THE EUROPEAN COMMUNITY AND EASTERN EUROPE TRADE AND INVESTMENT RELATIONS: LESSONS AND IMPLICATIONS FOR SOUTH AFRICA

RASHAD CASSIM

TRADE POLICY MONITORING PROJECT
UNIVERSITY OF CAPE TOWN

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1. INTRODUCTION

The Eastern European countries, like South Africa, are in a political and economic transition. The transitional character of these societies has created the need to redefine trade relationships with EC, and the world for that matter, and to give increasing attention to the critical role of trade, or more specifically exports as a medium for economic development.

Despite the importance of competitiveness of industry, export success is becoming increasingly contingent upon bilateral trade arrangements to secure easy access to target markets. A large part of world trade is governed by bilateral trade arrangements. Consequently, most countries’ trade regimes are dependent on trade arrangements. More specifically, the structure of EC trade and aid links with developing countries is governed by a complex set of preferential trade arrangements.

For Eastern Europe, most observers are unanimous that reconstruction of these countries in to market-based economies is closely dependent on their ability to form close relationships with the EC. Similarly, for South Africa, trade relations with the EC are very important. Firstly, the European market is currently South Africa’s most important market constituting an estimated 40% of South Africa’s total trade and 20% of the country’s total exports. There is a view that preferential access to EC market could have a beneficial impact on investment, exports and employment.

Neither South Africa nor Eastern Europe were part of the hierarchy of trade preferences granted by the EC. However, while some progress has already been made with regard to market access for Eastern European countries, through association agreements, no trade concessions have been granted to South Africa yet. Under scrutiny are three likely options for South Africa: firstly, a tailor-made bilateral trade agreement with the EC; secondly, a total package deal such as a Lomé Convention; and finally, a special arrangement for Southern Africa, including South Africa based on the Lomé Convention.

EC assistance in the form of market access and aid measures to the CEECs is informed by a mixture of political and economic factors. The EC wishes to encourage change in Eastern Europe on the grounds that such change would improve the long-term security and stability of Europe. There is a firm belief that economic progress in the CEECs will be beneficial to the EC, and that economic adversity in these countries could strain Western Europe owing, principally, to close geographical proximity. Such progress, it is believed, can only be achieved by a transition to a market economy and a pluralist democracy congruent with the Western European model.

Relations with Southern Africa, remain important for the EC. With South Africa being the most powerful country in the region, its importance for the EC must not be under-estimated. It is clear that the pressure for EC assistance towards Southern Africa is not as great as in the case of the CEECs, but nevertheless remains significant. In particular, the EC is keen to encourage the integration of South Africa into the Southern African Development Community (SADC). In other words, South Africa could play an important role in the reconstruction of economic and trade relations between Europe and the rest of Africa.

Both the process of European economic integration as well as the gradual incorporation of the CEECs into the former, is likely to impact on trade, capital and investment flows to developing countries.

There are two facets to this study. The first is a comparative analysis of EC/SA and EC/Eastern European countries trade and investment relations. Secondly, this study aims to explore the competitive challenges that Eastern European countries may pose to South Africa in the EC market. Both Eastern Europe and South Africa are competing for market share in the EC market as well as investment from European firms.
2. EASTERN EUROPE

The Central and Eastern European Countries (CEECs) including the Czech and Slovak Republics, Hungary, Poland, Albania, Bulgaria, Romania and Yugoslavia differ in various ways; in their institutional ties with the West; the level of marketisation or different levels in their economic reforms; their profile of exports and imports and different foreign trade regimes. Countries such as Poland and Hungary are more comparable to South Africa, in terms of industrial structure than Bulgaria or Romania. However, as far as trade flows to the EC are concerned, South Africa is more comparable to the latter countries.

Eastern European economies are currently experiencing various problems such as an inadequate institutional framework for the market, deep domestic contraction, and a lack of capital. These do not allow countries in the region to adjust smoothly to new trade conditions (Rosati, 1992: 80). However, one of the most important challenges facing Eastern European countries is their full integration into the multilateral trade system that will depend, amongst other factors, on further progress in their own reforms as well as increased and more secure access to western markets.

While most Eastern European countries are GATT members, their economic systems did not allow them fully to meet the GATT requirements on reciprocity, non-discrimination and transparency and in the absence of a market, caused adoption of special safeguards by other members to guard against possible dumping by state-trading organisations (Junz, 1991:4). Various Eastern European countries joined GATT at different times and the conditions of membership differed as did the concessions made to them by the Contracting Parties (see IMF, 1992:39) Until 1989 only Poland, Hungary and Czechoslovakia enjoyed MFN status. Imports from Rumania, Bulgaria, and Czechoslovakia were subject to substantially higher-than MFN rates of duty. The USA extended MFN status to Czechoslovakia and Bulgaria in 1990 and 1991, respectively.

The importance of the EC for CEECs has, however, overshadowed the CEECs' status in GATT. The move towards a Single European Market (SEM), as well as the reconstruction of Eastern European economies has given an urgency to EC and CEEC economic relations. Being part of the European continent, the CEECs have also been considered, in the long term, as potential members of the EC. However, there are many hurdles to overcome before these countries come any close to EC membership. As was noted, some kind of economic arrangement between two blocs is quite critical to both the economic transformation of the CEECs and the long term stability of the European community.

