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

Report by the secretariat

ADDENDUM 1

PART II

Diagnosis of the Problems

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).

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PART I
(E/ECE/1311)

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

PART II

C. INTRODUCTION

1. This report has three objectives: to examine the general problems confronting the transition economies in developing their trade, to identify specific measures which can be used to boost trade performance, and to present a regional action programme of recommendations addressed to transition and western market economies which can help stimulate the expansion of trade.

2. Few disagree on the need for transition economies to expand their trade. The transition process to a market economy in countries in central and eastern Europe has exerted a negative effect on production, GDP and, in many countries, on foreign trade. Trade is vital for the success of the transition to market economies. Increasing exports will raise the necessary revenues to import the capital goods which are required to restructure their enterprises. Increased trade moreover will integrate the transition economies into regional and world markets. It will also boost the competitiveness of domestic firms and allow for growth in economies still suffering from reduced domestic demand. In the short- to medium-term, as the barriers to the import of goods and services fall in transition economies and competition in their domestic markets intensifies, the need to increase their exports will grow even stronger.

3. While in general there is agreement on the need for transition economies to increase their trade and expand their exports, there is less consensus on the causes and on the solutions to the transition economies' trade problems. In examining causes of the transition economies' trade problems, for example, there is a wide debate as to the relative importance between external trade barriers (i.e. tariff and non-tariff barriers erected by western market economies, against eastern imports) and the internal barriers (i.e. the poor competitiveness of domestic firms and lack of adequate infrastructures and institutional support) in accounting for trading deficiencies. In addition, some see trade financing problems as due to a chronic shortage of capital in the region while others see the causes lying with the poor domestic financial institutional structures. On the measures and strategies to adopt to improve trading conditions, further debate is generated over the role of Governments in expanding trade, and the degree to which market failure and infant industry arguments can justify more protectionist and interventionist strategies. Additionally, the desirability of attracting foreign direct investment to expand trade has become a matter of considerable contention in several transition economies.

4. The answers to these and other questions which are discussed in this report are highly relevant in building strategies to develop trade in the region. The transition economies need to evaluate the importance of these factors in order to make their trade polices more effective and more efficient. With limited resources, together with the vast range of measures they are confronted with, they will be compelled to choose between those measures that are needed immediately and those that can wait until certain of the other measures have been implemented. Western Governments, too, must assess the importance of these factors influencing trade, not only because

they directly benefit from the enhanced trade performance of the transition economies, but because they want to be assured that their technical assistance policies are being properly targeted to those areas where it will have best effect. For example, should their technical assistance (on legislative and financing advice) which has laid the groundwork for numerous privatizations involving western companies be now considered appropriate when one of the effects of such investments has been the raising of import tariffs by Governments to protect newly acquired companies and to deter new investment?

5. It should be clear that the differences amongst transition economies, as well as the different stages at which they find themselves in the process of transition, makes the task of presenting a set of recommendations for all transition economies an extremely daunting one. In the trade field, for example, most of the CIS States are in the early stages of nation and institution building while the economies of central Europe already have well established institutions even if they are not completely structured for market economies. Clearly, CIS States will have sets of priorities that will differ from the central European countries. Nevertheless the transition process is itself still a sufficiently strong common factor and the goals of trade and export competitiveness sufficiently universal to justify the attempt to cover the transition economies as a group.

6. This report, however, given the scale of the topic and the relatively limited time frame, cannot cover all the issues affecting trade. It has thus tried to be selective focusing on those areas where the UN/ECE can make a particular contribution either through its own activities or in cooperation and support of other international agencies and made suggestions for carrying on with this work (see Part I, Section B, Recommendations). Governments of ECE member States are encouraged to examine these proposals and invited to make their own suggestions for follow-up work in an area which is bound to increase in importance as the processes of economic integration grow stronger in the region.

7. The report is divided into three Parts: part I, sections A and B, provides the Executive Summary and Recommendations of the report; part II, sections C, D and E presents the introduction of the report and a diagnosis of the main problems affecting the trade of transition economies. Part III, sections F and G describes the specific measures to facilitate trade and the conclusions of the report.

DIAGNOSIS OF THE PROBLEMS

D. IMPORTANCE AND STRUCTURE OF THE TRADE OF TRANSITION ECONOMIES

8. For the transition economies of east Europe and the former Soviet Union foreign trade has been an important factor of economic growth and the key determinant of their external balance. Except for Russia, all transition economies are relatively small economies with limited resources, and their reliance on trade has been increasing ever since they broke away from a policy of economic autarky in the late 1950s. Under the socialist regime, the countries of central and east Europe tried to develop intra-group integration, but those efforts failed because of the systemic deficiencies of central planning which led to massive misallocation and wastage of resources. The

significance of foreign trade further increased after the countries in the region decided to open their economies to international markets in the wake of comprehensive market-oriented reforms initiated in the late 1980s and the beginning of the 1990s.

9. However, the overall trade performance of the countries of east Europe and the former Soviet Union since the beginning of the transition process has been generally disappointing, with aggregate trade levels falling or at best stagnating. The dollar value of exports in 1993 was in most countries lower than in 1988, sometimes by large margins. Imports generally fell less, and in some countries even increased quite substantially, raising problems in the balance of payments. The asymmetric development of exports and imports resulted in a substantial deterioration of the trade balances of the transition economies between 1988 and 1993 (see table 1), and only in 1994 have some signs of an improvement begun to emerge.

Table 1
Foreign trade of transition economies,
1988-1993, million US$

Country group	1988	1989	1990	1991	1992	1993
East Europe*/						
exports	53,478	51,052	48,551	43,471	44,886	45,057
imports	48,031	46,735	45,697	45,636	52,066	56,837
trade balance	5,447	4,317	2,854	- 2,165	- 7,180	- 11,980
Russian Federation						
exports	..	74,735	71,148	50,911	42,391	44,297
imports	..	77,932	81,751	44,473	36.990	26,807
trade balance	..	- 3,197	- 10,603	6,438	5,401	17,490

*/ Bulgaria, Hungary, Poland, Romania, the Czech Republic and Slovakia (Czechoslovakia until 1992).

Note: Rouble trade flows in 1988-1991 for east Europe converted into dollars at a "consistent" cross exchange rate (see: UN/ECE Economic Bulletin for Europe, Vol.43/91).

Source: UN/ECE data base and national statistics.

10. The foreign trade performance of the central and east European countries (CEECs) in the first half of 1994 was marked by an expansion of trade flows and improvement of trade balances. The expansion signals the first reversal in the contraction of exports observed in the region since 1989, and a marked improvement over the first half of 1993 when exports fell by more than 4 per cent. For the same period, the overall value of imports into the region declined by nearly 5 per cent, again marking a reversal of the expansion observed in 1992 and 1993. If export growth was chiefly driven by a revival of western demand, the slow-down of imports has been mostly a policy-induced phenomenon which resulted from varying combinations of restrictive monetary

policies, protectionist measures, shifts in trade regimes (gradual elimination of barter transactions) and, in some cases, depreciation of domestic currencies.

11. A comprehensive assessment of trade developments in the region is not an easy task, chiefly because all the statistical measures of changes in the composition and levels of east European trade are subject to varying but substantial degrees of imprecision.1/ Nevertheless, three major tendencies, common to nearly all the transition economies, can be identified for the period 1988-1993. These are: the overall fall of exports, the reorientation of trade from east to west, and the shift in exports towards natural-resource-based and relatively less processed goods.

