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THE PROBLEM OF TRANSITION AND REINTEGRATION OF EAST AND CENTRAL EUROPE - CONCEPTUAL REMARKS AND EMPIRICAL PROBLEMS

Abstract: Eight years after the fall of the Berlin Wall and the Iron Curtain economic and political cleavages are still visible in Europe. With respect to social and economic transition the saliency of the problems seem to increase, as the efforts to solve the problems become the common business of governments and international organizations.
Regional economic and political integration have significant impacts on this process, namely through the European Union programs for restructuring and development. The purpose of this paper is to analyze the main problems in the process of transition and reintegration has to so overcome from a theoretical and conceptual point of view. The theoretical anchors political and economic theories of regional integration.
After a period with declining attention, regional integration has again become topic in various parts of the world. Concepts of integration are still pivotal in Europe, partly regarding the internal development of the European Union, partly as a framework of cooperation between the EU and the rest of Europe.
Based on the analysis of the concepts of Regional Economic Cooperation in Europe, the links between international economic integration and internal development are analyzed. The relationship between macroeconomic integration and the necessary of providing instruments to cover specific areas or sector from significant adverse effects of this process is given special attention in the analysis. This part of the analysis will focus on the needs for restructuring of existing EU-policies to meet the challenges of the next enlargements. The theoretical concepts will be used for a principal evaluation of the needs for a future regional policy for an enlarged community.
The process of transition and recovery in East Europe has been challenged not only by the regained influence of traditional political groups in East Europe but also through the reluctance of the EU to open their markets in sectors where the former CMEA-countries are competitive. To avoid further drawbacks it seems necessary to establish a self sustainable economic system able to handle external (i.e. the process of enlargement) as well as internal (i.e. the structural funds) demands for restructuring. The first precondition is the opening of western markets.
The second is to provide a reliable regime for development and knowledge transfer. Last but not least, the paper stress' the need to establish a reasonable framework for cooperation until the East and Central Europe can participate on equal terms in the mainstream of European Integration, and to handle the different waves of membership negotiations in a reliable way.

Keywords: Reintegration, Regime for transition, Concepts of structural adaptation and integration.

1. Introduction

Regional integration has been an important concept in the process of restructuring in Western Europe after the Second World War and is undoubtedly also the most important framework in the ongoing process of restructuring and reintegration of the East and Central European nations.

The old concept can provide guidelines for this policy, but the nature of the problem is significantly different. In the fifties and sixties most of the countries in Western Europe faced the same challenge, and their point of departure - economically and with the exemption of Germany (and to some extent Italy) were also similar politically. The situation today, almost 10 years after the removal of the Iron Curtain, is fundamental different.

The countries still suffer from structural lags, - institutional as well economical. Economic performance is still insufficient. Economic problems are unsolved, internal as well as external balance problems persists.

The analytical point of departure in this article is, that regional economic and political integration theory can contribute with significant concepts to analyze this area of policy. The purpose of this paper is to analyze the main problems in the process of transition and reintegration from a theoretical and conceptual point of view. The theoretical anchors political and economic theories of regional integration.

2. The concept of regional integration

After a period with declining attention, regional integration has again become topic in various parts of the world. Concepts of integration are still pivotal in Europe, partly regarding the internal development of the European Union, partly as a framework of cooperation between the EU and the rest of Europe.

The purpose of this study is to provide an tentative outline of a concept for the analysis of the process of reintegration of East and Central European countries into the main stream economic and political system in Europe, the European Union. The theoretical fundament of the processes of regional integration can be found in economic and political theory of integration. Theoretically the two approaches are distinct based in economics, in particular concept from the field of international economics and trade theory, and various branches of political science[1].

The economic concepts of regional integration where originally introduced by Jacob Viner (1950) in his analysis of Customs Unions, but the concepts have been expanded in scope to cover most aspects of regional economic cooperation. The purpose of this paper is not to provide an overview of the history and the development of economic concepts of regional integration, or of the theoretical and technical refinements of the discipline[2].

Based on these concepts, the future prospects of regional economic and political cooperation in Europe with special attention to the links between international economic integration and internal development, will be analyzed. The relationship between macroeconomic integration and the necessity of providing instruments to cover specific areas or sectors from significant adverse effects of this process is given special attention in the analysis. In particular the political approaches to integration are useful when focusing on the needs for restructuring of the existing EU-policies to meet the challenges of the enlargements with former CMEA-countries. The theoretical concepts will be used for a principal evaluation of the needs for a future policy for an enlarged community.

2.1 The Theories of Political Integration

Traditionally, four approaches to political integration are distinguished: the federalism, the transaction or pluralistic approach, and the functionalism and the neofunctionalism, the 'theory of Western European integration'. The different schools indicate, that no common consensus with regard to a definition exists. Some are focusing on the process of forming a regional body, others emphasize the stage of integration. In a review of the state of the art of political integration theory after the first 'honey-moon' of political integration and the first major draw-backs in real world integration as well as theory-building, Charles Pentland (1997) made the attempt to formulate what he called a common denominator of political integration:

> "All it seems possible to say is that international political integration is *a process whereby a group of people, organized initially in two or more independent nation-states, come to constitute a political whole which can in some sense be described as a community"* (Pentland 1973, p.21).

As mentioned, the latter in many respects failed the empirical prove, and was revised and amended many times. Partly to meet real world developments, partly because of conceptional weaknesses and shortcomings. In particular the lack of explanative and predictive power with regard to the political and economic trends in West European integration, where criticized. In many respects the famous book of Leon Lindberg and Stuart S. Scheingold (1970), *Europe's*

Would-Be Polity, is still a reasonable approach to explain the why (not) and how of European integration. The models of system change are discussed with special attention to the topic analyzed in the article in the figure below. Despite, the long time since the book was published, the models of system change still seem to be useful, at least as a starting point for a classification of processes in European integration, - obviously with regard to institutional issues and in an decision making perspective, but also for the understanding of transition and system-transformation mechanisms in the eastward enlargement negotiations.

