible capital investments. The others had been used another way: re-exported, used in the production process as components or other intermediate goods, stored as inventories, and so forth. Hence, the true physical structure of tangible capital investments into machinery and equipment may significantly differ from that of machinery and equipment imports. The shortcut that some Czech economists and the government tend to make between the present structure of imports and the desired future revitalization, modernization and improvement of performance of the economy (including soon expected improvement of its export performance and international competitiveness) is therefore not justified by the empirical evidence.

6. Conclusions

The pattern of the investment activity in the Czech Republic in the first half of the 1990s is, first of all, marked by the preceding end of the investment cycle of the 1980s which had reached its peak in 1990, coinciding with the end of the era of central planning and the eve of the radical economic reform. The year 1991 with its slump of tangible capital investments by -32.5 per cent in real terms had started the first investment cycle in the country after the beginning of the economic transformation. This current investment cycle is characterized by comparatively high investment dynamics and high investment rates. The increase in investment demand tended to continue (according to the existing preliminary data) also in 1996.

This development reflects the restructuralization needs of the economy. However, the pattern of the allocation of the new investment activities was up to 1995 showing a tendency to shift rather into the areas of the market infrastructure, services, and the financial sector, than into the manufacturing industry; namely, the relative increase of investments into the energy sector in the years 1993-1995 was compensated by the relative decrease of the share of manufacturing investments. A certain change of this tendency back towards investments into the manufacturing industry has started only in 1996.

Simultaneous with this development, a rapid increase of the deficit of the balance of trade has emerged; in 1996 this deficit had already counted for about 7-8 per cent of GDP. The fact of the increasing role of investments into the (generally speaking) area of production of non-tradable goods and services is in this context a warning sign, as it may bring the problem of financing of the domestic growth. Moreover, the situation is complicated by the fact that an important part of domestic investment activities is already financed by foreign savings.

In this moment, therefore, the big question of the Czech economy and economic policy is whether the massive contemporary investment wave of the first half of the 1990s will bring the necessary export-oriented restructuralization and modernization of the economy, and what will be its impacts onto the macroeconomic (in)stability of the country.

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Annex

Table 1: Real Investment Level and Rates in 1970s-1980s

Year	TCI	GCF/NMPU	GFCF/NMPU
1970	58,1	21,5	16,4
1971	60,0	19,5	16,3
1972	64,9	20,1	17,4
1973	71,3	21,6	18,4
1974	77,4	23,4	18,7
1975	84,5	24,6	19,8
1976	87,5	23,8	19,5
1977	92,9	23,3	20,8
1978	96,7	22,0	19,6
1979	97,5	21,3	17,1
1980	98,2	23,0	17,0
1981	93,7	18,5	15,6
1982	91,1	18,0	15,5
1983	93,7	16,4	13,8
1984	90,3	15,4	13,4
1985	94,7	15,6	12,8
1986	96,1	17,4	13,9
1987	100,3	17,2	11,9
1988	102,8	14,2	12,9
1989	104,6	13,8	12,9
1990	111,3	14,2	11,2
1991	81,5	8,5	3,1

TCI=tangible capital investments (billions CZK, 1977 const. prices), GCF=gross capital formation, GFCF=gross fixed capital formation, NMPU=net material product used (all three variables in constant prices, ratios in %)

Sources: Historical Statistical Yearbook of Czechoslovakia 1985, Statistical Yearbook of Czechoslovakia 1985, 1990, 1991, 1992, Statistical Yearbook of the Czech Republic 1993, own calculations

Table 2: Major Macroeconomic Indicators of the Czech Economy, 1990-1995

Indicator	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**
Change in real GDP	-1,2	-14,2	-6,4	-0,9	2,3	4,7
Change in gross real ind. prod.	-3,0	-24,4	-13,7	-7,4	0,1	9,2
Unemployment rate	0,8	4,1	2,6	3,5	3,2	2,9
Change in TCI	8,2	-32,5	16,6	8,0	17,0	12,9
Inflation (CPI)	9,6	56,6	11,1	20,8	10,0	9,1
Change in exports (goods and services), incl. Slovakia	-7,0	-8,8	0,9	7,5	0,2	3,2
Change in imports (goods and services), incl. Slovakia	3,2	-20,9	11,2	10,4	7,8	19,1
Change in unit labour costs +	-17,3	-14,8	32,8	25,8	9,5	n.a.
Budget deficit (as % of GDP)	-1,6*	0,6*	0,2*	-2,7	-0,9	-0,4

GDP=gross domestic product, 1984 constant prices; gross real industrial production: 1989 constant prices; TCI= tangible capital investments, 1992 constant prices; CPI=consumer price index (yearly average); changes in exports and imports: 1984 constant prices, budget deficit: nominal prices, 1990 - 1991 and 1993-1995 data incomparable (1993-1995 data based on consolidated budget of the general government). All data in the table are yearly changes in % (with the exception of the last row as indicated ibidem)

Sources: Czech Statistical Office, Czech National Bank, Ministry of Finance, + Transition Vol. 6 No. 4, April 1995, * Economist Intelligence Unit (quoted according to the World Bank's World Development Report 1996)

Table 3: Real Investment Level and Dynamics in 1990s

Year	TCI	G(TCI)
1990	255,3	n.a.
1991	172,3	-32,5
1992	200,9	16,6
1993	217,0	8,0
1994	253,8	17,0
1995	291,4	14,8

TCI = tangible capital investments (billions CZK, 1992 constant prices; 1995 preliminary)
Source: Tangible and Intangible Capital Investment in the Czech Republic in the First Quarter of 1996, Czech Statistical Office 1996 (Publication Code 10 08-96)

Table 4: Investment vs. Saving

Indicator/Year	1993	1994	1995
* Deposits (billion CZK)	130,2	127,2	129,1
* Deposits/Investment Ratio	50,8	38,2	31,4
* Deposits/GDP Ratio	14,3	12,3	10,6
Saving Ratio	10,7	10,5	11,2

* deposits = change in deposits (all bank deposits, in CZK and foreign currency), GDP = gross domestic product, investment = tangible capital investments, saving ratio = share of increase in CZK and foreign currency savings, cash, capital investments in securities and additional pension insurance by households in their net incomes - an indicator officially produced by ČNB (all variables in current prices, ratios in %)
Sources: Report on the Monetary Development in the Czech Republic for the First Quarter of 1996, Czech National Bank 1996, Tangible and Non-Tangible Investment in the Czech Republic in the First Quarter of 1996, Czech Statistical Office 1996 (Publication Code 10 08-96), own calculations.

Table 5: GDP Structure and Tangible Capital Investments (in %)

Activity (NACE)	GDP 1992*	GDP 1993	GDP 1994	GDP 1995	TCI 1992	TCI 1993	TCI 1994
Agriculture, fishing, hunting, forestry	5,9	6,6	5,8	5,2	4,1	3,7	5,4
Mining, quarrying	4,6	3,7	2,8	2,6	3,6	2,7	2,6
Manufacturing	32,3	26,7	26,3	26,7	26,7	27,8	28,3
Electricity, gas and water supply	7,7	6,6	5,7	5,5	14,0	11,6	11,4
Construction	4,3	5,2	5,9	6,2	2,2	2,5	3,0
Wholesale and retail trade; repair of motor vehicles, motorcycles, personal and household goods	10,1	10,1	9,8	11,5	6	4,2	5,7
Transport, storage and communication	6,5	5,5	5,8	6,3	11,2	10,6	12,4
Banking, insurance	-	8,6	10,7	10,0	7,3	10,1	8,1
Other market services	15,1	14,9	15,8	15,8	12,1	13,1	8,4
Non-market services	13,5	12,1	11,4	10,2	12,6	13,6	14,8
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0

GDP=GDP at factor costs including imputed interest (current prices), TCI = tangible capital investments (1992 constant prices),*TCI=change in the share of tangible capital investments into the given NACE group of activities (percentage points), G (*TCI)=relative change in the share of tangible capital investments into the given NACE group of activities; GDP 1992 data not comparable with GDP 1993-1994 data due to changed activity classification and method of calculation
Source: Statistical Yearbook of the Czech Republic 1994, 1995, 1996, own calculations.

Table 6: Structure of Manufacturing Industry in 1994 (in %)

Industry (ISIC)	Output
Food (311-12)	18,5
Beverages (313)	4,4
Textile (321)	5,2
Clothing (322)	1,1
Leather (323)	0,6
Footwear (324)	1,2
Production from wood (331)	1,9
Furniture (332)	1,4
Paper and paper products (341)	3,2
Printing (342)	1,5
Industrial chemicals (351)	4,0
Other chemicals products (352)	2,3
Oil refineries (353)	5,4
Rubber (355)	0,9
Plastics (356)	1,4
Porcelain and ceramics (361)	0,4
Glas and glass products (362)	2,1
Production from other non-metal minerals (369)	2,7
Ferrous metallurgy (371)	10,7
Non-ferrous metallurgy (372)	1,5
Metal-working (381)	4,9
Mechanical engineering (382)	7,5
Electrical engineering (383)	3,7
Means of transport (384)	8,7
Instruments (385)	0,8
Other manufacturing (390)	2,6
Manufacturing (total) (3)	100,0

Output = gross industrial output (1989 constant prices)
Source: Statistical Yearbook of the Czech Republic 1995, own calculations

Table 7: Structure of Tangible Capital Investments in Manufacturing Industry (in %)