12. The contraction of exports was mainly caused by the collapse of the Council for Mutual Economic Assistance (CMEA) trading system which involved the abandonment of artificially low rouble prices and a shift to decentralized trade among the eastern countries. The parallel expansion of exports to western markets, made possible by the general liberalization of foreign trade regimes in most transition economies, has not been sufficient to compensate for the fall of intra-regional trade. On the basis of an assumed set of consistent exchange rates,2/ the overall value of exports of six east European countries diminished from US$ 53.5 billion in 1988 to US$ 45 billion in 1993, while the value of exports of the Russian Federation dropped from US$ 74.7 billion to US$ 44.3 billion. In the same period, the combined trade balance of east European countries shifted from a surplus of US$ 5.4 billion to a deficit of US$ 12.0 billion.

13. Despite the fall of export levels, the proportion of exports to GDP remained relatively high in the transition economies because of the contraction of output. The ratio of exports to GDP varied in 1993 from 17-20 per cent in Poland and Romania, to 32-34 per cent in Bulgaria and the Czech Republic, with ratios of imports to GDP being generally higher. The relative dependence on trade is lower in Russia and some other larger CIS countries. It is important to note that most of the fast-growing Pacific Rim economies exhibit a much higher ratio of exports to GDP than these countries have done to date.

14. The fall of total export levels masks an important change in the territorial structure of east European exports: the share of the former CMEA partners in total exports declined from between 40 to 60 per cent in 1988 to between 15 and 30 per cent in 1993. Similar changes occurred on the import side. At the same time, the share of western countries increased sharply, with the European Union accounting now for between 50 and 75 per cent of total exports of the transition economies. Russia has been replaced by Germany as the most important single trading partner in the region.

15. The dissolution of CMEA, the collapse of the former Soviet market, and the overall liberalization of trade and payments in east Europe have all resulted in substantial shifts in the commodity composition of east European trade. Most adversely affected have been exports and imports of capital goods, including engineering products, metallurgy and heavy chemicals. Meanwhile, the share in total exports of raw and semi-processed materials and textiles increased sharply, as did the share of consumer goods in imports.

16. A good part of these developments has essentially been a result of the removal of administrative constraints on trade characteristic of central planning, and as such should be regarded as efficiency-improving. Politically motivated and economically unjustified trade flows have been discontinued and new markets have been found, mostly in western Europe. However, there are also grounds for believing that in some respects the adjustments may have gone too far, and that many potentially viable trade links have probably been destroyed because of the sudden collapse of existing institutional arrangements, lack of necessary finance, abrupt changes in the external environment, and the large increase in uncertainty. The switch from former CMEA markets to new areas of trade expansion, mostly in western countries, is a difficult and time-consuming process, which requires managerial and marketing experience, as well as substantial investment in physical assets and skills; but neither is readily available in transition economies. The precipitate dismantling of CMEA left intra-regional trade in disarray, and the lack of trading arrangements suitable for a market environment contributed to increased risks and high transaction costs, and depressed mutual trade well below economically justified levels. Also, the transition economies seem to have been losing rapidly the export potential which they had accumulated in the past in the engineering and high-technology sectors.

17. If these observations are correct, they may suggest that a purely liberal approach to restructuring is excessively costly in social terms, and may result in the creation of "second class" economies in Europe. "Market-friendly" policies can perhaps be used to a larger extent to order to support activities which have the potential to adjust successfully to market conditions. Historical experience with conventional industrial and trade policies has been disappointing in many cases, and the welfare losses from discretionary and politically-motivated intervention may have been substantial. To be effective, these policies must be innovative, transparent (rule-based rather than discretionary), temporary (gradually phased-out, according to a pre-determined time schedule) and credible. The design and implementation of these "market-friendly" policies is a major task and challenge for the transition economies at the current stage of market transformation.

E. MAIN FACTORS AFFECTING THE TRADING COMPETITIVENESS OF THE TRANSITION ECONOMIES

1. Competitiveness: The Role of Industrial Strategy and Support

18. Successful trading countries are ones which have competitive economies. This is why in looking at ways and means of expanding trade in transition economies, it is worthwhile to examine the meaning of competitiveness and the measures which are necessary to promote it.

19. Competitiveness is not an easy concept to define. The OECD defines competitiveness for a nation as "the degree to which it can under free and fair market conditions, produce goods and services which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long term." The OECD definition, although rather general, does underline the importance of trade to overall "competitiveness". However, it is not just trade which makes an economy competitive. Trade is determined by other factors, notably the level of its

domestic productivity which is in turn determined by the rate of investment in plants and equipment, R & D, education and training, etc. Strong investment itself requires a modern financial system and a competitive enterprise sector. Accordingly, expanding trade requires attention to factors which go beyond the trade area.

20. All countries, not just those in central and east Europe, recognize the importance of competitiveness and the need to improve it.3/ In the United States concern at large trade deficits and the loss of many high paying jobs to foreign competitors fuelled discussion about a general loss in competitiveness, focusing attention on wider issues such as education and training, innovation and investment. The European Commission has published a recent White Paper on the topic with the same broad remit.4/ Germany and the United Kingdom have issued separate reports.5/ National Centres of Competitiveness are being established in countries as diverse as the United States, Canada, South Korea, Portugal and Venezuela.

(i) Measuring competitiveness

21. Governments have legitimate purposes in desiring to measure their competitiveness. They wish to know how well they are succeeding against their competitors. They also wish to ascertain where their comparative advantages lie and where they will lie in the future in order *inter alia* to provide special assistance to the sector or sectors so defined (see Box 1), to fill gaps in appropriate institutional and infrastructural support for those sectors or to avoid making inappropriate investments in sectors where they thought they had a comparative advantage but which in fact they did not.

22. Overall competitive scorecards are useful indicators of a country's progress but of less value to the policy maker seeking sector- and branch-specific information. One should note, however, that the *World Competitiveness Report* of 1994 includes three transition economies for the first time in its annual survey. This report evaluates competitiveness according to eight different factors which themselves describe not only the viability of an enterprise but also its competitive environment: domestic economic strength; infrastructure; internationalization; management; government; science and technology; finance; and people. In the 41 countries listed in the World Competitiveness Scoreboard of 1994, Poland was placed last, Hungary 39th and the Czech Republic 36th. The three transition economies which are included in the survey are amongst the six least-competitive countries and are placed behind such countries as India, Colombia and Indonesia.

23. Most models of international trade explain the commodity composition of trade in terms of the law of comparative advantage: countries tend to export those goods which have the lowest relative costs (and therefore prices) under autarky. Direct measurement of past trade performance, or its "revealed" comparative advantage (RCA) can be used, with some reservations, to explain differences in competitiveness and trade.6/ However, in the case of the transition economies, any revealed advantage is bound to be strongly affected by distorted relative prices and the production structures of the former central planning era. Moreover, in many transition economies the trade and industrial data are not available for such measurements.

BOX 1
PORTUGAL'S COMPARATIVE ADVANTAGES

The Portuguese Ministry of Industry, together with 47 of the country's major private and public companies, hired the Monitor Company, a consulting firm headed by Harvard economist Michael Porter, to conduct a study of Portugal's comparative advantages. The intent was to identify those sectors of the economy that would be most competitive for Portugal in the short to medium term.

The study's first phase identified three main areas: agriculture, industry and tourism. Within these areas, Monitor identified for further review six entrepreneurial clusters: tourism, wine, footwear, textiles and clothing, timber products and automobiles. In the second phase, the study will specify actions to modernize the six clusters.

Reactions to the study's first phase were controversial, as some of the sponsoring companies were expecting that the results of the study would recommend the need for the country to concentrate on high tech and innovative technologies. Monitor's six clusters are all part of "traditional" industries. Porter's response was that all industries can be "high tech", and that the focus should be on upgrading them with the most modern equipment and production techniques.

Source: Export Today, p.38, "Why Portugal?", July/August 1994.

