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SEVENTH SENIOR SEMINAR IN FOREIGN POLICY

# U. S. Policy Interests in Trade Between Eastern European and Common Market Countries

by

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THIS STUDY DOES NOT CONSTITUTE A STATEMENT OF DEPARTMENTAL POLICY

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An analysis of the impact of the Common Market on Eastern Europe, current trends in relations between the two groups of countries and related United States policy interests.

In addition to prior interviews with authorities in the United States, the collection of background and materials for this report involved travel by the author in April-May 1965 to Prague, Bucharest, Budapest, Brussels, Geneva and Paris.

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## PREFACE

Relations between Eastern European and Common Market countries* are examined in this paper in light of broad United States policy objectives of furthering economic integration in Western Europe, of encouraging the Eastern European countries to renew traditional contacts with their Western neighbors and to reduce their reliance on the Soviet Union. A number of suggestions are made for policy guidance in the coming few years when the Common Market will be moving through its final transitional phase. During this period, the EEC is expected to develop a common commercial policy toward state-trading countries of Eastern Europe.

The study was also undertaken in light of growing polycentrist and nationalist tendencies within the Communist World and a related thaw in East-West relations that stimulated interest in trade and other contacts between Eastern European and EEC countries. Assuming that the international political and economic climate does not worsen, the period ahead should provide an excellent opportunity for normalizing relations between the two groups of countries.

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*As a rough indication of the relative size and economic importance of the two groups of countries, the population of Eastern Europe (excluding the Soviet Union, Yugoslavia and Albania) amounts to 100 million persons compared with approximately 180 million in the EEC countries; comparable gross national product estimates for 1963 were roughly 100 billion and 250 billion dollars, respectively.

Hopefully, this could be the basis for taking steps to resolve major divisive issues which have plagued Europe since and even before World War II.

Factors which affect trade between the state-trading countries of Eastern Europe and the market economies of Western Europe are also assessed. In addition, the paper examines the related impact of trade and other contacts on Eastern European economic practices and institutions.

While the study is necessarily focussed on Czechoslovakia, Rumania and Hungary, references to significant developments elsewhere in Eastern Europe have been included. The three countries were selected in light of varying backgrounds which affect their interest in expanding trade with the West and, in particular, with the EEC countries. All three are seeking to modernize their economies from different levels of development. Rumania is in the less developed category; while Czechoslovakia is an industrially advanced country; and Hungarian economic development is roughly between the two. Czechoslovakia has recently embarked on important economic reforms; Rumania has displayed little or no motion in this sphere; and Hungary again falls between the two. Only Rumania among the three is consciously seeking to reduce its reliance on the Soviet Union by shifting some of its trade to the West. Hopefully, the variety of experience reflected by the three countries should help to make the study broadly representative of Eastern Europe.

# Chapter I

## Summary

Relations between the Common Market and Eastern European countries are at a turning point as the EEC moves through the final years of its transitional period. A common commercial policy vis-a-vis the state-trading Eastern European countries remains elusive in the continued absence of an agreed EEC foreign policy. In recent years, Eastern European regimes have veered away from rigid ideological concepts about the Common Market to a more realistic approach. This change has been induced by the sustained economic expansion of the Six and by the interest of the Eastern European countries to increase trade and other traditional contacts with neighboring EEC countries. Polycentrism and renewed nationalism have stimulated this interest as well as a strong desire of Eastern Europe to modernize its economy with considerable reliance on Western technology.

Although the Eastern European countries have not recognized the legality of the Common Market as a customs union, informal "technical" contacts have been established, notably in the case of Poland which recently concluded negotiations with the Commission in regard to egg imports. Fear of the impact of the Common Market has cautiously receded in most Eastern European countries where foreign trade officials are pragmatically examining alternative

trade possibilities with a greater degree of confidence than a few years ago. Overall trade levels with the EEC countries have risen in recent years, but there has been some reduction in EEC imports of agricultural products such as eggs and poultry. Trade relations between the two groups of countries is influenced by the Eastern European priority concern of earning foreign exchange for needed imports contrasted with the emphasis of EEC countries in search of markets for their exports.

Significant shifts away from the present degree of reliance on the Soviet Union as the principal trading partner are not expected in any of the Eastern European countries except Rumania. However, Soviet initiated efforts of a few years ago to transform the Council for Mutual Economic Assistance (CEMA) into an integrated Eastern European economic unit have failed as a result of the strong opposition of Rumania and to a lesser extent of Bulgaria to proposals which would have slowed down their economic development. Continued divergent interests of member countries make it unlikely that CEMA could serve at this time as the spokesman for Eastern Europe in relations with the EEC or other Western-oriented economic institutions such as the General Agreement on Tariffs and Trade (GATT) and the Organization for Economic Cooperation and Development (OECD).

Trade between EEC and Eastern European countries is likely to continue to be governed by bilateral trade agreements -- a pattern which serves the immediate but differing national interests of France and the German Federal Republic, the two largest Common Market countries. No significant steps are likely to be taken by the Commission in regard to commercial policy toward Eastern Europe at least until the key elections of 1965 in France and Germany are past. The Commission seems to be leaning toward EEC bilateral trade agreements and related Community-wide quota restrictions to replace individual EEC country bilaterals with the various Eastern European countries. A possible move toward multilateral trading would depend on evolving relations between various Eastern European countries and the GATT. The outcome of the current Kennedy Round of tariff negotiations, in which a few Eastern European countries are participating, will be of much significance in regard to these relations.

EEC countries provide an important complementary trading area for Eastern Europe which exports mainly agricultural, primary and semi-finished products in return for much needed machinery and capital equipment. Interest in increasing trade with EEC and other Western European countries has helped to stimulate some economic reforms and changes in the trading structure of Eastern Europe. These reforms, although not altering significantly the basic centralized economic planning structure, contribute to important liberalizing trends in Eastern Europe that meet general Western objectives. Trade and other contacts also facilitate another important objective, shared by the U.S., of normalizing relations between the two groups of countries. Expansion of trade between the EEC and Eastern European countries can progressively reduce the reliance now placed on trade with the Soviet Union by the latter. From a broad U.S. policy point of view, the positive impact of this trade on the Eastern European countries and the levels involved could be maximized were present bilateral agreements replaced by multilateral trading arrangements under an EEC common commercial policy vis-a-vis the state-trading countries.

