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**WAYS AND MEANS OF PROMOTING THE EXPANSION
OF TRADE IN TRANSITION ECONOMIES**

Report by the secretariat

PART I

Executive Summary and Recommendations

Note: With reference to its decision C (49) on promoting the expansion of trade for products from the countries in transition in international markets, the Commission at its forty-ninth session requested the Executive Secretary, in consultation with member States of the ECE, to prepare a study containing recommendations on ways and means of promoting the expansion of trade of the countries in transition.

The secretariat has therefore prepared the following study entitled "Ways and Means of Promoting the Expansion of Trade in Transition Economies" in three parts: part I "Executive Summary and Recommendations" (E/ECE/1311); part II "Diagnosis of the Problem" (E/ECE/1311/Add. 1); and part III "Specific Measures and Conclusions" (E/ECE/1311/Add.2).

TABLE OF CONTENTS

	<u>paragraphs</u>
PART I (E/ECE/1311)	
A. EXECUTIVE SUMMARY	1 - 12
B. RECOMMENDATIONS AND PROPOSALS FOR A COORDINATED REGIONAL ACTION PROGRAMME	13 - 42
PART II <u>Diagnosis of the Problems</u> (E/ECE/1311/Add.1)	
C. INTRODUCTION	1 - 7
D. IMPORTANCE AND STRUCTURE OF THE TRADE OF TRANSITION ECONOMIES	8 - 17
E. MAIN FACTORS AFFECTING THE TRADING COMPETITIVENESS OF TRANSITION ECONOMIES	
1. Competitiveness: The Role of Industrial Strategy and Support	18 - 43
2. Macroeconomic stabilization and structural reforms . . .	44 - 49
3. Internal barriers to export development and enterprise competitiveness	50 - 62
4. Access to markets	
(a) The Uruguay Round as a framework for market access .	63 - 71
(b) Access to western markets	72 - 89
(c) Access to eastern markets	90 - 93
5. Relative importance of external and internal barriers in the trade of transition economies	94 - 107
PART III <u>Specific Measures and Conclusions</u> (E/ECE/1311/Add.2)	
F. SPECIFIC MEASURES TO FACILITATE TRADE	
1. Institutional measures	
2. International trade standards	
3. Foreign direct investment	
4. Improvements of settlement of payments and financing mutual trade	
G. CONCLUSIONS	

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**WAYS AND MEANS OF PROMOTING THE EXPANSION
OF TRADE IN TRANSITION ECONOMIES**

PART I

A. EXECUTIVE SUMMARY

1. Objective of the report

1. The purpose of this report is to analyse the trade-related problems faced by the transition economies and to propose selected, specific measures to develop their trade. It sets out a coordinated, regional action programme for the expansion of trade, to benefit the economies of central and eastern Europe and the Newly Independent States (NIS).

2. General results

2. Because most of the transition economies are relatively small and have limited resources, improving their trade performance is essential for the success of their reform processes. However, the trade performance of the transition economies since 1989 has been disappointing. The contraction of exports has coincided with a shift in the commodity composition towards mainly low value-added products and raw materials.

3. In order to improve this situation and to increase the competitiveness of their exports, Governments in the transition economies have an important role to play in supporting the creation of a favourable environment for their private enterprises. In this respect, macroeconomic stabilization and privatization are two prerequisites and should therefore be the primary objectives of all the Governments in the region.

4. The coordinated regional action programme identifies core sets of priorities for Governments of the Commonwealth of Independent States (CIS), of central and eastern Europe, and of western market economies. Faced with limited resources and with the impossibility of financing all the desirable measures, transition economies should rather concentrate on the issues where improvement is most needed. With a view to helping implement the recommendations of this report, some proposals are made in fields where the UN/ECE, in cooperation with other international agencies, has a significant role to play. These include studies and conferences, special projects, and large-scale trade development programmes.

3. Diagnosis of the problems

5. This report indicates that internal and external barriers hamper the development of trade in the transition economies. Although external barriers (e.g. market access conditions in western economies) should not be overlooked, in most transition economies internal factors (e.g. infrastructure-related problems and management deficiencies) seem to be relatively more important.