24. Recent empirical studies on central European countries based on more data on factor endowments confirm the general perception that transition economies may be most competitive in unskilled and semi-skilled labour-intensive products.7/ One study - which compares unit values and inputs for the same product category - to examine competitiveness in the trade between Germany and central European countries, reveals that all the transition economies, except Hungary, specialize in low quality goods (and import high quality German goods). Hungary is the only country which has been able to establish a relatively strong position in exports of more sophisticated products. Surprisingly, the Czech Republic reveals an insignificant level of "high quality" exports.8/

25. Other methods have been used to reveal competitiveness in transition economies. For example, one study using data on patents registered in the US for western firms which are attributable to technological activity carried out in east Europe between 1969-1990, has sought to identify local technologies in transition economies with a potential for growth and trade. This data reveals a concentration in research in the region associated with chemicals and machinery. Western chemical and pharmaceutical producers have developed certain categories of chemicals in central and east Europe, while metal production and mechanical engineering companies have created machine technologies.9/ This suggests, perhaps unsurprisingly, that in the former Comecon countries there is presently scope for development in some of the more standard technological fields.

26. These and other data on competitiveness in transition economies can only be used as approximations of general trends. They do not provide policy makers with objective indicators of which sectors or branches to promote and which not to promote.

(ii) Measures to boost competitiveness: role of industrial strategy and support

27. At the outset of reforms, Governments in the transition economies were recommended to liberalize their foreign trade sector speedily and in a comprehensive manner. As indicated above, the effects of the rapid liberalization in trade put pressure on these countries' trade balances and in some cases induced a shift in trade to low valued products. The question this raises is whether a more interventionist trade policy, including selective import protection, is now desirable in order to promote competitiveness and reverse some of the undesirable consequences of what, from hindsight, may appear to have been a too rapid liberalization.

28. It is very difficult to build an economic justification for intervention by transition economies in specific industries as part of strategies to boost trade and competitiveness. This is for the simple reason that such policies would not achieve their desired ends.10/ Much had been made of the success in the past of Asian countries and the selection by Government officials of a number of neo-infant industries for import protection. Today, however, research shows that in many relatively fragmented industries where entry barriers are low and there are numerous firms worldwide, it is exceedingly difficult for a single Government through subsidies, import protection or some other form of intervention to alter the international structure of trade or competition, or durably influence its own country's international trade performance.11/ In economic terms import protection acts as a relative disincentive to produce for export markets. The direct manifestation of the cost of this anti-export bias is resource misallocation (higher resource costs associated with production distortions) and higher prices to consumers (consumption distortions). In the reality of central and east Europe, discriminatory protection can send the wrong signals to interest groups, thus creating a momentum for more protectionism while policy makers, as said above, face innumerable difficulties in actually defining where their countries' comparative advantages lie.

29. However, one should not dismiss policies of discretionary import protection for other reasons. Given the technology and productivity gap existing between western and eastern enterprises, rapid liberalization has the potential for sweeping away many non-competitive industries. Protection of so-called "senile industries" can therefore be justified on the grounds of mitigating the adjustment and social costs of liberalization. A gradual phasing out of protection over say a five-to-seven year period is thus preferable. Less justifiable is the protection accorded to some foreign investors, particularly in high technology industries. In some cases, in return for investment and a commitment to jobs, foreign investors have been guaranteed exclusive purchasing deals with the State authorities. Imports of goods covered in the agreement have been restricted. While limiting imports may encourage western firms to invest, and may permit a modicum of employment to be retained over a few years, such agreements put impossible strains on Government officials, e.g. in ensuring that the technology has been transferred to the right specifications and on the agreed time schedule.

These agreements also provide no guarantee that a competitive industrial capability will remain once the agreement has come to an end.

30. For these reasons the use of selective industrial strategies to boost competitiveness should not be seen as a panacea to the poor competitiveness of transition economies.

31. Governments, however, do have significant roles to play if not through industry strategies but with policies of industrial support at the national level. As a general principle, it is enterprises which create wealth, not Governments, and the primary responsibility for improving competitiveness must lie with firms. The Government's role will be thus to create an environment conducive to facilitating private enterprise transactions.

32. A detailed description of the full gamut of policies which transition economies might adopt for this purpose lies outside the scope of this report. However, it is necessary to mention some general features.

33. The Governments' primary objective should be to promote sustained economic growth and higher living standards by ensuring that markets work properly and establishing a stable <u>macroeconomic</u> environment for business. A successful macroeconomic policy is central to competitiveness. Businesses require stability in order to plan investment strategies and to develop products and services. Rapid changes in policies are inimical to this objective; firms will be more willing to invest if they can be reasonably confident of sustained and steady growth in demand. Controlling inflation is also an important objective because of the way it distorts prices and pushes up interest rates. In transition as well as in developed market economies, high inflation encourages an emphasis on short-term profit at the expense of long-term returns. Equally a commitment to sound public finances is required, as without it the uncertainties and costs businesses face rise. High levels of Government borrowing increase the burden of public debt, raise interest rates and ultimately force higher taxation rates or cuts in public spending.

34. Such macroeconomic objectives, if successful, create the framework in which the private sector can develop. <u>Privatization</u> continues to be a key policy objective for transition economies. Already the growth in private sectors is bearing fruit in many of the countries in transition bold enough to have instigated comprehensive privatization programmes. The privatization of distribution networks, in particular, increases options for traders and consumers alike.

35. In their <u>monetary and exchange rate policies</u>, Governments should make capital inflows and outflows as free as is possible with a commitment in the medium term to full convertibility of currency transactions for both current and capital account purposes. This latter objective of course was only achieved by OECD countries after many decades. At present there is free convertibility for current account purposes only (with some restrictions on transactions by non-residents) which means in some countries exporters having to convert all their proceeds into the domestic currency at unfavourable official exchange rates.

36. Governments, operating under the principle of <u>fair and open markets</u>, can help their firms compete more effectively in international markets through an open trade policy, export promotion, cutting subsidies and State aids and

improving conditions for inward as well as for outward investment. Governments should also work to ensure market access for their firms and secure for them advanced and competitively priced inputs for their production processes by committing themselves to reducing trade barriers.

37. The rules and procedures of the new trading system set up under the WTO should be adopted as they will provide much needed stability for market operators in transition economies.

38. Export promotion skills should be developed in transition economies with Governments playing a key role in providing information, advice and support for exporters, drawing on the resources of their overseas offices and an expanding supply network at home. Governments can help exporters further by providing facilities for Export Credit Guarantees. In this regard foreign assistance will be necessary for financing these facilities.

39. Improvement in the institutional environment in which enterprises can boost their competitiveness is also vital. Finance for businesses to grow and to trade should be the top priority of transition economies. Governments amongst other things must, through reform of the financial sector, encourage the supply of long-term finance, the supply of capital to small and medium-sized enterprises (SMEs) and the availability of trade finance. Telecommunications modernization is essential, as is a good transport network. The EBRD and the World Bank, amongst other multilateral lending agencies, have targeted these sectors for support but further investment through different forms of financing (e.g. build, operate and transfer) will be necessary.

40. Businesses, their customers and their suppliers all depend on a clear and effective body of law and regulation. This basic commercial framework includes: competition; company law; commercial law; bankruptcy law; standards; environmental regulation; and intellectual property law.

41. The commercial framework can stimulate private sector development, competition and innovation, and encourage enterprise. But if the framework is weak it will act as a constraint and inhibit commerce. Some businesses may go elsewhere. The commercial framework must be:

- stable - so that it removes uncertainty to businesses:
- enforced - so that businesses are not penalized by the non-fulfilment of contracts or the failure to honour debts;
- lean - so it imposes no more burdens than are essential;
- clear - so that business knows what it can and cannot do;
- applied consistently - so businesses can plan ahead; and,
- business oriented - so that as far as possible businesses are free to make commercial decisions without distortions caused by tax or regulation.

