

Successes of trade reorientation and expansion in post-communist transition: an enterprise-level approach

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The geographic structure of trade in the East Central European post-communist economies underwent radical change in early transition. After only a few years (from 1989, the last full year of communism, to 1992, or 1994 at the latest) the dominant part of their trade, both exports and imports, shifted from the East (i.e. intra-COMECON) to the West, or in other words to trade with the mature Western economies. The general thrust of this reorientation has been dealt with in most articles dealing with foreign trade changes (including some by this author, see, e.g., Winiecki 1998a).

It was not only the speed of the westward reorientation that was particularly striking, but also various other features: indeed, the trade of the East-Central European transition countries – especially those regarded as ‘success stories’ – has been growing at a distinctly higher rate than world trade in general, in stark contrast with the foreign trade performance of the communist economies in the preceding decades, increasingly outdistanced by the other groups of countries.

To give a better idea of the dynamics of the westward reorientation, Table 1 presents the 1989-96 data on exports to the West (i.e. OECD countries) both in absolute terms and relative to the dynamics of world exports, revealing quite clearly that the successful transition countries increased their exports at almost twice the rate of world trade in the period under consideration (while Czechoslovakia, and subsequently the Czech Republic, increased its exports at about three times the world rate!).

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TABLE 1

EXPORTS FROM EAST-CENTRAL EUROPEAN ECONOMIES TO THE WORLD
MARKET RELATIVE TO WORLD EXPORTS, 1989-96
(1989 = 100)

Country	Export Dynamics (Absolute)	Export Dynamics (Relative to world exports)
Czechoslovakia/ Czech Republic + Slovakia ^a	544.8 ^b	319.3 ^b
Czech Republic	210.1 ^{b,c}	147.4 ^{b,c}
Poland	335.4	196.6
Hungary	290.3	170.2
Bulgaria	288.1	168.9
Slovakia	168.5 ^{b,c}	118.2 ^{b,c}
Romania	134.0	78.5

^a Data for Czechoslovakia for 1989; summed up exports of the Czech Republic and Slovakia for 1996.

^b Indicators for the Czech Republic and Slovakia are overstated due to the emergence of the trade between the Czech Republic and Slovakia as foreign trade.

^c Indicators for the 1993-96 period (1993 = 100).

Sources: OECD foreign trade statistics. Own calculations.

Thus trade was not only reoriented westwards, but also grew at rates much higher than elsewhere. An important consequence of the rapid growth in exports is also seen in the reversal of another long-term trend: while the communist countries had for decades been losing their world market shares (excluding the distorted trade among themselves), the post-communist countries of the region saw their shares increasing significantly in the 1990s: from 0.2 to 0.4% for the Czech Republic, from 0.2 to 0.3% for Hungary and from 0.3 to 0.5% for Poland. The Czech data do not reveal the full story as comparison here is between the 1989 share for Czechoslovakia and the 1996 share for the Czech Republic (adding data for Slovakia would improve the record further). Bulgaria also doubled its share, but from a very low base (from 0.04 to 0.09%), the only distinct laggard being Romania, whose share declined.

These countries were especially successful on the demanding markets of Western Europe, increasing their exports much faster than growth in the aggregated imports of the European Union countries. To give but one example, Polish manufactured exports to the EU in 1992-95 alone increased by 67% in the face of an aggregate growth of European Union manufactured imports of only 7%.

All in all, this is a very impressive foreign trade performance, and it surprised nearly everyone, especially as the communist record in this respect had been so uniformly bad – and indeed going from bad to worse (see i.a. Winiecki 1988). Such dramatic improvements called for explanation, and the literature on transition, and more specifically foreign trade in transition, has some answers to offer.

At the most general level it has been stressed, rightly, that there is a strong correlation between success in transition from plan to market (and the parallel or, in fact, preceding transition from totalitarianism to democracy) and foreign trade performance on the world markets. The best study in these terms is by Kaminski, Wang and Winters (1996), although their findings are too general for our purpose. It is undoubtedly true that without internal and external liberalization, without sound macroeconomic policy, and without the build-up of market institutions (and, let us add, without privatization), performance in foreign trade, like that in the other areas of economic activity, would have been much weaker. The differences between these 'success stories' and the fortunes of Bulgaria and, even more, Romania (to say nothing of the countries further East) well exemplify the basic soundness of transition-based generalizations.

However, the general thesis fails to explain the particular dynamics of trade reorientation and its other characteristic features. After all, westward trade reorientation might have taken place at any speed, above, equal to or below the rate of growth in world trade.

Moreover, the general thesis fails to account for certain particulars. It cannot explain the commodity composition, or structure, of trade in transition, nor the changes in that structure over time. In fact, both the geographic and commodity structures need a combination of historical (communist system-specific) and trade-theoretic explanations to show the contribution of both local and general determinants of exports.

The general thesis is, of necessity, silent on enterprises and their behavior in transition – their adjustment, non-adjustment, and quasi-adjustment strategies. For the purposes of this paper, it has nothing to offer regarding the relative importance of certain types of strategies, enterprises or industries over time, at different phases of the transition process. It is this broad range of issues we address below.

The need for such a broad approach is all the more evident when we survey the detailed trade-in-transition literature. If the trade-

success-follows-transition-success approach is too general for the purpose at hand, the detailed studies of foreign trade or, more often, exports are usually too specific, tending to concentrate on a single issue, such as 'distressed sales' of traditionally eastbound goods on the Western markets, the role of FDI in generating foreign trade, issues related to commodity composition (e.g. the role of intra-industry trade) or institutional arrangements (the outward processing trade). Rarely do they attempt to embrace a combination of factors determining successful world market performance, nor has any foreign trade study to-date weighed the varying importance of the diverse strategies pursued by enterprises (state-owned, privatized, foreign, or *de novo* private firms) in the transition process for aggregate export performance.

1. Communist history and trade theory: do expectations match?

Although the stress here is on micro-level performance it is, as we have already seen, impossible to abstract from history and theory. Therefore, I shall begin with a brief comparative inquiry into the rationale of trade performance expected on the basis of Soviet system-generated output *cum* trade distortions and in terms of the dominant trade theories, both classical (Heckscher-Ohlin) and alternative, concerning trade in manufactures.

To begin with, as I posited in a previous paper (*i.a.* Winiecki 1998b), since the post-communist economies in the region displayed many characteristics of middle-developed (albeit distorted) economies, the search for expected trade patterns in transition should begin by looking at the trade patterns exhibited by the middle-developed countries in non-communist Western Europe that – in terms of development measured in GNP *per capita* – belong to the same intermediate group of countries. The difference between them and the countries in question – a very significant one – is that the former did not undergo any traumatic systemic changes, and therefore their development patterns – including trade – may be regarded as more or less typical.

For example, the output and trade patterns of such middle-developed countries as Spain, Ireland (at that time) and Portugal,

showed much larger shares of light industry products than did the communist countries' exports. Therefore, in transition one should expect a shift in the commodity export structure resulting from sharper increases in the exports of light industry products and those characterized by higher levels of processing, such as clothing, furniture, pottery and china, glass and glass products, etc.

These expectations, based on the historical/empirical observations of stages in economic development process, are in perfect concordance with the trade theory-based expectations. The comparative advantages of the middle-developed economies are expected to lie largely in products requiring large quantities of semi-skilled labor (often products that are at the same time also natural resource-intensive). Most of the industries listed above belong to that category, and indeed one would hardly expect otherwise, as different development levels are closely associated with different factor abundance patterns.

Another relevant, expectations-related comment is that new patterns of comparative advantages may – in all probability – mean old patterns of comparative advantages that (hopefully) survived communist economics-generated distortions. Pre-war Czechoslovakia and Hungary, and to a somewhat lesser extent Poland, Romania, and Bulgaria could, even then, be roughly classified as middle-developed economies. Consequently, once the communist system-specific barriers to normal developmental patterns were removed, their exports should reflect the pattern of development of the pre-communist past, or in other words show the comparative advantages of middle-developed economies at a somewhat earlier stage of development, their exports thus containing larger shares of early industrialization-related products such as textiles, leather, wood products, etc.

