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1. DRAFT

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Andreas P. Cornett
Centre for European Studies
University of Southern Denmark
Grundvigs Allé 150
DK-6400 Sønderborg
Phone: 0045 6550 1000
Fax: 0045 6550 1292
e-mail: CORNETT@sam.sdu.dk

**TOWARD AN INTEGRATED EUROPEAN ECONOMIC SYSTEM?
AN ASSESSMENT OF THE INTEGRATION OF THE EUROPEAN
TRADING SYSTEM.**

Abstract:

The purpose of this paper is to provide a tentative record of the process of integration between the EU and the East and Central European economies. Twelve year after the break up of the former state trade system in Eastern Europe a new international system of production and trade is visible. The first countries are on the edge to become members of the EU.

After a brief examination of the state of the 'pre-accession' with regard to trade, FDI and the adaptation to the regime of market economies the nature of economic links between the EU and the CEEC is analyzed. Point of departure is survey of the political and institutional framework for economic transactions established during the decade, an economic analysis of the region is used to answer the initial question.

Based on this overview the main focus is on the issue of the participation of the former state trade economies in the regional production system in Europe.

The first step is an overall assessment of economic links (i.e. trade and FDI) within the region and between the involved countries and the outside world. Secondly, an in-depth analysis of trade and specialization is added, mainly through an outline of intra-industry trade between the EU and the former transition economies. The third step of the investigation concentrates on a case study of a particular sector (textile and apparel) to illuminate impacts of integration not only in the transition economies, but also in the EU countries.

The final section of the paper offers the findings and an assessment of the level of integration within the region. The latter is based on theoretical concepts of economic integration. Finally a number of scenarios for the future trends of development in the economic relations between the CEEC and the EU are sketched.

Key words: A new system of production - specialization - trade - FDI - regional integration

1. Introduction

The purpose of this paper is to provide a tentative record of the process of integration between the EU and the Central and East European countries (CEEC). Twelve years after the break up of the former state trade system in Eastern Europe a new international system of production and trade becomes visible. The first countries are on the edge to become members of the EU. It is well known that all CEEC's international trade has undergone tremendous changes. First of all the volumes declined sharply in the first years of transition. The second period was characterized by recovery of trade activities and a significant redirection toward the western market economies. The aim of this paper is to analyze the trade links between the CEEC's and the EU with special attention to the modes of integration into the western system of production.

2. The EU and CEEC

Form an institutional and organizational point of view the area covering the EU and the applicant countries is a very heterogeneous economic area. In spite of the fact that all countries are members of the World Bank-IMF system and the WTO (Lithuania as of June 2001, WTO 2001), many obstacles to free economic flows remain. The currency system of the transition economies varies (see European Economy 1999, C 1& 2001, C1), and full convertibility is still far away. With regard to trade and trade barriers the picture is also scattered, but for most countries the tendency toward liberalization is evident, and the importance of the EU and the trade agreements between the EU and the candidate countries can hardly be overrated. Nevertheless some obstacles to free trade persist, and as the analysis in the next section will show, the nature of trade within the EU and between the EU and the CEEC-countries is still very different. In this respect the quote from EU commission's progress report Nov. 2000 has to be taken with some reservations:

“The free trade provisions established by the European Agreements with the ten Central and Eastern European countries clearly paved the way for economic integration with the EU. The additional agricultural Protocols recently agreed in the framework of the Europe Agreements represent a major step forward which will further enhance trade relations between the EU and Central and Eastern European countries ... Negotiations will continue in order to broaden the scope of the agricultural bilateral trade concessions” (European Commission November 8, 2000, p. 20)

The crucial issue for the emerging market economies is, that strategies developed capitalistic in countries in the sixties, and only slightly modified when re-launched in the

Single European Market Program in the middle of the eighties, are not necessarily feasible for countries undergoing a process of total societal restructuring. First of all, strategies based on multilateral trade liberalization will not work in an environment of huge differences in economic performance and structure. The increasing competition from the established market economies will require protection of infant industries with potential harmful effects of developing a 'substandard' industrial base to guarantee the development of a healthy industrial base. To make this strategy feasible, a coordinated Western acceptance of unilateral preferential treatment seems necessary. The experiences with the economic agreements between the EU and East and Central Europe proves how reluctant the EU in the beginning was to grant preferential agreement in sectors within which the East European countries are potentially competitive like textile, steel and agriculture (see European Economy 1994).

