

# Integration: Eastern Europe and the European Economic Communities

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## I. INTRODUCTION

The dramatic political changes in Eastern Europe over the past year have been accompanied by legal, technical, institutional and financial efforts to link the countries emerging from communist rule to the structures of the European Communities (EC).<sup>1</sup> From both sides of Europe, the motivations for these efforts have mixed political and economic considerations, ranging from consolidating the Westward political orientation of a reunified Germany to supporting the economic development of market structures in the East. This article considers the array of institutional and legal mechanisms which have been and are being developed to implement these diverse goals.

This article initially examines the recent history of trade relations between the EC and the Eastern European members of the Council for Mutual Economic Assistance (Comecon)<sup>2</sup> to highlight the continuity between the liberalization efforts underway before the recent political changes and what have been seen as responses to those changes. Indeed, the initial responses from Brussels to those changes have been a surprisingly *ad hoc* and modest combination of trade and aid initiatives familiar from previous relations with the East or with other third countries. Even as the aid programs have become increasingly generous in recent months, the path for political and economic

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This article is based on legal developments and laws in force as of July 1, 1990.

1. The EC, sometimes referred to as the European Common Market, is comprised of three communities: the European Economic Community (EEC), the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (Euratom). The countries of the EC include Belgium, Denmark, the Federal Republic of Germany, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and the United Kingdom.

2. The seven Eastern European Member States of Comecon are Bulgaria, Czechoslovakia (now known as the Czech and Slovak Federal Republic), East Germany, Hungary, Poland, Romania and the Soviet Union (USSR). The other member countries of Comecon include Cuba, Mongolia and Vietnam. Angola, Laos, Ethiopia and North Korea have observer status in the organization and Yugoslavia only participates in Comecon activities with regard to certain sectors.

integration between Eastern Europe and the EC has become by no means clear.

The EC has indicated that these initiatives are to be continued and expanded in the context of a broader institutional or "architectural" approach to Europe as a whole. This article examines future plans to further relations between the EC and Eastern Europe from two perspectives. First, it places these initiatives in the context of the range of integrative possibilities already known to the EC, from previous enlargement negotiations through proposals for a more permanent arrangement with the European Free Trade Association (EFTA)<sup>3</sup> to the association agreement with Turkey<sup>4</sup> and relations established with the developing countries that participate in the Lomé Convention.<sup>5</sup>

These alternatives suggest that the Eastward expansion of the EC's influence may be institutionalized in a variety of ways. Those (including many in the EFTA countries) who consider membership an exclusive path to integration with the EC underestimate the range of the possible no less than those (including many in Brussels) who consider country-by-country association agreements the only approach for the Eastern European countries. This article concludes that although the specific approach currently being taken toward the old Eastern bloc countries fits within the historic ebb and flow of Western European integration, this approach may not provide the most advantageous structure from the point of view of the Eastern European nations.

Second, this article examines the largely non-institutional approaches to the EC that have been made by Eastern European countries to date. Beyond statements about potential membership in various Western European institutions, the Eastern European countries have focused on attracting foreign investment and integrating themselves into the international trade system. While their recent legislative initiatives relating to foreign investment vary in emphasis, they all seek to attract project investment and promote exports to the West. Although the tools for domestic industrial policy available in each country vary in sophistication, the governments in the East have not focused on the relationships among microeconomic policies, economic freedoms and harmonization initiatives associated with participation in the EC.

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3. See *infra* note 73. EFTA is composed of Austria, Finland, Iceland, Norway, Sweden and Switzerland.

4. See *infra* note 89.

5. See *infra* note 96.

It is difficult to know where this combination of an integrative single-market orientation in the EC and a focus on foreign investment, export promotion and democratic constitutional reform in the East will lead. In some respects, these are simply two political visions of economic modernization. This article considers some of the more important issues that negotiations between Brussels and the Eastern European countries may address as these visions are harmonized. The negotiations will be particularly sensitive because these two visions, taken together, may result in only the most technocratic dimensions of EC politics being extended Eastward while the East relates to the EC primarily as a developing and dependent economy. This is precisely the model of integration and the approach to politics which has proven least satisfactory elsewhere.

## II. PRIOR ECONOMIC RELATIONS BETWEEN THE EUROPEAN COMMUNITIES AND EASTERN EUROPE

The EC's current intentions toward Eastern Europe should be understood as the latest stage in an evolving history of EC-Eastern European trade relations.<sup>6</sup> Although the political and economic changes in 1989 and 1990 have no doubt caused the EC to accelerate its policy of improving its bilateral relations with the countries of Central and Eastern Europe, this process pre-dates recent upheavals. Indeed, the EC signed its first Eastern European trade agreement with Romania in 1980 without regard to the severe internal policies of Nicolae Ceausescu.<sup>7</sup> The EC's collective and economic focus has traditionally resulted in a certain distance between the bilateral political relations Member States were willing to pursue and the common trade policies developed in Brussels. Although the common policies have been used to foster foreign policy goals—most notably in applying sanctions and in certain enlargement negotiations—they remain distinct in the minds of policymakers. The relative autonomy of technocratic economic issues when pursued in Brussels continues to affect EC-Eastern European relations.

Prior to the 1980 agreement with Romania, no formal trade links existed between the EC and either Comecon or its Eastern European

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6. For a series of articles on EC-Eastern European trade relations, see *THE POLITICAL AND LEGAL FRAMEWORK OF TRADE RELATIONS BETWEEN THE EUROPEAN COMMUNITY AND EASTERN EUROPE* (M. Maresceau ed. 1989). See also Wellenstein, *The Relations of the European Communities with Eastern Europe*, in *ESSAYS IN EUROPEAN LAW AND INTEGRATION* 197 (D. O'Keeffe & H.G. Schermers eds. 1982); Nello, *Some Recent Developments in EC-East European Economic Relations*, 24 *J. WORLD TRADE L.* 5 (1990).

7. *Council Regulation 3338/80*, 23 *O.J. EUR. COMM.* (No. L 352) 1 (1980) (EC-Romania Agreement).

member countries beyond a limited number of sectoral agreements and common membership with Romania, Poland, Hungary and Czechoslovakia in the General Agreement on Tariffs and Trade (GATT).<sup>8</sup> Actual trade with these countries was also limited. In 1987, for example, the EC's total trade with these seven countries totaled 43.7 billion ECU while its total trade with Switzerland alone totaled 59.4 billion ECU.<sup>9</sup>

Following an initial period of hostility to European integration, Comecon made repeated efforts to commence direct negotiations for a comprehensive trade agreement with the EC. The EC refused on the basis that Comecon lacked the competence to conclude a trade agreement on behalf of its members.<sup>10</sup> Instead, the EC applied a trade regime to each of the countries of Eastern Europe which included a number of import restrictions and provided neither preferential treatment nor EC aid. It is perhaps ironic that Comecon's limited competence set in motion this country-by-country approach, in contrast to the collective approach urged upon the EFTA countries.

Romania's decision to break ranks with Comecon opened a second stage of EC-Eastern European relations. During this phase, Eastern European countries endeavored to "normalize" their trade and commercial relations with the EC through bilateral agreements independent of other Comecon members. Czechoslovakia and Hungary concluded such agreements in 1988, Poland and the Soviet Union (USSR) in 1989 and East Germany and Bulgaria in 1990.<sup>11</sup>

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8. The General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. (5), (6), T.I.A.S. No. 1700, 55 U.N.T.S. 194 [hereinafter GATT]. The GATT is reprinted in LAW AND PRACTICE UNDER THE GATT (K.R. Simmonds & B.H.W. Hill eds. 1989).

9. See COMMISSION DES COMMUNAUTÉS EUROPÉENNES, LES RELATIONS DE LA COMMUNAUTÉ EUROPÉENNE AVEC LE COMECON ET SES MEMBRES DE L'EUROPE DE L'EST 3 (Jan. 1989).

10. In contrast to the EC, Comecon does not direct a common commercial policy on behalf of its members.

Its precise competence as an international organization is a matter of considerable debate which has been considered elsewhere. See, e.g., Schweisfurth, *The Treaty-Making Capacity of the CMEA in Light of a Framework Agreement between the EEC and the CMEA*, 22 COMMON MKT. L. REV. 615 (1985); Nello, *supra* note 6, at 6-7; Note, *The Council for Mutual Economic Assistance and the European Community*, 84 AM. J. INT'L L. 284, 288 (1990). For our purposes, it is sufficient to say that Comecon does not have competence to conclude trade agreements on behalf of its members. Comecon has entered into agreements with several non-member countries which are generally intended to coordinate or facilitate trade relations between Comecon members and the third countries involved. Indeed, they generally lead to, or are simultaneous with, bilateral agreements between Comecon members and third countries. Intra-Comecon trade, while facilitated by multilateral framework agreements on how trade is to be conducted, including, in particular, the intra-Comecon currency exchange system, is governed in large part by bilateral conventions. The current system is in the process of being replaced in whole or in part by a hard currency trade regime.

11. See *Council Decision 89/215*, 32 O.J. EUR. COMM. (No. L 88) 1 (1989)

The focus of these agreements has been the elimination of commercial and legal barriers to trade.

Current EC-Eastern European relations have been built on these agreements. Indeed, despite the virtual end of communist regimes throughout Eastern Europe, so far there has been only modest progress beyond the trade agreement stage. For Poland and Hungary, "normalization" of trade relations has been virtually assured under the Poland/Hungary Assistance for Economic Restructuring (PHARE) program and the two countries have been granted certain preferential treatment and aid. For the remaining countries, as of this writing, the process of eliminating trade restrictions is still underway with aid only now forthcoming on the basis of the EC's recent decision to extend PHARE to Czechoslovakia, East Germany, Bulgaria and Yugoslavia.

As a prelude to an examination of the prospects for the integration of Eastern Europe with the EC, the next section considers the stages of EC-Eastern European relations in somewhat greater detail. It considers the autonomous regime applied pursuant to the EC's common commercial policy prior to the signature of any trade agreements, the implementation of "first" and "second" generation trade agreements and the PHARE program and related developments.

*A. The EC's Trade Regime for Eastern Europe Before Bilateral Relations: The Common Commercial Policy*

The EC's approach to trade with Eastern Europe prior to the recent changes differed from its approach to market economies in matters of form and detail but not in structure. The differences were more technical than political and their effects were felt primarily as special restrictions and duties on particular products, the traditional substance of technical trade disputes, rather than as a more dramatic ideological rupture. The atmosphere for resolution of these disputes

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(EC-Czechoslovakia Agreement); *Council Decision 88/595*, 31 O.J. EUR. COMM. (No. L 327) 1 (1988) (EC-Hungary Agreement); *Council Decision 89/593*, 32 O.J. EUR. COMM. (No. L 339) 1 (1989) (EC-Poland Agreement); *Council Decision 90/116*, 32 O.J. EUR. COMM. (No. L 68) 1 (1990) (EC-USSR Agreement). The East German and Bulgarian agreements had not been published in the *Official Journal* at the time of this writing nor was a second agreement concluded between the EC and Czechoslovakia signed in 1990. See *infra* notes 31-33 and accompanying text. The EC is expected to initial a new agreement on trade and commercial cooperation with Romania shortly.

Comecon itself accepted a more modest form of parity with the EC when the two organizations signed a joint declaration establishing official relations and agreeing to "develop cooperation in areas within their respective spheres of competence." 31 O.J. EUR. COMM. (No. L 157) 34 (1988). Ultimately, however, enhanced ties between the EC and Eastern Europe have resulted in a weakening rather than a strengthening of Comecon integration.

was often cold, but nothing in the structure of relations prevented resolution of these disputes, even absent revolutionary changes in the East.

Article 113 of the Treaty of Rome (EC Treaty),<sup>12</sup> pursuant to which the EC has exclusive competence to conduct a common external commercial policy on behalf of the Member States, provides the basis for its trade relations with Eastern Europe.<sup>13</sup> On the basis of article 113, Member States may not independently impose tariffs or quantitative restrictions on products originating in third countries. Further, they may not enter into voluntary export restraint or other trade agreements with third countries. This centralization of trade competence has led to the distance between Member State political alignments and the technically constituted EC commercial policy.<sup>14</sup> The importance of the common commercial policy is strengthened by articles 30 to 36 of the EC Treaty<sup>15</sup> which prevent a Member State from restricting the free movement of goods into its territory from other Member States even if the products are of third country origin.<sup>16</sup>

The EC's common commercial policy is pursued within the context of the GATT, which both permits customs unions and provides a framework for their trade relations with third countries. Within that framework, third countries are generally to be treated on a "most favored nation" (MFN)<sup>17</sup> basis, although some are given special "preferences" as part of the Generalized System of Preferences (GSP)<sup>18</sup> intended to assist developing countries. The GATT also

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12. Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 113, 298 U.N.T.S. 11 [hereinafter EC Treaty] (entered into force Jan. 1, 1958).