6. Although differences exist between the transition economies, there are common internal obstacles to the development of trade and enterprise competitiveness. The most significant are:

- a. at the national level:
 - payment-related problems
 - inadequate infrastructure
 - poor channels of information

- b. at the enterprise level:
 - low productivity
 - management- and human resource-related problems
 - obsolete plants and equipment
 - low quality products and inadequate marketing skills.

7. Regarding market access, there is still scope for conditions to be improved. However, in 1994-1995 the situation of the transition economies has benefited from the following:

- (a) the successful conclusion of the Uruguay Round which will have a beneficial, though different, impact on the transition economies, depending on whether or not they are General Agreement on Tariffs and Trade (GATT) members;

- (b) the conclusion of preferential trade agreements with both the European Union (EU) and countries of the European Free Trade Association (EFTA), with a growing number of central and east European countries, and the Partnership and Cooperation Agreements between the EU and some countries of the CIS;

- (c) the signing of various free trade agreements amongst transition economies (Central European Free Trade Agreement (CEFTA), Baltic Free Trade Agreement, and the CIS Free Trade Area Agreement).

4. Specific measures

8. The specific measures proposed to facilitate trade cover topics like institutional development, international trade standards, foreign direct investment (FDI), and settlement of payments and financing mutual trade:

- (a) Institution-building measures focus on the creation of trade facilitation, promotion and development organizations, which provide direct assistance to national exporters and/or help Governments to design appropriate trade policies.

- (b) International standards play a vital role in expanding international trade. UN/ECE standards will assist transition economies to improve their trade performance provided information can be disseminated to these economies and to the companies who will use them.

- (c) Foreign direct investment should be actively solicited, but only on the right conditions. FDI in the transition economies for the past four years has been disappointing. By the end of the first half of 1994 it was just over US\$ 20 billion, with almost half of it going to one country (i.e. Hungary). This report shows that all FDI does not have a positive impact on trade. FDI by small and medium sized enterprises seems to be more export-oriented and trade stimulating than capital invested by very large companies.

- (d) Improvements in payments and trade financing are urgently necessary to relieve major obstacles to the development of trading relations for enterprises in transition economies. In the CIS, in particular, the

inconvertibility of most national currencies and the absence of a multilateral payment system seriously hampers any trade development programme. Risk is the main source of transaction costs in all transition economies, and special measures should be implemented (supported by international financial agencies) to alleviate this problem.

5. Structure of the document

9. The document comprises three Parts (I, II and III) and is divided in seven Sections (A-G).

10. Part I consists of Sections A and B. Section A is this executive summary and Section B makes recommendations and proposals for a coordinated, regional action programme.

11. Part II sets out the diagnosis of the problems. It is divided in Sections C, D, and E which encompass the introduction (C), an analysis of the importance and structure of the trade of transition economies (D), and a discussion of the main factors affecting the trading competitiveness of transition economies (E).

12. Part III comprises Sections F and G. Section F proposes specific measures to facilitate trade, and Section G presents the main conclusions of the study.

B. RECOMMENDATIONS AND PROPOSALS FOR A COORDINATED REGIONAL ACTION PROGRAMME

1. Introduction

13. The purpose of this section is to present to ECE member Governments an outline for a Regional Action Programme on measures for expanding the trade of transition economies. This programme is based on the preceding analysis found in Sections A-C, and takes account of the assistance which is being provided both multilaterally by other international organizations and bilaterally to transition economies in the trade and trade-related fields.

14. The programme is divided into two parts: Part I describes the chief recommendations to Governments of western market economies and transition economies. Part II identifies specific actions that the Commission might consider adopting as a follow-up to this report.

2. Regional Action Programme to Boost Trade in Transition Economies

Principal Recommendations

(a) Addressed to transition economies:

(i) Prerequisites

15. Adopting measures to boost their trade and export competitiveness will be ineffective unless the transition economies establish an appropriate basic framework for their trade enhancing programme. This framework should consist of two prerequisites:

- a. macroeconomic stabilization (Part II, para. 33). 1/ Transition economies should reduce their macroeconomic imbalances, by measures to control inflation and reduce Government spending;
- b. the promotion of the private sector (Part II, para. 34). Transition economies should encourage the private sector since it is entrepreneurs, not Governments, that create trade. Broadly speaking, the development of a competitive private sector means the privatization and breaking up of the former State monopolies, the development of small and medium-sized enterprises, the reorganization of the financial sector and the creation of the necessary legal and regulatory framework.