Thought-provoking concern has been voiced by outstanding authorities on Eastern Europe regarding the danger of possible disintegration and Balkanization of Eastern Europe as nationalist tendencies there become more virulent. The Common Market, the rest of Western Europe and the U.S. should develop common policies responsive to this danger.

On the basis of these observations and conclusions, the following recommendations are made as suggested policy guidelines for the critically important four to five years remaining in the Common Market's transitional period:

1. A normalization of relations away from the Cold War pattern should be sought as an immediate objective in trade and other contacts between the EEC and Eastern European countries.

2. Expansion of trade opportunities for Eastern European countries in EEC and other Western European countries

should be encouraged so as to reduce progressively the degree of reliance on trade with the Soviet Union.

3. Preferably, trade relations between the two groups of countries should be encouraged to move toward a multilateral basis from the present pattern of bilateral agreements and quota restrictions with the view to facilitating trade expansion and the liberalization of trade and related economic institutions within Eastern Europe.

4. Sympathetic consideration should be given to Eastern European offers in the current Kennedy Round of tariff negotiations in GATT. Experimentally, an annual review technique or other device might be employed to examine trade policies of Eastern European countries for compliance with GATT principles. Ultimate accession of these countries to GATT should be encouraged, if the foregoing is successful.

5. Eastern European countries should be encouraged to recognize the Common Market and establish missions to the EEC in Brussels.

6. The United States should support possible Eastern European efforts to enlarge trade opportunities with the EEC,

particularly when these efforts would lead to multilateral trading arrangements.

7. In its efforts to encourage the EEC to open its doors to Eastern European countries and to develop an outward-looking trade policy, the United States should stress the potential importance of the Common Market in reducing divisive tendencies among Eastern European countries that could negatively affect the stability of all of Europe.

8. The United States should discourage the EEC from developing trade policies toward the Eastern European countries which could result in retaliation through CEMA or otherwise strengthen bonds with the Soviet Union.

9. In addition to GATT, cited above, existing organizations for broader economic consultation should be tried or, if necessary, new ones developed in order to facilitate further contacts between Eastern and Western European countries. (The OECD, the IMF and the IBRD are suggested as possibilities. Possibly a special liaison group of the OECD might review consultative machinery with representatives of Eastern European countries.)

## Chapter II

### Problems and Policy Objectives

By December 31, 1969, the terminal date of the transitional period, the Rome Treaty envisages the development of an EEC common commercial policy toward the state-trading countries of Eastern Europe. How this policy develops could determine whether the Common Market will become an economic and political pole of attraction for Eastern European countries. The latter have displayed increasing interest in expanding trade and other traditional contacts with neighboring countries now in the EEC. Future trade patterns between the EEC and the Eastern European countries and the Community's impact on the latter will be strongly influenced by the EEC's decision as to whether such trade should continue to be channelled through bilateral agreements with related quota restrictions or whether this commerce should move toward a multilateral, non-discriminatory basis. As in its relations with the rest of the world, whether the EEC's general trading policy is outward-looking or not will have a significant bearing on its impact in Eastern Europe. The EEC policy could help these countries renew traditional ties with Western Europe or alternatively oblige them defensively to continue to rely on the Soviets.

Depending on policies pursued in the next few years, the persistant political problems which have been plaguing Europe since and even before World War II could be approached constructively on a broad European basis or might deteriorate into open conflict. The evolution of these relations will reflect widely varying national interests among countries in Eastern Europe and in the Common Market.

The following policy objectives in Europe, that serve as the framework for this study, have a close bearing on these issues:

1. a normalization of relations between Eastern and EEC and other Western European countries;

2. the related resolution of traditional European rivalries and the avoidance of a renewed Balkanization of Europe with inherent dangers of instability and conflict;

3. the development of an outward-looking Common Market which could fulfill the political as well as economic goals of integration;

4. a reduction of dependence of Eastern European countries on the Soviet Union; and

5. a progressive liberalization and humanization of Eastern European economic and political institutions.

# Chapter III

## Background and Analysis

### A. Relations Between Eastern European and Common Market Countries

#### 1. Eastern European Attitudes Toward the Common Market

##### a. Relevant Political Trends in Eastern Europe

Polycentrism, a revival of nationalism and the detente in Soviet-Western relations have been the main political factors behind the interest in Eastern Europe to expand trade and other contacts with EEC members and other Western European countries. Since the shock of the 1956 revolt in Hungary, Communist regimes in Eastern Europe, with Soviet benevolent approval, have had some success in building a more popular base. Progress has been evident in the improvement in consumer availabilities, in a degree of humanization and liberalization of the regimes, and a relaxation toward Western contacts. With the intensification of Sino-Soviet differences in recent years, the Soviets have been obliged to reduce the degree of discipline they had previously exerted over the Eastern European regimes. This looser association may be preferred by the Soviets who probably want to avoid being overly committed to their Eastern European associates. An Eastern European authority, Richard Lowenthal, drew an interesting analogy with French disengagement from Algeria which gave it much greater diplomatic flexibility.1/

Nationalist tendencies are most evident in Rumania where the regime has actively exploited the opportunity provided by Sino-Soviet differences to reduce its economic reliance on the Soviet Union. However, in a less active form, nationalist overtones have been present in recent years in all Eastern European countries. Renewed nationalism was a major factor in CEMA's failure in 1963 to launch an economic integration program. The CEMA effort, discussed below, foundered mainly over Rumanian and to some extent Bulgarian refusal to accept a subordinate less-developed country status. Authorities on Eastern Europe such as Brzezinski, Montias and Shulman deplore the potentially negative impact of nationalistic tendencies which carry the disruptive danger of Balkanization. Eastern European countries had only sporadic experience with the dignity of independent statehood or achieved this status relatively recently as contrasted with Western European countries. Therefore, the former reflect a relatively more virulent form of nationalism.2/ This potential instability might be further stimulated by restiveness among Eastern European ethnic minorities which could conceivably again seek the dubious goal of separate statehood.