Table 1 The EU-enlargement: Models of System Change

Obligations:	*Outcomes:* Extension	Fulfillment	Retraction
To participate in joint decision-making, (i.e. to make new policy).	*System Transformation Model (s)* means an extension to specific or general obligations that are beyond the beyond of the original treaty commitments. The whole enlargement process constitutes a system transformation. This process is the precondition for an application of the four system-immanent process' in the other categories.	*Forward-Linkage Model* describes a sequence whereby commitment to participate in joint decision-making has initiated a process that led to a increase in the scope of the system or in its institutional capacities. Similar process to the 'spill-over thesis' of neofunctionalism. The relevance for the enlargement process is to secure a positive and dynamic policy according to the result of the reintegration process according to the negotiated.	*Output-Failure Model* refers to a situation in which a commitment was accepted but where the system was unable to produce an acceptable set of policies, which in our case means that the EU fails to introduce the policies required to a successful enlargement.
To implement agreements, and the routine enforcement of specific rules (i.e. to administer a previously agreed area of joint activity).		*Equilibrium Model* occurs when an area of activity is routinized or institutionalized. Rules are established and recognized, and there is little need for new intergovernmental bargaining. Relevant after a full-fledged reintegration.	*Spill Back Model* refers to a situation in which there is a withdrawal from a set of specific obligations.

Source: Based on Lindberg & Scheingold (1970 p.134 - 139)

Based on this approach, the challenges to political integration theory in general (Chryssochoou 1997, p. 1) and the classical models of system change[3] summarized in Table 1 lead to the following preliminary conclusions:

- The positive circle in this process can result in a system transformation but with a possible outcome which at the best will be reinforced by forward linkage (or in a Haas' terminology, spill over) mechanisms. The negative alternative after the system transformation is 'out-put failure' if the EU not is able to follow up on the fundamental transformation initiated by the reintegration of the East and Central European Countries
.
- The experiences of the first 8 years indicate that the risk of negative outcomes (output failure or spill back) is real. Particulary, in the fields of economic restructuring (internal in the EU as well as in the accession countries) and external with regard to economic assistance and the implementation of preferential treatment in the area of trade and other forms of economic exchange.

- In the field of political integration the record seems to be less ambiguous at the moment. The decisive test will come when East West negotiations will change character from more or less traditional intergovernmental frameworks (led by the presidential country of the EU to become an integrated part of the EU decision making with qualified majority voting etc. This will stress the still unsolved institutional issues only solved on the surface in the IGC of Amsterdam. The latter is another reminder of one of the crucial shortcomings of the concepts of regional integration, the ambiguity of the most common definitions of political integration, and the not very vel specified dimensions of an operational approach toward integration.

In this respect it seems useful to distinguish between several forms of international cooperation and integration depending on scope and institutional capacity of the framework under consideration. This distinction was originally introduced in the above quoted book by Lindberg Scheingold (1970, p. 99f.). Recently, a similar argument has been forwarded in a textbook on European Economic Integration by Jacques Pelkmans (1997, p. 21f.):

> "The European Community has developed in essentially three ways:
> - deepening of its economic liberalisation, common regulation and politics and of the commitments and prohibitions of the Memberstates);
> - widening (of the scope of its economic and other powers);
> - enlargement (of membership)"

With regard to the reintegration issue the main conclusion is, that the ambivalence between the scope and institutional capacity dimension of integration will resist, also after a geographical enlargement. The two classical problem-area stipulated in 1970 will persist. Weather the history of internal structural problems will repeat itself or not will only time could prove. The reaction in the 1970's was to extent scope at the price of serious shortcomings in decision-making and institutional capacities. At the turn of the millennium the new attention on subsidiarity and the focus on international solutions for transnational problems will probably led to a focus on the development of an appropriate institutional framework. This will not necessarily be supranational in an neofunctionalistic sense, but rather of intergovernmental or confederal (Sæter 1971) style, combined with the institutional structures developed in the EU-system[4] .The crucial argument with respect to the choice between a federalistic and a confederalistic approach to cooperation is, that the national government still has the control over the most important areas of politics, and that unanimity still is required if joint policy has to be made:

> “ Applied to the present Union, the term ‘confedereal refers to the structure of the larger management system, suggesting that, not only has the role of the member nation-states remained effective, but also that their government have found ways of strengthening their position domestically, regionally and internationally”. (Chryssochoou 1997, p.524)

In an enlargement perspective the most important impact of the situation described in the quotation is, that for every enlargement the decision-making structure becomes more complicated and the risk of being unable to produce necessary decisions increases (spill-back or output-failure in Lindberg and Scheingolds terminology).

The role of Greece with regard to the EU’s policy toward Turkey and to some extent Cyprus, illuminates this point. Enlargement with new members without institutional reforms, becomes a risky business, if the general principle of equal treatment and equal rights on obligations for all members is maintained. In policy-areas governed by the principle of veto according to the 1966 Luxembourg accord means that the EU will be unable to act if issues are at stake considered to be of national interest. In particular latent ethnical cleavages in East and Central Europe can become a major challenge to the EU’s political and economic ability to act.

