KOPINT-DATORG
Discussion Papers
No. 62 **Oktober 2000**

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Tamás Réti

The paper was presented on the round table on ”Ten Years of Trade Liberalisation in Transition Economies” organised by the OECD in Paris on July 10-11. 2000. The work was supported by the OECD. The content of this publication is the sole responsibility of the author.

ISSN 1216-0725
ISBN 963 7275 78 9

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Introduction and Executive Summary

1. Various regional economic co-operation initiatives that have emerged since 1990 in Europe are part of a process of constructing the European economic area. Preferential trade arrangements established in this context intend, not to be inward-looking, but to facilitate the participation of their members in the world economy. The initiatives are part of a strategy to liberalise and open national economies and implement export- and foreign investment-led policies. For the participating transition economies, regional economic co-operation represents a useful support for their accession to the EU.

2. During the twentieth century, economic co-operation between Central and Eastern European countries (CEECs) has gone through several radical changes. These generally small-sized economies concluded economic partnership agreements in the shadow of big powers (Germany and later the Soviet Union), which had strong political and economic interests in the region. Mutual economic relations were established on a bilateral basis and regional trade developed within this framework. Despite geographical proximity, mutual historical experiences and potential economic benefits stemming from regional co-operation, intra-regional trade tended to decrease. Political considerations were given priority, and comparative advantages remained under-utilised. The declining and limited scope of intra-regional trade has strengthened the conviction that small economies could not become natural partners and their relations could only be guaranteed through the intermediation of major economies in the region.

3. The changes in the political systems of former socialist countries in 1989 resulted in an external opening and liberalisation of foreign trade and capital flows. At the beginning of 1990s, the Council for Mutual Economic Assistance (CMEA) was abolished and, following the emergence of custom tariffs and non-tariff barriers, trade among the CEECs, considerably decreased. The CEECs sought to promote economic connections primarily with the European Union. With the entry into force of the Europe Agreements (EA), trade barriers between East and West started to be dismantled and the pendulum has largely swung to the benefit of the relations with the West.

4. In order to influence these trends, the so-called Visegrad Agreement was concluded in February 1991 among former Czechoslovakia, Hungary and Poland. The Agreement emphasised the existence of mutual economic and political interests, underlined the necessity for co-ordinating integration policies with the West, and stressed the need to further develop regional economic relations. In Visegrad, signatory countries expressed their common interests in relations with the West and agreed that their efforts would be more efficient if pursued jointly. Subsequently, their interest in mutual intra-regional trade was also clearly confirmed.

5. The Central European Free Trade Agreement (CEFTA) was signed in 1992. In the beginning, the CEFTA was supported by two major factors. The EU promoted the idea that associated countries also needed to establish a free trade zone within the region. The EU thus provided external impetus in the creation of the CEFTA. The second major factor was the economically unjustified low level of eastern trade relations and the fact that their economic recovery would be enhanced by developing intra-regional trade. The CEFTA

relied essentially on the trade part of the EA and set the goals of creating a free trade zone for industrial products in ten years and reducing trade barriers for trade in agriculture. The major difference between the two Agreements is that the EAs are based on the notion of asymmetry, while CEFTA seeks to exploit mutual benefits. The objective of the CEFTA was to create at least the same preferences as those provided by the EAs.

6. The present paper examines the Europe Agreements and the CEFTA and considers their impact on trade flows and trade policy of transition economies. It analyses in more detail the Hungarian experience, including the development of direct investment inflows from Hungary to neighbouring countries.

7. The relationship of regional trading arrangements to the multilateral trading system is an important issue in trade policy. Today, the intensification of regional integration initiatives is clear and regionalism emerges as an integral part of the trading environment. Regional trading blocks, however, should not be seen as alternatives to multilateral trade liberalisation and to global free trade. Regional trading arrangements are developed as “building blocks” and not as “stumbling blocks” to multilateral liberalisation.

8. What are the major driving forces behind regionalism? The prospects of enhanced economic growth resulting from the exploitation of scale economies, better regional specialisation and increased FDI flows attracted by expanding regional markets are important economic factors. The non-economic objectives of regionalism include strengthening of regional political cohesion, enhancing regional security and better control of immigration flows. Other objectives are to sustain domestic economic policy reforms, in particular trade liberalisation. In transition economies, regional trading arrangements are expected to complement and solidify shifts toward market-oriented reforms. Regional initiatives should not be inward looking but have to be associated with a strong outward orientation. If regional trading arrangements are properly conceived and implemented, they may contribute to the long-run goal of global free trade. Therefore, rather than to consider regional initiatives and the multilateral trading system as inevitably antithetical, they should be viewed as complementary. Multilateralism and regionalism are in contradiction only if liberalisation is exclusively associated with the global trade perspective while regional trade is linked with protectionist tendencies.

9. A former Director-General of the WTO proposed open regionalism as a possible solution.[1] Such an approach would comply with the basic legal requirements of the WTO and allow for a gradual convergence of regionalism and multilateralism. Regional initiatives can help the WTO accomplish its goals, as regional agreements involving fewer countries with similar conditions may be more flexible and encourage liberalisation in areas not yet covered by the WTO.

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1 Renato Ruggiero, ”The Road Ahead: International Trade Policy in the Era of the WTO, ” May 28, 1996. http://www. wto.org.