The exception should be Czechoslovakia (now the Czech Republic rather than Slovakia), because the Czech lands of the Habsburg empire had already become a large centre of heavy industries, especially in the field of engineering, a century ago. Under communism they underwent the peculiar process of economic 'reprimitivization' (see Winiecki 1988, and Winiecki and Winiecki 1992 on Czechoslovakia and the former East Germany). Therefore, under the new circumstances the Czechs should more readily return to their old patterns of exports, consisting of a larger share of heavy manufactures than in the other post-communist countries under consideration.

Other expectations concern the characteristics of branches of industry that might have affected export prospects in transition. Thus, one should expect, *i.a.*, that within an oversized – and severely distorted – heavy industry a minority of good performers, or at least firms with the capability to adjust, would emerge and, with often extraordinary efforts, find profitable niches on the world markets.

These observations square reasonably well with the trade-theoretic rationale offered in Winiecki (1998a), arguing that the post-communist economies would probably do reasonably well in exporting some intermediate inputs for further processing, especially in capital-intensive industries, including engineering, where a favorable mix of relatively skilled (but low paid) labor combines with large amounts of capital (although not usually of a very sophisticated variety). This type of comparative advantage is fairly consistent with the theoretical strand of thinking differentiating between horizontal and vertical intra-industry trade and linking the latter with differences in the level of economic development and associated different factor proportions (see, in particular, Falvey 1981). Within the framework of vertical intra-industry trade the middle-developed post-communist countries would export less sophisticated, less value adding parts, components and final products within the SITC product groups and import more sophisticated, value adding ones.

This framework of vertical intra-industry trade can also be extended to include trade based on the expanding possibility of production process fragmentation. In the course of time, and especially as from the 1970s, manufacturing activities became increasingly broken down according to the labor-intensity and capital-intensity of various stages of processing. In order to improve competitiveness through the reduction of labor (or, more precisely, of unskilled and semi-skilled labor) costs, Western firms, multinationals and others moved the labor-intensive – and increasingly also the simple capital-intensive – phases of manufacturing outside the high income, high wage areas. Thus, differences in factor endowments led to the emergence of yet another form of intra-industry trade differing from the traditional definitions of that trade, based on product differentiation or differences in product quality. This type of trade should also expand in transition – and beyond – as it is based on the same differences in factor endowments between post-communist East-Central Europe and

the Western world (Western Europe in the first place, given its geographic proximity).

Now, since the initiative to delocalize phases of production usually comes from firms in mature industrial economies, the growing role of that type of trade has been related to the appearance of multinationals (MNEs) in countries in transition. However, even without the multinationals' presence through direct foreign investment, this type of trade had already begun making its mark in trade relations between Western and Eastern Europe in the last decade before the demise of communism. Here the mind turns to what has been come to be known in West European terminology as outward processing trade (OPT), and in American terminology as *maquiladora*, or in other words the processing or assembling of inputs exported from a more developed country by a less developed country, which are then shipped back to the more developed country, usually reinforced by some quota or tariff advantages. These types of exports, mostly in light, labor-intensive industries, were on the increase in the 1980s and grew from strength to strength in the 1990s under the conditions of systemic change (see, e.g., Lemoine 1994 and Synowiec 1995), expansion often being achieved through arms-length trade (often, even, on the initiative of major retailers, rather than manufacturing firms), without the presence there of the MNEs.

Altogether it may be said that there is a reasonably good concordance between considerations based on the level of development (even taking into account communist *maldevelopment*) and those based on the comparative and other advantages stressed in the respective trade theories. This is hardly surprising. After all, each level of development is associated with a given mix of production factors, classical and non-classical, which in turn suggest the comparative advantages of the country under study.

Of course, given communist system-specific distortions, some expectations would not fit in with any trade theory. For example, no location-based trade theorizing would be specific enough to take into account the peculiar distortions from which long ago the Czech author Kolanda (1984) drew the conclusion that the least demoralized, and therefore best performing in westbound trade, would be the enterprises of moderate size, usually located far away from the communist centres of power (of course, working under communist censorship he did not put it in so many words...), since the relative lack of

attention resulted in a smaller share of investment blunders, and less pampering of management and workers with privileged access to scarce resources and the associated, excessively high wages. His analysis of early foreign trade performance in transition by Czechoslovakia (Kolanda 1993) seems to have confirmed the pattern under different systemic conditions.

Finally, one important communist system-specific characteristic seems to be worth signaling at this point, given its potential for affecting export performance in transition. Long ago (Winiecki 1990) I had occasion to remark that the external liberalizations of the (then) communist economies and those of the less developed countries (LDCs) must differ in one important respect (all other remaining constant). In the latter countries liberalization traditionally aimed at change in the relative size of the tradable and non-tradable sector in favor of the former by means of the resource allocation mechanism, while in the former the tradable sector (roughly agriculture plus industry) was already too large and, therefore, the increase in the supply of exportables must mean something other than the shift of resources from the non-tradable to the tradable sector.

Indeed, it did mean something else. For the communist economies, the main problem throughout their existence had been to find goods of sufficiently good quality within the tradable sector that would be saleable on the world market. In other words, the task was to find 'saleables' within the much larger category of tradables!

Now, in the *post*-communist economies that task became much easier, because, with internal and external liberalization, many disincentives to turning out higher quality goods disappeared, while the range of produced goods was large enough for many success stories to self-select themselves – a point that may, by the way, be one of the major explanatory variables of the extraordinarily rapid westward export surge of the countries under consideration. This linkage is one of the topics that I am going to consider at some length later.

2. The westbound export surge

2.1. *The early 'distressed sales' argument*

The trade reorientation was not only rapid but also broad-based. Data on exports from East-Central European economies in transition, classified in accordance with SITC product groups, suggest export increases over a very broad product range. An even more interesting picture emerges, as Benacek (1997) recently pointed out, if we calculate not only export dynamics, but also the relationship of exports to outputs.

Benacek calculated that these ratios increased in early transition (1989-94), often substantially, across the board for both light and heavy industries. His calculations for selected industries in both broad groups of manufacturing products for the Czech Republic are shown in Table 2.A. My own calculations for Hungary for the same early transition period (1990-94) confirm the pattern of increasing export/output ratios for both light and heavy industries (although, in contrast with the Czechs, the Hungarians increased the ratios more in light than in heavy industries).

A predictable 'outlier' in the pattern proved – in both countries – to be the engineering industries. The reasons for the decline in the ratio in question are obvious. With the disappearance of the communist economic system the markets for obsolete machinery and equipment disappeared as well, both domestically and in other ex-COMECON countries, and exports in engineering goods plummeted. The extent of the drop can be seen in Diagram 1, where exports of engineering (SITC 7) goods from Hungary are shown to have declined from very high levels (45-60% of total exports to communist countries) to something like 15%. Thus, by 1992 Hungarian exports of engineering goods to both East and West showed roughly similar shares in the total exports, as might have been expected since the earlier 3:1 ratio was the system-specific aberration, resulting from the existence under communism of dual foreign markets: the undemanding COMECON market and the demanding world market (on this point see Winiecki 1998a).