2.2 Economic Integration

At the first glance problems look less complicated with regard to economic issues and economic integration. Traditionally regional economic integration takes place between relatively similar countries regarding economic development or political traditions and institutional frameworks. As long as we are dealing with economic integration between competing countries we are in the mainstream of economic integration, which is usually considered to be the area where the change for economic gains is highest. Since the main benefits comes from economies of scale, specialization and economies of scope, the classical trade related advantages comes on the lower level of integration according to figure 1 below. Contrary, the nature of gains - and potential losses - change when the process of integration embark on forming a true common market or an economic and monetary union. In this case structural adaptation and usual transfer payments are unavoidable. Although there has been many attempts to form regional economic associations between third world countries, their success has been rather limited. According to Robson (1987, p.197) these attempts are usually based on the *classical approach of general trade liberalization* resulting in the formation of Free Trade Areas or Customs Unions, *complementarity agreements* (i.e. trade liberalization for certain existing industries) or *joint measures to regulate investment* in new industries aiming to exploit scale economies based on the total regional market. Especially the latter seems relevant for the emerging market economies in East and Central Europe, although they to some extend are similar to frameworks of cooperation used during the existence of the Council of Mutual Economic Assistance (CMEA). For a comparison of economic integration in various types of economic systems see Brada & Mendez, 1985. In their study, based on the examination of their ability to promote inter-member trade, one result was that the environmental factor inter-member distance was the most important individual factor. Regarding the effectiveness of their integration policy, the study shoved a relatively poor record for the highly institutionalized EC. The latter can partly be explain by the period of investigation, the early seventies were most trade effects from the implementation of the Customs Union were achieved. Regarding their comparison of the CMEA with the western approaches the most interesting conclusion is:

> "Thus the combined effect of central planning and of integration policy in CMEA causes that integration grouping to underfulfill its potential by about the same amount as the EEC. Consequently it does not seem that CMEA integration policies or the system of central planning appear to be significant greater barriers to promoting inter-member trade than do politics adopted among integrating market economies." (p. 555)

The first crucial issues regarding these roads to integration are how the structural shortcomings are solved and the process of transition can avoid serious social and political conflicts without huge transfer payments. This requires an appropriate set-up both in the accession-countries and in the EU.

The second problem is to assure, that they conform with especially GATT (WTO) rules on non discrimination and equal treatment as well as to avoid probably adverse impacts on East and Central Europe relations to the European Union. Recent association agreements between The East and the EU have already proved the importance of these concerns as far as salient sectors of the EU are involved (European Economy 1994b).Also in Western Europe the process of consolidation of the regional economic system is still in flow.

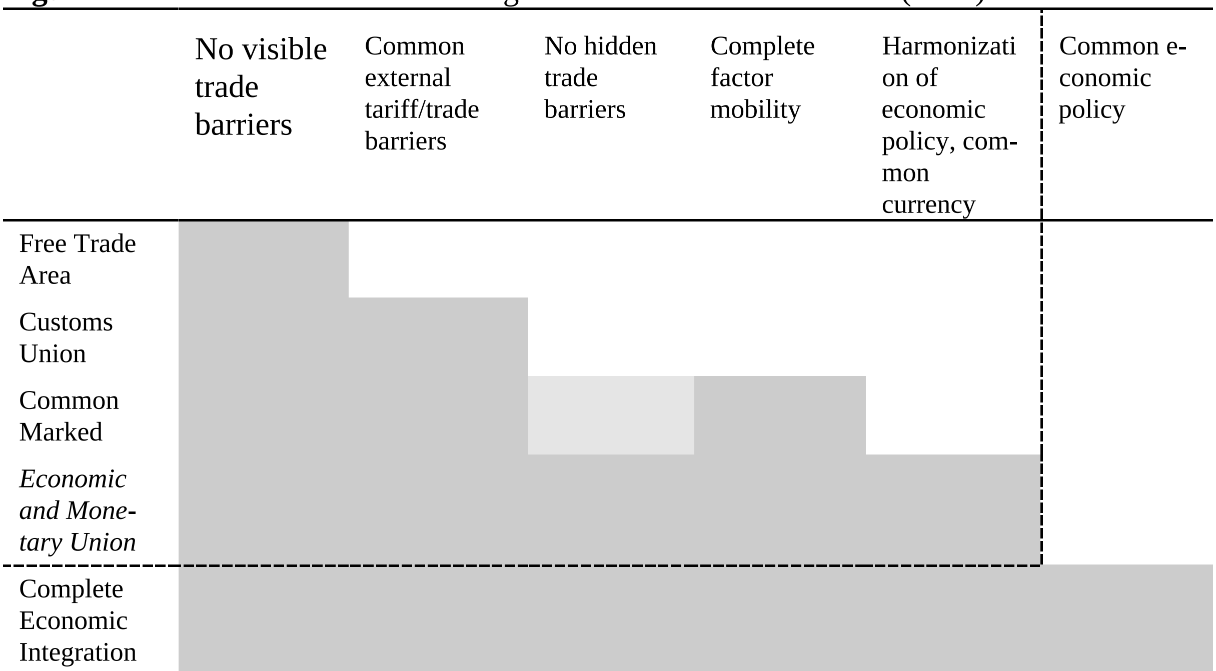
Switzerland, Liechtenstein, Norway and Iceland still have to rely on a intermediate cooperation scheme, The *EEA-agreement* establishing a European Economic Area covering the EU and the remaining members of EFTA (European Free Trade Agreement) despite of Switzerland, formed according to the Stockholm convention of 1960). Basically the EEA provides the EFTA countries since 1993 to participate in the Single European Market on equal terms [5].

A central issue in the discussions of the role of regional economic integration with regard to the formation of an international trade regime is whether regionalization has to be considered competitive or complementary to global solutions. This issue is also relevant in a reintegration perspective since close agreements with or membership of the EU, requires acceptance of the 'acquis communautaire', the total of legal rules and customs developed through 40 years of cooperation. In particular with respect to competition and trade policy the direct economic impacts will be significant from the beginning in the East and Central European countries. In a longer perspective of integration similar effects will arise in the field of environmental policy, industrial policy and labor market regulations, when adaptation to the Common market level of integration takes place. From an economic point of view, this has traditionally been addressed from an international trade and specialization perspective with major attention to the trade creation and trade diversion effects and the gains from scope and scale economies. Especially impacts on terms of trade has been considered to be important, partly for economic reasons, partly through increased influence of the involved countries in international trade negotiation[6]. The political institutional side of this process has at least in the last couple of years been highlighted even more, namely through the experience made in the EU. At least integration beyond the Customs Union level (see figure 1) does not seem not to be practicable without a strong political commitment[7].