3. EC/EASTERN EUROPEAN TRADE AND INVESTMENT FLOWS.

3.1 TRADE

Eastern European countries have a legacy of poor integration into the markets of the West. At least two-thirds of trade in 1988 in these countries took place within the socialist bloc through the Council for Mutual Economic Assistance (CMEA). With the disappearance of the CMEA arrangements and the transition to market economies, the pattern of trade of Eastern Europe is changing substantially.

The collapse of the CMEA trading system has had several repercussions. Firstly, it has hit the exports of all Eastern European states, especially Czechoslovakia and Bulgaria, which had the highest share of their trade with socialist partners.

Secondly, the commodity composition of exports to the CMEA and Western markets are significantly different. The collapse of the CMEA market resulted in a drastic reduction in CEECs exports of machinery and equipment. In the case of Czechoslovakia, for example, the share of machinery
and transport equipment in exports to the CMEA area before its collapse, at 60%, was considerably higher than in exports to Western markets (Killick and Stevens, 1992:21). Much of Eastern European industry is highly energy-intensive since oil imports from the Soviet Union used to be cheap before the latter shifted its price policy of its oil exports in convertible currency at world market prices.

Historically, Eastern European countries found difficulties in exporting to the West because of the poor quality of their manufactured goods. Most exports to the West from Eastern Europe consist mainly of fuels and primary materials. These are classified as sensitive in the sense that the EC provides protection for these products owing to strong domestic lobby groups. Sensitive goods are agricultural products, coal, iron and steel, some chemicals, furniture, leather goods, footwear, glass, clothing and textiles.

| Commodity Composition of Exports to the EC from Poland, Czechoslovakia and Hungary, 1988-90. (% of total) |
|-------------------------------------------------|-----------|-----------|-----------|
| Poland            |           |           |           |
| Food and agricultural products                     | 20.2      | 23.2      | 21.0      |
| Textiles and clothing                               | 10.6      | 10.3      | 11.3      |
| Iron and Steel                                       | 6.8       | 8.9       | 8.9       |
| Other products                                       | 62.6      | 57.6      | 58.9      |
| Czechoslovakia                                        |           |           |           |
| Food & agricultural products                        | 7.0       | 8.6       | 7.6       |
| Textiles and clothing                               | 10.9      | 9.9       | 10.7      |
| Iron and Steel                                      | 14.0      | 14.7      | 15.2      |
| Other products                                      | 68.0      | 66.9      | 66.5      |
| Hungary                                             |           |           |           |
| Food & agricultural products                        | 28.5      | 29.3      | 23.8      |
| Textiles and clothing                               | 15.8      | 14.7      | 15.7      |
| Iron and steel                                      | 7.5       | 7.2       | 8.3       |
| Other products                                      | 48.2      | 48.7      | 52.5      |

Source: European Economy, No 52, 1993

It is clear from the Table I above that so-called sensitive products feature quite prominently in CEEC exports to the EC. These figures are high despite various forms of contingent protection on the part of the EC to limit the imports of these products.

CEEC agricultural exports - 85% of which are sold on EC and EFTA markets - are concentrated in three groups of products: live animals and meat (Poland and Hungary supply one-fifth of total EC imports of meat), dairy products (the CEECs supply 10% of total EC imports of these products) and fruit and vegetables. (Messerlin, 1992:117).
In order to match the decline in exports to the former CMEA, the expected increase in exports from CEECs to the West can only be met in either (or a combination) of the following two ways. Firstly, the CEECs succeed in rapidly converting part of their production capacity formerly used to export to the East. Secondly, CEECs succeed in increasing their exports of sensitive products to the West. (European Economy, 1993:33)

A larger proportion of Central and Eastern European exports go to the EC, as a result of the collapse of the CMEA. For example, close to 50% of the total exports of the Visegrad countries (the Czech and Slovak Federative Republic, Hungary and Poland) goes to the EC. Table 11 shows that in most of the CEECs, more than 30% of their exports went to the EC in 1991. Moreover, the shares for 1992 and 1993 are increasing.

**TABLE II**

<table>
<thead>
<tr>
<th>Percentage Share of Total Exports to the EC, 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
</tr>
<tr>
<td>Czechoslovakia</td>
</tr>
<tr>
<td>Hungary</td>
</tr>
<tr>
<td>Poland</td>
</tr>
<tr>
<td>Romania</td>
</tr>
</tbody>
</table>

37.8 
32.0 (1990) 
39.7 
45.0 
34.2

*Source: IMF, Direction of Trade Statistics, 1992*

Table III shows that compared to other OECD countries, the EC is by far the largest destination for Eastern European goods.

In all countries listed below, the EC accounts for more than 70% of the total percentage share of Eastern European exports to the EC.

**TABLE III**

<table>
<thead>
<tr>
<th>Geographical Structure of CEECs trade with the OECD area (1992), (percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
</tr>
<tr>
<td>EC</td>
</tr>
<tr>
<td>EFTA</td>
</tr>
<tr>
<td>N America</td>
</tr>
<tr>
<td>Japan</td>
</tr>
</tbody>
</table>

*OECD Trade Statistics*
However, all countries below have a negative trade balance with OECD countries.