Against this background stands the post-World War II problem of a divided Germany. Neighboring Eastern European countries have been fearful of the political and economic potential of a unified Germany. The Soviets have exploited this fear, also shared in some Western European countries, by pointing to the enviable economic expansion in Western Germany, its likely dominant role in the Common Market, and to the possibility of nuclear arms in German hands. This frictional issue, as described recently by Brzezinski, has been stabilized for the time being as an unexpected outcome of the Berlin wall.3/ The resultant breathing spell could provide the opportunity for constructive steps in both Eastern and Western Europe which could facilitate a solution, with the Common Market in a position to play an important role.

b. Ideology versus Reality

The concept of European economic integration has been troublesome to Communist theorists since it has not fulfilled their dire predictions about capitalism. The Western European countries,under the "contradictions of monopoly capitalism", were expected to divide on the basis of conflicting national interests rather than move toward an international economic association. Soviet expectations of an early collapse of the Common Market gave way to more guarded observations as the integration time schedule of the Common Market was maintained and accompanied by enviable economic growth records. Communist doctrinal infallibility was awkwardly stretched to meet these unexpected developments and, in most of Eastern Europe, it seems to be giving way to pragmatism.

Prior to the Treaty of Rome of 1957, Soviet spokesmen viewed early economic integration efforts essentially as an American plot to dominate Europe. This was part of a general categorization which the Soviets also applied to the American-aided European Recovery Program and to NATO. During the period from its inception in 1958 until the United Kingdom's bid for entry into the EEC in July 1961, this theme occasionally appeared in the Communist press which, however, usually paid little attention to the Common Market.

Markedly stepped up interest in the EEC was evident in Communist circles in the ensuing period. Propaganda was directed against the Common Market as an instrument of NATO and monopoly capitalism also being employed in a neo-colonialist manner against the emerging countries. Diplomatic pressure was directed at Britain and other members of the European Free Trade Association (EFTA) which were applying for or considering EEC membership. By June 1962, the growing concern in the Communist camp was reflected in the calling of an emergency meeting of CEMA to consider possible steps which could meet the impact of a broader EEC.

Two items appearing in the Soviet press in the summer of 1962 provided a new and authoritative analysis of the Common Market for the Communist world.4/ One article was published in Pravda (August 26, 1962) on the eve of an international Moscow meeting of Marxist economists who discussed "the problems of contemporary modern capitalism". The other article was published under Premier Krushchev's name shortly after this meeting. Both articles recognized the economic and political reality of the Common Market. There was an implication that the Soviet Union was ready to take the Common Market into account within the broad concept of peaceful coexistence with the capitalist world. Although the Soviet authors maintained that capitalist contradictions eventually would lead to the failure of the EEC, they admitted some immediate positive results from economic integration. The faithful were comforted by the observation that since the commercial discrimination practiced by the EEC against the Socialist states "contradict the objective laws of world economic relations, they ... are built on sand".5/

The August 1962 International Moscow Conference, cited above, reflected significant differences among Communist parties in regard to the Soviet analysis and proposed tactics toward the Common Market. Representatives of the Italian Communist Party viewed the Common Market as a vital economic institution that had benefited workers. The Italian party urged Communists to work within the EEC to assure ... "the democratization of the supranational institutions."*6/ The Italian Communists in varying degrees received support from their Belgian, Polish, Yugoslav and Czech colleagues. In response to the apparent appeal of the position of this group, the chief Soviet representative, Anerchevank Arzumanjan, concluded that the Common Market was a viable economic union, but that it was not a response to all the problems of capitalism. He pointed to technological and scientific advances which were renewing fixed

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*The Communist-led Italian Confederation of Labor (CGIL) took a similar position in the December 1962 meeting in Leipzig of the World Federation of Trade Unions (WFTU). It opened a liaison bureau in Brussels to maintain contact with the EEC after unsuccessful efforts to have such an office established by the WFTU which has Soviet-oriented leadership.

capital in most capitalist countries. In addition, he warned the conference that "other countries were not standing still while the Eastern European countries move toward Communism".7/ These were serious admissions for a Communist spokesman to make in light of the earlier Soviet appraisal of the Common Market and capitalism.

The most recent change in Soviet and Eastern European tactics toward the Common Market came shortly after the January 14, 1963 de Gaulle press conference which presaged the breakdown of negotiations for the United Kingdom's entry into the EEC. Soviet and Eastern European spokesmen saw a resurgence of "contradictions" among the monopolies in the advanced capitalist states, a crisis brought on by changes in power relations in the West and a re-affirmation of the autarkic character of the EEC. The opportunity presented by the troubled state of European integration efforts was offset by a concern over the Franco-German treaty which was characterized as a war treaty and as a reflection of the new Paris-Bonn axis. While the Soviets still defend the old Marxist-Lenin analysis of the Common Market, its formulations in the current (since early 1963) phase allow for flexibility. Thus it includes the familiar line of opposition against this institution of monopoly capitalism (i.e., "the Europe of trusts") but also leaves room for the Italian position which seeks to increase Communist influence within the EEC and for the Polish and Yugoslav desire of encouraging trade between the two groups of countries.8/

In recent years, the Eastern European countries have generally become reconciled to the likely achievement of a customs union among the six member countries of the EEC. While at first apprehensive over possible negative effects of an EEC common commercial policy vis-a-vis the state-trading countries, Eastern European officials now appear more confident that the over-all trading position of their countries in regard to the EEC group will not be seriously affected. However, there is an expectation in these countries that the present trade pattern will necessarily change, particularly as a result of the EEC's common agricultural policy (CAP). Trade officials of the Eastern European countries now are looking pragmatically at ways to adjust to expected changes in regard to diversification of trade, as needed, and how to exploit their bargaining position as a growing market for quality exports from the EEC. Among the three Eastern European countries visited by this writer, only in Hungary did a foreign trade official allude to possible retaliatory measures against what he considered to be the implicit discrimination of the Common Market.

