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BACKGROUND NOTE

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EUROPEAN COMMUNITY TRADE RELATIONS WITH EASTERN EUROPE

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1. SCALE AND IMPORTANCE OF EAST-WEST TRADE

A Rising Trend

The European Community's trade with Eastern Europe has been growing faster than its trade with external countries as a whole.

For the Six original EC members, trade with the rest of the world (imports plus exports) in 1958 amounted to \$32 billion, rising to \$99 billion in 1971 and \$109 billion in 1972. Taking in the trade of the three new members of the Community, the 1972 figure rises to \$136 billion. These are the figures for the trade with countries outside the Community; the trade among the member countries themselves is not included.

The trade between the Community of Nine and the members of the Council for Mutual Economic Aid (COMECON) rose from \$1.9 billion in 1958 to \$8.4 billion in 1971 and \$9.7 billion in 1972. Over the period 1958-72, the import-export total increased almost five-fold.

Community imports from the East European countries in 1972 amounted to 4,742.6 million units of account (UA), an increase of 12 per cent over 1971. (One UA equals one 1970 dollar.) Poland came second to the Soviet Union as a supplier and Czechoslovakia was the third largest. The East European countries contributed 7 per cent to the total imports into the Community of Nine.

Imports into the Community of Nine from East European countries

(UA million)

	1958	1971	1972	Index 1971=100
Albania	0.5	10.1	8.8	87
Bulgaria	29.5	175.3	181.3	103
Hungary	67.2	398.1	518.9	130
Poland	214.8	764.5	901.9	118
Romania	66.3	485.0	563.8	116
East Germany	58.1	241.5	286.5	119
Czechoslovakia	131.3	519.0	572.7	110
U.S.S.R.	457.1	1,626.4	1,708.7	105
Total	1,024.8	4,219.9	4,742.6	112
Index (1958=100)	100	412	463	

In 1972, the exports from the Community to East European countries amounted to UA 4,963.2 million or 18 per cent more than in 1971.

Poland was again second only to the U.S.S.R. as a customer for Community products.

The share of the East European countries in the total exports from the Community of Nine was the same as for the Community of Six, amounting to 7.3 per cent.

Exports from the Community of Nine to East European countries

(UA million)

	1958	1971	1972	Index 1971=100
Albania	1.9	16.7	14.4	86
Bulgaria	27.2	219.2	218.3	100
Hungary	68.4	503.4	548.5	109
Poland	186.6	684.1	1,000.0	146
Romania	50.9	527.2	634.5	120
East Germany	53.9	242.6	312.5	129
Czechoslovakia	127.3	639.0	649.5	102
U.S.S.R.	356.0	1,361.2	1,586.0	117
Total	882.2	4,193.4	4,963.2	118
Index (1958=100)	100	475	563	

2. STRUCTURE OF TRADE BETWEEN THE EUROPEAN COMMUNITY AND EASTERN EUROPE

The main part of the Community imports from the countries of Eastern Europe consists of agricultural produce, raw materials, and semi-finished goods. The proportion consisting of manufactured goods still does not exceed 36 per cent, whereas the total EC imports from industrial countries show a 60 per cent proportion of finished goods. The following figures relate to the Community of Six -- the Federal Republic of Germany, Belgium, France, Italy, Luxembourg, and the Netherlands.

These figures show the comparative importance of imports in the different categories in 1960 and again in 1971. The detailed breakdown for 1972 is not yet available.

	1960	1971
Food, drink, etc.	23.3%	21.2%
Energy products	22.5%	21.7%
Raw materials	27.4%	19.9%
Chemicals	5.8%	4.9%
Machinery and transport material	3.7%	6.8%
Other manufactured goods	16.2%	24.6%

Between 1960 and 1971, there was no material change in the structure of imports into the Community of Six from the countries of Eastern Europe. In 1971, however, the proportion of raw materials showed a decline and that of manufactured goods showed an increase.

The Community exports to Eastern Europe consist, for the most part, of investment goods and high-value consumer goods. The following figures show the comparative importance of the different categories in 1960 and 1971.

