U.S. BUSINESS INVOLVEMENT IN EASTERN EUROPE

Case Studies of Hungary, Poland, and Romania

Martin Schnitzer

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PREFACE

The purpose of this book is to examine U.S. business involvement in Eastern Europe, with emphasis placed on various types of industrial-cooperation agreements. Special attention is given to three Eastern countries with which the United States has had good commercial relations—Hungary, Poland, and Romania. These countries have been receptive to attracting Western firms to participate jointly in a number of cooperation agreements. They sponsor, at least to some degree, joint-equity arrangements between Western and socialist enterprises. So far, the success of these arrangements has been somewhat limited, and the future potential for U.S. and Western European business involvement in these countries appears to be restricted to a degree because of the increased indebtedness of the East to Western financial institutions and a shortage of hard currency. The potential for U.S. and Western business involvement varies from country to country and also depends upon priorities established in the economic plans of the Eastern European countries.

Much of the data used in the study was based upon sources obtained in Eastern Europe and from the Washington embassies of Hungary, Poland, and Romania. Reliance was placed upon mail questionnaires and interviews with executives of U.S. firms operating in Eastern Europe. The objective of the questionnaire approach was to obtain information concerning the future potential for U.S. business involvement in Eastern Europe and to catalog the various types of industrial-cooperation agreements in which U.S. business firms are involved. Responses to the mail questionnaire constitute the foundation for the concluding chapter. Other major sources of information include publications of the Joint Economic Committee of the U.S. Congress and the Bureau of East-West Trade of the U.S. Department of Commerce.

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U.S. TRADE AND THE EAST-WEST ECONOMIC EVOLUTION

The purpose of this book is to explore the role of U.S. business firms in commercial contacts between the industrialized nations of the West and those nations of Eastern Europe, including the Soviet Union.[1] Special emphasis will be placed on newer forms of commercial relationships that have developed during the 1970s—relationships that come under the general category of industrial-cooperation agreements. These agreements represent a shift in the way business is being done between East and West, that is, the socialist and capitalist countries. Prior to the 1970s, East-West trade was characterized primarily by buying and selling, which involved straight export-import transactions. But as trade expanded, the forms of commercial relations between East and West also expanded and became more complex. A need developed for the East to alleviate its ever-increasing balance-of-payments deficit with the West and to compensate for its lack of investment capital. There was also a desire to expand and diversify individual national economies, to penetrate new markets, and to bridge an ever-widening technology gap with the West.

The problems that developed in Eastern Europe were to a large extent the result of an oversimplified approach to foreign-trade management and economic and industrial development. For a considerable period of time, industrial-development policy in the socialist countries emphasized the growth of a self-sufficient industrial base. This led to broad—but superficial, submarginal, and insufficiently specialized—industrial development. Stress was placed on import substitution rather than the promotion of manufacture based upon comparative advantage and efficient resource allocation. This approach slowed the evolution of domestic industry founded upon rational economic specialization and did not permit the early maturity of large-scale exports of specialized industrial production. Moreover, the small-scale production of numerous products did not create a sufficient export supply potential. Most often, these products were of low value, low technical levels not up to world standards, and frequently not adaptable to the needs and requirements of foreign customers. Thus, an imbalance in socialist foreign trade developed, with imports exceeding exports, and this led to balance-of-payments problems.

Industrial cooperation between East and West developed as a result of these socialist economic problems. Western firms have become involved in numerous industrial-cooperation agreements with the East. These agreements are defined by one writer as arrangements whereby individual producers, based in East and West, pool some assets and coordinate their use in the mutual pursuit of complementary objectives.[2] U.S. firms have not been as actively involved as other Western firms in participating in these agreements, but the interest is there. Three Eastern European countries offer some attraction to U.S. firms for reasons that are explained below. These countries are Poland, Hungary, and Romania. The U.S. business presence in each of these countries will be the subject of Chapters 4, 5, and 6, respectively.

The political situation in Poland, particularly vis-à-vis the United States, is relatively favorable to industrial-cooperation arrangements between U.S. business firms and Polish state enterprises. Even before the visit of Richard Nixon in 1972, Poland was a member of the General Agreement on Tariffs and Trade, had been granted most-favored-nation (MFN) status by the United States, and had been treated more leniently than its socialist neighbors by U.S. export control regulations. The Nixon visit and a subsequent visit to Washington by Polish Premier Edward Gierek resulted in a series of agreements that improved the already favorable business and commercial relations between the two countries. Export-Import Bank (Eximbank) credits were extended to include trade with Poland, with a reciprocal extension of credit by the Polish State Bank Handlowy w Warszawicz. Permission was granted to U.S. business firms to seek licenses for operating commercial representations in Poland, and a U.S. Trade Development Information Office was opened in Warsaw. Poland expressed strong interest in undertaking joint ventures in industrial cooperation with U.S. firms. During the 1970s the U.S. share of Western industrial-cooperation agreements with Poland showed a considerable increase, reflecting an increased interest on the part of U.S. business firms in Poland.