13. See, e.g., Criel Donckerwolcke v. Procureur de la République, Case 41/76, 1976 E. Comm. Ct. J. Rep. 1921. On the common commercial policy, see E.L.M. VÖLKER & J. STEENBERGEN, LEADING CASES AND MATERIALS ON THE EXTERNAL RELATIONS LAW OF THE E.C. (1985) (with emphasis on the common commercial policy); F. BURROWS, FREE MOVEMENT IN EUROPEAN COMMUNITY LAW (1987).

14. The Member States' existing bilateral arrangements with third countries can be maintained and renewed pursuant to a notification procedure contained in *Council Decision 69/494*, O.J. EUR. COMM. (NO. L 326) 39 (1969), to the extent that they do not conflict with the EC's common commercial policy. See Wellenstein, *supra* note 6, at 205-07; Puifferrat, *La CEE et les Pays de l'Est*, 273 REVUE DU MARCHÉ COMMUN [REV. M.C.] 25 (1984). For a discussion of the effect on the common commercial policy of existing bilateral trade restrictions contained in agreements between EC Member States and state-trading countries, see *infra* note 21.

15. EC Treaty, *supra* note 12, arts. 30-36.

16. On article 30 of the EC Treaty, see P. OLIVER, FREE MOVEMENT OF GOODS IN THE EEC UNDER ARTICLES 30 TO 36 OF THE ROME TREATY (2d ed. 1988). Article 115 of the EC Treaty also operates as an exception to the free movement of goods. See *infra* notes 19 and 22.

17. GATT, *supra* note 8, art. I, para. 1.

18. *Generalized System of Preferences: GATT Decision of 25 June 1971*, GATT Doc.

permits derogations in certain cases and provides for more restrictive treatment of state-trading countries. Non-GATT members benefit only from whatever bilateral arrangements they have negotiated. In general, the EC applies the same tariffs to imports from all third countries, including those in Eastern Europe, except those countries that have either negotiated special tariff reductions (such as Israel, Turkey and the EFTA countries) or those that participate in the GSP.

### 1. Quantitative Restrictions

The EC's approach to quantitative restrictions has traditionally differentiated third countries with market economies and those with state-trading economies. Significantly, however, a structurally similar institutional and legal process has been established for both systems. As a result, the main substantive difference was a greater willingness to penalize or exclude particular products from particular non-market economies. Once begun, negotiations have resembled trade disputes with other trading partners. As a result, "normalization" of trade relations with countries which had "joined the free market" could mean little more than the adjustment of a number of specific import restrictions—adjustments which had been under way on the basis of technical negotiations irrespective of ideological differences.

Member States of the EC are authorized to impose only a limited number of quantitative restrictions on their imports from market countries.<sup>19</sup> The continuing restrictions are primarily the result of certain grandfathered restrictions gradually being eliminated by the EC Council. This open regime is subject to two important general limitations. The EC Commission may, on its own initiative or at the request of a Member State, impose restrictions on products whose import would injure Community producers.<sup>20</sup> Such measures expire after three months absent further action by the EC Council. Where, following a request by a Member State, the Commission does not

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(L/3545), reprinted in GATT, BASIC INSTRUMENT AND SELECTED DOCUMENTS [B.I.S.D.] (18th Supp. 1972).

19. *Council Regulation 288/82*, 25 O.J. EUR. COMM. (No. L 35) 1 (1982), as periodically amended. The quantitative restrictions authorized under this regulation include specific restrictions (*i.e.*, those imposed on particular countries, such as a quota for Japanese cars) and non-specific restrictions which limit imports generally. They may be maintained until such time as they are prohibited by a qualified majority of the Council, although the Member States cannot unilaterally impose new restrictions. Under article 115 of the EC Treaty, a Member State may obtain authorization from the Commission to limit imports of non-EC goods into its territory from other Member States when national restrictions sanctioned under the common commercial policy are being circumvented through the free movement of goods from other Member States which cause serious economic difficulties for the Member State applying the restrictions. *See, e.g.*, E. MCGOVERN, INTERNATIONAL TRADE REGULATION 200 (1986).

20. *Council Regulation 288/82*, *supra* note 19, art. 11 and accompanying text.

submit a proposal for Council action, a Member State may act unilaterally to restrict imports on an interim basis or in accordance with a bilateral agreement between it and the third country in question. Furthermore, as a matter of EC law, the EC can impose Community-wide quotas, although this is unlikely to be done except perhaps in highly sensitive sectors such as steel, textiles or automobiles for which imports are currently limited by bilateral and multilateral voluntary export restraint agreements.

The Member States have been authorized to maintain a much greater number of specific quantitative restrictions on imports from state-trading countries.<sup>21</sup> A Member State maintaining such a quantitative restriction might limit imports of these goods directly into its territory from the third country in question. It may not restrict imports of these goods which have lawfully entered another Member State, except in accordance with a specific measure under article 115 of the EC Treaty.<sup>22</sup> In addition, the Commission is required to consider the economic characteristics peculiar to state-trading countries when reviewing requests by Member States to impose surveillance or protective measures. The basis for these additional safeguards and restrictions is the presumed potential for state-trading countries to harm EC industries by rapidly increasing exports in accordance with centralized planning decisions not dependent on market forces. The EC has not specified the characteristics of a state-trading country, but has simply indicated that the restrictions permissible under this regime apply to the Comecon countries (other than Cuba), Albania, North Korea and the People's Republic of China.<sup>23</sup>

The restrictions on direct imports from state-trading countries are fixed annually by the Council. The quotas imposed by the Member States have been gradually increased, or the restrictions eliminated entirely. Member States may request that the Commission impose or reduce import restrictions on an expedited basis and, in

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21. *Council Regulation 3420/83*, 26 O.J. EUR. COMM. (No. L 346) 6 (1983), as periodically amended (a separate regulation exists for the People's Republic of China). These restrictions are taken in large part from prior bilateral trade arrangements between Member States and state-trading countries. See Wellenstein, *supra* note 6, at 201-02. According to one commentator, Member States resisted the transfer of authority to the EC under the common commercial policy with respect to trade with state-trading countries. As a result, "rather than trying to harmonize [the Member States'] restrictions, they were incorporated *en bloc* and virtually unchanged into Community legislation." Nello, *supra* note 6, at 15.

22. EC Treaty, *supra* note 12, art. 115. See *supra* note 19. The Member States have made extensive use of Article 115 to limit imports from other Member States of products of state-trading country origin. See Nello, *supra* note 6, at 16.

23. See *Council Regulation 288/82*, *supra* note 19, art. 1; *Council Regulation 3420/83*, *supra* note 21, art. 1; *Council Regulation 1765/82*, art. 1, 25 O.J. EUR. COMM. (No. L 195) 1 (1982).

urgent cases, may act pending a decision of the Commission. Commission decisions are subject to Council review in the same manner provided for non-state economy countries.<sup>24</sup>

The EC's tolerance of significant quantitative restrictions imposed by the Member States has until recently applied equally to all Comecon countries, notwithstanding the GATT membership of Czechoslovakia, Hungary, Poland and Romania. Quantitative restrictions are permitted by the protocols of GATT accession for Hungary, Poland and Romania, as an exception to the general prohibition against quantitative restrictions contained in article XI of the GATT.<sup>25</sup> However, progress on the EC's elimination of quantitative restrictions imposed by its Member States has been clearly slower than contemplated at the time of Hungary, Poland and Romania's accession to GATT. In the case of Czechoslovakia, one of the original GATT signatories, there is no explicit justification for the EC's continued application of quantitative restrictions.

## 2. Anti-Dumping

Besides quantitative restrictions, the EC's anti-dumping rules, applicable to imports from both market and non-market economies, have placed the greatest burden on exports from Eastern Europe. The reason for this disparity is that EC producers have easily been able to argue that the lower prices at which products from Eastern Europe are sold in the EC are not determined by market forces and should therefore be subject to an anti-dumping duty. The EC's basic anti-dumping legislation establishes specific rules for imports from state-trading countries.<sup>26</sup> As in the EC's quantitative restrictions legislation, there is no definition of "state-trading country," but rather a list which includes all of the Eastern European Comecon countries.

The most important point to be noted is that the greatest difference between the approaches taken by the EC to market and non-market economies involves a method of technical calculation. In determining the "normal" value of a good for comparison with its sales price to determine if the product was dumped, the Commission or Council may select the price at which a like product is sold by a

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24. See Council Regulation 3420/83, *supra* note 21; Council Regulation 1765/82, *supra* note 23.

25. GATT, *supra* note 8, art. XI. For a discussion of the Hungarian protocol of GATT accession, see *infra* notes 40-45 and accompanying text.

26. Council Regulation 2423/88, 31 O.J. EUR. COMM. (NO. L 209) 1 (1988). For a general discussion of the special rules applied to state-trading countries in EC anti-dumping proceedings, see J.F. BESELER & A.N. WILLIAMS, *ANTI-DUMPING AND ANTI-SUBSIDY LAW: THE EUROPEAN COMMUNITIES* 64-73 (1986). For the rules used by the United States, see Jackson, *State Trading and Nonmarket Economies*, 23 INT'L LAW. 891, 904-08 (1989).

market economy producer in either the exporter's domestic market or in a third country, the constructed value of a like product in a market economy, or the Community price for a like product.<sup>27</sup> Prices on the exporter's home market for like products are rarely selected as the normal value because of the presumption that these prices are subsidized. As a result, prices or constructed values in market countries are generally selected, leaving the Eastern European exporters with little input in this determination. Since the third country selected is often more developed than the Eastern European country concerned, the advantages of lower wages and other production costs that the Eastern European producers are likely to enjoy can be eliminated.

As in the case of quantitative restrictions, negotiations on normalization with the newly created free market economies may ease these potential negative effects for specific exports. In any event, the EC has traditionally used the anti-dumping proceedings as a tool of industrial policy in both market and state-trading situations.<sup>28</sup> Thus, in the technocratic environment within which anti-dumping decisions are made, particular dumping determinations will continue to depend upon a variety of factors in particular cases, rather than upon any general ideological shift on the part of the exporting nation. Improved ties with the EC may enhance the Eastern European countries' input into the EC anti-dumping process, and the Commission may reduce its anti-dumping measures activity with respect to Eastern European products as a form of indirect aid. Such a policy could then be reversed if, for example, Korean and Japanese companies were to exploit the relaxation of trade restrictions on Eastern European products and the low cost of production in Eastern European countries to supply the EC market from new operations in Eastern Europe.

#### *B. EC-Eastern European Trade Agreements*

The central theme of the trade agreements between the various Eastern European countries and the EC is the elimination of EC quantitative restrictions on imports from these countries. This is true regardless of whether the agreements were negotiated prior to or after

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27. *Council Regulation 2423/88*, *supra* note 26, art. 2.

28. For example, *Council Regulation 2423/88*, *supra* note 26, contains provisions authorizing the imposition of anti-dumping duties on imports of component parts which are incorporated into finished products through so-called "screwdriver" assembly operations in the Community. This authority has been used by the Commission to compel foreign and, in particular, Japanese manufacturers to use a greater percentage of EC components in their finished products assembled in the Community although a recent GATT panel decision has found these provisions inconsistent with the EC's GATT obligations.

the governmental changes. Prior to the EC agreements with the USSR, East Germany and Bulgaria, all parties to the agreements were GATT members and the agreements sought to resolve the problem of quantitative restrictions largely in the manner already provided for under GATT. The agreements with these three non-GATT members apply a similar approach.

From the EC's perspective, the trade agreements purport to assure its producers access to Eastern European markets. In fact, the key legal barriers to EC exports to Eastern Europe are the import licensing systems authorized under GATT and used by various Eastern European countries to limit their balance of payments deficits, and the Coordinating Committee (CoCom)<sup>29</sup> restrictions on the export of certain products to Eastern Europe. Hungary is the only Eastern European country which has significantly liberalized its import licensing system.<sup>30</sup> It did so as part of a general economic reform, rather than in response to obligations under its trade agreement with the EC. Similarly, the loosening of CoCom restrictions is not coming about in the context of trade negotiations. In any event, non-legal barriers to EC exports to Eastern Europe and, in particular, the lack of convertible currency in Eastern Europe, are more important than any legal barriers.

