THE CMEA TRADE AGREEMENTS AND THEIR EFFECT ON EASTERN EUROPEAN FOREIGN TRADE, 1960 - 1990

A THESIS
SUBMITTED TO THE DEPARTMENT OF MANAGEMENT
AND GRADUATE SCHOOL OF BUSINESS
ADMINISTRATION OF BILKENT UNIVERSITY
IN PARTIAL FULLFILMENT OF THE REQUIREMENTS
FOR THE DEGREE OF
MASTER OF BUSINESS ADMINISTRATION

CORINA STOICA
JUNE, 1992

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I certify that I have read this thesis and in my opinion it is fully adequate in scope and quality, as a thesis for the degree of Master of Business Administration.

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ABSTRACT

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EASTERN EUROPEAN FOREIGN TRADE,

1960 - 1990

By

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Supervisor: Yrd.Doc.Dr. FATMA TASKIN

June, 1992

The aim of this thesis is to examine the characteristics of foreign trade in Eastern European countries, before and after the political and economical changes in 1989.

The export performance during 1970-1988 of four selected CMEA countries, Czechoslovakia, Hungary, Poland, and Romania, is analyzed through the Constant Market Share Method.

Special attention is paid to the CMEA Trade Agreements, and their effects on Eastern European trade flows.

KEY WORDS: Council of Mutual Economic Assistance (CMEA), "valuta" currency, Constant Market Share Analysis, Product Pattern, Market Pattern, Growth in Demand, Competitiveness Factor, economic reforms.

ÖZET

Karşılıklı Ekonomi Yardım Kurulu Ticaret Anlaşmaları
ve
Doğu Avrupa Dış Ticaret Üzerindeki Etkileri, 1960-1990.

Corina Stoica
M.B.A.

Tez Yöneticisi: Yrd. Doç. Dr. Fatma Taşkın
Haziran 1992

Bu tezin amacı, Doğu Avrupa ülkelerinin, 1989 daki politik ve ekonomik değişimlerden önce ve sonraki dış ticaret özelliklerini incelemektir.

Seçilmiş dört KEYK ülkesi, Çekoslovakya, Macaristan, Polonya ve Romanya'nın 1970-1988 yılları arasındaki ihracat performansı, Sabit Pazar Hisse Metod üyla analiz edilmiştir.

KEYK Ticaret Anlaşmaları ve Doğu Avrupa ticaret akımları üzerindeki etkileri, detaylarıyla incelenmiştir.

ANAHTAR KELİMELER: Karşılıklı Ekonomi Yardım Kurulu (KEYK), "valuta" sürümü, Sabit Pazar Hisse Analizi, Ürün Kalıbı, Pazar Kalıbı, Talep artışı, Yeterlilik Faktörü, Ekonomi Reformları.

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CHAPTER NO.1.

INTRODUCTION

After more than 45 years of communist regimes, the Eastern European countries face nowadays the difficult task of transforming their over centralized economies into more open, market oriented ones.

The purpose of this paper is to examine the characteristics of foreign trade in Eastern European countries, before and after the revolutionary changes in 1989. Eventhough before 1989 the foreign trade of these countries was dominated by CMEA trade agreements, after 1989 the intra-CMEA trade lost its importance. The process culminated in 1990 with the disintegration of the CMEA trade agreements. Overall, the properties of the pre-1989 trade conditions and specifically the reasons for changes in exports are analyzed.

A particular attention will be paid to four of the ex-socialist countries, namely Czechoslovakia, Hungary, Poland, and Romania. The selection was done based of the economic similarities of these countries before 1989, as well as considering the particularities of economic reforms after 1989 in each of the above mentioned countries.

This thesis presents the history and characteristics of the CMEA trade agreements. Properties of the bilateral clearing agreements, prices, trade balances, and exchange rates within the

CMEA is presented in the second section. This will be followed in the third section by an overview of the foreign trade in Eastern European countries, between 1960-1988. Analysis will be focused on the growth of trade, geographical and commodity composition of trade. The fourth chapter contains an examination of the export performance through the constant market share analysis for Czechoslovakia, Hungary, Poland, and Romania, during 1960-1988. The fifth chapter focuses on the characteristics of economic reforms and their impact on the foreign trade. Apart from the difficulties faced in implementing economic reforms, these countries' foreign trade was negatively affected by domestic and international recession, as well as by the CMEA disaggregation.

Altogether it becomes clear that the transformation of the centrally planned into decentralized market economies is a task of enormous difficulty. It involves a complex series of political, economic and social factors. The analysis of the foreign trade in several East European countries pursued here is aiming to open a way for further and perhaps more detailed studies on these economies.

CHAPTER NO. 2.

HISTORY AND CHARACTERISTICS OF THE CMEA TRADE AGREEMENTS

For the European planned economies, the process of recasting trade patterns began in 1947 with the initiation of bilateral agreements between the Soviet Union and most Eastern European countries. The creation of a separate socialist market took on a more formal character with the creation of the Council of Mutual Economic Assistance (CMEA) in 1949.

This institutuion has governed these countries' regional trade and payments arrangements for the past 40 years. Founded in 1949, it included Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania, the U.S.S.R., and Vietnam. Yugoslavia was an associate member, while a number of other countries such as Afganistan, Angola, Ethiopia, Finland, Iraq, Mexico, Mozambique, Nicaragua, Yemen, maintained a looser "observer status".

Maciejewski and Nuti (1985) explain the three main features which gave CMEA integration its unique character as:

* the integration was chiefly concerned with the coordination of central plans of individual countries, especially on matters of trade;

* the international socialist division of labor required

that integration was of an infrasectoral rather than sectoral nature, to avoid polarisation between industrialized countries and those producing raw materials;

* de facto Soviet hegemony implied a certain degree of political integration.(1)

The creation of the CMEA was subsequently reinforced through long-term bilateral trade and payment agreements which were linked to national development plans of each individual country. These agreements covered issues such as the commodities one country was to export to another socialist one, terms of delivery, type of payment. Usually these bilateral agreements were long-term arrangements and had a dominating effect on trade pattern between CMEA countries.

Trade among various CMEA members has traditionally been governed by a complex set of rules that have evolved since late 1940s. This set includes the bilateral clearing system (for planning, implementing, and settling bilateral transactions) as well as the pricing system. The rules are unlike those of any of the familiar concepts of regional economic integration, such as customs unions, free trade areas, or common markets. In the rest of the chapter, bilateral clearing system, pricing system,

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(1) Nello,S.S., "Some Recent Developments in E.C. - East European Economic Relations," Journal of World Trade. Vol. 24, No.1, February 1990, pp.5-7.

exchange rate, and the macroeconomic balances under CMEA are summarized.

2.1.BILATERAL CLEARING

In essence, the CMEA was a common set of rules for planning and implementing bilateral trade agreements, as well as settling bilateral transaction accounts. Bilateral trade between the member countries was broken down into a number of sub-balances which were to be cleared independently of one another. A surplus in one subbalance could not be used to settle a deficit in another. As a result, the CMEA's common accounting currency - the transferable ruble-lacked both currency convertibility and "commodity convertibility", along with other functions normally associated with money .

This rigid framework means that governments had to plan the size and composition of mutual trade in great detail , closely monitoring actual activity to minimize the accumulation of unplanned imbalances.

2.2.PRICES

Agreement on prices was explicitly or implicitly included in the bilateral treaties. From 1949, until 1975 the CMEA commodity prices were computed as a simple average of prices of all the CMEA countries over the previous five past years.
In 1975, the "Bucharest formula" was introduced and this was a five-year moving average of world market prices, converted

through the official CMEA exchange rate into transferable roubles. It served as basis for determining external prices and generated unambiguous reference price for publicly quoted basic commodities. However, product specifications rarely matched in manufactured goods and often international price information used in calculations was either arbitrary, or of poor quality, or was outdated. The pricing rule thus operated essentially as a starting position for a bilateral haggling with agreed transfer prices often differing substantially both from reference basis and between different pairs of countries .

One of the main problem with this trading system was that domestic relative prices in one country - determined largely by distributional or political considerations rather than market forces - interacted with very different sets of relative prices in other CMEA countries, and in the competitive world market. The potential for large profits and losses resulted from these noneconomic differences between relative price systems. There were attempts to neutralize these, through a "price equalization" mechanism, which used a variety of means, such as taxes and subsidies, and differential exchange rates. For example for various commodity groups, existed different exchange rates, according to the importance attached to the export/import of that specific commodity group.

2.3.TRADE-BALANCES AND EXCHANGE RATES

Under the traditional central planning, from which the CMEA regime has been derived, the trade balance was maintained by governments controlling all transactions at the micro level. Concern for ex post balances was reinforced by the fact that unplanned surpluses were highly undesirable for the creditor country, because the lack of currency or commodity convertibility turned them into involuntary trade credits. The main instruments of control, therefore, were export and import quotas and licences, often applied at the firm level. In this framework, the exchange rates did not-and were not supposed to - provide a market signal .