The taxonomy of economic integration in figure 1 coincides with the institutional commitment or capacity-concept discussed in the previous section. The tighter economic cooperation, the more important is a joint system of policy making[8].

The figure not only indicates an increasing level of economic integration, but also an growing need for policy coordination. In particular, the intermediate steps of integration are unstable in an economic sense, since traditional instruments of economic policy are not available on the national scene, and a joint policy-making system with supranational power is not established on Community level yet. A recognition of this problem were one of the impetus' to form not only the single European market in the 1980's, but also to reform the decision making system according to the parallel of the Single European Act. The lack of parallelism in this field in the implementation of the Treaty of European Union (TEU) is probably the major challenge, not only for the Economic and Monetary Union, but also for the enlargement process.

Figure 1 Classification scheme for Regional Economic Associations (REA)



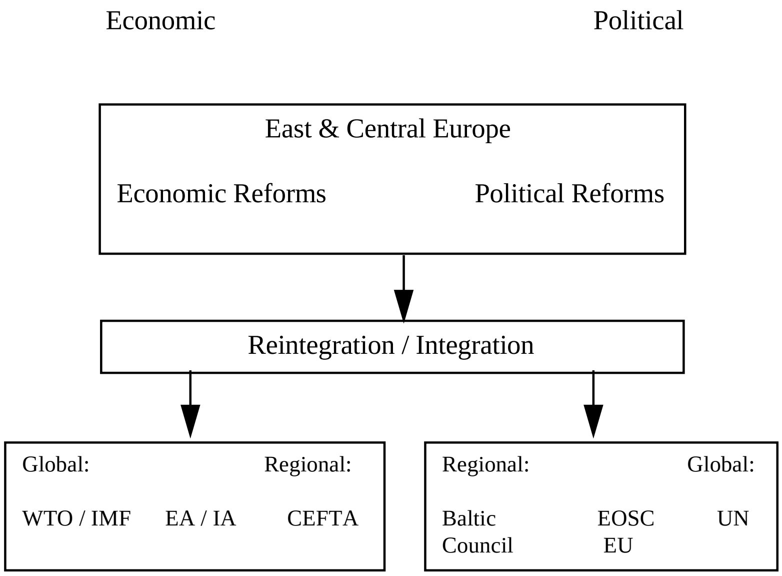
Note: *The shaded area:* steps toward economic integration. *The light shaded area:* The EU 1998.*Area within dashed line:* The target of the Maastricht treaty.
Source: Based on Robson (1987) and Hansen et all. (1992, p.4).

2.3 A Framework for Transition?

Regarding the reintegration of the former state trade economies into the western dominated market economic system the nature of the issue of complementarity and competitiveness are more complex. Historically most of the countries are familiar with the principles of the market, and at least some of the mechanisms used in the CMEA were similar to western concepts of integration. The traditional principles of integration in the former CMEA were at least to some extend based on the exploitation of scale economies in competitive sectors of the involved countries, according to common plans within the framework of the socialistic division of labor (see Robson, 1987, 215-232).

The crucial issues for the emerging market economies are, that strategies reasonable in developed capitalistic countries in the sixties and in a slightly modified version when launching the Single European Market Program in the middle of the eighties, are not necessity 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[9] to guarantee the development of a healthy industrial base. To make this strategy feasible a coordinated Western acceptance of unilateral preferential treatment seems necessary. Recent experiences with the economic agreements between the EU and East and Central Europe have shown how reluctant the EU is to grant preferential agreement in sectors within which the East European countries are potentially competitive like textile, steel and agriculture (see European Economy 1994).

Figure 2 Economic and Political Reintegration



Source: Adapted from Cornett & Iversen 1997

From a principle and conceptional point of view the result of our discussions so far 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 which for a considerable period will rely on exports from sectors with relatively limited potential for scale economies rather then on sectors with large potential for scale and scope economies.

The lessons of the 'up' and 'downs' of West European integration are unambiguous. It seems unavoidable that economic and political integration has to go hand in hand. Only coordinated policy in these two branches of international cooperation - both on the regional and global level - can lead to a successful and lasting result. The central brinks of these processes applied to the reintegration of East and Central Europe is summarized in figure 2.

3. Toward Transeuropean Integration?

Based on the analysis of the concepts of Regional Economic Cooperation in Europe, the links between international economic integration and internal development are analyzed. The relationship between macroeconomic integration and the necessity of providing instruments to cover specific areas or sectors from significant adverse effects of this process is given special attention in the analysis. This part of the analysis will focus on the needs for the restructuring of existing EU-policies to meet the challenges of the next enlargements. The theoretical concepts will be used for a principal evaluation of the needs for a future regional policy for an enlarged community.

As mentioned earlier, regional economic integration usually takes place between similar countries, and has until now been most successful in the developed part of the world. Nevertheless, regional integration has also been used as an instrument to promote economic development[10] i.e. in Latin America, mostly with modest results. The regional integration approach has only rarely been applied between countries belonging to fundamental different economic systems or on a different stage of economic development. The latter is NAFTA, the North American Free Trade Agreement an example of. The former has at least some features in common with the European situation in the 1990's.