As of May 1965, however, none of the Eastern European countries had recognized the Common Market as a customs union. No missions to the EEC had been established by these countries, but trade discussions have been held, for example, with Yugoslav and with Polish delegations. The latter concluded "technical" negotiations in regard to egg imports into EEC countries. It is very likely that such contacts will increase in the period ahead.

c. CEMA and the Common Market

The Council of Economic Mutual Assistance (CEMA), which was established in 1949 on the initiative of the Soviet Union in answer to the Marshall Plan, attempted little economic coordination let alone integration during the Stalin period. At the height of the Hungarian revolt in the fall of 1956, the Soviet Union pledged itself to respect the sovereignty and equality of all members of CEMA. Shortly thereafter, some initial steps were taken in CEMA to coordinate national economic plans, but little serious effort was attempted in this direction until June 1962 when the Moscow Conference of the representative of Communist and Workers Parties of CEMA member states approved "Basic Principles of the International Division of Labor." The principles, which had been under consideration since the end of 1961, focussed on the need for specialization among CEMA members. This step reflected Soviet and Eastern European reactions both to the threat posed by Britain's bid to enter the Common Market as well as to the growing intensity of Sino-Soviet differences. The action of CEMA was followed by a reorganization of its structure and an activation of its constitutent organs. In addition, some publicity was given to CEMA by prominent Communist officials, notably Premier Krushchev.9/

In the ensuing period, CEMA considered the coordination of long-term economic planning of member countries with the view to encouraging specialization in production, reduction in autarkic tendencies and the establishment of a more rational price policy. In late 1962, CEMA decided to establish an international bank to help multilateral clearances among member countries. Plans were furthered for the establishment of the "Freedom Pipe Line" to carry Soviet oil to Hungary and Czechoslovakia. An electric power grid was planned among several member countries. Cooperative arrangements were also developed in regard to railroad rolling stock and communications lines. In addition, the Standing Commission of CEMA worked on specialization agreements among member countries in different industrial spheres and facilitated the exchange of technical assistance. Information has been sparse on the operation of these plans and, particularly, how possible problems were resolved. Evidence of difficulties, however, have been admitted by Eastern European spokesmen and occasionally reach the press. For example, the views of a Polish CEMA bank official were reported in May of 1965 that CEMA's international bank was a failure because the rouble had not been made a convertible international currency upon which multilateral clearances among CEMA members could be based.10/

In July 1963, CEMA's key proposal for coordinating long-term economic planning of member states ran afoul of nationalist and autarkic tendencies primarily of Rumania and to some extent of Bulgaria, the lesser developed CEMA countries. Rumania, which had resisted CEMA authority since 1961, vigorously objected to the limitations proposed in regard to her industrial development plans. A long-term planning proposal was dropped, but provisionally, it was agreed that the shorter range (5-year) plans would be kept under review. Movement by CEMA toward any significant economic integration was arrested at this time. A cautiously worded communique of the 19th Session of the CEMA Council, which met from January 28 to February 2, 1965, reflected some continued economic cooperation. CEMA's Secretary, N. V. Fyeyev, in answering questions by journalists made it clear that nothing had been done in regard to possible economic integration.11/

Failure of CEMA to make any significant progress toward economic integration can be attributed to a number of factors:12/ (1) nationalist and autarkic tendencies in the various member countries, (2) inflexibility of centralized Communist state-planning machinery within member countries, (3) vested interest and pressure groups at the national plane that would be weakened by integration*, (4) overwhelming economic and political power in CEMA of a single country, the USSR, (5) absence of a rational price structure,

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*Egon Neuberger points out that agreement on curtailing investment in an autarkic industry appears much more difficult than lowering trade barriers in the West that might have a similar impact. He cites the EEC negotiations in the agricultural sphere as being particularly difficult since this represents an industry where governmental intervention with the free market is greatest. (Bibliography, item 11, page 15)

(6) lack of effective international financial mechanisms to facilitate trade and payments, (7) bars to movement of capital and manpower across borders, and (8) the wide disparities in the state of economic development among member countries.

Although it failed to bring about economic integration, CEMA was a useful instrument in promoting political unity in the Communist camp after the 1956 Hungarian and Poznan uprisings until early 1961 when Sino-Soviet differences had a significant impact on Eastern European countries. CEMA met the political objectives of the Soviet leadership during this period, but not the aspirations of the Eastern European countries which also sought economic advantages. Economic integration in Eastern Europe, unlike Western Europe, would probably first require political integration.*

From discussions with Eastern European foreign trade officials, it did not appear to this writer that CEMA is now providing more than a loose international consultative mechanism for member countries -- apparently less significant than the nearest equivalent, the OECD, is to the West. Although no open defections from CEMA are likely to occur, its recent activities have reflected a diminishing interest on the part of member countries which have been sending lesser officials to meetings and in some cases have abstained from CEMA specialization agreements. Since basic differences of

*Brzezinski cites Jacob Viner's observation "that it is more difficult to integrate centrally-planned socialist economies than market economies, without suppression of national identities." (See Bibliography item 3, page 402, footnote.)

interests among member countries are reflected in the reduced attention given to CEMA, it is doubtful whether the organization could speak with authority for the Eastern European countries as a group in possible relations with the EEC or other Western-oriented institutions such as GATT. Desirable as the objective may be, unless current trends are reversed, it is difficult to envisage CEMA carrying out a meaningful role of representing Eastern Europe in Europe-wide cooperative efforts along lines suggested by Brzezinski.13/

2. Common Market Policy Toward the Eastern European Countries

Polycentrism in the Communist camp has been matched by a certain degree of nationalism among EEC member countries that has slowed progress on a common commercial policy toward the state-trading countries of Eastern Europe. For somewhat different reasons, France and Germany have resisted moves in the EEC toward the establishment of such a policy. France apparently wishes to retain freedom of action in this sphere as long as possible in support of its campaign for rapprochement with Eastern Europe. It may also be trying to enlarge its trade activities as much as possible in Eastern Europe in order to reach a relatively higher base of commercial activity by the time the transitional period ends. The French have shown much interest in developing a market for capital equipment in Eastern Europe. German interest is centered primarily on the establishment of closer contacts with

Eastern European countries in the absence of diplomatic relations due to the inhibitions of the Hallstein Doctrine. To an increasing degree, Fedrep trading missions have been carrying out normal diplomatic functions. As far as can be determined, the interests of Italy and the Benelux countries are primarily commercial and these countries have not opposed the various Commission proposals designed to hasten the development of a common EEC policy.

Because of the forementioned divisions, only minimal steps have been taken by the EEC toward coordinating commercial policy vis-a-vis the state-trading countries. Reliance continues to be placed on bilateral trade agreements with the exception of certain agricultural products, presently eggs and poultry, which are subject to the EEC's common agricultural policy (CAP). So far, no member state has included the "EEC clause" in any bilateral agreement with a state-trading country although a Council decision of July 20, 1960 called for such a provision which would envisage the competence of Common Market organs with the establishment of a common commercial policy.14/

A decision of the EEC's Council on October 9, 1961 established a procedure for consultation in regard to bilateral trade negotiations between member and state-trading countries. Bilateral agreements could not go beyond the transitional period and only annual agreements were permitted unless an EEC clause or a 12-month cancellation provision was included. A further step was taken in September 1962 when EEC and country experts were called upon by the Commission to work toward a common policy on quota restrictions practiced in this sphere. However, this work was later suspended in the absence of progress toward an agreed policy within the Community.