I. Regional integration initiatives: The Europe Agreements

1.1. Institutional arrangements

Prior to the 1989 political and economic changes in central and eastern Europe, the relationship with the European Community progressed in a slow and hesitant manner. The Council for Mutual Economic Assistance (CMEA) and the European Community were very different trading organisations. The CMEA had no common commercial policy and external tariffs. Economic relations between the two groupings began to improve by the second half of the 1980s due to the economic reforms and the start of political liberalisation in central and eastern Europe. By mid-1988, diplomatic relations had been established between the Community and several eastern European countries. Hungary concluded a co-operation agreement in September 1988 that eliminated quantitative restrictions in the trade of industrial goods over a period of four years. Similar agreements were signed in 1989 and 1990 by former Czechoslovakia, Poland, Bulgaria and Romania. These Trade and Co-operation Agreements provided for mutual MFN treatment in accordance with the GATT, eliminated prohibitive trade barriers and abolished quantitative restrictions. The Community granted the General System of Preferences (GSP) to the former socialist countries as a unilateral advantage, leading to more favourable export terms for their agricultural products and increasing their opportunities for exporting textiles. The transition period for phasing out quantitative restrictions was abolished. As a response to the democratisation in the CEECs, the European Community has opened up its markets and provided aid to help market reforms.

The CEECs rapidly liberalised their trade regime and abandoned their state regulated, bureaucratic trading system, in particular by abolishing the state monopoly of foreign trade and moving to foreign exchange convertibility for current account transactions. External liberalisation was a necessary supplement to internal price liberalisation. Exposure to world market prices helped in de-monopolising the economy, supported competition and improved allocation of resources.

The most important instruments in establishing close relations with the European Community have been the Europe Agreements (Association Agreements). The first agreements were signed with Hungary, Poland, and former Czechoslovakia in December 1991. Since then, ten CEECs have concluded agreements with the European Community, later European Union. The Europe Agreements (EA), which followed the model of Association Agreements signed with some other countries, substantially modified mutual relations. They established a formal legal basis for a closer political relationship and dialogue and led to the creation of several common institutions, such as Association Council, Association Committee and the Association Parliamentary Committee.

Table A

Europe Agreements

	Europe Agreements are entering into force	
	Interim	Final
Hungary	March 1, 1992	February 1, 1994
Poland	March 1, 1992	February 1, 1994
Czech Republic	March 1, 1992[a]	February 1, 1995
Slovakia	March 1, 1992[a]	February 1, 1995
Romania	May 1, 1993	February 1, 1995
Bulgaria	December 31, 1993	February 1, 1995
Latvia[b]	June 12, 1995[c]	February 1, 1998
Estonia[b]	June 12, 1995[c]	February 1, 1998
Lithuania[b]	June 12, 1995[c]	February 1, 1998
Slovenia	January 1, 1997	February 1, 1999

Notes:
a Former Czechoslovakia
b Free Trade Agreement since January 1, 1995
c Signing of Europe Agreements.
Source: Stankovsky, J., Plasser, F., Ulram, A.. P., On the Eve of EU Enlargement. Economic Developments and Democratic Attitudes in East Central Europe. Signum Verlag, Wien 1998.

All the EAs concluded by the CEECs have the same structure. The preamble considers the EA as a step towards establishing a system of stability in Europe based on co-operation. It acknowledges that the CEECs' final goal is membership in the Community. Among the objectives, the EAs mention the gradual establishment of a free trade area that will cover substantially all trade between them.[2] In general, the transition period is fixed for ten years, though the latest agreements define different transition periods. For Estonia, a free trade regime entered into force on 1 January 1995, without a transition period. The articles of free movement of goods are divided into three separate sections: industrial products, agricultural goods and fisheries. The free trade arrangement applies only to industrial goods and not to agricultural products.

For industrial goods, three separate groups were defined: textiles and clothing, iron and steel products and other industrial goods. The EAs describe a schedule for reduction of customs tariffs, quantitative restrictions and other charges. According to the principle of asymmetry, the reduction of trade barriers by the EU is more rapid than that by the CEECs, which have to introduce full liberalisation of their imports from the EU within a transition period. The EU applies the same treatment for all the ten associated states. There are, however, important differences in liberalisation of different categories of products. As regards textile and clothing, separate protocols deal with customs duties and quantitative restrictions. In the case of Hungary and Poland, customs tariffs on imports to the EU have to be eliminated within five years of the entry into force of the interim agreements. The iron and steel products are covered by a separate protocol that abolishes quantitative restrictions on both sides for steel products. The EU accepted elimination of custom tariffs over five years for the first wave of EAs. Customs duties were finally removed for all the associated countries by 1 January 1996. Duties and quantitative restrictions on coal and

2 Europe Agreement with Hungary. Magyar Közlöny, 1994. január 4., 1. szám, Budapest

coal products were eliminated fairly rapidly, except in the case of Hungary where a longer transition period was established.

Textile, clothing, iron and steel and coal products, together with the agricultural goods, are the so-called sensitive products for which the opening of the Community’s market has been applied in a onger transition period. The CEECs are allowed to apply trade measures longer than the EU, but all restrictions limiting the free trade in industrial goods have to disappear by 2002. Hungarian industrial exports were fully liberalised from January 1998. In 1998, 50% of EU imports to Hungary were liberalised, and remaining customs duties will be eliminated by 2001. Although the number of EU anti-dumping investigations of imports from the CEECs has been decreasing, they continue to affect several important categories, such as steel, chemicals and wood products.

The EA provisions for agricultural goods were not initially very far-reaching. The concessions included lowering of levies and duties on quantities of a wide range of products, and some increases of quotas. Further liberalisation in mutual agricultural trade will take place by mid 2000. The Czech Republic, Hungary, Latvia, Lithuania and Slovakia have already concluded new agreements; the agreements with Bulgaria and Romania are under discussion; and the negotiations with Poland were interrupted. At present, only Hungary records a surplus in its agricultural trade with the EU. According to the agreement entering into force in July 2000, duty-free agricultural exports will amount to 72% of Hungarian sales and 54% of EU agricultural exports. In addition, export subsidies will be eliminated, and the tariff quotas will be increased annually.