16. The first requirement is necessary for building confidence amongst market operators and encouraging investment. The second, through, in particular, the creation of a strong and viable SME sector, will promote trade expansion and diversification.

17. Already, many of the transition economies have made considerable progress towards macroeconomic stability and the private sector has been growing significantly, although in both areas there still remains a lot to do.

18. In addition, in order to implement their trade development programmes, all transition economies need to develop a set of strategic objectives with regard to their trade sector. These objectives will of course have to take account of the country's particular resource and factor endowments. They will include no doubt political considerations concerning the direction of the country's trade. However as noted in this report, these objectives to varying degrees should set out to:

- a. increase the value of exports (Part II, para. 12);
- b. either sustain and build on the existing penetration of their exports in western markets or, in the case of the CIS, establish an export presence on these markets (Part II, para. 14);
- c. develop intraregional trade (Part II, para. 90);
- d. improve the commodity composition of exports (Part II, para. 15).

(ii) Fixing a core set of priorities with limited resources

19. In setting out to achieve these objectives and faced with limited resources the transition economies will not be able to finance all the measures they could or should adopt. They will rather have to identify priorities.

20. For CIS countries the priorities should be:

- improving the payments system and liberalizing trade;
- building trade promoting institutions;
- introduction of modern Customs procedures;
- adopting common standards;

- establishing a commercial framework with emphasis on legal enforcement and the protection of property rights;
- investing in trade facilitation.

21. With regard to payments, priority action by the CIS States and the international community is required (Part III, para. 54). No new payments system has been developed to support the shift from the old centralized trade structure, using techniques to balance trade flows bilaterally through Government arrangements and barter, to multilateral trade conducted autonomously by enterprises. In order to address this problem Governments should improve their regional payments services, support the introduction of a multilateral clearing facility and introduce measures to reduce exchange rate fluctuations amongst CIS currencies.

22. To this end, CIS Governments agreed in October 1994 to establish a Payments Union but considerable problems still remain in implementing the Agreement (Part III, para. 61). In order to implement it, the following measures should be taken:

- a. National foreign exchange markets should be strengthened;
- b. A blueprint should be elaborated for the establishment of a multilateral clearing facility for regional payments for goods and services in national currencies;
- c. facilities for financing regional trade and export insurance cover should be developed based on international experience and with international financial support.

23. Steps to improve trade financing should be accompanied by greater trade liberalization, achieved through:

- standstill and subsequent roll-back of existing restrictions on regional trade;
- phasing out of centralized trade, export quotas and licensing;
- coordinated harmonization of trade and Customs laws in line with multilateral standards (see below);
- development of a CIS secretariat charged with implementing the provisions of the free trade agreement and payments union.

24. Concerning Customs (Part II, para. 52), a modern Customs organization for effective revenue collection, the facilitation of international traffic and the application of controls to guard against illicit traffic and fraud, will be required. This will need:

- new Customs legislation;
- application provisions relating to the Customs code;
- training of Customs officials;
- the creation of suitable modern border posts at major frontiers;
- investment in modern information technology;
- collection of accurate trade statistics.

25. Not only will these measures facilitate international trade, they will improve revenue collection and cut down on fraud, so contributing directly to the public treasury.

26. Governments of the CIS States should commit themselves to develop a coherent system of standards and certification (Part III, para. 6). This is a priority because with the break-up of the Soviet Union (which had uniform standards and certification requirements for all the Soviet Republics), the Newly Independent States have created a separate system of standards and certification, resulting in the creation of artificial barriers which hinder the development of multi-country trade. In creating these common standards, Governments should ensure that they allow for mutual recognition among the CIS and western market economies, and investment in the latest non-destructive testing technology.

27. This will require the establishment of a network of institutions and organizations for standards and certification in the CIS compatible with those existing in western market economies.

28. A proper trade promotion office (TPO) should be created in each country. The central task of the TPO will be to provide helpful information to exporters on foreign markets, market access conditions and standards (Part III, para. 1). ITC in particular could be asked to assist in developing these institutions.