The general pattern of increases in export/output ratios in both light and heavy industries did not, however, jibe with the earlier ex-

TABLE 2

OUTPUTS AND EXPORTS IN CZECH AND HUNGARIAN
SELECTED LIGHT AND HEAVY INDUSTRIES
IN THE EARLY TRANSITION PERIOD, 1989-94

A. The Czech Republic

Industry	Output in 1994 ^a (1989=100)	Exports/ Output ratio in 1989	Exports/ Output ratio in 1994
<i>Light Industries</i> ^b	0.66	0.27	0.38
Textiles & clothing	0.56	0.27	0.39
Leather & shoes	0.55	0.31	0.33
Wood and products	0.93	0.26	0.38
<i>Heavy Industries</i> ^b	0.48	0.23	0.35
Iron & steel	0.84	0.13	0.35
Engineering goods	0.49	0.34	0.36
Transport equipment	0.48	0.27	0.34
All manufacturing industries ^b	0.64	0.17	0.25

B. Hungary

Industry	Output ^c in 1994 (1990=100)	Exports/ Output ratio 1990	Exports/ Output ratio 1994
<i>Light Industries</i> ^b	0.85	0.22	0.32
Textiles, clothing, leather & footwear	0.68	0.36	0.59
Wood, paper & printing	1.04	0.07	0.13
<i>Heavy Industries</i> ^b	0.83	0.41	0.44
Base metals and metal products	0.82	0.26	0.37
Engineering goods, transport equipment & precision instruments	0.83	0.51	0.48
All manufacturing industries	0.83	0.30	0.31

^a Gross output.

^b Only industries listed in the table.

^c Sales.

Sources: Data for the Czech Republic from Benacek (1997). For Hungary from national statistics; own calculations.

expectations of stronger comparative advantages for most East-Central European countries in transition in the unskilled/semi-skilled labor-intensive industries, roughly associated with light industries (the exception might be Czechoslovakia, later especially the Czech Republic, and to some extent Hungary). This discrepancy between expectations and realities, coupled with fast increasing exports of heavy manufactures from the countries in question prompted inquiry into the causes of the phenomenon.

The 'culprit' most often pointed out is the so-called *distressed sales* strategy of state-owned enterprises in these countries; in order to survive the simultaneous fall in domestic and ex-COMECON demand, the thesis has it, the state enterprises simply redirected westwards products traditionally exported to the East. The exception would, presumably, be engineering goods, given the limited market for obsolete machinery and equipment outside the by now disappeared communist world.

As a preliminary hypothesis for a readily observable phenomenon the *distressed sales* argument might have done, but questions soon arose as empirical studies gave the thesis rather limited support. For example, Hoekman and Djankov (1996) do not regard *distressed sales* as an important factor in the dynamic growth of westbound exports, estimating them to be limited to something between 12-20% of the aggregate exports in that direction.

Kaminski, Wang and Winters (1996) point out that for the *Višegrad countries* (former Czechoslovakia, Hungary and Poland), at least some of the large increases in manufactured exports were accounted for with redirection from the ex-COMECON markets (as well as the replacement of some East German exports to European Union), adding (but with scant reference to empirical material) that with respect to Hungary and Poland redirection appears to have played an important role. Their assessments square fairly well with suggestions that a major decline in Hungarian westbound exports and slowdown in Polish exports in 1993 were consequential on the disappearance of the loss-making exports that enterprises could no longer sustain (for Hungary, see comments by Kornai 1993).

By contrast, Brenton and Gros (1997) treat the issue as little more than marginal, claiming to have detected major shifts in the product structure of westbound trade in the transition countries analyzed, in comparison with their traditional exports. Given the chan-

ges in the commodity composition of exports, they do not regard the redirection issue as a primary contributor to the major expansion of trade with the West.

Given these, and other, differences of opinion, common sense suggests starting with the economic logic of the argument and, subsequently, turning to the basic statistics for preliminary confirmation or refutation as the case may be. Thus, certain manufactured products, heavily traded among the COMECON countries, could have been redirected to Western markets, and especially to the nearby markets of West Europe. Our knowledge of the communist economic system suggests that the ease of redirection would be negatively correlated with the degree of sophistication of the products. Basic inputs – some of the less sophisticated manufactured products – would stand better chances of being exported than (largely obsolete) machinery and equipment.

TABLE 3

DYNAMICS OF HEAVY INDUSTRY EXPORTS FOR SELECTED PRODUCT GROUPS
IN TWO SUBPERIODS: 1988-92 AND 1992-95
(starting year of each subperiod = 100)

Country/ Product group		Bulk Chem. (Org.) SITC 51	Bulk Chem. (Inorg.) SITC 52	Rubber & Prod. SITC 62	Paper & Prod. SITC 64	Iron & Steel & Prod. SITC 67
Bulgaria	1988-92	65.0	535.4	659.7	300.4	211.0
	1992-95	296.3	230.1	93.0	262.9	352.2
Czech Rep. ^a	1988-92	107.3	201.1	300.0	348.5	218.4
	1992-95	180.3	142.3	175.0	216.9	191.7
Hungary	1988-92	122.3	111.6	152.7	325.1	94.5
	1992-95	115.9	264.9	157.1	178.3	162.4
Poland	1988-92	164.6	107.4	321.9	322.6	200.6
	1992-95	176.3	197.2	219.8	274.1	189.7
Romania	1988-92	56.1	75.1	39.4	14.6	67.9
	1992-95	296.3	284.8	423.1	565.8	263.3

^a Data for 1988 and 1992 are for Czechoslovakia.

Source: OECD foreign trade statistics; own calculations.

And this is roughly what happened. Table 3 shows the dynamics of exports for the two periods of 1988-92 and 1992-95 for some heavy manufactures. Exports of bulk chemicals, rubber products, paper products, and iron and steel products increased in the earlier period, i.e. the one associated with simple redirection of traditional COMECON exports, an increase shown by 5 countries (Bulgaria,

Czechoslovakia, Hungary, Poland and Romania) in 16 cases out of 25 and, if Romania (a definite 'outlier' in the earlier period) is excluded, in 16 cases out of 20. Thus there is some support for stressing the importance of simple redirection of the traditional communist exports to the West.

But the support only goes that far, for if we look at the later, 1992-95, period we find that the export dynamics were sustained or accelerated in the following years, with growth in exports of the products in question over the 1992 level in 24 out of 25 cases (Romania joining all the other countries in export growth).

However, in order to prove the existence of *distressed sales* it is not enough to show that exports increased as such. *Distressed sales* are just what the term means, that is sales at any price (even at a loss). We do not have the cost data for East-Central European enterprises for these years (and even if we had, it would not help us much given the then different accounting standards), but economic logic suggests that no firm can continue selling below production cost in the long, or even in the medium run.

Therefore, although one might accept the redirection of trade thesis as a reflection of a common strategy chosen by the SOEs in heavy industries (in order to maintain certain volume of output rather than close production lines) in the short run (say till 1992), the thesis would be much less acceptable in the medium run, since the SOEs could not afford to go on accumulating losses until 1994 or later. For this very reason the data in Table 3, registering the continuous – and often even faster – growth of exports in the later period, cast doubt on the simple relocation thesis. For if the East-Central European exporters maintained their market shares, or even increased them in the longer run, then they might have simply been efficient exporters rather than distressed producers exporting at any price they could get.

In the light of all this, should we reject the *distressed sales* thesis and substitute it with an alternative thesis based on an efficient search for new markets in early transition? The answer is that we cannot – and for a number of reasons.

The first reason is that we have yet to look at the producers' costs and prices obtained by the East-Central European exporters on the Western markets. As we have seen, the costs are not available, but the unit prices on the European Union markets are and they should tell us something – something, but not everything, since unit prices

(on per kilogram or per ton basis) are indicative of two things together, namely of higher (or lower) unit prices for a given product or for a shift to higher (or lower) value products within a given product group (for more detailed analysis of the methodological issues involved, see Ohlsson 1980), and changes in the unit cost indicator may mean either.

In our particular case, unit prices in 1990-94 falling lower than in the earlier periods may suggest *distressed sales*, but not necessarily. Indeed, lower unit prices may alternatively mean a shift within a given product group towards simpler, lower value added products. Looking into the unit prices in East-Central European exports to Western Europe, Lemoine (1994) did not find the decrease in unit prices in 1988-93 period to be a common phenomenon. The only major product group she analyzed where the results were ambiguous was iron and steel (SITC 67) but, then again, she found declining unit values for simpler, less value adding products, and rising unit values for more value adding ones. From the relative size of both types of exports within that product group in the period under consideration she concluded that exporters restructured their product range towards the upper end of the product change. The unit price data in Table 4 for other heavy industry product groups (engineering goods, chemicals, tires) seem to confirm Lemoine's findings that no general decrease in unit prices took place between the communist period and the early transition period (1985), while the light industry product groups showed significant increases in unit prices relative to both the communist past and the present competitors on Western markets.