### TABLE IV

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>EXPORTS (US $ million)</th>
<th>IMPORTS (US $ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>1 600</td>
<td>1 916</td>
</tr>
<tr>
<td>CSFR</td>
<td>9 209</td>
<td>10 758</td>
</tr>
<tr>
<td>Hungary</td>
<td>7 368</td>
<td>7 845</td>
</tr>
<tr>
<td>Poland</td>
<td>11 214</td>
<td>13 614</td>
</tr>
<tr>
<td>Romania</td>
<td>2 397</td>
<td>3 122</td>
</tr>
</tbody>
</table>

OECD Trade Statistics

Meanwhile, imports from the CEECs make up a tiny proportion of the EC’s trade. The EC’s combined total purchases in 1992 from Bulgaria, the Czeck and Slovak republics, Hungary, Poland and Rumania made up 1.6% of EC countries’ overall import bill. (Financial Times, 16/06/93).

CEECs exports of ‘sensitive goods’ to the EC constitute a small fraction of total EC imports in those products (see table V).

### TABLE V

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>0.14</td>
<td>0.13</td>
<td>0.09</td>
<td>0.18</td>
</tr>
<tr>
<td>CSFR</td>
<td>0.24</td>
<td>0.59</td>
<td>0.53</td>
<td>1.18</td>
</tr>
<tr>
<td>Hungary</td>
<td>0.96</td>
<td>0.67</td>
<td>0.40</td>
<td>0.35</td>
</tr>
<tr>
<td>Poland</td>
<td>0.97</td>
<td>0.99</td>
<td>0.60</td>
<td>0.80</td>
</tr>
<tr>
<td>Romania</td>
<td>0.07</td>
<td>0.42</td>
<td>0.09</td>
<td>0.20</td>
</tr>
</tbody>
</table>

Notes: I Agricultural products
II Textiles and clothing
III Chemicals
IV Iron and steel

Source: Financial Times 07/06/93
In the case of South Africa, approximately 70% of South Africa’s export earnings comes from mining, of which gold accounts for about one-half. Other export items include metal ores and metal products (24%), diamonds (9%), food and livestock (7%), coal (5%) and chemicals (4%).

The EC currently accounts for 48% of South African (non-gold) merchandise exports. It is clear from Table VI that South Africa’s major exports to the EC in value terms were mineral products just over 3 billion, followed by base metals with a value close to R 2 billion, precious and semi-precious stones and vegetable products.

Most of South Africa’s exports to Europe, however, comprise raw materials and semi-processed products. However, trends since 1988 indicate that South African manufactured products are growing in importance as exports to Europe. Exports of transport equipment and clothing have more than doubled, while textiles and ‘other consumer’ goods exports to Europe are also rising. In contrast, South African ‘primary’ exports to Europe, other than food and fuel, but including gold, are declining rapidly (see Trade Monitor, May 1993).

### TABLE VII

<table>
<thead>
<tr>
<th>Commodity Composition of South Africa’s major Exports to the EC for 1992. (% of Total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mineral Products</td>
</tr>
<tr>
<td>Food and Agricultural products</td>
</tr>
<tr>
<td>Base Metals</td>
</tr>
<tr>
<td>Pearls, precious and semi-precious stones</td>
</tr>
<tr>
<td>Other Products</td>
</tr>
</tbody>
</table>

Sources: European Economy, No 52, 1993; SA Monthly Bulletin of Trade Statistics 1992

In comparing the commodity composition of exports of SA and CEECs to the EC it is clear both export predominantly primary products to the latter, although SA has slightly greater preponderance of primary products in its export composition than countries such as Hungary and Poland (compare tables I and VII). South Africa’s principle exports to the EC are primary products such as gold, coal, platinum and diamonds. The principal exports of the CEECs to the EC are also primary products as well as some ‘sensitive’ manufactured goods such as, in decreasing importance, food and agricultural products, clothing and textiles and iron and steel. Capital goods, on the other hand, account for the large percentage of total EC imports in both SA and the CEECs.

### 3.2 INVESTMENT AND CAPITAL FLOWS

There is a two-way causality between capital flows on the one hand, and the prospects for export earnings, access to major markets and continued progress in economic reforms in the CEECs, on the other hand. Capital flows, in other words are both a cause and consequence of the improved economic prospects of the CEECs (see World Economic Survey, 1993).

As far as capital flows are concerned, there have not been any significant inflows where many of the new loans granted to CEECs have simply offset the repayments of old ones. The Bank for International Settlement (BIS) has observed that there is not much prospect for even modest flows of private capital at present. It argues that in the absence of sufficient private capital, official aid is

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2 This section, owing to lack of data does not strictly look at investment and capital flows between the CEECs and the EC. Instead, it looks at investment and capital flows to the former in a general sense.
essential to fill the need for external finance, to act as a catalyst for reform, to bring along behind it private capital from abroad. (Pinder, 1991:86).

It is important to note that it has been mainly the multilateral institutions (notably the WB and the IMF) which have diverted funds to Eastern Europe, with smaller changes in bilateral official flows and relatively little in private flows.

Table VIII below shows that net capital flows to the five CEECs rose from less than $2 billion in 1990 to almost $8 billion in 1991, falling back to 4 billion in 1992. However, owing to the fact that net interests and dividend payments exceeded $5 billion a year, there was a negative net resource transfer of - $4 billion and -1.5 billion for 1990 and 1992, respectively (World Economic Survey 1993:117).