42. Innovation is essential for competitiveness. Countries need companies which innovate. Successful innovation requires good management, appropriate finance, skills and a supportive overall climate.

43. Finally, human resources are crucial for a competitive economy. Transition economies need to improve the skill base of their economies. In particular, a programme to develop management skills in marketing and trade is needed, establishing closer links between employers and educational establishments in transition economies.

2. Macroeconomic stabilization and structural reforms

44. The international competitiveness of the transition economies in the first stage of their market transformation has been affected by a large number of external and internal factors. On the domestic side, the macroeconomic stabilization programmes, as well as a wide range of institutional and structural reforms initiated at the outset of the transition, have been the most important influences on the short-run competitiveness of domestic producers relative to foreign suppliers.

45. Most of the stabilization packages applied in east Europe in the early 1990s comprised several components common to nearly all countries, such as: a) restrictive monetary policies, including high real positive interest rates and contraction of the volume of credit, b) sharp devaluation of domestic currencies, c) liberalization of most domestic prices, and d) a contraction of aggregate domestic demand through direct cuts in government expenditure and falls in private consumption and investment induced by falls in real income and wealth and by high interest rates. All these measures strongly affected trade competitiveness, although their individual impact on exports and imports varied.

46. Factors b) and d) clearly worked in favour of exports, through a combination of positive (increased profitability of exports sales relative to domestic sales) and negative (fall in the real domestic demand) influences. By contrast, factors a) and c) might have been expected to affect exports adversely, because of the reduced availability of export (and production) financing and higher prices for domestic sales. However, because the initial devaluations were typically excessive while a limited number of price controls remained in force, the impact of stabilization policies on exports were probably strongly positive overall. This has been confirmed by the rapid expansion of exports from transition economies to western markets in the immediate aftermath of transformation. On the import side, the devaluations, restrictive monetary policies and the contraction of domestic demand have all had a clearly negative impact on the volume of imports (via decreased profitability of import purchases and lower effective demand for imported goods), although domestic price liberalization has worked generally in favour of imports.

47. The trade of the transition economies has also been boosted by important institutional and structural reforms. First of all, liberalization of foreign trade and payments, including the introduction of convertibility of domestic currencies, allowed many new economic agents and new products to enter foreign transactions, a development which permitted the exploitation of the ample possibilities for price arbitrage through international trade. The institutional opening towards foreign markets resulted in an across-the-board expansion of exports from the transition economies. The internal liberalization of business activities has allowed domestic agents to choose freely the best outlets and sources of supply, a pre-condition for a new, more optimal pattern of trade, based on comparative advantage. Other reforms,

including the improved access for foreign direct investment (FDI) and the creation of capital markets, have also strengthened the incentives and the capacity to export.

48. However, the pro-trade impulses provided by the stabilization programmes are generally of a one-off character, and their effects on the growth of trade must be expected to weaken over time. After the initial devaluations, most east European currencies have appreciated in real terms, and unit labour costs have been increasing. Similarly, price and foreign trade liberalization has removed the administrative constraints on trading activities, but it does not guarantee the expansion of new, profitable exports. The market reforms create the possibilities for trade, but not the trade itself; for this to happen, a number of other conditions have to be met. First, enterprises in the transition economies have to be willing and able to respond to these new possibilities: this requires further reforms in the enterprise and banking sectors, including restructuring and privatization. Second, resources have to flow into potentially viable export sectors to ensure restructuring; but factor markets in transition economies are imperfect, and the inflow of FDI has been below expectations. Third, the prospects of future profits in export sectors are still blurred by the uncertainties surrounding domestic macroeconomic policies and the long-term security of access to western markets.

49. Some of these constraints are clearly beyond the control of the transition economies, but many can and must be addressed by more innovative domestic policies. Sustained growth in the transition economies can only be assured if it is based on a recovery of fixed investment and a continued expansion of exports; along with financial stabilization and fiscal consolidation, these should be the key policy priorities in transition economies.

3. Internal barriers to export development and enterprise competitiveness

50. In many cases traders in the transition economies responded quite well to the collapse of the former trading system. Substantial trade was reoriented from eastern to western markets. However, continued improvement is required if the external sector is not to emerge as a constraint on output. This in turn will mean dealing with a number of internal barriers that can be seen at the national and at the enterprise level, the most salient of which are described below.

(a) Main obstacles to trade at the national level

(i) Payments

51. One of the principal difficulties faced by traders concerns payment-related problems. Until and unless enterprises can be assured of prompt payment for goods and services, there is no real basis for trade. The causes of payments difficulties include high levels of debt, high interest rates and high taxation; the inadequate and inexperienced financial sector; the lack of adequate export credit and export insurance facilities; and the difficulties in enforcing contracts and in implementing bankruptcy laws.

(ii) Infrastructures

52. Exporters are severely handicapped by the lack of modern efficient telecommunications and a secure and reliable transport system. New investments are required to bring these infrastructures up to the necessary standard. Also Governments themselves have added to the transport problems by setting up costly and time-consuming trade procedures, involving the processing of Customs documentations and the collection of transit fees.

(iii) Poor channels of information

53. At the national level, Governments, business sector associations and chambers play important roles in the channelling of information about market opportunities and market access conditions. But in most transition economies, Governments still play only a marginal role in information provision while business associations and chambers are in the process of being developed.

(b) Main obstacles at the enterprise level

(i) Low productivity

54. The large size of plants, overmanning and poor utilization of labour and machinery means that many firms suffer from chronically low levels of productivity, which cannot be offset by lower wages.

(ii) Management and human resources

55. While creating excellent managers from a technical and scientific standpoint, central planning isolated them from direct contact with their suppliers and customers. Most enterprises in fact never developed an in-house capability to undertake an efficient marketing of their products. Under the distorted structure of incentives under central planning, managers did not have to elaborate strategies to sell their products to the domestic, let alone to foreign markets. This, however, varies; in some countries, like Hungary, enterprise managers had much more contact with, and hence knowledge of, foreign markets.

BOX 2
PRODUCING TRACTORS IN MINSK AND IN COVENTRY

A typical example of a plant suffering from poor productivity is the Belarus tractor factory in Minsk. With a total workforce of some 30,000, of which only about one third were directly employed in the production of tractors, it produced some 80,000 tractors per annum. The same year, the Massey Ferguson Tractor Plant in Coventry, England with just under 2,000 emp
loyees produced 120,000 tractors. Even when one takes into account the fact that the Coventry plant is modern and more automated than the one in Minsk, the difference in productivity is nevertheless highly significant.

56. Workforces have a high level of skills, which even if these are not fully adapted to the requirements of the market place, makes them potentially

competitive. However, discipline, work attitudes, working conditions, wages, etc. are poor which manifests itself in poor workmanship and absenteeism. In addition, there is large overstaffing with many employed in activities - constructing and maintaining housing complexes, many hospitals, schools, etc. - extraneous to the production activities of the enterprise.

(iii) Plants and equipment

57. With few notable exceptions, the majority of enterprises are housed in large, antiquated, badly maintained buildings that are filled with equally large, heavy, ageing machinery and equipment. Many enterprises do have automated machinery but they tend to be underutilized. Modern machinery can create bottlenecks if used alongside the far slower, older equipment. Also the poor state of many factories discourages owners from installing the most expensive and latest equipment.

(iv) Products and market-related problems

58. Many of the products currently manufactured in transition economies fail to meet the stringent regulatory (e.g. health and safety, environment) and design specifications enforced in the west. Product quality falls in many cases far below international standards. While quality controllers may generally be able to ensure a product's correct compliance to standards that can be measured physically, chemically, etc. they generally lack the criteria in which to judge the subjective characteristics of products, such as design, surface, finish, style, colour, etc. As a result there are many products that comply exactly to specifications in terms of dimensional tolerances, durability or performance, but whose visual impact and presentation leave much to be desired.

