Experience of Hungary's Association Agreement

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Hungary's expectations

When Hungary began negotiating the Europe Agreement (EA) on association, one of the most important goals was that it should reflect (as expressively as possible) the ambition of Hungary to attain full membership and that it should establish a kind of link between the process of association and accession. Thus the association was considered as a preparatory stage leading to future membership. This also meant, in Hungary's opinion that the agreement had to contain elements assuring the intention of the partners to go beyond simple free trade and facilitate real integration.[1]

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

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1 Juhász (1993)

Hungary also requested the immediate elimination of the EC duties on as many as possible industrial goods. Hungary for its part was to eliminate its duties as gradually as possible.

Hungary wanted to see substantial and immediate concession in market access for agricultural products. The Hungarian delegation had concrete proposals and a list of requests. The list was rather ambitious: apart from requesting 50-100% levy reduction, it included products considered as the "hard core' of the EC agricultural policy. Among the Hungarian ideas was the aim to form a customs union, as some of the earlier association agreements concluded by the EC included provisions on the creation of a customs union. Including this goal into the EA could have been mainly a symbolic element reflecting the strong intention to become member. On the other side, from economic point of view, creating a customs union in a relatively short time would have risked to raise a lot of problems due to internal difficulties related to the transformation process and to the East European economic environment.

In the field of the opening of the EC labour market the starting expectation of the Hungarian delegation was to establish either EC level or bilateral quotas with member states for Hungarian workers. The Hungarian negotiators' position was that considerable liberalisation must be reached concerning the possibilities allowing Hungarian labour into Community services (including transportation, which was of particular importance at that time) and that the partners would take steps toward the free but asymmetric movement of capital. It was a Hungarian claim that the EA should lay down concrete forms and possibilities for broad political and economic cooperation and that the EC should offer solid financial assistance. The original concept was that this assistance would have been recorded (with defined annual amounts) in a financial protocol. Concerning the financial protocol the Hungarian delegation did not submit concrete numerical proposals because even the Hungarians did not fully agree on the issue.

Outcome and compromises of the negotiations

During the first stage of negotiations, which can be characterised as an offensive period from Hungary's point of view, it became clear that the EC's concept and mandate differed on some points from the Hungarian requests. The Community mandate did not tie, in any form, the association with further full membership. The process leading to industrial free trade was conceived by the EC in two stages (but without a complete timetable) with the insertion of a Community checking, which would make it possible to stop or to delay market liberalisation. In this period of negotiations the EC had no genuine reaction to the basic Hungarian proposals of phasing out duties. The EC mandate did not allow the liberalisation of the movement of labour and did not schedule any engagement for financial assistance.

The continuation of the negotiations and the (even partial) meeting of the Hungarian requests necessitated a modification of the EC mandate. It was done four month after the starting of the negotiations. The second stage of negotiations could be characterised by the tendency that more and more details had been concretely fixed after a modification of the Community's negotiating principles.

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

In the question of establishing free trade area between the partners the EC gave up the principle of progressing in stages with interim checking. This opened the way for negotiating concretely the full timetable of the elimination of duties. The EC flatly rejected the possibility of a customs union. At the same time it formulated a proposal for the phasing-out of its industrial duties, which (although with a few Hungarian objections) was not far from the financial version already acceptable for Hungary. On the other hand, the EC asked for a grater degree of liberalisation of the Hungarian import duties than was originally proposed by the negotiators, especially in the first years of the EA. This reflected the EC's intention to weaken the asymmetry. Its proposals concerning the weakening of the right to special, unilateral safeguard measures on the part of Hungary also intended to modify the asymmetry. At the same time, the EC did not show at this stage any willingness to decide the definitive elimination on quantitative restrictions on the textile products and had no real reaction or counter-proposal to Hungarian requests concerning agricultural concessions. In an informal way the EC offered some opening of agricultural markets, but these did not satisfy the Hungarian requests neither for the product coverage nor for the level of levy reductions.

