

Trade and trade policy adjustment to the European Union Hungary's experience and lessons¹

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Hungary's expectations

When Hungary began negotiating the Europe Agreement (EA) on association, one of the most important goals was that it should reflect (as expressively as possible) the ambition of Hungary to attain full membership and that it should establish a kind of link between the process of association and accession. Thus the association was considered as a preparatory stage leading to future membership. This also meant, in Hungary's opinion that the agreement had to contain elements assuring the intention of the partners to go beyond simple free trade and facilitate real integration.

In the field of trade relations, Hungary's basic goal was the creation of free trade in industrial products, including steel and textile products (which were treated as special categories in the European Community and were regulated earlier by voluntary restraint agreements), together with the complete elimination of all trade barriers. In the timetable of achieving free trade, the Hungarian delegation wanted to fully assert the principle of asymmetry, reflecting the different level of the partners' economic development. This meant that by Hungarian intention the European Community (EC, later European Union, EU) should have consolidated the elimination and suspension of quantitative restrictions (already in force from 1 January 1990). Hungary also requested the immediate elimination of the EC duties on as many as possible industrial goods. Hungary for its part was to eliminate its duties as gradually as possible.

Hungary wanted to see substantial and immediate concession in market access for agricultural products. The Hungarian delegation had concrete proposals and a list of requests. The list was rather ambitious: apart from requesting 50-100% levy reduction, it included products considered as the "hard core" of the EC agricultural policy.

Among the Hungarian ideas was the aim to form a customs union, as some of the earlier association agreements concluded by the EC included provisions on the creation of a customs union. Including this goal into the EA could have been mainly a symbolic element reflecting the strong intention to become member. On the other side, from economic point of view, creating a customs union in a relatively short time would have risked to raise a lot of problems due to internal difficulties related to the transformation process and to the East European economic environment.

In the field of the opening of the EC labour market the starting expectation of the Hungarian delegation was to establish either EC level or bilateral quotas with member states for Hungarian workers. The Hungarian negotiators' position was that considerable liberalisation must be reached concerning the possibilities allowing Hungarian labour into Community services (including transportation, which was of particular importance at that time) and that the partners would take steps toward the free but asymmetric movement of capital. It was a

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Hungarian claim that the EA should lay down concrete forms and possibilities for broad political and economic cooperation and that the EC should offer solid financial assistance. The original concept was that this assistance would have been recorded (with defined annual amounts) in a financial protocol. Concerning the financial protocol the Hungarian delegation did not submit concrete numerical proposals because even the Hungarians did not fully agree on the issue.

Outcome and compromises

A very soft and vague wording about the link between association and full membership became finally acceptable for the Hungarian delegation. This wording without any obligation for the EC was put in the final text of the EA. There was a compromise on this question: the text expressed a much less explicit EC commitment than was originally expected by the Hungarian negotiators. It reflected the EC's view that association and accession were two different processes.

As far as the trade liberalisation is concerned, the parties finally agreed on strong asymmetry.

Regarding trade in **non-agricultural** products, all parties of the EAs committed themselves to observing the standstill principle, i.e., not introducing any new restrictions or not increasing already existing tariffs. Omission of this clause would make it possible to increase the scope of protection after the entry into force of the Agreements, which would violate the arrangements made earlier. In some exceptional cases defined in the Agreements, it was possible to raise the level of protection by using safeguard clauses. The basis for duty reduction was established in a way that allowed taking into account the outcomes of the Uruguay Round negotiations.

The EAs immediately removed almost all quantitative restrictions (QRs) on industrial imports from the CEECs (Hungary, Poland and Czechoslovakia at that time), except for textiles, steel and coal. They also removed tariffs on over 50% of the EU imports from the region. Tariffs on most of other products were to be abolished over a two-to-five year period (in case of Hungary – lasting to 7 years), except for textiles and clothing. Besides textiles and clothing, a few other groups of products (iron and steel, chemicals, furniture, leather goods, footwear, glass and vehicles) were treated as sensitive sectors, so trade of them was also to be liberalised at a slower pace. Moreover, exports of sensitive products from CEECs to EU were subject to liberalisation in the framework of preferential quotas (reduced import duty only for a limited amount of goods). The Copenhagen European Council (June 1993) decided to implement faster liberalisation in those categories. As a result, almost all of the non-agricultural exports of the three CEE countries to the EU were practically liberalised as of the beginning of 1995.