Activity (NACE)	TCI 1992	TCI 1993	TCI 1994	TCI 1992-1994
Food products and beverages (15)	17,6	17,5	14,5	16,4
Tobacco (16)	0,7	2,4	3,7	2,4
Textile (17)	3,1	4,8	4,2	4,1
Clothing (18)	0,8	0,7	0,7	0,7
Leather and footwear (19)	1,1	0,6	0,8	0,8
Production from wood (20)	2,1	2,2	2,3	2,2
Paper and paper products (21)	2,8	2,4	2,2	2,4
Printing (22)	2,5	3,0	4,0	3,3
Oil refineries and other products from oil and coal (23)	3,8	3,6	2,6	3,3
Chemical products (24)	13,9	10,4	10,5	11,4
Rubber and plastics (25)	4,7	3,5	3,8	4,0
Other non-metal minerals (26)	8,7	11,4	8,6	9,5
Metallurgy (27)	6,3	9,0	7,3	7,5
Metal-working (28)	5,8	4,5	5,3	5,2
Machinery and equipment n.e.c. (29)	8,4	6,5	9,4	8,1
Office machinery and computers (30)	0,1	0,1	0,4	0,2
Electrical machinery (31)	2,0	3,2	3,6	3,0
Radio, television and communication equipment (32)	1,0	0,8	0,6	0,8
Instruments (33)	0,3	0,3	0,5	0,4
Motor vehicles, trailers and semi-trailers (34)	5,6	8,5	10,7	8,5
Other transport equipment (35)	4,9	1,8	1,4	2,5
Furniture; other manufacturing (36)	2,4	2,3	2,2	2,3
Recycling (37)	1,4	0,6	0,7	0,9
All manufacturing (15-37)	100,0	100,0	100,0	100,0

TCI = tangible capital investments (1992 constant prices)
Source: Statistical Yearbook of the Czech Republic 1995, own calculations

Table 8: Technological Structure of Real New Tangible Capital Investments (in %)

Year	1993	1994	1995	G(TCI) 95-93
All new TCI	100,0	100,0	100,0	36,0
Construction works	39,6	34,1	31,6	8,5
Machinery and equipment	54,5	56,1	60,3	50,4
Other new TCI	5,9	9,8	8,1	88,6

TCI = tangible capital investments
1992 constant prices, the sector of households not included
Source: Tangible and Intangible Capital Investment in the Czech Republic in 1993, 1994 the First Fourth Quarters of 1995, Czech Statistical Office, own calculations

Table 9: Real Tangible Capital Investments into Machinery and Equipment (in %)

Activity (NACE)	1993	1994	1995	* TXI 95-93
Total of which:	100,0	100,0	100,0	-
Agriculture, hunting and related service activities (01)	2,8	2,8	2,3	-0,5
Coal and lignite mining; extraction of peat (10)	3,3	2,6	1,5	-1,8
Manufacturing (15-37)	38,2	35,5	24,8	-13,4
- food products and beverages (15)	6,2	4,8	3,2	-3
- chemicals and chemical products (24)	4,2	3,2	2,1	-2,1
- other non-metallic mineral products (26)	4,8	3,3	3,1	-1,7
- basic metals (27)	3,7	3,2	1,8	-1,9
- machinery and equipment n.e.c. (29)	2,2	2,3	1,9	-0,3
- motor vehicles, trailers and semi-trailers (34)	3,7	4,5	2,6	-1,1
Electricity, gas, steam and hot water supply; production of cold (40)	7,9	7,9	19,8	11,9
Construction (45)	2,4	2,4	2,1	-0,3
Wholesale trade and commission trade, except of motor vehicles and motorcycles (51)	2,1	7,4	6	3,9
Land transport; transport via pipelines (60)	1,9	3,1	4,1	2,2
Post and telecommunications (64)	6,2	4,9	6,3	0,1
Financial intermediation, except insurance and pension funding (65)	10,6	11,3	13,7	3,1
Public administration and defence; compulsory social security (75)	2,8	4,1	4,4	1,6
Health and social work (85)	2,8	2,9	1,9	-0,9

***** 1992 constant prices
Source: Czech Statistical Office (internal materials), own calculations

Table 10: Sectoral Structure of Real Tangible Capital Investments (in per cent)

Year	1993	1994	1995	G(TCI) 95-93
Real TCI	100,0	100,0	100,0	34,3
Corporate sector	63,1	63,4	63,2	34,5
Financial sector	10,5	10,4	11,4	46,2
General government	19,0	19,2	18,1	28,4
Households	7,5	6,9	7,3	30,8

TCI = tangible capital investments; 1992 constant prices
Source: Tangible and Intangible Capital Investment in the Czech Republic in 1993, 1994 the First Fourth Quarters of 1995, Czech Statistical Office, own calculations

Table 11: Ownership Structure of Nominal Tangible Capital Investments (in %)

Year	1993	1994	1995	* TCI 95-93
Nominal TCI	100,0	100,0	100,0	-
State (Central Gvnmnt.)	43,2	34,1	22,1	-21,1
Private domestic	24,1	28,0	25,2	1,1
Cooperative	3,4	2,9	2,5	-0,9
Municipal	5,9	7,8	8,1	2,2
Other	23,4	27,2	42,1	18,7

* TCI = tangible capital investments, current prices
Source: Statistical Yearbook of the Czech Republic 1995, Czech Statistical Office (internal materials), own calculations

Table 12: Share of Imported New Real Tangible Capital Investments

Year	1993	1994	1995
New real TCI			
- billion CZK	188,9	221,4	257,0
- %	100,0	100,0	100,0
Imported new real TCI			
- billion CZK	45,3	53,1	63,7
- %	24,0	24,0	24,8

TCI = tangible capital investments;
1992 constant prices, the sector of households not included
Source: Tangible and Intangible Capital Investment in the Czech Republic in 1993, 1994, the First Fourth Quarters of 1995, Czech Statistical Office, own calculations

Table 13: Share of Imports in New Real TCI into Machinery and Equipment

Year	1993	1994	1995
New real TCI into machinery			
- billion CZK and equipment	103,0	124,2	155,0
- %	100,0	100,0	100,0
Imported new real TCI into			
- billion CZK machinery and equipment	42,5	47,4	58,6
- %	41,3	38,1	37,8

TCI = tangible capital investments
1992 constant prices, the sector of households not included
Source: Tangible and Intangible Capital Investment in the Czech Republic in 1993, 1994, the First Fourth Quarters of 1995, Czech Statistical Office, own calculations

Table 14: The Industrial Structur of Imported Nominal TCI (in %)

Activity (NACE)	1993	1994	1995	* TCI 95-93
Total of which:	100,0	100,0	100,0	-
Agriculture, hunting and related service activities (01)	2,2	2,1	2,4	0,2
Coal and lignite mining; extraction of peat (10)	4,1	3,2	2,2	-1,9
Manufacturing (15-37)	51,9	45,9	35,6	-16,3
Food products and beverages (15)	6,9	5,8	4,0	-2,9
Tobacco products (16)	2,5	4,8	2,1	-0,4
Textiles (17)	3,3	1,9	2,3	-1,0
Publishing, printing and reproduction of recorded media (22)	2,2	2,6	1,2	-1,0
Chemicals and chemical products (24)	6,0	3,7	2,2	-3,8
Other non-metallic mineral products (26)	6,5	4,2	3,8	-2,7
Basic metals (27)	4,0	2,4	1,7	-2,3
Machinery and equipment n.e.c. (29)	2,2	2,1	2,5	0,3
Electrical machinery and apparatus n.e.c. (31)	2,4	1,9	1,5	-0,9
Motor vehicles, trailers and semi-trailers (34)	6,9	6,4	3,9	-14,4
Electricity, gas, steam and hot water supply; production of cold (40)	4,2	8,3	23,7	19,5
Construction (45)	2,2	2,0	1,9	-0,3
Wholesale trade and commission trade, except of motor vehicles and motorcycles (51)	2,0	3,3	3,3	1,3
Post and telecommunications (64)	7,8	6,4	7,3	-0,5
Financial intermediation, except insurance and pension funding (65)	7,7	8,0	5,7	-2,0
Public administration and defence; compulsory social security (75)	2,1	4,3	4,1	2,0
Health and social work (85)	3,6	4,3	3,2	-0,4

TCI = tangible capital investments; current prices, the sector of households not included
Source: Czech Statistical Office (internal materials), own calculations

Table 15: The Industrial Structure of Imported Nominal TCI into Machinery and Equipment (in %)

Activity (NACE)	1993	1994	* TCI 94-93
Total, of which:	100,0	100,0	-
Agriculture, hunting and related service activities (01)	2,2	2,2	0,0
Coal and lignite mining; extraction of peat (10)	4,3	3,5	-0,8
Manufacturing (15-37)	53,0	48,9	-4,1
Food products and beverages (15)	7,2	6,2	-1,0
Tobacco products (16)	2,7	5,4	2,7
Textiles (17)	3,4	1,9	-1,5
Publishing, printing and reproduction of recorded media (22)	2,2	2,8	0,6
Chemicals and chemical products (24)	6,2	4,0	-2,2
Other non-metallic mineral products (26)	6,6	4,4	-2,2
Basic metals (27)	4,2	2,6	-1,6
Machinery and equipment n.e.c. (29)	2,3	2,3	0,0
Electrical machinery and apparatus n.e.c. (31)	2,5	2,0	-1,5
Motor vehicles, trailers and semi-trailers (34)	6,5	6,6	0,1
Electricity, gas, steam and hot water supply; production of cold (40)	3,6	4,1	0,5
Construction (45)	2,3	2,2	-0,1
Wholesale trade and commission trade, except of motor vehicles and motorcycles (51)	1,7	3,6	1,9
Post and telecommunications (64)	8,3	6,5	-1,8
Financial intermediation, except insurance and pension funding (65)	7,0	8,0	1,0
Public administration and defence; compulsory social security (75)	1,8	4,7	2,9
Health and social work (85)	3,5	4,5	1,0

TCI = tangible capital investments; current prices, the sector of households not included
Source: Czech Statistical Office (internal materials), own calculations.