From a principle point of view the result seems to be clear. In real world politics obstacles persists. With regard to practical policy making it can be questioned whether regional integration is an appropriate framework at all for countries that for a considerable period will rely on exports from sectors with relatively limited potential for scale economies rather than on sectors with large potential for scale and scope economies. Anyway, it's obvious that the accession negotiations become more complicated as the EU develops toward higher levels of integration. The latest examples of this process are the so-called '*Protocol on European Conformity Assessment (PECA)*' aiming extending internal market rules on conformity assessment for manufactured goods to the accession countries before membership (European Commission November 8, 2000 p.12).

3. Trade and Specialization

The integration of economies is a complicated process, and the result of an analysis of relevant economic indicators will not always provide an unambiguous picture. High levels of investment flows (bilateral Foreign Direct Investment) can be a sign of integration of two economic areas with regard to the system of production and co-operation between firms. In this perspective FDI reinforces the intensification of trade flows, in particular the increasing level of merchandise trade between advanced economies (see WTO 1999 p.14). The history of investments in Latin America in the 1960s and 1970s tells a different story. Investments of the European and US automobile industry in this region were mainly due to the lack of market access, i.e. barriers to trade. In the former case high FDI is a sign of integration, in the latter

of barriers and a lack of free trade. Table 1 below summarizes the inflow of Net-FDI to the transition economies for selected years since 1992. The dominant providers of FDI in the European transition economies are the European Union Countries¹. Generally, the patterns of FDI links between countries often follow the well-known system of intensive trade between adjacent economies.

Table 1 FDI net inflow to selected Central and East European countries (Bill. US-\$)

| | 1992 | 1995 | 1998 | 1999 (est.) | 2000 (proj.) | Cumulative FDI-inflow 1989-1999 | FDI as % of GDP 1999 |
|------------------------|-------|-------|--------|-------------|--------------|---------------------------------------|-------------------------|
| Czech Rep. | 983 | 2.526 | 2.641 | 4.912 | 5.000 | 14.924 | 9,1 |
| Hungary | 1.471 | 4.410 | 1.453 | 1.414 | 1.650 | 17.770 | 2,9 |
| Poland | 284 | 1.134 | 4.966 | 6.642 | 7.000 | 20.047 | 4,3 |
| CEEC and Baltic States | 3.098 | 9.642 | 14.964 | 17.509 | 19.371 | 72.971 | 4,0 |

Source: EBRD 2000, p. 15

A survey of the trading patterns in Europe proves that intra-EU trade dominates the foreign trade of the EU countries, as well as the EU is the most important trading partner of the applicant countries from East and Central Europe (European Commission 2001a, p.26, Eurostat 1991).

3.1 Survey of Intra Industry trade

A more complex picture of coherence within the system of production can be obtained by an analysis of the pattern of specialization of international trade. Based on simple estimation of an index measuring the degree of intra-industry trade (here defined as trade in similar product groups) as a percentage of total trade, this paper tries to shed some light on the most recent development of economic specialization between the EU and the applicant countries.

The idea behind this approach is to identify some of the fundamental trends of cooperation and integration of the international system of production in a regional framework. It's well known that geographic proximity is one, if not the most, important factor behind international trade. Intra EU trade has dominated the foreign trade of the member states, just as trade with the EU dominated the foreign trade of most non-EU countries in Western Europe before they became members. In particular business-to-business trade - an indicator of the integration of the production system - is of increasing importance. In this perspective

1. For an analysis of the first half of the 1990's, see Agrawal 2000. The close links between trade and FDI patterns are also visible in a study of the economic links in the Baltic Sea Region, see Cornett 2001, (forthcoming).

growth of intra-industry trade can be seen as an indication of convergence of at least the production system of the involved economies.

An analysis of intra-industry trade based on Grubel-Lloyd² type of index' is very sensitive to the level of disaggregation of the data chosen for the analysis. If the disaggregation is very high, i.e. 4 or 5 digit level of the SITC (Standard International Trade Classification), the analysis provides detailed insight into the nature of bilateral trade and in particular in the nature of the distribution of competitive advantages between countries. An investigation on a rather aggregated level has the advantage to make more general features of the international division of labor and the patterns of specialization visible.

This approach can provide useful insight in the development and direction of integration and specialization process' within the EU, and between EU and the candidate countries. Table 2 below reports results based on figures for the 15 EU countries, indicating a moderate pattern toward convergence of foreign trade pattern with applicant countries toward a higher share of intra-industry trade. According to the approach used in this paper this is considered to be an indication of the integration into the western, market based system of production.