The process of duties elimination in the Hungarian non-agricultural imports may be divided into three parts. From the entry into force of the Interim Agreement until 1 January 1994, Hungary eliminated during three years in three equal phases the duties of the so-called “*quick list*”. The share of the concerned products of dutiable industrial imports was about 15 per cent in 1991, but it diminished after the adoption of the EA. Imports of goods listed here were marginal both from the fiscal and structural points of view. The criteria of being listed here were a relatively low level of duties and the minimisation of economic effects (i.e. these concessions were rather symbolic, with no substantial trade effect). Mainly machinery and chemical products, consumer goods, metal and metallic products were included in the so-

called “*normal list*”. Duties on these products were to be eliminated between 1995 and 1997 in three equal steps. The share of these goods in the Hungarian industrial exports was about 20-25 per cent. The structure of the so-called “*slow list*”, containing products for which duties were to be eliminated relatively slowly and gradually was similar to that of the normal list with the difference that textile and clothing and metallurgical products were mostly listed here. Part of them was also protected by quantitative restrictions. These duties were phased out by the end of 2000.

The provisions of the Europe Agreements concerning trade in **agricultural products** were very complex as they involved the mostly protected area of the EU activity. The commitments were limited (small reduction, not full elimination of protection) and selective (they included a relatively short list of products and did not cover all products as it was the case with non-agricultural products). Some product groups were excluded from the concessions (e.g. wheat, sugar, most of the milk products, etc.). As a general rule, the EU granted concessions to CEECs in the form of tariff quotas for defined products with gradually increasing levy or tariff reduction over the coming years. These concessions were valid for defined quantities of products imported from the Visegrád countries. The preferential quotas were increasing from the entry into force of the agreements by yearly 10% over 5 years. The administration of the tariff quotas in many cases was bureaucratic and sometimes non-transparent.

In Hungary the scheme of agricultural import concessions accorded to the EU suppliers followed that on the export side. Nevertheless, the product coverage of the concessions was more limited and the volume of the preferential quotas remained lower than on the export side. The pace of increasing these quotas was only the half as compared to their quotas in the EU. According to the Hungarian experience, concessions established in the EAs could produce two types of effects. On the one hand reduction of import charges could result in rising selling prices. On the other hand, because the concession is usually shared by the exporter and importer (in practice, most of it went to the importer), these concessions were able to maintain the interest of importers to buy products from the CEECs, thus to maintain or increase the level of trade. In reality, the reduction of the import burden was not perceptible in the export prices of the most Hungarian products. In many cases even a price decrease was registered or, if prices increased, they did not reflect the amount of the duty and levy reductions. Generally speaking, the concessions were not able to significantly increase the volume of exports either. In the Hungarian imports, since the concessions were limited, the EA scheme itself did not substantially influence imports.

As a compromise, Hungary had to accept a rather weak commitment from the EU in opening the **labour market**. At the same time, in the field of liberalisation of capital movement and trade in services, the principal Hungarian interests could be asserted (with some exceptions), since the opening in these areas remained rather limited.

The partners also arrived at a compromise on the issue of **financial assistance**, which earlier evoked strong aversion within the member states. The agreement, although it did not fix precise amounts of money, determined the possible long-term forms of financial assistance to Hungary (e.g. Phare, EIB loans etc.).

Europe Agreement and further steps on the way to EU membership

Despite its compromises, the Europe Agreement played important and in some field essential role in reorientation and substantial upgrading of Hungary’s trade relations, in modernisation

of its structure and enforced market economy type trade policy discipline. The EA contributed to the modernisation of the economy, created favourable conditions for a massive inflow of foreign direct investments.

From political and economic point of view and from the point of view of legal harmonisation, the Europe Agreement became an indispensable and decisive step on the way to the accession. It was a sort of starting point and at the same time offered a framework for successful preparation for membership. This process was especially efficient in the field of trade policy integration, since the biggest part of the EA's provisions was directly or indirectly linked to trade and its regulation. Nevertheless, after the entry into force of the Europe Agreement, starting from the mid 1990s, the implementation of the EA and the process of preparation for the accession in the EA framework were going parallel with another new process and framework of deep legal harmonisation.