1.2. Main trends in foreign trade of transition economies

The political and economic changes have substantially altered the geographical and product structures of foreign trade in the CEECs, in particular as regards their trade relations with EU partners.

Table B

Share of the transition countries in the EU-15 external trade (percent)

	EU exports				EU imports			
	1994	1996	1998	Rank 1998	1994	1996	1998	Rank 1998
Poland	2.4	3.2	3.8	4	2.0	2.1	2.3	8
Czech Rep.	1.8	2.2	2.4	10	1.4	1.7	2.1	10
Hungary	1.5	1.6	2.3	11	1.2	1.5	2.1	11
Slovenia	0.8	0.9	0.9	26	0.7	0.7	0.7	30
Romania	0.6	0.7	0.9	28	0.5	0.6	0.7	31
Slovakia	0.4	0.6	0.8	29	0.4	0.6	0.8	28
Estonia	0.2	0.3	0.4	44	0.1	0.2	0.2	49
Bulgaria	0.3	0.3	0.3	45	0.3	0.3	0.3	44
Lithuania	0.2	0.2	0.3	47	na	na	na	na
Total	8.2	10.0	12.1		6.6	7.7	9.2	

Source: External and intra-European Union trade 12/1999, Monthly statistics, eurostat, European Commission, Luxembourg

Table B clearly shows that the significance of the CEECs as an export market for EU countries has been much higher than their importance as a source for EU imports. For EU external exports, the cumulated share of the ten CEECs associated countries in 1998 was more or less equivalent to the share of Japan and Switzerland. Between 1994-1998, total external EU exports calculated in ECU increased by 39.7%, while its exports to the CEECs grew by 106.2%. In parallel, the share of 10 CEECs in external EU imports in 1998 was about equal to the share of Japan, the second most important import market of the EU. In the period 1994-1998, total external EU imports increased by 37.4 % and imports from the associated CEECs rose by 91.5 %. Thus, the EAs led to a rapid growth in mutual trade, with EU exports to the CEECs, developing more dynamically than EU imports from these countries (see Table C).

Table C

Growth of foreign trade between the European Union and several associated countries 1990-1998

(percent based on current dollar price)

	Czech Rep.	Hungary	Poland	Romania	Slovenia	Slovakia[a]
Export to the EU	487	417	255	274	222	321
Import from the EU	460	443	637	341	215	368

Note: [a] 1992-1998

Source: Countries in Transition. The Vienna Institute for Comparative Economic Studies, 1996. CESTAT Statistical Bulletin 1999/3, Hungarian Central Statistical Office, Budapest, 2000.

These developments led to considerable trade deficits recorded by most CEECs in their trade with the EU, particularly in the Czech Republic (1996), Hungary (1994), Poland (1998), Romania (1996) and Slovakia (1998) (see Statistical Annex). Assessing the reasons and the consequences of this trade situation is complex, as several aspects need to be considered. On the one hand, it is understandable that the transition countries have considerable import requirements related to their modernisation needs. In addition, pent-up demand in private consumption, backlogs in the infrastructure and restructuring of enterprises have also contributed to import surges. Fixed exchange rate policies led to currency appreciation that added strong upward pressures on import demand. FDI inflows have entailed further imports. On the other hand, restrictive policies on the EU side adversely affected several sensitive sectors in which the CEECs still enjoyed some comparative advantages. Moreover, the external opening and trade liberalisation have intensified competition in the CEECs' domestic markets.

However, CEECs have also succeeded in considerably improving their export capacities. The most remarkable development occurred in the exports of machinery and equipment by the CEECs. Their share in total exports increased substantially in certain countries, reflecting mostly the impact of FDI, particularly in the Czech Republic, Hungary, Poland and Slovakia. In contrast, the limited scope of changes in Bulgaria and Romania indicates the delay in enterprise restructuring (see Table D).

Table D

The share of machinery and transport equipment in the total exports
(percent)

	1990	1992	1994	1996	1998	1999/I-III
Bulgaria	na	17.9	12.2	12.5	11.1a	na
Czech Rep.	37.7	25.4	25.9	32.7	41.3	42.6
Hungary	25.6	21.2	25.6	36.3	52.0	56.5
Poland	26.2	19.2	19.8	23.4	28.4	29.0
Romania	na	na	14.3	13.6	14.6	16.6
Slovakia	na	17.4	19.0	23.2	37.4	39.2
Slovenia	38.1	29.4	30.3	33.4	36.7	35.4

Note: [a] 1997

Source: Countries in Transition 1996, 1999. The Vienna Institute for International Economic Studies, CESTAT Statistical Bulletin 1999/3, Hungarian Central Statistical Office, Budapest, 2000

1.3. Trade developments in selected transition economies

Prior to the systemic changes, ***Bulgaria*** was highly integrated into the Soviet trading bloc, making the country vulnerable and greatly trade-dependent. Since 1989, there has been a reorientation of foreign trade, and OECD countries have become the most important trading partners. Among the EU, Germany, Italy and Greece dominate both imports and exports. However, supply-side barriers continue to limit the country's export capability. The wars and economic sanctions affecting former Yugoslavia have seriously affected trade relations with the other Balkan states, and the disruption of the most direct transportation ties also hurt Bulgaria's export performance to the West. Bulgaria's trade balance has considerably varied since 1989. Trade surpluses emerged in the period 1995-1997, reflecting a severe contraction in domestic demand and serious delays in foreign and post-privatisation investments that usually cause a surge in machinery and equipment imports. Trade deficits emerging in 1998-1999 indicate a lack of export competitiveness and changes in domestic demand.