Because the EC negotiates trade matters individually with each Comecon country, relations between the EC and Eastern Europe have not been uniform. Czechoslovakia and Romania signed so-called "first generation" trade agreements which cover only industrial products and did not contain a firm commitment to eliminate all

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29. CoCom is a voluntary organization composed of representatives from the NATO countries (excluding Iceland and Spain) and Japan. It was formed in 1950 to control the export of goods and technology which may contribute significantly to the military potential of Communist countries. CoCom export restrictions, which must be adopted unanimously and for which implementation is up to the members, can be incorporated into three lists: the International Atomic Energy List, the International Munitions List and the International List. See, e.g., Hunt, *Multilateral Cooperation in Export Controls - The Role of CoCom*, 14 TOLEDO L. REV. 1285 (1983). The International List is of most importance for exports to Eastern Europe because it contains so-called "dual-use" (military and non-military) items which enables the breadth of the CoCom restrictions to be quite broad. As a result, this list has been the most controversial because it is a barrier to exports of basic technology, such as in the areas of telecommunications and electronics sectors, necessary for the economic modernization process in Eastern Europe. In June 1990, a number of CoCom restrictions were abolished. See *infra* note 58 and accompanying text.

30. See Naray, *The End of the Foreign Trade Monopoly - The Case of Hungary*, 23 J. WORLD TRADE L. 85 (1989). Indeed, Hungary's reform process was well underway at the time it signed its trade agreement with the EC in 1988. See also Martonyi, *La Décentralisation du Système de Commerce Extérieur en Hongrie*, 1988 REVUE INTERNATIONALE DE DROIT ECONOMIQUE [REV. INT. DR. EC.] 191; Naray, *Hungarian Trade Reform*, 20 J. WORLD TRADE L. 274 (1986).

discriminatory quantitative restrictions set by these countries on exports to the EC.<sup>31</sup> The EC signed "second generation" trade and commercial cooperation agreements first with Hungary in 1988 and with Poland in 1989.<sup>32</sup> The USSR, East Germany, Czechoslovakia and Bulgaria signed second generation accords with the EC in 1990 and the EC and Romania have initialed a second generation accord.<sup>33</sup> These agreements cover all products other than textiles and European Coal and Steel Community (ECSC)<sup>34</sup> goods and contain a firm commitment for the abolition of quantitative restrictions by a certain date. In addition, the agreements establish joint committees to consider commercial cooperation possibilities. East Germany stands apart from this third group of countries because of its special trade relationship with West Germany, and the impending reunification of Germany.

### 1. First Generation

The agreement on trade in industrial products between the EC and Romania (EC-Romania Agreement) entered into effect in 1981.<sup>35</sup> The obligations of each party primarily reflect those assumed under GATT. In particular, the EC agreed gradually to reduce quantitative restrictions against Romanian imports authorized by Romania's GATT Protocol of Accession. The agreement incorporates a list of priority products for which the EC agreed to lift quantitative restrictions immediately. Subsequent liberalization has been negotiated in the context of an EC-Romania joint committee. In addition, Romania was, until the PHARE program, the only Eastern European country to benefit from the GSP regime. In exchange for these commitments from the EC, Romania agreed to increase and diversify its imports of EC products at the same rate as for other GATT contracting parties, including several Comecon countries. In addition, the Romanian authorities undertook to ensure that Romanian goods were delivered in the EC at "market-related prices."<sup>36</sup>

Romania's aggressive export policy and limitations on internal consumption, coupled with the reduction in restrictions made by the EC under the trade agreement, led to a consistent surplus of

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31. *See supra* notes 6, 7 & 11.

32. *See supra* note 11.

33. *Id.*

34. The ECSC was created pursuant to the Treaty Establishing the European Coal and Steel Community, Apr. 18, 1951; 261 U.N.T.S. 140.

35. *See* EC-Romania Agreement, *supra* note 7.

36. *Id.* art. 7.

Romanian exports to the EC over imports from the EC.<sup>37</sup> This fact, together with the greater attention given by many EC Member States in recent years to human rights abuses under the Ceaucescu regime, prevented Romania from obtaining the complete elimination of EC discriminatory quantitative restrictions and a commitment by the EC to negotiate a commercial cooperation agreement. The overthrow of Ceaucescu immediately led to humanitarian aid from the EC, but Romania still awaits the implementation of trade concessions and economic assistance by the EC.<sup>38</sup>

## 2. Second Generation

After long negotiations, the EC-Hungary Agreement entered into force on December 1, 1988.<sup>39</sup> The agreement reflects progress toward a second generation agreement in three ways. First, it establishes a timetable for the elimination of quantitative restrictions against Hungarian exports to the EC. Second, it creates a framework for trade negotiations on agricultural products. Finally, it includes a commitment to commercial cooperation between Hungary and the EC.

The basis for the EC-Hungary Agreement is the EC's lack of progress in eliminating discriminatory quantitative restrictions on Hungarian exports to the EC following Hungary's accession to GATT.<sup>40</sup> At the 1986 review of Hungary's accession to GATT, the Hungarian delegation contended that the EC had only eliminated ten percent of the quantitative restrictions applied by its Member States to Hungary.<sup>41</sup> In contrast, as early as 1975, all the GATT contracting parties other than the Members States of the EC, Norway and Sweden indicated that they applied no discriminatory quantitative restrictions

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37. See Leskovsek, *U.S.-Romanian Trade: Foreign Debt, Trade Barriers, and Future Problems and Prospects*, 21 *LAW & POL'Y INT'L BUS.* 71, 77-80 (1989).

38. See *infra* note 55 and accompanying text.

39. See *supra* note 11.

40. Article 4 of the Hungarian Protocol of Accession to the GATT reads:

(a) Contracting parties still maintaining prohibitions or quantitative restrictions not consistent with Article XIII of the General Agreement on imports from Hungary shall not increase the discriminatory element in these restrictions and undertake to remove them progressively.

(b) If, for exceptional reasons, any such prohibitions or restrictions are still in force as of 1 January 1975, the Working Party . . . will examine them with a view to their elimination.

20 B.I.S.D. 3 (1974).

41. 33 B.I.S.D. 136, 139 (1986). For a more detailed discussion of consultation under GATT with respect to EC quantitative restrictions on Hungarian imports, see Van den Bossche, *GATT: The Indispensable Link Between the EEC and Hungary*, 23 *J. WORLD TRADE L.* 141, 144-50 (1989).

against Hungary.<sup>42</sup> The 1988 agreement resolved this issue by adopting a schedule for the abolition of the quantitative restrictions permitted by Hungary's Protocol for Accession to GATT, with the last restrictions to be abolished by the end of 1995.<sup>43</sup>

Consistent with the terms of Hungary's GATT accession, the EC did not require Hungary to commit to increasing its imports from the EC. Hungary does not impose specific quantitative restrictions on EC goods and is required to administer its tariff system in a manner consistent with its GATT obligations. Accordingly, the EC obtained a promise that Hungary would administer both its import licensing system, sanctioned under GATT because of its balance of payments deficit, and its global quota for consumer goods in a non-discriminatory fashion.<sup>44</sup>

In the agricultural sector, the agreement contains a simple covenant for a joint EC-Hungary committee to consider "the possibility of granting each other reciprocal concessions on a product-by-product basis."<sup>45</sup> Although this provision is not a legally enforceable obligation, the trade agreement appears to be a framework pursuant to which the EC is prepared to consider reducing the application of tariffs, levies and quantitative restrictions on Hungarian agricultural exports in contrast to its generally conservative approach to agricultural trade matters.

The EC-Poland Agreement, which entered into effect on December 1, 1989, as well as the EC's 1990 agreements with the USSR, East Germany, Bulgaria and Czechoslovakia, closely parallel the EC-Hungary Agreement.<sup>46</sup> Article 9 of the EC-Poland Agreement provides for the EC, "subject to exceptions, progressively and regularly to increase . . . quotas with a view to elimination by the end of 1994 of the quantitative restrictions" authorized by the Polish GATT Protocol of Accession.<sup>47</sup> Poland did not waive its right to deviate from its substantially equivalent trade obligations following the reinstatement of qualitative restrictions by the EC.

In the case of the EC-USSR Agreement, the EC agreed to

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42. 22 B.I.S.D. 54, 57 (1975).

43. EC-Hungary Agreement, *supra* note 11. In contrast to the EC-Romania Agreement, the EC-Hungary Agreement includes both a general and a special safeguard clause. The special clause permits the EC to reinstate quantitative restrictions following expedited consultations if EC producers suffer or are threatened with material injury from imports of a product for which restrictions were abolished under the agreement without Hungary having the corresponding right contained in the general clause to deviate from its free trade obligations.

44. *Id.* art. 10.

45. *Id.* art. 6.

46. *See supra* note 11.

47. EC-Poland Agreement, *supra* note 11, art. 9.

eliminate all discriminatory quantitative restrictions (outside the ECSC, textile and agricultural sectors) by the end of 1995 except for "those concerning a limited number of products which might be deemed to be sensitive."<sup>48</sup> Unlike the EC's agreements with Poland and Hungary, the EC and the USSR did not make a specific commitment to achieve mutual concessions with respect to agricultural products, although the agreement is generally applicable to agriculture. The EC has therefore indicated its intentions to act more cautiously in reducing barriers to Soviet products than it did with respect to Poland and Hungary.

The EC-USSR Agreement is of particular significance because the USSR is not a GATT member. Thus, while the MFN treatment promised by the parties in the Romanian, Czechoslovakian, Hungarian and Polish agreements was merely a reiteration of an obligation already assumed under GATT, it has greater legal significance in the EC-USSR Agreement. Similarly, the EC's commitment to reducing discriminatory quantitative restrictions imposed on Soviet products by the end of 1995 is more than the fixing of a date by which it agrees to fulfill its obligations under the GATT Protocols of Accession. It is noteworthy, therefore, that the USSR, unlike Hungary, did not waive its right to deviate from its obligations in respect of substantially equivalent trade in the event that the EC re-imposed any quantitative restrictions lifted in accordance with the agreement. As with the recent EC-Czechoslovakia Agreement, the arrangement includes an agreement between the European Atomic Energy Community (Euratom) and the Soviet Union on cooperation in matters relating to nuclear energy.

### 3. East Germany

The quantitative restrictions imposed by the EC Member States on East German goods have been less detrimental to East German exports than those imposed on goods of other East European countries. East German products have been accepted into West Germany, the EC's largest market, on a strictly regulated basis and treated as domestic products pursuant to West Germany's Basic Law.<sup>49</sup> This practice is recognized by the EC Treaty's Protocol on Inner German Trade.<sup>50</sup> Shortly before the East German elections in March 1990,

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48. EC-USSR Agreement, *supra* note 11, art. 11.

49. GRUNDGESETZ [GG] (W. Ger. 1949, amended 1973).

50. EC Treaty, *supra* note 12, Protocol Relating to German Internal Trade and Connected Problems. In principle, East German goods exported to West Germany are in free circulation in the Community and Member States do not have recourse to article 115 of the Treaty of Rome to request protective measures from the Commission. Article 3 of the Proto-

the EC and East Germany agreed on a trade and commercial cooperation pact modeled on the second generation agreements between the EC and Hungary, Poland and the USSR.<sup>51</sup> A more important development, however, has been the clear choice by the East German voters of immediate union with West Germany and the acceleration of this process both at the German and EC levels. As a result, trade and aid are increasing together with the creation of a common German monetary system as of July 1, 1990 and the extension of the freedoms and policies of the EC Treaty.<sup>52</sup> The financial and bureaucratic resources involved, although still a matter of estimate, are certain to be much greater than the trade concessions and aid packages offered to the other Eastern European countries. The East German situation is interesting as a demonstration of what can be done to integrate and stabilize a Community neighbor.

### C. *Initiatives After the Governmental Changes: PHARE*

Just a few months after concluding long negotiations with Hungary and Czechoslovakia, and in the middle of negotiations with Poland over the reduction of the EC's specific quantitative restrictions, the EC was faced in July 1989 with a new non-Communist government in Poland and with widespread speculation that Hungary was preparing to apply for EC membership. President François Mitterand of France concluded that the celebration of the French Revolution and the beginning of the French Council Presidency on July 14 in Paris should be capped by a meeting of the leading industrialized nations to permit the EC to take the lead on Eastern Europe.