On January 24, 1963, the Council issued regulations on imports from state-trading countries of agricultural products subject to the authority of the EEC (i.e., grains, pork, eggs and poultry). While these regulations abolished quantitative restrictions on the agricultural products covered, so-called "value quotas" -- in effect, a limit of 20 percent above the average 1960-61 levels of imports -- were not to be exceeded. This arrangement, which was due to lapse in December 1964, was extended another year. A subsequent effort in April 1965 to have the Council of Ministers consider Commission proposals on quota restrictions and credit policy toward state-trading countries failed when the French representative insisted the latter was a "political" matter which could only be decided in the national capitals. However, the discouraged Eurocrats apparently did not consider the situation hopeless, according to an Economist report of this development.15/ Mention was made in this item of the possible use of leverage by the Commission that may be provided by agricultural subsidy payments, which begin in 1967, to bring recalcitrant EEC countries into line on commercial policy vis-a-vis Eastern Europe.

The Commission has complained that due to the low degree of harmonization of commercial policy achieved, increasing recourse has been made to Article 115* of the Rome Treaty. By January 1964, 159 complaints had been submitted in regard to various Eastern European imports which had been re-exported to other member countries. (The products covered such economic sectors as consumer items, chemical products, metals and automobiles.)16/

The Commission plans, of course, to continue to encourage the elimination of quota restrictions in trade with the Eastern European countries and to work toward the transformation of the present bilateral agreements into Community agreements by the end of the transitional period. However, the immediate outlook for progress toward a common commercial policy is not bright. Bilateral trade agreements with Eastern European countries, discussed below, are generally looked upon by EEC countries as a means of assuring certain exports. Unless moves are made toward multilateral East-West trade arrangements within the broader GATT context, it seems likely that the Common Market will retain the familiar bilateral pattern on a Community-wide instead of country basis. Conceivably, such EEC trade agreements might take on the characteristics of "Conventions of Association" employed in some cases by the Common

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*Under provisions of Article 115, member countries can obtain compensation in cases of market disruption due to price disparities of imports originating in third countries.

Market to provide for a gradual adjustment of certain countries to changes in established trading patterns that will result from the creation of the customs union. (For example, such Conventions have been negotiated with Greece, Turkey, Austria, Israel, etc.) The term itself would, of course, be unacceptable at this time to Eastern European countries, but the objective of providing for a gradual accommodation to multilateral trading arrangements might be included in possible EEC bilateral agreements with Eastern European countries. Provisions might, as in the case of the Conventions, vary in accordance with the trade patterns and the related state of economic development of each of the countries.

B. <u>Trade Between Eastern European and EEC Countries</u>

1. Levels, Composition and Relative Importance

Available trade data* show that Eastern Europe's commerce with the Common Market countries is not large in volume, representing about two percent of the latters' total foreign trade in recent years. For the Eastern European countries, however, this trade is considerably more significant at about ten percent of their total foreign commerce.17/ The average ratio of about

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*A statistical caveat is advisable when using East-West trade statistics for more than a general indication of trends. The estimates, quoted below, in regard to Eastern Europe exclude the Soviet Union, trade between the Soviet Zone of Germany and the Fedrep and the trade of Yugoslavia. Marked shifts can occur from year to year because of the institutional structure of trade in East Europe (discussed below) and because of uncertain variations in the agricultural sphere which is an important component of this trade. In addition, changes in availability of credit can have a significant effect on annual rates of trade.

5 to 1 in the relative importance of mutual trade is higher for the less developed Eastern European countries such as Rumania and Hungary than for Czechoslovakia, Poland and Eastern Germany. In 1963, imports from Eastern European into Common Market countries amounted to $784.8 million; while exports from the latter to Eastern Europe totaled $711.6 million.18/

Although Eastern European trade with Common Market countries increased in the past few years, except for Rumania it tended to follow the general upward movement in levels of overall foreign trade for both groups of countries. Thus, in the regional distribution of trade, intra-CEMA trade has remained at about 70 percent with Soviet trade apparently becoming somewhat more important within the Communist group.19/

Intra-CEMA trade has, of course, been much more significant to the small Eastern European countries than to the huge and practically self-sufficient Soviet Union. This trade, nevertheless, is of great significance to the Soviets who have used Eastern Europe as a workshop to process their basic materials into machinery, transport equipment and certain consumers' goods for use in the USSR and in the developing countries. Trade with Eastern European countries has undoubtedly released key Soviet resources to concentrate on high priority heavy industry, precision equipment, rockets and ultra-modern weapons. Were it not for Eastern European trade, the Soviets would have probably been obliged to reduce some of their world power activities, including their dramatic space exploits.20/

EEC countries account for about 50 percent of Western European trade with the Eastern European countries, with the Fedrep representing about 50 percent of the Common Market's share. Exports from Eastern European to Common Market countries tend to be relatively heavy in agricultural products (over one-third); industrial products make up less than one-third and raw materials and fuels the remainder of roughly one-third. About 80 percent of total imports into Eastern Europe from the Common Market countries represent industrial products with the remainder in the agricultural and raw materials categories.21/ A further examination of the important category, industrial products, would reveal significant proportions in quality machinery and capital equipment imports from EEC into Eastern European countries. A Czech official explained to this writer that the need to broaden his country's trade (i.e., to the West) reflects a change from requirements of the early post-war growth period in basic industries to the present need to modernize technology throughout the economy. It should be noted that the composition of the important agricultural component of Eastern European exports, of course, is largely in the usual temperate zone products that are likely to be increasingly affected by the CAP which would tend to make the EEC self-sufficient in these agricultural products.

2. Factors Affecting Trade Between the Two Groups

a. Institutional Framework22/

The general structure of East-West trade, of course, has a major bearing on the evolving trade relations between the Eastern European and EEC countries. Except for Yugoslavia, foreign trade is a monopoly of the Foreign Trade Corporations in the various Eastern European countries. The Foreign Trade Corporations are generally responsible for both imports and exports in broad production and servicing categories (e.g., metallurgical products, textiles and clothing, machinery, chemicals, agricultural products, transport facilities, etc.). Foreign trade is an integral part of central planning in these countries and overall targets are included in the plan for trade in the two categories, "socialist countries" and "capitalist countries", respectively. The process of planning involves lower echelon enterprises which submit draft plans, including foreign trade elements, to the State Planning Commission. The import plan is the essential part of foreign trade planning with exports looked upon primarily as a source for needed foreign exchange.