U.S. relations with Romania have also been generally good. President Nixon's visit to Romania in August 1969 was the first by a U.S. president to a Warsaw Pact country. In April 1971 the U.S. secretary of commerce visited Romania with the subsequent result that the country was made eligible for Eximbank credits. Romania was also granted MFN treatment with respect to exports to the United States. In turn Romania took a number of steps to expand and facilitate trade with the Western world. It became the first socialist country to join the International Monetary Fund and the International Bank for Reconstruction and Development. Of more practical importance to U.S. business firms were Romanian measures designed to make their country more accessible to foreign firms, culminating in the Romanian laws and regulations of 1971 and 1972 permitting the formulation of joint ventures with foreign firms and the decree of 1971, which allows foreign firms to establish their own offices in Romania. In 1973 the visit of Romanian President Nicolae Ceauşescu to the United States resulted in the creation of a bilateral U.S.-Romanian Economic Commission.

Hungary has been the most active of the Eastern European countries in seeking and concluding industrial-cooperation agreements with Western firms. This can be attributed to economic and political reforms that have given Hungary an economic system significantly different from the other countries of Eastern Europe, combining state ownership of the means of production with economic planning but lacking the command system of allocation used to implement the plans elsewhere. Instead, the plan was to be the framework for a "guided market" allocation system in which the economy would be run on a profit-based incentive system for enterprises. Industrial cooperation with the West was a part of overall Hungarian economic policy in which, among other things, the Hungarian economy was to be adapted to changing conditions of the international division of labor. Cooperation with Western firms was seen as a means to stimulate greater efficiency and productivity in Hungarian enterprises. Industrial-cooperation agreements are used to gain access for Hungarian exports in Western markets and to provide a substitute for imports through the cooperative delivery of end-use products.

THE EAST-WEST ECONOMIC EVOLUTION

The current, but fragile, trend toward closer economic cooperation between the capitalist and socialist countries is the result of a number of political and economic factors that have materialized primarily in the last decade. Probably the most important factor was the easing of worldwide political tensions between East and West in the late 1960s and early 1970s. Détente brought about a change in attitudes on the part of both the capitalist and socialist countries. Much of the easing of restrictions by the capitalist countries, in particular the United States, has been based on the premise that closer economic ties between East and West will lead to a decrease in political tensions. The socialist countries have reached a point in economic development where progress has to be brought about by using their plants and labor more efficiently. A move from an extensive to an intensive economic development has required new technology, industrial efficiency, and a hard-currency market and, of necessity, has precipitated a number of economic reforms within the socialist countries.

Economic Reforms

To improve economic efficiency, a series of reforms was instituted by the socialist countries, especially during the late 1960s. The significant elements of these reforms involved a number of areas. State industrial enterprises were given greater freedom to choose ways and means of plan fulfillment. Profit was accepted as the main indicator of state-enterprise performance, while the total number of success indicators was reduced drastically. Increased importance was attached to material, as distinct from moral, incentives. Planning was made less prescriptive and detailed; instead, efforts were made to lay down broad targets expressed in value terms. Prices were brought more in line with production costs to reduce the need for state subsidies and to enable the typical state enterprise to be profitable. Similarly, procurement prices paid to state and collective farms were raised in relation to industrial prices to increase agricultural production and to improve living standards in rural areas. There was some overhaul of the retail and wholesale trade network, designed to improve services to consumers and to enable effective transmission of customers' preferences to producing enterprises.

These reforms were by no means uniform in all of the socialist countries. Yugoslavia, which has remained free from Soviet influence, has had more latitude in terms of reform action. The purpose of the Yugoslav economic reforms has been to develop a decentralized economic system—in part, for political reasons and, in part, to promote economic efficiency. The other socialist countries, within the limits of Soviet tolerance, were able to pursue different policy lines. The policies that were implemented by the countries were related to their perception of economic performance and requirements. Romania was less inclined than the other socialist countries to vary from Stalinist economic institutions in that priority was given to the development of heavy industry. On the other hand, economic reforms in Czechoslovakia, Hungary, and East Germany took the form of changes in price policies. Each country adopted a multiple-price system, with some prices free, other prices varied within limits, and some prices fixed. Production criteria of total quantity output at the enterprise level were replaced by monetary and qualitative criteria such as sales, costs, and profits.

The reform movement in Eastern Europe emerged because of general dissatisfaction with the nature and result of the traditional Soviet-type economic system installed in the area after World War II. However, there has been a general retreat from reform, the extent of the retreat varying from country to country. Changes in administrative organization, planning methods, performance indicators, and incentives created the opposition of special interest groups. There was an ambivalent attitude on the part of Communist party leaders, who feared a lessening of their authority and control. Caution and delay were often involved in the implementation of the reforms. The state was ready to take away what it had given at the first sign of real independence. In Hungary, for example, enterprises and individuals discovered that indirect regulators and controls exercised by the state provided constraints that manipulated the market framework.[3] Moreover, there were no political reforms to accompany decentralization of economic decision making at the enterprise level. Although there was an effort to achieve decentralization of decision making, there was no corresponding effort to provide more autonomy in terms of political rights. All economic decisions have had to be made within the constraints of a highly circumscribed political framework. Inevitably, the reforms have come into conflict with ideological and political issues.