<table>
<thead>
<tr>
<th></th>
<th>NET CAPITAL FLOWS</th>
<th>NET TRANSFER OF RESOURCES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>2</td>
<td>-4</td>
</tr>
<tr>
<td>1991</td>
<td>8</td>
<td>3.5</td>
</tr>
<tr>
<td>1992</td>
<td>4</td>
<td>-1.5</td>
</tr>
</tbody>
</table>

Notes: CEEC 5 – Czechoslovakia, Hungary, Poland, Bulgaria and Romania


The major private capital flows into the region has been direct investment, reaching almost $3 billion of which 90% was channelled to the Czech Republic and Hungary (World Economic Survey, 1993:117).

Direct foreign investment in CEECs climbed from minuscule amounts in 1989 to over US $7 billion in 1992. Foreign investment in these countries has grown rapidly from a very low base and now accounts for about 9% of total FDI flows to developing and transitional economies. Despite the growth of direct foreign investment into CEECs, the level of investment is still a tiny fraction of what is still needed. (see Gray and Jarosz, March 1993).

For CEECs the relative importance of export credits compared with financial market borrowing continued to rise significantly, reflecting continued official support as well as some reluctance by bankers to proceed without guarantees. Moreover, the share of CEECs in the total debt owed by all countries was 10% in 1991, unchanged from 1990, suggesting that there was no significant diversion of resource flows from the developing countries to the CEECs.

As South Africa aims to restructure its economy, access to capital markets and the need to encourage FDI, have become critical, especially after a period of economic and financial sanctions where South Africa experienced a net outflow of capital as well as disinvestment by many foreign firms. Lack of access to finance became a serious constraint on the South African economy since it was forced to meet its debt commitments from 1985.

SA experienced a decline in the share of average annual FDI inflows in gross domestic capital formation from 0.8% in the period 1980-2 to -1.4% in the period 1985-87 (see Hirsch, 1993).
4. EC TRADE REGIME TOWARDS CEECS

The current changes in Eastern Europe have led to a change of the EC trade regime towards the former. The underlying motive of improved access for Eastern Europe is primarily a political gesture though it reflects EC's attempt to define its role in promoting the process of political and economic reform in the former countries.

4.1 PRE-ASSOCIATION TRADE REGIME

The CEECs generally faced more barriers (tariff and non-tariff) than did developing and Mediterranean countries. The region has been near the base of the hierarchy of trade preferences given by the EC. Only Romania and Yugoslavia benefited from the EC's generalised system of tariff preferences (GSP) from the 1970s.

CEEC exports faced substantial barriers - both tariffs and NTBs - in four major exports sectors: agriculture, textiles and apparel, iron and steel, and chemicals. The major barriers imposed by the EC on CEEC major exports are not tariffs, but NTBs.

The EC treats the Visegrad group (Czechoslovakia, Hungary and Poland) on the one hand, and Bulgaria and Romania on the other, as separate economic areas, discouraging (re-integration through trade among these former members of the now-defunct CMEA. (EBRD, July 1993:19)

4.2 THE ASSOCIATION AGREEMENTS

During the past three years, industrial countries have taken a number of steps to improve access of Eastern Europe to their markets. The EC had moved far towards free trade by applying the GSP scheme and removing and suspending most of its quotas on imports of industrial products - with the important exception of textiles, steel and coal - from East European countries.

Major changes in EC relations with Eastern Europe have occurred between 1988 and 1991, where the EC entered in separate Cooperation Agreements with Bulgaria, Czechoslovakia, Hungary, Poland and Romania. The EC accorded Hungary and Poland GSP status in Jan 1990. This was extended in October to Bulgaria and Czechoslovakia. In Jan 1991, the more limited version previously granted to Rumania was upgraded to be on par with those of the others (see Pinder, 1991:31).

Trade association agreements with these countries were to provide a basis for a move to free trade between EC and these countries in most manufactured products. These agreements are asymmetric in the sense that trade liberalisation and the removal of obstacles will be reciprocal but timetables will differ. These agreements involve a ten year programme in which quotas and tariffs on Czechoslovakian, Hungarian and Polish goods are to be progressively removed in the first five years, and these countries remove their barriers on goods from the EC in the following five years.

Owing to increasing pressure on the EC to provide more serious concessions and to shorten the time-frame of EC market access than the current ones allow, an agreement reached at the Copenhagen summit of the EC on 21-22 June 1991 stated that duties will be abolished on industrial, mainly chemical products after two years rather than four and on products such as footwear, glassware, electrical goods after three years rather than five. For textile products duties for textile products will be abolished after five years rather than six. Steel duties are also likely to be abolished earlier this period. Moreover, a 10% increase in agricultural quotas is to take place six month earlier.

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3 Refer to Table VII on the next page for a breakdown of association agreements
4 For a detailed account of product by product tariff and NTBs faced by CEECs on the EC market before the associations agreements see Stevens 1992, pp 45-52
than planned, as is the 60% cut in duties or levies within these quotas (EBRD Economic Review, July 1993: pp 19-20).

Despite the association agreements a number of problems remain. Firstly, protection limits remain in force on CEEC exports of so-called ‘sensitive goods’ such as iron and steel, farm products, chemicals, textiles, clothing and footwear which often represent the sole means for these countries to compensate for sharp falls in formerly staple exports to the old Soviet bloc. It is important to note that contingent protection is built into the agreements, in the form of anti-dumping and safeguard provisions. The CAP is perhaps the largest obstacles to trade between the EC and Eastern Europe. A significant increase in access to the EC market for Eastern European agricultural products would seem to linked to reform of the CAP and the outcome of the Uruguay Round negotiations.