Table E

Bulgarian trade orientation by region, Jan-Sep 1998-1999 (percent)

Exports Imports

	1998	1999	1998	1999
Total	100.0	100.0	100.0	100.0
CEECs	23.3	19.7	32.8	28.3
CIS	13.1	8.3	25.9	21.4
CEFTA	5.1	4.0	5.3	6.1
OECD	63.3	67.5	54.1	59.8
EU	50.9	53.1	44.4	50.2
EFTA	0.8	1.6	1.6	1.6

Source: Bulgaria, 1st quarter 2000, Country Report, The Economic Intelligence Unit, The Economist, London.

After the collapse of the former CMEA markets, the ***Czech Republic*** experienced a rapid reorientation of trade. The EU and within it Germany became the largest export markets. Czech export growth has been limited by a number of anti-dumping measures against Czech exporters. Large FDI, in particular in the motor vehicle industry, allowed for a rapid development of high-value added products. Since 1992, strong real wage growth, industrial recovery and fast appreciation of the national currency caused rapid import growth, largely outstripping the increase of exports. The Czech government was committed to nominal exchange rate stability between January 1991 and May 1997, which resulted in a real appreciation. In reaction to the growing external and governmental deficits, austerity measures have been introduced to lower imbalances. Currency devaluation and establishment of floating exchange rates, together with a reduction in domestic demand, have resulted in improvement of the external balance, but the economy entered into a recession, which lasted until the end of 1999.

Hungary has traditionally been an open economy. After 1990, a substantial part of the foreign trade with CMEA countries was redirected towards Western markets. Starting in 1993 the trade balance turned into large deficits, resulting from a dramatic decline in exports and a fast increase of imports. Several measures were undertaken, in particular the devaluation of the currency, the introduction of an import surcharge and restrictions of the domestic consumption. These measures and considerable FDI inflows helped to overcome external imbalances. Development of FDI and related export capacities have also been facilitated by the creation of industrial customs-free zones.

Re-integration of ***Poland*** into west European trade proceeded rapidly. By the mid-1990s, the EU was well established as the country's biggest trading partner. Between 1998-1999, the trade deficit expanded from $13.7bn to $14.5bn, in large part due to the high import sensitivity of the manufacturing industry. The crash of the Russian market contributed to the decline in Polish exports. The volatility of the zloty's exchange rate has also affected the country's trade performance.

Table F

EU share of Polish trade (percent of total)

	1991	1992	1993	1994	1995	1996	1997	1998
Exports	55.6	57.9	63.2	62.7	70.5	66.2	64.0	68.3
Imports	49.9	53.2	57.2	57.5	64.6	63.9	63.8	65.7

Source: Poland, Country Profile 1996-97, 1999-2000, The Economist Intelligence Unit Limited, The Economist, 1997, 1999.

Prior to the systemic political changes, ***Romania*** was a relatively closed economy, recording a trade surplus by minimising imports and carrying out forced export activities. After 1990, the new governments diverted exports of food and consumer goods to the domestic market and began to eliminate unprofitable exports. This has resulted in a growing trade deficit. Exports under outward-processing arrangements, mainly with Germany and Italy, are accounting for a large part of its export growth. Recent Romanian export results were impaired by the Russian crisis, military conflict in Yugoslavia, and inaccessibility of a part of the Danube River. A better trade balance was brought about by the rapid real devaluation of the national currency that made imports more expensive, though at the price of high inflation.

Slovakia has rapidly reoriented its trade to the West. Despite the creation of the Custom Union, the economic linkage with the Czech Republic has continuously decreased. Slovakia's overall trade position began to deteriorate in 1996, due to exchange rate appreciation, strong import demand, low export competitiveness and high dependence on exports of price-sensitive intermediate goods, such as basic steel products, refined fuels and base chemicals. Exports have developed in the transport equipment sector, which benefited from FDI inflows. A deterioration of the trade balance, which accelerated in 1998, prompted the government to initiate an austerity package in 1999, devaluate the currency and re-introduce the import surcharge. Following these measures, economic growth has slowed down and the trade balance considerably improved. In particular, the country managed to generate a trade surplus of US$ 220 mn in its trade with the EU.

Slovenia is a largely open economy with the share of foreign trade representing 115 % of GDP in 1998. After having gained political independence, the country reoriented rapidly its trade from the former Yugoslav markets to Western Europe. Slovenia intends to bring its tariffs applied to non-EU countries fully into line with the EU's common external tariff in 2002. The composition of exports is rather diverse, including in particular automobile and other industrial components. Slovenia has a competitive edge in exporting electrical machinery, medicines, household goods, clothing, furniture and wooden products. In 1999, Slovenia was also confronted with a deterioration of its trade balance, recording its highest deficit in the 1990s. This situation is due to strong investment activity, mostly in the infrastructure, but the Kosovo conflict also affected negatively Slovenian export markets in Croatia and other former Yugoslav republics.

II. The Central European Free Trade Agreement

2.1. Institutional arrangements

The Central European Free Trade Agreement (CEFTA), concluded by the former Czechoslovakia, Hungary and Poland, was based on the Visegrad Declaration of 15 February 1991 and the Cracow Declaration of 6 October 1991. The Agreement was signed on 21 December 1992 in Cracow and was applied from 1 March 1993 and entered into force on 1 July 1994. Slovenia acceded to CEFTA in 1996, Romania in 1997 and Bulgaria in 1999.