The new EC mandate and the modified and less rigid standpoint of the Community negotiators resulted in some proposals concerning the free movement of workers, services and capital. They offered rather modest changes in the conditions of access to the EC labour market. This was very far from the Hungarian proposals based on explicit quotas for Eastern European workers. On the other hand, concerning capital movement and services, the EC wanted to see much stronger liberalisation in Hungary. At this stage of negotiations no comforting results were achieved in these three areas. The EC's position remained low-key on the question of financial assistance, especially concerning definite amounts. At the same time partners successfully (without major contradictions) fixed most of the parts of the text determining the different fields and forms of economic and political cooperation.

In the middle of negotiations, it became clear and was outlined which questions the partners could successfully negotiate (or were close to a compromise) and which problems could not be settled on the basis of the then mandate because of the differences in partners' points of view. Here we have to mention on the EC side the timetable of liberalisation of textile trade, the opening of the agricultural markets, the possibility of the Hungarian workers to have access to the labour market and the question of the financial assistance. On the Hungarian side the most problematic issues were the opening of the market of services and the degree of the liberalisation of capital flows. Questions about mutual regulation of general and specific safeguard measures were also raised in this phase of negotiations but there were no irreconcilable differences of opinion.

Before the final third stage of negotiations it became more or less clear that the negotiations could only be concluded if the EC modified its position and at the same time Hungary accepted some compromises, changing its standpoint in a way that its original requests were reduced. This re-interpretation of positions took place on both sides before the last two concluding rounds of negotiations.

At that stage, the EC was already inclined to accept (even if indirectly) a final deadline for the liberalisation of trade in textile products. This timetable was (and that was a compromise on the Hungarian part) longer than in the case of most of the other industrial products. It was also an involuntary compromise that the Hungarian delegation modified its first and original proposal concerning the elimination of industrial duties and quantitative restrictions in Hungary. Anyway, the original proposal to liberalise the import regime (especially for the first years of the agreement) was rather modest, was practically no more than a gesture and was based on a long timetable. Nevertheless, Hungary could avoid in a satisfactory degree hurting the principle of asymmetry. The extraordinary pressure coming from the Community delegation concerning bigger and faster industrial trade concessions in the Hungarian import regime could be partly explained by the fact that Polish and (at that time) Czechoslovak negotiators accorded more important liberalisation to the EC in the first stages of free trade than Hungary did. Thus, it may be said, that there is strong link and interaction between similar negotiations conducted by the EC/EU in parallel with several partners.

The proposals of the EC for opening the agricultural market already showed important changes in comparison with its original and more modest concept. This more or less corresponded to the Hungarian request list. The price for this compromise was that the relatively important asymmetry in favour of Hungary had to be reduced. The EC negotiators achieved this by concentrating bargaining on the product coverage and the volume of preferential quotas. It is interesting to note that the final set of requests of the EC represented a sort of shopping list in which specific products and concessions could be linked to concrete member states. The negotiating staff of the Commission evidently tried to "sell the deal" to member states by satisfying the specific requests of each of them.

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

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

Europe Agreement and further steps on the way to EU membership

Despite its compromises, the Europe Agreement played important and in some field essential role in reorientation and substantial upgrading of Hungary's trade relations, in modernisation of its structure and enforced market economy type trade policy discipline. The EA contributed to the modernisation of the economy, created favourable conditions for a massive inflow of foreign direct investments.

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

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

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

Trade policy slippages in the period of association

This chapter contains an overview of those Hungarian trade policy measures taken during the 1990s that meant a certain deviation from the general rule, tendency and logic of the liberalisation process.[2] In most of the cases of the practical application of these measures there is nothing special. They are frequently used in the international trade policy practices. Nevertheless, they reflect a situation when the existing trade policy regulation is being considered not protective enough or when specific public policy and sectoral considerations prevail over the general tendency.