With regard to East and Central Europe the situation is slightly different. The countries are not underdeveloped, but they are lacking mainly for institutional and structural reasons. Since the countries historically have been a part of the European Economic Space, fully integrated in the marked based economies before World War II, reintegration - at least measured in trade figures - took place relatively smoothly (see table 4). Weather the participation in the Council of Mutual Economic Assistance (CMEA), was an advantage or not, for the ongoing process of reintegration is hard to judge. Undoubtedly the CMEA created some similar effects to the western market based frameworks. In a comparison of economic integration in various types of economic systems, see Brada & Mendez (1985). In their study based on the examination of their ability to promote inter-member trade, one result was that the environmental factor inter-member distance was the most important individual factor. Regarding the effectiveness of their integration policy, the study showed a relatively poor record for the highly institutionalized EC. The latter can partly be explain by the period of investigation, the early seventies where most trade effects from the implementation of the Customs Union where achieved.

The crucial issues regarding these roads to integration are how to ensure, that they conform with especially GATT rules on nondiscrimination and equal treatment and to avoid probably adverse impacts on East and Central Europe relations to the European Union. The European Agreements (see overview in table 3) between The East and the EU have already proved the importance of these concerns as far as salient sectors of the EU are involved. In this perspective the European Agreements are a stepping stone to full fledged membership for the East and Central European countries of the first and probably also the second wave of membership-negotiations. To what extent the links toward the remaining countries of East and central Europe (see last row in table 3) will remain on a pre-membership negotiation level or not is impossible to judge at the moment.

4. The Process of Reintegration

The process of transition and recovery in East Europe has been challenged not only by the regained influence of traditional political groups in East Europe but also through the reluctance of the EU to open their markets in sectors where the former CMEA-countries are competitive[11] . To avoid further drawbacks it seems necessary to establish a self sustainable economic system able to handle external (i.e. the process of enlargement) as well as internal (i.e. the structural funds) demands for restructuring. Furthermore it is important to adapt EU-assistance policy not only to the internal EU modes of operation but also to take the needs and organizational setting of the receiving countries into consideration.[12] The first precondition is the opening of western markets. This section will, according to the framework sketched in table 1 and figure 2 address some of the institutional and policy changes necessary to facilitate the new members. Secondly, a brief overview of some of the economic issues of the process is provided.

4.1 Institutional frameworks

The European Union is the cornerstone of the rearrangement of the economic landscape in Europe after the break up of the East, politically as well as economical. Nevertheless, it is still too early to take this process for granted, despite of the fact that the IGC of Amsterdam at least on the surface paved the road for the first round of eastward enlargement. The pivotal position of the EU does not mean that the EU is the only important factor in this process. Individual countries, ethnic groups and especially also the revival of traditional goals in Russian foreign policy and the derived perception of threats in East and Central Europe as well as in parts of the former Soviet Union, constitute decisive features of the regional system. Both in an economic and social perspective the German reunification has proved the evidence of the tremendous problems facing East Europe in their attempt to recover after 40 years of command economy. Despite of huge transfer payments from West to East the area of the former GDR will suffer for probably decades before total recovery. One lesson of German reunification is the infeasibility of political motivated top down approaches to economic reintegration in an all European scale.

From an internal EU point of view this problem of policy realignment is still unsolved, especially not with regard to the institutional set-up. Also the economical and financial most costly sectoral adaption are only premature[13].

Regional disparities persists and are to some extent widening, mainly because of budgetary constraints[14] and the unwillingness of the more wealthy northern EU countries to expand the budget, but also caused by insufficient development programs.

With regard to the future and speed of the process of transition and reintegration of East and Central Europe not only budget constraints like the availability of financial resources and the lack of preferential treatment from the established market economies are important (see section above). The single most important precondition of a succesful reintegration is to find a solution of the internal political and institutional shortcomings of the EU, the impetus of the process of integration not only within western part of the continent, but in Europe as a whole. The more successful this process is, the more difficult the catch-up process for the economies in transition will be since the gap they have to bridge, is increasing faster than they can catch up, in particular when dealing with real economic figures (see table 5-7).

With regard to the generel frameworks for economic activities, this problem is less significant, since the application countries to a large extent have included EU rules, the socalled ’aquis communautaire’ in the national revision of their economic systems.The main advantage of the applicant countries is contrary to present non European experiences with regional integration in which groups of countries are developing a common frameworks of cooperation, the European case, at least from a principle point of view, is more similar to the process of re-unification between West and East Germany. The main difference is that neither market form nor political transformation is covered by a common legal or constitutional framework, facilitating a smoth process of transition[15].

Table 2 The impact of successive enlargemets of the EU

	Increase in area	Increase in population	Increase in GDP (PPP)	GDP per capita	
				Change	Average (EU-=100)
EU-12/EU-9	48 %	22 %	15 %	- 6 %	91
EU-15/EU-9	43 %	11 %	8 %	- 3 %	89
EU-26/EU-15	34 %	29 %	9 %	- 16 %	75

	Eligible population in 1000	Eligible population as % (EU=100)	Objective 1 population in 1000	Objective 1 population as % (EU=100)
EU-12 1989	140.6	43,3 %	69.7	21,4 %
EU-15 1995	185.6	49,8 %	94	25,2 %
EU-26 2000+	291.4	60,9 %	199.8	41,7 %

Note: EU-15 including German reunification, based on 1995 data
Source :*European Commission* (1997c) ,Agenda 2000, Part II **-** Analysis, 3. Structural Policy

Also in the case of becoming a member of the EU new members are assked to accept the economic and institutional regime. Applicants have to accept the 'acquis communautaire'. The legal framework of the EU - of course less complex in scope and capacity than in the case of the amalgamation of the two Germanies - has developed considerably since the previous enlargements in 1973 and during the first half of the eighties. The 1995 accession of Sweden, Finland and Austria was a much more complex. Despite of the facts that the saliency of the economic issues involved were rather limited - and to some extent solved in advance through the 1984 Luxembourg Agreement between the EFTA and the EC and the EEA agreement, a wide range of political complex problems had to be solved.