In the Preamble of the Agreement, the parties express their wishes to participate actively in the process of economic integration in Europe, and to foster the intensification of mutually beneficial trade relations among them. They agree to gradually establish a free trade area in conformity with Article XXIV of the General Agreement on Tariffs and Trade in a transitional period ending on 1 January 2001, at the latest. For industrial products, the Agreement stipulates that no new customs duties on imports shall be introduced and the current duties abolished. The basic duty to which the successive reductions are to be applied is the Most Favoured Nation (MFN) rate applicable on 29 February 1992. This means that CEFTA introduced a so-called standstill clause, which defined the maximum level of protection, and the parties committed themselves not to raise it. All charges other than customs duties on imports and exports have to be abolished. The CEFTA envisages the complete abolishment of duties, charges and non-trade barriers on trade in industrial products by the end of the transitional period. There are some exceptions, such as Polish car exports to Hungary and Hungarian exports of paper products to Poland, for which the transitional period will end only on 1 January 2002

Article XXIV of GATT defines the conditions to be met by a free trade area. The CEFTA meets the provision that requires a reasonable timetable for setting up a free trade area. A major feature of the CEFTA is that tariff concessions are included in bilateral protocols that form an integral part of the Agreement. The liberalisation in industrial products is based on the principle of balanced concessions, setting up timetables for tariff reductions that are very similar in individual schedules. The Parties aimed at reaching a balance, and symmetry in granting concessions reciprocally.

The liberalisation of trade in industrial products has been accelerated three times. The first adjustment was in 1994, when the timetable for reduction of tariffs was shortened for the most sensitive goods, liberalisation for medium sensitive products was accelerated, and several goods were shifted to lists with shorter periods of liberalisation. A second acceleration occurred in 1995 for a great number of industrial goods. The last amendment accelerating liberalisation of trade in industrial products took place in 1996. As a consequence of the successive acceleration rounds, only a small share of industrial products remained subject to customs tariffs by January 1997. These include the most sensitive goods such as vehicles, textiles, steel products and some chemical products. The full elimination will take place in the years 2000-2002. For the agricultural sector, the agreement does not contain a standstill rule. Concessions are granted to limited groups of products and a complete elimination of tariffs is not envisaged. The concessions, modifying the original Agreement in view of larger specific liberalisation, are exchanged bilaterally by the respective countries. Recently, some CEFTA countries applied trade restrictions, especially increased tariffs, in this area. For example, tariffs were raised on Hungarian chicken exports to Poland, Romania and Slovenia.

In order to facilitate the accession of new countries, the original Agreement was amended on 11 September 1995. Formally the applicant had to be a European country and the application had to be accepted by all CEFTA members. There are now two new conditions--membership in the WTO and an EA signed by an applicant county with the EU. Following these amendments, CEFTA membership was enlarged to include Slovenia, Romania and Bulgaria. CEFTA is a free trade agreement and does not deal with free movement of capital, labour and services. It has no permanent institution and its Parties enjoy full sovereignty in their decision-making. The co-ordination of its activities is under the authority of the Joint Committee composed of the Ministers responsible for international economic co-operation. The Joint Committee works by common agreement and may establish sub-committees or working groups for special tasks.

2.2. Trade development within the CEFTA

During the first years of CEFTA between 1993-1997, trade liberalisation in member countries led to a rapid expansion of foreign trade. Dynamism of regional trade was due to the cumulative effect of several positive factors. First, dismantling of customs and other non-tariff barriers led to trade creation. The first years of CEFTA correspond to a reconstruction period, since the starting trade levels were very low. Second, intra-regional trade also benefited from the end of the so-called transformation recession and the subsequent economic revival in most CEFTA member countries. Economic growth was primarily based on the development of the domestic demand, both personal consumption and investments, which create a strong demand for imports. Third, growing trade imbalances vis-à-vis the EU recorded by most CEFTA countries also encouraged the search for new alternative export markets. 34. Between 1993-1997, trade balances of individual CEFTA countries significantly differed. In the case of the Czech Republic and Slovakia, CEFTA-trade has led mostly to export surpluses, while Poland and Slovenia posted import surpluses. Hungary was in an intermediate position: it achieved trade deficits vis-à-vis the Czech Republic and Slovakia, but had trade surpluses with Poland and Slovenia. CEFTA's total intra-regional imports increased from US$ 7.4bn in 1993 to US$ 13.8bn in 1998.

Table G

Share of CEFTA-trade in the total trade of CEFTA countries (percent)

	Exports						Imports					
	Cz.	Hu.	Po.	Ro.	Sl.	Sk.	Cz.	Hu.	Po.	Ro.	Sl.	Sk.
1995	21.4	5.9	5.4	na	4.8	44.3	16.3	6.4	5.6	na	6.7	33.1
1996	22.8	7.4	5.9	3.6	5.4	42.1	14.6	6.9	5.8	4.7	6.5	29.7
1997	22.0	7.3	6.7	4.1	5.7	38.7	14.0	6.5	6.3	5.7	7.4	28.9
1998	20.3	8.9	7.2	5.4	6.5	32.3	14.0	6.9	6.3	9.2	7.2	25.2

Source: Economic Survey of Europe 1999 No.3, Economic Commission for Europe, United Nations, Geneva, CESTAT Statistical Bulletin 1997/4, 1998/3, 1999/3 Hungarian Central Statistical Office

The share of CEFTA in total trade increased in Hungary, Poland, Romania and Slovenia. The shrinkage for the Czech Republic and Slovakia were mainly due to the trade decline within the Custom Union. As an export market, the CEFTA plays an important role for the Czech Republic, Hungary, Poland and Slovakia. It is interesting to note the increase in the Romanian import share in 1998, occurring after trade liberalisation.