Probably the most important general trade policy deviation from the prevailing logic, having an across-the-board effect was the introduction in March 1995 of the import surcharge of 8 percent, implemented on the erga omnes basis. It was one of the main features of the March 1995 package of stabilisation measures designed to address serious macroeconomic imbalances. Its temporary character was stressed from the introduction. This measure was notified to the WTO and justified by the Hungarian government on balance-of- payments grounds. The surcharge was applicable to imports from all sources and covered all products except primary energy products. It was refundable in the case of machinery imported for investment purposes. As the surcharge was in-

[2] This chapter and the next one are based on Meisel (2005)

cluded in the selling price upon which VAT was levied, the overall restrictive effect of the surcharge considerably exceeded 8 percent. It was gradually reduced to 6% from 1 October 1996, 4% from 10 March 1997 and 3% from 15 May 1997 before being eliminated on 1 July 1997.

As far as the measures taken on the basis of the national customs legislation are concerned, one of them was introduced in 1992, just after the entry into force of the Europe Agreement. At that time Ford was considering to make important investments in Hungary and as part of the incentive package, besides tax and other preferences allowed by the legislation of that time, trade preferences also were shaped. It meant that customs tariff specification of the vehicles of the Ford Transit category were modified so as this vehicle was able to enjoy duty free market access, thus having on important preference as compered to the competitors. In a very short time this measure was sharply contested by the European Commission because of the discrimination incompatible with the Europe Agreement. The Hungarian authorities could not re-establish the original duty because it would have contradicted to the stand still provision of the EA. So the 0% duty remained in force for all the types of the vehicles of this category.

The other measure of this kind was the increase of certain not bound in the GATT agricultural duties. At that time a lot of domestic criticism was formulated concerning the agricultural trade scheme of the EA and the sudden increase of agricultural imports from the EU, associated with the impact of the Agreement. Nevertheless, besides the market protection effect, this step may be considered as a symbolic gesture in favour of agriculture, which is reflected by the fact that tropical products were also included in this regulation. The prevailing motivation besides this gesture was budgetary consideration to increase customs revenue.

The Europe Agreement contained unilateral provision allowing the associated states to take exceptional measures to temporary protect infant industries and those undergoing restructuring. The timetable and conditions of such measures have been fixed in the EA. Shortly after the entry into force of the Interim Agreement, in February 1992, Hungary formulated a request to use this tool in the case of 16 products, among them passenger cars that really could have been considered as subject to infant industry clause (remember Suzuki and GM that opened new plants in Hungary). After long lasting consultations Hungary withdrew from the request list a lot of products and the EU accepted as justified the temporary increase of duties in the case of 8 products, belonging to 3 product groups. (See Table 1.) So it is justified to conclude that Hungary was able to benefit from this possibility only to a limited extent, especially as compared to some other associated countries.

General safeguard clause was the most frequently used market protection tool of the Hungarian import regime before the accession to the EU. This fact is reflected in Table 2. Hungarian authorities introduced erga onmes based safeguard measures in three cases and this happened before the entry into force of the WTO agreement. After 1995 such measures have been taken in trade with Eastern European countries, republic of the CIS, not members of the WTO. Utilisation of this instrument is seemingly concentrated on relatively few industries. Application of the general safeguard clause by Hungary was the most frequent in the steel sector, followed by cement industry including products made from asbestos.

Table 1.
Measures taken on the basis of infant industry or restructuring clause

Legal basis	Application	Content	Countries affected
Art 28. of Europe Agreement	1995-2000	Increase of duties for insecticides, fungicides, herbicides, disinfectants	EU Member States
	1995-2000	Increase of duties for wood-free paper and coated paper	EU Member States
	1995-1997	Increase of duties for tempered glass and laminated glass	EU Member States

Source: Meisel, 2005, p.209.