	1960	1971
Food, drink etc.	3.3%	7.3%
Energy products	0.3%	1.4%
Raw materials	6.2%	3.6%
Chemicals	9.7%	13.0%
Machinery and transport material	31.1%	37.4%
Other manufactured goods	49.1%	36.5%

Between 1960 and 1971, the Community doubled its export of high-value consumption goods to the countries of Eastern Europe. The exports of investment goods showed an increase, and those of other manufactured goods decreased materially.

3. PROBLEMS IN THE EAST-WEST TRADE

Economic reforms, industrial expansion, and rising standards of living are factors leading the countries of Eastern Europe to assign greater importance to external trade as a factor of economic growth.

The trade balances of these countries, however, show that they are having serious difficulties in expanding their exports at the same rate as their imports.

Between 1958 and 1967, except only for the years 1960 and 1961, the trade balance of the Community of Six with the East European countries was in deficit. Since 1968, it has been in credit, due to the shrinkage in the debit balance with the U.S.S.R. and the growth of a credit balance with the other COMECON members. In 1972, the Community's trade balance with the eastern countries showed a considerable improvement, both with the U.S.S.R. and with other countries.

For the Community of Nine, the trade balance with Eastern Europe in 1972 showed a surplus, but with the U.S.S.R. it showed a deficit. This is due to the considerable excess of British imports from the Soviet Union.

If the deficit in the trade balance of the eastern countries which are members of COMECON should indicate that their exports to the Community have reached saturation point, it may be a limiting factor on the future development of the trade.

For the East European countries, trading with the Community raises a two-fold problem -- the financing of purchases (imports) and the structure of the sales (exports).

Financing of the purchases:

There is a scarcity of hard currencies and the Soviet gold reserves available for financing purchases from the West vary with economic conditions. In 1972, and again in 1973, the U.S.S.R. bought very large quantities of wheat and forage cereals in world markets. This may lead to a reduction in some of the other imports, especially of capital equipment from Western Europe, as was the case in 1960 and 1961, when the U.S.S.R. imported wheat from the United States and Canada.

In addition, the fact that currencies of East European countries are not convertible, is scarcely likely to facilitate trade transactions. Since the beginning of 1973, the COMECON countries have been working together to create the necessary underlying conditions which would make it possible for the foreign exchange rouble to be convertible and the national currencies of the Member States to be convertible among themselves. Various measures to be taken between now and 1980 should, in principle, make it possible for a single exchange parity to be laid down.

Recently, the East European countries have been seeking to deal with their shortage of currency resources by turning to the Euro-dollar market. In this, they are making use of the differential rates of inflation between the East and the West. With an inflation of around 5 or 6 per cent in the lending country, the real cost is very small.

The real problem, and the key to the whole question of economic relations between East and West lies in the structure of the export trade from the eastern countries. In its present form, it reflects both a specific conception of the part exports would play in the economic system and the difficulties which the eastern countries are having in adapting their supplies to the requirements of the western markets. It also indicates a certain backwardness in modern marketing techniques. Moreover, this structure does not work to the advantage of the eastern countries. The exports incorporate only a small proportion of added value, whereas the goods they buy from the West are apt to consist of highly manufactured products at a technically advanced level. The terms of trade are, therefore, adverse to the eastern countries; and there is the risk that such a situation may grow worse and compromise the future development of the trade. An improvement, consisting of a higher content of manufactured goods in the export trade, would help to remedy the shortage of foreign currencies. It is noted that there has been some progress in this direction.

It seems scarcely probably that the East European countries will be able to secure any substantial increase in their share of the western markets for agricultural produce and raw materials as they did during the Sixties. Their agricultural production has shown little progress; and the decisions to raise the level of internal consumption and standards of living for their populations result in a reduction in the exportable surpluses. Moreover, the prospects of increasing the sales of agricultural produce to Western Europe seem to be rather limited.

An increase in sales of manufactured goods, however, depends on the eastern countries approaching the problem from a new angle. They would have to think in terms of the actual demand and come more closely into line with the standards of the EC market in such matters as quality and competitive standards in packaging, presentation, marketing, and after-sales service.

4. THE COMMON COMMERCIAL POLICY

On December 16, 1969 the EC Council of Ministers set up an exceptional system for East-West trade. The decision adopted authorized the individual member countries, as an exceptional measure, and subject to case-by-case decision by the Council, to enter into bi-lateral negotiations with the countries of Eastern Europe. This system came to an end on December 31, 1972.

