Competitive Prospects in Eastern Europe

A Parting of the Ways

Among the former CMEA countries, some are moving faster and more radically toward the market system than others. Prof. Winiecki shows that the former will in future be in a better position to compete on world markets than those countries whose transition to the market system is incomplete or distorted.

Fast moving developments in countries that began shifting away from the Soviet-type economic system toward the market-type one (referred to below as post-STEs) signify a parting of the ways between Poland, Hungary and Czechoslovakia on the one hand and other countries of the region which are only tinkering with their economic system on the other. Nowhere is the difference between post-STEs and STEs more visible than with respect to international competitiveness. The establishment of a market system is expected to improve post-STEs' competitive position through both the ascertaining of proper comparative advantages and the attracting of more direct foreign investment. An analysis of the foreign trade and investment prospects of both STEs and post-STEs is followed in this article by an analysis of the internal and external threats to post-STEs' performance. It is posited that much greater threats stem from a possibly incomplete or distorted transition to the market than from anything else.

Let us begin by looking at the lack of competition in STEs in terms of the Burenstam Linder preference-for-similarity hypothesis, for it is here that an inherent weakness of STEs is revealed. Burenstam Linder stresses the role of domestic demand in shaping a strong production and marketing base for future export expansion. Without the domestic market test, by and large non-existent in permanently disequilibrated economies, STE enterprises manufacture goods of inferior quality, often technologically obsolete, that are not easy to sell even at a discount. It should also be noted that STE goods also cannot be measured by the next Burenstam Linder test, the similar markets test. This is the case because all STEs—under pressure of persistent excess demand—are equally lenient with respect to quality requirements. It is only at the third stage, that of dissimilar markets, that STEs are really submitted to the test.

It is with respect to competitiveness that the parting of the ways between STEs and those countries of the region that are transforming, or have already transformed, to the market system will reveal itself most clearly. The former will continue to maintain their costly pattern of production and trade, and will sell more and more abroad in return for less and less, while the latter, freed from the shackles of the Soviet economic system, will search rationally for new competitiveness (new in the sense that proper relative prices will quickly reveal which are the wrong exports).

New Competitiveness

Now, new competitiveness is to begin with most probably going to mean old competitiveness, that is the competitiveness these countries possessed in the past (before communist rule). And because adjustment under competitive conditions is the easier, the less sophisticated

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the product, it can be expected that the traditional exports of light industry manufactures will expand first. Thus, textiles and clothing from Hungary and Poland, shoes and glassware from Czechoslovakia, pottery from Poland etc. will increase their shares in both these countries' exports and EC imports.

This should be relatively easy, as even under the disadvantageous STE conditions these countries were able to improve, often markedly, the relative prices obtained on the EC market. While unit (kilogram) prices of engineering goods sold to the EC have been falling decade after decade, the prices obtained on the same market for many light industry product groups improved in relative terms. This is partly reflected in Table 1, where unit (kilogram) prices obtained by all former CMEA countries are shown as a percentage of prices obtained by other competitors on the EC market.

What is also interesting is the fact that the more sophisticated the product group, the lower the price obtained by STEs. This is probably one of the strongest indictments of the Soviet economic system, which has been designed to catch up with and surpass the capitalist system.

The question of competition with developing countries is often raised at this point. Undoubtedly the attempt to regain old competitiveness in traditional light industry manufactures will increase the already strong competition on the EC market, and in fact on the entire west European market, in these products. There are some areas where finer distinctions reveal parallel specialization rather than competitive ones (e.g. STEs and post-STEs in woollen clothing and LDCs in cotton clothing) but some displacement of remote LDCs' products seems unavoidable. Locational advantages also matter: for example, recent Austrian research shows that 40% of exports are shipped no further than 400 km. The short distance from markets may present certain advantages to Czech and Hungarian producers, as well as to other producers in post-STEs.

It is probably with respect to skilled labour-intensive products of medium technological sophistication that the shift to the market system will create the greatest opportunities for expansion. The comparative advantage of a relatively well educated labour force coupled with distinctly lower wages (relative to both the level of education and to productivity levels elsewhere) will show themselves not so much at the level of industries but at the level of "niches": products and three or four digit product groups, more often than not labour-intensive intermediates requiring the "right" level of skills for their manufacture.

Marketization and (hopefully) fast privatization should increase the number of medium-sized firms performing well under the conditions of infinitely greater openness and new opportunities arising therefrom. They would be the first beneficiaries of the shift to the market system.

Foreign Investment

Up to this point we have considered the search for comparative advantages in the context of mobile goods and immobile production factors. It should be immediately obvious that also in the case of inward foreign investment fast liberalizing post-STEs will have strong advantages.

Table 1

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1 Without intra-German trade.


3 Data quoted at the recent conference on East European reforms, Laxenburg, April 22-23, 1990 by Professor Gerhard Fink.