Secondly, despite the association agreements, EC’s trade surplus with the five core countries in the region (now six following the break-up of Czechoslovakia) rose Ec2.5bn last year from Ec1.4bn in 1991. During the previous years, up to 1990, the EC ran a deficit with the region. However, this may not be directly as a result of the association agreements, rather reflecting the increased imports by CEECs as a result of liberalisation of their economies (Financial Times, 07/06/93).

Thirdly, there are limitations imposed by the rules of origin clause. The association agreements impose a local content requirement of 60% for CEECs. Only goods which originate in the CEECs qualify for any improvement in access under these agreements.

It is important to note that imported material from the EC is exempted from the local content requirement. The EC, through the rules of origin clause, discriminates between two groups in Eastern Europe. For example, an interim agreement covering trade between the EC and Romania came into effect on 1 June 1993. The most important change in this agreement is the absence of a cumulative country of origin clause which would have treated intermediate imports to Romania from the Visegrad group as ‘domestic’ for the purpose of value added calculation (and thus of access to the EC market) (EBRD, July 1993:19).

Part of the problem is that the association agreements are based on two different motives. On the one hand they reflect the EC’s reaction to trade liberalisation undertaken by the CEECs, and in this respect they obey the motive of freer-trade. On the other hand the agreement embodies the EC’s commitment, consistent with the Single Market Programme. (Messerlin, 1992:131).

5. EC ASSISTANCE TOWARDS EASTERN EUROPE

The question of aid, in whatever form, has been an overriding issue in EC/ CEEC trade and investment relations. The underlying motive of Western aid is to facilitate the reforms in the East in order to reintegrate their economies into the world economy. How may the West, or in our case the EC, provide the best form of assistance to Eastern European countries?

Aid is granted to CEECs on the basis of their firm commitment to political and economic transformation to a pluralist democracy and market economy. This consists of mainly three types of measures: easier market access for industrial products, technical assistance for economic restructuring and financial assistance for macroeconomic stabilisation (see, Kramer, 1993).

Aid, on the part of the EC, has met with limited success in Eastern Europe. An aid programme, initially for Poland and Hungary but extended to other CEECs, was established in 1989 by the group of 24 OECD countries called PHARE (Poland and Hungary: Aid for Economic Reconstruction). The main aim of PHARE was to assist the process of reform to a market economy. Most EC aid to CEECs is channelled through EBRD.
5.1 AID VS TRADE

An important concern here is the relationship between aid and trade in the light of assessing the trade potential of the CEECs. The first issue is whether aid arises as an alternative or as a complement to market access. This raises questions as to whether market access as a form of aid is the best option that the EC could give to these countries or whether there may be more preferable ways in which the latter may assist the former.

The ability of CEECs to increase their exports depend, to a large extent, on import-intensive investment requirements. To what extent is the need for capital inflows a precondition for increasing competitiveness of manufacturing sector in these countries? Or to what extent do debt-servicing obligations of CEECs undermine their trade prospects? Increasingly donor countries and multilateral institutions who provide concessional finance or aid to recipient countries are concerned with the latter countries' ability to service their debt by encouraging export capacity.

Some of the debates of different forms of aid packages are examined below. 5

5.2. MARKET ACCESS

There is a view that the best form of aid that EC could give to the CEECs is markets access. Trade preferences, as a way of assisting developing country's to improve their export prospects has, however, generated mixed feeling amongst analysts.

There are indeed persuasive arguments for the supremacy of market access as a form of aid. Market access does not only encourage exports in products in which countries have a comparative advantage, it also encourages diversification of exports.

There are important linkages between market access and capital flows. Eastern Europe may provide a useful production base for many European firms seeking to supply this growing market, and for exports to Western Europe that could arise directly as a result of market access.

There are some arguments against trade preferences. Firstly, they are considered to be out of fashion and do not fit well into the multilateral trading system. Secondly, it is unclear whether CEECs can reap the benefits of market access for the coverage of products granted by the EC. Thirdly, trade preferences are not a sine qua non for export success as was evident in the case of the NICS which did not enjoy an trade preferences at critical stages of their economic growth (see Hewitt 1990 and Page and Stevens 1992).

5.3 TRADE FINANCE

An important constraint on the trade prospects of CEECs is finance. More urgently the breakdown of intra-regional trade is causing severe adjustment problems for Eastern European countries. As the former Soviet Union (FSU) shifts a significant share of imports of manufactured goods away from traditional suppliers in Eastern Europe, it is causing great concern to the latter. Intra-regional trade is also being discouraged because of the need for convertible currency. Firms in the former CMEA region will prefer to export their goods and services outside the region rather than within the region, because they know that buyers in the region are less likely to be able to pay with convertible currency (Bond, 25:1991)

An urgent task is to prevent the total collapse of intra-regional trade in Eastern Europe in order to avoid severe unemployment losses as a result of falling output. The abrupt decline on intra-regional trade has left no time or resources available for an orderly adjustment (see Rosati 1992).

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5 There are two forms of aid packages: aid in a general sense and aid that could help a country develop its trading potential It is the latter that is a main concern here.
There are various ways in which aid could stem the speedy disruption of intra-regional trade in what was formerly the socialist bloc. Firstly, the establishment of a trade and payments union for Eastern Europe in response to the shortage of convertible currency.