Incidentally, what might have misled not a few analysts entering the field of transition economics were the very low absolute unit prices obtained by the post-communist economies (relative to those of their competitors on the West European markets). It was one short step from discovering the low unit prices obtained in early 1990s to the conclusion that these low unit prices were a characteristic feature of transition. As such they argued in favor of the *distressed sales* thesis. However, as shown in Winiecki (1998b), the communist economies had been registering low relative unit prices of their exports for decades – not only low, but indeed ever lower. Thus, the low unit prices of the early 1990s were a stage in a long-term trend that has not yet been reversed by the transition process.

TABLE 4

RELATIVE UNIT (KILOGRAM) PRICES OF MANUFACTURES EXPORTED
FROM EAST-CENTRAL EUROPEAN COUNTRIES OBTAINED
ON THE EEC/EU MARKETS IN 1985-94 PERIOD
(Prices obtained by all exporters on the EEC/EU markets = 1.00)

Country/ Product group		Eng. SITC 7	Chem. SITC 5	Tires SITC 625	Glass SITC 665	Furn. SITC 821	Textil. SITC 652 ^a
Bulgaria	1985	0.25				0.44	0.58
	1990	0.24	0.22	0.59	0.18	3.01	0.52
	1994	0.51	0.14	0.72	0.21	2.88	0.37
Czech Rep. ^b	1985	0.25		0.66	0.83	0.44	0.82
	1990	0.38	0.91	0.60	1.62	5.22	1.07
	1994	0.78	1.17	0.77	2.63	8.04	1.46
Hungary	1985	0.35		0.51	0.45	0.70	1.12
	1990	0.81	0.60	0.63	0.79	8.61	1.50
	1994	0.98	0.73	0.65	3.71	11.58	1.13
Poland	1985	0.23		0.83	0.57	0.47	0.79
	1990	0.38	0.37	0.72	0.82	6.17	0.95
	1994	0.40	0.31	0.62	1.09	8.04	2.00
Romania	1985	0.29		0.54	3.34	0.42	0.76
	1990	0.45	0.35	0.59	6.33	4.41	0.81
	1994	0.30	0.24	0.43	8.75	3.46	0.66

^a Only cotton textile fabrics.

^b Data for 1985 and 1990 are for Czechoslovakia.

Source: OECD trade value and volume database. Own calculations.

This is to some extent typical of a certain type of approach to transition process that looks at the starting point of transition as a kind of t_0 period in a model with nothing of importance coming from the past, while in the case of the post-communist economies the past casts a long shadow.

Another example of such an approach is the 'discovery' of declining male life expectancy in transition, also taken in a model-without-memory manner and interpreted as an outcome (an 'unbearable cost') of transition. Again, however, the decline in male life expectancy was not a novel, transition-related phenomenon, but the continuation of a long term trend that started in the former USSR in the late 1950s, in former Czechoslovakia, Hungary and Poland in the late 1960s, and in Bulgaria and the former GDR in the early 1970s (no data for Romania were ever made available). Thus falling male life expectancy was a stage in a long-term trend yet to be reversed in the early 1990s by the transition to normality (in the successful transition countries).

Returning from this digression to the main theme of this paper, some *distressed sales* might have taken place in early transition – and indeed they did – but they should not be regarded as the main engine of the successful export reorientation and expansion. The data on both export volumes and unit prices are not suggestive of sales at any cost (unsustainable in the longer run and otherwise readily identified in downward unit price changes).

But before we decide that the opposite view is closer to the truth, or in other words that it was largely the successful strategies of the SOEs and privatized firms that explain successful reorientation and expansion, the issue should be scrutinized somewhat further. Again, in terms of economic logic, there are no *prima facie* arguments in favor of Polish, Hungarian, etc., comparative advantages in, say, steel making. Thus, if these countries continued to export iron and steel, as well as steel products, and in fact significantly increased these exports in the 1990s, there must be some rationale to explain the phenomenon.

In economic terms the advantage could come from the lower costs of primary inputs, but all COMECON countries, except the Soviet Union, imported iron ore and all but Poland imported coking coal. And all of them, again except Soviet Union (and, until the late 1970s, also Poland) were net importers of energy inputs. Thus, their comparative advantage could not come from lower material input costs (at comparable prices). Alternatively, the advantages could come from more advanced technology, or better organization of the production flow, but studies conducted long ago (see, e.g., Szpilewicz 1979) showed Poland and Hungary, for which comparable data existed, to be much behind the Western countries in technological/organizational activities. Thus, the answers must come from beyond the standard economic logic, and it is on this issue that I bring the focus to bear in the following subsection.

2.2. The 'distressed non-replacement of capital' strategy: a complement to the 'distressed sales' argument

Given that the *distressed sales* cannot be seen as the main driving force behind the reorientation and continuing dynamic expansion of westbound exports, we should look for other, less explored determi-

nants. One very interesting interpretation of enterprise behavior in transition comes from Benacek (1997). Using the already quoted Czech data (see Table 2.A. above) as a starting point, he suggests the following.

The general expansion of exports, whether in those industries credited with relatively strong comparative advantages or in those expected to shrink (if not actually fold up), is in many cases the outcome of peculiar adjustments, taking place at the enterprise level under the circumstances of excess labor and capital inherited by enterprises from the past. These conditions, combined with certain privatization strategies, offered firms the opportunity to adjust to new circumstances in highly unusual ways.

Generalizing on Benacek's considerations (1997), which were formulated with respect to the Czech industry but have region-wide application, the following characteristics of the production *cum* export environment for enterprises may be noted:

- The new owners differed from the central planners and their political masters, who decided on investment allocation in the past. Even if the enterprises have not yet been privatized, the managers and workers (wherever the latter have a strong voice, as in Poland) are to a significant extent *de facto* owners, with claims to a substantial part of any surplus of receipts over expenditures.

- The new owners, in cases other than direct sale to strategic investors (often foreign), acquired the property at 'bargain basement' prices. In the cases of citizens' privatization (like the Czech *coupon* privatization) the price was close on zero. The situation was much the same in the cases of insiders' - managers *cum* employees' - privatizations, while in the yet to be privatized SOEs the appropriation of surplus on the basis of *de facto* ownership was pursued at zero cost.

- In the light of these facts, Benacek is right in pointing out that in many cases the acquisition of property rights may be treated as virtually a free gift. One important consequence is that the new owners' or *de facto* owners' expectations of returns on capital differ sharply, in the downward direction, from those of the typical owners of a capitalist firm.

- Expectations of returns on capital are strongly reinforced by the situation on the market for used (second-hand) physical capital. In the first place, a substantial and - in heavy industry - dominant

part of capital is industry- or even firm-specific and cannot be sold. Besides, even if general purpose machinery and equipment can be sold, the obtainable price for it is very low due to similar supplies from other SOEs and ex-SOEs trying to get rid of excess physical capital.

– The new owners, given the signaled characteristics of property rights, have more limited access to the financial markets than the owners of well performing larger private firms, especially those under strategic ownership, the latter affording banks greater confidence in the sense of their restructuring strategies. Therefore, the former firms' capability to restructure by scrapping large chunks of the old and installing new machinery and equipment is relatively low.

As a result the new owners or *de facto* owners may choose an atypical strategy of running down the existing equipment and at best replacing only the used up parts in the obsolete equipment as long as the value added generated in that manner exceeds the variable costs (wages). This possibility was also noted by Jackson and Repkin (1997).

Benacek (1997) points out that the sunk cost situation in which capital need not be replaced in full, or in some cases need not be replaced at all, as the strategy is to run it down to zero post-depreciation value, establishes a *new, albeit temporary, competitive advantage*. Artificially created low-to-zero capital costs of production have the same international trade effect as competitive advantages created by the firm with its technological and organizational or other cost-reducing superiority.