29. TPOs should not be allocated any controlling or licensing functions; they should be purely devoted to serving the business sector. In this capacity it is advisable that close contacts be built between the TPO and the local business community with representatives of trade organizations and chambers of commerce being invited to attend meetings and to participate as members of the Board of Directors.

30. Special measures are required to build export promotion skills, including training programmes for staff and training courses on export promoting skills in universities and business schools. Ideally, they should be partly publicly and partly privately funded, with private revenues coming from enterprises in the form of fees for services rendered. Whenever feasible, the private sector should be involved in planning the training.

31. Establishing an effective national trade facilitation organization (NTFO) in each country should be a priority. The objective of an NTFO is to simplify trade and transport procedures by promoting consultation and cooperation among all participants in international trade from both the public and private sectors. An NTFO provides a forum for dissemination, discussion and national adaptation of UN/ECE standards on trade facilitation. It can further assist in channelling advice and information on these standards to market operators. The importance of establishing an NTFO has led to a specific UN/ECE recommendation on this subject. 2/

32. For the non-CIS countries a different although related set of priorities will be required:

- a. strengthening and extending their intraregional free trade associations; the Central European Free Trade Agreement (CEFTA) and the Baltic Free Trade Agreement should be encouraged and

extended to include new members. Progress in lowering of barriers to mutual trade should be accelerated (Part II, para. 90);

- b. disseminating information on and assisting exporters reach western product, health and safety, technical and environmental standards (Part II, para. 53); Governments must provide their exporters with information on these standards and new specifications and assistance in meeting these;
- c. enforcing the newly created commercial frameworks (Part II, para. 40); while a host of new laws have largely completed the legal framework of a market economy in many of these countries, there are problems with implementation and enforcement of laws, contracts, etc. Indeed, the institutions that are necessary to support this framework, civil law lawyers, judges and the registration institutions for lands and property rights are either undeveloped or absent;
- d. simplifying Customs procedures (Part II, para. 52); transition economies should streamline Customs and trade procedures in order to bring them into line with best western practices. Unlike in the CIS, developed procedures do exist but they utilize few modern techniques and lack the latest information technologies. UNCTAD's programme for streamlining of trade and Customs procedures, Customs computerization, trade information and the establishment of trade points offers interested economies in transition excellent support;
- e. developing export financing facilities (Part III, para. 65); export financing for pre-shipments, short to medium-term credit and for certain products is difficult to obtain in these transition economies. As noted, the problem is not a lack of resources but often the weak institutional framework. Banking institutions are underdeveloped. Country risk is high and possibilities for assessing and mitigating risk are limited. Governments should develop these institutions and seek assistance in financing them from western donors. Specifically, export-import banks might be set up. Training bankers in export financing techniques should also be a priority. The EBRD has substantial programmes to improve local banks' ability to provide finance by increasing the confidence of foreign correspondent banks in dealing with them; by providing re-financing facilities for export and pre-export finance; and in assisting the banks in managing foreign exchange risk.
- f. establishing export credit guarantee facilities. Transition economies should develop the full set of guarantee instruments available to western firms. Deficient insurance systems increase the transaction costs in trade finance which negatively affects bank-client relationships and intraregional trade in particular. Some transition economies have established Export Credit Guarantee Facilities but these tend to suffer from a lack of finance. Direct technical assistance to local export credit agencies has been extended to the Czech and Slovak republics. More generally, assistance is given to six agencies via the Secretary General of the Berne Union with support from the EBRD.

- g. encouraging FDI from western SMES to boost intraregional trade. FDI from western small and medium-sized companies should be targeted. SMEs can have greater pro-trade effects than larger companies. Because of their size they tend to be more attracted to locations with low factor cost advantages and where they can benefit from such lower costs to establish export-oriented production. Larger firms have entered eastern Europe predominantly to sell goods and services to the domestic market. Some of the large-scale investors have moreover influenced Governments to protect their newly acquired local markets, a policy which, if used extensively, can have a negative effect on exports (Part III, para.38). SMEs, although they do not bring with them as much investment capital as larger foreign companies, can have better trade effects over the longer term. Thus, encouraging investment promotion from this sector will increase the pro trade effects from FDI.
- h. promoting new forms of financing trade. To overcome the financial problems faced by these smaller western companies Governments should also look at alternative arrangements which can have significant trade effects, notably subcontracting and leasing. In addition, Governments should encourage asset-based financing techniques where western companies are paid for importing equipment, machinery and management skills and quality standards from the production which is exported to western markets.
- i. encouraging FDI in technology intensive industries. Governments should also use FDI to upgrade the technological capabilities of their countries by providing assistance to foreign firms to set up R & D operations and to create linkages between these firms and local enterprises.
- j. improving the provision of services to exporters. TPOs should commission studies of products and markets with export potential (see study undertaken for Portugal, Part II, Box 1) in order to determine whether they are providing such sectors with the best services. These studies are important for making TPOs more efficient and in ensuring that scarce resources are used to their greatest effect. The International Trade Centre (ITC) has valuable expertise to offer.

