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EC Integration:
Does It Mean East-West Disintegration

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The opinions expressed in this paper are those of the authors and do not necessarily reflect the views of the Bank of Finland.

EC Integration: Does It Mean East-West Disintegration?¹

1 Introduction

The title question is a multi-dimensional one. One aspect of the question pertains to how the integration process itself is moving ahead. Looking at this question, we have to distinguish between the enlargement of the EC and the strengthening of the integration process within the EC. Moreover, we should also ask what is the difference between strong and weak performance with respect to EC integration as regards East-West co-operation.

The second aspect of the title question concerns whether there are certain factors related to EC integration which could convince us to believe that the process will produce an economic wall or walls in Europe. However, we know only too well that there are already many barriers, formal and informal, to economic cooperation between the East and the West, although the situation has dramatically changed since the dissolution of Comecon. Thus, instead of asking about building up the wall, we should merely ask if the trend to lower the existing trade barriers will continue.

Third, in order to get a general picture of economic integration in Europe, we should also look on the other side of the curtain to see what conditions must obtain before the post communist countries open up their economies and become partners in the overall economic integration in Europe. One particularly interesting question is how the former Comecon countries will organize their mutual economic cooperation and their relations with Western Europe.

In this paper we present a brief review of East-West economic integration in Europe. In particular, we concentrate on trade policy between the EC and the transition economies and on regional developments in the former Comecon countries.

¹ This paper was presented in the workshop on "The economic dimensions of conflicts and cooperation in the Baltic Sea Rim", Nov. 5-7, 1993 in Tampere (Tapri). The opinions expressed in this paper are those of the author and do not necessarily represent the views of the Bank of Finland.

2 EC integration: deepening and enlargement

The current state of EC integration can be analysed using the concepts of deepening and enlargement; deepening refers to the integration process within the EC and enlargement to possible new members of the EC. By the deepening of the integration process we usually mean further integration with respect to monetary and fiscal policy but it also refers to more extensive coordination of foreign and security policy. Although it is difficult to draw a distinct line between foreign policy and trade policy, one can not readily detect any serious threat to East-West cooperation in the current discussion on the deepening of integration. On the contrary, one might well conjecture that the deepening of integration within the EC could alleviate the problems related to East-West cooperation, in particular, if further integration were to improve economic performance in the EC area.

According to some studies there are reasons to believe that the current decision making mechanism of the EC can, at least in some cases, produce excessive protectionism in the sense that its member countries, acting alone, would generally implement more liberal trade policies (Winters 1993). For example, it has been said that, in addition to the motive to liberalize trade, a reason for the Association Agreements with Czechoslovakia, Hungary and Poland (the Visegrad group) in 1991 (effective in March 1992) was to harmonize the trade policies of the EC member countries. Thus, in practice, the outcome of these Agreements has been said to be a more protectionist trade policy regime than would have been expected from the attitude of the Commission. There are three factors that could explain why the protectionist view won over the liberalization view in the EC: the economic cost to the EC countries of a liberal trade regime, the economic cost of a liberal trade regime to some powerful sectors within the EC and the absence of support for more liberal trade by EC exporters (Messerlin 1993).

On the other hand, today there is no longer such a need to harmonize the trade policy of the EC member states with the transition economies. Thus, we can expect that in the future the motives behind the EC's trade policy towards the transition economies are likely to be more transparent – unless the possible enlargement of the EC changes the situation.

The possible enlargement of the EC to include the EFTA countries may have an impact on future trade policy agreements between the EC and transition economies, in particular in the northern part of Europe, as Sweden, Finland and Norway have signed free trade agreements with the Baltic countries but the EC has not. Thus, it is possible that some new trade barriers will develop in the Baltic Rim in the near future. However, this development will depend on how the EFTA countries progress in their membership negotiations and, on the other hand, how relations between the Baltic States and the EC develop in the near future. On balance, the possible enlargement of the EC could help the Visegrad countries to integrate with western markets by unifying EFTA countries trade policy with the policies of the EC, since the EC is said to have given better terms to those countries than has EFTA (Hindley 1993). So, in general, it might well be that in practice the impact of the EC enlargement on overall trade policy will be rather small.