In fact, here appears an important difference between centrally planned economies and the free market ones , as far as the foreign trade subsystem is concerned. The two group of countries used the exchange rates and currencies differently in expressing their foreign trade. For the CMEA countries, the exchange rates refer to so-called "valuta" currency, not directly related to the domestic currency. This system was only used in the trade with the world. Basically the value of exports and imports were published in "valuta" currency only, which was comparable with foreign prices of the rest of the world, but without being directly compatible with other indicators of domestic activity, such as NMP (net material product), consumption, etc., expressed in domestic prices of the country.

The system of "valuta" currency introduced some kind of insulation of domestic prices from the world market prices. Imported or exported goods having the same dollar price, may have had different domestic prices in the domestic markets, and vice-versa. This was due to variable subsidy and taxation rates applied to different items in foreign trade. Thus, in order to be able to export them, some goods which did not meet the international production cost, were subsidized from the national budget.

Hungary in 1976, and Poland in 1982 introduced a direct connection between world and domestic prices . They abolished the "valuta" currency system and introduced direct exchange rates for their domestic currency. This was the result of an increased openness of these governments towards developed market economies.

Another characteristic of the CMEA foreign trade consisted in the fact that the intra-CMEA trade used to be expressed in terms of transferable rouble . There existed a transferable rouble/dollar exchange rate (in 1985 about 0.7 rouble per dollar). The rates were established annually by the International Bank for Economic Cooperation in Moscow. The rates did not obey the arbitrage conditions. As a result the dollar value of foreign trade calculated from roubles using the direct rouble/dollar exchange rate differed considerably from the same dollar value obtained through initial conversion from roubles to domestic currencies and then from this to dollars. At the beginning of

1980s, Poland and Hungary have set direct exchange rates of their domestic currencies for the rouble and the dollar at the same time, and stopped using "valuta" currency.

The intra-CMEA prices changed according to a pattern different from that of the world prices. The price adjustments were much slower and with considerable delay compared to world prices. This was mainly due to the specific type of price setting.

2.4. IMPACT OF THE CMEA RULES

Even though there is a controversy in correctly assessing the gains from trade, the prevailing view is that over the last two decades the terms of trade had on balance been highly unfavourable for the Soviet Union - an outcome that is often interpreted as "hidden subsidy" to the rest of the countries members of CMEA.(2) This has resulted in part from commodity pattern of trade, which shows that Soviet Union was selling mostly "hard" (easily exportable to the rest of the world) raw materials, in exchange for mostly "soft" (esentially uncompetitive by international standards) manufactures.(3) In addition, under CMEA pricing system, raw materials have tended to be "underpriced", while manufactures have tended to be "overpriced".

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(2) Schrenk, M., "Whither COMECON?," Finance and Development. September 1990, pp.28-31.

(3) Schrenk, "The CMEA System of Trade and Payments," 1990.

This resulted in short-term gains for the GDR, Czechoslovakia, Hungary, Poland, and Romania, notably because their main exports towards U.S.S.R. consisted of manufactures. None the less, this exacerbated already existing distortions of the price structures, fostering delusions of cost competitiveness. This has been a major force behind the growing structural problems in a dynamic perspective. Bilateral treaties implemented under tight government control have created supply monopolies - especially if specialization agreements assigned production to one of the countries -and product development has been discouraged.

The export industries have been locked into an uneconomic output structure, and outmoded product and process technologies which have increasingly made them uncompetitive by world market standards . As a result, Eastern European countries faced severe constraints when it came to exporting to the world market. The lack of export marketing and know-how made matters worse.

The European planned economies have also sought to benefit from the international division of labor. Specialization in certain priority sectors has been a specific aim of CMEA integration. Recent studies conducted by the Economic Commission for Europe, attempted to determine whether or not this specialization has been reflected in the intra-industry trade of these countries. The development of intra-industry trade in manufactures, represents a two-way trade in similar, if

differentiated, goods. The findings show that the intra-industry trade in the European centrally planned economies was less intensive than that of developed market economies. Various studies have shown that intra-industry trade accounts for a high share - 60% to over 80% - of the trade in manufactures of the industrialized countries (Havrylyshyn and Civan, 1983).

Calculations for Czechoslovakia's total trade for instance, yield an intra-trade coefficient of 56% in 1977 (Drabek and Greenway, 1984). The same source reports that Poland's intra-trade coefficient rose from 29% in 1967 to only 37% in 1978.(4) As regards the trade of Eastern European countries with the West, the ECE Secretariat's calculations also yield relatively low intra-trade coefficients (ranging from 10% to 50%). The intra-trade coefficients of all European planned economies increased to various extents in the 1960s. However, since the first half of the 1970s these coefficients have remained roughly unchanged. Only Hungary's coefficient has increased in the 1980s, although much of the rise represented a recovery from the decline in the 1970s. Other studies (e.g.Brabant, 1988 ; Crane and Skoller, 1988), focusing on CMEA and applying different measures, have concluded that specialization agreements have not had great success in increasing economic integration .

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(4) Drabek, Z. and Greenway, D., "Economic Integration and Intra-Industry Trade: the EEC and the CMEA Compared," Basel. 1984, pp.444-469.

In sum, the Eastern European countries must contend now with a unique set of challenges arising from the complex relations they have built up with one another over the past 40 years. The challenge is to progressively throw out the elements of the CMEA regime that made it so inefficient and inflexible, transforming it into a more advantageous one for all participants.

The next section will cover the trade developments within the Eastern European countries, during 1960-1988. Special attention will be given to four selected East European countries, respectively Czechoslovakia, Hungary, Poland, and Romania. They were chosen considering a series of factors such as: their geographical proximity, their economic relationship with the Soviet Union, as well as their similar characteristics in the foreign trade development.

CHAPTER NO. 3

EVOLUTION OF FOREIGN TRADE OF THE EUROPEAN CENTRALLY PLANNED ECONOMIES : 1960-1988

3.1.GROWTH OF TRADE

1960-1988 period was characterized by a decline in the growth of trade volumes of the Eastern European countries. In 1960-1970, Eastern European trade grew at about same rates as world trade: 8.5-10%. During the first half of 1970s, the growth of world trade slowed down to 5.8% per annumm. However, the effect of the slowdown was not felt in the Eastern Europe trade which continued to grow about 8% during the first half of the 1970s. In the second half of the 1970s the impact of the decline in the growth rate of world trade lead to a similar slowdown of the Eastern Europe trade. This slowdown was more pronounced in the imports of Eastern European countries, with a much slower growth rate of imports compared to exports (2.8% as compared to 6.5% for exports). During the second half of the 1980s when the signs of recovery in the world trade were observed, the East European countries' trade growth continued to lag behind the world trade growth rate (Table no.1.).

TABLE NO. 1

WORLD AND EASTERN EUROPE FOREIGN TRADE,1961-1988;

FIVE-YEAR AVERAGE RATES OF CHANGE

PERCENTAGES

	World Trade Growth Rate	Growth Rate of Eastern Europe Exports			Growth Rate of Eastern Europe Imports		
		Total	To Socialist	To Non-Socialist	Total	From Socialist	From Non-Socialist
61-65	8.5	9.0	8.1	10.6	9.1.	8.3	10.9
66-70	8.5	8.5	8.5	8.7	10.9	10.8	11.2
71-75	5.8	8.3	9.4	6.3	8.6	7.9	9.7
76-80	5.8	6.5	6.6	6.2	2.8	2.6	3.3
81-85	2.6	4.9	4.9	4.9	0.5	1.5	-1.1
85-87	4.2	2.1	3.4	-0.1	3.6	4.3	2.2

Source: Economic Commission for Europe, Common Data Base.

The relative importance of the European Centrally Planned Economies in world trade continued to increase until 1982-1983. But thereafter their share in world trade declined.

During 1960-1987, Eastern Europe's share of the world imports rose during 1960-1980 from 2.49% in 1960 to 4.21% in 1980. Starting with 1985, the group's market share of world imports started to decline due to a slower growth rate in the Eastern European imports, compared to the growth rate of world trade.

Eastern Europe's share of world exports followed the same pattern as the imports. Thus, from 1960 until 1980 it constantly rose, from 2.57% in 1960 to 3.99% in 1980. Starting with 1985, their share declined to 3.46% and 3.12% in 1985 and 1987, owing to the slowing down growth of its export volumes (Table no.2.).

TABLE NO. 2

EASTERN EUROPE'S MARKET SHARE IN WORLD TRADE,

1960-1987

(PERCENTAGES)

	Constant 1980 prices						
	1960	1965	1970	1975	1980	1985	1987
Exports	2.57	2.89	3.31	3.83	3.99	3.46	3.12
Imports	2.49	2.95	3.88	4.59	4.21	3.71	3.60

Source : ECE Common Data Base

The factors underlying these long term developments are diverse. One factor is the relatively easy access to external finance in the 1970s. In the 1980s the situation reversed itself with a series of economic shocks, and the downturn in the world trade. Interest rates increased, adjustments had to be made with growing indebtedness, as financing opportunities declined. All of these severely impinged upon the Eastern European countries' ability to sustain imports, as it can be seen from the slower growth rate of imports.