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col, however, permits a Member State to take "appropriate measures . . . to prevent any difficulties arising for it" from this flow of goods. The Court of Justice of the EC recently held that this does not entitle Member States to prohibit all imports from West Germany of East German goods because they could not show that the imports caused an injury to their economies "as a whole." *Schäfer Shop B.V. v. Minister van Economische Zaken*, Case 12/88, 32 O.J. EUR. COMM. (No. C 266) 6 (1989) (court's holding, full case not yet published). It held instead that Member States could impose an import licensing requirement on East German goods imported into the Community through West Germany. Licenses could be refused only if this were the only means to prevent injury to domestic producers in the relevant sector. West Germany has made this injury less likely to occur by maintaining most East German goods in West Germany and by forbidding exports of East German goods to other Member States except at market prices.

51. The agreement was signed in May 1990. The trade aspects of the agreement do not affect East-West German trade.

52. These include implementation of measures regarding the right of establishment, the freedom to provide cross-border services, the free movement of capital, the free movement of workers, the free movement of goods, transport policy, regional development, state aids and public monopolies. Because East Germany will become part of the EC through unification with West Germany, the transitional measures to be negotiated are likely to be somewhat different than those previously adopted with respect to Ireland, Greece, Spain and Portugal.

At the summit, the EC Commission was given a mandate to coordinate aid for Poland and Hungary on behalf of all the countries of the Organization for Economic Cooperation and Development (OECD)<sup>53</sup> under the Poland/Hungary Assistance for Economic Restructuring (PHARE) program.<sup>54</sup>

In February 1990, the OECD countries decided that the aid programs would in principle be extended to include Czechoslovakia, East Germany, Romania, Bulgaria and Yugoslavia, subject to continued progress in economic and political reform in those countries. This wait-and-see approach primarily required each country to establish economic restructuring programs sanctioned by the International Monetary Fund (IMF) and to undergo successfully the transition to a government selected through multi-party elections. However, it was not until the EC summit in Dublin, Ireland in June 1990 that the EC Council actually approved extension of PHARE. In a reversal of its earlier policy, the EC is also considering the possibility of aid to the USSR.<sup>55</sup>

The PHARE program is significant in two respects. First, the program unifies a variety of quite different initiatives and places Brussels at the center of relations with the East. Although the OECD countries meet regularly to discuss PHARE initiatives, the EC's aid programs are primarily being determined and implemented independent of the OECD process, with EC procedural rules often attached as conditions. This approach recognizes the importance of the EC as a "pole of attraction" for the Eastern countries, while fixing Western initiatives within the technocratic and unification-oriented political processes in Brussels.

Second, the PHARE program offers the Eastern countries precisely the mix of trade concessions, aid and investment guarantees that were available as models from pre-existing EC negotiations with

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53. The member countries of OECD are Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States, with Yugoslavia having special status. Convention on the Organization for Economic Co-operation and Development, Dec. 14, 1960, 12 U.S.T. 1728, T.I.A.S. No. 4891.

54. The various measures which make up the PHARE program are described in Sarat, *L'Assistance de la Communauté à la Pologne et à la Hongrie*, 333 REV. M.C. 14 (1990). See also Krenzler, *Die Europäische Gemeinschaft und der Wandel in Mittel- und Osteuropa*, 45 EUROPA ARCHIV 89 (1989).

55. In response to recent political events, the decision requires further action for extension to Romania. EC officials have been particularly hesitant about extending the PHARE program to Romania because of concerns that the current government is not committed to a non-communist political and economic system. The EC and Romania have initialed a second generation trade agreement. Furthermore, Romania has already benefitted from EC food aid.

the East and with developing countries. Despite the bureaucratic and monetary costs involved, this initial program sets relations between the East and West in Europe on a path of continuity and provides for only modest integration (excluding the case of East Germany).

The PHARE program is a grab bag of initiatives ranging from emergency food aid to Poland to the establishment of a European Bank for Reconstruction and Development (EBRD). The most significant achievement of the PHARE program to date is the reduction or elimination of the EC's historical barriers to, and in certain cases, the granting of special treatment in favor of, Polish and Hungarian products exported to the EC. The PHARE program has surpassed the EC's trade agreements with Poland and Hungary by abolishing all specific quantitative restrictions imposed by the Member States on Hungarian and Polish products (excluding textiles and agricultural products as well as goods governed by the ECSC).<sup>56</sup> This change gives Poland and Hungary treatment equal to that accorded to most of the EC's other GATT trading partners.

In addition, the EC adopted a regulation suspending for 1990 the application by the Member States (other than Spain and Portugal) of non-specific quantitative restrictions on Polish and Hungarian goods.<sup>57</sup> This regulation puts Hungary and Poland in a better trading position than most of the EC's other GATT trading partners for exporting products for which Member States maintain quantitative restrictions, such as cars, shoes and toys. Also in the context of PHARE, the EC has extended to Poland and Hungary the GSP system of preferential tariff concessions on imports from developing countries.<sup>58</sup>

Outside of the trade area, much of the EC aid currently being made available is either emergency food and medical assistance or

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56. *Council Regulation 3381/89*, 32 O.J. EUR. COMM. (NO. L 326) 6 (1989). The Regulation became effective January 1, 1990. Similar initiatives are now planned for the other Eastern European countries (except Romania and the USSR) in connection with the extension of PHARE.

57. *Council Regulation 3691/89*, 32 O.J. EUR. COMM. (NO. L 362) 1 (1989). Non-specific quantitative restrictions are those imposed on the EC's other trading partners.

58. *Id.* For example, the quotas imposed by France on imports of Hungarian color televisions were abolished by this regulation even though the trade agreement may have allowed them to remain in place for several more years. Separate negotiations have yielded some results with respect to quotas for imports of Eastern European products in the agricultural, textile, coal and steel sectors.

In another trade development not technically part of PHARE, at its June meeting, the CoCom members voted to eliminate a large number of categories of items from the restricted list altogether and eased restrictions even more for Hungary, Poland and Czechoslovakia. East Germany will be subject to very few restrictions for the period prior to political union with West Germany.

direct loans to Poland and Hungary.<sup>59</sup> The EC initially committed three hundred million ECUs for Poland and Hungary in 1990. A significant portion of these funds are being used to purchase agricultural products in the EC at market prices for shipment to Poland. Local proceeds from the sale of the food, which is donated by the EC, are being used to establish counterpart funds to finance the modernization of local agricultural production.<sup>60</sup>

The remainder of these aid funds are being divided among grants for industrial "infrastructure," training programs and environmental projects. The Hungarian and Polish governments will identify infrastructure projects to be funded. The Hungarian and Polish joint venture laws give some indication as to which projects Hungary and Poland are likely to select. For example, the Hungarian joint venture law gives special tax benefits to joint ventures in, among others, the pharmaceutical, electronics, packaging, machine tools and waste recycling fields.<sup>61</sup> An *ad hoc* EC committee chaired by the Commission is responsible for awarding the aid and EC tender rules are applied to awarding the related contracts. The Commission's proposal regarding public procurement in the transportation, water, energy and telecommunications sectors, requires EC Member States to favor a bid by an EC company which is no more than three percent higher than an equivalent bid by a non-EC company. This proposal indicates that EC companies will have an inside track to obtaining these funds.<sup>62</sup>

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59. The EC is implementing a US \$1 billion medium term loan program for Hungary (*Council Decision 90/83*, 33 O.J. EUR. COMM. (No. L 58) 7 (1990)) and several Member States will participate in a \$1 billion zloty stabilization fund for Poland.

60. *Council Regulation 3906/89*, 32 O.J. EUR. COMM. (No. L 375) 11 (1989). Romania is also receiving emergency food assistance although not technically as part of the PHARE program. *Council Regulation 282/90*, 33 O.J. EUR. COMM. (No. L 31) 1 (1990). More EC money will be committed soon in connection with the extension of PHARE to the other Eastern European countries.

61. Act XXIV of 1988 on the Investment of Foreigners in Hungary § 15 [hereinafter *Hungarian Foreign Investment Act*] (effective as of Jan. 1, 1989), reprinted in UNITED NATIONS ECONOMIC COMMISSION FOR EUROPE, EAST-WEST JOINT VENTURE CONTRACTS 107 (1989) [hereinafter *EAST-WEST JOINT VENTURES*].

62. 32 O.J. EUR. COMM. (No. C 264) 22 (1989). The EC has also agreed to guaranty one billion ECUs in loans to be made by the European Investment Bank (EIB) over a three-year period. Much of these funds will be committed to major public projects in such sectors as transport, energy and telecommunications. Private companies will also have access to the funds on the basis of normal EIB rules. Smaller projects will be funded pursuant to lines of credit advanced to banks in Poland and Hungary. Joint venture and other private companies in these sectors would presumably only have access to these funds when awarded a contract through the tendering process. On a long term basis, the EC has taken the lead on the establishment of a European Bank for Reconstruction and Development (EBRD), which promises to become a major source of financing for joint ventures and development projects in Eastern Europe. EBRD's membership includes, *inter alia*, all the OECD countries and eight Eastern

The PHARE program illustrates that the EC is prepared to relinquish trade barriers against Eastern European products, except perhaps in certain "sensitive" sectors such as agriculture, textiles, coal and steel. Outside of the trade area, however, the EC appears unable to find a coherent, programmatic expression of its view that the opportunity has arrived to reverse the post-World War II division of Europe through bold action. The PHARE initiatives contain few surprises and repeat many aspects of prior development programs, including lengthy bureaucratic procedures for each ECU spent and a bias toward purchases of EC agricultural surpluses.

### III. INTEGRATING EASTERN EUROPE: THE VIEW FROM BRUSSELS

In his January 1990 address to the European Parliament, Commission President Jacques Delors described the Community as a "lodestar" for the transformation of the totalitarian regimes in Eastern Europe.<sup>63</sup> Indeed, there is no doubt that integration into the EC is a great attraction for the current leaders and peoples of Poland, Hungary and Czechoslovakia, who are nostalgic for pre-World War II Europe and are not fully aware of the complex technocratic political apparatus which has been built in Brussels over the past thirty years. Likewise, for a number of Western non-members, led by Austria, membership in the EC has also recently been perceived as the only response for outsiders to the economic pull of a growing internal market.<sup>64</sup>

On the other hand, EC officials initially gave the impression that it would have been much more convenient had Eastern Europe waited until the official completion of the internal market at the end of 1992 to shake off the Stalinist yoke. In recent months, it appears that much of the EC's collective energy is focused on Eastern Europe and yet an institutional cautiousness remains, particularly on matters of trade and political integration. The EC has set an ambitious agenda for removing internal barriers to trade, creating economic and monetary union as well as setting an unofficial goal of making inroads into U.S.

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European countries. The EC and its Member States would hold a slightly larger than majority share with the Commission holding 3% on behalf of the Community and EIB itself holding a 3% share. EBRD would make loans for both public and private projects with a 40% cap on public lending. A formula has been agreed upon limiting the USSR's access to EBRD funding over an initial period.

63. *Presenting the Commission's Programme for 1990*, speech by Jacques Delors to the European Parliament, in Strasbourg, France (Jan. 17, 1990).

64. The Commission is now reviewing Austria's application for EC membership in order to render its opinion.

and, to an even greater extent, Japanese competitive advantages. From this perspective, the demands by Eastern Europeans for participation in putatively "Western" institutions pose a problem.

The problem is not simply the geopolitical dilemma that movement too far toward the West may destabilize a series of delicate national and ideological accommodations between Berlin and the Urals. It is also not simply that West Germany may be distracted from the project of Europe-building, or that deeper unification may be undone once again by the temptations of breadth, although these are real concerns. Nor is the problem simply the anticipation that the political balance between right and left in Western Europe would be unsettled were membership expanded eastward. The problem is that Eastern reformers have been demanding a form of democracy and a form of market freedom which the EC has increasingly abandoned for a more technocratic political culture and industrial policy.

It is ironic that the European Communities' 1992 program should coincide with demands for mass democracy in Eastern Europe. Precisely as Eastern Europeans demand more democratic political forms at home, the EC has bid the cumbersome legislative, judicial and administrative structures of national democratic government farewell for a more flexible and technically sophisticated approach to government. As a result, the Western European response to developments in the East shows a mix of encouragement and anxiety, for the democracy of mass parties in both its Western and Eastern form seems strangely antiquated.