(v) Costing and pricing

59. Having been brought up in an era when all prices were fixed by the Government, enterprise managers lack the basic know-how on the correct costing and pricing for their products. In many cases, products are offered at too low a price, because their full costs of production have not been calculated correctly and their quality, design and development costs have not been reflected in the price.

60. In other cases, the price asked for a product is far too high compared to similar products offered by competitors. This unsatisfactory situation will continue until proper costing and pricing techniques and know-how are acquired by the enterprises, and the number of accountants in the country increases.

(vi) Delivery

61. On-time delivery of products to the customer is one of the deciding factors for sustained market penetration. Customers will refrain from purchasing even the highest quality products that are competitively priced if these cannot be delivered within an agreed delivery schedule. Enterprises from transition economies have difficulties in meeting such contractual obligations particularly in the regional markets due to transport and transit difficulties. The customer of course does not care whether the delay is due to suppliers or someone else's deficiencies; the basic problem is ensuring predictability of delivery.

(vii) Export packaging and labelling

62. The non-availability of satisfactory packing materials and inadequate labelling is a common problem for enterprises in this region. Good packaging and labelling are essential to prevent damage in transit and for a competitive presentation of products to customers. Packages and labels should be sufficiently attractive and designed in such a way that they help advertise and sell the products. The text printed on labels must always be in the language of the customer's market and must comply fully with that market's often quite complex labelling regulations and requirements.

4. Access to markets

(a) The Uruguay Round as a framework for market access

63. When the Uruguay Round of trade talks between the Contracting Parties of the GATT began in 1986, the Soviet bloc was still a political reality. The Council for Mutual Economic Assistance (CMEA) was the principal trade framework for the countries of central and east Europe, and their economies were subject to socialist central planning. The eight long years of trade negotiations coincided with the collapse of the Soviet system, the demise of the centrally-planned economies, and the re-entry of the successor countries to the world economy. The successful conclusion of the Uruguay Round and the imminent establishment of the World Trade Organization now provides the framework for the transition economies to liberalize their economies and adjust to free market trading conditions.

64. The Czech Republic, Slovakia, Hungary, Poland and Romania are contracting Parties to the GATT and will become founder members of the WTO. The GATT Secretariat understands that all the transition economies wish to join the WTO in the medium term, but many will need time and substantial technical assistance to adapt their trade policies and economic structures to the free market rules. In the meantime, there will be differential impact on those transition economies who are GATT members and those who are at an earlier stage in the transition process.

65. Overall, the GATT Secretariat forecast that the Uruguay Round would expand world trade by between 9 and 24 per cent.12/ The extent to which transition economies benefit will in large measure be dictated by their capacity to participate in international trade and their competitiveness. The transition economies are marginal to the world economy, accounting for less than 2.5 per cent of world trade in 1992.13/ But the Uruguay Round should be seen as a permissive framework which should encourage the transition economies to accelerate their adjustment processes.

66. The main results of the Uruguay Round may be summarized as four-fold:

- market opening measures
- stronger rules on free and fair trade
- new international rules on services, intellectual property and trade-related investment
- a new international agency: the WTO.

67. These measures will have combined quantitative and qualitative effects. In the case of the transition economies, the short-term impact may be negative - for example, tighter controls on environment-related trade - but in the medium to longer term they are expected to benefit substantially from the liberalized trade framework, probably by more than the most-developed economies. Agriculture and textiles, notably, are two sectors which should benefit significantly from the conclusion of the Uruguay Round.

68. In the case of those transition economies who are GATT Contracting Parties, the benefits will be more immediate. At the same time, however, it should be stressed that the beneficial effects of the Uruguay Round on their exports to their major markets in the European Union will be overtaken by the Europe Agreements. They provide an increasingly favourable framework for reducing barriers to trade between the EU and the Czech Republic, Slovakia, Poland, Hungary, Romanian and Bulgaria.

69. Empirical evidence from Slovakia, Hungary and Poland confirms the impossibility of firm qualitative estimates of the impact of the Uruguay Round. So much depends on the capacity of the transition economies to respond to market demand and to produce competitively to meet the required quality standards. There are pervasive expectations that the Uruguay Round will prompt more east-west joint ventures, especially in services. Moreover, the fact that the GATT members in east Europe will open their markets, bind their tariffs, and dismantle protectionist quantitative restrictions is likely in turn to encourage western investors to set up in these transition economies, not only to supply the domestic market but also for intra-regional exports.14/

70. Russia, the largest trading entity among the transition economies, is not a GATT Contracting Party and did not participate in the Uruguay Round. It is anticipated that the Russian Federation will negotiate accession to the World Trade Organization later in the decade. The majority of Russian commodity exports already meet minimal tariff barriers. For Russia, the priority is to ensure that the Uruguay Round does not result in more discrimination against its processed exports. Russia seeks to establish equality as a basic principle within a comprehensive, global trading system. But the Russian economy is still subject to substantial State regulation and the transition process has yet to be completed.

71. The Trade Policy Review Mechanism established in the Uruguay Round will act as a means of imposing discipline on the transition economies regarding their trade policies. It will also offer them an assurance of access to third country markets and reinforce a rule-based international trade environment.15/

(b) Access to western markets

72. Greater market access is considered one of the most effective means of supporting the reforms: not only does it strengthen the capacity to import, but it facilitates structural adjustment and the development of a new pattern of trade, based on comparative advantage reflecting new relative prices.

73. Many transition economies, however, have complained that various measures taken by western Governments have limited the access of their goods to western markets and have harmed their trading performance. On the other hand, in the

past five years, an array of new trade agreements and unilateral actions has resulted in a major liberalization of trade relationships between the west and the transition economies. These accords have facilitated the growth of eastern exports to the developed market economies, which has partially offset the loss of trade with their former CMEA partners, and contributed to the dramatic reorientation of their trade flows toward the west. The degree to which western markets have indeed opened to producers from east Europe can be examined in terms of western countries' policies on (1) tariffs; (2) non-tariff barriers; and (3) other factors that may restrict trade.

(1) Tariffs - Most Favoured Nation (MFN), General System of Preferences (GSP) and Preferential Trade Agreements (PTAs)

74. Concerning the award of Most Favoured Nation (MFN) and General System of Preferences (GSP) status to transition economies, it should be noted that since the 1960s and 1970s all transition economies had benefited from MFN status in western Europe and Canada. The US, however, granted MFN to Hungary, Poland and Romania only very recently. The European Union granted MFN to the ex-USSR in 1989 within the framework of its Trade and Cooperation Agreement. MFN status was re-confirmed by the Partnership and Cooperation Agreement signed in June and July 1994.

75. Under **GSP**, western industrialized nations give preferential rates of duty to less-developed countries, without receiving reciprocal trade concessions from them; sensitive products are usually excluded and ceilings are set on the benefits available to any one country for a specific product. GSP rates are not binding, they can be revoked unilaterally in case of export surges and other circumstances. Obtaining GSP status improves in principle the ability of transition economies to penetrate western markets. In January 1993 GSP was granted to several CIS countries by the EU. Some 10 per cent of the products of CIS States are eligible for GSP treatment; if the GSP is used by CIS, the average tariff for industrial products entering the EU would amount to only 0.3 per cent.16/

76. Although used in the past, these tariff concessions towards transition economies have been re-extended since the countries began their reforms. Partnership and Cooperation Agreements for example, covering a wider area than trade, have been signed in summer 1994 between the EU and the Republic of Moldova, Russia and Ukraine. However, timetables for discussions on transforming these tariff concessions into Free-Trade Agreements will not be discussed before 1998.