In carrying out the foreign trade aspects of the plan affecting individual enterprises, the Ministries of Foreign Trade guide the appropriate Foreign Trade Corporation. The State Bank, in turn, generally has been charged with licensing the use of foreign exchange for given transactions and is usually the repository of foreign exchange receipts. The pattern of setting prices under the state planning procedure and the absence of currency convertibility, of course, also have a significant impact on trade

Although central planning systems in Eastern Europe are geared primarily to quantitative decisions, presumably based on some indication of relative efficiency, the absence of an objective cost and related price structure results inevitably in arbitrary decisions affecting the domestic economy as well as foreign trade. There is often little relation between the internal and external prices of Eastern European countries. This stems both from the weaknesses of the internal price system as well as the artifical exchange rates. Nove's comments on the Soviet Union have much relevance when he notes that were prices related to those of the West under any exchange rate and trade based on profitability and comparative costs, a basic revision in foreign trade plans would result. Complicated internal accounting systems attempt to adjust profit and loss inconsistencies due to differences between the international and domestic Eastern European prices and to the artifical exchange rates.24/

In recent years, there has, of course, been an increasing awareness of the price problem in Eastern European countries, including the Soviet Union. Some economic reforms currently being introduced in Czechoslovakia are directed largely at this problem and are being closely watched by other Eastern European countries. Foreign trade is also expected to benefit, but the principal objective claimed for the Czech reforms is to improve the efficiency of the overall economy by introducing some market factors in establishing prices at the consumer and intermediary levels.* Prices for major capital equipment and raw materials will continue to be fixed by the Central Planning Commission. Apparently, differences among Czech officials developed over the reforms and, according to one official, some of those who were concerned with foreign trade favored more radical changes.

In addition to reforms in price setting, foreign trade incentives have been provided in Czechoslovakia to individual enterprises which can retain certain foreign exchange earnings for use in the purchase of needed imported equipment or in enabling officials to travel abroad. The latter incentive apparently is important to Czechs who are anxious to renew traditional contacts in Western Europe. In addition, a few large firms can now engage directly in foreign trade activities without going through the Foreign Trade Corporations.

Trade officials in both Hungary and Rumania have been watching Czech reforms closely. To a more limited extent, incentives

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*The introduction of some market factors in regard to consumers' prices in certain Eastern European countries has received much attention in the West since it runs counter to basic tenets of the rigid central planning system. According to one close observer of Eastern Europe, ECE's Stein Rossen, the market-oriented reforms have been modest when compared with recent improvements in efficiency criteria employed by the central planners. He believes that the impact, for example, of Polish economist Tzerciokowski's refinements in econometric models used in optimization analysis is relatively more important, particularly when teamed with an increasing use of computers. The type of reforms employed would, of course, have an important effect on the nature of evolving economic institutions in Eastern Europe. In either case, if a more rational price system ensues, it would facilitate foreign trade.

have also been extended to Hungarian enterprises to increase foreign trade activities. Hungarian foreign trade officials have recently been promoting a so-called "division of labor" with enterprises in market economy countries. Essentially, the scheme calls for licensing and marketing arrangements between Hungarian and Western enterprises. Several such schemes have been under negotiation with large enterprises in Austria and Western Germany. However, none of significance had been completed up to early May 1965 by the Hungarian authorities who apparently are exercising considerable caution before embarking on new directions. This type of arrangement, one Hungarian official remarked, would be particularly attractive to firms in those Western European countries experiencing labor shortages. The arrangement would be particularly helpful to Hungary in accelerating the adaptation of new technology without the need for prior costly research.

Trade officials in the various Eastern European countries apparently are increasingly adjusting practices to requirements of trading with Western countries. In Czechoslovakia, officials of two large Foreign Trade Corporations (Metalimex, which deals with metal ores and coke, and Koospol, which handles agricultural products) explained to this writer how they supplement their technical staffs with well-qualified experts from individual enterprises as needed in trade negotiations. Resort to market research, advertising, packaging, etc. was mentioned in regard to food products destined for Western consumers. A Rumanian foreign trade official concerned with "market research" applied this term broadly to the analysis of economic trends in Western countries that is used in guiding over-all trade policy and plans. In all three countries, the foreign trade officials seemed to be looking for practical solutions. Mention of the possible impact of the Common Market on patterns of trade with Eastern Europe was generally met by an assurance that alternatives were actively being examined.

In none of three Eastern European countries visited by the writer did officials look upon Yugoslavia as a possible model for Eastern European reforms in the economic and trade spheres. One prominent Czech economist, who played a major role in developing the reforms in his country, expressed the view that the Yugoslav system takes too much authority away from the central planners in regard to investment. He attributed recent inflationary problems in Yugoslavia to what he characterized as this basic defect of the Yugoslav system. Part of these inflationary pressures, he explained, also came from individual enterprises competing in regard to foreign trade. In addition, he cautioned that Yugoslavia is dealing with the special problems of a less developed country that are not relevant to his country.

C. Role of Other International Institutions: GATT, OECD, etc.

The General Agreement on Tariffs and Trade (GATT) and, in a broader economic sphere, the Organization for Economic Cooperation and Development (OECD) or other international organizations might provide channels for helping to normalize economic relations between the Eastern European and EEC as well as other Western countries. The EEC Commission has alluded to the importance of the current Kennedy Round of tariff reduction negotiations in GATT in regard to future trade possibilities for Eastern European countries with the Community. Although not playing a direct role in the trade sphere, the OECD could conceivably serve indirectly to facilitate trade contacts as well as to provide a useful channel for economic consultation and possible technical assistance.