Table 16: Technological Structure of Nominal Imported Investment Goods

Year	1993	1994	1995	G(MI) 95-93
All imported investment goods (billion CZK)	100,0 (91,0)	100,0 (106,2)	100,0 (133,8)	- 47,0
Machinery and equipment (billion CZK)	98,4 (89,5)	97,9 (104,0)	97,4 (130,4)	- 45,6
Constructions (billion CZK)	1,2 (1,1)	1,3 (1,4)	1,7 (2,3)	- 97,0
Others (billion CZK)	0,4 (0,4)	0,8 (0,8)	0,9 (1,2)	- 236,7

in % , current prices (data in parentheses in billion CZK)
Source: Ministry of Industry and Trade (internal materials), own calculations

Table 17: Physical Structure of Nominal Imports of Machinery and Equipment

Year	1993	1994	1995	G(ME) 95-93
Machinery and equipment (billion CZK)	98,4 (89,5)	97,9 (104,0)	97,4 (130,4)	- 45,6
1. Machinery and equipment for primary production and civil engineering	6,1	6,2	77,0	68,5
a) Agricultural machinery including tractors	2,5	3,1	3,6	109,1
b) Civil engineering and contractors' plant and equipment	3,5	3,1	3,4	39,5
2. Machinery and equipment (technology) for manufacturing	19,77	19,8	19,4	42,8
a) Metal-working machines	4,,3	5,8	5,2	76,2
b) Other machinery and equipment for particular industries	15,4	14,0	14,2	33,6
3. Machinery, equipment, instruments of general use	74,2	74,0	73,6	44,5
a) Machinery and equipment - for energy supply - dominantly for accomplishing and maintaining productive operations	25,3 3,6 21,7	22,7 1,3 21,3	24,1 3,9 20,0	38,7 58,1 35,5
b) Office and telecommunication equipment - office technology and computers - telecommunication equipment	21,6 17,4 4,2	21,0 17,0 4,0	20,4 16,0 4,4	37,3 33,6 52,6
c) Vehicles and transport equipment - road vehicles - other vehicles and transport equipment	10,5 9,3 1,2	12,8 12,0 0,9	14,2 13,77 0,5	98,4 115,6 -34,0
d) Special instruments and equipment, others n.e.c. - instruments and equipment - others n.e.c.	16,8 13,6 3,2	17,5 14,4 3,1	14,9 12,5 2,4	29,0 33,9 8,4
I Machinery and equipment for production (1+2+3a)	51,1	48,7	50,5	43,8
II Precious technology, vehicles and transport equipment, others (3b+3c+3d)	48,9	511,3	49,5s	47,5

in %, current prices (data in parentheses in billion CZK)
Source: Ministry of Industry and Trade (internal materials), own calculations

Siegfried Lange*

Reorganization of Industry-Related Research in Countries of Central and Eastern Europe. Cultural Differences as Barrier for Know-How Transfer

Three steps of development of cooperation within Europe can be distinguished: first, there is the demand for copying Western models to solve problems. Statements like "this country needs technology parks" or "data bases will solve our information problem", stand for this step. Second, the experience is made that the simple transfer of Western models cannot solve the problems properly and that each country has to develop specific models concerning the specific economic, social and cultural conditions of that country. Hopefully the third step will toe the creation of new models in Central and Eastern Europe and the import of experience to the Western countries. It is a long experience in world history that new ideas, new institutions and new technologies come more from the former "province" than from the former "center".

I will give a report about the transfer of special experience - the organization of industry oriented research and development - from Germany to Croatia[1] and about the social and cultural barriers of know-how transfer, which may also be true for other countries which are on their way to a larger Europe.

1. Activities of ISI in Middle and Eastern Europe

The Fraunhofer Institute for Systems and Innovation Research (ISI) is an institute of the German Fraunhofer Society. By its research and consulting activities ISI anticipates risks, opportunities and barriers associated with technological developments and assists in promoting the necessary processes of adaptation and innovation.

ISI supports countries in Central and Eastern Europe by assistance in the transformation process and the conception and realization of modern technology and innovation policy, the development of procedures, the foundation of new institutions, training and consulting. In Slovenia and Croatia the main focus is industry-oriented R&D. In Slovenia ISI organized workshops about technology transfer and industry-oriented R&D, gave support for the development of an innovation agency, and for the development of evaluation procedures. In Croatia ISI helped to reorganize industry-oriented R&D and to establish new R&D institutions. A new industry-oriented R&D institute, the "Center for Technology Transfer" in Zagreb has just been established. In Belarus a similar project is starting now. ISI assists the only recently established Institute for Systems Analysis and Information in Minsk to develop

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suitable services. In Hungary ISI participated in the analysis of advantages and disadvantages of industries and the development of methods.

Regarding the problems and severe changes in countries like Slovenia and Croatia, the question concerning the foundation and concept development of industry oriented R&D institutions is: is it the right time to concentrate on science, technology and innovation policy or should this be postponed to later years?

Already in the 80ies there was a shortage of resources for R&D in the countries of Middle and Eastern Europe. The technical equipment was already obsolete. Industry-oriented R&D came into severe difficulties. In the 90ies the reorganization of R&D started, special science ministries were established. We have seen the deliberate decrease of resources in order to improve the industry-orientation of science and to force science to cooperate with industry. We have seen the avoidance of mutual damage of the scientists affected by reforms and the initiative to overcome the social distance to the Western colleagues. But up to now there is a disappointment concerning the quality improvement of industry-oriented R&D.[2] The success in reorganization of R&D depends severely on the economic success of transformation. Unless there is economic success of industry there will be no quality improvement of industry-oriented research and development.

This statement about the necessary conditions of R&D quality improvement is true, but not all the truth. The much more urging problem is wrong expectations concerning the necessary time of development after the foundation of a new institution. Even in Germany it will take seven years to develop a new institution and to be able to evaluate the success. Therefore we must start today to establish new R&D institutions for applied industrial R&D against all barriers if these institutions will be needed in future.

2. Foundation of Industry Oriented R&D Institutions

ISI was asked in l993 to start cooperation with the Ministry of Science and Technology in Croatia. The first step of cooperative work was the analysis of the Croatian R&D market, the analysis of the demand and the supply side.

The opinion was found in some of the former socialist countries that basic research of high quality will be a guarantee for economic success in the long run. Therefore in their opinion basic research had to be identified and enlarged to additional fields. The important role of the transfer of basic research results to industry-oriented research and development and to innovations, and the close connection and communication between basic research, applied research, industrial development and innovations, however, was not seen clearly enough. If these countries want to foster innovations the reorganization of industry-oriented research and development and its integration into the innovation process is necessary. This is a worldwide challenge and is true for Germany as well as for Croatia.

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[2] See also Uwe Schimank, "Die Transformation der Forschung in Mittel- und Osteuropa: Gelegenheiten, Ziele und Zwänge", S. 321ff in: Wollman, Wiesenthal und Bönker (Hrsg.) "Transformation sozialistischer gesellschaften: Am Ende des Anfangs", Zeitschrift fur Sozialwissenschaft, Heft 15/1995.

What are the challenges to industry oriented R&D institutions?[3]

- Industries needs are more and more important as inputs for R&D. Procedures to get information about the needs are needed (industry orientation)

- Cooperation of scientific disciplines for interdisciplinary problem solving (problem orientation)

- Problems are normally not disciplinary problems, not economic neither technical or social problems but a mixture of many aspects. Some effort and time is necessary to overcome the pure disciplinary perspective and form interdisciplinary teams.

- R&D management for promotion of industry orientation and problem orientation by decentralization of responsibility and share in success (success orientation)

- Qualified R&D is not only a consequence of good scientists, but also a consequence of good management, the ability to form teams of scientists and to combine projects to a programme. The management must stress decentralization of responsibility and decision making and share in success.

- Internationally comparable scientific performance, organizational flexibility.

- Sufficient equipment of information and communications technology, and international social contacts and language competence are substantial parts of the cooperation ability.

- Fast reactions to changing demand, early pick up of new R&D topics and the development of new markets within the region (strategy orientation).

- There must be organizational instruments to form the strategy, e.g. organized communication with institutions of the European Commission.

- Efficient organization of know-how and problem transfer between science and industry and a favorable political environment for innovations ("organization of transfer").

- An infrastructure of know-how transfer is needed.

These general requirements are true for all countries. It takes time to fulfill the general requirements. The interests of potential clients and their ability to pay for R&D increase only slowly. There are also special requirements and chances for countries of Middle and Eastern Europe as partner of the European Union. International cooperation with the regional neighbours and the countries of the EU is a must. The international cooperation within the EU itself has become a basic instrument to overcome barriers of language, economy and culture between the countries of the European Union and to establish a prosperous region. This experience is now being transferred from EU to Middle and Eastern Europe. The absolutely necessary condition for cooperation with the European Commission are good working relations to R&D institutions in the countries of EU and in the neighbour countries. Only on the basis of existing working relations it is worth in future to apply for CEC projects.

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[3] See also Stefan Kuhlmann u.a. "Erfolgskontrolle der wirtschaftsnahen Forschung in Baden-Württemberg - Erfolgsfaktoren und Leistungskriterien", Heidelberg, Physica Verlag l995.

The Case of Croatia: Demand for R&D

The survey results and interviewing conducted in Croatian industry confirmed that the demand is predominantly for non-research activities like measuring, testing, quality control, expertise and consultancy. There are many reasons for that.

Industrial enterprises follow short-term strategies of survival. Part of this strategy are cost-saving efforts, as well as some technological efforts directed to remove some non-optimal domestic inputs and bottlenecks. The objectives are growth of production, enlargement of the product range and the best usage of production capacities. At the same time all enterprises are in situation of a pressure of transition toward a competitive market economy. The requirements for export orientation are more and more evident. The companies are confronted with many problems: shortage of management skill, inadequately marketing skills, scarcity of financial resources and technical services as well as scarcity of information exchanges. Strategic planning is only rudimentarily developed and R&D does not live up to the state of the art. Most business decisions are not connected to R&D.