2.: The degree of Intra Industry Trade for a particular industry according to Grubel and Lloyd is:

$$GL_i = \frac{|X_i - M_i|}{X_i + M_i} * 100 \quad [1]$$

Average degree of Intra Industry Trade for all industries can be defined as:

$$GL_i = \frac{\sum(X_i + M_i) - \sum|X_i - M_i|}{\sum(X_i + M_i)} \quad [2]$$

$GL_i = 0$ (all trade inter-industry)

$GL_i = 100$ or 1 in equation 2 (all trade intra-industry)

For further elaborations of the topic, see standard textbooks on international trade or international economics in general. This section is based on Nielsen et al., 1995 and Lüthje 1997. For a discussion of the Grubel & Lloyd index and probable modifications, see Lüthje, 1997. The analysis in this

chapter is based on the simple version of the index for all industries, equation [2]. It is important to stress that this analysis does not provide insight with regard to whether the specialization takes place on the import or export side (Lüthje 1997, p. 290).

Table 2 Intra-industry trade between the EU and the applicant countries

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|------|------|------|------|------|------|------|------|------|------|------|
| First-6: | | | | | | | | | | | |
| Index intra-trade: | 24,5 | 39,4 | 44,8 | 47,5 | 51,0 | 56,4 | 57,8 | 60,9 | 62,1 | 65,5 | 69,4 |
| Index intra-trade: (non agriculture) | 37,5 | 41,5 | 47,8 | 48,4 | 52,5 | 57,0 | 57,7 | 61,2 | 62,7 | 66,1 | 70,0 |
| Second-6: | | | | | | | | | | | |
| Index intra-trade: | ... | ... | 47,5 | 52,5 | 46,7 | 46,0 | 48,7 | 49,7 | 49,5 | 48,8 | 51,9 |
| Index intra-trade: (non agriculture) | ... | ... | 47,2 | 52,3 | 47,2 | 46,6 | 48,9 | 50,1 | 49,6 | 48,6 | 52,3 |
| EU-15: | | | | | | | | | | | |
| Index intra-trade: | ... | 97,1 | 97,5 | 97,9 | 97,9 | 95,5 | 95,8 | 95,6 | 95,4 | 95,1 | 95,7 |
| Index intra-trade: (non agriculture) | 97,4 | 97,1 | 97,5 | 97,8 | 97,9 | 95,4 | 95,7 | 95,4 | 95,2 | 95,0 | 95,6 |

Note: Data according to Harmonized System Rev.1 1988-1997, Grubel Lloyd index estimated on 2 digit level 100 (100 commodities) First 6: Czech Republic, Hungary, Poland, Estonia, Slovenia & Cyprus. Second 6: Romania, Bulgaria, Slovakia, Latvia, Lithuania & Malta. Data for Baltic States from 1992 (Fin & S from 1991), Bulgaria, Romania, Hungary, Malta & Cyprus from 1990, Slovakia and Czech Republic from 1993. Austria from 1995.

Source: OECD-ITCS (1998 & 2000)

The data reported in table 2 also prove a slightly higher level of intra-industry trade between the EU and the first group of applicant countries compared to the second group of countries³. More interesting of cause, is the trend toward higher shares of Intra-industry trade in the reported period. The latter indicates an increasing integration of the countries into the European production system. Nevertheless, there is still a tremendous difference compared to the level on intra-industry trade within the EU. Contrary to the findings in Cornett (2000) there seems to be a very small difference with regard to the share of intra-industry trade when comparing total trade and non-agricultural trade. With regard to the second group, the latter is also true, but on a significant lower level of intra-trade. The latter indicates that the second group is less integrated into the western production system.

An analysis of GDP per capita data in the findings in the ‘Second report on economic and social cohesion’ (European Commission 2001b & 2001a), supports the point that enlargements will effect economic convergence with the EU as a whole in a significant way,

3. The two groups are dominated by transition economies, but both include one smaller South European economy. Cyprus is in the first, and Malta in the second group. Due to the size of these countries the figures are dominated by the transition economies.

but of cause not within the group of the current member-countries. This does not mean that the current EU-countries all are affected in the same way by enlargement with regard to trade.