For all these reasons, Western Europeans are right to be wary about admitting new members from the East, and the range of *ad hoc* measures they have proposed may well suit their own unification aims. At the same time, however, it has been difficult for those outside the EC to imagine a form of association not dominated either by the objective of EC membership or by the acceptance of the particular trade and aid concessions currently being advanced.

The EC has said that the countries of Eastern Europe are neither politically nor economically prepared for EC membership. Instead, it has proposed association agreements with each of the countries of Eastern Europe, other than the Soviet Union, achieving an unspecified level of political and economic reform. The precise nature of the "association" relationship remains vague. It has been described as the basis for the establishment of a "free trade zone" and for the extension of EC aid. The EC has stressed that association would not determine any eventual application for EC membership.

“Association” is provided for in article 238 of the EC Treaty.<sup>65</sup> In the past, this term has had different meanings for different countries. For Greece, association was intended to and did serve as a prelude to EC membership. Association is, however, neither a prerequisite to, nor a guaranty of, EC membership. Countries at a similar level of economic and legal development with the other Member States, such as the United Kingdom and Denmark, attained membership without any apprenticeship. In contrast to Greece, the twenty-five year old EC-Turkey association agreement (EC-Turkey Association Agreement) has functioned primarily as a preferential trade agreement, with some direct financial aid for infrastructure projects in Turkey. Although of more limited scope than the EC-Turkey Association Agreement, the EC’s preferential trade agreements with other neighboring countries, including Israel, Yugoslavia and the so-called Maghreb and Mashrak countries, have had similar results in practice.<sup>66</sup>

Association, therefore, is simply the architectural title given by the EC to its future initiatives with respect to Eastern Europe. The promise of association agreements does not itself constitute a coherent program. Everyone agrees that there is no formula for undoing forty years of totalitarianism and planned economies to enable the countries of Eastern Europe to participate in a world economy dominated by market economies. However, framing the problem in this way easily leads to misunderstanding, for the situation in the Eastern European countries is neither uniform nor simply marked by government presence in the economy, any more than Western economies are uniformly developed or innocent of government.

Each Eastern European country is, to a greater or lesser extent, substantially industrialized, while at the same time completely unprepared to compete with the West because of technological underdevelopment, lack of experienced managers, chronic indebtedness, severe balance of payment deficits and intrusive legal rules regarding economic operations. Moreover, Eastern Europeans have never experienced the mass-marketing of consumer goods that has been experienced by the Western public since World War II.

These semi-industrialized countries, conscious of their cultural affinity and economic attraction to Western Europe, might use negotiations with the EC as an opportunity to address the *sui generis* nature of these economic problems, rather than responding primarily to the

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65. EC Treaty, *supra* note 12, art. 238.

66. The Maghreb countries are Tunisia, Morocco and Algeria and the Mashrak countries are Lebanon, Syria, Jordan and Egypt.

unification-motivated Western proposals. To establish a framework for integration, this article briefly considers four different examples of relations between the EC and third countries: accession, the EC-EFTA free trade agreements and the prospective establishment of the European Economic Space (EES), the EC-Turkey Association Agreement, and the Lomé Convention.

*A. Enlargement: Integration Through Membership*

Membership has been the traditional means to integrate neighboring countries into the EC. Britain, Denmark, Ireland, Spain, Portugal and Greece have been admitted as members since the formation of the Community.<sup>67</sup> The membership process has been used to integrate neighbors of varying levels of development, with greater and lesser degrees of political and democratic stability and experience. Indeed, for Spain, Greece and Portugal in particular, membership has been seen as a tool to solidify democratic and free market commitments and to bring about economic development.

EC membership permits a country to participate in the decision-making processes of the Communities while subjecting it to the growing body of Community law and policy administered in Brussels. The participation of the new member is a structural one and, as a result, microeconomic and regulatory processes are more important than simple trade and aid concessions. The key is acceptance of existing Community legislation and the extension of the EC Treaty's freedoms and policies to the territory of the new member. Moreover, a member may receive huge transfer payments as part of either normal EC programs or special "cohesion" initiatives for under-developed regions, and may experience sharply increased trade with and investment from the Community.

The accession process has also proven to be extremely flexible and capable of accommodating long and complex transitional arrangements. Currency conversion restrictions, local aid arrangements, historic insulation from free market forces and various competitive weaknesses have all been accommodated. Historically, the accession process has started with the formulation of certain legislation and the negotiation of a trade agreement. This step has generally been followed by lengthy negotiations concerning transitional arrangements and other special accommodations. Thereafter, the new member begins participation in the administration and legislative

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67. For an interesting contemporaneous discussion of the legal implications of the first enlargement, see M.E. BATHURST, K.R. SIMMONDS, N.M. HUNNINGS & J. WELCH, *LEGAL PROBLEMS OF AN ENLARGED EUROPEAN COMMUNITY* (1972).

processes of the Community, with the transitional periods acting as incentives to bring about the economic restructuring necessary for eventual open competition within the EC.

It is important to note that the EC has been willing to accept institutional participation before a country is ready to apply all of the Community's legislation and policy. The EC has also been willing to devote enormous resources to economic restructuring and integration. As a result, one might reasonably ask why membership has not been thought of as an appropriate solution for integration of the Eastern European countries, particularly in light of the willingness to absorb East Germany, once unified with the Federal Republic of Germany.

From the Eastern European point of view, as from that of EFTA members, much political and legal independence would need to be sacrificed for EC membership.<sup>68</sup> The costs would be particularly high for EFTA countries that might achieve a great deal of participation in the internal market and policy structure of the EC through an appropriate arrangement on the European Economic Space (EES). Country-by-country membership negotiations would also prevent the development of a common Central European unity, just as membership would largely prevent the achievement of an independent political middle way between East and West.

More important resistance to membership, however, comes from the EC itself and should be understood as a matter of bad timing. Although resistance to membership is defended in terms of the inability of Eastern European countries to survive the transition to membership, the EC has shown itself flexible enough on this score before. The resistance results more from the particular politics of integration prevalent within the EC at the moment. Integration of the East is shaped by concerns for integrating the West.

Prior to the accession of the United Kingdom, Ireland and Denmark in the early 1970's (and the offer of membership to Norway), EC membership was seen as an alternative to deepening integration among the original six members.<sup>69</sup> After the so-called Luxembourg Compromise of 1965,<sup>70</sup> the Community's decision-making procedures were blocked by the exclusive use of unanimity voting in the Council of Ministers, despite provisions in the EC Treaty providing for

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68. On the Austrian case, see Kennedy & Specht, *Austria and the European Communities*, 26 COMMON MKT. L. REV. 615 (1989).

69. The original six members of the EC were Belgium, the Federal Republic of Germany, France, Italy, Luxembourg and the Netherlands.

70. For a discussion of the Luxembourg Compromise, see J.H. JACKSON & W.J. DAVEY, *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS* 200 (2d ed. 1986).

qualified majority voting in certain cases.<sup>71</sup> Once the French objection to British membership was dropped, expansion seemed one way to get the integration effort moving again. Breadth seemed desirable, at least so long as depth seemed unattainable.

In the 1970's, as the EC struggled to absorb these new members, accession came to be seen in a different light. With more members, the unanimity rule seemed even less workable. Impatience at the slow pace of integration made some members willing to dispense with the Luxembourg Compromise. By the time negotiations were under way with Greece, and then with Spain and Portugal, expansion seemed to be the corollary for a revision of the voting process to deepen the Community. These accessions were followed by the Single European Act,<sup>72</sup> which set the stage for the 1992 program.

Once the deepening process was underway, however, new membership seemed less attractive. As the Community extended integration, the substantive opposition of existing members—often those admitted in the first wave—became increasingly frustrating for the Europeanists. The Single European Act, moreover, did not fully abolish unanimity. Even countries content with the current weighted voting scheme might hesitate to see their participation in a qualified majority vote diluted by new members.

As a result, the extension of the Community has come to be seen in Brussels as a threat to its success, particularly if the Bonn-Paris axis were to be either diluted or distracted by concerns in the East. It is in this context that Commission President Delors proposed the alternative of a Europe of "concentric circles" on the basis of which neighboring countries could share some of the glow of EC integration without being invited on stage. It was a vision born of the drive for EC unification, not of an interest in integrating the countries of the East.

#### *B. Integration Without Membership: The European Free Trade Association*

In terms of trade and trade relations, the EFTA countries are at the other end of the spectrum from Eastern Europe. In contrast to the limited flow of trade between the EC and Eastern Europe, the EFTA countries together form the EC's largest trading partner. On the basis of trade agreements between the EC and each of the EFTA countries, industrial products circulate among the eighteen member

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71. EC Treaty, *supra* note 12, art. 43.

72. *Single European Act*, 30 O.J. EUR. COMM. (No. L 169) 1 (1987), reprinted in 25 I.L.M. 506 (1986).

countries of the two organizations generally without tariffs or quantitative restrictions.<sup>73</sup>

The EFTA countries also differ from Eastern Europe because they are deemed by the EC to be its economic and political peers. Indeed, Norwegian voters rejected the EC's offer of membership, and the controversy over Austria's recent application for EC membership has been directed at the compatibility of its policy of neutrality with EC decision-making, rather than its political or economic institutions as a whole. Similarly, although certain of the EC-EFTA trade agreements afford the EFTA countries additional protection in a few selected areas, such as in the fishery sector for Iceland, they are non-preferential agreements pursuant to which the EFTA countries are required to reduce trade barriers at the same rate as the EC.<sup>74</sup> The EC provides no aid to the EFTA countries as it does under its trade or association agreements with virtually all other countries, including Israel, Yugoslavia, Turkey, and the Maghreb, Mashrak and Lomé countries.<sup>75</sup>

The EFTA countries, unlike the countries of Eastern Europe, are thought to be fully prepared for EC membership. Some of them reject the prospect of EC membership because they fear the loss of political independence and the opportunity to develop their own local industrial policy. They also fear that their agricultural sector will suffer if merged into the EC's Common Agricultural Policy. For its part, the EC has proposed the negotiations toward EES as an alternative to EC membership for EFTA countries. This is an effort to avoid diverting bureaucratic energy from work on the internal market to arduous accession negotiations and the process of accommodating new members with long individualist traditions.

The current EC-EFTA trade agreements reflect the EC's dominance over the negotiation process which, some EFTA observers fear, may be extended to EES. Although ostensibly the result of individual negotiations, the trade agreements are virtually identical. As a

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73. See *Council Regulation 2836/72, as amended*, 16 O.J. EUR. COMM. (No. L 300) 1 (1972) (EC-Austria Agreement); *Council Regulation 2838/72, as amended*, 16 O.J. EUR. COMM. (No. L 300) 96 (1972) (EC-Sweden Agreement); *Council Regulation 2840/72, as amended*, 16 O.J. EUR. COMM. (No. L 300) 188 (1972) (EC-Switzerland Agreement); *Council Regulation 2842/72*, 16 O.J. EUR. COMM. (No. L 301) 1 (EC-Iceland Agreement) (1972); *Council Regulation 1691/73*, 17 O.J. EUR. COMM. (No. L 171) 1 (1973) (EC-Norway Agreement); *Council Regulation 3177/73, as amended*, 17 O.J. EUR. COMM. (No. L 328) 1 (1973) (EC-Finland Agreement). Like Comecon, EFTA does not have the power to enter into trade agreements on behalf of its members.

74. *Id.* As another example, the special EC-EFTA rules of origin were developed largely on the EC's initiative and have been a source of friction between the two groups.

75. For a discussion of agreements with the Lomé countries, see *infra* Section III(D).

striking example, article 23 of each agreement contains little-used competition law provisions which are taken virtually verbatim from articles 85, 86 and 92(1) of the EC Treaty.<sup>76</sup>

The EC-EFTA agreements are limited almost exclusively to trade matters. A separate joint committee oversees implementation of each agreement.<sup>77</sup> In advance of the current EES negotiations, there was some effort to expand the scope of EC-EFTA integration, partly through negotiations between the EC and individual EFTA countries. The most recent and comprehensive example is the EC-Switzerland non-life insurance treaty, which seeks to guarantee the reciprocal rights of EC and Swiss insurers to establish themselves and provide cross-border services on each other's territories.<sup>78</sup> The EC and EFTA also have some joint institutional memberships. In particular, all the EC and EFTA countries are members of the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization (CENELEC) and the European Telecommunications Standards Institute (ETSI), the three European technical standards bodies.<sup>79</sup>

Establishment of the EES would essentially extend the five freedoms of the EC Treaty (free movement of goods,<sup>80</sup> of capital<sup>81</sup> and of workers,<sup>82</sup> right of establishment<sup>83</sup> and freedom to provide

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76. EC Treaty, *supra* note 12, arts. 85, 86, 92(1).