Negotiated Commercial Policy:

Since the beginning of 1973 the position regarding negotiations between Community countries and the countries of Eastern Europe is the same as for negotiations with any other countries outside the Community.

Accordingly, if and when agreements are to be negotiated between the Community and the countries of Eastern Europe, the Commission will put forward its recommendations to the Council of Ministers, which will then authorize it to open the necessary negotiations and may lay down directives in relation to them. These negotiations are carried out by the Commission; and it is for the Council of Ministers to pronounce upon any agreements reached.

It is to be noted that most of the existing trade agreements between the member countries of the European Community and the countries of Eastern Europe expire at the end of 1974.

Pending the outcome of negotiations to be conducted by the Community as such, the latter will be able to adopt autonomous measures of commercial policy to regulate the system of importation from the countries concerned. It is nevertheless clear, that any substantial progress and the resolution of various problems arising in East-West trade will necessitate negotiation.

At present there is already a "common nucleus" of trade liberation, consisting of Community lists of goods, the importation of which has been liberated by all the Member States.

A total of 702 customs headings, and 122 sub-headings has been liberated with respect to Bulgaria, Hungary, Poland, Romania, Czechoslovakia, and the U.S.S.R.

5. NEW INSTRUMENTS OF COMMERCIAL POLICY

The Eastern countries now hope to intensify their imports of capital goods and know-how from the West, in order to bridge their technological gap. To this end, they are taking advantage of the present détente, and in some ways furthering it so as to enable themselves to attain their economic objectives. No doubt they also wish to derive further benefit from a better distribution of resources and the means of production, and so avoid economic wastes which would, in the long run, be insupportable. Formerly their trade with the West was considered of problematical value, limited to short-term transactions and thus of only small scope. Now, however, the improved political atmosphere makes it possible for them to think of foreign contributions to long-term projects; and, in some industries, the foreign contribution is regarded as a decisive factor.

There has, in fact, recently been a considerable increase in cooperation agreements covering very long periods. On July 5, 1972, the Federal Republic of Germany signed a ten-year cooperation agreement with the U.S.S.R.; a ten-year Franco-Polish agreement for economic, industrial, scientific, and technical cooperation was concluded on October 5, 1972. On June 29, 1973, the Federal Republic of Germany signed a ten-year agreement with Romania, and on July 10, 1973 France entered into a ten-year cooperation agreement with the U.S.S.R. Cooperation covers practically all the phenomena incidental to external trade and exchanges.

It may, for example, relate to exchanges of patents, licences, specialization agreements or cooperation in exports to specific external countries. In Romania, too, there are joint undertakings in which 49 per cent of the capital is in western ownership. The most usual pattern of cooperation, however, consists of agreements providing for the supply and erection of factories which are to be paid for by the export of the goods they manufacture. The eastern countries thus hope to secure a quantitative increase in their exports and still more, to change their general structure. These seem to be the indispensable conditions for a recovery in their payments balances, the current state of which is an obstacle to any harmonious and intensive growth in their trade.

From the Community standpoint, the problem is partly, but only partly, to avoid these cooperation agreements resulting in the common commercial policy being diverted or emptied of its substance. It is also to take advantage of the potential offered by the Community exports to give these agreements a Community dimension and facilitate competition in the eastern markets with exporters from, for example, Japan or the United States.

On October 3, 1973, the Commission adopted a text for a communication to the Council on the economic cooperation agreements, into which the Member States are increasingly entering with State controlled trading countries. It proposes the setting up of a system of Community consultation to operate both before the agreements are made and during their operation. In proposing this, it is adapting the same procedures which produced effective results during the interim period before the common commercial policy came into operation.

The policy of export credits and credits guarantees is a matter of far-reaching importance for the commercial policy of the Community. At the end of 1971, the total amount of credits granted to eastern countries for periods exceeding five years was more than \$3 billion.

The European Commission would wish to check the over-bidding which goes on between the member countries in questions of export credit. On June 6, 1973, it put forward a draft for a Council regulation fixing joint principles and a management procedure to cover the duration of guarantees and export credits in trade with industrial countries and State trading countries.