The other important form of assistance is through the provision of export credit facilities. The provision of these facilities will also provide a payment guarantee adequate to attract international commercial bank financing for intra-regional trade. Hungary, for example, has had difficulty exporting to the FSU, since advanced industrial countries have been extending substantial trade credits to the latter for the purchase of goods traditionally supplied in the CMEA (see OECD Country Economic Surveys, 1992). Trade credits play a very important role in allowing firms that lack finance to imports to facilitate exports by, for example, the purchase of the modern technology. Part of the problem, however, is that it will be very difficult for CEECs to attract private-sector trade credits against a background of debt rescheduling (see Rollo, 1990: 108).

Interestingly enough, trade credits have played a critical role in South Africa's international credit structure specifically after 1985 when financial sanctions were imposed on South Africa. Trade credits were specifically excluded from most of the sanctions legislation (see Hirsch 1989).

5.4 TECHNICAL ASSISTANCE

A great deal of emphasis is given to the importance of technical assistance as a form of aid. With limited technical assistance, financial aid may have limited success in these countries. Western aid should first concentrate on building the basic infrastructure of a competitive market economy so that financial grants and technology transfer to the East are not to be wasted.

The specific emphasis on technical assistance to CEECs stems from the fact that these countries are undergoing a transition from planning to market economies. Such far-reaching change requires a fundamental restructuring of institutions such as the financial services, marketing, legal system, etc, as well as the development of new institutions to, for example, facilitate trade and currency convertibility. For example, more detailed industrial research in individual CEECs show that institutions to assist export promotion are badly needed owing to the lack of culture of exporting to Western markets.

South Africa, by contrast, may require some of the technical assistance that is quite critical to the success of the CEECs. The former has highly developed financial services, marketing skills and various other institutions that are pivotal to export success. This is not to deny that South Africa does require a certain degree of technical assistance, but with a different emphasis from that of the CEECs. Clearly, South Africa has a different set of problems which are related more to a minority white elite that controls such institutions. Hence it is not surprising that a large proportion of EC aid to South Africa is devoted to training and development of the disenfranchised majority.

The EC has an established grant finance programme of assistance to South Africa. The country currently receives an estimated 100 million ECU, which finances development programmes through NGOs. It is important to note that South Africa is a recipient of the EC's largest single programmable development initiative in Africa. Moreover, the EC is also the largest international donor of external assistance to South Africa. However, EC donor assistance to South Africa will be constrained by rising demands from Eastern Europe.

5.5 EVALUATING AID

The question of aid remains complex in relation to what the most appropriate form of aid is, how effective different forms of aid packages are, especial in assisting countries develop an export potential.
Many observers warn that what the EC should not repeat the schemes of the seventies: to give easy credit and then raise trade barriers to prevent Eastern European countries from exporting what is needed to pay back the debt. Trade concessions and assistance to develop these countries' export potential should be privileged, so that they may earn the foreign currency needed to modernize their economies and to repay at least part of the debt. There are also strong calls to make western economic assistance conditional upon far-ranging changes which could considerably help Central European reformers to push through unpopular reform programmes.

However, the effectiveness of economic aid to the CEECs must be considered against the backdrop of the policy environment and the institutional or absorptive capacity in these countries, in addition to the world economic environment and the policies and practices of aid agencies (Killick, 1993). Some typical examples of these are, firstly, aid to promote foreign policy often leads to procurement tying. Secondly, there is the problem of donor agency weaknesses such as inadequate staffing, pressures to spend, bias towards capital intensive projects, etcetera (Killick and Stevens, 1992).

These concerns are borne out by some recent criticisms that have emerged in the media with regard to the efficacy of the PHARE programme. Some of the criticisms against this programme are the following: firstly, slow disbursement of funds; secondly, heavy reliance on costly consultants from northern EC states; thirdly, problems of bureaucratic procedures and a lack of qualified specialist know-how (FT, 10/06/93).

This raises important questions for both South Africa and the CEECs. Questions about whether assistance in restructuring the economies of South Africa and CEECs could be more effective than providing improved trade access need to be looked at against the backdrop of some of the problems associated with the way current aid packages are implemented.

6. IMPLICATIONS FOR SOUTH AFRICA

It is clear that the opening up of CEECs to the world economy, and the EC in particular, is likely to create some competitive pressures for a country like South Africa. The principal concern is to what extent could the integration of CEECs into the EC divert trade and investment away from South Africa. This section explores some of the factors that could influence trade or investment flows.

6.1 TRADE DIVERSION

South Africa currently enjoys most favoured nation status (MFN) with the EC, which ensures that a tariff reduction to any one country is offered to all other countries that are GATT members of similar status. The former's exclusion from the EC's web of trade preferences stems from the country's history – its notorious apartheid regime, sanctions and the formal classification of the country as a developed economy by the World Bank and GATT when it is in fact a middle-income developing country.

The transitional character of South African society, particularly the move towards a democratic regime against a background of deep-rooted socio-economic problems gives it a clear claim, in terms of several of the criteria normally used, for external encouragement and assistance from the EC (see Page and Stevens, 1992:70). However, such claims have come about at a time where the EC is under increasing pressure to divert some of its aid funding to the CEECs.

It is clear that the extension of trade preferences to new countries could reduce their value to existing beneficiaries. An increase in the pyramid of privilege for the CEECs means an erosion of

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6 Killick (1993) defines absorptive capacity as the ability of the economic system to put additional aid to productive use.
trade preferences for developing countries. For South Africa it represents a competitive disadvantage despite the fact that trade preferences for CEECs have not meant an erosion of preferences for South Africa since it never did enjoy trade privileges from the EC.