We can at least hypothesize that the influence of the transition economies would increase if the EFTA countries were to join the EC. How this will affect the EC decision making mechanism and trade policy towards the transition economies in general is still an open question. On the whole, however, there are no such dramatic changes going on in Western Europe as would allow one to say that trade barriers in Europe are generally increasing. On the other hand, we cannot say that current developments will inevitably lead to a more liberal trade policy regime in Europe.

3 Integration in the transition economies: a difficult start

If integration of the West-European countries has proven to be difficult, the situation in the East seems to be much more difficult. It is interesting that for the former communist countries cooperation with the EC seems to be easier than cooperation between the former Comecon countries. One reason for this, of course, is their experience with Comecon trade. The fact that the economies in transition are very different and have chosen very different approaches to the market economy also complicates their cooperation.

Despite of all these problems, there are some signs of increasing regional cooperation within the transition economies. In December 1992, the Visegrad group signed an agreement providing for the establishment of a free trade zone within eight years. This new agreement, covering a region with 64 million people, is undoubtedly an important milestone in political and economic cooperation in Eastern Europe and it may increase these countries' negotiating power vis-à-vis the EC. However, there has been some dispute concerning the advantages of the new agreement. In particular, the Czech Republic has claimed that the free trade agreement can delay Czech integration into the EC because the whole Visegrad group can now be treated as one entity. Thus, the Czech Republic, which has made relatively good progress, fears that the integration process will depend on the performance of the least developed country of the Visegrad group (Tiusanen 1993).

The same problems regarding regional cooperation can be found in the area of the former Soviet Union. After the collapse of the Soviet Union, the Baltic countries shared much the same interests but they did not manage to escape their history of not cooperating with each other, and it took a rather long time before there were any signs of increasing cooperation. However, on September 1993 the three Baltic countries signed the Baltic Free Trade Agreement, a joint declaration of regional security and an expression of a willingness to sign free trade agreements with the EC. On the other hand, due to the lack of prior cooperation, very different approaches to and speeds of reforms and the still-difficult mutual relations, we cannot be very optimistic about how the Baltic free trade agreement will work in practice. Moreover, it can be claimed, as in the case of the Visegrad group, that the Baltic free trade agreement was achieved only because of pressure applied by the EC and EFTA countries.

In the other regions of the former Soviet Union the situation is still much more complicated and it is even difficult to say whether the disintegration process in the region is still going on or is at a stand-still or whether there is already some scope for the re-emergence of old ties. Nonetheless, it seems that whatever the outcome for regional cooperation in the former Soviet territory, the EC will continue to cooperate with these countries on a bilateral basis.

4 East-West integration: progress despite problems

A precondition for further integration between the EC and transition economies is that the latter continue to move toward the market-based economy. It is evident that the huge differences that still exist between these groups' economies and societies as whole make cooperation between them very difficult.

The collapse of the old system in Eastern Europe has been accompanied by a severe economic recession and external and internal macroeconomic imbalances. Thus, there has been a huge need for technical assistance and financing to stabilize and restructure these economies. The EC has played an important role in this area. The aid and financing granted by the EC has included humanitarian aid, balance of payments support, loans, guarantees and technical assistance. The share of the EC in total Western financing has been around 60 per cent (Nutti 1993).

However, although aid and financing have been important, the common understanding is that the best way to help the transition economies is to open up the EC markets to exports from these countries. For the time being, the major means for achieving this goal have been the so-called Europe Agreements with the Visegrad countries, which came into effect in March 1992. These agreements envisage the creation of a free trade area within ten years and they also involve elements of further integration, ie the four freedoms of movement (goods, services, labour, capital).

The major friction between the transition economies and the EC has been in the so-called sensitive sectors; steel, textiles, agriculture and chemicals. The underlying problem is that there is enormous overcapacity in these sectors, both in the EC and in the transition economies. Thus, the EC does not want to open its markets but rather proposes that capacity be reduced in both the EC and the transition economies. Moreover, the Common Agricultural Policy (CAP) and the dumping issue have raised several still-unsettled problems (Nutti 1993).