The granting of credits and guarantees for periods exceeding 5 years, in respect of the export of goods and services to industrial non-member countries and to State trading countries, should be subject to previous consultation in a consultative and management Committee operating under the aegis of the Commission.

This consultation would be based on a system of exchanges of information and consultation, supplemented by compulsive measures in respect of the final decision. In December 1972, the Commission had already proposed to the Council a regulation to fix a minimum interest rate applicable to guarantees of 6.5 per cent with respect to exports to industrial non-member countries and State trading countries.

6. DEVELOPMENT OF ECONOMIC RELATIONS

Arrangements for Agriculture

The Community has agreed with Bulgaria, Hungary, Poland and Romania on technical arrangements regarding agricultural produce. No additional amounts are to be charged on the agricultural produce imported from these countries, provided they undertake to conform to guaranteed selling prices.

Romania and Generalized Preferences

On June 4, 1973, the Council adopted a decision of principle, by which Romania is to be included, as of January 1, 1974, in the list of countries benefitting from the Community system of generalized preferences.

The actual inclusion of Romania will be subject to an official decision autonomously fixing the terms on which the generalized preferences shall apply to goods from Romania.

7. POLITICAL RELATIONS

The 1972 Summit

At the meeting of Heads of State or Government and the Commission in the Summit Conference in Paris, October 22-23, 1972, the Member States of the Community stated their determination to promote, with respect to the eastern countries, a policy of cooperation based on reciprocity.

Community Participation in the Conference on Security and Cooperation in Europe

On July 3, 1973, at the opening of the first stage of the Conference on Security and Cooperation in Europe (CSCE) at Helsinki, the head of the Danish delegation spoke as representative of the country responsible, for the time-being, for the presidency of the EC Council of Ministers. He stated that: "the draft mandate for the economic committee of the Conference covers matters which lie within the competence of the European Economic Community, which consists of nine countries which have taken part in the preliminary discussions for the Conference.

"This applies particularly to questions of trade, in relation to which the Community follows a common policy.

"On some of the subjects the Community may be implicated, in accordance with its own competences and procedures, in the future negotiations, and the eventual success of the negotiations on these subjects will depend on the agreement of the Community."

This decision is now being applied in the second phase of the CSCE in Geneva where the standpoint of the Community in matters within its competence, economic problems, is being put forward by the EC Commission.

Actions and Statements of Representatives of the Eastern Countries

On December 21, 1972, during the 50th anniversary celebration of the formation of the U.S.S.R., Soviet Community Party Secretary Leonid I. Brezhnev stated that it was possible to "discover the elements of certain forms of relationship between the Common Market and COMECON" "provided the countries of the Common Market abstain from any attempt at discrimination against the other party and permit the development of authentic bilateral links and pan-European cooperation."

Soviet Prime Minister Aleksei N. Kosygin, questioned during his July 5, 1973 visit to Vienna on the possibility of setting up contacts between the Community and COMECON, replied that "the U.S.S.R. does not exclude the possibility of contacts of this type and the problem is under examination."

Kosygin showed a certain optimism about the prospects of East-West cooperation. He added, however, that "it would be a mistake to reduce this cooperation to the relations between the Community and COMECON. The U.S.S.R. attaches great importance to bilateral economic relations with the countries of the West."

On August 27, 1973, COMECON Secretary General Nicolaï Fedeyev, in the course of a visit to Copenhagen, had a meeting with the President currently in office of the EC Council of Ministers. It is understood that he put forward the idea of negotiations between the Community and his own organization.

At its meeting on September 20, 1973, the Council agreed that the President's office should inform the Secretary of COMECON, through the Danish Ambassador in Moscow, that the Institutions had taken note of the recent informal contacts in Copenhagen. It further specified that if COMECON wished to approach the Community, the appropriate body to receive all relevant communications and to approach was the Commission.

Moreover, the problem arises of how contacts with COMECON can be considered, while the countries of the East, which are its members, have not yet put their relationships with the Community on a regular footing. Problems of this type naturally call for a thorough study before any solution can be brought forward.

It should be noted in this connection that the field of competence of COMECON is by no means the same as that of the Community, and that, unlike the Community institutions, it has no real supra-national character.

This, however, does not mean that the noticeable change in the attitude of the eastern countries should be overlooked.

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