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Foreign and Commonwealth Office

London SW1A 2AH

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Dear Charles,

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EC/Eastern Europe

Work is in hand here on the paper for Strasbourg which was commissioned at the Prime Minister's meeting with the Foreign Secretary on 14 November. In the meantime, you might / find it useful to have the enclosed factual note describing the current situation.

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FRAMEWORK FOR THE COMMUNITY'S RELATIONS WITH EASTERN EUROPE

CURRENT SITUATION

Mediterranean Cooperation and Association Agreements

1. The EC has, under Article 238 EEC, concluded Cooperation or Association agreements with Turkey (1963), Malta (1971), Cyprus (1973), Yugoslavia (1980), Morocco, Algeria, Egypt and Israel (1976), Tunisia, Jordan, Syria and Lebanon (1977), ie all the countries of the Mediterranean littoral except Albania and Libya. The Association Agreements with Turkey, Cyprus and Malta have customs union as their ultimate objective; only in the case of Cyprus is real progress being made towards that objective. Otherwise Cooperation and Association Agreements are essentially the same. They provide Mediterranean countries with:

- Preferential trade access:

(i) duty-free access to the EC for industrial products, (except for some textiles which are subject to voluntary restraint agreements and certain sensitive industrial products from Yugoslavia which are subject to duty-free ceilings).

(ii) Varying degrees of preferential access for agricultural products.

- These trade concessions are not reciprocal ie. the EC receives only Most Favoured Nation treatment in return except in the case of Israel where both sides enjoy duty-free trade in industrial products and Cyprus where transitional arrangements towards customs union in industrial products began in 1988.

- Economic and technical cooperation covering a wide range of fields (eg industry, agriculture, energy, technology, training).
- Financial Assistance in the form of additional protocols which provide grants from the EC budget and loans from the EIB. (Israel receives only EIB loans).
- Cooperation/Association Councils which meet at Ministerial level, in principle once a year, though in most cases less frequently, to review the operation of the agreements. In practice these tend to be routine exchanges of position; mechanisms exist at official level to resolve problems, but are not always fully effective.

2. Only the Association Agreement with Turkey contains a clause which refers to the possibility of membership once Turkey is in a position to accept the obligations of the EC Treaties.

3. It may be interesting to detail the Yugoslavian Cooperation Agreement:

(a) Trade - Agreement more advantageous than the benefit which Yugoslav receives from the Generalised Scheme of Preferences. 90% of Yugoslav industrial exports enter the EC duty free; the other 10% have ceilings above which duty can be payable if demanded by a member state. Preferential access for specific agricultural products.

(b) Economic - cooperation in energy, agriculture, environment, transport, fisheries, tourism, science and technology, industry, training and standards.

(c) Financial - 2 protocols have provided Yugoslavia with 260 mecu [in grants] and 550 mecu in EIB loans.

B. EFTA Agreements

The EC concluded individual agreements with the six EFTA members (1972, 73) though the agreements are virtually identical. They provide for:

- Free trade in industrial products and a limited range of (mainly processed) agricultural products
- Joint Committees which are held regularly at official level. EC/EFTA Ministerial meetings are held on an ad hoc basis.

4. The Free Trade area provided for under the agreements was achieved in early 1984. The EC and EFTA cooperate closely on the elimination of technical barriers to trade. In April 1984 EC and EFTA Ministers agreed the Luxembourg Declaration which called for:

- Cooperation on harmonisation of standards, elimination of technical barriers, simplification of border formalities and rules of origin.
- Cooperation in the field of research and development, working conditions, culture, consumer protection, the environment, tourism, social protection and intellectual property.

The overall aim was to create "a dynamic European economic space". Some progress has been made over the past five years to implement these objectives.

5. Since the Brussels EC/EFTA Ministerial meeting in March 1989, the Commission has explored with EFTA ways to extend the Single Market to EFTA ie free movement of goods, services, capital and persons, plus some flanking policies such as energy, environment, research. The Joint Ministerial on 19 December will review progress and formal negotiations on these objectives is likely during 1990. Decision making (how EFTA should be able to shape decisions which it will subsequently apply) and compliance by EFTA with appropriate elements of Community law will be the most difficult issues.

C. EC Relations with Eastern Europe

6. Agreements follow one of three models: limited sectoral; trade and commercial cooperation alone; or trade, commercial and economic cooperation. The Community seeks to reflect in each the extent of political and economic reform in the country concerned; the more the reform achieved, the more extensive the cooperation envisaged. Each agreement also provides benefit to the EC eg better access for business.

7. (i) CMEA/EC

- Joint Declaration June 1988: Principally a statement of mutual recognition, plus some provision for possible cooperation activities. A face saving formula which was followed by requests from all East European countries except Romania to establish diplomatic relations with the Community. Negotiation of bilateral agreements then followed in most cases.