77. Preferential trade agreements (PTAs) offer the most substantial tariff reduction. They cover all products except some agricultural products. The Europe Agreements (signed with the EU) and Free-Trade Agreements (signed with EFTA) in contrast to the GSP, provide for reciprocal tariff concessions. Nevertheless the reciprocity is not immediate as the transition economies were given more time before they must lower their trade barriers (principle of asymmetry).

78. By early 1995, EU restrictions on most of these PTA beneficiary countries' industrial goods had been completely lifted. The only exceptions are these countries' coal and steel products, for which the remaining tariffs are to be abolished by the end of 1995, and textile products covered by the

Multi-Fibre Arrangement which is due to be tariff-free by the end of 1996. For the latter, some quantitative restrictions will also remain until 1 January 1999. In December 1994 at the EU Council meeting in Essen, it was decided to adjust the liberalization granted to Bulgaria and Romania to the levels of the Visegrad countries. The Baltic States also started to benefit from preferential access to the EU market as of 1 January 1995 with the entry into force of Free-Trade Agreements.

79. The Uruguay Round agreement will have a differential impact on market access in the ECE region. Since 1 January 1995, the transactions of those countries which conduct their trade on an MFN basis are subject to lower tariffs as a result of the implementation of the first of five equal reductions in scheduled tariffs. As regards those transition economies enjoying preferential arrangements, the EU Europe Agreements and EFTA Free Trade Agreements (FTAs) stipulate a reduction in the original tariffs (i.e. the so-called basic duties) in the light of the Uruguay Round results. Implementation of these reductions will preserve, at least in part, the preferences accorded under the association agreements and the FTAs. In those cases where tariffs have already fallen to zero, and probably in some where they have not, the exporter's preferences will be eroded and thus lead to greater price competition from third countries (the erosion of preferences benefiting Bulgaria and Romania is less pronounced due to the lagged implementation of their interim agreements). In 1995 the Baltic States will have benefited, first, from the implementation of tariff cuts under their FTA's with the EU and, secondly, from the further reduction of basic duties in those agreements that are linked to the Uruguay Round reductions.

(2) Non-tariff barriers

80. Quotas, voluntary export restraints or price regulations, the Multi-Fibre Arrangement (administrative sharing of available quotas for textiles, targeting transition economies as State-trading countries) have been largely eliminated, as the enterprises are no longer considered to be State-trading companies. Those non-tariff barriers which remain are concentrated in "sensitive" sectors (i.e. agriculture, iron and steel, chemicals, textiles and apparel). This protection partly offsets the favourable impact on trade brought about by the lowering of traditional trade barriers (e.g. tariffs and quotas) in western markets. Contingent protection may restrain the exports of goods in sectors other than those to which the specific measures are applied. All exporters (and potential foreign investors) may feel that their goods, too, will become a target for protectionist actions and, as a result, reduce their sales (investments) below what they would otherwise be. There is a danger too that the use of these instruments will have a knock-on effect on transition economies. On the other hand, the EU has now abolished all specific quantitative restrictions which previously applied to State-trading countries. Safeguard clauses have been applied in the case of aluminum. Seven categories of products exported by Russia have been subject to anti-dumping duties and eight others are under investigations. If concluded, the total volume remaining affected would represent less than 1 per cent of total trade.17/

BOX 3
HIGH TECHNOLOGY PRODUCTS FROM THE EAST

Some transition economies have identified problems of market access for their high technology products. However, as regards standard protection, evidence of particularly high tariffs can be found in neither the EU nor in the United States.

In the EU, for instance, the MFN import tariff rate for satellites is 6.4 per cent. For military airplanes and helicopters the MFN rate varies between 5 and 15 per cent. For electronic components and microprocessors it is never higher than 14 per cent and for telecommunication equipments it is around 7.5 per cent. These rates cannot be considered as being especially high, when compared for example with the 20 per cent MFN import duty faced by footwear products, or with the import regime of agricultural goods. Evidence of significant non-tariff protection that would apply to high technology products in general could not be found, either.

Source: Code des Douanes 1994, Union Européenne, Customs Code 1994, USA.

81. However, there is inevitably a time lag between adopting new measures and a general recognition of the changed situation in the transition economies. Perhaps more needs to be done by State agencies to create greater awareness in the private sector of new opportunities.

(3) Other actions that may restrict trade

a. Health, safety and environmental measures

82. Marking and packaging requirements, quality certification measures, environmental standards on products and packaging and transportation can also represent trade barriers. Information on these measures is often very difficult for exporters from the transition economies to obtain.

b. Anti-dumping and countervailing duties

83. While technically not barriers, it is often suggested that anti-dumping or countervailing duties are used to limit competition because the investigatory procedures are often long and expensive. Transition economies face specific problems. Within the framework of the GATT, special procedures were established for anti-dumping enforcement on imports originating in so-called State-trading economies that require references to a third country's prices. This procedure was considered unfair by transition economies because of the dramatic differences their economic structure. Russia is still treated as a State economy, but has abolished its monopoly on trade. Even those transition economies considered market economies face problems because the EU sometimes still uses the methods of "constructed value" (using the costs and prices of a surrogate country) rather than domestic sales as a reference.

BOX 4
ANTI-DUMPING PROCEDURES

Another complaint of the transition economies is the administration and verification of the cost/price questionnaire that producers charged with dumping are required to fill out: too short delays; differences in accounting systems; unavailability of relevant information on the enterprise; artificial nature of exchange rates; etc.

84. Dumping is a threat when economies suffer from allocative and productive inefficiencies. For allocative efficiency, relative prices must reflect costs of production. For productive efficiency, firms which do not use the most efficient combination of inputs to produce given outputs must pay a penalty (ultimately, to be declared bankrupt). However in transition economies, it is argued that as a result of the widespread failure of enterprises to pay debts and the lack of enforceable bankruptcy procedures to rid the markets of non performers, allocative and productive efficiency become distorted.18/ Consequently, it is suggested that these distorted features can make a pricing strategy based on incurring losses in the short term (e.g. dumping through predatory pricing) a sustainable strategy for certain firms. Clearly this can create trade frictions with western partners.

85. The effects of anti-dumping on transition economies can be assessed by looking at the direct and indirect effects of such actions. As far as the central European economies are concerned the direct effects appear rather marginal. As seen in Table 2, the number of anti-dumping cases begun by the European Union has declined steadily since 1988. In addition EU anti-dumping measures cover 0.32 per cent of EU imports from Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia, and 0.36 per cent of industrial imports from these countries. Relatively more anti-dumping actions however have been taken against CIS exporters.19/

Table 2
Initiation of EU anti-dumping cases against the CEECs

	1988	1989	1990	1991	1992	1993
Bulgaria	1	1				1
CSFR	1	1		1		
Hungary	1	1		1		1
Poland	1	1		2	1	
Romania	2	2			1	
Total	6	6	0	4	2	2

Source: Costello et. al. (European Economy 1994).

86. Probably more significant has been the indirect effects of anti-dumping measures, although measurement of such effects on both inward investment and on trade is very difficult.20/ However, studies on the indirect effects of trade caused by anti-dumping have identified the very threat of action as having a strong trade deterrent effect.21/

c. Rules of origin

87. Rules of origin are conditions a given product must meet in order to benefit from a preferential trade regime. In the Europe Agreements, the "local content requirement" is 60 per cent on the average, depending on the product.22/ Materials imported in the producer country (i.e. the EU or any Associated State) cannot account for more than 40 per cent of the value of the inputs used in the production of the goods concerned. This situation was eased by the diagonal cumulation of rules of origin decided in December 1994 at the EU Council in Essen. Once implemented, this decision will allow inputs imported from any Associated Party to be considered as local in calculating local content. This measure was aimed at promoting trade integration between the Associated States, and has considerable potential for expanding trade.

d. Protection of property rights

88. The Europe Agreements state that protection of property rights can be a ground for justifying restrictions on trade. This may become a problem for the Associated States, since the "doctrine of exhaustion" will not be applied within the framework of the Europe Agreements.23/ This means for instance that cheap products from central and eastern Europe can be prevented from entering the EU markets as parallel imports. This feature may become a negative factor, since the Associated States are trying to escape from the situation of dependency, created by the concentration of their exports in a few low value-added products and raw materials.