The next enlargement will both economically and politically be more complex, and require both a longer and more complicated transitional period. Since full membership of the emerging market economies seems to be impossible in the short run, partly for internal reasons in the former CMEA, but also caused by structural constraints within the EU, more workable patterns of cooperation are required. Most obvious are the impacts on agricultural and structural policy. The former is under constant scrutinicy and evaluation due to internal (budgetary) and external (WTO) reasons. The later will probably meet the highest pressure after an eastward enlargement, since the internal economic balance within the EU will be seriously effected through enlargement, as shown in table 2. Fundamental changes will also be necessary in this area (Armstrong 1996).

To solve the obvious structural shortcomings of the applicant countries two concepts seem feasible. The first is the long discussed approach of the two speed Europe, often dismissed for political reasons, but still relevant, also within the 15 current members. The above mentioned European Economic Agreement framework belongs to this category.

A preliminary result of the discussions in this section indicates two possible frameworks, which will be analyzed more in details in the remaining part of the paper:

- Full membership with a long internal periode of transition with regard to economic aspects and full political integration.

- EEA-like agreement with some sectoral exemptions.

The latter could also be a workable approach to deal with the countries now belonging to the second or third group of potential applicants. The structural policy with its huge elements of transfer-payments links the internal adaptation process in the EU-system as well as in the applicant-countries toward the increasing economic interdependence between the two former divided economic systems.

2.3 Economic Aspects

Foreign Direct Investment (FDI) and trade are the most common forms of international economic exchange within a non-governmental framework. When governmental transactions are included loans and guaranties as well as unilateral transfers play an increasing role. In this respect the economic relationship between the East and Central European Countries and the EU is a mixture of the above mentioned transactions and EU-transfers mainly within the framework of PHARE, TACIS[16] and the 'Pre-Accession Strategy' within the framework of the 'Agenda 2000'.

In the discipline of regional economic integration most attention is usually given to the development of trade and the regulations of the trade regime. This section will focus on trade and the change of trade patterns during the transition period, although these can be taken as one indication of regional integration processes in the region considered. In a step-wise concept of regional inebriation developed in figure 1 the next step after forming the trade-based regional economic associations (Free Trade Areas and Customs Unions) is to form a true common market including free movement of capital. Foreign Direct Investment (FDI) is one aspect, indicating a more persistent link between two economies. FDI and international commodity trade are both complementary and substituting instruments in international business. If strong trade barriers persists the latter is the case, if a liberal trade regime is predominant FDI is complementary, reinforcing the economic links[17]. A recent survey of the statical office of the EU Eurostat shows that EU-countries are major investors in the applicant countries. In 1995 the net position of the EU in applicant countries approximately 13 bill. ECU. The distribution according to receiving countries are probably the most interesting. The Czech Republic and Hungary, two of the most advanced East European economies with regard to the transition process received 4.1 and 4,8 billion respectively. Poland was the number three receiving 2.6 billion ECU[18] . A closer look on the numbers shows, that there seems to be a connection between the level of the transition process (both economically and institutional) and the level of FDI. A second feature is the geographical link between receiving and sending country well-known from international trade-flow analysis is also visible with regard to FDI between the EU and the transition economies. In ex. Denmark (39%), Finland (21 %) Sweden (15%) and Germany (14%) counts for 89 % of all FDI in the three Baltic States in 1995.

Although the figures show a significant change in *trade patterns* of the economies in transition already in the first years of the process it is evident that the relative distribution of trade is only a part of the truth. In absolute figures the process has been modest and especially less homogenous. The basic problem remains, despite of the below mentioned European Agreements, that the European markets as many other are still relatively closed for these countries, especially in sectors where they are competitive. In this regard the treatment of East and Central Europe is similar to many LDC's experience with OECD-members.

Table 3. The Trade regime of the EU toward CEEC Ultimo 1997)

Title of agreement	Country, date of signature/into force	Aim/type of agreement:	WTO-status
Europeagreements (Signed and ratified)	Hungary Poland (12.12.91/1.2.94) Czech Rep. Slovak Rep. (4.10.93/1.2.95)	Association agreement providing for free trade and a forerunner to possible accession	Interim Agreement notified April 1992. First CRTA meeting to examine agreement 18 September 1996
	Bulgaria (8.3.93/1.2.95) Romania 1.2.93/1.295		Interim Agreement notified Dec. 1994. Working party has not yet met. Now for CRTA.
Europeagreements (Signed)	Estonia Latvia Lithuania (12.6.1995)	Association agreement providing for free trade and a forerunner to possible accession	Free Trade Agreement notified, June 1995 Working party has not yet met
	Slovenia (10.6.96)		Not yet notified

Note: Estonia, Latvia & Lithuania where not members of WTO when the current source was published
Source: *European Economy* (1997a)

Table 4 provides a brief summary of the changes in the trade pattern of the East and Central European countries since the beginning of the transition period in the early 1990's. From 1988 to 1992 major changes took place in the distribution of trade of the CMEA countries. Internal CMEA exportations were reduced from 36,8 % to 17,6 percent. At the same time the EU-12 share almost doubled from 28,8 to 46,9. The changes were more significant when the 6 Central and East European countries are considered. Here CMEA exportations where down from 31,9 % to 12,1 % (Cornett 1994, p.8).

Table 4 EU's share of exportations of Central and East European Countries

	1990	1991	1992	1993	1994	1995	1996
Bulgaria	38,0	44,2	37,2	43,5	45,6	48,2	51,1
Czech Rep.				60,8	60,6	59,2	62,7
Estonia			92,0	60,1	63,2	64,8	70,5
Hungary	48,3	58,7	55,0	54,1	68,4	68,5	70,8
Latvia			87,2	69,8	68,3	64,0	67,9
Lithuania			84,4	67,7	55,1	53,6	49,6
Poland	49,7	61,1	63,0	68,1	69,4	69,9	69,2
Romania	35,5	42,0	42,0	39,6	47,4	49,0	52,0
Russia			22,8	45,0	39,5	36,4	36,0
Slovakia				38,4	44,5	45,1	47,6
Slovenia				68,4	73,2	69,8	67,4

Note: Figures based on US-$

Source: *International Monetary Fund* (1997)

Since many of the East and Central European states have had a period of relatively high economic growth during the last years, and the medium term forecasts for most of the countries expect positive real growth (see table 5), the balance of payment problems caused by the increasing negative trade balance becomes steadily more serious, reinforced by an increasing accumulated foreign debt burden of most of the transition economies.