The Europe Agreements have been strongly criticized as being still too protectionist. Due to this criticism and the need to accelerate developments in the transition economies, the EC decided in June 1993 to speed up the political and economic integration of the Visegrad countries and Bulgaria and Rumania into the EC. The new programme includes the dismantling of tariff barriers (incl. sensitive sectors) more quickly than was initially perceived, and it holds out the prospect of future EC membership, though without any definite time schedule (Okolicsanyi 1993).

Agreements signed with the Baltic States have naturally been less comprehensive, although the first stage 'Partnership and Co-operation' agreements are under negotiation.² Moreover, despite the EC's desire to treat the Baltic countries as a group, Estonia in particular would like to proceed on a bilateral basis. With Russia, the EC has had some problems in negotiating a 'Partnership and Co-operation' agreement. These problems are related, for example, to the conditions under which foreign banks operate in Russia and Russian exports of aluminium to the EC area. Thus, the signing of an economic agreement has been delayed. However, as a sign of some progress, the EC has proposed to treat Russia as 'an

² In February 1994, it was reported that the EU tries to negotiate free trade agreements with the Baltic countries during 1995 (Helsingin Sanomat 9 February, 1994).

economy in transition' rather than a 'state trading' country, which provides a basis for further trade liberalization measures (Financial Times Nov. 5, 1993).

Despite strong criticism of the EC's policy toward the Visegrad countries, the growth of Visegrad group exports to the EC has been remarkable. However, it is clear that there is much potential for trade between these countries that is yet to be exploited. When the transition economies become more market-oriented and have mature trade relations with Western Europe, the relative importance of trade agreements in trade creation and trade diversion will diminish and the transition economies will have to focus more on traditional issues related to competitiveness. It has been argued that the lack of price competitiveness (partly due to overvalued domestic currencies) is already the Visegrad countries' major obstacle to trade expansion (Okolicsanyi 1993).

From the western viewpoint, it is clear that there are also many barriers in the eastern market which effectively delay the integration process between Western and Eastern Europe. Foreign direct investments in particular have not developed as vigorously as had been expected. The major reasons for this are the underdeveloped state of the legal infrastructure (eg property rights), the still very unstable business environment (taxation, capital movements) and the slow pace of privatization.

In addition to the above-mentioned bilateral agreements, negotiations are also proceeding on the multilateral level, which could facilitate cooperation between Western and Eastern Europe. For example, in June 1993 Russia applied for Gatt participation. This could smooth the way for further cooperation with the West, even though it may take several years before the application is approved. The European Energy Charter, which deals not only with energy questions but also with more general issues like, for example, direct investment, is another important step in this direction. And other international agreements, like those linked to the Helsinki process (CSCE), also help pave the way for more intense cooperation.

5 Conclusion

It now seems that we can no longer speak of a single economic wall between East and West; rather there are different fences around different regions. The current tendency, fortunately, is to lower these fences rather than to strengthen them.

If we examine the different regions in the context of East-West economic integration, we note that there are at least three types of countries: those that may apply for membership in the EC (or European Union – EU – as of autumn 1993) in the foreseeable future (Visegrad countries), those that hope to be EC members in the longer run (Bulgaria, Rumania, the Baltic States) and those that need to arrange their relations with the EC on some other basis. The actual outcome in each case will depend on (in addition to developments within the EC itself) how fast these countries can restructure their institutions and economies and reach the income level of the poorest parts of the current EC. Naturally, geographical factors also matter, as the major criterion for EC membership is location in Europe (Nutti 1993).

In this paper, we have looked at East-West economic integration almost entirely from the point of view of trade policy. However, economic integration has a momentum of its own, and our ability to affect the process by the means of trade policy is limited. Moreover, the underlying inclination of business to move towards integrated European (or global) markets is so strong that even the regional trade policy arrangements can be viewed as steppingstones to access to global markets. Indeed, the regional arrangements in the East are being pushed forward in part by western countries in an effort to promote cooperation between East and West. Thus, we can speak of 'integration induced regionalism' or even 'forced regionalism', instead of regionalism as an alternative to integration.

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