Table 2.
General safeguard measures

Legal basis	Application	Content	Countries affected
Government Decree No 113/1993 Art 30. EA Art 28. CEFTA Art 20. EFTA	1992-1993	Import restriction on cement	Erga omnes
		Import restriction on intra-ocular lenses	
		Import restriction on certain paper products	
Government decree No 113/1993	1995-1996	Quota on imports of cement	Rumania
	1998-2002	Quota on steel products	Russia, Ukraine
	1998-2000	Quota on certain steel products	Ukraine
	2000-2004	Quota on steel products	Russia
	1999-2003	Surcharge on imports of ammonium fertiliser	Russia, Ukraine

Source: Meisel, 2005, p.210.

Besides the above mentioned slippages of Hungarian trade policy some other also should be quoted.

In the 1990s Hungary, like almost all of the European trading partners, several times used import restrictions on the basis of phytosanitary and veterinary regulations. From time to time Hungary applied such restriction vis-a-vis the EU members and CEFTA countries.

Speaking of internal measures affecting imports an important step should be mentioned. Under the Customs Duty Law of 1995, imports of cars older more than four years were prohibited between 1995 and 2000, on environmental and safety grounds. An exception involved specialised older vehicles, which were allowed to be imported, provided they passed a special technical test. Along with rather high tariffs on cars imported from MFN partners this measure benefited domestic carmakers and also EU and CEFTA producers enjoying growing tariff concessions.

Turning now to export regulation, here one can also observe some backsliding. These entirely concern agricultural trade. Hungary during the 1990s several times applied temporary, export restrictions on certain agricultural products (mainly animal feeds wheat and sweet corn) on the basis of shortage clause. As the statistical and information system of the Hungarian agriculture was far from being transparent, it is difficult to judge about the justification of such measures.

Determinants of the Hungarian trade policy in the period of association

It is not easy to point on a few evident determining elements that shaped Hungarian trade policy during the 1990s. Determinants sometimes are hidden and in many cases their impact is not direct but is often interrelated. So the following description is only on attempt to discover some possible elements that played role in the Hungarian trade policy formulation.

Probably, the most important determinant of the Hungarian trade policy during the 1990s was a strong commitment to achieve a successful transition to market economy, to advance in the integration in the world economy and to establish as close links a possible with the European Union, taking into consideration the accession to the EU as a strategic objective. These commitments may explain the fact that the strategic and dominant tendency of economic and trade policy liberalisation – despite some slippages – was maintained. Thus institutional and legal instruments, both GATT/WTO objectives and preferential agreements enforced this general track. Certainly, in some cases and periods, especially in the first years of the 1990s, there was a certain discrepancy between the pace of liberalisation optimal from the point of view of the internal transformation and that prescribed by external commitments. It is also true that external agreements limit the room of autonomous actions. Nevertheless this external institutional setting served as an important stabilising element of the liberalisation. The starting of the accession negotiations even reinforced this impact. Obviously trade policy can be hardly shaped and implemented without certain interactions with other internal policies. The direct link between trade policy and its major backsliding in Hungary during the 1990s is evident in the case of the macroeconomic stabilisation program and the introduction of the overall import surcharge. Apart of this measure, macroeconomic policy did not directly affect trade policy formulation, at least it did not enforce any other deviation from the general line.

Referring to the slippages of trade policy analysed in the previous section, a clear determining impact of financial and budgetary considerations can be observed in the case of the increase of agricultural duties.

Developments and backsliding of trade policy on sectoral level can be explained differently.

In Hungary far most of the protective measures (in the form on safeguards) were taken in steel sector. Here, it seems, the negative consequences of – to some extent – premature liberalisation of the quantitative regime, the lack of a clear industrial policy as well as of regional development policy, and, as a result employment problems were compensated by increasing the level of trade policy protection.

Partly this is true for the cement industry, where the bargaining power of the actors is much stronger, although the economic situation was similar to that in steel production.

In the paper industry, which also enjoyed market protection, a strong foreign company acquired the most important production plants and shortly after this, it was able to prove potential injury of imports that led to the application of a safeguard measure.