Therefore industry demand for R&D is mostly oriented to everyday routine problems of enterprises and to everything that is connected with cost-effectiveness. Due to the shortage economy in general, there is no real interest on the industry side to introduce new knowledge, new technology, to implement research results. The consequences are that the R&D institutions' activity in major part shifted away from research. There are many reasons for this. Since domestic industry cannot afford applied research and since there is budget-cuts as second major support source, and since rare foreign investors do not rely on the national R&D resources, there is no strong demand for domestic research capacities at all.

Supply of R&D

On the other side the supply offered by R&D sector is in some areas narrow, specialized and fragmented, and not harmonized with the requirement of enterprises whose needs are usually complex and ill-defined. The present situation in this sector creates the impression that the obstacles for better cooperation with industry lie in the R&D institutions, the universities and public institutes, which have not mastered the structural change to a system of distributed knowledge production. R&D institutions are burdened by budget-cuts, by deterioration of research capacities placed in industry' and brain-drain and brain-waste. R&D institutions are mixing their survival and restructuring too. Changing financial make R&D institutions more dependent on additional income. At the same time, after adopting new legislation for S&T system, started the reform inside institution too. This reform means reorganization of decision making and defining research profile of R&D institutions, as well as setting clear rules for research and business management. All these changes are being implemented pretty slowly. The role of R&D institutions was not yet decided, so long-lasting uncertainty of institutional reform causes a loss of research enthusiasm and a general decrease of research interest.

Another characteristic is, that many research teams are working separately and not integrated in networks. On the other hand, their professional career is more and more dependent on managers, managerial skills and a distinct organizational profile. However, it is just on this level where weaknesses in missing science management and long-term research strategy are most articulate. There is a pretty strong inability of R&D institutions, particularly public institutes, which are oriented towards basic research to bridge the gap with industry and at the

same time there is a lack of actions in internal restructuring of such institutes. In a such situation it is impossible to organize cooperation between industry and science without any obstructions, particularly if there are only traditional institutional forms of cooperation.

New firms as spin-off of the integration of these two spheres, arising from universities, public institutes and industrial R&D, and initiated by growing entrepreneurship are very rare. There is a significant number of "candidate entrepreneurs" who would like to exploit further some own invention or from their institutions, but demand constraints have a strong impact in inhabiting their growth. Nevertheless, it is rather important to stress that the outcomes are not related to advanced technology and to research exploitation. It is more a strategy of personal survival. Today we see a "double life" of scientists and engineers, which could be an informal form of "brain-waste" in future. Bridging institutions like technology transfer agencies and similar intermediaries as new institutional forms of cooperation and integration are still rather rare.

Implications

The results of the analysis were that presently there is no strong demand for domestic research capacities and that obstacles for cooperation lie in the R&D institutions. Science-industry relations in Croatia are more determined by the interests on the science side than on the industry side. Industry has not yet shown new adjustment strategies involving innovation and new products, and as a consequence there is more short-term demand for non-research activities than on R&D. While public R&D institutes and universities are trying to survive and adjust themselves, and industrial R&D institutes are downsizing and restructuring, the outside assistants' role are rather knowledge distributors than knowledge producers.

To increase the cooperation with industry, the internal organizational structure of R&D institutions has to be improved. It is important to set up new mechanisms like establishing special units responsible for interaction with the industry, placement of scientists into enterprises, involvement of businessmen in the institutional management board, etc. These measures should increase attention to industrial needs and should improve the communication between science and industry.

Science-industry interactions in Croatia requires developed administrative capabilities, close cooperation and bridge-building between science, industry and government. Especially a "shortage economy" needs considerable public investment in special programs, which should be more available for the development of useful products and processes. This should be further reinforced by several instruments like tax incentives, jointly financed projects, introduction of competitive evaluation procedures and properly understanding the role of new bridging institutions till industrial demand will appear.

The first steps have not been too encouraging: the Science Law (1993/94) has provided the rules and objectives for the reorganization of science following science immanent criteria, without respect to the needs of industry. No members of industry were elected as responsible members of the committees. The National Science and Research Program (1995) has formulated the priorities for the years 1996-1998, with rules for project funding, but not any competition between R&D institutions. The R&D priorities of industry remained unknown.

But there was the expressed will of the responsible Ministry of Science and Technology to establish industry oriented R&D institutions against the existing barriers. Therefore ISI started the next step of work.

Procedure of the Establishment of an Industry Oriented R&D Institution

The analysis of the R&D market with demand and supply was conducted in 1993/94, the conceptual phase in 1995/96. After the analysis of the relations between science and industry the Croatian Ministry for Science and Technology decided to establish an industry-oriented R&D institution as pilot project and to organize the necessary preparatory work. In the conceptual phase ISI had to identify potential R&D markets and engaged R&D institutions, on the basis of interviews with universities, faculties, and public institutes, and industry throughout the country between Osijek and Dubrovnik.

The decision about alternatives had to be made. Should the new institution be developed from the ground or should an existing institution be adapted to the new challenges? The advantages of a new institution from the ground would have been that it would be tailored to the selected functions. But the disadvantages would have been that it would be strongly dependent on the fast market success or heavy private or public financial support. The advantages of an existing institution would have been a better chance of survival in the start phase, the disadvantages that existing interests and bureaucratic rules would reduce or hinder the suitability for the new functions.

The decision was made for the compromise: a new institution within an old institution was set up, partly tailored to the selected functions and hence with a better chance of survival in the start off than a new institution from the ground; partly with more flexibility than an old institution dependent on market success, but manageable in the case of failure. The disadvantage of time consuming change of social behavior within the old institution had to be accepted.

One important step to find a suitable institutions was the "equipment provision action". The step was made in order to find engaged institutions and companies. The German government had offered some money for the purchase of R&D equipment which should be used for projects of public R&D institutes for industry. The condition was that the cooperating industry would pay a substantial part of the equipment. A call for proposals was organized concerning the provision of equipment for cooperation between science and industry and the best proposals for cooperative projects were selected. The results of this action were twofold: firstly, some projects of applied R&D were initiated which met the demand of industry, and secondly, the successful proposals were used as an indicator for good working relations between specific R&D institutions and companies. As it turned out, mechanical engineering and shipbuilding, food and biotechnology were the main fields of (efficient) cooperation, and the corresponding faculties at the university of Zagreb were the most active institutions.

Further detailed analysis of the economic, social and political conditions which influence the realization of the industry-oriented R&D institution in being was conducted, a check was done of the basic conditions to be fulfilled by the selected institution as competence, cooperation with industry, and engagement, and check of the willingness of the government for partial financial support. After discussions with the faculties and the ministry about institutional alternatives concerning different markets, offered R&D services, organization, financing and

management the decision for the Faculty of Mechanical Engineering and Naval Architecture as engaged institution and as the potential founder was made.

Visits of members of the Faculty of Mechanical Engineering in Germany were organized. Various German models as starting point were selected and used as source for different features. It took some time to overcome the Croatian demand for "the one" proved German model as a branded good, which was thought to be important for PR and promising a one-to-one transfer without the costs of an experiment. So the faculty and ISI developed together the concept for a non-profit R&D private limited company "Center for Technology Transfer CTT" of the Faculty of Mechanical Engineering and Naval Architecture.

The elements of the concept are: the faculty as owner of the CTT, the executive manager is simultaneously professor at the faculty, and for the first three years also the scientific staff of the faculty would work for the new institution. The ministry provided for a building, technical staff, and equipment. The basic aim is transfer of knowledge and technology to foster development and management of modern technology. Services include courses and seminars in quality assurance programs, R&D of technologies useful in restoring and developing the infrastructure destroyed by war, activities in energy conservation and defense.

The decision about the establishment was made in April 1996. In June 1996 the "Center for Technology Transfer CTT" was established as non-profit R&D private limited company.

3. Challenges to International Cooperation: Social and Cultural Differences

The main visible result of the cooperation between institutions of Germany and Croatia is the establishment of a new industry-oriented R&D institution. An important experience of both sides is the overcoming of specific communication problems and information behavior.

Communication problems coming from the time lag between understanding terms and understanding contents delay the work to be done. Terms like "project", "program", "competition" the contents of which seem to be obvious to Westerners give cause for misunderstandings. An "R&D project" in Germany is a term connected with associations like time frame, amount of time of scientists, costs, mile stones, management, interdisciplinary cooperation, calculation, overhead costs, responsibility, interests, property rights, patents and licenses. Many of these meanings are in Croatia usually not connected to the term "R&D project". An "R&D program" in Croatia is not much more than a collection of projects, whereas in Germany associations like problems, interests of entrepreneurs and unions, of political parties, objectives of the program, alternatives, R&D potential, industrial needs and priorities, discussions between government, industry and science, funds, management of the program, responsibility of a special program agency, expected results, evaluation are connected to the term "R&D program". "Competition" in Croatia is used with the meaning of situation of shortage, prices of goods, competitors as 'enemies', privatization, products for given markets, whereas in Germany meanings are important like quality, strategy, new products and new markets, cooperation with competitors, life cycle of a product, R&D markets. The ability to avoid such misunderstandings doesn't depend only on information and discussions but also on experience which takes time.

Similarly information behavior differs between Croatia and Germany. Decisions of individuals and institutions are necessary about which information can be given, and which information must not be given to other parties. Information can be an expensive economic good, which is not given for free to third parties. But often information has to be offered as "payment" for other information demanded, to the advantage of both sides. Therefore decisions are necessary, which information is given in exchange for information and which information must not be given.

The experience is that there are considerable differences in the definition of exchangeable information. Information is held back in Croatia which in Germany would be offered to other parties. The active information distribution behavior is seldom. Predominant is a passive information collecting behavior and the waiting for being informed. In relation to Germany an underdeveloped social networking for information exchange is to be found.