Czechoslovakia alone among the Eastern European countries is a contracting party of GATT. However, this status has mainly been a formality since the country passed into the Communist camp in 1948. Most contracting parties do not apply GATT rules to Czechoslovakian exports which have been subjected to quota restrictions as have those of other Eastern European countries. Bilateral agreements tend to be the pattern for trade between the market economy and the centrally planned countries of Eastern Europe. Restrictions are often placed on the convertibility of currency earnings by the Eastern European countries in these trade agreements, although the trend has been toward full convertibility of foreign exchange earnings in recent years.25/

Yugoslavia and Poland had at first become associated with GATT and more recently have acquired the status of "provisional members." All three of the forementioned Eastern European countries are participating in the Kennedy Round of tariff negotiations in GATT. Rumania has reportedly made some inquiries regarding possible association with GATT. Some of the Eastern European countries are experimenting with tariffs for use primarily as a bargaining device in trade negotiations. A Hungarian official described to this writer a two-tier tariff system his country has established that will be employed in negotiations for MFN status with Western countries and implicitly to counter what he considers tariff discrimination by the EEC.

Some major problems for the GATT mechanism in regard to possible multilateral trading relations with Eastern European countries relate to the assurance of effective reciprocity and of access to markets. Tariffs would not appear to most observers as the principal mechanism that could be used by state-traders either to control access to markets or to discriminate among sellers. Both the Czechs and Poles have made proposals for ex post facto examinations in GATT of their trade policy as a way of meeting these concerns. In the current Kennedy Round, mention has been made of offers from these countries to assure a given percentage increase in trade with GATT contracting parties over a fixed period of time. Progress might be examined through an annual review procedure within GATT.

Probably a more difficult problem is posed for Eastern European countries in the GATT framework by those Western countries which prefer the type of trade assurances provided by bilateral trade agreements contrasted with the seemingly greater uncertainties of multilateral trade with state-trading countries. In GATT circles, this view has been conveyed by a few of the larger Western European countries which bargain for their exports when seeking a balance in trade while negotiating trade agreements. A similar attitude to possible multilateralization of Eastern European trade seemed to be evident to this writer in EEC circles in Brussels. In any event, the developments in the current Kennedy Round should be of considerable importance in regard to future relations of Eastern European countries with GATT -- an institution which admittedly has been geared closely to the trade needs of the industrially advanced Western market economy countries.

In the interest of facilitating entry of Eastern European countries into GATT negotiations, one Brussels Eurocrat spoke to the writer of a possible "Special Chapter" in GATT for problems of the state-trading countries, pointing to the analogous approach undertaken for the developing countries. This idea, he hurriedly went on to note, would probably be opposed by many GATT members, including the United States. Such an approach, of course, runs the risk of perpetuating the current bilateral trading arrangements between Eastern and Western European countries. Preferably, a differentiation between the advanced and less developed Eastern European countries could be considered within GATT. Some help to the less developed countries could be provided by not requiring full reciprocity along the lines now applied to Yugoslavia. To the extent possible, use should be made of the educational value of obliging the advanced Eastern European countries to qualify for MFN treatment under GATT rules.26/

The OECD* offers a possible channel for closer economic relations between the Eastern European and particularly the Western European countries. Since 1955, Yugoslavia was invited as an observer to attend certain meetings of OECD's predecessor, the Organization of European Economic Cooperation (OEEC). It has participated fully in the OEEC's (and now OECD's) work in agriculture, productivity and scientific and technical personnel. Since 1961, Yugoslavia has also participated fully in the work of Economic and Development Review Committee which carries out the OECD's annual review of the economic situation and prospects in member countries. It should be noted that since 1962 Yugoslavia has also been sending observers to meetings of CEMA.

Discussions with the OECD Secretariat and the Yugoslav delegation leave the writer with the impression that the organization's

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*In addition to Western European countries, United States, Canada and Japan are members of the OECD. Yugoslavia, as noted above, and Finland are associated in some aspects of OECD activities.

activities have been useful in facilitating contacts for the Yugoslavs with the West, in obtaining technical assistance and advice on various problems, and in providing some insight into economic developments in member countries that might affect trade opportunities in the West. Apparently, other Eastern European countries have not made any direct overtures to the OECD, although mention has been made in OECD circles of some signs of interest on the part of the Czechs in the organization's activities. There is, of course, the political problem of overcoming the history of the 1948 Marshall Plan preparatory conference which preceded the establishment of the OECD's predecessor, the OEEC. At that time, the Czechs left the conference with some reluctance on orders from Moscow. Looking at the types of advantages found by the Yugoslavs, it seems that the OECD could provide a possible consultative channel through various aspects of the organization's activities as the trend continues toward a normalization of relations between the Eastern and Western European countries.

Alternatively, such a possible role for the UN's Economic Commission for Europe (ECE) may be hampered by its Cold War history as a forum for East-West propaganda skirmishes. Although the quality of ECE Secretariat work has been excellent, the regular activities of its constitutent elements do not appear to provide the practical advantages of the OECD.

On balance, GATT would seem to be the most promising international channel for further contact at this time between the Eastern European and Western countries in the trade sphere, but it would not be suitable for broader economic consultation and cooperation. Between the two organizations operating in the broad European economic sphere, the OECD seems to have some advantages over the ECE. At a later stage, probably after the two key European elections of 1965 are over and the outcome of the Kennedy Round is in sight, it would be useful to give serious thought to international institutional arrangements which could foster constructive contacts between Eastern and Western Europe. Perhaps some type of ad hoc consultative mechanism could be developed by the OECD or a completely independent structure for this purpose might be considered.

## Chapter IV

## Conclusions and Recommendations

Polycentrism and renewed nationalistic trends in Eastern Europe have been reflected in a strong desire to normalize relations with Western Europe and particularly with Common Market countries where traditional ties have been closest. In recent years, the Eastern European countries have been trying to approach trade and other contacts with the EEC countries in a pragmatic way, relatively devoid of the ideological content which was common until 1962.

Recent economic reforms and related changes have not resulted in any apparent weakening of the Communist regimes in the Eastern Europe. On balance, the nationalist trends accompanied by humanizing and liberalizing tendencies have probably provided a greater degree of popular support for these governments than heretofore. Increased trade and other contacts with the West will probably stimulate pressures for further reforms within Eastern Europe. This process progressively could lead to further modernization, greater consumer orientation of the Eastern European economies, a relatively greater economic interdependence with the West and, concomitantly, to a normalization of international relations.

The economic expansion of Common Market countries, whether attributed to economic integration or not, has disturbed Communist spokesmen in their efforts to explain contemporary capitalism. The record of the EEC hardly reflects Marxist-Leninist writ on the decadence of capitalism and the pauperization of the proleteriat. Eastern theorists have pointed to the expanded market as an important factor behind the favorable economic trends in the EEC countries. There has been some continuing criticism of alleged monopolistic forces in the EEC that are contrary to the provisions of the Rome Treaty. Occasional slackening of economic activity in EEC countries has been magnified by Communist observers. However, the Soviet and Eastern European spokesmen have increasingly been moderating their former doctrinal assertions on the Common Market by introducing some factual data and descriptive analysis into current discussions.

