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**INDUSTRIAL COOPERATION WITH CENTRAL AND EASTERN EUROPE
WAYS TO STRENGTHEN COOPERATION**

Information Memo P/90/46 attached

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INDUSTRIAL COOPERATION WITH CENTRAL AND EASTERN EUROPE*
WAYS OF STRENGTHENING COOPERATION

1. SUMMARY AND CONCLUSIONS

- 1.1 The purpose of this memorandum is to propose a series of measures for strengthening industrial cooperation with the countries of Central and Eastern Europe. The concept of "industrial cooperation" is taken here to include action ranging from measures to promote industrial activity, e.g. by helping to establish the right framework conditions, to joint activities between industrial firms in the Community and in the countries of Central and Eastern Europe. The industrial sector is broadly defined as covering both manufacturing and service activities. Scientific and technological cooperation in general with Central and Eastern European countries and cooperation in the field of telecommunications were the subject of recent communications (**) to the Council and to the European Parliament. In the same way, the Commission recently issued an information note giving an overall view of the economic aspects of the reforms process in these countries (***).

The political and economic reforms that are being carried through with increasing vigour in the countries of Central and Eastern Europe offer them a unique opportunity to become integrated into the European and world economy. They bring to an end a period of relative economic autarky within Comecon. This process will also open up new possibilities for trade between the Community and the countries concerned.

The year 1990 is being heralded as a turning-point in international economic relations. The meeting of Heads of State or Government in Paris at the end of November 1989 had already reasserted the Community's determination to support the reforms now under way with all the means at its disposal. Adoption by the CSCE Conference on Economic Cooperation in Europe on 11 April 1990 of a document acknowledging the importance of market mechanisms bears witness to the resolve of the participating countries to speed up the liberalization of their economies and to strengthen cooperation throughout Europe.

In order to support the on-going reform process in Poland and Hungary, the Group of major industrialised countries (G-7) decided at the Summit of the Arch in Paris in July 1989 to launch an operation of economic assistance to these countries (PHARE operation) to which 24 industrialised countries now participate (G-24).

Major Community initiatives have already been launched to develop industrial cooperation with the countries of Central and Eastern Europe

* For the purposes of this memorandum, the group of countries under discussion comprises Poland, Hungary, Czechoslovakia, Romania and Bulgaria. This paper also discusses possibilities of cooperation with the USSR.

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Section 3). As part of the PHARE operation, which the Commission is coordinating, an initial support programme has been launched to assist Hungary and Poland. The operation has been extended by the G-24 to other countries (Czechoslovakia, Bulgaria, the GDR, Yugoslavia) and financial resources will soon be increased.

The priorities identified include in particular the opening up of markets in the West, investment and restructuring aid, and vocational training.

The Community has concluded or is negotiating trade and cooperation agreements which are also designed to improve the framework for industrial cooperation and which should, therefore, be put fully into effect pending the conclusion of association agreements with these countries.

At the same time, initiatives such as the establishment of the EBRD (European Bank for Reconstruction and Development), the granting of ECSC loans and the increase in EIB resources will make it easier for the countries of Central and Eastern Europe, most of which are saddled with heavy debts, to finance structural improvement in their economies.

1.2 The impediments to rapid expansion of industrial activity which the countries of Central and Eastern Europe have inherited are beginning to be better understood (Section 2).** The first of these impediments is the extent to which industrial competitiveness in these countries lags behind. The transition from planned economies - most of which have a large industrial base - to market economies will have major implications for subsidized and structurally unprofitable industries. The speed of transition will, it is true, vary from one country to another but the risks of inflation and unemployment are present everywhere and may jeopardize the process. The success of the economic reforms depends largely on support being provided by the industrialised countries, notably by businesses in those countries that are capable of improving through cooperation the technological content, performance and structures of the economies making this transition. Alongside poor competitiveness, there is a serious problem of transparency as regards the real industrial situation which is deterring foreign investors. Lastly, considerable headway has been made recently in developing cooperation between firms in Western Europe and their counterparts in Central and Eastern Europe although it has not been sufficient to create inter alia the legal, tax and banking frameworks necessary for vigorous industrial expansion.

1.3 Major programmes have already been decided, that aim at reviving productive activity in these countries. However, given the prevailing economic situation in these countries, more needs to be done in order to improve investments climate and transparency, as well as to promote an enterprise culture. In the framework of the cooperation agreement, the Community should offer technical assistance on the basis of its own experience and regulations.

This could also add to the fostering of a coherent development of the legislative framework in the countries of Central and Eastern Europe and would limit the risk of distortions in competition.

** For further details, see the recent Commission Communication on the economic situation in the countries of Central and Eastern Europe (SEC(90)827).

The practical measures to be taken must involve as far as possible Community industry and must complement those already taken or should strengthen certain initiatives that have already been launched in Poland and/or Hungary under the PHARE operation (Section 4). Such measures should take account of each country's specific characteristics and situation, it being understood that the GDR is a special case that will have to be dealt with in a different context.

Measures should be taken for:

- improving the investments climate, conditions and transparency;
- assisting furthermore SME development, the creation of a more favourable business environment and cooperation in the field of standards;
- developing exchanges of industrial experience.

The implementation of the outlines of the present communication in projects to finance within the framework of an extended PHARE action (article 966 of the 1990 budget), will be subject to the procedures of the Council Regulation EEC/3906/89. Other possible actions which have not the characteristic of economic assistance or which do not correspond to the framework of this regulation would have to be accounted for on the appropriate budget line, notably article 990 of the budget (actions in the framework of trade and economic cooperation with third countries).