It is – says Benacek – understandable that many of the firms following the capital non-replacement strategy will simply wither away, even without officially declared bankruptcies. Thus, it may be said that the foregoing strategy is a medium-to-long term equivalent of the short-term 'distressed sales' strategy, a 'distressed non-replacement of capital' strategy, which largely precludes long-term survival. In the meantime, however, by pursuing one or another variant of the strategy, the SOEs or ex-SOEs may survive and even give the appearance of profitability on their domestic and export sales.

The situation outlined above is not typical of the Czech Republic only. The Polish iron and steel industry may be another example. At the time of writing Poland is in its eleventh year of transition, and

all twenty steel mills, large and small, have survived, pursuing often only partial equipment replacement strategy (and cutting employment along the way), producing less than before 1989, but in all cases exporting a significant part of their output.

The logic of *distressed non-replacement of capital* strategy implies to the present writer a new lease on life for the *distressed sales* argument. Under the described circumstances temporary profitability, maintained until the complete run-down of the equipment, allows otherwise inefficient producers to continue manufacturing and exporting for much longer than originally thought possible under the *distressed sales* hypothesis. In industries, such as steel manufacture, where the average lifetime of the equipment is long, this strategy could even continue for a decade or more (as the Polish case suggests).

Consequently, when we add the share of 'distressed sales' (differently estimated by different analysts) to the share of sales associated with the 'distressed non-replacement of capital strategy' (which could only be guesstimated), we may arrive at a somewhat more significant share of the total than with the above quoted estimates for 'distressed sales' alone. The feeling of this author is, however, that even in the early period, say until 1992-93, the foregoing aggregate would not be the dominant contributor to the very rapid growth of westbound exports. Other determinants must have contributed much more than either 'distressed sales' or 'distressed non-replacement of capital' survival strategies. It is to these determinants that we shall turn in the following sections of this article.

3. Another past history-based determinant: turning oversized industry from burden into opportunity

The first of the three, also in the chronological sense of the sequence in which these determinants exerted their maximum influence on export expansion, is the oversized tradable sector in the post-communist economies under consideration (and, indeed, in all the post-communist economies). As was pointed out in Winiecki (1998b), the distorted, oversized industrial sector had in the communist past been

the main source of turbulence in all the centrally planned and administered economies.

However, one may assume that in the *post-communist* period, with most disincentives to decent work removed with transition to the market, the opportunities for better performance improved considerably. *A large number of enterprises across the whole manufacturing spectrum gained the opportunity to survive and prosper*, even if they were all to varying extents burdened with excess (and often obsolete) capital and huge overmanning. What mattered greatly was the willingness to try. The necessary conditions might have been – and usually were – very stringent. But a spate of enterprise level studies suggest that whenever initial conditions were not extremely bad and managers ready to take the lead, trade unions ready to compromise, and workers ready to adjust to new, more demanding work schedules, the probability of success (in the short-to-medium run at least) increased significantly.

Of course, many enterprises chose the strategies outlined in the preceding section. The choice of running down the physical capital strategy more often than not ruled out the probability of long-term survival. But even the short-term ‘distressed sales’ strategy, if abandoned relatively quickly and followed by serious adjustment efforts, offered them a glimmer of hope. What was needed in nearly all cases was a judicious injection of at least some new capital, technology and marketing skills.

For level of development-related reasons, the enterprises in labor-intensive and labor-*cum* resources-intensive industries were better positioned to take advantage of the new opportunities. In fact, in a substantial number of cases the new opportunities were in fact the re-discovery of old opportunities, since these enterprises, established before communist rule, cultivated the pre-communist tradition of decent performance even under the adverse conditions of disincentives to good work. All in all, more enterprises in industries closer to the post-communist economies’ comparative advantages succeeded in surviving and prospering, or at the very least getting a ‘breather’ that – well used – promised better survival prospects for the future.

The point is borne out by export statistics on the light industry performance of the countries under consideration. As Lemoine’s (1994) calculations of export shares for these industries reveal, the countries under consideration (Bulgaria, Czechoslovakia, Hungary,

Poland and Romania) increased their 1988-93 shares in aggregate exports to European Union countries:

- in leather products from 3.6 to 4.6%;
- in clothing from 12.1 to 17.0%;
- in furniture, footwear and other manufactures not elsewhere classified from 8.4 to 9.6%.

Interestingly, in the same period it was not only the exporters of some light industry products that increased their shares in total exports, but also those of some heavy industries. Contrary to expectations based on the impressive figures of absolute volume of the iron and steel exports, the share of that product group (SITC 67) in total westbound exports did not in fact increase (declining slightly, from 9.6 to 9.3%) since the volume of westbound exports actually increased very sharply across almost the whole range of manufactured products. The share winners among the heavy industries were engineering goods (non-electrical and electrical machinery and transport equipment), whose combined share increased from 14.3% for the group of countries in question to 21.8%. The increase was not of the same proportions across ex-COMECON countries, the most impressive gains being shown – not unsurprisingly – by the most developed countries of East-Central Europe, Czechoslovakia (from 16.2% in 1988 to 25.6% for the Czech Republic and Slovakia taken together in 1993) and Hungary (from 13.5 to 25.5%). However, the engineering industries registered gains in all the countries, except Romania, in the period taken by the study quoted above. Thus, for some countries at least the engineering industries performed better than the aggregate predictions for the countries as a group would suggest.

This seems to indicate that, given a very large number of enterprises in all industries, whether or not the post-communist East-Central Europe possessed comparative advantages in them, it was always possible to find *winners who displayed their competitive advantages at the level of the firm*, although lacking in comparative advantages.

This is not an unknown phenomenon. In all countries there are good performers that survive and prosper, competing against firms from countries whose comparative advantages correlate positively with the competitive advantages of the firms. The success stories are

accounted for by firms at both ends of the possible spectrum: firms in industries which their countries lost their comparative advantages in long ago, but in which some firms thrive in spite of adverse country-level conditions, and firms in the more sophisticated industries, where the countries have not yet gained comparative advantages, but where some firms have already outpaced the rest. What differentiates the post-communist countries in transition is *the sheer number of firms in the oversized industrial sector from which winners may possibly emerge*.

The emergence of 'success stories' might have been supported by another feature typical of the communist economic system, namely the extremely wide range of enterprise performance within each industrial branch or even product group under central planning and administration of the economy. However, what had been acceptable in the no-exit economy ceased to be so in transition to the market. Thus, the worst performers were often (albeit not always!) liquidated *via* withering away or bankruptcy, but the best prospered in the new more demanding environment.

Summing up the foregoing considerations, it may be argued that in the post-communist environment the inherited oversized industrial sector, with its excessively large range of then unsaleable tradables, turned from the long term burden to short-to-medium term opportunity. Stabilization *cum* liberalization programs in the developing countries, where successful, tended to reallocate production factors from the non-tradable to the tradable sector. By contrast, in post-communist countries the production factors were already there, however distorted, excessive and, in the case of the labor force, often demoralized. So, wherever the distortions were not overwhelming, and the willingness to try was strong enough, *competitive exporters emerged faster than they would have in liberalizing LDCs*, where resource reallocation alone could expand the range of exportables.

Everything, of course, has a price and in this case the price was a high casualty rate in terms of the quota of enterprises that had (or still have) to exit, a rate certainly much higher than in the case of new firms in liberalizing LDCs. But this should be seen as one more unfortunate legacy of the communist past.

4. The impact of the newcomers

4.1. *The arrival of multinational firms*

We should note that the determinants of trade expansion are not clear-cut, easily compartmentalized categories. In fact there has usually been some overlap between most of them. Thus, one may well picture how the management and workers of some firms that had pursued *distressed sales* strategies in the early years of transition did not have enough stamina to enter the demanding path of adjustment, opting to hobble on through *distressed non-replacement of capital*, and thus switching from one non-adjustment strategy to another.