Table 5 Economic growth in Central and East European Countries

	GDP, real % change				
	1995	1996	1997	1998F	1999F
Bulgaria	2,6	-10,9	-7,4	2,3	3,8
Czech Rep.	4,8	4,1	1,1	1,9	2,6
Estonia	2,9	4,0	9,7	6,8	7,0
Hungary	1,5	1,3	4,0	4,5	4,6
Latvia	-0,8	2,8	5,9	6,3	6,6
Lithuania	3,0	4,2	6,0	6,6	6,7
Poland	6,9	6,1	6,9	6,1	6,0
Romania	7,1	4,1	-6,6	-1,6	1,4
Slovakia	6,8	6,9	6,2	4,4	3,5
Slovenia	3,9	3,1	3,1	3,6	3,9
CEC-10	5,2	3,9	3,4	4,1	4.5

Note: E: estimates, F: forecast

Source: European Economy (1998), Supplement C, no.2, April 1998

Table 6 External imbalances of CEEC.

	Trade Balance (% of GDP)					Debt-export ratio in %		
	1995	1996	1997	1998F	1999F	1995	1996	1997
Bulgaria	0,9	2,1	3,8	1,9	0,8	151,0	153,0	159,0
Czech Rep.	-7,3	-10,4	-8,6	-6,6	-6,4	77,0	94,0	98,0
Estonia	-18,7	-24,0	-23,9	-23,1	-21,7	14,6	14,2	8,5
Hungary	-5,6	-5,9	-4,0	-5,0	-6,9	250,0	185,0	112,0
Latvia	-14,5	-15,9	-17,6	-18,6	-19,9	28,5	26,2	22,5
Lithuania	-11,7	-11,4	-13,2	-14,3	-14,2	29,5	33,9	33,4
Poland	-1,6	-6,3	-8,5	-90	-9,8	192,0	166,0	145,0
Romania	-4,4	-7,0	-6,0	-5,0	-4,6	58,0	74,0	84,0
Slovakia	-1,3	-11,0	-7,6	-75	-64	53,1	71,6	97,5
Slovenia	-5,1	-4,7	-4,2	-44	-4,8	29,0	38,2	40,0
CEC-10	-4,1	-7,5	-7,5	-7,5	-7,9			

Note: E: estimates, F: forecast

Source: European Economy (1998), Supplement C, no.2, April 1998

In particular the high debt-export ration of most of the applicant countries is a heavy burden for the future. Table 6 indicates that the medium term forecast with regard to the development of the trade balances are not too optimistic. Financial transfers will be important for a long period to keep the external disequilibrium at an acceptable level. Assistance are also necessary to avoid social and political unrest due to increasing prices and growing numbers of unemployed (see table 7).

As in the patterns of trade the European Union is the dominant actor regarding international help to the countries in transition, but the EU and the member-states theme self are facing increasing budget problems (The Economist, March 21, 19998), which also will influent the amount of resources available for the new member states. To some extent the budget situation with the build-in ceilings for EU spending becomes a zero-sum game between internal and external commitments.

Although the EU is the major contributor, it has to carry the responsibility for the lack of efficiency of many programs also at least to some degree. One of the main problems is the discrepancy between financial commitments and actually transferred help.

The internal aspect of the issue is probably the most urgent one, at least from a social perspective. Unemployment persists on a high level, and most countries are also challenged by an inflation rate, still significantly higher than in the EU-area.

Table 7 Inflation and Unemployment in Central and East European countries

	Inflation, private consumption deflator					Unemployment rate % (end of period)		
1995	1995	1996	1997E	1998F	1999F	1995	1996	1997
Bulgaria	53,8	127,5	1000,0	31,0	13,0	11,1	12,5	13,7
Czech Rep.	9,1	7,8	8,5	9,5	8,40	3,0	3,5	5,2
Estonia	34,0	23,1	12,0	8,5	7,5	4,1	4,3	3,6
Hungary	26,3	21,7	18,3	14,9	11,5	10,4	10,5	10,4
Latvia	21,1	17,6	8,4	6,6	5,7	6,6	7,2	6,7
Lithuania	39,7	24,6	8,8	6,8	6,2	7,3	6,2	6,7
Poland	28,7	19,9	14,9	13,4	12,3	14,9	13,6	10,5
Romania	33,3	43,9	155,0	60,0	30,0	9,5	6,3	8,8
Slovakia	9,7	5,7	6,2	7,0	7,0	13,1	12,8	12,5
Slovenia	14,3	10,9	9,1	8,8	7,9	14,5	14,4	14,8
CEC-10	25,2	24,2	56,2	17,5	12,5			
CEC-8	22,6	16,3	12,9	11,7	10.4			

Note: E: estimates, F: forecast CEC-8 excluding Bulgaria & Romania

Source: European Economy (1998), Supplement C, no.2, April 1998

5. Concluding Remarks

Regional integration deals with political and economic aspects. The process of reintegration of East and Central European Countries - political as well as economic. The lesson of European integration is that the two processes are undividable in practice.

The analysis in the previous sections have shown, that the transition process walks hand in hand with huge socio-economic changes in the applicant countries as well as the fact that the process will require structural changes in the West European way of cooperating and in the policy of economic equity.