The current debate with regard to trade preferences for South Africa has mainly focused on the possibility of South Africa becoming part of Lomé. However, there exists some doubt whether this would be a feasible option. Another option, many policy-makers argue, is likely to be a bilateral association agreement with the EC outside of Lomé. The obstacles to Lomé range from the political difficulty of allowing such a relatively developed and large country as South Africa, by ACP standards, into what is one of the most liberal aid and preferences deals. Moreover, there is uncertainty regarding the future of Lomé in the light of the gradual evolution of EC trade policy. For example, there is some suggestion that the EC is moving from a differentiated trade regime to regionally specific regimes.

Were South Africa to enter a bilateral association agreement with the EC, such an agreement should encourage regional integration or intra-regional cumulation through the rules of origin. It is propable that, if the experience of the CEECs are anything to go by, South Africa will not be able to enter a non-reciprocal agreement, the kind the EC has with North African countries. The EC, owing to its own internal problems is concerned with mutual liberalisation of trade regimes, albeit an asymmetric time-frame allowing a long gestation period for developing countries. This may not be an unbearable impediment for South Africa since pressure for liberalisation of the economy is coming from GATT already.

However, were South Africa to be admitted to the EC’s hierarchy of trade preferences, three important factors need to be considered: firstly, a limited number of non-primary products from South Africa are considered to be competitive in the European market. These are processed agricultural products, engineering goods and some clothing items; secondly, sugar, beef and wine are products in which South Africa competes in other export markets, but which are largely excluded from the EC market by the high level of CAP protection; finally, three of South Africa’s major commodity exports enter the EC without any major barriers: these are gold, diamonds and platinum. In fact, there is no advantage for any form of preference for about 60% of the EC’s imports from South Africa (see Page and Stevens, 1992 and Page 1993).

Of particular interest to South Africa, and developing countries that enjoy trade preferences with the EC, is what kind of preferences are granted to Eastern Europe and to what extent the latter can take advantage of the market access opportunities accommodated to them. Although the responses of CEECs, in the short to medium term, to their newly granted trade preferences are limited by supply constraints, a recent study on the effects of GSP preferences granted to CEECs shows that the supply response of countries such as Poland and Hungary is not as low as anticipated. They have been able to exploit GSP preferences granted to them rather effectively. For example, in 1991, the share of dutiable imports into the EC actually benefiting from GSP has increased to 47% from 34% in 1990 in Poland, and to 41% from 35% for Hungary (European Economy, 1993: 39). Alternatively stated, the most dynamic component of Polish and Hungarian exports to the EC are those products which have actually received GSP treatment. For instance, for Poland, GSP granted exports have grown by 66% between 1990 and 1991, while total exports have only risen by 20%.

Where the CEECs will gain immediately in tariff-free access and the elimination of TQs over GSP-beneficiaries is in the standard products, mainly non-ferrous metals (such as copper and aluminium) chemicals, fibreboard and plywood. They will also gain through the immediate abolition of

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7 For a detailed discussion on the implications of South Africa’s trade options with the EC there exist a lively debate. See Page and Stevens 1992; Stevens et al 1993; Cassim and Hirsch 1993 and Goodison 1993
TQs for semi-sensitive and sensitive products i.e. iron and steel products, footwear and non-MFA textiles (Page and Davenport, 1993).

In the case of South Africa, products most likely to benefit from a preferential trade regime (such as Lomé) are deciduous fruits and new fruits, vegetable and flower products; paper products such as uncoated craft paper and paper board; leather products; engineering products such as catalytic converters; and, at least in the short-run, some chemicals. South African coal in particular faces important barriers from the EC (Page and Stevens, 1992).

If South Africa became a far more significant exporter of manufactured products to the EC it could face substantial competition from the CEECs. Countries such as the Czech Republic, Poland and Hungary currently export a range of manufactures such as chemicals and other semi-manufactures, and light manufactures such as clothing and footwear. The importance of manufactured exports relative to primary exports from both South Africa and countries such as Poland and Hungary, to the EC is increasing.

Both SA and the CEECs are experiencing considerable restructuring of their industries and competition is likely to develop in the long term more on the lines of manufactured products. However, in general it is the NICs and ASEAN countries of South East Asia and Latin America and some low-cost producers in Southern Europe that will feel the brunt of increased competitiveness on the part of the CEEC. (Davenport, 1993: 12) It seems that CEECs will not pose a competitive threat to South Africa in the short-term though this could happen in the medium to long term when South African manufactured exports become more significant.

For South Africa, what is equally important is that the trade preferences must take into consideration not only South Africa current exports but also potential exports, particularly of manufactures.

6.2 AID AND INVESTMENT DIVERSION

Could official support to Eastern Europe divert resources away from traditional borrowers? According to a recent study this is not likely in the case of non-concessional flows from multilateral and export credit agencies, which are not typically constrained by lending limits; the effective constraints are more likely to be the credit worthiness of the recipients. For concessional assistance, however, worries are valid. Although net disbursements of official development assistance to Eastern Europe in 1990 were small in relation to all developing countries, commitments to Eastern Europe are significant (WB, Global Economic Prospects, 1992:8).

Many argue that the ability of CEECs to divert capital away from developing countries is limited. This stems, in part, from a limited absorptive capacity in these countries where a great deal of emphasis needs to be given to technical assistance and institutional development before more finance is likely to gravitate to the former countries.