Another factor is the worsening of the terms of trade of the Eastern European countries during 1970-1988, with respect to the world. Focusing now on the four selected countries, table no.3 reports the developments in the terms of trade of Czechoslovakia, Hungary, Poland, and Romania. The decline was more pronounced after 1980, for all countries. During 1970-1988 period, with the exception of Poland, all these countries experienced a steady decline in their terms of trade till mid 1980s. In the second half of 1980s, the terms of trade showed a slight improvement. In Poland terms of trade improved in mid '70s and worsened in early '80s with some signs of recovery since 1985 onward.

Losses in the terms of trade of Eastern European countries with respect to the rest of the world, lead to restrictions on feasible import volumes, and resulted in a reduction of the import growth rate of these countries, especially since 1985. Decreasing terms of trade during 1970-1980 implied a faster growth of exports as compared to imports. During 1980-1988, when terms of trade improved, a slower growth of exports was registered when compared to imports.

TABLE NO. 3

EASTERN EUROPE TERMS OF TRADE, 1970-1988
(1980=100)

Country	1970	1975	1980	1985	1987	1988
Czechoslovakia	122	110	100	85	86	90
Hungary	125	103	100	92	89	91
Poland	100	105	100	94	99	101
Romania	106	103	100	91	88	90

3.2.GEOGRAPHICAL DISTRIBUTION OF TRADE

The trade with socialist countries dominated the external trade of the European centrally planned economies since early 1950s. Recent data indicate that this situation has not changed significantly during 1970-1988 (Table no.4.). The share of East European exports destined for the socialist countries remained during this period at more than 50% of total exports.

During 1970-1988, Eastern European imports originating in the socialist countries was permanently above 50%. The percentage increased in 1985 to 63%, after having declined between 1970-1980 from 63 to 54%. This was partially due to the fact that during 1975-1980 the imports from the non-socialist group has stagnated around 44-46% of total imports.

Trade with the industrialized economies (Western European countries, USA, Canada, and Japan), grew from 27% in 1970 to 34% in 1988 for exports, while imports from these countries represented 29% in 1970 and 34% in 1988. The tendency, both for East European exports and imports was, during 1970-1988, to increase the trade flow towards non-socialist economies, and to reduce trade with the socialist countires (Table no.4.).

TABLE NO.4.

EASTERN EUROPEAN EXPORTS BY MAIN DIRECTIONS

1970-1988 , PERCENTAGES

Region	1970	1975	1980	1985	1987	1988
Socialist	64	61	55	57	54	53
Non-Socialist	36	39	45	43	46	47
of which:						
Industrial.	27	27	31	29	33	34
Others	9	12	14	14	13	13

EASTERN EUROPEAN IMPORTS BY MAIN DIRECTIONS

1970-1988, PERCENTAGES

Region	1970	1975	1980	1985	1987	1988
Socialist	63	56	54	63	55	53
Non-Socialist	37	44	46	37	45	45
of which:						
Industrial.	29	36	33	26	34	36
Others	8	8	13	11	11	11

Source : ECE Secretariat Common Data Base.

Country groupings: Socialist : Eastern European member countries of CMEA, and Soviet Union; Non-Socialist : 1.Industrialized - EEC countries, USA, Canada, Japan; 2.Others - All remaining non-socialist countries.

3.3.COMMODITY COMPOSITION OF TRADE

When the commodity composition of trade in Eastern European countries is analyzed, in spite of the large increases in industrial output and the intentions of planners, the composition of trade (calculated at 1980 prices) has not changed much in the past decade especially in trade with the non-socialist countries (Table no.5.).

TABLE NO.5.

EASTERN EUROPE COMMODITY STRUCTURE OF TRADE

BY DIRECTION, 1960-1987 (1980 PRICES)

(PERCENTAGES)

EASTERN EUROPEAN COUNTRIES: TRADE WITH SOCIALIST COUNTRIES

	EXPORTS					IMPORTS				
	(1)	(2)	(3)	(4)	(5)	(1)	(2)	(3)	(4)	(5)
1960	40.7	13.1	24.7	9.2	12.2	23.1	19.8	38.4	13.9	4.9
1965	45.5	10.3	21.7	9.7	12.7	28.7	20.6	37.5	8.5	4.7
1970	47.6	9.7	18.4	10.4	13.9	28.7	24.8	32.7	8.2	5.6
1975	52.4	3.1	18.7	10.4	13.7	35.7	25.5	27.6	4.8	6.4
1980	54.2	3.1	18.7	10.4	13.7	35.7	25.5	27.6	4.8	6.4
1987	59.2	3.1	15.9	8.1	13.7	36.9	28.0	23.5	3.7	8.0

TABLE NO.5.

(CONTINUED)

EASTERN EUROPE COUNTRIES: TRADE WITH NON-SOCIALIST COUNTRIES

1960	11.1	18.7	32.7	25.6	11.9	12.3	5.5	58.4	20.9	2.9
1965	10.2	21.7	31.4	22.6	14.2	18.1	6.3	53.6	19.2	2.8
1970	13.8	21.2	31.6	19.9	13.4	24.1	10.2	48.7	12.3	4.7
1975	19.9	19.1	29.6	16.0	15.4	30.0	9.0	46.9	10.1	3.9
1980	21.2	21.1	30.6	11.7	15.3	19.2	16.2	42.5	17.5	4.6
1987	19.2	20.0	34.3	12.5	14.0	20.2	13.4	43.9	15.0	7.4

Source: Economic Commission for Europe Common Data Base

Note: (1)-Machinery and Equipment; (2)-Fuels and Energy; (3)-Other production inputs; (4)-Foodstuffs; (5)-Industrial Consumer Goods.

During 1960-1987, exports of machinery and equipment, and industrial consumer goods towards the non-socialist countries have increased steadily from 11.1% in 1960 to about 21% in 1980 and, respectively from 11.9% in 1960 to about 15% in 1980, with the shares of both commodities declining since 1985, measured at 1980 prices. Fuels have consistently represented around 20% of total exports, and during 1980s, foodstuffs another 11-12% of total exports towards non-socialist countries. Moreover, a portion of "other production" inputs (typically raw materials) represented over 30% of non-socialist exports (Table no.5.).

Eastern European imports from the non-socialist area were

dominated by manufactures. Machinery and equipment accounted for about 20% of total imports in 1987, down from about 30% in the mid-1970s, while the share of consumer goods has increased to 7% in 1987 as compared to 2.9% in 1960. Over 40% of imports from non-socialist countries is represented by "other industrial inputs" The most important item imported were the semi-manufactures. During the 1980s, foodstuffs and fuel represented other important commodities to be imported. The latter reflected in part, crude-oil purchases from OPEC for refining and re-export to mainly Western European markets. Foodstuffs percentage declined from 20.9% in 1960 to 15% in 1987. Fuels and energy imports went up from 5.5% in 1960 to 16.2% in 1980, declining thereafter, to reach 13.4% in 1987 (Table no.5.).

The major flow of Eastern European foreign trade was oriented towards the socialist countries. The manufactures component of Eastern European exports to the socialist countries (largely the Soviet Union) has increased steadily from 40.7% in 1960 to 59.2% in 1987. This raise in the share of machinery and equipment deliveries, was due to the boom in Soviet imports which was made possible by favourable terms of trade in the other East European countries. The proportion of consumer goods in exports has remained relatively unchanged during 1960-1987, at around 12-14%. Foodstuffs exports increased to 10.4% in 1980, from 8.5% in 1960, and declined to 8.1% in 1987. Fuels and energy exports marked a heavy decline, from 13.1% in 1960, to only 3.1% in 1987.

Imports into Eastern Europe from the socialist area, mainly the Soviet Union, reflect a lower share of manufactures than do its exports to that area. Machinery and equipment imports increased from 23.1% in 1960 to 36.9% in 1987. The combined shares of machinery and equipment and consumer goods have represented only 45% of imports in 1987, as compared to 73% of exports in the same year. The share of all manufactures was likely to be higher because of the large component of semi-manufactures in "other production inputs" (23.5% in 1987). The share of fuel imports has been comparatively high and rising from 19.8% in 1960 to 28% in 1987, while foodstuffs exports declined from 13.9% in 1960 to 3.7% in 1987 (Table no.5.).

The evolution of the share of the European planned economies in Western markets for manufactures deserves special attention . The importance of these markets arises due to two reasons: First, the market constitutes the main source of convertible currency . Second, the growth of the market has been relatively rapid during 1960-1987, providing opportunities to expand sales.

Available data indicate that the shares in Western markets of all Eastern European countries and the USSR have increased from 1.52% to 1.96% between 1960-1975, by 1987 the aggregate share of the area in total Western imports of manufactures had fallen to 1.22%. This decline was widespread and affected every single member of the group without exception .

A more detailed analysis of the export performance of four selected Eastern European countries, can be seen in the next chapter. The analysis will be based on the constant market share method, and will explain the export performance of Czechoslovakia, Hungary, Poland, and Romania, during 1970-1988.

CHAPTER NO.4.

AN ANALYSIS OF EXPORT PERFORMANCE OF CZECHOSLOVAKIA, HUNGARY, POLAND, AND ROMANIA, BETWEEN 1970-1988, USING THE CMSA

The main purpose of this chapter is to analyze the export performance of Czechoslovakia, Hungary, Poland, and Romania during 1970-1988, using the constant market share method. These countries were selected based on their similarities such as their geographical proximity, trade relationship within the CMEA, as well as on their particularities, especially with regard to their degree of "openness" with the rest of the world.