(iii) Second phase measures

33. Having dealt with, or set about remedying, the core deficiencies in their programmes to expand trade and export competitiveness, the transition economies should promote, with the help of international assistance, a series of enterprise support projects at the micro-level. These should include:

- a. **measures to build-up the response of the enterprise sector to the new trading opportunities** As the new trade rules and the liberalization following the GATT agreement are put into effect, Governments should develop support projects to inform their traders of the new opportunities and what they should do in terms of improving packaging, marketing, quality control and supply of

components. The ITC has projects in these areas and could provide assistance.

- b. **organization of a partenariat for SMEs** In view of the need to restore the commercial and economic ties that broke down following the collapse of the former trading system, Governments should promote economic cooperation between SMEs in order to develop multi-country trade. The PHARE programme could assist with providing information on how such schemes have been working in western Europe and in Poland.
- c. improving the **negotiating skills of exporters of commodities** from transition economies. The dependency of many transition economies on commodities for the bulk of their export revenues means that Governments should ensure that their companies have adequate training and information on prices in concluding deals and marketing arrangements with large western sellers of commodities. UNCTAD provides training in specialized commodity trading.
- d. **increasing the channels for western technical assistance into firms.** The best means of assisting enterprises to develop trading opportunities is to have western business experts work in the plants on a short-term basis as advisers, helping with finding suppliers and finance from the west for trade. The TACIS funded European Senior Services Consortium (ESSC) aims to tap the vast wealth of experience of over 20,000 western European business experts. This is an innovative means of providing excellent advice to enterprises with no experience of trade. It can therefore have an immediate and direct beneficial impact on exports. Transition economies should therefore encourage this form of assistance.
- e. **developing and modernizing commercial road haulage.** Much of the trade will go by road and Governments should assist this sector to modernize, encouraging privatization, the break-up of monopolies and the developing of partnerships with western road transport companies.

(iv) Upgrading trading infrastructures

34. Feeding into these core areas and second stage projects, transition economies will have to adopt the necessary measures to upgrade the infrastructures vital for their trade. Exporters cannot export without an adequate communications network, a transport system that ensures speedy and reliable delivery of products to key markets and a source of energy supply that is secure (Part II, para. 39).

35. None of the basic infrastructure works adequately in transition economies.

36. Finance represents the key constraint as upgrading will require substantial amounts of capital. Multilateral lending agencies, notably the EBRD and the World Bank, are assisted in this task but their contributions will not be able to match the requirements. Governments should therefore explore new methods of financing the development of these necessary infrastructures. In particular they should consider broadening the financial

base of these services - telecommunications, transport, energy, etc. - to private sector companies.

(b) Addressed to western market economies:

37. The principal way that western market economies can assist transition economies in boosting their trade is to remove all remaining trade barriers. Tariff-free access to western market economies will help to end the uncertainty over market access and build confidence amongst traders and foreign investors.

38. Agreements recently concluded with the Baltic Republics should be extended to those CIS States which have shown their commitment by introducing market economy reforms. Talks on free trade agreements with some CIS States scheduled for 1998 should also be brought forward (Part II, para. 76).