Overlooking these differences produces disappointments in cooperation on both sides. Short-term consultations by Western institutions are subject to this danger of misunderstandings. Insofar it is important to develop stable relations and to cooperate for years. The more so, as there is a severe difference in what could be named the "culture of cooperation". In countries like Croatia and Slovenia we have found that cooperation and informal communication across borders of each kind is underdeveloped. What is seen in Germany as an obvious condition of work, seems to be a severe problem in these countries. The cooperation across borders of all kind must be trained, between disciplines, regions, associations, institutions, companies.

Deficits of cooperations across borders hinder innovations. One important source of innovations is the connection of ideas, institutions, technologies and sciences which up to now have no connections to each other, like in former times carriage and engine, and today mechanics and microelectronics, biology and technology. The ability to overcome traditional barriers or "building bridges" insofar is a condition for all economic success in future.

David L. Ellison*

The Eastern Enlargement: A "New", or a "Multi-Speed" Europe?

Seven years after the Fall of the former Soviet Bloc, the timetable for the accession of the ten applicant countries of Central and East European (CEECs) to the European Union (EU) appears set. Six months after the completion of the 1996-1997 Intergovernmental Conference (IGC), and after the Council of Ministers has considered the opinions of the Commission on the preparedness of the applicant countries for membership in the EU, membership negotiations will begin with the four Visegrad countries Poland, the Czech and Slovak Republics, and Hungary, the three Baltic states, Estonia, Latvia and Lithuania, the two Balkan states Romania and Bulgaria, and the former Yugoslav state, Slovenia, presumably sometime in early to mid 1998 (European Commission, 1997a).

Yet there are still many obstacles along the road to accession. And many maintain that a failure of the IGC to make appropriate adaptations to the decision-making institutions of the European Union in order to be able to accommodate a total of 25 Member States - not an unlikely scenario given its current lack of progress - would result in an even further postponement of enlargement.

Yet the most daunting task of accession and enlargement is the process of economic transition and industrial restructuring that the CEECs are currently undertaking in their attempt to gain access to and membership in the EU, and in their attempt to adjust to the strictures of the world marketplace and international trade.

However, though little emphasized, the potential beneficiaries of this economic restructuring are not the CEECs alone. The Member States of the EU also stand to gain considerably from the enlargement process. But, while much of the literature tends to emphasize security imperatives, the costs of CEEC membership to the Member States of the EU, or the extent and the gravity of the changes that need to be undertaken in the CEECs, very little emphasis is placed on the potential gains that the EU is likely to reap (and has already) from the enlargement process.

This contribution will focus on the consequences of enlargement for the CEECs and the EU. The central point I will make is that the Member States of the EU stand to gain from enlargement to the CEECs. However, these potential gains are largely ignored in the conceptual statements of the Council and most of the Directorate Generals of the EU, though they are occasionally acknowledged in more general statements on the issue of enlargement.

The paper proceeds in four parts. First, it considers the visions of the EU on the issue of enlargement and assesses some of the gains, both real and potential, to the EU as a whole. Second, it discusses ways in which the EU has structured the process of accession and the degree

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to which it has benefited both the Member States and the CEECs. It then discusses the issue of competitiveness and the concerns of the CEECs with respect to their potential to catch up with the Member States of the EU. Finally, it addresses the potential impediments to the enlargement process, and the issue of the structural and cohesion funds and the Common Agricultural Policy (CAP).

1. Visions of a Wider Europe? What Does the EU Stand to Lose?

There are few genuine visions of a wider Europe that build upon the potential economic gains of enlargement, at least coming either from the Council, the Commission, the European Parliament, or from the Member States of the EU itself. Taking the theoretical and economic justifications for the creation of the Internal Market as a benchmark, little mention is made of the positive role the Central and Eastern European countries could play within the larger framework of boosting European competitiveness. While with the creation of a large Internal Market, the EU (then the European Community) hoped to improve its market competitiveness vis-à-vis the United States and Japan (Cecchini, 1988), no such grandiose statements have been made in favor of enlargement to the CEECs.

This is curious in view of the fact that while these countries currently represent a reasonably small share of EU foreign trade (currently 7.2 per cent of imports in 1995, and 8.4 per cent of exports),[1] the economic changes awaiting these countries in the next several decades are likely to be quite far-reaching. The Member States of the EU are likely to gain considerably, and have already, from these changes, both in terms of trade with the CEECs, and perhaps as well via access to the markets of the Newly Independent States (NIS) beyond, as well as through the often neglected potential gains in employment that lie behind such growth in trade (see table 1).

Table 1: EU Trade with Central and Eastern European Countries 1990-1995

(in billion ECU's)	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**
CEEC exports to EU	13.0	16.2	22.5	26.8	33.9	41.7
% growth from prev. year		25%	39%	19%	26%	23%
EU exports to CEECs	12.1	17.7	24.6	33.2	40.3	49.3
% growth from prev. year		46%	39%	35%	21%	22%
EU Trade Balance with CEECs	-0.9	1.5	2.1	6.4	6.4	7.6

Source: Eurostat: Statistics in Focus: External trade, 1995 (no.7), 1996c (no.7), and own calculations.

On the part of the various institutions of the EU, there does at least appear to be some recognition of the fact that the EU stands to gain from enlargement. For example Stefano Micossi, Director General of DGIII at the time, made the following statement in an article on the new orientations of industrial policy in the EU:

> The economic reforms that have been undertaken in the Central and East European countries offer considerable opportunities for the expansion of the European market. ... The reduction of commercial barriers between the EU and these countries will allow for the opening up of expansion potential of their economies, which represents for European

[1] Eurostat, 1996 c: 1.

> enterprises the principal region of future expansion. In this domain, coordinated policies will be necessary in order to facilitate the process of adaptation and to reduce the economic and social costs. (Micossi, 1996: 164).

Similar statements concerning the potential economic gains of trade with the CEECs can be found in Commission documents on industrial cooperation, and one of the impact studies of the Commission.

But in general, there has been no broad over-riding statement of the goals of enlargement that would recognize these interests. There are many reasons for this hesitation. At the time of the collapse of the former East Block, the economies of Central and Eastern Europe were in considerable disarray. Their levels of competitiveness and productivity were far below that of their West European counterparts. Though there is a great degree of variation among the individual CEECs, with countries such as the Czech Republic, Hungary and Poland fairing far better than Bulgaria or Romania, all of these countries have experienced severe economic decline in the early years of transition. Industrial production sank by up to 30 per cent in some CEECs (European Commission, 1994 b: 4). Reeling from decades of Communism, economic mismatch with the international marketplace, and struggling through the collapse of their former CMEA markets, these economies have only recently begun to regain their balance. Most of them have only managed to achieve positive rates of economic growth in the past two to three years, while almost all of them, apart from the possible exception of Poland in 1996, have yet to regain the level of economic development they had achieved in 1989 (see Table 3 below; EBRD, 1996: 5, 22).

These drastic changes have certainly tended to slow the process of accession to the EU. But whatever the explanation for the delay, the EU took until June 1993, at the Copenhagen summit, to make its first definitive statement regarding the possibility of accession and membership.[2] Moreover, the Europe (or Association) Agreements (the initial trade and cooperation agreements between the EU and the CEECs), some of which had been negotiated as early as 1991, explicitly avoided any mention of the actual fact of membership in the EU and clearly stated that the agreements were not to be understood as ‘pre-accession’ agreements (Sedelmeier and Wallace, 1996: 370).

The European Parliament as well, has adopted the same view of the need to minimize the impact of enlargement on EU employment. The Oostlander Report (EP, 1996a) and the accompanying parliamentary resolution (EP, 1996 b), for example, clearly reflect this concern. While the Oostlander proposal for a parliamentary resolution contained a more tepid version,[3] the resolution adopted by the European Parliament makes clear and specific statements about protecting employment in the current EU.

Similar views course through the institutional branches of the European Commission, and a recent Opinion of the Economic and Social Committee (ESC) likewise strongly criticizes the fact that the "White Paper on the Preparation of the associated Countries of Central and Eastern Europe for integration into the internal market of the Union" fails to give sufficient consideration to the Social Dimension. The ESC Opinion points clearly to the potential for "social dumping" to cause frictions and political complications in the Member States with respect

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[2] If the Copenhagen Summit of June 1993 left any doubt, the Essen Summit of December 1994 clearly confirmed the principle of membership of the CEECs in the EU, and established a series of criteria.

[3] The original proposal for a parliamentary resolution does not contain points 19 or 20 of the final resolution.

to the process of enlargement (ESC Opinions and Reports, 1996: 10-11). This reflects a moderate degree of support for such views even among employers of the EU.[4] Similar views and concerns are expressed even more strongly by sectoral level organizations within individual Member States of the EU. Though none of these organizations openly *opposes* enlargement, it is clear that some of them, especially those in the more labor-intensive sectors, are made uneasy by the prospect of competition with the CEECs or the potential for labor migration.

This said, researchers in several of the West European states now see potential gains in the area of employment, and this in those countries that are most likely to experience the greatest immediate impact from enlargement. A recent German study, for example, on the impact of trade and association with the CEECs on EU employment has been quite favorable. The authors find that although there are likely to be differences between sectors, and that some sectors will lose while others will win, the growth in exports is expected to outweigh the decline in production and employment in labor-intensive sectors. All in all, the authors find that even for those two countries most likely to be hardest hit by the changes, Germany and Austria, the adjustment costs are well within the means of these two countries (DIW, 1996).[5] In Austria too, there have been quite positive reports of the overall impact on employment. Breuss notes that other estimates of the positive impact of trade with the CEECs on Austrian employment vary from 15,000 (earlier studies, 1993) to 50,000 (later study, 1995) (Breuss, 1995: 4-5).

Meanwhile, overall, the West European Member States appear to have gained from increasing trade relations with the CEECs. If anything, it is on the other side of the East/West divide that trade issues have become more of a problem. It is now more frequently the CEECs that are asking for longer trade restrictions and less so the West European countries (Richter, 1996).[6] This is in part simply the result of the fact that the West has done comparatively well in trade with the East, while the East has often done far less well than expected.