Next, the SOEs and ex-SOEs pursuing one or another strategy (or each of them in turn, as the previous paragraph suggests), would all come from the excessively large pool of firms in the oversized post-communist industrial sector. But this is not the end of the overlapping. The topic of this subsection, namely the impact of the direct foreign investment of multinational firms, gives rise to yet another overlap. The FDI in East-Central and Eastern Europe showed a significantly greater share of 'greenfield' type investment projects than those in other regions of the world, but the share of acquisitions of the (overwhelmingly) state-owned firms – especially in the case of the larger-scale FDIs – created an overlap between the large pool of firms in the oversized post-communist industry and the MNEs' activities affecting the trade performance of the countries in question.

There is, however, one qualitative difference between the former overlap and the latter. One may assume – with a high degree of probability – that it was the worse than average SOEs that slipped from one non-adjustment strategy to another, while the better than average SOEs drew the attention of foreign multinational firms and came to be privatized through acquisition by MNEs.

In the foreign trade context, which is of primary importance here, the contribution of MNEs from a host country perspective is seen not only in terms of the traditional benefits of capital and technology transfer – the transfer of management skills and the fostering of a market-based business culture – but more specifically in terms of opening up new marketing and sales channels abroad. New exports

are expected to be accomplished through sales to other subsidiaries or, also within the MNE framework, through marketing goods abroad to the MNEs' customers.

Theoretical and empirical studies of foreign trade and investment offer certain suggestions as to the type of exports that would result from the presence of multinational manufacturing firms. One type of trade flow would be the exchange of inputs sent from the MNE's headquarters to a subsidiary and the reverse flow of finished products sent from the subsidiary to the headquarters. Balcet and Enrietti (1998) present a typical case of this type of exchange between Fiat (Italy) and Fiat (Poland), reproduced here in Table 5. The statistics refer to Italy and Poland, but give or take a few *Lancias* and *Alfa Romeos*, the Polish-Italian automotive trade is an intra-firm, intra-Fiat trade.

TABLE 5

TRADE BALANCES IN POLISH-ITALIAN INTRA-FIRM TRADE IN PASSENGER CARS AND PARTS THEREOF 1992-95 IN \$ MILLION
(-' sign indicates negative balance for Poland)

Product group/year	1992	1993	1994	1995
Passenger cars (SITC 781)	184.6	178.5	163.9	247.2
Motor vehicle parts (SITC 784)	-128.9	-78.9	-66.4	-105.5

Source: Balcet and Enrietti (1998).

It is worth bearing in mind, however, that in the more horizontally integrated MNEs the flows would be multidirectional rather than bidirectional, with inputs flowing to a new subsidiary from HQ and other subsidiaries, and the new subsidiary not only assembling the finished products and producing some inputs for use in those products but also specializing in some inputs and selling these inputs to other subsidiaries within a given MNE system. Thus, the pattern of trade flows to and from the newly built General Motors' plant in Gliwice (Poland) may in the next decade look different from the 1990s Fiat pattern.

Another point to make is that the statistics in Table 5 hide in the SITC 781 (passenger cars) trade balance yet another type of trade flow of a more traditional type. In a pioneering work Burenstam-Linder (1961) pointed out that countries exchange similar manufac-

tured goods, but of different quality (and associated different price). In the literature on intra-industry trade, this type of trade flow later gained the name of *vertical intra-industry trade*. Falvey (1981) pursued the approach further, linking it to the classical Heckscher-Ohlin model. The exchange of finished products between Fiat/Italy and Fiat/Poland follows the pattern described above. Fiat/Poland have been producing in Poland and exporting to Italy lower quality/less expensive brands (*Fiat 126*, *Cinquecento*), while it had first been importing and later also assembling higher quality/more expensive brands such as *Punto*, *Bravo/Brava* and other brands, also of other Italian manufacturers such as Lancia and Alfa Romeo.

The German car manufacturer Volkswagen follows a somewhat similar trade pattern *vis-à-vis* its Czech subsidiary (Skoda). Volkswagen's higher-priced brands are marketed in the Czech Republic via Volkswagen's subsidiary's sales force there, while modernized *Skodas* are exported from there, not only to Germany but also to third countries, and especially to those where Skoda brand recognition was already relatively high in the past. This strategy was taken one step further in Poland, where Volkswagen converted its local acquisition (in Posnan) into a Skoda assembly plant.

Finally, while on the subject of the MNEs' impact upon trade flows, we should also mention the 'classical', or horizontal, intra-industry trade. This is primarily 'trade among equals', or in other words among countries with similar factor endowments. The basis of trade here is the 'love of variety' or the quest for the 'ideal variant' of a product, and differentiated products from abroad either increase the range of choice or bring some domestic customers closer to their ideal variants.

Within the framework considered here, focusing mainly on trade between middle-developed, post-communist East-Central Europe and the mature, developed economies of the West, the expectations are that the earlier forms of intra-industry trade – parts and components for finished products and lower quality finished products for higher quality finished products – would dominate the trade patterns.

Turning from theory to empirical studies in search of confirmation for our expectations, we must at the outset point out that empirical exercises have so far been drawing on the extremely limited statistical resources. Even the latest, and most exhaustive, study by Aturupane, Djankov and Hoekman (1999) relies on data for the 1990-

95 period. The problem is, however, that the period may have been sufficient to study foreign trade patterns in the early transition, but it does not suffice for the study of FDI-generated trade flows since, in early transition, Hungary near-monopolized the FDIs flowing into the region. In 1994 the FDIs in Hungary accounted for half of all the foreign investments in East-Central and Eastern Europe. The Czech Republic started its FDIs some 2-3 years after Hungary, with Poland surging forward to the first place it now occupies only in the latter half of the 1990s. Thus, whatever generalizations are formulated on the basis of studies such as that mentioned above, they should be interpreted with caution since the FDI patterns in the other countries studies might have been less well established, given the very limited presence of FDIs there at the time, when FDI studies turned to the available statistics. After all, in 1995 the FDIs in East-Central and Eastern Europe accounted for only 3.8% of the world total, and the share inched up only slightly in the following year or two (4.6% in 1997, including the post-communist countries of the former Soviet Union, but excluding those of former Yugoslavia).

With this *caveat* in mind, we next turn to the findings of Hoekman and Djankov (1996) and Aturupane, Djankov and Hoekman (1999), which are roughly in line with what might be expected on the trade theory basis. Vertical intra-industry trade dominates the trade of East-Central and Eastern Europe in general, and trade with the European Union countries in particular. In the latter case some 80-90% of all intra-industry trade is vertical (similar goods differentiated by quality), but given the very high level of disaggregation in the studies referred to here we cannot establish the existence of the parts-and-components-for-finished-products pattern that are strongly present in intra-firm trade, especially with regard to trade between subsidiaries in the less developed countries and headquarters (and subsidiaries) in the mature developed economies.

Both studies showed that the vertical intra-industry trade is positively and significantly correlated with FDIs, which confirms expectations in this respect. However, an earlier study (Hoekman and Djankov 1996) noted that if some 'outliers' (FDIs in automotive industries in the Czech Republic, Hungary and Poland) and electrical machinery and equipment (FDIs in Hungary) are excluded, then the relationship becomes less robust, which prompted the authors to hypothesize that "exports are mostly 'home grown' and intra-industry trade is substantially arms-length in nature" (*ibid.*, p. 7).

Regardless of whether this is really the case, it is doubtful whether their findings do indeed support the foregoing interpretation. Firstly, one should look to the motives for FDIs, especially in lower and middle income countries, where horizontal intra-industry trade plays a limited role. A plethora of earlier studies, concerning manufacturing FDIs in LDCs, suggest that multinationals come to these countries motivated by one or the other of two aims, namely either to capture the local markets or to use them as a sourcing base for their foreign sales or for other subsidiaries. The first type of investment project – the quest for markets – generally dominated and, as is shown in the survey by Lankes and Venables (1996), may have dominated FDIs in the post-communist countries of the region as well. This type of trade would be expected to generate a *disbalanced* trade, accounted for mostly by exports of parts and components to post-communist economies, or in other words one-way rather than two-way, vertical intra-industry, trade. This does not detract from the importance of the FDIs in generating trade flows: the implication is that the impact of the host market-oriented FDIs comes largely on imports.