2. CONSTRAINTS AND LIMITATIONS AFFECTING THE PRESENT INDUSTRIAL COOPERATION FRAMEWORK

2.1 Lack of competitiveness

2.1.1 The economic reforms under way provide a better insight into what industrial structures in Central and Eastern Europe are really like. Basically, we find:

- a high percentage of obsolete capital goods in the industrial and energy sectors - some of which date back to the pre-war period - and of antiquated buildings; hence the very high levels of energy consumption and pollution;
- the virtual absence of any measures to combat pollution;
- an inadequate and ill-adapted infrastructure which, while already deficient in the capital cities and the major economic centres (e.g. telephones, fax machines, buildings, market services), is now beginning to cause concern in the outlying regions (road infrastructure, railways, energy, telecommunications, etc.);
- a structural mismatch between supply and demand for most basic necessities and consumer durables;
- overmanning, a workforce largely demotivated by the absolute guarantee of employment, and a wage structure which does not adequately reflect real productivity;

- managements poorly equipped to work in a decentralized business environment and lacking appropriate management tools (e.g. accountancy).

2.1.2 Apart from the excessive industrial specialization of its members involved by the principles of COMECON as they existed until now, the high degree of centralization of the economies, the importance of heavy industry and the excessively concentrated integration of industry in the countries of Central and Eastern Europe are largely responsible for the lack of competitiveness in those countries relative to the West.

Industrial specialization taken to the extreme represents an incomplete and misunderstood application of the principle of the international division of labour. By setting in place an arrangement whereby one country was responsible for the entire output of a particular product within Comecon (e.g. Hungary for buses and lorries, the GDR and Czechoslovakia for certain capital goods and the USSR for the bulk of supplies of oil and other raw materials) while being isolated from the rest of the world, these countries were largely shielded from the effects of international competition and created monopoly situations within Comecon.

Taking trade in industrial products, 70% goes to other COMECON countries whereas only 15% can be sold to the industrialised countries (the remainder being accounted for by the developing countries).

This isolation from the world market goes a long way towards explaining the technology gap between East and West and the lack of international competitiveness. As the pace of technological progress, characterized essentially by the diffusion of microelectronics, picked up in the early 1980s, the gap in productivity and living standards continued to widen between the developed countries and the countries of Central and Eastern Europe.

For most of them, the loss of international competitiveness has led to a chronic shortage of foreign exchange and to greater interdependence in trade. This has contributed to a further deterioration in competitiveness since capital goods appear on Comecon markets ten years or more later than in the West.

The energy market in the countries of Central and Eastern Europe is characterized mainly by a precarious balance between supply and demand, overdependence on a single source and, in many cases, supplier and domestic prices bearing no relation to international market prices. These countries are having to contend with a yawning technology gap, a manifest shortage of energy resources, and inadequate and ill-adjusted infrastructures at all levels of energy supply and consumption. Need for adjustment will be considerably increased by the shift to hard currencies for the financing of trade between COMECON countries in the energy sector.

2.1.3 The needs as regards modernization of the capital-goods infrastructure in the countries of Central and Eastern Europe are enormous. However, while managements and governments would like to purchase capital goods abroad, they are hampered in this by the shortage of foreign exchange and by the high level of indebtedness.

Under the circumstances, if purchases of capital or consumer goods were replaced by industrial cooperation projects (notably in the form of joint ventures), this would be an inexpensive and efficient way of gaining access to technology. However, it is not without its difficulties.

2.2 Lack of transparency

- 2.2.1 The changes taking place in the countries of Central and Eastern Europe are entailing upheavals which, for the time being, will change the reference framework for potential investors.

The situation is compounded by debt-related constraints and by a lack of knowledge of international markets, both of which may cause potential investors to be somewhat wary.

- 2.2.2 The dearth of statistics and information on trade makes it difficult to assess the changes that are taking place. A large number of economists in the countries of Central and Eastern Europe themselves admit that many statistics, including those on industrial output and GDP, were often influenced by political considerations. In estimating GDP, for example, the results may differ by a factor of two.

While it is true that statistics are still a useful indicator of the level of industrial output, they still do not depict correctly the inadequate relationship between supply and demand. Lastly, the statistics do not take account, for example, of the inefficient use of energy and raw materials or of the quality of production.

The lack of reliable and accurate statistics on the economy and market conditions in these countries may hamper foreign investment. For want of adequate accounting data, the same uncertainties complicate any attempt to evaluate the competitiveness of possible partners as regards industrial cooperation.

2.3 Industrial cooperation with Central and Eastern Europe: a difficult undertaking

Foreign investment in the COMECON countries is still limited, being put at some \$ 2 bn (the bulk of which in Hungary and the USSR), an inadequate figure when compared with any assessment of what is needed to bring about economic recovery in the countries of Central and Eastern Europe.

Direct investment in these countries rose prior to the second oil crisis, when they were building up their stock of capital goods and had few, if any, financing problems. However, most firms had reckoned on industrial cooperation bringing rapid results and, disappointed by the worsening industrial cooperation climate, shied away from investing there, notably on account of:

- the scale of countertrade and the difficulty of obtaining the foreign exchange necessary for imports or for transferring part of their profits elsewhere;

- the cumbersome and complicated bureaucratic procedures at central, regional and local levels;
- difficulties in obtaining supplies of raw materials and high-quality semi-manufactures, and delays in supplies.

The firms that remained behind knew how, and were able, to adapt to the difficult conditions of industrial cooperation. Some simply decided not to transfer profits abroad and reinvested them locally while others simply took advantage of the cheap and well-trained local workforce.