While accepting the reality of the Common Market, the Eastern European regimes are not enthusiastic about the institution. No Eastern European country has extended legal recognition to the Community or established a mission in Brussels to deal with its constituent elements. However, the Eastern European countries have been moving cautiously toward de facto or "technical" relations with the EEC. (e.g., Negotiations between Poland and the Commission regarding import prices for eggs, which were concluded in April 1965, were characterized as "technical".)

Trade between the Eastern European and EEC countries tends to follow the pattern of relations between developing and industrially advanced countries. Exports from the Eastern European countries concentrate on agricultural products, primary commodities and semi-manufactured goods. Eastern European imports from the EEC area consist to a considerable degree of machinery, chemicals, transport and other equipment. In both size and content, this trade is relatively more important to the Eastern European countries than to the member countries of the EEC. Such trade represents about 2 percent of the total foreign trade of the Common Market area and is not of high priority content, but about 10 percent of the total trade of the Eastern European countries is involved with heavy emphasis on much needed quality imports.

The Common Market can be a vital element in the evolution of liberalizing trends in Eastern Europe. As a complementary economic unit, it would normally be the most attractive Western trading unit for the Eastern European countries. It is the common interest of the non-Communist world that this relationship be encouraged in a fashion which would sustain liberalizing trends in the Eastern European countries. The EEC, were it gradually to move away from bilateral to multilateral trading patterns, could stimulate further reforms in the trading structures of Eastern Europe. Progress in this respect also depends on the outcome of the Kennedy Round tariff negotiations in GATT in which Czechoslovakia, Poland and Yugoslavia are participating. An outward-looking EEC trade policy, including the important agricultural sphere, would do much to foster close cooperative relations. Alternatively, a narrow protectionist trading policy could lead to retaliatory efforts on the part of the Eastern European countries with a possible strengthening of relations with the Soviet Union.

It would be unrealistic to expect rapid or fundamental changes in the internal economic structure and institutions of Eastern European countries to result from current trends in trade with EEC and other Western countries. However, further reforms will probably be made in the foreign trade structure of Eastern Europe in order to facilitate new trade opportunities. The Foreign Trade Corporations which now have a monopoly in foreign trade within Eastern European countries (except for Yugoslavia) will probably give some ground to direct foreign trade relations by large enterprises. Increasingly, special incentives are being provided to the latter to expand their foreign trade with the West. Upgrading of Eastern European personnel recruited for work in foreign trade appears to be going on as a result of trade efforts directed westwards. Important reforms in pricing, undertaken in Czechoslovakia in the interest of increasing the efficiency of the overall economy as well as to meet requirements of foreign trade, are being watched closely by other Eastern European countries. In addition, licensing and marketing arrangements with Western European firms are under active consideration in Eastern Europe, particularly in Hungary. The resulting direct contacts between Western European management and technical personnel and those of Eastern European enterprises could be influential in the general industrial scene.

In regard to specific EEC trade relations problems, the Eastern European countries appear to share the same concern as the United States over possible protectionist trade policies, particularly in the agricultural sphere. However, continued reliance on bilateral trade agreements could tend to make the impact of the CAP on Eastern European trade less marked than on multilateral trade in regard to the products in question. In an effort to maintain export levels envisaged under bilateral agreements, the EEC might in effect provide preferential treatment through assured quotas to Eastern European countries.

The risks of disintegration and Balkanization in Eastern Europe while integration moves ahead in Western Europe have, with much conviction, been cited by Brzezinski and Montias. This is a high priority concern which should warrant careful joint examination by the United States and the Western European countries. It is hoped that, in the not too distant future, the Common Market countries would be in the position to decide on a common foreign policy responsive to this basic concern. Such a step seems to be essential before a meaningful common commercial policy toward the Eastern European countries can be developed. Various international institutions could facilitate a constructive evolution in relations between the Eastern and Western European countries. GATT, initially on trade matters, and subsequently, in a broader sphere, the OECD or some alternative mechanism could provide needed channels for consultation and possibly association in regard to common economic concerns of all European countries.

Recommendations:

On the basis of these conclusions and in the light of broad United States policy objectives in Europe, the following proposals are set forth as suggested policy guidance for the final few years remaining in the EEC's transitional period:

1. A normalization of relations away from the Cold War pattern should be sought as an immediate objective in trade and other contacts between the EEC and Eastern European countries.
2. Expansion of trade opportunities for Eastern European countries in EEC and other Western European countries should be encouraged so as to reduce progressively the degree of reliance on trade with the Soviet Union.
3. Preferably, trade relations between the two groups of countries should be encouraged to move toward a multilateral basis from the present pattern of bilateral agreements and quota restrictions with the view to facilitating trade expansion and the liberalization of trade and related economic institutions within Eastern Europe.

4. Sympathetic consideration should be given to Eastern European offers in the current Kennedy Round of tariff negotiations in GATT. Experimentally, an annual review technique or other device might be employed to examine trade policies of Eastern European countries for compliance with GATT principles. Ultimate accession of these countries to GATT should be encouraged, if the foregoing is successful.

5. Eastern European countries should be encouraged to recognize the Common Market and establish missions to the EEC in Brussels.

6. The United States should support possible Eastern European efforts to enlarge trade opportunities with with the EEC, particularly when these efforts would lead to multilateral trading arrangements.

7. In its efforts to encourage the EEC to open its doors to Eastern European countries and to develop an outward-looking trade policy, the United States should stress the potential importance of the Common Market in reducing divisive tendencies among Eastern European countries that could negatively affect the stability of all of Europe.

8. The United States should discourage the EEC from developing trade policies toward the Eastern European

countries which could result in retaliation through CEMA or otherwise strengthen bonds with the Soviet Union.

9. In addition to GATT, cited above, existing organizations for broader economic consultation should be tried or, if necessary, new ones developed in order to facilitate further contacts between Eastern and Western European countries. (The OECD, the IMF and the IBRD are suggested as possibilities. Possibly a special liaison group of the OECD might review consultative machinery with representatives of Eastern European countries.)

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