Table 3 Intra-industry trade with applicant countries for selected EU members

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|------------------------|------|------|------|------|------|------|------|------|------|------|------|------|
| <i>Austria:</i> | | | | | | | | | | | | |
| first-6 | ... | ... | ... | ... | ... | ... | ... | 55,8 | 62,3 | 63,3 | 67,3 | 64,7 |
| Second-6 | ... | ... | ... | ... | ... | ... | ... | 46,0 | 48,8 | 48,5 | 54,5 | 53,8 |
| EU | ... | ... | ... | ... | ... | ... | ... | 76,9 | 76,8 | 79,6 | 80,0 | 81,3 |
| <i>Denmark:</i> | | | | | | | | | | | | |
| first-6 | 14,6 | 21,9 | 29,3 | 31,6 | 38,1 | 43,7 | 38,5 | 41,3 | 44,8 | 48,1 | 47,4 | 50,4 |
| Second-6 | ... | ... | 17,0 | 21,7 | 22,5 | 25,2 | 28,4 | 34,4 | 39,7 | 33,6 | 33,5 | 31,3 |
| EU | 66,4 | 68,2 | 68,3 | 69,3 | 68,9 | 69,4 | 67,3 | 66,1 | 66,5 | 66,9 | 67,5 | 70,9 |
| <i>Finland:</i> | | | | | | | | | | | | |
| first-6 | 15,4 | 17,2 | 27,9 | 53,1 | 48,6 | 37,9 | 44,9 | 46,7 | 45,6 | 46,2 | 47,2 | 42,6 |
| Second-6 | ... | ... | 24,5 | 14,8 | 17,3 | 22,6 | 20,1 | 21,0 | 19,7 | 19,2 | 23,8 | 15,3 |
| EU | 47,6 | 49,8 | 51,8 | 55,0 | 57,4 | 57,1 | 56,2 | 54,7 | 56,6 | 56,2 | 55,0 | 52,9 |
| <i>France:</i> | | | | | | | | | | | | |
| first-6 | 33,0 | 33,4 | 42,5 | 38,4 | 49,6 | 54,9 | 56,8 | 59,2 | 55,4 | 55,6 | 63,7 | 59,4 |
| Second-6 | ... | ... | 40,0 | 41,7 | 28,5 | 38,9 | 44,8 | 43,3 | 43,4 | 47,0 | 50,7 | 45,2 |
| EU | 81,1 | 82,1 | 82,6 | 83,6 | 85,2 | 86,7 | 88,0 | 88,2 | 87,8 | 87,1 | 87,8 | 87,2 |
| <i>Germany:</i> | | | | | | | | | | | | |
| first-6 | 27,6 | 29,5 | 39,7 | 43,9 | 42,2 | 48,6 | 51,4 | 56,3 | 57,9 | 62,2 | 67,0 | 68,4 |
| Second-6 | ... | ... | 30,4 | 30,6 | 27,4 | 33,2 | 37,9 | 41,7 | 43,7 | 46,8 | 51,7 | 48,9 |
| EU | 70,7 | 72,1 | 75,1 | 80,2 | 79,4 | 77,9 | 78,9 | 78,1 | 76,8 | 75,3 | 75,6 | 73,8 |
| <i>Spain:</i> | | | | | | | | | | | | |
| first-6 | 33,1 | 33,0 | 39,5 | 39,8 | 43,0 | 50,9 | 51,9 | 47,6 | 52,8 | 50,5 | 53,2 | ... |
| Second-6 | ... | ... | 28,3 | 23,2 | 30,8 | 38,8 | 31,2 | 25,3 | 21,1 | 29,2 | 38,6 | ... |
| EU | 69,1 | 68,3 | 68,4 | 66,2 | 68,4 | 69,1 | 69,3 | 70,1 | 72,6 | 71,9 | 73,5 | ... |
| <i>Sweden:</i> | | | | | | | | | | | | |
| first-6 | 27,0 | 41,6 | 41,7 | 42,3 | 41,3 | 49,8 | 47,7 | 47,7 | 49,5 | 55,6 | 62,3 | ... |
| Second-6 | ... | ... | 20,0 | 18,5 | 12,9 | 19,0 | 22,1 | 30,6 | 29,2 | 32,6 | 28,4 | ... |
| EU | 70,1 | 69,8 | 71,0 | 70,8 | 70,2 | 69,8 | 71,9 | 70,3 | 72,1 | 72,2 | 74,2 | ... |
| <i>United Kingdom:</i> | | | | | | | | | | | | |
| first-6 | 28,7 | 29,9 | 42,2 | 39,4 | 37,4 | 50,1 | 54,2 | 55,1 | 56,7 | 60,0 | 64,3 | ... |
| Second-6 | ... | ... | 41,6 | 38,6 | 38,6 | 34,5 | 35,1 | 32,2 | 34,8 | 31,0 | 32,3 | ... |
| EU | 71,8 | 73,3 | 78,0 | 82,0 | 82,5 | 79,7 | 78,5 | 80,2 | 79,6 | 78,5 | 79,7 | ... |

Note: See table 1, Figures for Germany France & Denmark does not include trade with B-LUX 1999.

Source: OECD-ITCS (1998 & 2000).