These two cases demonstrate the fact – which was predicted in early 1990s – that a more powerful foreign company is better placed in requesting and argumenting for protective measures as compared to traditional domestic firms. It should be noted that this situation somewhat changed and domestic companies also have learned how to protect their interests.

A rather coherent picture can be observed in the car industry. In the beginning of the 1990s this was an entirely new industry in

Hungary. During the association talks Hungary was able to resist the strong pressure of the EU aiming at a rather fast liberalisation of this sector. According to the provisions of the Europe Agreement trade of passenger cars was liberalised only at the last stage. A rather strong tariff protection was maintained in relation with MFN countries, which was often subject to criticism, mainly by the USA. This high level of protection was complemented between 1995 and 2000 by imposing ban on the imports of cars older than four years.

It is interesting to note that there were traditional sectors that remained relatively less protected, although professional interest groups of them were permanently arguing for stronger protection. The pharmaceutical industry can be mentioned as examples. One should not forget, certainly, that trade of pharmaceuticals is not a pure trade policy issue and is closely related to the social security system. This trade till 2001 was subject to individual licensing but the representatives of the industry always complained of permanent overlicensing.

As in most of the European countries, including first of all the EU, trade policy regulation of the agricultural sector is a specific issue. Trade policy formulation in this sector is highly influenced by internal political considerations. This is the same in Hungary, as in many Central and Western European states. Internal trade policy disputes in the 1990s were immediately transmitted on the highest political level. That made Hungarian agricultural trade policy rather unstable and vulnerable. But this was only one element of instability.

Probably more important element of instability was, on one hand, the lack of a well-defined agricultural policy. It is rather difficult to build up a consistent agricultural trade policy without the basic policy. On the other hand – interpreting the matter in a simplified way – the system of information on the agricultural sector (who is producing, what is producing, how much is producing?) could be established only with difficulties. It was almost impossible to formulate a coherent trade policy on this unstable basis. This was reflected in symbolic – from political point of view – measures (like tariff increase in 1994), or in sudden and questionable restrictions on exports. Contrary to some other Central and Western

European countries, the political sensitivity and economic uncertainty represented the main determinants of the agricultural trade policy in Hungary and not the existence of a strong agricultural lobby. Nevertheless, it is legitimate to note that in this sector trade policy slippages were not more frequent than in some others.

Hungarian experience and general lessons

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

If there is enough political motivation and willingness, the European Union can change its negative or reserved attitude even on the toughest questions. Hungary had a theoretical and practical possibility to influence effectively the provisions and the rules of the Europe Agreement and in many cases was able to overcome the absolute rigidity of the EC in some areas.

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

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

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

- Political determination seems to be an essential element of elaborating a successful agreement. The concept of negotiations and the process of implementation – if possible - should be backed by broad internal consensus (political elite, government institutions, business, population, etc.).
- Clear definition of the country's interests may influence in an efficient way the course and the outcome of the negotiations. It can only based on well-developed and prompt cooperation and interaction between the different actors of administration, business and civil society.
- Stability of the trade policy administration is desirable.
- It is important to mention the need to be able to form coalitions with member states. It is not only in Brussels where trade policy decisions are elaborated. A country being in a process of negotiations and close cooperation should not neglect the "capitals" (i.e. administration) of the member states.

- The Hungarian experience shows that trade policy concessions are undoubtedly important, but the stability of domestic macroeconomic conditions is even more essential in order to take profit from the renewed framework of cooperation with the European Union.
- A trade agreement incorporates and enforces trade policy discipline and stability. Nevertheless, authorities of an associated country should not be "shy" or "servile" in using trade defence instruments, when needed. On the other hand, they have to resist to misuse them.
- In the process of upgrading the relations with a partner like the European Union, it seems to be essential to establish a workable framework of dissemination of information and dialogue with all partners, practically with the society. Unfortunately this was a weak part of the preparatory work in Hungary before the association. The consequences were unfounded illusions in short run and disillusions after.

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