39. The conditions contained in the existing preferential agreements should be improved (Part II, para. 89):

- the EU should signal its willingness to extend free trade to agricultural goods, as foreseen in the Europe Agreements. A pre-condition of such a move would be the restructuring of the Common Agricultural Policy of the European Union, which has already begun in the context of the Uruguay Round.
- the rules of origin should be improved through the easing of local content requirements (Part II, para. 87).
- progress towards more simplified and transparent procedures regarding anti-dumping should be made (Part II, para. 83). Non-European industrialized countries can also remove obstacles to the expansion of the trade of transition economies, e.g. the USA could simplify its anti-dumping procedures. Provided the relative prices of their products reflect the real costs of production, western economies should use the normal calculation procedures of determining price and not the ones applied to State-trading economies (Part II, para. 83).
- the EU, within the framework of the Europe Agreements, should apply the doctrine of exhaustion (Part II, para. 88).

40. Other subsidiary but nevertheless very important ways in which western market economies through large-scale programmes of technical assistance can assist transition economies will include:

- help in building trade promoting institutions in transition economies;
- encourage the development of standards and the fullest possible participation in international standards organizations;
- provide transition economies with timely information on new standards and conditions, especially relating to health and environment;
- encourage flows of export-oriented FDI;

- assist in the creation of trade financing institutions, for example, export-import banks in transition economies;
- support the creation of efficient Customs operations and the adapting of Customs legislation to the requirements of market economies.

41. Many, if not all of these activities are already covered by existing Technical Assistance programmes. However, the number of countries now requiring such help has increased and the resources and programmes devoted to this work must be correspondingly enlarged.

3. Specific measures

42. The following proposals are intended to assist in implementing some of the main recommendations in this report. They are divided into (i) studies/conferences to explore some of the issues raised in more depth and to undertake follow-up studies, (ii) special projects to be undertaken by UN/ECE's Principal Subsidiary Bodies and working parties, in conjunction with other organizations providing technical assistance in the trade area; and (iii) large-scale trade development programmes that will require special funding. Where appropriate, it is suggested that these proposals are carried out with, or for, other international agencies providing technical assistance to transition economies in the trade area.

(i) Studies/conferences:

- a report on the technical assistance which is being provided to boost trade and strengthen the export capabilities of transition economies, identifying gaps, duplication and possible synergies and priorities;
- a conference involving the OECD and the TCMD Division (responsible for Transnational Corporations) of UNCTAD, to examine the use of trade related incentive measures in attracting FDI as a possible barrier to trade in transition economies in order to shed light on this practice and to make recommendations;
- an examination of successes and failures of industrial policies adopted by central European countries to boost enterprise competitiveness;
- a study on raising the competitiveness of east European agriculture, steel and textiles;
- workshops on the importance of investment in trade related technologies.

(ii) Special projects:

- meeting by the UN/ECE of Trade Ministries in transition economies to discuss common problems and strategies for renewal of trade policies (to be organized under the auspices of the Committee on the Development of Trade);
- organization of a pilot investment promotion seminar for the SME sector in a CIS country;

- development of a Guide or training manual on trade financing techniques and practices for bankers in transition economies (This Guide could be prepared under the auspices of the Working Party on International Contract Practices in Industry (WP.5));
- a conference on the importance of UN/ECE standards - in industry, agriculture, environment, UN/EDIFACT, etc. - and their practical utility in boosting trade. The purpose of this project will be to encourage representatives of transition economies to participate in international and regional standard setting activities and to understand their importance for building their export capabilities;
- a project to simplify Customs procedures in transition economies in cooperation with the World Customs Organization;
- a project to help transition economies in assessing the suitability of the legal environment for trade and investment, undertaken by the UN/ECE group of legal experts, constituted in the Working Party on International Contract Practices in Industry (WP.5).

(iii) Large-scale trade development programmes

- assistance to Governments in the design of their trade policies (in cooperation with UNCTAD, ITC and UNIDO);
- projects to assist transition economies in trade promotion by:
 - * establishing trade promotion offices;
 - * increasing the effectiveness of Customs departments and chambers of commerce;
 - * providing training and counselling to standards institutions.
- projects to assist the trade of small transition economies by:
 - * assisting primary and commodity producers to increase their export earnings;
 - * developing new tourism projects;
 - * increasing competitiveness of existing exports and finding new markets;
 - * providing technical assistance in new information technologies.

Notes

- 1/ The reader is referred to the corresponding section of the report for further details.
- 2/ Recommendation No. 4, "National Trade Facilitation Organs", Working Party on Facilitation of International Trade Procedures (WP.4).