The Constant Market Share Analysis is a statistical technique, aimed at the quantification of structural advantages or disadvantages inherent in the geographical and/or commodity composition of a country's exports. The method consists of estimating the demand and "competitiveness" components of export growth. It has been widely used in the analysis of foreign trade since it was first suggested in 1951 by Tyszynski.

The approach consists in partitioning a given change in a country's exports into structural demand components and a component described as the "competitiveness" factor. The demand component is further divided into a product pattern effect, a market pattern effect, and a growth of demand effect. They are calculated on the assumption that the period export shares remain constant.

To estimate the demand components, a three step procedure is used :

1. The export increase that would have occurred if the country's exports increased at the same rate as total foreign demand (world trade) is calculated. The export increase thus obtained is considered as the demand growth effect;

2. The export increase that would have occurred if the country's export of each commodity increased at the same rate as the foreign demand for these commodities is calculated. The difference between this increase and the one due to the demand growth effect gives the effect of the product pattern of demand growth. It will be positive (negative) when the country's exports are concentrated in products for which foreign demand grows faster (slower) than the average;

3. The export growth that would have occurred if the country's exports of each product to each importing country grown at the same rate as each country's imports of the same commodities is computed. The difference between this hypothetical export increase and the effect of the product pattern gives the effect of the country pattern of growth in demand for each product. It will be positive (negative) when a country primarily exports to fast (slow) growing importers;

The difference between the actual export increase and the sum of these demand effects provides the change in exports attributed to "competitiveness".

While interpreting the results of the constant market share analysis attention should be paid to its limitations. First, it is based on an identity, the competitiveness component being determined as a residual. This complicates the interpretation of the "competitiveness" effect because, although some demand effects can be removed, the residual is still affected by some demand as well as supply factors. Second, the method has no stochastic basis and cannot be used to make probability statements about future export performance. Therefore, the analysis apply only to the specific period for which the analysis was carried out.

Despite these limitations, the constant market share analysis, by decomposing a country's export growth into the approximate effects of different factors, can point to those areas where the explanations of export performance are likely to be found. It also provides a broad and consistent framework in which the performance of a number of competing suppliers to a given market can be examined and compared.

At the first stage of the analysis, changes in the value of exports are split down into two components: the total demand and a residual which is, the "competitive" component of each country export growth. The percentage contribution of these two factors, for Czechoslovakia, Hungary, Poland, and Romania between 1970-1988 are shown in table A.

Overall, it is to be noticed that during 1970-1988, the same

trend was followed by all the countries under analysis, although at various degrees.

Thus, after a good performance during 1970-1975, the export growth declined markedly during 1975-1980, with a slight recovery in 1980-1985, and a further decline in 1985-1988. The steepest decline in exports growth between 1975-1980, was recorded by Poland, followed by Romania, Czechoslovakia, and Hungary. This generalized decline during 1975-1980, partially represented the effect of isolation from trade with the industrial economies of the West, which wanted to prevent Eastern Europe from importing higher quality machinery and also to prevent them from earning the hard currency required for imports. The basic impact on their domestic industries was that they were unable to benefit from the economies of scale arising from the exploitation of larger markets, while the isolation from foreign competition removed much of the incentive for domestic industries to improve the quality specifications.(5)

The recovery which followed in 1980-1985, was more accentuated only in Poland and Romania to some extent. Export growth declined during 1985-1988 in Poland and Romania, while Czechoslovakia and Hungary registered increasung export growth rates in 1985-1988, as compared to 1980-1985. The 1985-1988 decline in the competitive factor performance of Poland and Romania was

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(5) Smith, Alan, "The planned economies of Eastern Europe." New York, 1983, pp.150.

determined by the lost of the Most Favourized Nation Clause: Poland as a result of the martial law introduced in 1981 and Romania as a result of violating human rights.

For Czechoslovakia, the export growth performance during 1970-1975, was mainly due to the competitive factor. The demand factor accounted only for a very small portion of total export growth, during this period. The "competitiveness" increased between 1970-1975, mainly due to the integration between Eastern European countries themselves. Thus, clear areas of complementarity arose between the industrial economy of Czechoslovakia and the coal producing regions of Poland.(6) Starting with 1975 though, Czechoslovak exports growth rate slowed down. Both demand and "competitive" factors affected this decline. However, during 1970-1980, the competitive factor had a higher contribution to total export growth than the demand factor. Starting with 1985, the situation reversed itself: the demand factor gained more weight, although declining when compared to previous periods. In 1985-1988, export growth started to improve, due both to the demand and competitive factor. The improved performance of country's exports after 1985, stems from the domestic policy, which during this period focused on increasing exports.

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(6) Ibid. (5), pp.151.

Hungary registered a sustained growth in exports during 1970-1975, particularly due to the "competitiveness" of its exports. This trend however was not consistent, as the exports growth started to slow down during 1975-1980 (but still high compared to 1985). During 1980 - 1985 it registered an even steeper decline, to slightly recover between 1985-1988. During this period, the "competitive" factor represented the major contribution, although continuously declining, to Hungary's total export growth.

TABLE A

THE CONTRIBUTION OF DEMAND AND "COMPETITIVENESS" FACTORS TO THE GROWTH IN EXPORTS FROM 4 EAST EUROPEAN COUNTRIES 1970-1988 (PERCENTAGE CHANGE)

COUNTRY	1975/1970	1980/1975	1985/1980	1988/1985
CZECHOSLOVAKIA				
export growth,	120.3	15.6	4.3	12.5
of which:				
demand factors	8.3	5.6	2.8	6.2
"competitiveness"	112.0	10.0	1.5	6.3
HUNGARY				
export growth,	147.4	93.7	3.6	15.1
of which:				
demand factors	7.7	5.2	0.6	5.6
"competitiveness"	139.7	88.5	3.0	9.5
POLAND				
export growth,	210.5	12.2	298.0	67.0
of which:				
demand factors	7.7	5.0	9.7	5.2
"competitiveness"	202.8	7.2	288.3	61.8
ROMANIA				
export growth,	208.3	19.0	41.0	9.8
of which:				
demand factors	8.2	5.6	2.3	6.0
"competitiveness"	200.1	13.4	38.7	3.8

The demand factor's contribution to Hungary's export growth was small, and declining from 1970 until 1985, to slightly improve between 1985-1988.

As a country strongly dependent on foreign trade, during 1975-1980, Hungary was at the same time affected by the negative change in the world market such as higher interest' rates, recession, increasing protectionism in the West, have contributed to its negative performance during this period.

Poland also registered a positive performance of its export growth during 1970-1975. The situation deteriorated markedly during 1975-1980, mainly due to the recession in the West. Moreover, during the same period, Poland's exports of coal and other minerals were negatively affected due to the restrictions imposed by the European Coal and Steel Community.(7) During the 1980-1985 period, the exports grew markedly, the growth being almost entirely due to the "competitive" factor. The explanation of this boom in exports lies in the fact that after 1981 when the martial law was introduced, the military government embarked on a reforming program focused on reducing the country's debt through increased exports. In 1980 Poland's foreign debt had reached to US$ 25 billion, the highest among CMEA countries. Never the less the effects of this reform were positive only for a short period, as starting with 1985, exports growth declined

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(7) Ibid. (5), pp.150.

markedly and the country's debt increased even further, to reach US$ 38 billion in 1988.

Romania, like the rest of CMEA countries, registered a high export growth rate during 1970-1975, after which the growth declined continuously, with a very slight recovery during 1980-1985. During 1975-1980, the country which exports towards West consisted mainly from agricultural and foodstuffs, was affected by the agricultural policies pursued by the EEC. Starting with 1974 and during 1975-1980, Romania was also seriously hit by the massive increase in OPEC oil prices. Unlike any other socialist country, Romania was the only CMEA state which imported very limited quantities of oil from the Soviet Union, so it did not benefit from the favourable CMEA clearing prices. Up to 1978-1980, Romania was not interested in Soviet raw material supplies. To safeguard his relatively independent foreign policy, Ceausescu apparently did not want to offer the U.S.S.R. any possibility of exercising influence through imposed trade policy measures.(8)

Moreover, Romania had to expand its oil imports in the mid 1970s especially as domestic oil production fell. Thus, during 1970s, Romania almost exclusively had to buy OPEC supplies, which entailed increasing debt. Furthermore, Romania was also hit by increased interest rates in the world market, during 1975-1980.

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(8) G.D.R. and Eastern Europe - a Handbook. Vermont, 1989, pp.251.

This negatively affected the domestic production and thus the exports. In 1984 Romania's indebtedness reached its highest figure US$ 10 billion. As a consequence of increased indebtedness, Romania embarked on an adjustment program, starting with 1985. It was focused on increasing exports, as a measure directed towards eliminating the foreign debt. However, the country did not succeed to boost its exports markedly, so the debt was mainly paid through a drastic reduction in imports, especially of crude oil, machinery, and foodstuffs.