77. The Court of Justice of the EC has held that "unconditional and specific" provisions of the EC-EFTA agreements have direct effect in the EC and therefore must be applied by the national courts of the Member States. See *Hauptzollamt Mainz v. C.A. Kupferberg & Cie*, Case 104/81, 1982 E. Comm. Ct. J. Rep. 3641. For a discussion of the provisions of the agreements likely to be deemed by the Court to have direct effect, see Bernitz, *The EEC-EFTA Trade Agreements with Special Reference to the Position of Sweden and the other Scandinavian Countries*, 23 COMMON MKT. L. REV. 567, 574-78 (1986). The current free trade agreements are unlikely to be given direct effect in national courts in the EFTA countries. See *id.* at 588-93. The EC will undoubtedly insist that EFTA take appropriate measures so that any EES agreements would be directly applied in the courts of the EFTA countries.

78. See 33 O.J. EUR. COMM. (No. C 53) 1 (1990). The agreement will enter into effect upon full ratification.

79. The voting procedures of CEN and CENELEC provide that a norm is binding on the standard bodies of the EC Member States when a majority vote of the EC countries is obtained (in the manner described in the EC Treaty), even if the norm is not adopted by the full body. The standard bodies of EFTA countries are only bound if a qualified majority vote of the entire CEN or CENELEC is obtained. See Masclat, *L'Elimination des Entraves Techniques dans les Echanges Intercommunautaires des Marchandises*, 18 DROIT PRATIQUE DE COMMERCE INT. 9, 26-28 (1989). This difference reflects the greater political integration of the EC as opposed to EFTA. There are other examples of EC-EFTA institutional cooperation, most notably at the level of the Council of Europe and in connection with joint research and development and training projects.

80. EC Treaty, *supra* note 12, arts. 3, 8-10, 18, 30-36.

81. *Id.*

82. *Id.* arts. 48-50.

83. *Id.* arts. 52-57.

cross-border services<sup>84</sup>) to the EFTA countries. As a corollary to the five freedoms, the EC and the EFTA countries would likely develop common policies in such areas as competition law, environmental protection and worker safety. Extending EC freedoms and policies to the EFTA countries means, as a practical matter, the necessity of accepting a great deal of the existing and prospective rules of Community law by which those freedoms are implemented (the "*acquis communautaire*"). In the 1992 program, the free movement of goods or services has come to mean much more than reciprocal open borders. It also means a harmonization of regulatory provisions and the establishment of common minimum standards. Similarly, if the common policies are to become more than articles in an association agreement, there must be coordinated administrative and judicial action.

In exchange for submitting to the Brussels legislative and judicial machinery, the EFTA countries have demanded input into the decisionmaking process. Although the form for such input remains unclear and is treated with much trepidation in Brussels for its tendency to complicate an already difficult decision-making process, it is clear that some joint institutional framework must be devised to give EFTA members input into the legislative and administrative process and the right to reject individual pieces of EC legislation if the EES approach is to become a viable alternative to membership. Without such a system, an EFTA country would sacrifice more sovereign independence as a participant in the EES than it would as a participant in the EC.

Regarding the free movement of goods, the *acquis communautaire* means the adoption by the EFTA countries of the growing body of harmonization directives. Under these directives, the Member States have relinquished their authority to prevent imports from other Member States on the basis that the goods do not satisfy their own quality and safety rules, so long as the goods comply with the EC rules set forth in the directive or with the rules of a Member State deemed to be an equivalent by the Commission.<sup>85</sup> This integration goes well beyond the abolition of tariffs and quantitative restrictions, because it calls for the EFTA countries to modify their legislation, at least as it applies to imports from other EES countries. Like certain EC Member States, many EFTA countries maintain standards that may be higher than the common denominator reached by the EC for a given group of products. For EFTA countries such as

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84. *Id.* arts. 59-63.

85. For a discussion of the EC's so-called "new approach" to the harmonization of safety and technical standards, see Waelbroeck, *L'Harmonisation des Règles et Normes Techniques dans la CEE*, 3 CAHIERS DE DROIT EUROPÉEN 243 (1988).

Austria, which has gradually been preparing itself for EC membership, the harmonization process is already well under way. Even where the EFTA countries can agree to accept the existing Community rules on the free movement of goods, the implementation and modification of these rules, as well as the development of rules for additional products or new technologies, calls for joint dispute resolution and decisionmaking institutions.

The other area in which these institutional issues are raised dramatically is the freedom to provide cross-border services provided for in articles 59 to 63 of the EC Treaty.<sup>86</sup> Implementation of this freedom, particularly in highly regulated industries like banking and insurance, has proven to be difficult for the EC. It has long been the view of the Commission that an EC insurer, for example, should be entitled to do business throughout the EC without any obligation to establish a local branch under the insurance regulatory rules of its home Member State as long as these rules meet a common standard. Faced with resistance from Member States eager to protect local insurers and consumers, the EC has only partially achieved this goal over a period of almost two decades. Extension of this policy to the EFTA countries would certainly be difficult and, moreover, would require adequate institutions for its development and enforcement.

The solution to this institutional dilemma is by no means clear. Both sides may come to feel comfortable with the creation of an EES court with judges from both EC and EFTA member countries, although the compatibility of such a court with current EC law is difficult to ensure. Much more difficult problems are joint decision-making procedures for future legislative initiatives and joint executive actions, such as those performed by the EC Commission in the competition area. Given the EC's reluctance to offer EC membership to EFTA countries because of the risk that it would make the process of harmonization and economic and monetary union more difficult, the EC is unlikely to agree to a structure which would delay or impede its decision-making.<sup>87</sup>

One solution which would accommodate both this concern of the EC and the desire of the EFTA countries to decide individually

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86. EC Treaty, *supra* note 12, arts. 59-63.

87. Indeed, the Treaty of Rome was amended in 1987 pursuant to the Single European Act which, among other provisions, expanded the instances in which the Council could adopt legislation by majority vote. See, e.g., Glaesner, *The Single European Act: An Attempt at an Appraisal*, 10 *FORDHAM INT'L L. J.* 446 (1987) (with full text of Single European Act attached); Bermann, *The Single European Act: A New Constitution for the Community*, 27 *COLUM. J. TRANSNAT'L L.* 529 (1989); Note, *The EEC Legislative Process: An Evolving Balance*, 27 *COLUM. J. TRANSNAT'L L.* 679 (1989).

whether to adopt individual EC measures would be to permit EFTA countries the full opportunity to participate in the decisionmaking process except that current EC rules regarding adoption of measures would continue to apply and EFTA countries would be free to accept or reject any measures adopted without their support. In practice, however, this alternative could lead either to a gradual drift away from the common rules established at the time of creation of the EES or to the EFTA countries feeling compelled to adopt legislation for which their input was not valued equally. The dilemma for the EFTA countries therefore is how to reconcile their desires for political independence and economic integration when the EC, by both deliberate action and sheer geographical and bureaucratic vastness, has written much of the script.

The EC-EFTA relations probably cannot serve as a model for EC-Eastern European association agreements. The Eastern European countries will have to dismantle their export licensing systems and reduce tariffs on EC goods on a gradual basis pursuant to preferential agreements on the basis of which the EC reduces tariffs on an accelerated basis. In addition, the restructuring process calls for substantial and sustained aid from the EC of the kind never made available to the EFTA countries. However, in order to avoid the limitations traditionally associated with the EC's relations with less-advanced countries, such as those with Turkey and the Lomé countries, Eastern European countries should insist that they be treated like peers of the EC in areas of commercial and legal cooperation. This would include immediate participation in CEN and Cenelec, in EC-EFTA research and development projects and in meaningful consultation on measures to be taken by the EES which may affect their exports.

The EC-EFTA negotiations are significant as illustrations of the advantages and difficulties of pursuing integration with the EC at the levels of industrial and microeconomic policy as well as trade.<sup>88</sup> In particular, some Eastern European countries may want their own association agreements with the EC to reflect progress with respect to the free movement of goods between the EC and the EFTA countries and joint decisionmaking and consultation between the EC and EFTA institutions. The EC-EFTA negotiations demonstrate the difficulty, even for well-developed neighbors acting together, of resisting

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88. There were several papers on this subject delivered at a 1989 conference in Dublin, Ireland on the EC. Temple-Lang, *Institutional Aspects of EC-EFTA Relations*, in *CREATING A EUROPEAN ECONOMIC SPACE: LEGAL ASPECTS OF EC-EFTA RELATIONS* 17 (1990); Norberg, *Legal and Institutional Aspects of EC-EFTA Relations in a Dynamic and Homogeneous European Economic Space - An EFTA Point of View*, in *id.* at 63; Schermers, *Institutional Options in EC-EFTA Relations*, in *id.* at 77.

the standardized pressure simply to accept Brussels legislation. In any event, the outcome of these negotiations are of interest to Eastern European countries because, upon satisfaction of certain criteria of political and economic stability, they may in the future be invited to join the EES.

*C. Association: Turkey*

The EC-Turkey Association Agreement was signed in 1963. A 1970 Protocol (the Protocol) contains detailed provisions for its implementation.<sup>89</sup> The EC-Turkey association arrangement is, with good reason, viewed as the most comprehensive model for the EC-Eastern European association agreements. Its scope is quite broad, ranging from trade to the free movement of workers. Moreover, it is a preferential agreement in that Turkey is authorized to lift trade restrictions on EC products at a slower pace than the EC does for Turkish products and Turkey is granted special derogations such as with respect to the liberalization of payments and state aids. Finally, in the context of association, the EC has awarded the Turkish government and, in certain cases, private Turkish companies, financial aid for economic development.

Except in the area of quantitative restrictions and tariffs, the EC's obligations under the various agreements and protocols which make up the association arrangement require further action by the parties on which there has been little progress. The long-standing Greece-Turkey dispute, political instability in Turkey, slow progress in Turkey's economic development and requests for protection from Turkish exports by Community producers have all served to retard this progress. Turkey has now deemed itself ready for accession to the EC at a time when the Community has determined that further expansion is against its interests. Further, Turkey's strategic importance has declined as a result of the opening up of Eastern Europe.<sup>90</sup>

Like the EC-EFTA agreements, the Protocol draws its inspiration from the EC Treaty. It provides for the elimination of quantitative restrictions and tariffs as the initial goal and for the gradual implementation of other aspects of the free movement of goods as well as the remaining four freedoms. It also provides for the harmonization of competition rules, economic policies and other laws relevant to the association relationship.<sup>91</sup> On an institutional level, integration

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89. *Council Decision 64/372 & Council Regulation 2760/72, reprinted in 3 COLLECTION OF AGREEMENTS CONCLUDED BY THE EEC 541-683 (1978).*

90. The Commission recently delivered an opinion expressing its view that negotiations regarding Turkey's accession to the EC should not be started at this time.

91. The number of cross-references to the EC Treaty in the Protocol is striking. They

between the EC and Turkey is much less than that contemplated for EES, although the potential for joint action is in principle greater than is traditionally the case through the EC's trade and cooperation agreements.<sup>92</sup> In addition, the agreement explicitly contemplates consideration of Turkey's accession to the EC after a certain period. Significantly, these institutional aspects of the EC-Turkey arrangement are virtually identical to those contained in the EC's pre-accession association agreement with Greece.<sup>93</sup>

In general, it would appear, with the Greek example as a guide, that the legal relationship between Turkey and the EC contains the promise for gradual political integration of Turkey into the EC and significant EC investment in Turkey's economic development to facilitate its eventual accession to the EC. This promise is far from being realized as a result of the lack of follow-through on the part of both Turkey and the EC.