The Cannes Summit of the European Council in 1995 offered to associated countries willing to become members a well-detailed programme of legal harmonisation and adjustment of the laws to the *acquis communautaire*. The programme took the form of so-called White Book. On the basis of the principal fields of harmonisation indicated in the White Book Eastern European countries elaborated their national programmes of the adoption of the *acquis*.

The parallel implementation of the Europe Agreement and the Hungarian national program of the adoption of the *acquis* contributed to be prepared from the legal, administrative and institutional point of view to a smooth integration in the EU, in its single market and in its common policies, including common commercial policy. Besides that these two frameworks created a solid staff of specialists and professionals in different ministries and authorities, together with their networks. These were the essential elements of the successful management of the accession process.

General lessons from Hungary's experience

During the establishment of the base of a new relationship and cooperation, the parties are usually motivated on the one hand by the external political situation, but on the other hand by their own political and economic interests. For Hungary, the changes in the beginning of the 1990s made it possible to reconstruct, in a political and economic sense, its relations with Western Europe and its integration institutions. In early 1990s the EC was led by the need to react to the changes in the partner countries when offered association agreements. At that time "association" as a form of cooperation had been present since the 1960s and 1970s in the external relations of the EC. Concerning the new content of the association, the EC only had broad ideas based on the precedent of favourable and unfavourable experiences. The lack of a definite association concept had serious disadvantages. However, it should be remembered that precisely this fact could open a relatively clear way for Central European countries to shape the Europe Agreements with definite ideas and to force the Community to renew its concepts. Anyway, a conclusion offered by this experience is that in general the problems to be negotiated are in many cases not EU initiatives but may be presented to a big extent by the negotiating partner as well. The situation of the early 1990s is rather similar to the present one, when EU seeks to find new forms of cooperation (i.e. in the form of DCFTAs) with potential partners in Eastern Europe.

If there is enough political motivation and willingness, the European Union can change its negative or reserved attitude even on the toughest questions. Hungary had a theoretical and

practical possibility to influence effectively the provisions and the rules of the Europe Agreement (and also later in the accession talks) and in many cases was able to overcome the absolute rigidity of the EU in some areas.

However, the Hungarian evaluation of the situation showed some weaknesses. The Hungarian negotiating team was not completely aware of the extent of future problems deriving from the domestic economic situation of that time, from the reorientation of its economic relations and from the inheritance of the past. It is a question to what extent these problems were predictable. Anyway, detailed and well-founded studies on the potential effects of the emerging new trade policy framework would have been needed.

The advantages from the new trade regulations and concessions can be truly exploited only by a dynamic economy. When Hungarian economy was not dynamic and its sectors were not competitive enough (i.e., if there were no products to export and thus the market access possibilities could not be utilised), most of the benefits of the mutual liberalisation go to the strongest and more competitive partner. Hungary had to witness such situations and had to face their consequences. Besides that, when only one of the partners, the stronger one can make use of liberalisation, the original asymmetry is easily eroded.

On the basis of the experience of Hungary (and apparently on that of the other Central and Eastern European countries) some short conclusions can be formulated.

- Political determination seems to be an essential element of elaborating a successful agreement. The concept of negotiations and the process of implementation – if possible - should be backed by broad internal consensus (political elite, government institutions, business, population, etc.).

- Clear definition of the country's interests may influence in an efficient way the course and the outcome of the negotiations. It can only be based on well-developed and prompt cooperation and interaction between the different actors of administration, business and civil society.

- Stability of the trade policy administration is desirable.

- It is important to mention the need to be able to form coalitions with member states.

It is not only in Brussels where trade policy decisions are elaborated. A country being in a process of negotiations and close cooperation should not neglect the “capitals” (i.e. administration) of the member states.

- The Hungarian experience shows that trade policy concessions are undoubtedly important, but the stability of domestic macroeconomic conditions is even more essential in order to take profit from the renewed framework of cooperation with the European Union.

- A trade agreement incorporates and enforces trade policy discipline and stability. Nevertheless, authorities of an associated country should not be “shy” or “servile” in using trade defence instruments, when needed. On the other hand, they have to resist to the misuse of them.

- In the process of upgrading the relations with a partner like the European Union, it seems to be essential to establish a workable framework of dissemination of information and dialogue with all partners, practically with the society. Unfortunately this was a weak part of the preparatory work in Hungary before the association. The consequences were unfounded illusions in short run and disillusion after.

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