Table 3 summarizes the figures for 8 of the 15 EU members. The countries reported represents a survey of the 15 members of the EU in 2001, some with traditional close links to East and Central Europe and the Baltic States, some more oriented to other parts of Europe or toward oversea trade partners. The figure clearly indicates that geographic proximity is an important determinant for trade with the applicant countries. In both groups 5 of the 6 countries belong to East and Central Europe. The low score of Finland is due to the fact that Russia, still an important trading partner, is not included in the survey.

Since the analysis is conducted on a rather modest level of disaggregation, the results have to be interpreted carefully. In this case a high level or increasing share of intra-industry trade is only an indication of sectoral convergence of the considered economies foreign trade sector. The figures reported in table 2 and 3 have to be seen in this perspective. Also the 'Sixth periodic report on the social and economic situation and development of the regions of the European Union' (European Commission 2000a, pp.90f), stresses the shifts in the sectoral structural of the East and Central European countries GDP, with decreasing importance of the traditional industrial sector. The figures in table 2 & 3 at least indicate that the remaining or new industrial base seems to develop in accordance with the West-European pattern.

With regard to East-West trade, intra-industry trade is significant lower, but generally increasing during the period reported. The latter can be seen as an indicator of increasing integration of the transition economies into the regional system of production and specialization. An examination of non-agricultural trade confirms the pattern reported in table three, generally with slightly higher scores on the Grubel Lloyd index⁴.

So far, the analysis has concentrated on the process of reintegration mainly seen from a West European perspective. Table 4 provides similar information for three of the transition economies, the Czech Republic, Poland and Hungary, all belonging to the first group of applicant countries. For all three the Grubel Lloyd index score increases from 1993 onwards with the EU. More interesting is that all three countries have higher scores in their total trade (World), and in particular within the group of the 'first six'. The latter indicates a recovery of traditional pattern of specialization, but as mentioned earlier on a rather low level of trade⁵.

4. For details see Cornett 2001 (forthcoming). For a technical discussion of the Grubel-Lloyd index, see Lüthje (1997).

5. The share of exports and imports of the 'first six' of the total trade of the three analyzed countries have increased during the 1990's indicating a tendency toward a reestablishment of old trading patterns.

Table 4 Intra-industry trade for Czech Republic, Hungary and Poland selected groups of trading partners.

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|-------------------------------------|------|------|------|------|------|------|------|
| <i>Czech Republic:</i> | | | | | | | |
| EU: | | | | | | | |
| Index intra-trade | 48,8 | 43,4 | 43,2 | 45,9 | 47,5 | 49,3 | 50,2 |
| Index intra-trade (non agriculture) | 49,6 | 43,2 | 42,8 | 46,1 | 47,8 | 49,1 | 49,9 |
| first-6: | | | | | | | |
| Index intra-trade | 23,7 | 43,7 | 44,4 | 47,1 | 49,5 | 54,3 | 58,1 |
| Index intra-trade (non agriculture) | 26,6 | 45,8 | 45,1 | 49,9 | 50,9 | 55,6 | 59,2 |
| Second-6: | | | | | | | |
| Index intra-trade | 37,9 | 45,6 | 46,7 | 52,6 | 55,9 | 56,6 | 53,7 |
| Index intra-trade (non agriculture) | 43,9 | 50,6 | 51,9 | 57,6 | 60,1 | 60,5 | 59,7 |
| World: | | | | | | | |
| Index intra-trade | 54,6 | 49,4 | 50,2 | 53,7 | 52,2 | 53,6 | 54,7 |
| Index intra-trade (non agriculture) | 53,5 | 49,7 | 50,6 | 53,9 | 52,3 | 53,3 | 54,4 |
| <i>Hungary:</i> | | | | | | | |
| EU: | | | | | | | |
| Index intra-trade | 48,8 | 43,4 | 43,2 | 45,9 | 47,5 | 49,3 | 50,2 |
| Index intra-trade (non agriculture) | 49,6 | 43,2 | 42,8 | 46,1 | 47,8 | 49,1 | 49,9 |
| first-6: | | | | | | | |
| Index intra-trade | 23,7 | 43,7 | 44,4 | 47,1 | 49,5 | 54,3 | 58,1 |
| Index intra-trade (non agriculture) | 26,6 | 45,8 | 45,1 | 49,9 | 50,9 | 55,6 | 59,2 |
| Second-6: | | | | | | | |
| Index intra-trade | 37,9 | 45,6 | 46,7 | 52,6 | 55,9 | 56,6 | 53,7 |
| Index intra-trade (non agriculture) | 43,9 | 50,6 | 51,9 | 57,6 | 60,1 | 60,5 | 59,7 |
| World: | | | | | | | |
| Index intra-trade | 54,6 | 49,4 | 50,2 | 53,7 | 52,2 | 53,6 | 54,7 |
| Index intra-trade (non agriculture) | 53,5 | 49,7 | 50,6 | 53,9 | 52,3 | 53,3 | 54,4 |
| <i>Poland:</i> | | | | | | | |
| EU: | | | | | | | |
| Index intra-trade | 48,8 | 43,4 | 43,2 | 45,9 | 47,5 | 49,3 | 50,2 |
| Index intra-trade (non agriculture) | 49,6 | 43,2 | 42,8 | 46,1 | 47,8 | 49,1 | 49,9 |
| first-6: | | | | | | | |
| Index intra-trade | 23,7 | 43,7 | 44,4 | 47,1 | 49,5 | 54,3 | 58,1 |
| Index intra-trade (non agriculture) | 26,6 | 45,8 | 45,1 | 49,9 | 50,9 | 55,6 | 59,2 |
| Second-6: | | | | | | | |
| Index intra-trade | 37,9 | 45,6 | 46,7 | 52,6 | 55,9 | 56,6 | 53,7 |
| Index intra-trade (non agriculture) | 43,9 | 50,6 | 51,9 | 57,6 | 60,1 | 60,5 | 59,7 |
| World: | | | | | | | |
| Index intra-trade | 54,6 | 49,4 | 50,2 | 53,7 | 52,2 | 53,6 | 54,7 |
| Index intra-trade (non agriculture) | 53,5 | 49,7 | 50,6 | 53,9 | 52,3 | 53,3 | 54,4 |