On the other hand, in typical sourcing-oriented FDIs the impact would be largely related to exports. These export-oriented FDIs tend to exploit locational advantages, and those in the countries in question would lie – to a substantial extent – in labor intensive production (Hoekman and Djankov 1996 and Aturupane, Djankov and Hoekman 1999 report positive and significant correlations with the labor intensity of traded products), given which trade would again be disbalanced, but in the opposite direction, i.e. exports from the subsidiaries dominating the trade flows. Again, the importance of the FDI would not be questioned here, but only its ability to generate balanced vertical intra-industry trade.

The available data on trade flows generated by firms of (total or partial) foreign ownership in Poland confirm the foregoing patterns. Out of 16 product groups in industries with the largest FDIs in 1997, one registered 9 product groups with a significant excess of imports over exports and 6 product groups with the reverse pattern. There was only one 'outlier' (rubber and rubber products), where intra-firm trade was balanced (assumed here as a deviation not exceeding 15%). Details are in Table 6.

Also, as expected, excess of FDI-generated exports over imports took place in industries characterized by high labor and natural resources intensity. Thus, it may be said that at least in the case of Poland the multinational firms conformed largely in their foreign production and export patterns to the comparative advantages. Thus, the exports may be seen as 'home grown' (see Hoekman and Djankov 1996) only in the sense that specialization patterns are based on country-specific comparative advantages, regardless of whether these exports are arms-length exports or intra-firm exports of MNEs.

However, even such close qualification of the foregoing assessment needs tying in yet further. The excess of imports over exports generated by the FDIs in capital- and technology-intensive industries in Poland does not mean that an export base is not established there. On the contrary, Polish exports in road vehicles by MNEs reached over \$ 1.7 billion in 1997, with typical vertical intra-industry trade in the sense described above: exchange of lower quality cars for higher quality cars (plus imports and two-way exports of car parts, with more sophisticated, and costly, parts imported and less sophisticated ones exported from Poland). Since Polish exports of passenger cars and car parts have been growing very fast, we may soon see the emergence of a new export specialization. This is very much in line with what happened earlier, e.g., in Spain and Ireland in Western Europe and in Korea in East Asia. And what has been said of Poland applies equally to the other successful middle-developed transition countries.

Besides, we must also bear in mind that the large inflow of machinery and transport equipment by MNEs today suggests that the future output of foreign-owned firms will expand substantially. Judging by the past patterns, with an increased share of exports being generated by foreign-owned firms (as has been the experience of Hungary and Poland so far), an increasing part of the future output would be exported. And the changing comparative advantages of the middle-developed economies suggest that a growing proportion of the exportables would be accounted for with more sophisticated capital- and technology-intensive goods.

Be that as it may, the FDIs have played an important role in the westward trade reorientation of the post-communist ECE economies, but much greater in later expansion than in the initial shift from east-bound to westbound trade. Thus, to take the example of Poland once again, firms with foreign capital participation accounted for 38% of

TABLE 6

POLISH FOREIGN TRADE OF FOREIGN-OWNED FIRMS IN INDUSTRIES
WITH SIGNIFICANT FOREIGN OWNERSHIP: IMPORT ORIENTATION,
EXPORT ORIENTATION AND BALANCED TRADE IN 1997 IN \$ MILLION

Industry ^a /Orientation	Import-oriented	Export-oriented	Balanced trade
<i>I-II. Agricultural products</i>			
Dairy, eggs, honey	E	124.8	
	I	69.9	
Fruits and nuts	E	162.0	
	I	79.4	
Coffee, tea and spices	E	29.2	
	I	226.8	
<i>IV. Prepared foodstuffs</i>			
Confectionery	E	106.4	
	I	48.6	
Cocoa and products	E	101.1	
	I	134.1	
<i>VI. Chemicals</i>			
Perfumes, cosmetics and toiletries	E	102.1	
	I	298.4	
Soaps and detergents	E	141.0	
	I	210.3	
<i>VII. Plastics and rubber and articles thereof</i>			
Plastics	E	297.2	
	I	1332.1	
Rubber	E		280.3
	I		304.3
<i>X. Pulp, paper and paperboard</i>			
Paper and paperboard	E	489.4	
	I	727.3	
<i>XI. Textiles and clothing</i>			
Clothing, knitted or crocheted	E	159.7	
	I	93.1	
Clothing, not knitted or crocheted	E	878.7	
	I	199.5	
<i>XIII. Articles of stone, ceramics and glass</i>			
Glass and products	E	115.5	
	I	210.6	
<i>XVI. Machinery and equipment</i>			
Electrical machinery and equipment	E	2015.3	
	I	3470.8	
<i>XVII. Transport equipment</i>			
Road vehicles	E	1751.4	
	I	3413.4	
<i>XX. Miscellaneous manufactures</i>			
Furniture	E	924.9	
	I	290.8	

^a Categories according to Polish industrial classification.

Source: Chojna and Durka (1999). Own calculations.

Polish exports in 1996, but much less in the early phase of transition (10% in 1992). This increasing role had emerged even earlier in Hungary, where the share of firms with foreign participation had reached 30% by 1992, as compared with 11% in 1990 (Hamar 1993). But Hungary is an exception, as that country was the early leader in inward FDIs.

4.2. *Exports of de novo private sector firms*

And, last but not least, we shift our attention to yet another category of newcomers, namely the generic private sector, consisting of domestic firms established as private from scratch. The overwhelming majority of these firms were established after the communist collapse, and outside Hungary and Poland all of them. They will be playing an increasingly important role in the future export performance of these economies.

The above hypothesis is based on the comparative experience of other middle and highly developed economies, where small and middle-sized enterprises (SMEs) play an important role in export performance, and *de novo* firms in post-communist countries are mostly, if not almost exclusively, small and middle-sized firms. Even leaving aside the well known position of Germany's *Mittelstand* firms, other countries register shares in the aggregate exports of SMEs in the range from a low 15-20% (e.g. Singapore, Australia) to over 50% (Italy, Taiwan), with countries such as Japan, Korea, Denmark, the Netherlands, Sweden and Switzerland finding themselves in the middle range of 30-40%.

The communist economies were, as is well known, characterized by oversized firms, and the starting point of transition was therefore not from significant exports generated by small and middle-sized firms. However, as the sector expanded, its export activities began to grow as well. Neither the industrial nor the foreign trade statistics show the export shares of firms of differing size in terms of output or employment. We have no regular, comparable data on the export shares of the SMEs and their changes over time. However, even if we cannot draw conclusions concerning the export dynamics of the SMEs in the countries under consideration and resultant growing shares in aggregate exports, we can at least expect – on the basis of experience in other countries – that these shares will grow.

Some patterns in post-communist countries in transition are nonetheless discernible. Indeed, the *de novo* firms became an important intermediaries in imports and exports early in transition as it was easier for them to find markets for the products of the then largely state-owned firms, both the manufacturing SOEs and the state trading organizations being less flexible and efficient in spotting opportunities offered by the world markets. With a lag, however, they were followed by the generic private firms, which found markets for their production abroad. A survey by Szymanderski (1996) of a sample of Polish private entrepreneurs exporting their own products westward revealed how important for all of them was their earlier experience in the West, a large proportion of them having worked there (legally or illegally) for periods ranging from a few months to a number of years, or at least having visited the West frequently enough on business (often working for state trading organizations). All this equipped them both with knowledge of markets and business contacts to rely upon.

