

Trade Liberalization vs Institutional Change

Angela Chepeta

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Abstract

Empirical studies find that Central and East European (CEE) countries trade much differently than West countries. Using a border effects procedure we find a home bias (preference for trading domestically) much higher for CEE countries than for EU members. The low level of East-West trade can thus be partially explained by the fact that a lot of CEE countries' trade is still taking place within national borders. The integration of CEE countries into the European Union is expected to lead the former becoming more alike the latter, including in the way they trade. In this paper we focus on the factors that are most likely to promote CEE-EU trade integration. Trade liberalization measures undertaken by both parties were very important but did not always produce expected results. Much less progress has been reached in improving the functioning of CEE institutions (e.g. progress in the privatization process, reducing corruption). Moreover, countries where most important changes at the institutional level occurred were also the ones that increased the most their trade with the EU. We study both policies mentioned above (trade liberalization and institutional change) to find which has a stronger impact on CEE-EU trade (in bringing it to the intra-EU level).