Note: Data according to Harmonized System Rev.1 1988-1997, Grubel Lloyd index estimated on 2 digit level 100 (100 commodities) First 6: Czech Republic, Hungary, Poland, Estonia, Slovenia & Cyprus. Second 6: Romania, Bulgaria, Slovakia, Latvia, Lithuania & Malta. Data for Baltic States from 1992 (Finland & Sweden from 1991), Bulgaria, Romania, Hungary, Malta & Cyprus from 1990, Slovakia and Czech Republic from 1993. Austria from 1995. *Please note that the figures in the table not all are correct due to a data error observed just before submitting the paper. A new table will be available in Zagreb. Nevertheless the main tendencies reported should be correct.*

Source: OECD-ITCS (1998 & 2000)

3.2 Textile and apparel: The case of Denmark

The analysis of intra-industry trade in the previous section has proved a tendency toward 'normalization' of the composition of trade between the former state trade economies and the old market economies in the BSR, measured on a rather rough level of aggregation. Using this type of aggregated data has both advantages and disadvantages. The main advantage is that similarities are identified within the same branch or group of data, and emerging joint systems of production becomes visible. The obvious disadvantage is that the high level of aggregation hides significant differences in imports and exports. For the purpose of this paper the former aspects is the most important.

According to the European Agreements between the EU and the applicant countries market access for merchandize trade for the East European partner countries is one of the principal objectives within the pre-accession strategy. The development of sustainable economies is another. In particular the latter is highlighted in the latest reforms of the EU structural policy and in particular the ISPA (European Commission 2000b). The problems and the often built-in contradictions of this policy is the topic of the following section.

Traditionally, the textile industry has been protected against external competition in most industrial countries for many years. The so-called Multi Fibres Agreements (MFA, for details see Kenis & Schneider 1987) is the best example. The policy is continued in the above-mentioned EA/IM agreements where textile, steel and agriculture got the major exemptions from free trade in the early 1990's.

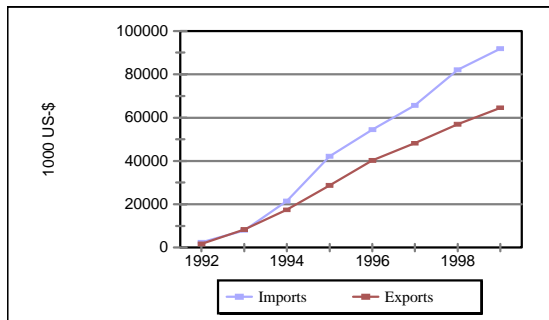
In spite of the exemptions for textile, trade with textile products plays an important role in some of the bilateral trade relations within the BSR. The reasons are many (see Illeriis 2000), but important are low production costs due to low wages, the availability of a skilled labor force and probably most important the closeness to the markets, and the outsourcing firms in Western Europe. The latter is the main competitive edge of the East European transition economies compared to low-cost producers in Southeast Asia. Due to fast changes in fashion, short delivery time is essential for competitiveness.

This unique combination of advantages is one reason for choosing the textile sector as an illuminative case for the analysis of the impacts of the reintegration of East and Central European countries into the traditional Western system of production⁶.