89. To sum up, for States benefiting from preferential trade agreements with western countries, progress should still be made towards improving market access. For non-beneficiaries the situation is more difficult. Although 83 per cent of Russia's exports to the EU enter tariff free, and the weighted average tariff for Russian industrial exporters to the EU is estimated at only 1.1 per cent (due to the high share of raw materials in Russia's exports), for producers of so-called "sensitive goods" the market-access conditions are far from constituting the ideal framework for their transition to market economies. Despite the progress made to date, many individual enterprises in the CIS fear that EU markets are closed to them.

(c) Access to eastern markets

90. The decline in trade between the countries of the former CMEA was steep, particularly amongst the States belonging to the CIS. Since the degree of trade dependence in the region was extremely high, the re-establishing of some trade relations could be positive. In particular, it would allow the producers of capital goods which are not able to compete on western markets to export again to their traditional markets. Thus, the revival of intraregional trade could provide exporters with time and resources to restructure in order to gain competitiveness.

91. In order to revive intraregional trade, certain States have signed agreements on a bilateral and multilateral basis to liberalize their trade. The Central European Free Trade Agreement (CEFTA) was signed in December 1992, by the Czech and Slovak Federal Republic, Hungary and Poland in Visegrad (hence the so-called "Visegrad group"). It entered into force in March 1993. All barriers on mutual industrial trade are to be dismantled by 1 January 2001. The Baltic Free Trade Agreement (BFTA) was signed in September 1993 by Estonia, Latvia and Lithuania. It entered into force in April 1994 and covers mostly industrial goods. In September 1993, all CIS States with the exception of Ukraine (which is an associated member of the CIS) signed a treaty envisaging the establishment of an Economic Union in which the free circulation of all factors of production would be guaranteed.

92. Having significantly liberalized their import regime when the reforms were launched, the transition economies have tended in some cases to re-introduce tariff barriers. Russia for instance adopted in July 1992 an average import tariff rate of 5 per cent. Two years later, after several revisions, the average tariff rate was increased to 14 per cent, with peaks at 100 per cent of certain goods. Recently, a partial revival of regional trade has been observed among central European countries, which may reflect the beneficial effects of the CEFTA. On the other hand, the entry into force of the Baltic FTA and the CIS Economic Union are still too recent to have had any major impact on intraregional trade.

93. However, although trade agreements have led (or will lead) to tariff reductions amongst the transition economies, many non-tariff barriers remain and new ones have been established. These include the adoption of a growing number of new standards and regulations. For example, some countries which opted for future accession to the European Union are trying gradually to upgrade their sanitary, ecological, and other requirements to align them with those of western Europe. This can create barriers to mutual trade as regional producers, even if they are aware of the latest regulations, are not always able to meet the new requirements.

5. Relative importance of external and internal barriers in the trade of transition economies

94. Having examined both internal and external barriers to trade of goods from transition economies the following issues can now be assessed: (i) the degree of importance market operators attach to these barriers; (ii) the relative importance of external and internal barriers to exporters in the transition economies; and (iii) the extent and effectiveness of the western technical assistance directed at alleviating the problems identified by the market operators.

(i) The relative importance of external and internal barriers to exporting in transition economies

95. According to a survey of 42 Romanian exporters carried out by the UN/ECE in conjunction with the Centre for Promotion of Small- and Medium-sized Private Enterprises in Bucharest, the following areas, ranked in order of importance, have proved particularly troublesome:

a. lack of information on foreign markets, prices and standards, and insufficient help from the domestic export promotion agency;

b. deficient infrastructures and, in particular, problems related to Customs procedures;

c. lack of low-interest export finance and payment-related problems;

d. insufficient quality of Romanian goods and services, which prevents them from meeting international standards;

e. the lack of knowledge of Romanian products on international markets and their bad reputation;

f. restrictive market access conditions (tariff and non-tariff barriers);

g. problems in meeting the price and quality level of international standards;

h. governmental and bureaucratic obstacles (e.g. corruption);

i. embargo-related impossibility of using the Danube river for transport.

96. An OECD survey was carried out a few years earlier. This tends to present the same type of problems faced by exporters, namely:

- infrastructures (telecommunications, transport);

- underdeveloped banking sector and financial services;

- inefficient Customs administration and other border-crossing facilities;

- information: excessive and frequently changing regulations on all aspects of foreign economic relations: delays in receiving information on domestic regulatory changes, lack of information on longer-term government economic policies;

- insufficient access to western commercial information: prices, regulations (the inability to deliver GSP origin certificates, incorrect registration of textile quotas);

- technical barriers: standards, quality problems.

97. A survey of importers undertaken by the OECD, involving 2,000 purchasing professionals from Germany identified:

- negative quality standards;
- credit worthiness;
- Customs service;
- meeting delivery times.

98. Other surveys of importers confirm that the main barriers were the same as those identified by domestic firms (communications, Customs services, unstable regulatory environment, payment difficulties).

(ii) <u>The relative importance of external and internal barriers to exporting in transition economies</u>

99. The relative importance of external and internal barriers depends on the country, its competitiveness, the sector and industry. For Romania, the survey showed that internal factors were more commonly cited than external barriers. Market access problems were ranked only sixth in terms of their importance as trade barriers. The OECD survey furthermore confirms this picture that domestic barriers were rated by exporters from the transition economies more highly than external ones.

100. Results from questionnaires, while illustrative, do not always provide the reliable indicators of reality that researchers are looking for. However in the absence of econometric analyses to determine the relative weight of internal and external factors, it is these or specific sectoral analyses that researchers are left with to draw their conclusions.

101. If we take east European agriculture, which is often cited as an example of a sector where the transition economies possess comparative advantages (Bulgaria, Hungary and Poland were traditionally major exporters of agri-food products) but who do not reach their full potential because of the protection of western markets, we find, on closer examination, that such competitiveness may be exaggerated.

102. On the supply side, in the first stage of transition, part of the supplies for available exports were actually surpluses resulting from decreased domestic demand, not production for export <u>per se</u>. Production too declined significantly, due especially to uncertainty of farm policies and restructuring, drop in input use and drought. Indeed, in some countries, the shortage of supplies led Governments to establish a temporary ban or control on exports. Low productivity and efficiency of agricultural holdings is another crucial obstacle, which may be explained, in particular, by temporary disturbances due to land reform and farm restructuring, decrease of investment in the sector, low input use (chemicals, certified seeds), obsolete equipment, and lack of skills and management abilities. For instance, in the livestock sector, the breed mix and the feed conversion rate are frequently rather poor.

103. The organization of markets in agricultural products, especially institutional and marketing aspects, have broken down and now need to be restored. Market transparency has to be established: information on supplies and outlets, prices, quantity and quality requirements, market trends, etc. is required; likewise for stock exchange, wholesale markets, farmers organizations and professional chambers. The absence of such institutions hamper both domestic and external trade. Sales abroad strongly need export facilities such as export promotion and credit. In contrast, in western countries there are highly organized trading and processing corporations, which provide fierce competition which is extremely hard to meet.

104. Because of low productivity, rather high costs and poor marketing, prices of agri-food products from the transition economies are frequently too high compared to international prices. The challenge of transaction lies precisely in achieving a structural shift away from these problems. Adequate investment and technical assistance can bring about dramatic improvements and there is evidence to support the view that east European agricultural markets are benefitting.