Economic integration on the lower levels deals with removal of barriers, - negative integration in Tinbergens terminology (Robson 1987). In Europe the process of negative integration is followed by the set-up of new frameworks for the economies, namely the almost implemented Common Market and the Economic and Monetary Union. This positive steps of integration in a Tinbergens sense are impossible without a political and institutional back-up. In this point the political and economic concepts of integration coincide if development follows fruitful circle ('spill-over' or 'forward -linkage'). If the outcome is negative we are dealing with 'spill- back' or' out-put-failure' according to Lindberg and Scheingolds models (see figure 1).

The combination of these two approaches - in the 40 years perspective of integration in Western Europe - constitutes a fruitful framework for the understanding of the underlying processes of system-transformation in Europe as a whole, and of the transition and transformation processes in East and Central Europe.

For real world politics the lesson could be:

- The process of system transformation is an All-European process, and not only a process for the applicant countries.

- Economic integration has to go beyond negative integration, and include a participation on equal terms for East and Central European countries in the building of a new economic constitution (positive integration)

- Transition periods and economic transfers have to be adapted to each other (the more restricted the transfer payments, he longer transition-period or exemptions from EU-rules

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Last but not least, the analysis of hard core economic figures indicates, that is seems feasible to go further and faster with regard to the political aspects of integration in short and medium term, than with economic integration.

Endnotes:

1. For a brief overview of the four classical concepts of political theories of regional integration see i.e. Pentland, 1973 and Panild, 1989 for a discussion of the transnational and intergovernmental approaches to regional integration The latter are also discussed in an specific European Union context in Chryssochoou (1997).

2. The basic concepts of regional integration can be found in many economic textbooks. Useful and comprehensive studies are Balassa 1973 or Robson 1987. A technical and theoretical assessment of the discipline can be found in Baldwin (1995)

3. In many respects the political processes within the EU-system can be analyzed within an abstract model - well-known from national politics - of the political system in the sense of David Easton (see Lindberg 1967). In his analysis of the European Community as a political system similarities and differences to national government where stressed. Despite of the fact that national policy patterns as well as the nature of the Community have changed, the relevance of the concepts are still evident. A recent contribution of Dimitris N. Chryssochoou 1997, illuminates the intermediate stage of the EU-system between a national political system and traditional foreign policy, in Chryssochoous words the Confederal Consociation Thesis (Chryssochoou 1997, p.524 ff.)

4. For a graphical illustration of two variants of the sketched transnational political system see figure 2 p. 535 in Chryssochoou (1997).

5. 1993 the EEA-agreement was refused after a referendum in Switzerland, so that certain economic aspects of the agreement had to be renegotiated by the remaining participators. The EU decision to open up for membership-negotiations with Estonia, Poland, the Czech. Republic, Hungary, Slovenia and Cyprus, caused new problems, in Particular with Turkey, but also most other CEEC-countries were disappointed.

6. The recently concluded GATT round seems to indicate some modifications in the latter argument, at least as long as all other EU countries than France are considered. For an overview of the various EU agreements involving the WTO, see Annex II in European Economy (1997, p. 235-238) Most countries discussed in this article are members of the WTO or are at least in the process of becoming a full member. For details see table 3 in section 4.

7. This has also lead to a new interest for the field of political integration theories and the implication of regional integrations on political discussion making in REA, for a recent contribution, see Chryssochoou (1997).

8. The concept of a economic and monetary Union and the European Political Union were originally considered to be two pillars of the Maastricht Treaty of the European Union.

9. Third world experiences with regional economic associations as a means of economic development have at least been mixed. (Robson 1987, pp. 194ff) See also Brada & Mendez, 1985).

10. Although there has been many attempts to form regional economic associations between third world countries, their success has been rather limited. According to Robson (1987, p.197) these attempts usually are based on the *classical approach of general trade liberalization* resulting in the formation of Free Trade Areas or Customs Unions, *complementarity agreements* (i.e. trade liberalization for certain existing industries) or *joint measures to regulate investment* in new industries aiming to exploit scale economies based on the total regional market.

11. For a recent survey see European Economy (1998)

12. A simple transfer of old and established Western assistant frameworks developed in other contexts seems inappropriate: "Indeed, one must say that the EC, in its response to the challenges posed by central and east European economic and political transformation processes, has not been very innovative or daring. Its activities do not go beyond the established instruments of Community foreign relations and the normal range of Western international activities in economic restructuring."(Kramer 1993,234)

13. See for a discussion from the EU's point of view 'Agenda 2000, Reinforcing the pre-Accession Strategy', Communication of the Commission Doc 97/7.The specific problems of the Common Agricultural Policy are analyzed in European Economy (1997b).

14. The fundamental problem of EU regional policy is very closely related to the issue of public finance in an Economic and Monetary Union. Despite of that the EU is not an EMU at the moment, many features of a Common Market already imply significant disadvantages to less developed areas. Regional and structural grants provided by the EU have been increased every time major steps toward further integration has been decided, latest through the establishment of the 'Coherence fund' according to the Maastricht Treaty for a Economic and Political Union form December 1991. Regarding a discussion of the most important political and economic provisions of the treaties see Artis, (1992) and Corbett (1992) and Pelkmans (1997, pp.29-43) for a comprehensive discussion of the economic constitution of the EU.

15. Recent German figures indicate that 8 years of transition backed up by tremendous amount of money are not sufficient to solve the problems. Political and economic cleavages persist, and seem in some fields again to increase (SPIEGEL, 1998 various issues)

16. PHARE and TACIS provides economic and technical assistance to Central and East European countries and to CIS-countries and Mongolia. For further information see: Grants and loans from the European Union, (European Commission 1997a)

17. For a further discussion of these aspects in a general integration perspective, see Cornett (1998) and World Trade Organization (1995).

18. The exact figures are (million ECU): Hungary: 4.804, Czech Republic: 4.168, Poland: 2.636, Slovakia: 547, Baltic countries: 462, Slovenia: 338, Bulgaria: 67 and Romania: 34. (Eurostat 1998).

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