With the constant market share analysis the total demand component can be also broken down into a product pattern, a market pattern, and a growth in demand component. Table B presents the percentage contribution of these factors and of "competitiveness" to changes in exports between 1970-1988.

TABLE B

THE PERCENTAGE CONTRIBUTION OF DEMAND FACTORS AND "COMPETITIVENESS" TO THE INCREASE IN TOTAL EXPORTS, 1970-1988

EXPORTER	ACTUAL EXPORT INCREASE (US$)	OF WHICH, % CONTRIB. DUE TO: GROWTH IN DEMAND	PRODUCT PATTERN	MARKET PATTERN	TOTAL DEMAND EFFECT	COMPETITIVE EFFECT
			1975/1970			
CZECHOSL.	4563.74	6.90	62.40	- 81.30	- 12.00	112.00
HUNGARY	5567.30	5.20	51.50	- 96.40	- 39.70	139.70
POLAND	4148.07	3.60	32.60	-139.00	-102.80	202.80
ROMANIA	3212.73	3.90	15.60	-119.60	-100.10	200.10
			1980/1975			
CZECHOSL.	6534.95	97.60	58.40	- 66.00	90.00	10.00
HUNGARY	42856.10	78.40	42.00	-108.90	11.50	88.50
POLAND	3523.50	38.50	71.50	- 17.20	92.80	7.20
ROMANIA	4711.79	50.40	48.90	- 50.00	49.30	50.70
			1985/1980			
CZECHOSL.	2650.28	56.10	-59.80	102.20	98.50	1.50
HUNGARY	9628.32	17.90	4.90	74.20	97.00	3.00
POLAND	237919.00	128.00	-40.40	-275.90	-188.30	288.30
ROMANIA	18685.10	25.80	- 8.30	43.80	61.30	38.70
			1988/1985			
CZECHOSL.	7405.53	53.30	- 2.40	42.80	93.70	6.30
HUNGARY	32875.37	37.00	- 0.30	53.80	90.50	9.50
POLAND	881925.08	8.60	- 5.00	34.60	38.20	61.80
ROMANIA	8739.75	59.70	-17.10	53.60	96.20	3.80

Czechoslovak product pattern of export growth contributed with 62% at country's total growth, during 1970-1975. The proportion declined to 58.4% in 1975-1980, to negatively affect exports growth thereafter. Hungary recorded a similar trend during the same periods. The only exception is 1980-1985, when product pattern contribution declined to 4.9% as compared to 1975-1980, when the percentage was about 42%. Poland recorded an increase in its product pattern contribution, from 32.6% in 1970-1975, to 71.5% in 1975-1980. Starting with 1980, this factor had a negative contribution, -40.4% in 1980-1985. and only -5% in 1985-1988. Romania's product pattern contribution increased from 15.6% in 1970-1975, to 48.9% in 1980-1975. Starting with 1980-1985, this factor's contribution was negative, -8.3% in 1980-1985, -17.1% in 1985-1988.

One explanation behind these trends lies in the countries' commodity structure. Thus, during 1980-1975, the product pattern contribution declined for all four countries, as compared to 1970-1975, because of their high degree of product concentration, which made them sensitive to the recession in the western countries.

The market pattern of demand growth, negatively affected export growth for all four countries during 1970-1975, and 1980-1975. The negative effect was decreasing in Czechoslovakia, Poland, and Romania, while it slightly increased for Hungary. After 1985, the situation reversed itself, the effects of the

market pattern were positive for all countries except for Poland (during 1980-1985). The market pattern became more important in 1988-1985 for Poland and Romania while for Czechoslovakia and Hungary the percentage declined in 1988-1985, as compared to 1980-1985.

During 1970-1975 and 1975-1980, although the world demand for Czechoslovak products increased, the total demand effect was smaller than the growth in world demand. This was due to the market effect which negatively affected the total demand effect. The increase in exports within 1970-1975 was due to the "competitiveness" effect. During 1975-1980, the market pattern had also a negative contribution to the total demand effect, but smaller than in the previous period. Starting with 1980-1985, the demand growth slows down. This time the market pattern has a positive contribution to the total demand growth. Thus, the total demand contribution to the actual increase in exports gains more importance, as compared to the competitive factor. It contributes with 98.5%, while the competitive factor with only 1.5%. The product pattern has a negative effect on total demand. For 1985-1988, the growth in demand is slowing down as compared to the previous period. The product pattern still has a negative effect, although smaller than during 1980-1985. The market pattern effect lost of its importance. Overall, the total demand effect slightly reduced its contribution in the actual increase of exports to 93.7%, the competitive factor contributing with 6.3%.

For Hungary, during 1970-1975, the market pattern was largely negative, thus negatively affecting the total demand, despite the positive contribution of world demand and product pattern. The competitive factor was the only one contributing to the actual increase in exports. For 1975-1980, the market pattern effect continued to be negative and it was larger than during the previous period. The world demand for Hungarian products grew faster as compared to 1970-1975. The product pattern also had a positive effect. All of these led to an improved total demand effect, but the main contribution to the increase in exports was still due to the competitive factor (88.5%). During 1980-1985, the world demand growth slowed down, but the market pattern effect improved considerably, contributing with 74% to the total demand growth. The total demand was thus the main factor affecting the actual increase in exports. The competitive factor reduced its contribution considerably (only 3% as compared with 88.5% during 1975-1980). For the 1985-1988 period, the world demand grew compared to the previous period, but the product pattern effect became negative. The market pattern reduced its contribution and thus, the total demand effect on the actual increase in exports was smaller than during the 1980-1985 period. The competitive factor increased its contribution to 9.5%.

Poland followed the same trends as the other countries. Thus, within 1970-1975, the market pattern effect negatively affected the total demand. The product pattern as well as the world demand have had a positive effect on total demand. The

total demand though, had a negative contribution to the actual increase in exports, due to the large negative influence of the market pattern. The only factor positively contributing to the actual increase in exports was the competitive one. For 1975-1980, the world demand grew faster than the previous period, as well as the product pattern effect. The market pattern effect continued to be negative, but at a lower level. Thus, the total demand effect was positive, contributing with 11.5% to the actual increase in Polish exports. The 88.5% was due to the competitive factor. During 1980-1985, despite a very impressive growth in the demand for Polish products, the product and market pattern effects were negative. They thus offset the positive contribution of world demand growth in the total demand effect. The competitive factor was the only one contributing to the incrase in exports. It is to be mentioned here that during 1981-1982, the Polish government artificially appreciated its currency (zloty) with respect to the US$. Therefore when the export data in zloty is converted to US$, it looks like there is a sudden increase in exports. This affected the competitive factor and the conclusions for Polish export performance during 1980-1985, can be misleading. For 1985-1988, the product pattern effect on total demand was negative. The world demand for Polish products was much smaller as compared to the previous period. An improvement registered the market pattern effect which became positive. The total demand thus contributed with 38.2% at actual increase in exports, while the competitive factor accounted for 61.8%.

Romania also registered the same evolution. During 1970-1975, the market pattern effect was negative, largely offsetting the demand growth and the product pattern effects. The total demand effect on actual increase in exports was thus negative, the competitive factor accounting for the balance. During 1975-1980, the world demand for Romanian products grew faster than during the previous period, as well as the product pattern effect. The market pattern effect continued to be negative, though at a lower level. The total demand effect was positive, contributing with 49.3% of actual export increase, while the competitive factor accounted for 50.7%. During 1980-1985, the product pattern effect was negative. The market pattern effect and the world demand growth offsetted the negative effect of product pattern, thus the total demand effect was positive and increasing to 61.3% as compared to 1975-1980. The competitive effect declined from 50.7% during 1975-1980 to 38.7%. During 1985-1988, the demand growth accentuated as compared to the previous period. The market pattern effect was also positive and gained more weight in total demand. The only negative effect was recorded by the product pattern. Overall, the total demand contributed with 96.2% at the increase in actual exports. The competitive factor accounted for the balance.

As a review over the whole period, some general conclusions could be drawn thus:

1. All of the countries under analysis registered favourable effects of the competitive factor during 1970-1975. This effect

continuously lost importance during the next period, with a slight recovery during 1985-1988. Anyhow, the results for the 1985-1988 are somewhat biased by the fact that this period covers only three years as compared to the other ones which cover five years;

2. All of the countries export performance was negatively affected by the market pattern effect during 1970-1975 and 1975-1980 and by the product pattern effect during the two remaining periods. This leads us to the conclusion that, during the first two periods these countries exports were concentrated on markets with a slower than the average growth rate. For 1980-1985 and 1985-1988, the product pattern was negative, meaning that the commodity composition of trade was concentraded on goods with a slower than the average growth.

This chapter concludes the analysis pursued for the Eastern European and the four selected countries' foreign trade during their socialist stage. The fifth chapter will focus on the economic reforms and foreign trade characteristics of Eastern Europe, after 1989.

CHAPTER NO. 5.