The Member States of the EU, and above all those such as Germany or Austria with the strongest trade links to the CEECs, have clear economic interests in the CEECs. Thus, while the European Council would like to proceed with enlargement, it is all but incapable of getting the Member States to agree on an explicit agenda. The European Council is hesitant to make any public and strongly visionary statements about the overall gains to the EU of enlargement, since this would strengthen the hand of the CEECs in placing demands upon the EU for transfer payments. In this sense, the Commission and the Council are caught in a difficult balancing act between the wish to proceed with enlargement and the difficulties of building support for it from the Member States.

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[4] Some earlier studies have generated quite negative predictions about the potential impact of enlargement on EU employment. For example, a study by Holzmann et al. (1994), came up with far more negative predictions of the potential impact on employment in Western Europe.

[5] Schumacher comes to similar conclusions for Germany, and adds that most of the transition has already occurred. Although further adjustment is likely to occur as purchasing power grows in the CEECs, this should be distributed over a number of years, and thus should exert only a minimal influence on the German economy (1995: 34-5). See also Gabrisch, 1995. Moreover, there are several studies that address the relationship between high wages and potential investment outflows from Germany to other countries. However, most of these studies likewise find evidence to support the view that Germany employment is not greatly threatened by low wage competition (Derks and Halbach, 1996; RWI, 1996; Burger and Jungnickel, 1996).

[6] The Telò (1994a) volume likewise carries numerous references to this point. See also *Business Central Europe, The Annual 1996/97*: 22. This point has also arisen in numerous interviews.

2. Dividing up the Spoils? Has the EU Done Enough?

The role the EU has played in the restructuring of the CEECs is at best controversial. As the White Paper states quite clearly: "The associated countries themselves have the main responsibility for alignment with the internal market and will establish their own sectoral priorities" (European Commission, 1995c: 2). Thus, industrial restructuring and development in the CEECs is for the most part left to these countries themselves.

Based on statements of the European Commission, policy towards the CEECs is based on four pillars: the Europe Agreements, the "structured dialogue", the PHARE programs, and the alignment of single market legislation. Since the most direct and measurable impact of EU policy has resulted from the Europe Agreements, I will focus in the following on their impact on trade with the CEECs. The PHARE programs have likewise had the intent of providing the CEECs with financial and technical assistance through the transition process. However, while the degree of financial assistance has not been insignificant,[7] very little of this money has actually reached the applicant countries themselves (most went to Western experts) and the overall success of the program has been minimal (Kiss, 1996; Langewiesche, 1995).

With respect to the Europe Agreements, their most direct impact has been on the terms of trade between the EU and the CEECs. In this respect, trade experience for the CEECs has been more mixed than it has for the EU. For the CEECs, recent trade experience has resulted in mounting concern about the advantages of trade and trade openness. While between 1991 and 1995, CEEC exports to the EU have likewise increased, with some fluctuation, at a dramatic rate (Table 1 above), this increase in trade has been paralleled by a steady increase in the trade deficit, reaching 7.6 billion ECUs for the CEECs in 1995.

However, despite the severe initial decline in industrial development in the first few years of transition in the CEECs, and despite their mounting trade deficits, not all recent experience has been negative. Although there is a great deal of variation across these countries, for one, they have exhibited relatively stable rates of economic growth since approximately 1993-1994 (Table 2). On average, they have experienced rates of growth that exceed those of the EU (5 per cent in 1995, compared to approximately 2.4 per cent in the EU) though a few of the CEECs still remain below the European average.[8]

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[7] Ludlow, for example, compares EU aid to that of other countries and finds that the EU has offered the bulk of funding to the CEECs (1996: 19-21).

[8] European Commission (11/1996), EBRD (April, 1996), and European Commission (1996b).

Table 2: Growth in Real GDP

Countries	Average Rate of Growth in Real GDP 1990-1995	Rate of Growth in Real GDP 1994	Rate of Growth in Real GDP 1995 (estimate)
Bulgaria	-4.3	1	3
Czech Republic	-2.2	3	5
Estonia	-6.5	-3	4
Hungary	-2.5	3	2
Latvia	-8.7	2	1
Lithuania	-12.5	2	3
Poland	0.2	6	7
Romania	-2.7	4	7
Slovakia	-2.2	5	7
Slovenia	-1.0	6	5

Sources: EBRD (1996), and own calculations.

Even with their current trade deficits, the CEECs have likewise experienced great increases in their overall trade with the EU. The exports of the CEECs to the Member States of the EU have grown at an impressive rate, allowing these countries to replace much of their lost trade with the former CMEA countries. Between 1991 and 1995, EU imports from the CEECs grew from 3.3 per cent to 7.2 per cent of total imports, and the annual average growth rate was almost 21 per cent (Eurostat, 1996c: 1). Thus, recent trade experience with the EU has certainly not been all bad, and much of the turnaround in CEEC economic development can be attributed to the expansion of trade with the EU. For another, these countries have done remarkably well in certain economic sectors. In trade with the EU, the CEECs have exhibited the greatest *surpluses* in apparel and clothing, iron and steel, furniture and mattresses, non-ferrous metals, cork and wood and related products, and coal and coke. In addition, these trade surpluses have been growing more or less steadily since 1991.[9] Among the *most imported* products by the EU from the CEECs are apparel and clothing, road vehicles, electrical machinery and appliances, electrical components, iron and steel, furniture and related parts.[10]

However, despite the considerable growth in CEEC trade with the EU, in quite significant ways the Europe Agreements between the EU and the CEECs have advantaged the Member States of the EU at the expense of the CEECs. In many senses it is possible to say that the Member States of the EU have done their best to structure the accession process in ways that protect their interests, but do little to ensure the protection of Central and East European interests.

The principle effect of the Europe Agreements has been to protect the most "sensitive sectors" (steel, coal, textiles and agriculture) of the Member States of the EU against precisely those sectors in which the CEECs had the greatest potential comparative advantages. Criticism of the protectionist character of EU trade policy with the CEECs was strong, and the EU made attempts to open its markets even further at the Copenhagen Summit in June 1993 (Rollo and Smith, 1993; Sedelmeier and Wallace, 1996). In addition to this however, the literature neglects the fact that the Europe Agreements fail to provide similar "asymmetries" for goods that the EU trades most heavily with the CEECs, or for comparable "endangered sectors" in the CEECs.

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[9] Among these products, the only exception is iron and steel, which saw a brief decline from 1992-1993, but then recovered (Eurostat, 1996c: 7).

[10] All trade data from Eurostat, 1996c: 3, 7.

The European Commission has clearly indicated that the CEECs must conform to the market structure of the EU. The applicant countries are required to conform to the existing "*acquis communautaires*" (the body of existing EU rules and regulations) - a fact which has been true for previous applicant countries as well. While this is to be expected if the EU is to continue on the path of building the Internal Market and standardizing Internal Market legislation, it is curious to observe the "carrot and stick" approach that the EU has adopted with respect to the advances of the CEECs on this front. The EU has gone as far as to tie further improvements in trade relations with CEEC improvements in the implementation of EU competition and state aid policy.

On the other side, the bargaining position of the applicant countries and their respective sectoral organizations is especially weak compared to that of their EU counterparts.[11] This is true for many reasons, not the least of which is the fact that trade with the EU represents a much larger share of overall economic activity for the CEECs than it does for the Member States of the EU. In addition, however, the CEECs and their respective sectoral organizations simply lack experience in the area of pressure politics, especially within the EU. Not only do they have only limited experience with this type of political behavior, they likewise often do not have any clear conception of the potential role they might play, while the West European organizations make no bones about defending their own interests.

In addition, and particularly on the employer side in the CEECs, many of the necessary organizations have not yet been created or are poorly integrated, if at all, into the structure of European industry-level employer federations. While the situation is perhaps somewhat more advanced for the labor organizations in the CEECs, both in terms of their organizational strength in individual CEECs, as well as in terms of their integration into the European structures of the trade union movement, there are still considerable deficiencies on this side as well. UNICE, the West European umbrella confederation for employers, has organized far fewer of the Eastern employer organizations than its counterpart on the labor side, the European Trade Union Confederation (ETUC). This image is mirrored at the industry level.[12]

While the EU is constantly concerned about the potential consequences of market distortions that might occur from "unfair" competitive advantages in the CEECs, it seems far less concerned about the consequences of such distortions for these countries. The trade restrictions of the EU have presumably led to considerable market distortions in the CEECs. For one, restrictions on the capacity of these countries to take advantage of trade in goods in which they have a comparative advantage limits their growth potential and causes a shift in investment away from these industries. For another, such restrictions likewise limit the extent of foreign direct investment in these industries, as foreign producers would be unable to benefit from the

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[11] In this respect, Sedelmeier and Wallace note that during the negotiation of the Europe Agreements, EU producer organizations were much quicker to place pressure on the institutions of the EU than the CEECs (1996: 371). In my own interviews, I have repeatedly encountered the fact that the Central and East European organizations on the union side seem to have only a very limited sense of the potential pressure group role they could potentially play on such issues.

[12] There is considerable variation in the degree to which national CEEC industry-level federations have been integrated into the European industry-level federations. Once again, CEEC trade union organizations are more thoroughly integrated into the European structures than are employer organizations. Many organizations on the Eastern side note the existence of competitive tensions, and in mutual encounters between East and West, the unions recognize the potential for competitive tensions to divide interests and note the importance of attempting to counteract such tensions.

later re-export of such goods. Finally, OPT trade likewise creates market distortions that favor Western producers but is arguably less beneficial to Central and East European producers.[13]

The restriction of market access to the EU and the resulting misallocation of resources has likely had significant consequences for the CEECs. The relative importance of trade with the EU for the CEECs is great compared to the importance of trade with the CEECs for the EU. Already in 1992, trade with the EU accounted for almost 50 per cent of the total trade of Central and Eastern Europe (Ludlow, 1996: 12-13). As of 1994, the figure had risen to over 60 per cent, and was highest for the Czech and Slovak Republics (72.6 and 82.9 per cent respectively) and for Poland (68.8 per cent) (Piazolo, 1996: 5).[14] In addition, CEEC exports to the EU, measured as a share of GDP, represent a substantial amount of economic activity in these countries. In 1995, for example, this share was over 30 per cent for Slovenia, Latvia and Estonia. While this share is somewhat smaller for the Visegrad four, it is still substantial (26 per cent for the Czech Republic, 25 per cent for Slovakia, 23 per cent for Hungary, and 13 per cent for Poland).[15] Thus shifts in the trade relations of these countries with the EU can be expected to have a relatively large impact on their internal economic structure.