Nevertheless, in an environment hardly conducive to industrial cooperation prior to the recent economic liberalization, some forms of cooperation have proved relatively successful. Take, for example, investment in electrical engineering and in footwear and textiles (notably in Hungary).

2.4 New legal and administrative environment for joint ventures: progress but, as yet, no satisfactory framework

- 2.4.1 The number of cooperative ventures has risen in the last year or so as all the countries of Central and Eastern Europe have brought in laws on joint ventures. For the host country, this arrangement has the advantage of providing access not only to commercial and technical know-how but also to foreign capital (where appropriate, in the form of imported capital goods), and as such it is a highly visible form of cooperation. For foreign investors, it allows entry to a new market with high growth potential (given the unsatisfied demand and existing bottlenecks) in conjunction with a partner already established there. Nevertheless, the environment for such joint ventures will remain difficult, even in the medium term. The underdevelopment of communications, banking and service infrastructures, bureaucratic practices and, in some cases, non-existent or only partial convertibility are the difficulties most often mentioned and the main reasons why some cooperative ventures take so long to get off the ground or fail altogether.

The recent economic liberalization in the countries of Central and Eastern Europe has also improved the basic environment for SMEs, which, compared with State-owned enterprises, faced discrimination in the tax, legal and financial spheres.

The faster rate at which joint ventures are now being set up is clearly illustrated in the car industry. The shortage of cars (attributable in part to the export policy pursued) explains the large demand which present capacity is unable to meet. Hence the new investment by foreign manufacturers (including from Europe).

- 2.4.2 The reforms under way should make the operational environment for joint ventures more welcoming. In practice, they involve aspects such as:

- the role of the plan, which would, from now on, have to provide guidance rather than a binding framework;
- decentralization of foreign trade, abolition of the monopoly enjoyed by the public import-export agencies, and revision of the Comecon mechanisms;

- price deregulation;
- currency convertibility;
- special conditions for foreign investment,* e.g. protection or profit repatriation;
- new laws on property and more suitable employment and social security laws; however, emigration is intensifying in some cases and is tending to accentuate the shortage of skilled labour;

the introduction of rules on competition for firms, particularly in the public sector.

All in all, these countries have embarked on major reforms, notably as regards privatization, currency convertibility and the freedom to import, even if the pace of them may vary from country to country.

The planned easing of export restrictions, especially those coordinated by CoCom, should also improve the conditions for technology transfers and hence for closer industrial cooperation.

The possibility of new measures at Community level to reinforce existing investment and export insurance schemes could serve the aim of reducing the risks associated with investment in the countries of Central and Eastern Europe.

3. CURRENT COMMUNITY EFFORTS HAVING A BEARING ON INDUSTRIAL COOPERATION

Any attempt to look into ways of improving industrial cooperation with the countries of Central and Eastern Europe must take account of, or complement, the bilateral or multilateral measures already taken by the Community, the most prominent of which are discussed briefly below.

3.1 PHARE operation

3.1.1 Priorities

Community assistance for Poland and Hungary is based on an action programme centred on five priorities most of which are of special interest for industrial cooperation:

- improved access to the Community market for Polish and Hungarian products by scrapping quantitative restrictions and granting GSP treatment;
- promotion of vocational training (notably under the aegis of the European Training Foundation and the TEMPUS programme);
- measures in support of economic reform and investment promotion;
- food supply for Poland and restructuring of agriculture in this country;
- cooperation on environmental protection, including for projects in the energy field.

* A brief summary of the essential characteristics of the arrangements for joint ventures is attached.

3.1.2 Widening the scope of assistance

At the meeting of the Group of 24 on 4 July 1990, Ministers welcomed the commitment of these countries to the consolidation of reform and agreed to extend the G-24 assistance commensurate to the progress in political and economic reform to the GDR, Czechoslovakia, Bulgaria and Yugoslavia in order to support this process.

The financial perspectives for 1990-1992 have been modified in order to allow for an appropriation of ECU 500 million in 1990, rising to almost ECU 1 bn in 1992.

Starting this year, the financial framework provided for in the Community budget could make it possible to support forms of industrial cooperation if the new beneficiary countries submitted practical projects in time and respect the procedures of Council Regulation EEC/3906/89. This does not, however, prevent suitable large-scale industrial projects or infrastructure projects from being assisted instead by the EBRD or the EIB (see point 3.3 below).

Furthermore, extension of GSP treatment to the other countries of Central and Eastern Europe (with the exception of the USSR), as proposed by the Community to the G-24, and the dismantling of quantitative restrictions ahead of the schedule laid down in the agreements discussed at point 3.2 will have the effect of further opening up the Community market to imports of industrial products from these countries and, in so doing, improving sales prospects in the eyes of foreign investors.

3.2 Trade and cooperation agreements

Trade and cooperation agreements have been signed in turn with Hungary, Poland, the USSR, the GDR, Czechoslovakia and Bulgaria. In the case of Romania, an agreement has been initialed. At its meeting of 18 June 1990, the Council has decided to pronounce itself on the signature at a subsequent meeting.

In these agreements, the chapter dealing with trade cooperation is designed notably to facilitate a whole range of business operations, including the exchange of market information.

One of the purposes of the chapter on economic cooperation is to promote cooperation between economic agents with a view to fostering investment and setting up joint ventures or other forms of industrial cooperation. Among the possible fields of cooperation mentioned are industry, environmental protection, research, energy, telecommunications, vocational training, standards and statistics. Within the joint committees, the partners can identify the economic sectors and industries where they would like to see an expansion of cooperation. Industrial cooperation at Community level complements the instruments available to Member States in this field.