ECONOMIC REFORMS, THE COLLAPSE OF THE CMEA AGREEMENTS AND THEIR IMPACT ON EASTERN EUROPEAN COUNTRIES FOREIGN TRADE

5.1.NECESSARY CONDITIONS FOR ECONOMIC TRANSITION

In the last two years, the countries of Eastern Europe have passed through an unprecedented wave of political and institutional changes. The most important "revolution' in these countries has been the rapid erosion of the dominant role of the Communist Party. In prior periods, the dominance of the Communist Party was not directed only towards the political process or economic management, but extended throughout society into the life of every citizen. The wider social effects of over forty years of such single party rule will not disappear soon. This means that, even in a study restricted to economics, it is impossible to limit the analysis solely to this area. The political issue is strictly related to the economic one.

The shift to an open, market-oriented economy implies the need to build a political and a social consensus. Without a clear political agreement on decision-making by consensus, a credible reform program will be impossible to achieve. Moreover, popular support may be easier to maintain in countries where policy makers have a popular mandate, endorsed by democratic elections, than in countries where they may be attempting to impose economic change from above.

A framework for the transition to a market economy must cover the comprehensivness of the reform ("how much to change"), the speed with which the various reforms can be implemented ("how quickly can it be changed") and the sequencing of the various reforms ("what to change first"). Any attempt to do everything at once would lead to chaos and the probable abandonment of the reform process.(9)

One of the most important reform area is the trade and foreign exchange liberalization. As the economies in transition are willing to integrate quickly and as much as possible with the international economy, special attention must be devoted to the reconstruction of the trade and foreign exchange sectors of these economies. Openess to the world economy will help to provide a system of relative prices and much needed competition for domestic producers. The trade and foreign exchange liberalization will provide an adequate system of relative prices for traded goods and increases the competition to reduce the scope for monopolistic price increases for domestic suppliers.

In the former economic system, there was high protection against imports. This took various forms of import and export quotas, foreign exchange licensing, often through bilateral agreements. Presently, all these barriers to trade will have to

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(9) U.N. Economic Commission for Europe, "Economic Bulletin of Europe," Vol.42/1990, pp.119-121.

be replaced by conventional commercial-policy instruments, mainly tariffs and exchange-rate policies.

Although some measures to protect existing economic structures may be necessary, it would appear to be counter-productive to try to insulate the reforming countries from foreign competition.

The former exchange rate system with its multiplicity of rates (see Chapter no.1), will need to be replaced with one based on a single exchange rate. The main problem to be solved here will be the way in which the exchange rate will be adjusted without affecting the credibility of policy. A substantial undervaluation will foster exports and allow competitiveness to be maintained at the given exchange rate even after a period of "corrective inflation". In practice, the majority of the countries in transition appear to be opting for undervaluing the exchange rate (as compared to a rate that would generate current-account balance) without an explicit commitment to a crawling peg policy. For instance Poland has used the exchange rate, together with restrictions on nominal wage increases, as the main process of the reform.

Moreover, with the collapse of the CMEA system of transferable rouble clearing and its particular price arrangements, it is important that the economies in transition avoid falling into the trap of trying to balance their mutual

transactions on a bilateral basis. The explanation is that a rebilateralization of the trade among the former CMEA members can pose new barriers to the introduction of market economies. The effects of the CMEA agreements dissagregation, will be discussed in more detail in the next sub-chapter.

5.2. THE COLLAPSE OF THE CMEA AGREEMENTS AND ITS EFFECTS ON THE FOREIGN TRADE OF EASTERN EUROPEAN COUNTRIES

Economic performance of Eastern Europe after 1990, has been seriously affected by the collapse of trade among the former CMEA countries. This was the effect of the decision taken in 1990 to replace the CMEA trade and payments regime with a system based on world market prices and convertible currencies.

The process determined associated shifts in the terms of trade and in the geographical distribution of trade, especially a rapid rise in the importance of trade between this region and OECD. On the other hand, Eastern Europe's terms of trade were bound to decline markedly under the new system. The area's import prices would rise sharply when the Soviet Union rised the price of its fuel exports to world market levels, while the prices of East European manufactures would tend to decline.

The most important force behind the collapse of the intra CMEA trade has been the inability or unwillingness of the Soviet Union to purchase goods for hard currency from Eastern European countries. Imports of the U.S.S.R. have been limited largely to

those which could be financed under residual clearing agreements. Exports of USSR to Eastern Europe have also fallen sharply, reflecting both demand and supply factors. On the demand side, East European countries have compressed their imports from the Soviet Union to a minimum, paying hard currency only for essential energy and raw materials. On the supply side, declining Soviet production of energy has implied a significant amount of rationing of petroleum, while other Soviet "hard" goods have been channelled to the West. The collapse of intra-CMEA trade has been one element explaining the fall in output for all Eastern European countries (Table no. 6.).

TABLE NO. 6.

EASTERN EUROPEAN FALL IN OUTPUT, 1990-1992
(PERCENTAGE CHANGE OVER THE PREVIOUS YEAR)

COUNTRY	1990	1991	1992e
Czechoslovakia	- 1.1	-12.0	- 5.0
Hungary	- 5.0	- 7.0	1.0
Poland	-12.0	- 8.0	- 1.0
Romania	-10.5	- 9.0	- 4.0

Source: OECD Economic Outlook, December 1991. (e =estimation)

The contraction in output in the european CMEA countries was accompanied by a much steeper decline in exports. The volume of exports fell by more than 12% in 1990 compared to 1989. Imports into the region also declined, by 2.5% within the same period.(10)

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(10) Ibid. (9).

TABLE NO.7.

EASTERN EUROPE FOREIGN TRADE: ANNUAL PERCENTAGE CHANGE

1988-1990

	EXPORTS			IMPORTS		
	1988	1989	1990	1988	1989	1990
Czechoslovakia	3.2	- 2.0	- 13.0	2.9	2.7	- 2.5
Hungary	5.1	-	- 4.3	-2.0	1.0	- 3.4
Poland	9.1	0.2	14.9	9.4	1.5	-15.6
Romania	7.4	-10.8	-25.0	-5.8	3.7	4.0

Source: ECE Secretariat

TABLE NO. 8.

EASTERN EUROPE NMP AND CONSUMPTION, 1989-1990

(ANNUAL PERCENTAGE CHANGE)

Country and Period	Net Material Product	Consumption Total
Czechoslovakia		
1989	1.0	3.7
1990	-3.1	1.1
Hungary		
1989	-1.1	-0.5
1990	-5.5	-4.5
Poland		
1989	-0.2	-1.7
1990	-13.0	-24.0
Romania		
1989	-7.9	0.1
1990	-10.5	10.0

Source: ECE Secretariat Common Data Base

The larger part of this downturn reflected a steep downward spiral of trade among the european CMEA countries. This was caused by political and institutional developments in the region, including the dissolution of the special CMEA trade and payments arrangements, but also by the economic recession in these countries. The trade of the East European countries with "socialist" economies (and, notably among themselves) contracted even more sharply, by an ECE estimate of 18-21% in volume, in 1990 compared to 1989, reflecting the greater severity of the recession in these countries. In trade with the market economies, the East European exports stagnated in volume in 1990 compared to 1989, according to ECE Secretariat estimates.

The next section of this chapter will detail the experiences and immediate prospects for reform in Czechoslovakia, Hungary, Poland, and Romania. The effects of the CMEA trade agreements collapse are also to be analyzed further on.

5.3.COUNTRIES EXPERIENCES

5.3.1.THE "SHOCK TREATMENT" : POLAND

The policy measures designed to introduce a market economy system in Poland have been characterized as a "shock-treatment". This process involved a sudden and comprehensive liberalization of all domestic markets for goods, services, and production factors, a liberalization which also extended to foreign trade.

It is evident that such a reform could not be carried on without the existence of a broad political and social consensus in favour of creating a market economy. Indeed, the negotiations held between the government and the Solidarity in spring 1989 resulted in a broad consensus on future political and economic reforms. The elections that followed revealed the lack of support for the Polish Communist Party. The new Mazowiecki government, (non-communist), established measures to stabilize the economy, and many laws related to it were prepared and passed by the parliament in very short time. (Poland's Economic Programme, Oct.1989).

The center of the transition process from centrally planned to market economies is the creation of the legal institutions which support the market economy system. Decentralization of decision-making, privatization, price liberalization, the liberalization of foreign trade are some of the priority elements.

In Poland some limited steps towards the liberalization of foreign trade had already been introduced in the 1980s, especially with regard to trade with convertible-currency countries. This was reflected in a large increase in the number of firms holding permits which allow them to make independent arrangements with foreign partners. The authorities completely liberalized foreign trade for registered firms at the beginning of 1990.

Customs duties and the exchange rate have replaced administrative regulations as the major regulators of external commercial relations. The few exceptions to free trade concern the radioactive and nuclear materials, weapons and arms, as well as selected services such as franchising. Restrictions were also imposed on trade in alcoholic beverages and tobacco in 1990.(11) A major feature of the reforms was to cut the import tariffs on many goods in order to increase competitive pressure from abroad. Many customs duties, especially on intermediate goods, were suspended in the course. Export quotas were strictly limited during 1990 and applied mainly to areas where free trade may have led to serious domestic supply shortages (e.g. of coal).