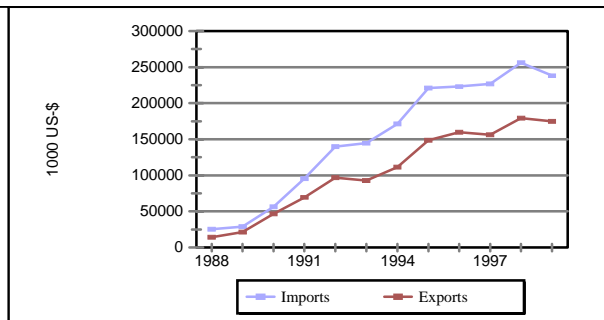
Figure 1 summarizes the development of textile trade between Denmark and the two most important target countries for the outsourcing of Danish textile industry, Poland and Lithuania.

Figure 1 Denmark trade in textile with selected partners since 1988. (1000 US-\$)

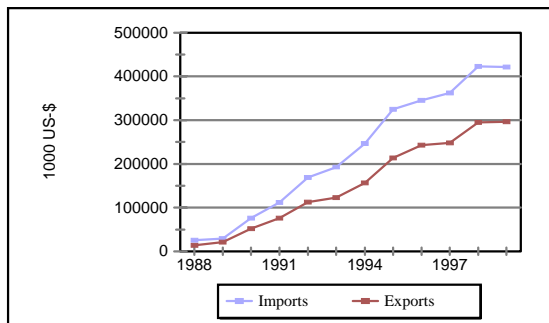
Poland:



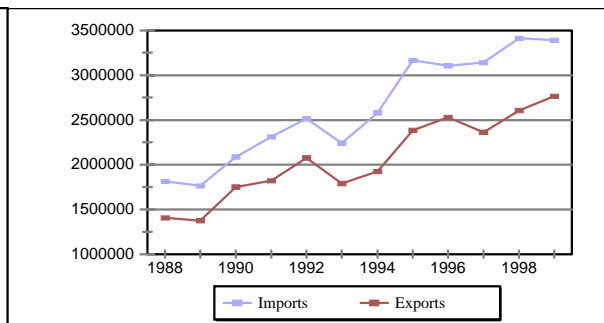
Lithuania:



All 12 candidate countries:



World total:



Source: OECD-ITCS (1998 & 2000)

6. A reason to focus on this case from a Danish point of view is the geographical concentration of the Danish textile industry. Case studies of the structural changes in Danish textile industry in the aftermath of the break down of the iron curtain illuminate how the adaptation process has taken place not only in the transition economies, but also in Denmark. The particular structure of the Danish apparel and textile business and the geographic concentration (about 50% of the industry is located in few municipalities in Central Jutland) enables us to analyse not only overall changes but also the regional impacts of changes in the competitive environment. The outsourcing of production from the Danish core region of the textile industry accelerated from the beginning of the 1990s (Illeriis 2000, Cornett 2001).

The impressive growth in the textile trade reflects the outsourcing of production as well as the change in the international division of labor taking place in the North European textile business. A closer look on the composition of the trade flows can shed new light on the nature of the restructuring process. As it can be seen from table 5 textile counts only for 6-7% of Danish imports and approximately 5 % of the exports. Regarding the most important trading partner, the EU figures are similar. A close look on the trade with the applicant countries and in particular Poland and Lithuania disclose a total different pattern.

Table 5 Distribution of Danish textile trade since 1988 by major trading partners

| | World | EU-15 | All 12 candidate countries | Poland | Lithuania |
|-----------------|-------|-------|----------------------------|--------|-----------|
| <i>Imports:</i> | | | | | |
| 1988 | 6,7 | 6,3 | ... | 10,6 | 4,2 |
| 1995 | 6,9 | 5,6 | 25,9 | 30,2 | 44,4 |
| 1999 | 7,7 | 5,5 | 27,3 | 34,8 | 50,1 |
| <i>Exports:</i> | | | | | |
| 1988 | 4,9 | 4,9 | ... | 13,0 | 3,8 |
| 1995 | 4,7 | 4,9 | 15,1 | 22,5 | 21,3 |
| 1999 | 5,6 | 6,2 | 16,5 | 21,7 | 27,7 |

Note: 1988: figure for Lithuania belongs to 1992. CSSR not included.

Source: OECD-ITCS (1998 & 2000)

The analysis of textile trade between Denmark and Poland reported in figure 1 proves an extensive growth, but more detailed analysis shows that the textile trade only has increased its share of total trade in a more modest scale. An analysis of the narrow trade environment in the Baltic Rim has shown a tremendous increase of East West trade in the Baltic Sea Region (Cornett 2001) Nevertheless, textile is still an important factor in the bilateral trade between Denmark and Poland. With regard to Lithuania, the same takes place, but on a much higher level. Half of the Danish imports from Lithuania in 1999 were textiles, and more than 27 % of the exports belonged to the textile sector. Textile is the single most important commodity in the bilateral trade between Denmark and Lithuania⁷.