3. Competitiveness?

Given the recent trade experience of the CEECs with the EU, it is not surprising that even the most advanced of these countries are currently voicing concerns about the "competitiveness" of industry and the consequences of increasing economic integration with, and enlargement to or membership in the EU. To what extent these countries should actually be concerned about the issue of competitiveness, and what this means for the potential of the CEECs to "catch up" in terms of their level of economic development to the Member States of the EU is controversial. In general, there is a growing concern that the conditions which drive competitiveness, and thus economic growth, are not ensured by the mere fact of trade openness and the introduction of market relations.

Apart from the trade data already noted above, some of the strongest evidence in support of the view that the CEECs will have difficulty competing successfully with the Member States of the EU comes from the data on foreign direct investment (FDI). Most studies on the issue of foreign direct investment in the CEECs emphasize the lack of investment flows to these countries. If one assumes that the competitiveness of these countries is based entirely on such comparative advantages as low wages, then this fact is surprising and even counter-intuitive. While one might expect that low wages would represent a significant attraction for investors

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[13] In the textile industry, which accounts for the larger share of OPT, concerns are growing that this kind of trade will have a potentially negative impact since it pulls resources away from more fully integrated production processes and makes individual firms more vulnerable to market fluctuations and changes in producer demands (Gabrisch, 1995).

[14] It should be noted that both of these studies only consider a slightly restricted group of CEE countries. They include Bulgaria, Czechoslovakia (or the Czech and Slovak Republics, depending on the year), Hungary, Poland, and Romania.

[15] Figures calculated on the basis of data from EBRD, 1996; Eurostat, 1/1997; and European Commission 11/1996.

and producers in the high wage countries of the EU, in particular Germany, Austria and the Netherlands, they do not ultimately appear to do so.[16]

While employer organizations repeatedly emphasize the need for an appropriate legal framework that would improve the security of investments in these countries,[17] this factor has not hindered some large-scale investments, nor quite a large number of joint ventures. While there is some evidence that political instability and the lack of a sufficient legal infrastructure may slow certain types of investment in the CEECs,[18] the legal infrastructure in countries such as the Visegrad four (the Czech and Slovak Republics, Hungary and Poland) is relatively advanced.

If low wages were the predominant factor predicting the flow of foreign direct investment, then the bulk of FDI would flow to countries such as the Ukraine. However, the bulk of FDI flows to those countries that have somewhat higher wages, above all to Hungary, but also to the Czech Republic and Poland (EBRD, 1996: 12).[19] In addition, Gabrisch provides evidence to support the view that it is not labor-intensive sectors in the CEECs, but rather the more capital-intensive sectors, which have tended to attract the most FDI (1995: 8). Several studies point to the relative importance of a highly skilled laborforce in attracting FDI in the CEECs (e.g. Lansbury et al., 1996). But there is ample reason to expect that much more is at stake than simply the relative skill levels of labor. As many authors insist, there are several other factors that should be considered in terms of what drives the investment decision. Factors such as the relative proximity of potential suppliers, infrastructure (such as education, access to technological know-how, and the quality of local services, transportation) are seen as increasingly important in establishing a competitive advantage.[20] More generally, competitiveness is seen as something which countries must "acquire", rather than something which they naturally possess.

Whether the CEECs will make advances in their overall competitiveness with the EU is controversial. Landesmann (1996), for example, presents evidence that the CEECs are indeed engaging in further specialization as a result of the liberalization of trade with Western Europe. The CEECs have moved towards the production of labor-intensive goods and away from capital or energy-intensive goods, though this trend is stronger for the less advanced CEECs such as Bulgaria and Romania, and is less pronounced for the more advanced CEECs such as the Czech Republic, Hungary and Poland. Trade with the EU, in this respect, is strongly inter-sectoral, i.e. it is characterized by trade in typically comparative advantage sectors.

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[16] Perhaps the strongest statement to this effect comes from Meyer-Stamer (1994). See also Burger and Jungnickel (1996). Döhrn likewise provides evidence that low wages do not represent a significant motivation for investment interests among the 15 EU Member States (1996).

[17] This particular point has came up over and over again in the interviews I have conducted.

[18] Lankes and Venables (1996), for example, find that political instability and the lack of a sufficient legal infrastructure may hinder vertical investments, since these involve relocation and the potential for breakdowns in the supply network.

[19] I am indebted to a discussion with Attila Havas for this observation.

[20] Generally speaking, this is the view of the endogenous growth school. It is strongly supported by such European authors as Meyer-Stamer (1994) and Gabrisch (1995). Lankes and Venables (1996) likewise point to the importance of skilled labor and infrastructure variables.

However, comparative advantage trade has not been consistently successful for the CEECs. Despite the trade surpluses they exhibit in some of the typically labor-intensive sectors noted above, the CEECs have likewise had considerable difficulties taking advantage of the quotas that were granted in these sectors in the Europe Agreements. In 1993, for example, only the Czech Republic was able to take advantage of more than 50 per cent of its quotas (54 per cent), while the next highest country was Bulgaria, with 36 per cent of its potential quotas (Ludlow, 1996: 18). While this argues in part that the trade restrictions in the Europe Agreements did not have a serious impact on trade, it also points to the difficulty that the CEECs have had in competing with the EU in areas in which they presumably possess a comparative advantage. Even in the immensely important agrofoods sector, all of the CEECs except Hungary are net importers of EU products and have been unable to take full advantage of EU quotas.[21]

More importantly, advances in the area of inter-sectoral trade should not necessarily be equated with improvements in competitiveness with the EU. In the long run, the principle concern of the CEECs is whether or not they can find a way out of the potential path dependence created by economic development based on low wages and labor intensive production. The implications of endogenous growth theory are of great import here. If, as endogenous growth theory would predict, the CEECs are dependent upon significant improvements in infrastructure and technology in order to move beyond this path dependence and to catch-up to the level of development of the Member States of the EU, then the crucial question becomes how they are to achieve this. OPT takes on added significance in this respect. If OPT and related FDI in fact lead to a significant transfer of technology, then the CEECs should benefit considerably from such exchanges. But if such economic activity propels the economies of Western and Central and Eastern Europe does not have an impact on technological development and drives these regions further apart, they are less advantageous.

One of the principal measures of progress in competitiveness is the measure of the degree of "intra"-industry trade. As economies become more fully integrated, it is assumed that trade will be more and more strongly characterized by trade "within" sectors (intra-industry trade), as opposed to trade "between" sectors (inter-sectoral or inter-industry trade). Moreover, the degree of intra-industry trade is also considered a proxy for the level of development and convergence between economies. As economies become more fully developed and approach the level of the more advanced economies, the level of intra-industry trade increases and the level of inter-industry trade declines.

On measures of intra-industry trade, the evidence is more controversial. As some authors have found, there has been an increase in the share of intra-industry trade. Landesmann, for example, notes that the share of intra-industry trade increased over the period 1989-1993, for Hungary and the Czech Republic, while for Poland and Bulgaria the share stagnated, and declined slightly for Romania. Döhrn (1997) provides similar findings for the former CMEA countries over the period 1988-1994. However, on other indicators such as the "price/quality gap" between Western and Eastern commodities, there has been no significant change.

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[21] European Commission, 1995a (p. 10). In fact, the Commission argues against the fears of EU farmers, stating that there is no risk of a flood of cheap imports from the CEECs, and points to the generally favorable trade balance in the agrofood sector with the CEECs (European Commission, 1995b: 29). Current complaints of CEEC farmer organizations about EU agrofood imports likewise bear witness to problems of competitiveness. Finally, even for net exporter Hungary, trade with the EU has led to a declining trade balance as a result of the fact that the EU has greatly increased its agricultural exports to Hungary, while Hungary's agricultural trade with the EU has remained more or less stable (Falussy and Izikné Hedri, 1995: 34).

However, in order for significant convergence to occur, it is argued that significant advances should be found in this area as well (Landesmann, 1996: 16-18).

Overall, the CEECs still have a long way to go to attain market stabilization and to begin to catch up to the level of economic development of the Members States of the EU. As noted above, all of the CEECs have yet to regain the level of economic development that they had achieved in 1989 (Table 3). While Poland, Slovenia, Hungary, the Czech Republic and Slovakia have begun to improve, the level of economic development in some of the CEECs is still substantially below their 1989 level.

Table 3: GDP as Share of 1989 GDP and EU Average

Countries	Estimated Real 1995 GDP as share of 1989 GDP	1994 per capita GDP as share of EU average	1995 per capita GDP as share of EU average (at PPP)
Bulgaria	75%	6.0%	25%
Czech Republic	86%	17.7%	52%
Estonia	66%	7.8%	na
Hungary	86%	20.3%	36%
Latvia	54%	7.1%*	na
Lithuania	41%	16.3%**	na
Poland	99%	12.4%	30%
Romania	84%	7.0%	24%
Slovakia	85%	11.8%	41%
Slovenia	93%	35.3%	58%

* Figures for Latvia 1994 GDP per capita based on GNP.
** Figures for Lithuania 1994 GDP per capita based on GNP per capita at PPP.

Sources: GDP per capita as share of EU average: own calculations based on EBRD, 1996; OECD, 1997; GDP per capita as share of EU average at PPP: *Business Central Europe*, Sept. 1996: 80; Estimated Real 1995 GDP as share of 1989 GDP: EBRD, 1996: 22.