Table H

Structure of intra-CEFTA exports in 1998 (percent)

	Czech Rep.	Hungary	Poland	Romania	Slovenia	Slovakia
Czech Rep.	-	9.8	24.0	0.6	3.9	51.3
Hungary	31.4	-	26.0	10.5	7.9	24.2
Poland	49.2	19.9	-	4.4	6.7	19.8
Romania	17.9	50.3	13.4	-	4.2	9.9
Slovenia	36.4	33.6	10.8	6.7	-	12.4
Slovakia	73.8	9.8	10.1	0.4	2.4	–

Source: CESTAT Statistical Bulletin 1999/3, Hungarian Central Statistical Office, Budapest, 2000. Author's calculations.

Table I

Trade balances within the CEFTA (US$ mn)

	Czech. Rep.	Hungary	Poland	Romania	Slovenia	Slovakia
1996	962	-91	-680	-249	-165	368
1997	970	9	-926	-298	-209	320
1998	1299	273	-948	-641	-137	211
1999/I-III	688	-32	-606	-268	-160	230

Source: Author's calculations based on the CESTAT Bulletin 1999/3

2.3. Hungarian experience with the CEFTA

In general, the product structure of intra-CEFTA trade is dominated by lower value-added goods, particularly energy, raw materials, foodstuffs, agricultural products and manufactured goods classified by materials. In the case of Hungary, the difference between trade flows with CEFTA partners compared to the country's trade with the EU is even more important than in case of other CEFTA countries. The higher share of machinery and transport equipment in Hungarian exports to the EU reflects the strong presence of multinational enterprises in Hungary, their considerable involvement in export activities and intra-firm trade.

Table J

Product structure of the Hungarian trade with the EU and CEFTA in 1999 by sections of custom tariffs, HS based (percent)

	Export to EU	Export to CEFTA	Import from EU	Import fromCEFTA
I. Live animal, animal products	2.5	4.8	0.3	1.0
II. Vegetable products	1.9	7.6	0.6	0.9
III. Animal, veget. fats	0.0	1.1	0.2	0.3
IV. Prepared foodstuffs, beverages, spirits	1.5	10.7	1.1	4.1
V. Mineral products	1.5	3.9	1.2	14.0
VI. Products of chemical industry	2.4	13.0	7.9	10.4
VII. Plastics, rubber and articles	3.1	10.4	6.5	4.5
VIII. Raw hides, skins, leather	0.7	0.9	1.4	1.4
IX. Wood, art. of wood & cork	1.6	1.8	0.6	4.6
X. Pulp of wood, cellul., paper	0.9	5.3	3.1	7.0
XI. Textiles and articles	7.2	5.4	6.8	5.2
XII. Footwear, umbrellas	1.7	0.4	0.7	0.6
XIII. Articles of stone, plaster, cement, glass	1.1	2.5	1.7	2.8
XIV. Pearls, jewellery	0.1	0.0	0.1	0.0
XV. Base metals and articles	5.6	10.3	7.7	16.2
XVI. Machinery and mechanical appliances	53.0	16.3	45.0	15.4
XVII. Vehicles, transport	10.3	3.4	10.9	8.6
XVIII.Optical, medical instruments	1.0	0.7	2.1	0.4
XIX. Arms and ammunition	0.0	0.0	0.1	0.0
XX. Miscellaneous manufactured articles	3.8	1.5	2.1	2.4
XXI. Works of art, antiques	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0

Source: Hungary's Foreign Trade 1999, Ministry of Economic Affairs, MEA Information, Budapest

In 1998-1999, Hungary recorded trade surpluses with the southeast European states (Bulgaria, Romania and Slovenia), but posted trade deficits with the northeast European economies (the Czech Republic, Poland and Slovakia). It had a global deficit vis-à-vis CEFTA countries, reflecting probably increasing protectionist trends in the agricultural trade, which were particularly damaging for Hungary.

One major obstacle to further development of intra-CEFTA trade is the low amount of foreign capital flows. Central and East European enterprises have so far participated to a limited extent in acquisitions and green-field investments in other regional economies. This phenomenon can be explained by the shortage of domestic capital, lack of foreign-investor friendly privatisation policies, and resistance to selling domestic enterprises to neighbouring countries. The low volume of foreign direct investments inhibits expansion of regional trade turnover.

Table K

Hungarian direct investment flows to the CEFTA-countries ($ mn)

	1996	1997	1998	1999
Poland	-	4.1	6.4	10.5
Romania	4.9	28.2	35.4	56.3
Slovakia	5.1	13.2	-	7.9
Slovenia	2.2	-	-	-
Total Hungarian capital exports	54.6	356	434	234

Source: Hungarian National Bank

Within the CEFTA region, the major destination for Hungarian direct investment is Romania. According to Romanian statistics, Hungarian direct investment amounted to US$ 158.5mn at the end of December 1999. The number of enterprises with Hungarian participation reached 3 092, from which about 30 firms represented over US$ 1mn of investment each. Hungary ranks eleventh among foreign investors in Romania, with its share amounting to 3.6 %. The most important Hungarian investor has been the Mol, the Hungarian Oil and Gas Company which has brought some US$ 50mn of investment, most in petrol stations. Among other large investors are Dunapack Ltd, an Austrian owned packaging company, Richter Gedeon Ltd, a pharmaceutical company, Zalakeramia and Budapest Bank. Among the more than 3 000 firms with Hungarian participation, 36.3 % are active in retail trade, 28.5 % in the industry, 12.4 % in business services, 10.4 % in wholesale trade and 8.1 % in the food industry.