Eventual replacement of these trade and cooperation agreements by association agreements will lead to a strengthening of industrial cooperation and will be aimed at establishing a free trade area between the Community and the associate countries.

3.3 Other financial resources

The Community has taken initiatives and supported measures to create new financial resources to which these countries will have access:

- an ECU 870 million loan in support of the continuing structural adjustment programme and reforms in Hungary;
- Hungary and Poland are eligible for ECSC loans totalling up to ECU 200 million for certain investment projects in the coal and steel industries or in steel-consuming sectors such as infrastructures;
- the KTB has available for three years an amount of ECU 1 bn that may be used to extend its lending activities to Poland and Hungary;
- establishment of the EBRD, which, with a capital of ECU 10 bn, will make it easier to finance projects in the countries of Central and Eastern Europe. Since it will apply market conditions so as not to contribute to any increase in the debt burden of the beneficiary countries, the intention is that it should accord priority (to the extent of 60% of the funds earmarked) to private initiatives. Finance is also to be made available for major infrastructure projects such as linking of their transport networks to those in Western Europe.

4. ADDITIONAL MEASURES TO BE ENVISAGED

4.1 Overall view

The transition to pluralist democratic systems is already well under way in the countries of Central and Eastern Europe. In a number of them, major macroeconomic adjustments have been started and are beginning to bear fruit. Some are setting about implementing measures to support business activity, particularly in the form of legislation favourable to joint ventures.

Despite these initiatives, discussions with western industrial concerns and the perception of the real situation in the countries of Central and Eastern Europe confirm that the steps being taken to revive businesses and productive activity as broadly defined are still far below what is necessary. The development of production, and particularly industrial production, in these countries is vital if their economic liberalization strategies are to be successful. Consideration should therefore be given to additional industrial cooperation measures.

The additional measures to be envisaged should stem from the realization that the current lack of progress is due to a combination of three major deficiencies:

- (1) The first is the, as yet, incomplete nature of the measures taken to establish in a consistent manner all the framework conditions necessary for a modern market economy to function properly. The rapid transition from planned to market economies calls for the creation of new framework conditions in the legal, tax, accounting and other spheres in the countries of Central and Eastern Europe. The Community should continue to provide support and backing for this transition by offering substantial assistance (in the field of standardization too) to help create conditions favourable to a modern industrial economy with a network of small businesses;
- (ii) The second deficiency is the almost total absence of an enterprise culture necessary for a market economy to operate. This is due to the fact that in practically none of the countries concerned have managements had to confront the vital decisions western firms have to face. The result is a serious lack of management know-how in such basic fields as cost accounting, investment analysis, price determination, etc.;
- (iii) The third deficiency is that the economic prospects of the countries of Central and Eastern Europe suffer from the serious handicap of a lack of transparency and predictability. Such a degree of uncertainty all too often deters or delays investment decisions, which are themselves essential for the expansion of productive activity. The economic liberalization and gradual integration of the economies of the countries of Central and Eastern Europe into the world economy entail the dismantling of Comecon in its present form. As a counterpart to this dismantling process, however, a major effort must be made to promote greater transparency and predictability so that economic operators can take rational investment decisions. Given the size of each of the economies concerned, a multilateral framework could offer - as was the case in the western economies and the CEEC in the early 1950s - an optimum degree of transparency and predictability.

The proposed measures set out below will increase the effectiveness of existing initiatives, and in particular the instruments for encouraging investment and promoting vocational training referred to in the previous section. They could be supplemented by specific sectoral measures.

4.2. Improved transparency

Action is being taken to improve economic transparency under the PHARE operation to assist Hungary and Poland, involving a practical investment guide (pending the setting-up of a data bank) and various studies of these countries. This action should be stepped up in the following ways:

- (a) Increased transparency of conditions governing direct investment in host countries

Given the ever-changing legal and economic environment for cooperative ventures, interested Community firms could benefit from greater transparency of the conditions governing direct investment in host countries, including information on the economic environment in those countries not included in the PHARE operation (e.g. the USSR). SMEs in particular could be made more aware of the scope for

meetings on investment in the countries of Central and Eastern Europe recently organized within the framework of the CSCE;

- The organization of business days on sectoral themes, which would be open to industrialists from East and West, could be envisaged. They could take place annually in each of the countries of Central and Eastern Europe and would constitute an appropriate framework for meetings;

(b) Increased transparency of market prospects

- As knowledge of the market is vitally important for investors, practical steps could be taken to reinforce the instruments of market analysis, where appropriate through the use of consultancy firms, with a view to demonstrating the potential, the needs and the specific characteristics of markets.

The size of the market and the comparative advantages of each of these countries should be ascertained more precisely, particularly in those sectors benefiting from special investment conditions.

The Commission could disseminate the information obtained in this way through appropriate channels.

To this end, more regular contacts between industry in these countries and European trade organizations could also be encouraged. They could serve as a forum for the exchange of information on, say, investment.

4.3 Horizontal measures

While some horizontal measures have already been launched on a limited scale under the PHARE operation (e.g. in the fields of standardization and certification) or under cooperation agreements, it would seem desirable to incorporate them into a systematic approach, while at the same time taking account of the specific characteristics of each country. These measures should pursue three main aims: creation of a favourable environment for businesses, support for the development of SMEs, and cooperation on standardization.