In non-sensitive sectors, the EC has eliminated quantitative restrictions and tariffs on Turkish products in accordance with the Protocol. With respect to textiles, steel and agriculture, however, Turkey's access to the EC market has been by no means guaranteed. For many years, Turkey abandoned its tariff reduction obligations and is at this date many years behind the schedule established in the Protocol. There has been no significant progress in other areas covered by the Protocol, most dramatically with respect to the free movement of workers.<sup>94</sup> In the context of Community enlargement (for

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include a covenant that the parties will adopt rules for the application of EC competition law between the parties, and a recognition that Turkey is a region with an abnormally low standard of living within the meaning of article 92(3)(a) of the Treaty of Rome for purposes of authorizing aid by the Turkish Government for economic development.

92. The association agreement establishes a Council of Association composed of representatives of the Council, the Commission, the Member States and Turkey. The parties are obligated to implement any decisions of the Council of Association, including any decision of the Court of Justice of the EC or a competent court rendered following a referral by the Council. The agreement also calls for the Council of Association to facilitate contacts between the EC and Turkish Parliaments. The EC is required to consult with Turkey regarding any future preferential trade agreements executed with third countries or accession to or association with the Community.

93. One exception is that under the EC-Greece agreements either Greece or the EC could unilaterally submit any unresolved dispute to the Council of Association for arbitration while this can only be done by decision of the Council of Association under the EC-Turkey agreement.

94. The Protocol requires the Council of Association to establish rules for the progressive implementation of the free movement of workers between the EC and Turkey between the twelfth and twenty-second years after the entry into force of the association agreement. With Germany in the lead, the Member States resisted Turkey's repeated efforts to develop these guidelines. Finally, after the twenty-two year period had expired, Turkey brought a test case to the Court of Justice arguing that the Protocol required Germany to permit Turkish workers to establish themselves in their territories. The Court of Justice held in 1987 that the free

Greece, Spain and Portugal) and the EC's extension of preferential trading agreements (to the Maghreb and Mashrak countries, for example), Turkey expressed the frustration that it was losing ground on agricultural exports to the EC and even faced a less favorable regime than countries with the new preferential trade agreements. The prospect of cooperation between the European and Turkish Parliaments has been largely unrealized.

At the time of its accession, Greece faced problems similar to Turkey's in terms of economic underdevelopment, balance of payments and political instability. Greece also competed with other Member States particularly in the agricultural sector, on the basis of an association agreement substantially the same as the EC-Turkey arrangement. The successful integration of Greece, however, stands in clear contrast to the embryonic nature of Turkey's association with the EC, demonstrating that the EC can muster the political and financial resources to integrate poorer neighbors into the EC when it wants to do so. The irony of West Germany accepting thousands of East Germans and ethnic Germans on a daily basis just two short years after a clear determination by the European Court of Justice that Germany had no obligations to accept Turkish workers was certainly not lost on Turkey.<sup>95</sup>

Turkey's experience with EC association can serve as both a lesson and a model for Eastern European countries interested in integration with and eventual accession to the EC. In the area of trade, Eastern European countries may want to consider negotiating up front a schedule for increased access of their products to the EC market in sensitive sectors rather than leaving it to open negotiation under the association agreement. Trade concessions for Eastern Europe may never be more popular than they are today. Eastern European countries would also want to "upgrade" the Turkish model to incorporate aspects of EC-EFTA relations, such as to include equal participation in programs regarding research and development, environmental protection and the elaboration of technical standards, which are as important for helping to achieve the integration of Eastern Europe into European economic and political affairs as for their substantive aspects. Real progress on the free movement of workers may also be a priority for some Eastern European countries. Finally, in the area of aid, Eastern Europe will want to make an effort to

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movement of workers provisions of the Protocol were not sufficiently clear to be directly applicable in the Member States and, indeed, that the Protocol explicitly contemplated action by the Council of Association for their implementation. *See Demirel v. Ville de Schwäbisch Gmünd, Affaire 12/86, 8 Recueil 3719 (1987).*

95. *See supra* note 94.

obtain more money than has been made available to Turkey and to ensure that it is available to local businesses without requiring guarantees from the Eastern European governments.

*D. Development Assistance: The Lomé Convention*

The Lomé Convention (Lomé), first signed in 1975 between the EC, the EC Member States and forty-six African, Caribbean and Pacific countries (the ACP States), is the EC's most comprehensive preferential trade and financial aid arrangement.<sup>96</sup> In its current version, Lomé IV, the arrangement extends to sixty-eight ACP States, all of whom qualify as less or least developed countries. Lomé is quite detailed. For purposes of this discussion it is sufficient to understand that it covers three main areas: preferential trade arrangements; export stabilization; and financial and technical aid.<sup>97</sup> One of the drawbacks characteristic of Lomé in each of these areas is that dependency on exports to the EC, particularly of raw materials, is encouraged.

Lomé's preferential trade regime is the most liberal afforded by the EC to any third countries. The EC has eliminated tariffs on a vast number of imports from ACP States with no reciprocity obligations on the part of the ACP States and has agreed to special rules of common origin. Unlike Turkey or the EFTA countries, the ACP States for the most part supply the EC with products not available from Community sources.<sup>98</sup> On the other hand, in the few cases where Community producers have complained about competition from ACP States, such as textiles, the ACP States have faced barriers to market access similar to those faced by Turkey.<sup>99</sup>

The Stabex and Sysmin export stabilization funds are classic examples of the dependency aspects of the EC-ACP relationship.<sup>100</sup> The funds protect ACP States dependent on export earnings from certain raw materials and agricultural products, including peanuts,

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96. The Third Lomé Convention is published at 29 O.J. EUR. COM. (No. L 86) 1 (1986). The Fourth Lomé Convention has not yet been fully ratified and therefore has not been published in the *Official Journal*. A general discussion of the new measures contained in the Fourth Lomé Convention appears in Cova, *Lomé IV: Une Convention pour 10 Ans*, 333 REV. M.C. 1 (1990).

97. Lomé contains several other provisions inspired by the EC Treaty, such as those governing the right of establishment and the right to provide cross-border services, which have had little impact in EC-ACP relations.

98. See Lucron, *Méditerranée, Lomé: Des Politiques Globales?*, 318 REV. M.C. 321, 322 (1988).

99. See, e.g., Annual Report of the ACP-EC Council of Ministers 29-31 (1981).

100. For a discussion of the Stabex fund, see Faber, *The Economics of Stabex*, 18 J. WORLD TRADE L. 52 (1984).

bananas, coffee, cotton, copper, manganese and iron ore, from reductions in export earnings. The Stabex and Sysmin products are, for the most part, products not produced in great quantities in the EC which enjoy significant demand from Community producers and consumers. Advances made under the funds have traditionally been treated as loans and the EC has expressed the view that ACP States should use Stabex and Sysmin aid in the subsector for which it was granted. In the recent Lomé IV negotiations, the EC agreed to extend some Stabex and Sysmin funds in the form of grants, as well as to work towards more ACP processing of raw materials and access to the EC market for exports of finished and semi-finished products.

The total expenditures by the EC and its Member States over the years for development aid under the Lomé Conventions have been significant. Given the large number of beneficiary countries and the infrastructure projects selected, however, this aid has only made a limited contribution to the development of the production sector in the ACP States. The Community has previously sought to limit aid to those countries following development policies approved by the EC. Beginning with Lomé III, the ACP States have requested that there be more emphasis on direct investment by EC companies and on the development of industrial activities, including the private sector. Nevertheless, it is doubtful that the Lomé system, which has until now been driven by raw materials exports, can transform itself into an engine for self-sufficiency for sixty-eight of the world's poorest countries.

From an institutional point of view, the Lomé Conventions have successfully provided a forum for consistent contacts between the EC and the ACP States.<sup>101</sup> This consultation process has prevented the gaps in relations which have characterized EC-Turkey relations.

There is little danger that the EC will seek to copy the Lomé model directly for the integration of Eastern European countries. Eastern European countries have few raw materials in demand in the EC and, indeed, Eastern European and Community producers compete in a number of sectors. There is, however, some danger that the economic woes of Eastern Europe may lead certain countries in this region to accept a different kind of dependency relationship which would resemble EC-ACP relations except for the overall higher standard of living enjoyed by Eastern Europeans. Eastern Europe may

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101. The formal institutions are the Council of Ministers, the Consultative Assembly, in the context of which delegates from ACP states and the European Parliament meet, and the Committee of Ambassadors, which meets on a regular basis in Brussels with the Commission and the Member States' permanent representations to the EC. See Lucron, *supra* note 98, at 326.

well be tempted by a hard currency export led model of growth which emphasizes industries and sectors which neither compete with Western producers nor contribute to intra-East trade and development. For example, eager to obtain foreign investment, Eastern European countries might be tempted to accept (and maintain existing) industrial facilities deemed undesirable in Western Europe because of hazards to the environment and worker safety. Similarly, Eastern Europe may become a favored spot for Western companies to establish low technology industries which only contribute in a limited way to improving the region's self-sufficiency and standard of living. The dangers increase to the extent the EC and Eastern Europe focus on trade and aid—even infrastructure aid—without considering the microeconomic aspects of the integrated markets based on the EC Treaty's economic freedoms and common policies.

The experience of the ACP countries clearly marks the limits of dependency on the EC. For Eastern European countries with EC integration as a goal, however, the initial terms of association are crucial in creating the conditions for integration rather than dependency as an outsider. With respect to aid, the Eastern European countries need to focus not only on increasing the volume, but the means of distribution so that aid does not become an instrument for the EC to determine the sectors to be developed. Without deciding the issue of EC membership, the EC's participation in the economic development of Greece, Portugal and Spain might provide the model in this area. The countries of Eastern Europe, despite their economic problems, may be well advised to establish themselves as "insiders" in political, economic and technical cooperation. There are plenty of precedents for asserting the right to refuse actions being taken by others on the inside because of potential disruptions to the economy or to developing industries. Finally, Eastern European countries, either collectively or individually, may wish to insist on institutional links with the EC which will promote the continued integration of their microeconomic policies as well as make it harder for the EC to restrict market access in sensitive sectors.

#### IV. JOINING THE WEST: THE VIEW FROM EASTERN EUROPE

##### *A. Membership in Western Institutions*

The agenda for institutional discussions between the EC and the Eastern European countries has largely been set in Brussels. Initial efforts to integrate these countries into the Western European economic and political structure have been designed and motivated by the experience and ambitions of the European Communities. The

East has so far responded within the framework offered, negotiating country by country trade and aid packages and, in some cases, making clear their interest in eventual EC membership. There has been only modest discussion about alternative and more long-term approaches to integration with the Communities and very little attention to the relationship between internal microeconomic reform and integration with the EC. Unlike some EFTA countries, such as Austria or Norway, which have long-standing internal debates about the forms and conditions of membership in the EC, the Eastern European countries have largely left the institutional form for their relations with the EC as well as issues of regulatory compatibility without comment for the moment.

The most important institutional exceptions have been strong interest, particularly in Hungary, in the human rights institutions of Western Europe, and efforts, led by Czechoslovakia, to promote both an extension of the Helsinki process and development of a Central European alternative to Comecon with at least Poland and Hungary. These later efforts would be important for relations with the EC, if only because they would make it more difficult to deal with the Eastern countries one by one, rather than jointly, as the EC has been advocating for EFTA. This, in turn, might lead to greater political participation by the Eastern countries in the integration process.

These political developments, while encouraging, will not by themselves lead to Eastern European participation in the many other areas of cooperation, such as those being discussed by the EC and EFTA, which are ultimately more vital to their economic restructuring. In the absence of any concrete proposals for sustained interaction outside of trade with the EC, East Europeans have sought integration with the free markets of Europe not primarily through institutional means, but through economic and legislative reform at home.

### *B. Foreign Investment and Industrial Policy*

So far, the East's primary strategy for integration with the economies of the West has been to encourage foreign investment. East Germany, Romania and the USSR have adopted "first generation" investment laws, prior to which there existed no clear legal basis for foreign investment. Bulgaria, Czechoslovakia, Hungary and Poland had prior foreign investment laws, which have been modified as part of their economic restructuring programs. The Hungarian and Polish laws in particular deserve the title "second generation" in that they have settled such issues as the right of a company with foreign

investment to own property, the right of a foreign investor to repatriate profits and the independence of companies with foreign investors from the centrally planned economy.<sup>102</sup>

In addition to removing historical impediments to foreign investment, these laws also seek to promote foreign investment, primarily through a variety of tax incentives. Foreign investors have further learned that additional benefits and investment protection can often be obtained through negotiations with government entities in each country. In order to understand the approach taken by Eastern Europe to increasing foreign investment as a strategy for economic integration with the West, we will look briefly at the Hungarian and Polish foreign investment laws of December 1988 and two specific experiences of Western investors in Hungary.