Several factors encouraged the entry of Hungarian small and medium-sized companies in Romania, in particular geographical proximity and lack of language barriers. A major part of Hungarian investments is located in the partly Hungarian populated Transylvania. Some of these joint companies are family enterprises that are nevertheless vulnerable to local nationalistic manifestations. Small enterprises have often been created to promote bilateral trade in order to benefit from tax and custom allowances. Hungarian investments are made in an environment where the total amount of foreign investments is low, markets less saturated, competition undeveloped, and political instability and economic risks high. In recent years, the establishment of small and medium-sized business decelerated, and the presence of bigger investors, mostly transnational companies, has strengthened. Hungarian investors also participate in foreign trade relations, as confirmed by the recent fast increase in Hungarian exports. There are, however, several difficulties with Hungarian capital penetration in Romania. In addition to political uncertainties, investors risk suffering from macroeconomic instability, especially high fluctuations of the exchange rates. High inflation also complicates business and investment strategies. However, the Romanian economy constitutes an important market opportunity.

Among CEFTA partners, Slovakia is another important beneficiary of FDI from Hungary. By the end of 1999, Hungarian investments in Slovakia amounted to US$ 40mn. At the beginning of 2000, Mol, the Hungarian Oil and Gas Company, paid US$ 262mn for 36.2% of Slovnaft, the Slovak oil company – the biggest single acquisition of a transition country in the region. Joint companies have been established in foreign trade and wood production. In general terms, Hungarian capital investments are inhibited by the lack of capital formation and high real lending rates. The Hungarian government established an investment promotion agency that mainly focuses on achieving profitability of existing investments. Hungarian accession to the EU may further weaken the national character of capital exports and strengthen their international character.

Despite the fast increase in trade turnover among the CEFTA countries, the volume of intra-regional trade is modest and therefore might have a considerable expansion potential, due to geographical proximity, complementary production structures, balanced economic relationship and the level of development for member countries. The establishment of a number of transnational enterprises has already had a positive impact on intra-regional trade flows. These enterprises often establish affiliates in other central and eastern European economies and, by developing specialised production, encourage intra-industry trade within CEFTA.

III. Concluding remarks

The CEECs have made remarkable progress in the process of the trade liberalisation. Trade liberalisation has led to greater international openness and an increased level of integration into the global economy. A more liberal trade regime allowed for rapid export developments and a greater outward orientation. Liberal trade regimes encouraged economic development in the region and contributed to economic growth. However, several major policy problems related to trade liberalisation had to be dealt with, especially the timing of currency convertibility, the level of protection and the speed of liberalisation. In particular, it was necessary to weigh the trade-off between protection of less competitive industries and the importance of strong competitive pressures. Trade liberalisation in the CEECs thus has been a difficult task.

Following the collapse of the CMEA, which seriously disrupted regional trade flows, regional agreements sought to revive and help in developing economically rational trade relations. The EAs and the CEFTA established the basic framework for comprehensive regional economic co-operation. These agreements called for the gradual introduction of free trade in industrial products and concessions in trade of agricultural goods. They facilitated the inevitable process of trade orientation, especially the shift to trade with the EU, which became the most important trading partner. Since imports of the CEECs from the EU increased more rapidly than their exports, their trade balances with the EU generally deteriorated. Trade liberalisation in the CEFTA was rapid and to some extent deeper compared to the EAs. However, protectionist tendencies in CEFTA agricultural trade indicate a certain deceleration in the trade liberalisation process.

The initial rapid increase in trade among CEFTA members reflected very low initial levels of intra-regional trade. It is doubtful that these high growth rates could be pursued in the future. The future dynamism of intra-regional trade relations will very much depend on economic developments in partner countries, their economic convergence and their individual progress in integration within the EU. Simultaneous balanced and sustainable growth of the whole region appears to be an important condition for the development of regional economic co-operation.

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ANNEX

Table 1

Tariff Revenues (percent of imports)

	1991	1992	1993	1994	1995	1996	1997	1998
Bulgaria	2.4	4.1	7.1	6.9	6.1	4.6	4.8	na
Czech Rep.	na	na	3.9	4.1	2.6	2.6	1.7	na
Estonia[1]	na	na	0.9	0.9	0.2	0.1	0.1	0.0
Hungary	9.1	11.8	12.0	12.6	12.9	9.6	4.0	2.6
Latvia	na	2.8	2.9	3.2	1.8	1.5	1.4	1.1
Lithuania	na	na	1.1	3.2	1.4	1.2	1.3	1.1
Poland	12.7	14.7	15.3	18.5	15.0	10.7	5.6	4.0
Romania	6.7	5.0	6.6	6.0	6.2	5.1	4.5	4.9
Slovakia[2]	na	na	2.3	3.4	3.3	2.9	3.3	2.6
Slovenia	na	6.8	7.3	7.0	7.1	6.1	4.0	3.2

Notes: 1 Excludes differential excise taxes on imports
2 Refers to import tariffs, custom duties and import surcharge.
Source: Transition Report 1999, EBRD London.

Table 2

Exports to the EU-15 (in millions USD)

	Czech Rep.	Hungary	Poland	Romania	Slovenia	Slovakia
1990	3473	4022	7548	1957	2668	1179
1992	5409	6655	8657	1535	4066	1858
1994	7710	6837	11931	2965	4480	2340
1996	12755	10949	16196	4569	5367	3644
1998	16914	16782	19270	5358	5928	5966
1999/I-III.	13470	13369	14088	4054	4176	4403

Source: Countries in transition 1996. The Vienna Institute for Comparative Economic Studies. CESTAT Statistical Bulletin 1999/3, Hungarian Central Statistical Office, Budapest, 2000.