4.3.1 Promotion of an appropriate legal framework

- (a) The introduction of a market economy makes it necessary for the authorities in the countries of Central and Eastern Europe to supplement their legislation with legal and accounting rules favourable to firms and encompassing a modern body of company and tax law and a regulatory framework suited to the needs of industrial expansion.

- The absence, in most of these countries, of a proper body of company law comparable with that in the industrialised countries is a considerable obstacle to greater industrial cooperation. In some countries, public and private limited liability companies are unknown; bankruptcy law and rules governing the settlement of disputes are inappropriate or even non-existent.
- The same degree of priority must be attached to the inclusion of accountancy and company taxation in such action. The valuation of property and other assets raises major difficulties not only in the case of the privatization of State-run enterprises but also in connection with the setting-up or winding-up of joint ventures. Similarly, the calculation of annual profits is impeded by the lack of appropriate rules for calculating depreciation and/or for the tax treatment of re-invested profits.

In the fields of worker protection at the place of employment, consumer and environmental protection and also indirect taxation, the prospect of the economies of the countries of Central and Eastern Europe and those of the Community gradually moving closer together requires closer alignment of legislation affecting firms. In the meantime, a code of conduct for firms in these areas would make up for the legislative deficiencies and preserve the environment when new industries are set up.
- Finally, steps should be taken to introduce or, where appropriate, reinforce a set of suitable competition rules in order to ensure that the market economy functions smoothly.

The Community's achievements in these fields are considerable. The Commission could provide assistance (if necessary, in the form of vocational or professional training, e.g. for accountants) once these countries have decided to undertake radical reforms of their legal systems. This type of cooperation could be carried out within the framework of bilateral agreements or within the framework of the coordination of G-24 activities.

Mention should be made in this context of the help given to Polish and Hungarian privatization agencies and of the technical assistance provided for the reform of the banking system and for the creation of a stock exchange in Hungary.

- (b) Adequate and effective protection of intellectual, industrial and commercial property is one of the key conditions for establishing and reinforcing industrial cooperation with the countries of Central and Eastern Europe.

Although these countries are party to a number of international agreements in this field administered by WIPO (World Intellectual Property Organization), only a few of them are signatories to certain agreements, such as the 1970 Patent Cooperation Treaty or The Hague Arrangement on the International Deposit of Industrial Designs. Furthermore, protection in these countries was closely linked to the prevailing economic system, which was based on collective ownership of the means of production. This had two major consequences:

- firstly, the legal systems relating to intellectual, industrial and commercial property were isolated from international developments, particularly those in the Community. Furthermore, this field is not generally accorded priority in national legislation;
- secondly, Community nationals were not very interested in seeking protection in the countries of Central and Eastern Europe.

Some rights (e.g. patents) receive inadequate protection, and special attention should be paid to them.

The Commission could take steps (where appropriate, within the framework of joint committees) to promote the adaptation of national legislation in these countries to past and future economic changes and could endeavour to ensure that these countries comply with existing multilateral agreements in this field.

4.3.2 Support for the development of SMEs

Industrial cooperation is a useful means of assisting SMEs in the countries of Central and Eastern Europe. The main problems in this area seem to be to provide European firms with the necessary information on the legal, tax and administrative framework for the setting-up of joint ventures in those countries, to identify potential partners on both sides wishing to engage in industrial cooperation in specific fields, and to bring the two sides together. The most promising ways of achieving this - a start on some of which has been made under the PHARE operation - would seem to be:

- the setting-up of a data bank containing all the information necessary for western operators in the countries of Central and Eastern Europe to take investment decisions; a feasibility study is to be finalized in the very near future;
- use of a data bank to match offers of, and requests for, cooperation: The BC-Net (Business Cooperation Network) set up by the Commission is a computer-backed network of European business advisers. Its extension to the countries of Central and Eastern Europe could speed up identification of potential partners. Admittedly, the technology gap in data-processing equipment and telecommunications networks means that a fully operational service can be set up only in the medium term;

- the development of structures for supporting or assisting SMEs in the countries of Central and Eastern Europe: the Community is already preparing a programme for SME development in Poland and Hungary, including the possible set-up of Euro-Info centres.
- participation in international fairs and exhibitions: (see point 4.2): personal contacts between potential partners (cf. projects of the Europartnership type) are of vital importance for SMEs;

The Commission's departments are also studying the possibility of launching a programme to encourage investment by Community operators in the countries of Central and Eastern Europe that would involve minority contributions of risk capital. It goes without saying that this action should be in addition to any similar measures taken at national level. Use will be made of the experience acquired by the Commission's services since 1988 encouraging Community investments in other regions of the world.

4.3.3 Standardization and certification

- Greater convergence in the fields of standardization and conformity assessment should be one of the priority aims of cooperation. Generally speaking, the countries of Central and Eastern Europe would welcome the application of international standards. They have identified international and European standards as an effective and rapid means of improving the quality of their products and production methods and hence of boosting the opportunities for exporting goods, particularly to the Community and to the EFTA countries (the latter already take part in the Community's work on standardization).
- The economic benefit to the Community is also clear because, in so far as Comecon or national standards were replaced by international and European standards (or, in their absence, by standards established in the Member States), trading opportunities would increase. Through the adoption of international and European standards in these countries, the technical bases could be established for the conclusion of agreements with the Community on the mutual recognition of tests and certificates.
- If effective assistance is to be provided by the Community, the countries of Central and Eastern Europe should indicate their special needs and priority sectors. Depending on the situation in each country, such assistance could take the form of detailed information on standards and procedures, training of staff or technical seminars. These countries should also consider a relaxation of the compulsory nature of their standards and a transfer of competence in the standardization/certification field to the private sector.
- As to the question of possible direct participation by these countries in the work on developing European standards, discussions could begin, in conjunction with the organizations concerned (CEN, CENLEC, ETSI), on possible solutions.