One may surmise that what worked so well for private producers should have worked even better for private traders. No surprise, then, that already by mid-1995 the private firms had a 55.4% share in Polish exports and 69.7% in Polish imports (Zarzycki 1995). The overwhelming share in the above was held by generic private firms, the exception being a few large privatized foreign trade organizations. The pattern may have been repeated in those ECE economies that had more intensive interaction with the West in the communist past which, apart from Poland, would include Hungary, the Czech Republic, to a lesser extent Slovakia, and – ranging beyond our direct concern here – also Slovenia.

There are no data on exports by the SMEs, but only on exports by foreign trade firms in Poland in the above-cited study by Zarzycki (1995). Nonetheless, the latter are also indicative of export patterns. Firstly, many generic private firms do not use foreign trade intermediaries and export goods themselves. And, secondly, if they use intermediaries, then they more often than not use other SMEs since, for the large trading firms, the size of their export offer would not be particularly attractive. Thus, exports from small and medium-sized exporting firms are substantially exports from the SMEs themselves.

With the foregoing qualifications in mind, the Polish data show that the generic private sector concentrated, not unexpectedly, on exporting labor- or natural resources- *cum* labor-intensive products. By

1994 the SMEs were already shipping abroad 79.9% of the aggregate exports of textiles and clothing, 75.9% of agricultural and food products, 63.9% of furniture and about half (50.2%) of engineering products. Most of their exports went to European Union countries, for a total share in exports of 73.9% in 1994.

There are three reasons for such production and trade patterns in the generic private sector:

- First, the overwhelming majority of these firms are new. And, being relatively or even absolutely small, they failed to accumulate sufficient capital. A natural choice for a small firm is labor-intensive rather than capital-intensive production since the latter usually requires a certain minimum efficient size even in the start-up period. Besides, in the post-communist economies with their underdeveloped financial markets biased against small private firms, the ability of these firms to raise sufficient capital to start capital-intensive production is much lower than in the West.

- Secondly, it is not only the naturally small size of start-up firms that suggests low capital-intensity, but also the comparative advantage of the ECE economies, which lies to a substantial extent in labor-intensive products. Labor-intensive products, often combined with local natural resource-intensive products, have accounted for a growing proportion of their exports since 1989.

- The concentration of the generic private sector on the areas closest to the manufacturing base (in Poland: 80.7% share in exports to the countries of the former Soviet Union and the already quoted 73.9% share in UE-bound exports) is also explainable in terms of the size of these firms. As transportation, insurance, marketing, and other costs rise with distance, it is largely the bigger firms that can afford to search for distant markets.

In theory, with the structure of incentives set right in transition, the generic private firms could also thrive on human capital-intensive (high skill- or research-intensive) production but, at the same time, not on highly capital-intensive production. The level of education and extent of R&D activities in the past seem to indicate this type of production, but there are surprisingly few studies that concentrate on the generic private firms in post-communist transition, privatized and yet to be privatized firms accounting for the bulk of research.

But the circumstantial evidence from press reports on 'high technology' firms invariably reveals the dynamic expansion of small firms in the generic private sector, producing and exporting highly sophisticated goods. Often they are already firms that have passed the threshold of SME size (in Poland up to 250 persons), such as *Atlas*, a producer of glues used in construction that already exports a substantial share of its products. A study by Kaminski (1998) shows an increase in the share of technology-intensive products in westbound exports from 8.8% in 1984-89 to 14.8% in 1990-95 and of human capital-intensive products from 12 to 16.7% respectively. These aggregate figures may contain a substantial share of the generic private sector.

In all countries with comparable knowledge of the West (see above) and similar progress achieved in transition to a capitalist market economy one would expect similar results. The tradition of the Czechs in mechanical engineering suggests that not a few privatized SOEs may have been returning to their former competitiveness, while the relatively high share of FDI in Hungarian engineering foreshadows a fairly rapid turnaround of the old SOEs-turned SOE-directed MNE subsidiaries. Indeed, the latter had already begun by 1996. These observations refer to the larger firms, but the Czech, Hungarian, and other SMEs in human capital-intensive industries or product groups should also expand quite rapidly – for the same reasons adduced for the Polish case.

Here we must point out yet another overlap between the categories of exporters. Quite a few private exporting SMEs may be enterprises already accounted for in the earlier subsection, namely small and medium-sized firms with full or partial foreign ownership. In fact, the latter may have shown a higher propensity to export, and for two reasons. Firstly, these 'mini-multinationals' have a natural advantage in being able to find export markets, which may be intra-firm markets in the first place. And, secondly, although those domestic SMEs exporting to the West are usually run by individuals who have a reasonably good knowledge of the market conditions in the West, as emerges from the above-cited survey by Szymanderski (1996), the ability to obtain a variety of export supporting services in the export markets may be greater in 'mini-multinationals' than in the domestic firms (given the longer track record, headquarters location at the export market, etc.).

5. Conclusions

A point that emerges forcefully in the light of the foregoing considerations is the *surprisingly large number of microeconomic factors contributing to the unexpectedly strong westbound export surge* shown by the ECE economies in transition. It is, most probably, the combined effect of these factors that has made aggregate performance so outstanding. The usual approach has been to evaluate institutional progress in the transition process positively or register significant restructuring and deduce improved trade performance from it. The surprise often expressed by analysts at the strong export drive shown by these economies might be due to underestimation of the range of contributing factors, the various authors focusing on more limited numbers of microeconomic export determinants.

My attention has focused on the microeconomic explanation most often asserted, namely that of *distressed sales*, and found it logically convincing, with some empirical and historical evidence supporting the logic of trade diversion. But the same logic forced me to accept a time limitation on *distressed sales*, because no firm can sustain sales at a loss for a long time. Next, following Benacek (1997), I extended the argument to the medium-to-long run by pointing at what I call a *distressed non-replacement of capital strategy*. It has been noted that the strategy of running down obsolete equipment as long as the value added is sufficient to cover variable costs and generate enough profit to continue for the time being is pursued at the cost of long term survival. In the meantime, however, it allows the firm to be internationally competitive. An important consequence of the run-down strategy is an extension of the *distressed sales* concept to the medium or even long run, as shown by the story of the Polish steel industry.

The most novel development – and possibly that accounts for most of the westward export shift – is the difference between the typical post-communist ECE and the typical LDC in terms of the source of the expansion of the tradable sector. Here, the old weakness of oversized but badly underperforming industry was turned into a potential strength in transition. The firms need not reallocate their resources to the tradable sector or get established there from scratch. They were already there. There are no free lunches, though, as Milton

Friedman has it. The price is a high exit rate by those already there but handicapped from the start by the follies of the central planners or so distorted over decades of disincentives to decent performance that they had little chance of surviving.

The next source, i.e. direct foreign investment, is largely a derivative of the preceding one. Most FDI, and especially large-scale FDI, took the form of buying some assets of privatized SOEs, or buying them up whole, rather than that of *greenfield* investment. Take-overs by foreign firms strongly reinforced the survival probabilities of firms in the tradable sector in most cases, and the export performance of firms with foreign capital participation in Hungary and elsewhere proves the point.

Finally, it is worth stressing the role of the generic domestic private sector. Given the nature of its origin and expansion in post-communist transition, it should be stressed that new private firms would be expected to expand first in the industries that require relatively little capital and much labor, unskilled, semi-skilled, and to some extent also skilled (human capital-intensive industries). Since, firstly, these countries' comparative advantages lie in labor-intensive production and, secondly, capital accumulation requires either time or well functioning financial markets able to support the high risk projects of new entrepreneurs. Polish exports from small and middle-sized firms well reflected these expectations.

As a final comment, I would like to stress *the changing weight of the microeconomic determinants of export expansion in the long run*. Obviously, even the *distressed non-replacement of capital strategy* cannot last forever. The firms with the capital run down close to zero wither away, as do the handicapped firms in the oversized tradable sector. But the remaining factors increase in importance over time. It is the dynamics of the domestic generic private sector and of firms with foreign capital participation that will decide about the sustainability of the East-Central European economies' export performance and increasing competitiveness in the years to come.

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