Many of the CEECs, and especially the Czech Republic, Hungary and Poland among them, do nonetheless possess potentially considerable advantages. They have highly skilled labor-forces and considerable research and development pontential, though this "potential" needs to be restructured (Widmaier and Potratz, 1997; Potratz and Widmaier, 1996). In addition, prior to their incorporation into the CMEA, the three countries just noted, and in particular the Czech Republic, were relatively strongly integrated into industrial Europe (Widmaier and Potratz, 1997: 301). Thus, in some respects, some of the CEECs, and above all the Czech Republic, Hungary and Poland, may well possess the potential to rise above problems related to competitiveness. But while the European Commission emphasizes the importance of cohesion policy, one cannot expect the CEECs to take it more lightly.

4. Institutional and National Impediments to Enlargement

Whether or not the EU will successfully proceed with enlargement to the CEECs is, for the most part, dependent upon the potential to resolve internal budgetary and sectoral conflicts. In this respect, the ratification of any final decision on enlargement poses a serious dilemma for the EU. While in the case of the Europe Agreements, the EU was able to override sectoral and national interests by passing Interim Agreements which took the place of the actual Europe Agreements during the ratification process,[22] such a procedure is not possible for the case of ratifying enlargement. Since agreement at the national level can have a much larger impact on the overall acceptance of enlargement (unanimity requirement), and since sectoral level interest groups can have a much larger potential impact on the ratification procedure at the national level, one can expect national and sectoral interests to be much more fully and strongly mobilized during the process of negotiation of the accession treaties.

As a result, the structural and cohesion funds policy, the CAP, and other sectoral and national level issues provide the most significant potential stumbling blocks to the negotiation process. Whether or not individual national governments will attempt to block such agreements depends upon the degree to which EU institutions manage to balance the interests of the Member States and their respective sectoral interest groups. While, due to their reliance on structural and cohesion funding and the CAP, one might expect considerable opposition to enlargement to come from the Southern tier states, it is not only the Southern tier states which are likely to pose the most significant obstacles to enlargement. Opposition may also come from sectoral forces within individual states which are clearly in favor of integrating the CEECs into the EU.[23]

Another dilemma regarding the structural and cohesion funds is that the entry of most or all of the current 10 applicants to the EU would result in an overall shift in the recipients of structural and cohesion funding. Currently, regions with a GDP that is 75 per cent or below that of the average of the EU qualify for Objective 1 funding. However, if the CEECs become members of the EU, they will likewise bring about a downward shift in the average EU GDP, thus rendering many regions that are currently net recipients ineligible for continued funding. Rather than expanding structural and cohesion funds expenditures, current thinking on the potential reform of structural and cohesion funds policy within the European Commission and the Parliament would set limits to the amount of funding that the CEECs could receive. In this approach, the CEECs would not receive levels of funding that correspond to current levels of expenditure in the Southern tier states of the EU. The strongest statements in this respect have come from Monika Wulf-Mathies, Commissioner of Directorate General XVI for Regional Policy. In a speech on the reform of the structural and cohesion policy of the EU before the EU-Committee of the German Bundestag on June 21, 1996, she stated that "gradual integration into Community structures", was necessary due to the fact that these countries exhibit what is generally referred to as a low "absorptive capacity".

The concept of "absorptive capacity" is based on the notion that, under current structural and cohesion fund rules, the CEECs would receive transfers that surpass both their current administrative capacities, as well as their budgetary capacities, since sructural and cohesion policy requires levels of co-financing which the CEECs currently could not hope to match.

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[22] See e.g. Telò, 1994b: 13.

[23] The German agricultural sector, for example, is opposed to the notion that incorporating the CEECs into the framework of the EU would be used as a means to force a reform of the CAP.

According to Wulf-Mathies, current rules would lead, for example, to assistance which equals 10-20 per cent of the current GDP's of these countries. Thus, the approach being suggested is that the CEECs be required to accept progressive integration into the structural and cohesion funds policy of the EU. Without such transitional periods, it is assumed, these countries will be unable to meet the expenditures necessary either to administrate such resources, or to meet the current EU co-financing requirements.

The prospect of raising revenues in order to increase expenditures and thus cover potential increases in the budget resulting from enlargement likewise meets with strong objections. This would require an increase in the revenues of the EU that were set in 1992 at a level not to exceed 1.27 per cent of the GNP of the respective Member State (Edinburgh Summit, Dec. 1992).[24] Opposition to this position comes from those countries which are currently the highest net payers into the EU budget, Germany and the Netherlands. However, two of the largest EU Member State investors in the CEECs are likewise these same countries. Moreover Germany, along with Italy, France and the Netherlands, based on their average share of trade with these countries from 1993-1995, likewise stand to gain the most from trade with the CEECs.

The Common Agricultural Policy, on the other hand, poses very different difficulties. A general consensus seems to be developing thus far around a couple of significant points. First, given the relative price differences between East and Western Europe in the agricultural sector, there is little need for price support payments in the CEECs. Instead, consensus has settled upon finding some way to assist the CEECs in restructuring and modernizing the agricultural sector.[25] The importance of this objective is great, as predictions are that a significant share of current employment in the agricultural sector in the CEECs will have to be trimmed. The Directorate General for Agriculture, for example, estimates that some 3 million jobs or approximately one third of the labor force in the agricultural sector will have to be shed.[26] While these may be overestimates,[27] the potential for labor migration likewise represents a serious concern for the Member States of the EU. Thus, it is likely that efforts in this direction will be reinforced.

Second, there is likewise consensus on the notion that the CEECs cannot support the same price levels for agricultural products as Western Europe, and thus would not be able to adopt the same pricing mechanisms. Though prices may be expected to increase in these countries as the economies begin to improve, since expenditure on food products absorbs a relatively large share of personal income, large increases in food prices in these countries could be both economically and socially destabilizing. [28]

Thus, current efforts focus primarily on the types of proposals initiated with the 1992 McSharry reforms, and which undertook the reduction of price supports and a shift to direct compensation payments. Moreover, new negotiations of the Uruguay Round Agreement that will start in 1999 will also likely produce more downward pressure on EU price supports. While resistance to such reforms is likely to come from the agricultural sectors in the Member

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[24] At least one indication of the difficulty of increasing revenues is the fact that this increase, even as of 1996, has not been ratified by more than one Member State (*Together in Europe*, 5/15/96: 6).

[25] European Commission, 1995a: 31; European Commission, 1995b: 26, 27.

[26] European Commission, 1995a: 5-6.

[27] Nuti, 1996: 508, 510.

[28] European Commission, 1995a: 31; European Commission, 1995b: 9.

States, it is arguable that the real problem is not enlargement itself, but simply the difficulty of continuing to reduce price supports that are likely to be introduced whether enlargement takes place or not. Furthermore, while the reduction of EU price supports may turn out to be costly in the short term,[29] they would yield substantial consumer gains and greatly improve the overall competitiveness of Member State economies.

Conclusions

When and how many of the Central and East European countries will join the EU remains an open question. Without going into details here, it is certain that some countries will accede before others. More significant, however, is the way in which they will accede, and the degree to which the EU itself is willing to assist them in the process of economic transition and development. The creation of a "New" Europe requires equal treatment among all Member States, new and old alike. The acceptance of a "multi-speed" Europe means the passing off of the costs of transition onto countries that are ill-equipped to handle them.

Given that most of the industrial markets between West and Eastern Europe have already been liberalized, the CEECs now need to think seriously about the advantages and the disadvantages of membership in the EU. While Barta and Richter, for example, note a number of potential economic advantages (free access to EU markets, elimination of anti-dumping and safeguard measures, reduction of transaction costs, greater FDI flows, more MNC activity, EU funds, and the free migration of labor),[30] these advantages need to be weighed carefully against the potential disadvantages that arise from requirements to adopt EU regulations, and from the inability to act independently of EU directives.

Membership in the EU means a significant loss of sovereignty. Among other things, this includes the capacity to erect market barriers to safeguard internal economic development. Without adequate economic support from the EU, the preservation of the capacity to erect market barriers may be the only way to preserve internal solidarity and support for the process of economic transition these countries are required to follow to adapt to the strictures of the Internal Market. While full integration in the EU is likely to bring the greatest economic benefit, under current budgetary constraints, the CEECs are hard put to meet all of the social and economic costs of transition or to ensure competitiveness on their own terms. Thus, the loss of internal sovereignty may be costly in the short term and warrants the reward of adequate compensation and sufficiently long transition periods to allow Central and East European industry time to come to terms with Western levels of productivity and overall competitiveness.

Western Europe, on the other hand, needs to think seriously about the consequences of failing to recognize the interests and needs of the CEECs. The longer it takes to integrate these countries into the fold of the EU, and the longer it takes to assist them with the costs of transition and economic restructuring, the greater the likelihood that the CEECs will see greater advantages to remaining outside the Union. Shortchanging the CEECs on structural and cohesion funds policy or the CAP is equivalent to shifting the burden away from those countries which are most likely to gain from enlargement, and to placing it on those which are most likely to bear the brunt of its costs. This expectation is too great.

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[29] As the Commission notes, the reduction of milk and sugar prices to world prices would likely necessitate direct compensation payments of some 10,000 to 15,000 million ECU (European Commission, 1995b: 22).

[30] Barta and Richter, 1996: 17-18.

As has been quite clearly pointed out, the goals of economic and social cohesion are not only among the clearly stated goals and objectives of the association of Member States, they are also integral components of the groundwork upon which the EU will be able to build and consolidate opportunities for peace and security in the historically, geographically and symbolically significant region of Central and Eastern Europe, and across Europe as a whole. Failure to meet the demands of building competitive economies and failure to move forward with the project of convergence and cohesion is likely to create unnecessary and perhaps long-term divisions in the old Europe.

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