- The relevant department in the Commission are preparing programmes for cooperation in the field of standardisation and certification in coordination with competent European organisations.

4.4 Sectoral measures

- 4.4.1 The above measures can be supplemented by action of a sectoral nature. It would be useful to institute a dialogue on the future development of the different sectors of industry not only with the public authorities but also with the private sector, and in particular between industrial federations. The objective would be twofold: to gain a better idea of new developments in the sectors under consideration, and to make available to the countries of Central and Eastern Europe the experience and advice of Community experts for the purposes of assisting the restructuring of certain sectors, for introducing suitable legislative or technical instruments (e.g. those linked to environmental and consumer protection, such as the study of the environmental impact of any new industrial project) or improving commercial, technical and management know-how.

This twofold objective could be achieved through a series of operational measures which fall into the categories indicated below, it being understood that the degree of success will depend on the determination shown, and priorities specified by, the Central and Eastern European countries concerned:

- (a) Expertise to enable these countries to achieve a better awareness of the potential of firms and markets on the basis of objective criteria normally used in market economies in the West.

This expertise, which the Commission could foster by providing easier access to consultancy firms and/or groups of experts from the corresponding sectors in the Community, would make it possible, where appropriate:

- to propose short-, medium- and long-term measures for improving the competitiveness of the firms analysed in the technical, commercial and general management fields;
- to adapt possible measures for modernizing and/or rationalizing certain industrial sectors to anticipated market trends, particularly in the countries of Central and Eastern Europe.

- (b) Vocational training through specific seminars in industrial enterprises in the countries of Central and Eastern Europe or periods of training for the various types of manager and specialists worker from those countries in industrial enterprises in the Community; this would cover production, marketing, accounting, management, etc.

- (c) Technical assistance, where appropriate through pilot schemes within enterprises. The aim here would be to implement the different measures for improving competitiveness that are identified as a result of expert appraisal and which do not necessitate substantial investment programmes: management methods, accounting systems, etc. Here again, experts - either from specialist companies or from the firms themselves - could carry out technical assistance measures.

The introduction of modern management and accounting systems is a priority under the PHARE operation described above at point 3.1. They should enable the industrial authorities and economic operators in the countries of Central and Eastern Europe to take the major strategic decisions on industrial investment (and, where appropriate, disinvestment) which will be necessary to modernize their priority industries and which will probably entail substantial financial resources and/or will carry social implications for the level of employment in most industrial sectors.

4.4.2 The choice of sectors in which these measures could be carried out will lie with economic operators in the countries of Central and Eastern Europe. These measures are nevertheless likely to be concentrated in two main types of sector:

- sectors (and enterprises) in which radical restructuring will be needed to achieve levels of productivity and competitiveness comparable with those in the Community; steel, shipbuilding, basic chemicals, paper and cement are notable examples;
- sectors in which major developments are anticipated as the corresponding new production or distribution structures are set in place; the car industry, agri-foodstuffs and the consumer goods and equipment industries generally are likely to appear in this group in the medium and long term.

Some industrial cooperation initiatives have already been launched by private firms in the West. For example, the cement industry represented by CEMBUREAU, has already taken steps to develop possible forms of cooperation with the Polish cement industry (particularly in the fields of training and environmental protection).

4.4.3 At Community level, an important industrial cooperation initiative was launched a few months ago in the steel industry. During discussions in the Council on the negotiating brief for the external measures under the 1990 steel plan, a number of suggestions were put forward by some Member States and by the steel industries and associations in the Community with a view to supplementing the gradual trade liberalization set in train with five of the Central and Eastern European countries through an offer of industrial cooperation in this sector. The Commission undertook in the Council to draw up, in conjunction with the Community steel industry, a programme of cooperation with the Central and Eastern European countries through an offer. The implementation of this programme is described in detail in an annex.

5. FINAL CONSIDERATIONS

This memorandum has discussed a number of measures to supplement or expand existing measures.

Measures to improve transparency could be implemented rapidly, where appropriate with the help of industry and the authorities. The "horizontal" proposals aim to place industrial cooperation on a more systematic footing. They would reinforce the action taken under trade and cooperation agreements in certain fields. Some of them could be implemented rapidly (e.g. practical measures to assist SMEs) while others merely constitute offers of cooperation or assistance which, in some cases, will necessitate the assistance of national bodies (e.g. in the field of standardization).

As in the steel industry, for example, practical steps could be taken at sectoral level, with a view to arranging detailed discussions and paving the way for additional measures. It is probable that, as has happened in the cement and shipbuilding industries, discussions have taken place or contacts been established in other sectors. The Commission believes it will be useful to reach agreement with industry, on making such sectoral discussions or measures more transparent and visible.

Community measures would usefully supplement the bilateral industrial cooperation measures taken by the Member States and other Members of the Group of 24 with respect to the countries of Central and Eastern Europe where the assistance is coordinated by the Commission.