Three aspects of Hungary's foreign investment law render it the most favorable to foreign investors in Eastern Europe. First, foreign investments of up to fifty percent of the equity of a company do not require government approval. Second, the National Bank of Hungary will convert the local currency (forint) dividends paid to foreign investors into the hard currency of the foreign investment for repatriation. Third, the law targets various sectors in which companies with foreign investment will receive special tax incentives. The joint venture law was accompanied by a reform of Hungarian corporate law, which resembles modern Western European laws, and a law on the privatization of State-owned enterprises. In addition, for a number of

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102. All of these laws other than the East German law, which was adopted on January 25, 1990, are reprinted in EAST-WEST JOINT VENTURES, *supra* note 61. They are titled as follows: *Order on the Establishment and Activities of Enterprises with Foreign Participations in the German Democratic Republic of January 25, 1990*; *Decree No. 424 on Constitution, Organization and Operation of Joint Companies in the Socialist Republic of Romania and Decree No. 425 Regarding Tax on Profits of Joint Companies constituted in the Socialist Republic of Romania*; *Decree No. 49 of the USSR Council of Ministers on the Establishment in the Territory of the USSR and Operation of Joint Ventures with the participation of Soviet Organizations and Firms from Capitalist and Developing Countries* (and certain related decrees); *Decree 56 on Economic Activity Issued by the State Council of the People's Republic of Bulgaria*; *Act No. 173/1988 on Enterprises with Foreign Property Participation (Czechoslovakia)*; *Hungarian Foreign Investment Act*; *The Law on Economic Activity with the Participation of Foreign Parties (Poland)*. See Note, *Perestroika in Eastern Europe: Four New Joint Venture Laws for 1989*, 21 LAW & POL'Y INT'L BUS. 1 (1989); Piontek, *Polish Foreign Investment Law 1988*, 23 J. WORLD TRADE L. 5 (1989); Lieberman, Starr, Esser & Waters, *Investment in the Soviet Union and in Hungary: A Comparison of the New Soviet and Hungarian Investment and Tax Laws*, 23 GEO. WASH. J. INT'L L. & ECON. 1 (1989); Tifenbrun, *Joint Ventures in the U.S.S.R., Eastern Europe, and the People's Republic of China as of December 1989*, 21 N.Y.U. J. INT'L L. & POL'Y 667 (1989); Conner, *Recent Developments in Eastern European Laws on Investments by Foreign Firms*, 4 I.C.S.I.D. REV. 241 (1989). The Polish law was amended on December 23, 1989 to modify provisions regarding taxes and repatriation of profits. Czechoslovakia enacted a new foreign investment law in April 1990 replacing its 1988 law. On March 14, 1990, Romania adopted a new law on foreign investment.

years Hungary has been pursuing a system of liberalizing foreign trade both by permitting non-state enterprises to engage in foreign trade and by limiting the need for import and export licenses.

Without taking into account the foreign investment law, Hungarian companies are taxed at thirty-five percent of profits up to three million forints (approximately US \$50,000) and forty percent thereafter. Companies with foreign investment of at least twenty percent or five million forints at establishment are entitled to a twenty percent allowance. Companies with at least twenty-five million forints in capital and thirty percent foreign investment operating in specified priority sectors receive a five year tax holiday and a sixty percent allowance thereafter. The priority sectors include electronics, vehicles, packaging, waste recycling and telecommunications. Significantly, the incentives themselves are not conditioned on the joint venture company having a specified amount of hard currency exports and, moreover, certain of the special incentives apply to sectors such as telecommunications which are unlikely to be in a position to export to the West in the near future.

It is perhaps easier to see the extent to which foreign investment is considered to be a cornerstone of the Hungarian economic restructuring program when one looks at what Western investors have obtained through negotiations with the Government. In two of the most significant transactions in Hungary to date, the sale of Tung-gram, a major light bulb producer, to a consortium of Austrian banks and the establishment of the First Hungary Fund, to enable Western investors to invest in Hungarian equity securities, investors were able to obtain guarantees from Government entities which made the investments virtually risk-free. The Tunggram shares were sold to the Austrian banks with a guaranty that the banks would be reimbursed for any loss they incurred in connection with a resale. The parties agreed to split any amount in excess of the purchase price obtained by the Austrian banks upon resale of the shares. The First Hungary Fund received a variety of put options which protect investors against decreases in the value of the fund, political developments undermining its investment objectives, devaluation of the forint and the lack of a market for transfer of the fund shares.

There has been some backlash in Hungarian public opinion with respect to the Hungarian Government's foreign investment policy. In particular, on several occasions it has been widely believed that privatized companies were sold too cheaply. In response to this, a central Government agency has been established to review the fairness of privatizations. Interestingly, some Czechoslovakian government

officials who are advocating large-scale reforms in that country have criticized the Hungarian approach, which has in fact been developed for a number of years by communists and reformers, as being too cautious in adopting free market principles.<sup>103</sup>

Under the Polish foreign investment law, all foreign investments require authorization from the Agency for Foreign Investment, but the authorization procedure is relatively transparent and reliable. The law provides that authorization is to be granted for investments (up to one hundred percent) that introduce new technologies and management methods, manufacture goods for export, improve the supply of high quality goods for the domestic market or are involved in the protection of the environment.

The more severe economic situation in Poland has led the Polish Government to impose greater restrictions on companies with foreign participation than the Hungarian law. Foreign parties must invest at least \$50,000 and acquire twenty-five percent of the company's equity. Fifteen percent of a company's hard currency earnings must be converted into local currency (zlotys). When the Polish law was first implemented in 1988, the Polish Central Bank did not undertake to convert zloty dividends into hard currency for repatriation. In December 1989, the law was amended to permit repatriation in hard currency of fifteen percent of local currency profits. Because all foreign investments require authorization, unlike in Hungary, it remains to be seen how reluctant the Polish government will be to approve foreign investments in companies that will not have substantial hard currency earnings because of this repatriation obligation.

In the area of tax incentives, the Polish law, at least initially, was clearly designed to stimulate foreign investment which can result in exports to hard currency countries. Polish corporations are generally subject to a forty percent tax. A tax holiday of three years is granted to companies with foreign investment. Prior to the December 1989 amendments, this rate could be reduced to as low as ten percent by reductions of four tenths of a percent for each one percent of the company's gross revenues derived from exports. The tax holidays can be extended for up to an additional three years for companies operating in preferred sectors, such as construction, telecommunications and transport. The Polish Government has also indicated that it is considering the elimination or reduction of these tax incentives. Poland does not yet have the same experience with respect to major foreign

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103. The revised Czechoslovakian joint venture law adopted in April 1990 still, however, requires government approval of all investments and requires companies to convert thirty percent of hard currency profits into local currencies.

investments as Hungary. Therefore, it is more difficult to say what benefits Poland would provide to foreign investors in the course of private negotiations.

The Hungarian and Polish foreign investment laws convey a mixed message as to the road Eastern Europe intends to take. For the most part, Eastern Europe has shed the reluctance to accept foreign investment and private enterprise which were characteristic of communist rule. Foreign investment remains more highly regulated than in the West, which can be attributed to two independent factors. First, uncontrolled foreign investment could exacerbate Eastern Europe's already critical balance of payments and debt situation. Second, there is a strong sense that governmental control is required to direct foreign participation in economies which are still predominantly state-owned even if the companies with foreign participation are permitted to operate independently of the planned economy. In addition, the free market aims of most current Eastern European leaders face resistance from those who remain in significant positions long after the fall of the communist leaders and who either seek to block or to benefit from the reform process. Reformers must come to terms with a public which is unaccustomed to the often brutal and inequitable results of capitalist economic relations.

Aside from these different currents in the procedures for permitting foreign investment, the Hungarian and Polish foreign investment laws seem to mix export-oriented development with internal restructuring in an ambivalent fashion. The Polish foreign investment law, particularly before the December 1989 amendments on tax incentives and repatriation of profits, indicates a preference for foreign currency generating foreign investments. Hungary's foreign investment law suggests a recognition that it would be beneficial to develop internal sectors which will contribute to industrial and commercial growth even if this requires in some cases the repatriation in hard currency of profits earned in forints by foreign investors. The Hungarian government's willingness to take major risks for "big bang" foreign investments like securities funds, however, may be a diversion from the task of creating conditions on the basis of which Hungarians learn to compete both on the internal and external markets and with or without foreign investment.

What appears to be underrepresented in Eastern Europe's general approach to the EC countries is a recognition that integration with the West is not wholly dependent on the attraction of foreign investment and on expanding exports to the West. In order to avoid the isolation experienced by Turkey and the dependency of the ACP

countries, the countries of Eastern Europe might well use regulatory and institutional integration with the West (and with each other) in such areas as the free movement of workers, the provision of cross-border services, standardization, environmental protection and legal harmonization as a tool for internal microeconomic development. The PHARE program, with its emphasis on large infrastructure programs, suggests that the EC has not yet decided to commit itself to opening up the EC to the East in these other areas. For this reason, EC aid may actually encourage Eastern Europe to neglect the development of internal competitive conditions by concentrating too narrowly on exports and on developing large scale Western-style institutions like stock exchanges.

## V. CONCLUSION

Eastern European countries face two distinct dangers in pursuing economic modernization and integration into the institutional and economic structures of Western Europe. On the one hand, they could become a new third world, a region of stagnant, often unstable dependent economies. On the other, as they accede to the first world, they may find themselves subject to a technocratic political and legislative machinery in Brussels which is incompatible with their current aspirations for democratic governance and market freedom. It is against these dangers that the preliminary approaches to integration—from both East and West—may be measured.

The EC and its new Eastern partners have approached their new relations in strangely similar ways. From both sides we find a continuity with programs and initiatives which predated the revolutionary governmental changes that purportedly inspired them. We find continuity with both familiar models of development and ongoing negotiations concerning East-West trade and aid. Indeed, in both Brussels and the East we find a focus on trade, aid and investment rather than on microeconomic restructuring and legislative or administrative harmonization. Both sides seem to accept an inevitable chronology of macro and microeconomic policy. And on both sides we find an eagerness to negotiate on a country-by-country basis rather than collectively.

Our purpose here has been to question these assumptions. Within the recent history of the European Communities' relations with its neighbors, we find the basis for alternative approaches to integration: approaches which focused on reciprocal political relations and placed participation in microeconomic policies and freedoms ahead of export and investment driven growth. We have pointed out

the possibilities for association negotiations which would go beyond trade and aid to legislative harmonization and the free movement of workers, services, goods and capital. Although it may seem that such issues can only be addressed after trade and aid schemes have been successful, our caution is rather the opposite. Unless these issues are addressed together, the trade and aid will be achieved by putting in place legislative regimes which will be resistant to later harmonization. This is easiest to see in the environmental area. Trade and investment may well follow lower environmental standards which will then act as an impediment to true integration.

Although pursuit of a more balanced program of relations with the EC may be advisable for the countries of the East, there is little that can be done to avoid the technocratic political vision of the Community legislative structure. Indeed, the closer neighbors come to membership, the more wary they might rightly become about accession to the politics of 1992. Joining the European Communities means a large scale and largely irreversible transformation of a nation's substantive law, governmental structure and international status. Despite formally democratic roots in national parliaments and the presence of a European Parliament, most observers agree that Community decisionmaking is a largely autonomous and technocratic process, in which legislative competence has increasingly shifted from parliaments to the executive and in which the Court, rather than the elected Parliament, serves as the only institution empowered to control the executive organs.

This bias in favor of executive policy-making has been heightened by the development of a substantive industrial policy reaching deeply into the regulation of the market in every Member State in the 1992 program. The EC's sophisticated institutional regime has increasingly supplanted traditional forms of national sovereignty with a more appropriately post-modern political culture in which national political authority and democratic legitimacy is steadfastly invoked, but always seems elsewhere, deferred or displaced. By pursuing an assertive policy of association with the internal market of the West as an expression of newfound democratic and economic freedom, the new neighbors find a technocratic administrative apparatus driven to strengthen its own economic mechanisms through governmental regulation and intervention. This is perhaps the irony of Eastern European integration into the West: finally to seek integration into democracy and the free market, only to discover that these concepts have been transformed in their absence.