BOX 5
COMPETITIVENESS OF HUNGARIAN PIGS

Hungarian pigs have an average lean meat-to-fat content of 46 per cent; compare this to 60 per cent plus lean meat content of Danish pigs and it is obvious that Hungarian producers start with a distinct disadvantage in the highly competitive west European market.

Source: "Not what it seems: EC quotas can appear protectionist but are they the only obstacle to trade?", April 1994, Business Central Europe.

105. On international markets, especially those in western countries and the European Union, the quality of the products is the key factor for competitiveness. Quality covers various requirements: commercial, sanitary, phytosanitary, as well as presentation and packaging. Labelling for consumer information, including environmental aspects (eco-labelling), require increased attention by producers, sellers and public authorities. As transition economies were in the past mainly oriented towards markets in central and east Europe, quality was not given so much importance. Accordingly, in the transition economies which are major exporters of agricultural products, the promotion of quality is a priority in new food and agricultural policies, with the primary objective to comply with international requirements (European Union, UN/ECE commercial quality standards).24/

106. Thus, while there are clear external barriers to the access of east European agricultural products to western markets, e.g. variable levies, subsidies and quotas, the lack of competitiveness of this sector in transition economies means that even if these barriers did not exist there would be no certainty that sales of east European products would expand unless the products themselves were improved. Technical assistance and agricultural modernization programmes will play an important role in upgrading future production.

(iii) The extent and effectiveness of the western technical assistance directed at alleviating the problems identified by the market operators

107. The OECD's (CCET) Register contains information on technical and humanitarian assistance provided to transition economies by OECD countries. Several barriers were chosen to see whether (and how much) western countries' assistance had been targeted to these areas:

- Customs administration: most assistance centres on training of Customs officials, automating information collection and designing legislation. Only three projects mention supplying equipment. No project directly mentions efforts at increasing the efficiency of services for exporters or importers;

- technical barriers to trade (health and safety measures, marking and packaging requirements, quality certification procedures): the assistance projects focused on joint seminars, help in standards and other regulatory drafting;

- information on market access problems: no specific assistance projects were on record, but the ITC and other agencies are currently implementing several projects;

- telecommunication and banking: the register search revealed, not unexpectedly, that a large number of well-funded assistance programmes are focused in this area, but are not necessarily targeted as assistance for exporters.

Notes

1/ Comparison of pre-reform and post-reform trade flows is difficult as it requires conversion of trade flows expressed in largely artificial prices and in transferable roubles into dollar values. Statistical coverage of trade transactions has also changed as a result of the unification of rules of statistical reporting which makes temporal comparisons even more problematic. Frequent devaluations and high inflation further blurred the picture of trade, and the comparison of trade levels with GDP levels gives biased results because the official exchange rates are in most cases seriously undervalued. Finally, for some newly independent countries comprehensive foreign trade statistics simply did not exist prior to transition.

2/ See UN/ECE, Economic Bulletin for Europe, Vol.43/91.

3/ Some economists have, however, criticised this concern with competitiveness, in particular focusing on what they saw to be the dangerous implications it had for trade policy. Paul Krugman has for example argued that obsession with competitiveness would lead Governments to misallocate resources through protectionist industrial policies and corporate subsidies. However, generally speaking, Governments, while adhering to the need to increase their countries international competitiveness, have shunned restrictive industrial policies or protectionism and rather given their support to further liberalization of world markets, as symbolized in the GATT trade agreement, and to the principle of fair and open markets. They have however tended to take a broader view of the factors leading to competitiveness. See Paul Krugman, "Competitiveness: A Dangerous Obsession", Foreign Affairs 73 (March/April 1994); Peddling Prosperity: Economic Sense and Nonsense in the Age of Diminished Expectations, (New York, N.Y.: W.W. Norton 1994). For a critique of Krugman's views, see Daniel Burton Jr. et al in "Jobs, Trade and National Prosperity" in The Washington Quarterly, Autumn 1994.

4/ Commission of the European Communities; Growth, Competitiveness, Employment: The Challenges and Ways Forward into the 21st century. [COM (93) 700] (1993)].

5/ Report of the Federal Government on the safeguarding of Germany's future as an industrial location, [Federal Government] (1993); Competitiveness: Helping Business to Win, CM 2563, London: HMSO (1994).

6/ For the methodological problems in using comparative advantage as a means of measuring competitiveness, see D. Williamson, Trade and Industrial Policy in Developing Countries, 1993.

7/ See D. Rosati, "The Economic Interpenetrations between the EC and Eastern Europe: The Consequences for Polish Industry", Brussels 1994 mimeo; L. Halpern, "Comparative Advantage and Likely Trade Patterns of the CEECs", CEPR Discussion Paper Series, No. 1003.

8/ Economic Bulletin for Europe, UN/ECE, Vol. 46 (1994), pp. 57-64.

9/ "International Trade and Technology in Industrial Restructuring in Central and Eastern Europe", John A. Cantwell (mimeo), 1994.

10/ "Industrial Policy: the Role of Government in Promoting Industrial and Technological Development", S. Lall, UNCTAD Review, 1994.

11/ Beyond Free Trade, Ed. D.B. Yoffie, Harvard Business School, 1993.

12/ See GATT-WTO News, 6 November 1994, p.1.

13/ See "The Impact of the Positive Conclusion of the Uruguay Round on Intraregional Trade with Special Reference to the Countries in Transition", TRADE/R.619, p. 16.

14/ See "The Impact of Foreign Direct Investment on the Trade of Countries in Transition: Results of a Preliminary Survey", TRADE/R.617.

15/ See Trade Issues in the New Independent States, Constantine Michalopoulos, Studies of Economies in Transition, No. 7, The World Bank, Washington, 1994, pp. 15.16.

16/ See European Commission document, "Des échanges commerciaux et de l'assistance dans les relations entre l'Union Européenne, les pays d'Europe centrale et orientale et ceux de la Communauté des Etats indépendants", MG/NN/FW, 13 October 1994.

17/ EC informal statistics document on "Anti-dumping measures currently in force: cases involving central and eastern European countries and CIS", 10 September 1994.

18/ D. Begy and R. Portes, "Enterprise debt and economic transformation: financial restructuring of the State sector in central and eastern Europe", Centre for Economic policy Research, Discussion paper No. 695, June 1992.

19/ 20 anti-dumping measures were still in force against products from CIS and Lithuania, mainly in basic chemicals and steel.

20/ Measuring the impact of the indirect effect on inward investment is particularly problematic since one cannot observe investments which would otherwise have taken place.

21/ P.A. Messalin, "The association agreements between EC and central Europe: trade liberalization versus constitutional failure?" in J. Fleming and J. Rollo (ed.), Trade Payments and Adjustment in Central and Eastern Europe and L.A. Winters "VERs and expectations: extension and evidence", Economic Journal, Vol. 104, pp. 113-123, 1994.

22/ L.A. Winters, "The Europe Agreements: With a Little Help from Our Friends", in Center for Economic Policy Research, The Association Process: Making it Work, Occasional Paper No. 11, CEPR, London, November 1992, p.19.

23/ Within the EU, this legal principle prevents property owners from banning sales of "parallel imports" in order to earn excess profits.

24/ For the main exporting transition economies, sales on west European markets are regulated by agreements with the EU and EFTA, including quotas, and minimum prices which are to be progressively adjusted over a transitional period. Prospects for membership in OECD and later in the EU are already now defining the overall framework and the orientations to be followed by agricultural and trade policies of transition economies. On international markets in general, major obstacles for exports come from agricultural support and trade policies and subsidized prices, although the GATT agreement will progressively diminish the level of those subsidies.