ANNEX I

MAIN ELEMENTS IN THE LEGAL AND ADMINISTRATIVE FRAMEWORK FOR
JOINT VENTURES*

POLAND

- there are no restrictions on the level of foreign participation or the composition of the management;
- the minimum contribution of foreign capital is US\$ 50 000 and 20% of the total;
- a foreign investor may become a shareholder in a privatized public enterprise by purchasing shares;
- profits are taxed at a rate of 40%, although exemption is possible for three years and then for a further period of three years if the activity in question is carried out in a priority sector;
- the repatriation of profits in foreign currency is guaranteed in part; there are double taxation agreements with almost all EC countries;
- the effects of the policy to combat inflation and the devaluations of the zloty are likely to pose major problems for potential investors.

HUNGARY

- the limit on foreign participation (50% of capital) may be exceeded only with the agreement of the Ministry of Finance; a joint venture may be set up through the foreign investor's participation in a public enterprise (privatization is automatic where a foreign investor undertakes to subscribe for 20% or more of the shares);
- the maximum rate of tax on profits is 50%; it is reduced to zero for five years if the activity in question is carried out in a priority sector;
- as in Poland, there are legal or administrative arrangements to ensure that profits can be transferred; there are also international agreements for preventing double taxation.

The conditions in Poland and Hungary for foreign investors are substantially more advantageous than those in the other countries of Central and Eastern Europe.

* Situation as on April 15th, 1990

CZECHOSLOVAKIA

- the legislation governing joint ventures has been greatly liberalized; transfers of profits and foreigners may acquire majority holdings;
- it will be possible for joint ventures to be set up in the form of public limited companies incorporated under Czechoslovak law;
- the tax regime is favourable in that tax on profits is levied at only 40%; agreements to prevent double taxation have been concluded with EC countries;
- there are no agreements on investment protection.

ROMANIA AND BULGARIA

Foreign trade has not been liberalized in either of these countries; subject to authorization, both countries allow foreigners to acquire majority holdings; neither country has introduced convertibility, although Romania permits domestic trade to be transacted in foreign currencies.

USSR

- the limit on foreign participation in the capital of joint ventures has been scrapped and the conditions governing the nationality of managers eased;
- after two years, joint ventures pay a 30% rate of tax on profits and a rate of 20% on repatriated profits; tax relief may be granted for certain categories of investment (in remote areas and for the production of consumer goods) and exemptions from the employment and social security laws are possible;
- joint ventures are free to import or export but must themselves obtain the foreign exchange they need, possibly by selling on the Soviet foreign exchange market.

ANNEX II

INDUSTRIAL COOPERATION IN THE STEEL INDUSTRY

Analysis of the steel industry

The steel industry plays an important role in the economies of the countries of Central and Eastern Europe, not only in terms of its contribution to GDP but also and particularly because of the number of jobs involved and the foreign currency earned from exports of steel products. Crude steel production in the six countries concerned amounts to more than 60 million tonnes, with Czechoslovakia, Poland and Romania accounting for between 14 and 17 million tonnes each, the GDR for 8 million tonnes and Hungary and Bulgaria for between 3 and 4 million tonnes each (this compares with production of 140 million tonnes in the EC).

Steel plants are generally obsolete, have a low level of energy efficiency and cause serious environmental problems. This is illustrated by the continuing reliance on Siemens-Martin furnaces (not used in the EC since 1980), which still account for 40% of crude steel production, and by the continuous casting rate, which averages only 20% compared with 95% in the EC.

Overall productivity is very low. The industry employs 700 000 people compared with a figure of 400 000 for the EC. Given the respective production figures and assuming comparable statistical data, this means that these countries achieve only a quarter of the average level of productivity in the Community. The cost of production as measured by objective criteria is probably therefore too high. In addition, organization is, in many cases, inefficient, with excessive central planning and defective distribution and marketing systems.

Rationalization and modernization measures and, where appropriate, capacity reductions will, therefore, have to be undertaken in any event and employment problems will inevitably arise during the adaptation process.

Objective of cooperation

The objective of cooperation should be to offer these countries the expertise and advice which Community experts possess when it comes to restructuring the industry and managing steel enterprises so as to enable them to carry through, in a manner consistent with their general economic development, the reorganization and modernization of their steel industries.

This objective, which would be supplemented in the longer term by industrial investment, could be achieved through a series of operational measures which can be grouped together in the categories referred to in point 4.4.1 of the memorandum: expertise, vocational training and technical assistance.

The decisions regarding investment (and disinvestment) which might stem from these measures will have to be approached cautiously by the Central and Eastern European countries concerned, in view of their major financial and, in particular, social implications. Nevertheless, certain types of investment, such as that designed to improve the environment or to establish infrastructures for steel firms, could be carried out rapidly. This would necessitate the direct participation of steel firms or capital-goods suppliers as well as monitoring by the Commission if Community financing (e.g. ECSC lending) is requested.

ECSC loans totalling ECU 200 million and earmarked for financing certain types of investment (infrastructure, environment, joint ventures) in the coal and steel industries will be supplemented shortly by other public financial instruments (EIF, EBRD) to which the countries of Central and Eastern Europe will also have access for steel investments which comply with the criteria applicable in each case. Recourse to foreign capital will undoubtedly be necessary given the anticipated volume of investment in this industry.

Existing measures

The practicalities of industrial cooperation were discussed with Hungary and Poland during the negotiations held in Brussels in March on an ECSC agreement on commercial and economic cooperation. The Commission staff explained the broad lines of the Community approach as set out in point 4.4 of the memorandum and, following the responses of these two countries, exploratory visits designed to ascertain real needs are now taking place. Czechoslovakia has shown great interest in industrial cooperation of this kind and on-the-spot discussions have taken place with the heads of the steel industry and the ministries concerned. During past visits, considerable interest was shown by the authorities responsible for the steel industry and by steel managements in the restructuring process under way in this industry in the Community since 1980, in the viability criteria applied to firms wishing to gain access to public financing and, especially, in the social and regional back-up measures specifically designed to cushion the impact of restructuring on the workers and regions hardest-hit by the steel crisis. Bulgaria and Romania were informed of the broad lines of this plan during the negotiations on the steel arrangements in March 1990.