Since 1982 the Polish authorities had followed a policy of flexible adjustment of the zloty to the U.S.dollar to ensure the profitability of the exports. A system of retention quotas was introduced that permitted firms to keep for themselves an important part of their foreign exchange earnings from exports and use them for import of inputs. Starting with January 1990, zloty suffered a nominal devaluation of 46% as compared to December 1989.

At the same time internal convertibility was introduced. Internal convertibility means that registered firms can freely convert domestic currency into other currencies for most foreign

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(11) Ibid. (9).

transactions but at the same time they have to surrender their foreign exchange holdings to the central bank. In contrast, non-resident firms are still restricted in this respect.

The demand for foreign exchange for non-trade purposes (e.g.tourism) is met in the open parallel market. It is to be noted that this market rate has remained stable and close to the official uniform rate since early 1990.

To stimulate foreign direct investment it was planned to provide the legal structure for free transfer of profits abroad in the course of 1991 once the necessary changes in the existing joint-ventures law have been passed.

As regards exports, these increased by 15% in 1990 compared to 1989, after having declined in 1989 compared to 1988 from 9.1% to 0.2%. In Poland, given the progress made in the structural reform, the exporters were able and willing to take advantage of the decentralization of economic decision-making and liberalization of foreign trade to boost exports towards West. Thus, the rate of growth of its convertible currency exports quickened throughout 1990, reaching a rate of nearly 75% in value during the last quarter of 1990 (E.C.E. Secretariat estimates). However, output has fallen sharply in Poland within 1988-1990, under the impact of this country's stabilization policy on domestic demand, and it is one of the first successes of the Polish transformation policies that this led to a determined

search for outside markets by Polish enterprises. This situation was determined by the drastic reduction in domestic consumption, which contracted more strongly than the output, creating thus the possibility of a dynamic export growth (Table no. 6, 7 and 8).

5.3.2.REFORM IN THE MAKING: CZECHOSLOVAKIA,HUNGARY

For more than two decades Hungary has been in the vanguard of economic reform among the centrally planned economies, while in Czechoslovakia the traditional system remained almost intact until 1989. In Hungary, fundamental constitutional changes started by 1988, while the political transition in Czechoslovakia occured in November 1989, through the "velvet revolution".

In Czechoslovakia, the reform measures are contained in an official document entitled the Scenario of Economic Reform. The actions of the Hungarian government, however, do not derive directly from a single document. None the less, both countries are committed themselves to establish a strong social market economy, in which private property is to dominate.

One of the core elements of the reform in both countries is the foreign trade liberalization and convertibility. After price liberalization, the second cornerstone of the Czechoslovak reform proposals was the immediate establishment of internal convertibility of the crown from 1 January 1991. This implies the compulsory sale of foreign exchange to banks and the possibility of free purchase of currencies for the purpose of imports. This

means that each company must sell to banks their foreign currency profits, in exchange for national currency. For imports, they are allowed to freely buy foreign currency at the official established rate of exchange. At first such access to foreign currency was to be reserved for companies only. Unlike in Poland, private citizens, state financed bodies continue to be controlled and limited. One important issue connected with the establishment of internal convertibility concerns the determination of a sustainable exchange rate policy. The Czechoslovak authorities opted for a relatively large initial devaluation and set the exchange rate at 28 crowns to the dollar, somewhat below the estimated marginal cost of producing 1 dollar's worth of exports. The tourist rate was abolished, and the foreign exchange auction, was discontinued.(12)

After the failure of initial moves to convertibility (in 1968), the issue of liberalizing imports in Hungary (more precisely: convertible currency imports) was put aside for almost two decades. In 1988 a gradual liberalization of imports and a relaxation of profit repatriation limitations were launched at the same time. As a result of further measures introduced in January 1991, the forint has become almost fully convertible for the purposes of imports and profit repatriation.(13)

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(12) Zahradnik, J., "Czechoslovakia's Approach to Currency Convertibility Issues." Prague, January 1991.

(13) National Bank of Hungary. Annual Report, pp.72.

Changes in corporate structures also mean that a growing number of agents can perform foreign trade activities besides the traditional foreign trade organizations. In Hungary this process started in 1968, while in Czechoslovakia the decisive step was taken only in April 1990. The changes in legislation allowed foreign trade to be carried out by any economic agent irrespective of the type of ownership and irrespective of the agent's nationality (domestic or foreign) on the basis of simple registration with the authorities. An important push has been given to this process by the termination of the intra-CMEA trading and payment agreements from 1 January 1991. The lack of competition on the CMEA markets and the dominance of the bilateral trade relations meant that it was impossible to give real commercial independence to firms with significant trading relationships with CMEA partners. In both countries a complicated system was required to link domestic producers with their CMEA partners and an almost completely different mechanism was needed to link them with the western market economies. Since January 1991, all these were replaced to a unified foreign trade system based on appropriate exchange rates and market conformity regulations.

Nevertheless, some temporary administrative measures are maintained or have been introduced to prevent a rapid rise of consumer goods imports. Hungary, for example, ever since its accession to the GATT, has been operating a quota system for this

purpose. According to the 1991 guidelines, the quota for the aggregate of non-liberalized consumer goods was set at US$ 630 million, which was three times the 1990 figure.

During 1988-1990, Czechoslovak and Hungarian exports fell continuously. Czechoslovak exports fell with 13% in 1990 as compared to 1989, while Hungarian exports fell by 4.3% within the same period. Imports from the two countries also fell by 2.5% for Czechoslovakia and by 3.4% for Hungary, between 1989-1990.

In 1990, Czechoslovakia's exports to the convertible currency area, increased for the fourth consecutive year. A stronger export performance towards the West was offset by a sharp contraction of sales to the developing countries. The fall in the Czechoslovak exports to developing countries, appears to reflect suppresion of arm sales and the ongoing policy to phase out exports to non-creditworthy countries.(14)
Exports of raw food materials, construction materials, consumer goods, live animals and chemicals to the convertible currency area as a whole were especially strong.

In 1990 exporters appear to have benefited from the first round of economic reforms. These resulted in a growing number of enterprises exercising their foreign trade rights, and a broader access to foreign exchange through the system of currency auctions.

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(14) Ibid. (9).

The boom in convertible currency imports, reflects the more liberal import policy of the new government. Consumer and engineering goods imports grew particularly rapidly.

For Hungary, the convertible currency trade and payments developed favourably during 1990. Domestic demand contracted further and this set the stage for continued export growth. Export growth was helped by the improved access to Western markets granted within the framework of various EEC supporting programs. Hungarian economists have estimated that some one third of Hungarian export growth to the west in 1990 could be attributed to western trade concessions. As a result, convertible currency exports rose by 17% in value during 1989-1990. A good export performance in the western market was important in the light of collapsing CMEA demand and was estimated to have compensated for one third of the decline in Hungary's exports to the Eastern trade area.

Convertible currency imports were stagnant during 1990, despite the further liberalization of the import regime undertaken in January 1990. Overall, the value of convertible currency imports rose by 12% during 1990.

5.3.3.LATE STARTER: ROMANIA

Romania have had more difficulties than the other Eastern European countries in definitively breaking with the communist past, and political disagreements have affected reform efforts.

Meanwhile, the economic situation deteriorated steadily as the old system of central planning collapsed without being replaced by any market based system of co-ordination.

The political situation has been plagued by the continuing uncertainties about the precise roles played by the army, secret police and the communist party in the overthrow of the Ceausescu regime in December 1989. The elections held in May 1990 gave the National Salvation Front (NSF) a large majority in the new parliament. The NSF won the elections on its reputation acquired during the December revolution and on a promise to introduce a market economy gradually, protecting those most vulnerable to change.

The lack of social consensus already appears to be a problem. The first phase of price liberalization in November 1990 led to large price rises and demonstrations against the government. Strikes have been widespread and while some strikers have merely demanded pay rises and improved working conditions, others also demanded a quickening in the pace of reforms. There thus seems to be little chance of an early emergence of a wide social consensus in Romania. However the government is determined to press ahead with its chosen, radical reform program, despite the lack of a broad social consensus.

Reform of the trade regime is particularly urgent , as a collapse in exports in 1990 (due to much reduced domestic

production and the diversion of exportables to home use) meant that the country ran down much of its foreign exchange reserves in paying for imports. Many enterprises have obtained licences to trade directly with foreign firms and the role of the trade ministry has been reduced, though the ministry still has the power to limit some imports and exports.