7. Comparing imports and exports between Denmark and Poland we found a slightly higher concentration of commodity groups in Danish exports than imports. The most interesting is, that the latest figures for 1999 seem to reflect a change with respect to the dominating commodity groups. In 1999 the same groups dominates import as well as export, but with significant higher share in exports. This can be taken as a sign of further integration of the two systems of production compared to the previous reported years. 1992 and 1995 'man made stable fibres' group 55, played a major role in Danish exports to Poland, for details see Cornett 2001. In many respects the trade figures illuminates the point made by Illeriis:
 " It is primarily the sewing work which has been outsourced: This means that the Danish firm typically

Without overstating the statistics, it seems as if the pattern has changed with regard to Poland toward a more balanced system of trade, measured by group of commodity. This could be taken as an indication that Danish companies are still doing the marketing, design and control work, but that many of the raw materials no longer are shipped from Denmark.

The Danish Lithuanian trade follows in the overall pattern the same model, but the dominance of textile is much higher, and the dominance of the two most important commodity groups is significant higher than in the Polish case. The content of semi-manufactures is also still much higher in this case than in the Polish, reflecting a cost-advantage of Lithuania compared not only to Denmark, but also to Poland.

Overall, the analysis of the textile trade between Denmark and the two countries seems to support that an integration of the production system as mentioned in the introduction takes place. In Denmark, the Danish textile industry has undergone a significant structural change toward a more high value adding industry, and less labor intensive.

4. Summary and Perspectives

No paved road leads from an isolated non market based economic system to a position as full fledged member of the western market based economic system. The purpose of this final section is to summarize the results of the presented data and to give a tentative assessment of the level of integration of the economies investigated. Finally, a number of scenarios for the future trends of development in the economic relations between the CEEC and the EU are sketched.

The most important tendency identified in the presented results is that trade patterns and economic links between the EU and the applicant countries are undergoing a significant change converting toward the West European patterns, at least measured as gross figure and shares of foreign trade. A closer look on the nature of this trade proves that huge differences persists, but that there are signs of leveling the disparities.

For the transition economies the analysis of intra-industry trade indicates that they have embarked on a catch-up process with regard to an adaptation to the European market based

still buys woven cloth or carries out the knitting work, organizes the dying and cutting operations in Denmark, ships the pieces to Poland or another transition country where they are sewn (but remain the property of the Danish firm), and has the clothes transported back to Denmark where they are quality

system of production, but the analysis of three of the most advanced economies in the region also discloses interesting internal changes within the group of transition economies.

Overall, the results of the analysis presented point toward:

- The analysis of intra-industry trade has shown a tendency toward convergence of the trade pattern within the old EU countries and with the applicant countries.
- This convergence takes place on a still significant lower level of intra-industry trade compared to the figures for the EU as a whole and the analyzed EU countries.
- With regard to the three CEES's analyzed the most interesting finding is - in addition to the mentioned general trends – that a revitalization of old trading and specialization patterns are indicated in the analysis of the intra-industry trade of the Czech Republic, Poland and Hungary.
- The analysis of intra-industry trade has identified a tendency toward adaptation and integration of the transition economies since the early nineties, but the latest figures point toward a slow down in the speed of the process.
- Within the textile sector and the linkages established, it seems possible to identify a tendency toward higher level co-operation due to the nature of the traded goods between in particular Denmark and Poland in the latest trade statistics.
- Generally the level of intra-industry trade is slightly higher for non-agricultural trade for most countries.
- The integration of the production system can lead to the creation of new competencies and positive spin-offs with regard to income and growth.

A tentative conclusion of the results presented in this paper is, that there are signs in the analyzed trade figures pointing toward the formation of an spatially integrated European Economic system, at least in some sectors. Further investigations are required in particular for the sectors originally covered by the EA/IA agreements exemptions. An analysis solely based on trade statistics is of course not sufficient to identify emerging production systems on the regional or firm level. This type of analysis can only identify changes and new trends on the more general level, and provide a starting point for in depth analysis of sectors and industries or international production systems.

Overall, the results reported in this paper have to be taken as rather rough indications of changes in trends and patterns of economic links due to the nature of the analyzed data. It has

always to be questioned to what extent intra-industry trade index' can be taken as an indication of spatial specialization. Technically, the results depend both on the level of aggregation of the analyzed trade figures and the size of the analyzed trade flows.

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