Following the liberalization moves in the countries of Central and Eastern Europe, more and more contacts have been established between representatives of governments and especially steel firms in Member States and their counterparts in those countries. Interest has focused on commercial or industrial cooperation (and even joint ventures), exchanges of information, vocational training, and technical and management advice.

Mention should also be made, however, of the activities of non-Community countries in this region. Austria has always had close links with these countries for geographical and historic reasons but Scandinavian, Japanese, Australian and US companies are also offering cooperation and assistance.



**INFORMATION · INFORMATORISCHE AUFZEICHNUNG · INFORMATION MEMO · NOTE D'INFORMATION
ΠΛΗΡΟΦΟΡΙΑΚΟ ΣΗΜΕΙΩΜΑ · NOTA D'INFORMAZIONE · TER DOCUMENTATIE**

Strasbourg, Brussels,
11 July 1990

**INDUSTRIAL COOPERATION WITH CENTRAL AND EASTERN EUROPEAN COUNTRIES:
SUPPORT FOR ECONOMIC REFORMS**

The Commission considers that, if practical support is to be given to the radical economic reforms announced in the countries of Central and Eastern Europe, measures should be taken to develop industrial activities in those countries.

It is not enough for those countries to acquire capital goods, to engage in joint ventures with firms from Western Europe and to have access to new technologies. In the Commission's view, they also need help in creating an entirely new legal, administrative, banking and tax environment in order to pave the way for industrial expansion and to improve the conditions for foreign investors, thereby enabling hitherto closed economies to integrate into the European economy and to participate in world trade, from which they have been almost entirely cut off.

Such is the message contained in a discussion paper which the Commission has now adopted on Mr Bangemann's initiative and the main lines of which will serve as a basis for the debate called for by the Ministers for Industry of the Twelve.

In essence, the document sets out the practical measures already taken under the PHARE programme. The aim is not to modify this major programme but to supplement it with specific measures - to be defined at a later date - to help all the countries of Central and Eastern Europe, including those, such as the USSR, which are not included in the PHARE programme.

Handicaps suffered by planned economies

The bottlenecks in planned economies are well-known: obsolete factories, polluting and energy-intensive heavy industries, overmanning, managers inadequately trained for the modern management of decentralized enterprises, poor-quality products, technological backwardness, economies isolated from the world market.

The extreme sectoral specialization within Comecon and, consequently, the isolation of these economies from the world market are very largely responsible for the technological backwardness of the countries of Central and Eastern Europe.

It is interesting to note a number of facts concerning the operation of industrial cooperation between the Comecon countries. Hungary, for example, was alone responsible for producing buses and lorries for all its partner countries while the GDR and Czechoslovakia produced the bulk of capital goods, with the USSR being primarily responsible for supplying its partners with oil and other raw materials.

In this way, Comecon absorbed some 70% of trade in industrial products, with only 15% being sold to the industrialized countries; the remainder was accounted for by developing countries. These practices not only had the effect of isolating these countries from the rest of the world; they also sheltered them from healthy international competition.

A further major handicap is that foreign investment in the Comecon countries is still limited despite certain liberalization measures (see annex). Capital invested by foreign companies is estimated at some \$2 billion, the bulk of which has gone to Hungary and the USSR.

Improvements still insufficient

Although, as the Commission points out, substantial improvements have been made to the legal and administrative environment by most of the countries of Central and Eastern Europe (particularly for joint ventures), much remains to be done. Western partners still complain about the underdevelopment of communications and banking infrastructures, a defective or non-existent network of services, bureaucratic procedures and the non-convertibility or, at any rate, insufficient convertibility of currencies.

Faced with this situation, the Commission is proposing a series of practical measures:

- Improved transparency of conditions for direct investment in host countries (the organization of "business days" focusing on particular sectors of the economy and open to industrialists from East and West would provide an appropriate framework);
- Improved transparency of market trends by reinforcing the instruments permitting closer analysis of markets, particularly through the forging of more regular contacts between industry in these countries and European trade organizations;
- promotion of a new legal framework: the introduction of a market economy means that the authorities in these countries will need to establish a genuine body of company law (at the moment virtually non-existent), rules governing the accounts and taxation of firms, provisions relating to worker protection at the place of employment, consumer and environmental protection and competition rules adapted to a market economy;

- effective protection of Intellectual, Industrial and commercial property;
- support for the development of small and medium-sized firms: use of a data bank for comparing offers of, and requests for, cooperation. The Business Cooperation Network set up by the Commission - a computer-backed network of European business advisers - would be extended to the countries of Central and Eastern Europe and could speed up identification of potential partners;
- cooperation in the fields of standardization and certification, which will substantially improve the quality of products made in these countries and thus give them better access to world markets;
- finally, sectoral measures; the choice of sectors would lie with economic operators in the countries concerned and could focus on:
 - sectors and enterprises in which radical restructuring will be necessary to achieve levels of productivity and competitiveness comparable with those in the Community; steel, shipbuilding, basic chemicals, paper and cement are notable examples;
 - sectors which are expected to expand sharply, provided that proper production and distribution structures are established; these sectors include the car industry, agri-foodstuffs, and, consumer and capital goods generally.

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