There is an important symbiotic relationship between trade flows and flows in foreign direct investment. The change in the EC’s trade regime towards the CEECs is likely to affect direct investment flows. Investment has, for example, played a very important role in circumventing actual or potential instruments of protection to ensure future market access.

The pivotal issue is whether the integration of CEECs into the EC will divert investment away from developing countries to the CEECs. The inclusion of southern European countries in the mid-1980s into the EC, for example, significantly increased their attraction as host countries for foreign direct investment (see UN, 1993b). This gave these countries an immediate advantage over its developing country competitors, in attracting direct investment.

By contrast, the inclusion of CEECs into the EC at this stage seems far-fetched. The first phase of
IMPLICATIONS FOR SOUTH AFRICA

integration between the blocs is a free trade area to be reached in 10 years time.

Clearly different degrees of integration between the CEECs and the EC is likely to lead to different competitive pressures for developing countries. There are two simultaneous processes at work here; the process of European economic integration along with the gradual integration of the CEECs in this process.

In some senses, both developing countries and CEECs may experience greater difficulties in the 1990s to increase their relative share of FDI inflows than they did in the 1980s. This stems from the fact that common market, or the liberalisation of trade and factor movements between developed countries, which have proceeded to integrate their economies into regional "internal markets" entail important benefits for countries participating in that process but can prove to be quite detrimental to outsiders. (UN, 1993a: 24).

There are two scenarios for export-oriented FDI in developing countries from the EC. If the EC implements policies designed to promote European sourcing, then export-oriented FDI in developing countries could weaken, as TNCs may respond by exporting less to the Community and investing more within it. Contrasting such a scenario, FDI flows into developing countries could rise sharply if the borders around the single market are kept open to imports of components and final goods from non-EC countries (UN, 1993a).

Despite the fact that the CEECs are in the near future not considered part of EC enlargement process, as was the case with Southern European countries, they are likely to provide serious competition to developing countries for FDI.

It is probable that certain developing countries as attractive locations for direct investments by TNCs, both as export bases and as domestic markets to which to sell (UN, 1993b:28)

In the end, the nature and character of investment differ in many ways. Patterns of FDI will obviously depend on whether firms are investing for extraction (of resources), processing, sub and final assembly, sale and distribution, technology development or overhead functions. Whether such investment decisions are cost reducing or market driven.

At this stage it Eastern Europe as an investment location for EC firms seems fairly attractive and there is no doubt that South Africa will face serious challenges from these countries. A number of factors will make Eastern Europe a more attractive location for direct investment. Chief among these are relatively good levels of education, training and public health; a much bigger potential market and closer cultural and geographical ties to Western Europe. Furthermore, the emphasis on European integration and pan-European ideology increases the comparative attraction of Eastern Europe.’(Darbon and Santamaria, 1992:41)

South Africa’s capacity to attract Western European firms will, however, depend on the progress of both the political and economic transformation of CEECs and the pace of integration of these countries into the EC.

7. CONCLUSION

In general there are many lessons to be learnt for South Africa from the CEECs. First and foremost, South African policy-makers must show an appreciation of the limitations of EC’s trade preferences such as a prolonged time-tabling of the liberalisation process on the part of the EC, coupled with limited concessions for sensitive products, the ready use of contingent protection measures such as anti-dumping, and constraints imposed by the rules of origin.

The EC has through the rules of origin clause discouraged integration between the CEECs. In South Africa, by contrast, policy makers are emphasising suitable rules of origin in order to
encourage the integration of South Africa into Southern Africa. South African accession to Lomé, for example, would encourage trade creation among ACP countries through intra-regional cumulation through rules of origin.

The nature of preferential trade on the part of the EC both towards ACP countries and CEECs show that products in which these countries have a competitive advantage are precisely the ones where preferential trade is not as generous as the ones where they have a limited comparative advantage. This raises questions whether South Africa would want trade preferences at the forefront of its trade or international negotiating strategy or to follow the NIC route of having an industrial strategy and simply using any preferences that came its way. (Page, 1993)

It seems that from the experience of CEECs, if South Africa were to be granted certain trade concessions from the EC, it would have to reciprocate this by liberalising its own market. However, as mentioned earlier, any kind of reciprocation that the EC may demand from South Africa may be pre-empted by the requirements of the Uruguay Round. Market access is a form of aid which the EC grants by influencing the economic policies of recipient countries. The EC encourages liberalisation less because it is a target market for EC exports but more because it underpins the political and economic motives that informs its aid programme.

EC attempts to ensure market access to the CEECs must be seen in the context of EC enlargement. Although CEEC integration into the EC seems far-fetched in the near future, it does form the backdrop to many of the concessions and other forms of measures currently granted to the CEECs. The current association agreements are designed to initiate a free trade agreement between the CEECs and the EC in 10 years time. This could be a significant leap towards ultimate integration.

An important mixture of political and economic factors informs EC’s external assistance. In particular, the political urgency that underlies the EC’s attempts to make concession with CEECs, is not as great in its relationship with South Africa.

Market access as a form of aid is important but should not override other important forms of assistance such as financial and technical aid. However, the kind of institutions that act as a conduit for external assistance are quite critical to the success of aid programmes.

Finally, the intensified competition for the EC market from the CEECs will depend on both the integration links between the two blocs and will as other factors that internally may improve the supply capacity of CEECs.
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