Table 3

Imports from the EU-15 (millions of USD)

	Czech Rep.	Hungary	Poland	Romania	Slovenia	Slovakia
1990	3971	3720	4870	2005	3259	na
1992	6117	6670	9860	2584	3659	1780
1994	8331	8927	14076	3427	5052	2210
1996	17297	11301	23738	5986	6360	4147
1998	18281	16479	31027	6829	7017	6554
1999/I-III.	13205	12948	21530	4482	5046	4218

Source: Countries in Transition 1996, The Vienna Institute for Comparative Economic Studies. CESTAT Statistical Bulletin 1999/3, Hungarian Central Statistical Office, Budapest, 2000.

Table 4

Balance of Foreign Trade with the EU-15 (millions of USD)

	Czech Rep.	Hungary	Poland	Romania	Slovenia	Slovakia
1990	-498.0	302.1	2677.3	-48.3	-591.7	na
1992	-707.9	-14.6	-1202.7	-1049.2	406.4	77.6
1994	-622.0	-2090.5	-2145.1	-462.3	-572.0	129.1
1996	-4541.4	-1442.7	-7549.3	-1417.5	-993.5	-502.6
1998	-1367	303	-11757	-1471	-1089	-588
1999/I-III.	265	421	-7442	-428	-870	185

Source: Countries in Transition 1996, The Vienna Institute for Comparative Economic Studies. CESTAT Statistical Bulletin 1999/3, Hungarian Central Statistical Office, Budapest, 2000.

Table 5

EU imports. Main EU trading partners by main products (in millionECU/Euro and percent)

	1998			Jan-Jul 1999	
	Value	%	Rank	Value	Rank
Cereals and preparations SITC 04					
Hungary	97	5.1	5.	62	5.
Beverages 11					
Bulgaria	67	3.1	6.	41	6.
Czech Rep.	51	2.4	10.	31	9.
Hungary	56	2.6	9.	29	10.
Cork and wood 4					
Latvia	481	7.4	3.	320	3.
Czech Rep.	305	4.7	6.	214	6.
Estonia	248	3.8	7.	184	7.
Poland	211	3.3	10.	137	10.
Pulp and waste paper 25					
Czech Rep.	63	1.6	9.	36	9.
Fertilizers 56					
Poland	184	10.6	4.	91	4.
Lithuania	144	8.2	7.	68	7.
Czech Rep.	53	3.1	9.	32	9.
Plastics 57					
Hungary	225	3.7	7.	104	7.
Czech Rep.	166	2.7	8.	92	8.
Poland	118	1.9	9.	65	9.
Power generating machinery 71					
Hungary	2394	10.2	2.	1512	2.
Czech Rep.	390	1.7	7.	240	7.
Telecommunication 76					
Hungary	1386	5.2	5.	799	5.
Office machines, computers 75					
Hungary	1238	2.3	9.	1051	9.
Of which computer 752					

	1998			Jan-Jul 1999	
	Value	%	Rank	Value	Rank
Hungary	860	2.9	8.	728	8.
Electrical machinery 77					
Hungary	1704	3.1	9.	1082	9.
Czech Rep.	1468	2.1	10.	966	10.
Road vehicles 78					
Czech Rep.	2458	6.7	4.	1647	4.
Slovakia	1603	4.4	5.	1134	5.
Poland	1536	4.2	6.	1006	6.
Hungary	996	2.7	7.	995	7.
Of which passenger cars 781					
Slovakia	1332	6.2	5.	958	4.
Czech Rep.	1473	6.9	4.	939	5.
Hungary	431	2.0	8.	574	6.
Poland	764	3.6	6.	458	7.
Slovenia	693	3.2	7.	407	8.
Ships, boats 793					
Poland	40	1.3	8.	242	3.
Romania	43	1.4	9.	73	10.
Non-metallic mineral manuf. 66					
Czech Rep.	580	3.5	8.	364	8.
Poland	427	2.6	10.	246	10.
Iron and steel 67					
Czech Rep.	645	5.2	5.	358	5.
Poland	631	5.1	6.	288	8.
Textil yarn, fabrics 65					
Czech Rep.	583	3.6	10.	371	9.
Clothing and accessories 84					
Romania	1866	4.6	8.	1153	7.
Poland	1869	4.6	7.	1068	8.

Source: External and intra-European Union trade 12/1999, Monthly Statistics, eurostat, European Commission, Luxembourg.

Table 6

Mutual trade turnovers (percent)

	Export	Import	Data/year/month/
Share of the Hungarian turnover in Czech trade	1.68	1.52	1999/1-3
Share of the Czech turnover in Hungarian trade	1.62	1.86	1999/1-6
Share of the Hungarian turnover in Polish trade	1.82	1.27	1999/1-6
Share of the Polish turnover in Hungarian trade	2.02	2.05	1999/1-6
Share of the Hungarian turnover in Romanian trade	2.93	3.79	1999/1-5
Share of the Romanian turnover in Hungarian trade	1.79	0.78	1999/1-6
Share of the Hungarian turnover in Slovak trade	4.41	2.40	1999/1-6
Share of the Slovak turnover in Hungarian trade	1.21	1.67	1999/1-6
Share of the Hungarian turnover in Slovenian trade	1.53	2.34	1999/1-5
Share of the Slovenian turnover in Hungarian trade	1.00	0.58	1999/1-6

Source: Calculations based on national statistics.

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