(ii) Poland

- Trade, Commercial and Economic Cooperation Agreement; 1989 valid for 5 years: Community undertakes to remove trade discriminatory quantitative restrictions. Poles to improve business conditions for Community operators. Economic cooperation in a large range of sectors.

Following that agreement, extensive further measures followed rapidly:

- Bilateral MFA textiles agreement
- GSP to be granted for five years
- 105 mecu in food aid
- Access to EIB loans granted
- (With Hungary) to share 300 mecu budget line for 1990 covering agricultural reform, environmental measures, and manpower training.

(iii) Hungary

- As for Poland, except food aid, but bilateral Agreement valid for ten years.

(iv) USSR

- Negotiations in final phase on a trade, commercial and economic cooperation agreement. On the same lines but less favourable than for Poland and Hungary, bearing in mind state of reform and non-membership of GATT. Agreement also to cover Euratom.

- Negotiations under way on a bilateral MFA textiles agreement.

- Negotiations stalled on a fisheries agreement.

(v) GDR

- Mandate prepared by Commission on a trade and commercial cooperation agreement (ie more than Czechoslovakia, less than Hungary/Poland). Not yet submitted to Member States, Commission now likely to propose economic cooperation as well.

- Subject to autonomous Community regime for textiles.
Contacts on a possible textiles agreement.

- Specialised agreement covering trade in sheepmeat.

- In addition under a protocol to the EEC Treaty, trade in manufactured, and some processed agricultural goods, between the Germanies is free of import duty. However a VAT refund is repayable if the same good is then re-exported to another member state. The Protocol provides that other member states may take safeguard action in case of unfair disruption of their markets. The FRG has been reminded of the need to ensure that risks of leakage post 92 must be minimised.

(vii) Czechoslovakia

- Agreement on trade in industrial products, limited scope and commitment (1988). Community to make progress in removing discriminatory QRs, Czechoslovaks to improve business conditions.

- Bilateral MFA textiles agreement.

(viii) Romania

- Existing trade agreement (1980).
- Stalled negotiations on a trade and commercial and economic cooperation agreement.
- Bilateral MFA textiles agreement.
- GSP beneficiary.

D. Council of Europe

No Eastern European membership but Hungary formally applied on 16 November 1989 - Poland will do so. Hungary and Poland are parties to some Council of Europe Conventions. Soviet Union has proposed extensive cooperation. Parliamentary Assembly has accorded special status for Hungary, Poland, Yugoslavia and the Soviet Union. The main criteria for membership are democracy and respect for human rights.

E. Membership of GATT, IMF/IBRD

Hungary, Poland, Yugoslavia and Romania are members of the GATT and IMF/IBRD, Czechoslovakia is a member of GATT, and Bulgaria has applied for GATT membership.

F. The State of Reform in Eastern Europe

1. The Reformers: USSR, Hungary, Poland and Yugoslavia

- Soviet Union: wide freedom of expression. Free, but not pluralistic, elections in March 1989 resulted in an increasingly independent Supreme Soviet. Massive legislative programme includes human rights. Economic reforms have scarcely begun to bite; economy deteriorating.

- Hungary a pluralist system, free elections spring 1990. The Communist Party has become the Hungarian Socialist Party. Other political reform in train. Much of the legal basis for a market system is in place, but budgetary subsidies continue and state-run industries need reform. Trade and exchange controls have been liberalised (contributing to a mounting balance of payments deficit).

- Poland A pluralist system: semi-free elections have been held, coalition government in place, completely free local elections due in 1990, and the Communist Party reforming. Some legal framework to dismantle the command economy is in place; the Government is committed to reform monetary, fiscal and incomes policies, and to privatise the economy, but its pace is undecided.

- Yugoslavia A moribund one-party system with elements of pluralism in Croatia and Slovenia. The least dirigiste of the East European economies, but widespread inefficiency and indebtedness (and rampant inflation). Plans for political and economic reform hampered by inter Republican rivalries and lack of central authority.

2. Reluctant reformers: GDR, Bulgaria

- Bulgaria No political reform. Much confused tinkering with economic system, but still a pure command economy. Implications of recent leadership changes not yet clear.

- GDR. The GDR leadership is moving towards political reform. Free elections are promised, but Communist party retains leading role under constitution. Own variant of economic management but is still a command economy. Economic reform is promised but will take a long time.

C. Potential reformer: Czechoslovakia

Less antagonistic handling of dissidents in recent months, but Party completely in control. Tinkering with economic mechanisms but still a command economy.

D. Anti-Reform: Albania and Romania

Both maintain a rigorously Communist system and oppose current developments in Eastern Europe. Only recent improvement is Albania's desire for better relations with Western Europe. Romanian isolation within the Warsaw Pact continues.

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