The 60% devaluation of the official exchange rate in September 1990 was designed to discourage imports. Foreign currency auctions have been introduced as a first step towards convertibility (the government's report programe aims for full convertibility of the leu in 1992), with the exchange rate in the auctions operating in parallel with the official rate until convertibility is achieved. The first auction set a rate of 200 leu to the dollar. More recently, the government has agreed with the IMF further to liberalize trade in foreign currency from April 1991.(15)

Since the beginning of 1990, Romanian foreign trade has been in a critical state, characterized by the collapse of industrial output and exports. The exports decreased, as the new government has abandoned the harsh trade policy pursued by the communist regime during the previous decade. In late 1989, with a view to improving supply to domestic markets, the authorities sharply cut food exports and increased imports for

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(15) Neue Zurcher Zeitung, 11 March 1991.

food, consumer goods and various inputs needed for agricultural production. During 1988-1990, Romania's total exports fell considerably, by 10.8% in 1989 compared to 1988 and by 25% in 1990 reported to 1989. Imports on the other hand grew by 3.7% in 1989 as compared to 1988, while in 1990 they increased by 4% more than in 1989. Exports to the convertible currency area fell by 25% in 1990 as compared to 1989. Convertible currency imports boomed throughout 1990, increasing by 45% in value terms as compared to the previous year. Romania increased purchases from the developed market economies, while reducing imports, mainly of crude oil, from the developing countries (Table no. 6, 7, and 8). In response to the rapidly deteriorating trade balance (US$ 1.7 billion 1990 deficit), in July 1990, the government announced measures to reduce the inflow of imports and curb the depletion of the country's foreign reserves.

CHAPTER NO.6.

CONCLUSIONS

It appears clear that during 1960-1988, the Eastern European countries' foreign trade has been dominated by the CMEA trade agreements. The major flow of exports and imports was developed within this framework. Moreover, their foreign trade had some major particularities such as the five-year moving average of world market prices for establishing their own export/import prices. Another major characteristic is the use of the transferable rouble as the official exchange rate within the CMEA.

Another specific characteristic was the Soviet leadership within the CMEA agreements. The U.S.S.R. represented the major importer of Eastern European manufactured goods during 1960-1988. At the same time, it was the most important supplier of raw materials for all these countries.

During 1960-1988, Eastern Europe's share of World exports rose until 1980, from 2.49% in 1960 to 4.21% in 1980, to decline therafter to 3.60% in 1988. The Eastern European countries were not particularly affected by the first oil price shock, mainly because the Soviet Union was supplying oil at lower prices. However they were affected by the World recession during 1980s, as by that time Eastern European countries were trying to

increase their foreign trade with the Western countries.

The constant market share analysis for Czechoslovakia, Hungary, Poland, and Romania during 1970-1988, shows that these countries export performance was good during 1970-1975 period. Starting with 1975, these countries export performance worsened, due to various political and economical factors, specific to each of the analyzed countries. For the 1970-1975 period these countries foreign trade was favourized by the easy access to external finance. After 1975, the Eastern European countries had to suffer the effects of the isolation from trade with the industrialized countries from the West, especially imposed by the E.E.C. During 1980s, these countries were also negatively affected by the growing indebtedness, increasing interest rates, and declining financing opportunities.

Starting with 1989, the Eastern European countries embarked upon a reforming process, which also included the foreign trade. As it was emphasised, each of the selected country, Czechoslovakia, Hungary, Poland, and Romania, have some specific characteristics in the implementation process. This affected the development of the trade flow of each country.

Apart from the characteristics and especially from the difficulties faced in reforming their economies, these countries had to deal with declining output, with internal and international recession. All these, combined with the

disintegration of the CMEA trade agreements, negatively impinged upon the foreign trade performance of each country. Moreover, the collapse of the CMEA negatively affected the output of the Eastern European countries. This was due to the fact that most of the Eastern European commodities were destined to be exported in the Soviet Union. These commodities were usually of low quality. In the situation in which the Soviet Union was not any more willing to pay hard currency for such products, and the West industrialized countries did not want to buy them, the ex-socialist countries were forced to drastically reduce their production output.

The prospects for the future are not too optimistic as well. According to the EEC Secretariat estimates, the Eastern European countries' output will continue to fall during 1992. There might appear the possibility for economic recovery after 1992, as the association agreements with the EEC will be concluded.

Overall, the Eastern European countries face now a difficult period, in which they have to restructure their centralized economies into market oriented ones. The effects of the implemented reforms will be only seen after a period of time, during which these countries will have to face high rates of unemployment, inflation, declining output.

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APPENDIX

CONSTANT MARKET SHARE ANALYSIS OF EXPORT GROWTH

METHODOLOGY AND DATA

Following is a formal description of the constant market share method used in the present study. For each country (i.e.Czechoslovakia, Hungary, Poland, Romania), the variables are defined as follows:

Xij	exports of commodity i to market j, in base year, value, current US$;
X.j	total exports to market j in base year, value, current US$;
Xi.	total exports of commodity i in base year, value, current US$;
X	total exports in base year, value, current US$;
ΔX.j	increase in exports to market j (value);
ΔXi.	increase in exports of commodity i (value);
ΔX	increase in total exports (value);
Qij	growth rate in imports of commodity i in market j;
Q.j	growth rate in imports of market j;
Qi.	growth rate in world imports of commodity i;
Q	growth rate in total world imports;
XijQij	increase in exports of commodity i to market j, assuming that they grew at the same rate as region's j total imports of commodity i;

$X_{i.}Q_{i.}$	increase in exports of commodity i, assuming they grew at the same rate as total world imports of commodity i;
$X_{.j}Q_{.j}$	increase in exports to market j, assuming they grew at the same rate as market's j total imports;
XQ	increase in total exports, assuming they increased at the same rate as world imports;
$X_{i.}Q$	increase in exports of commodity i, assuming they increased at the same rate as world imports;
$X_{.j}Q$	increase in exports to market j, assuming they increased at the same rate as world imports.

The growth rates represent percentage increase over the previous year.

The calculations used to estimate the demand and competitiveness components of export growth are calculated as follows:

Demand growth effect $= XQ = \sum_i X_{i.}Q$

Commodity pattern effect $= \sum_i (X_{i.}Q_{i.} - X_{i.}Q)$

Effect of the market distribution of the growth of demand for each commodity $= \sum_i (\sum_j X_{ij}Q_{ij} - X_{i.}Q_{i.})$

Total demand effects $= \sum_i \sum_j X_{ij}Q_{ij}$

Competitiveness effect $= \Delta X - \sum_i \sum_j Xij Qij$

This means that exports can be differentiated by destination as well as by commodity type, aggregated over all i commodities and all j markets thus:

$$\Delta X = \sum_i \sum_j Qij Xij + \sum_i \sum_j (\Delta Xij - Qij Xij) = \underset{(a)}{(QX)} + \sum_i \underset{(b)}{(Qi.-Q)Xi} +$$

$$\sum_i \sum_j \underset{(c)}{(Qij-Qi.)Xij} + \sum_i \sum_j \underset{(d)}{(\Delta Xij - Qij Xij)}$$

(a) the effect of the general rise in world exports;

(b) the effect of the commodity compositon of a country's exports;

(c) the effect of the market composition of country's exports;

(d) the effect of the "competitiveness" effect .

DATA

The sources used while collecting the necessary data refer to statistics published by international organizations for 1970-1988 period. They were:

- U.N. Geneva: COMECON Data 1970-1988;
- U.N.C.T.A.D.: Commodity Yearbook 1991, and Handbook of International Trade and Development Statistics, 1990, for the World export growth rates;
- O.E.C.D.: Foreign Trade by Commodities, 1980 - 1989, for O.E.C.D. data.

In order to facilitate the identification of a long term trend, data for period 1970-1988 were used. The exporting

countries whose foreign trade was analyzed are: Czechoslovakia, Hungary, Poland, and Romania. Foreign trade transactions of the CMEA countries are defined as follows:

a) trade within the CMEA, is measured in transferable roubles, an accounting unit introduced and administered by the International Bank for Economic Cooperation in Moscow, an official bank of the CMEA;

b) trade with outside the CMEA area, in the currencies of the partner countries, or in US$. Foreign trade data were, however, reported in national currencies of each country which is converted to US$ amounts, using the respective official conversion factors. Thus, the CMS analysis is based on exports defined in current US$ values. Therefore, the results of the export performance analysis are inevitably distorted by other factors (i.e. US$ price changes, inflation rate in the U.S.A.).

The markets considered in the analysis were classified as socialist and non-socialist. The total growth rate of imports as well as the commodity growth rate for the socialist region was computed using as proxy the growth rates from the Eastern European countries member of CMEA. The similar growth rates for the non-socialist region were calculated using as proxy the O.E.C.D. data. For the world rates, no proxies were used. The real data were collected from various statistical books shown above.

The commodity groups included in the analysis were:

1. Industrial machinery and equipment (CTN 1);
2. Fuels,mineral raw materials (CTN 2);
3. Chemicals,fertilizers,rubber,building materials and construction parts (CTN 3,4);
4. Foodstuffs, raw materials of vegetable and animal origin, live animals (CTN 5-8);
5. Industrial consumer goods (CTN 9).

This is the commodity grouping according to the CMEA Trade Nomenclature. The commodity groups for OECD and world data are classified according to the Standard International Trade Classification (SITC). Unfortunately, available statistics for the CMEA countries do not allow a breakdown of their trade classification into similar SITC classes. Thus, in order to determine the effects on demand of exports by commodity, it was necessary to match the two commodity nomenclatures, which differ in their structure. Therefore, some necessary grouping of the SITC was done. For instance to be able to have a similar CTN 2 grouping for the SITC, it was necessary to add the SITC 2 corresponding to "Crude Materials, Inedible, Except Fuels", and SITC 3 corresponding to "Mineral Fuels, Lubricants, and Related Materials".

VITA

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