Problems of unsatisfactory growth rates, balance-of-payments difficulties, and lagging technological progress continue to be pervasive in the Soviet Union and Eastern Europe. The proliferation of economic claimants for goods and services runs well ahead of the ability of the output increases to satisfy demands. Options for improved performance are somewhat limited, and the mixture of costs and benefits is somewhat complex. Investment resources are not easily shifted from defense and export industries to modernize and expand consumer-related activities. Likewise, modest economic growth limits the incremental resource supply to be shared among the various resource claimants. In their search for corrective ways other than changes in the economic mechanism, the Eastern European countries have turned their attention to foreign trade and investment.

Rising Living Standards

Consumers in the Soviet Union and Eastern Europe have long paid the price for rapid industrialization and economic growth. There have always been shortages in the production of consumer goods, for top priority was assigned to the development of the capital goods industries. Resource allocation went into the production of capital goods, the procreative element in economic growth. This, however, has been subject to some change, because socialist consumers have come to want a higher standard of living now rather than at some unspecified time in a Communist utopia of the future. Although there is no question that consumers' standard of living has improved rather dramatically, particularly since 1970, both the quantity and quality of consumer goods still leave much to be desired. The speed with which new products and new production methods are introduced remains unsatisfactory. After three decades of socialist rule, the supply of many goods and services remains limited. Standing in line, waiting years for cars and apartments, searching the shops for scarce products, and bribing the butcher and the repairman are a way of life for socialist consumers. For the many families in which all adults work, often moonlighting as well, there is never enough time to shop.

The automobile, a ubiquitous symbol of high living standards in the West, is in short supply in the Soviet Union and Eastern Europe. To some extent production of automobiles is circumscribed by a lack of good roads and repair facilities. However, the socialist countries have found it very difficult to independently produce such highly complex products as motor vehicles on an economic scale. Moreover, few of the vehicles are competitive in world markets. Car prices are high and quality is low by Western standards. Necessary production equipment, common vendor-supplied parts, and broadly diversified supporting industry are not available in the socialist countries. Despite some experience in mass producing motor vehicles, particularly trucks, the Soviet Union only recently began a serious program to expand the output of modern automotive production equipment. The Soviet Union does not have the capacity to provide automotive items to Eastern European countries, and feelings of national sovereignty have kept individual countries from supporting the role of the Council for Mutual Economic Assistance (CMEA), as an instrument to guide and coordinate the development of an integrated regional industry.

Problems of Agriculture

An increase in population and a rise in per capita income have combined to generate a constantly increasing demand for an improved product mix in the socialist countries. However, there have been perennial problems of inefficiency, low labor productivity, and high production costs associated with socialist agriculture. Despite the fact that agriculture has received a high priority in the five-year plans and the economic reforms of the socialist countries, farm productivity lags far behind productivity in industry. Emphasis on mechanization and material incentives to stimulate farm output has not yielded the desired results. The end result of general agricultural inefficiency is that the socialist countries are among the most expensive food producers in the world, a fact that redounds to the disadvantage of the consumer because real income is reduced in comparison with that in other countries. There have been meat shortages in Poland and the Soviet Union. The need developed in the socialist countries to import agricultural products, including farm machinery, from Western sources. For the 1972-76 period, agricultural products accounted for nearly 74 percent of U.S. exports to the socialist countries as a whole.

Persistently unsatisfactory performance in agriculture has directed increased policy efforts by the socialist countries toward potential gains from expanded and improved participation in the international division of labor. Agricultural products from the West have increased in terms of demand. In 1976, for example, agricultural products represented around 60 percent of total U.S. exports to the Soviet Union and 70 percent of U.S. exports to Poland. Wheat and corn exports are of particular importance and reflect contractual agreements made between the United States and the two socialist countries. While the total value of wheat and corn sales is large, accounting for $1.5 billion in exports to the Soviet Union and Poland, they account for a small portion of U.S. grain production. Wheat sales to the Soviet Union and Poland represented less than 8 percent of total U.S. grain production in 1976, and corn production represented less than 3 percent of total U.S. production. Viewed another way, wheat and corn sales to the two most important socialist importers of U.S. products represented 13 percent of total U.S. wheat and corn exports to the world markets in 1976.

Other Factors

Recent developments in the socialist economies of Eastern Europe have created an environment for favorable industrial cooperation between East and West. Mounting problems in the economic systems of the socialist countries have exacerbated many economic deficiencies. Extensive economic development brought out costly and widespread industrial inefficiency and labor shortages. The development plans of the socialist countries called for a move from extensive to intensive economic growth, a departure from promoting growth through the addition of new plants and increases in the labor force to promoting it through a more efficient utilization of existing plants and labor. One of the problems faced by the socialist countries has been that their economic development was being hampered by a lack