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**DEVELOPING
INDUSTRIAL COOPERATION WITH
CENTRAL AND EASTERN EUROPE
AND THE INDEPENDENT STATES OF THE FORMER SOVIET UNION**

**COMMUNICATION
FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

**DEVELOPING INDUSTRIAL COOPERATION WITH CENTRAL AND EASTERN EUROPE AND THE
INDEPENDENT STATES OF THE FORMER SOVIET UNION**

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Summary and conclusions

The aim of this communication is to review progress in industrial cooperation between the Community and Central and Eastern Europe since the Commission's communication of 12 July 1990 on the topic.¹ It also responds to a request from the Council which, at its meeting of 15 October 1990, strongly endorsed the Commission's approach.

The nine Central and Eastern European countries concerned here are Albania, Bulgaria, the Czech and Slovak Federal Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Romania. Account will also have to be taken of the new Republics which have emerged from the former Yugoslavia, on the basis of the new links that the Community is or will be forging with them. The Independent States of the former Soviet Union are dealt with separately.

Given the scale of the industrial challenge in the economic transition of Central and Eastern Europe, the Commission has started structured discussions on strengthening industrial cooperation with the countries concerned. The key role assigned to private initiative underpins the whole of the July 1990 communication, which proposes measures aimed in particular at improving the business climate as part of a three-pronged approach:

- (1) achieving greater transparency in legal, economic and commercial affairs;
- (2) horizontal measures to help create a propitious business environment, initiatives to support small and medium-sized enterprises and assistance in standardization and certification;
- (3) sectoral cooperation.

¹ 'Industrial cooperation with Central and Eastern Europe: Ways to strengthen cooperation', communication from the Commission to the Council and the European Parliament (SEC(90) 1213 final of 12 July 1990).

Events in the East and measures being taken by the Group of 24 and the Community

Since July 1990, the political and economic situation in Central and Eastern Europe has changed radically: German unification, dismantling of Comecon, fundamental transformation and then dissolution of the Soviet Union, Yugoslav crisis. On the economic front, the Central and Eastern European countries are embarking on or continuing their reforms under extremely difficult conditions. As far as industrial cooperation is concerned, these developments do not alter the basic diagnosis established in 1990; the same problems persist and have even worsened in many cases. In conjunction with the G-24 countries, the Community has developed initiatives in Central and Eastern Europe, under PHARE and the Europe Agreements in particular, and in the former Soviet Union, in the context of technical assistance.

Sectoral aspects

Many initiatives have been developed in different branches of industry, involving private economic operators, trade associations, Member States and Commission departments. A great deal of work has to be done to carry out studies, build up contacts and provide assistance in a variety of fields. In order to be able to support and where necessary launch initiatives of this type, the Community needs to have PHARE programmes geared to industrial cooperation.

Proposals

In addition to continuing the measures in hand, this communication advocates:

- further action to improve transparency (sectoral and market data, for example);
- stronger support for the development of a suitable legal and regulatory framework (accountancy law, company law, etc.);
- action under the G-24 working party on investments;
- greater emphasis on schemes for restructuring enterprises or industrial sectors;
- programmes to support industrial cooperation;
- regional industrial development programmes;
- initiatives to strengthen sectoral cooperation;
- an approach to the areas covered by technical assistance to the independent states of the former Soviet Union which takes into account restructuring and industrial cooperation.

1. THE BACKGROUND TO INDUSTRIAL COOPERATION

The far-reaching changes that have taken place over the last three years in the countries of Central and Eastern Europe and the Independent States of the former Soviet Union have initially triggered disorganization of the economies and recessions partly due to difficulties in making economic and financial adjustments and achieving new stability. Since the development of industrial cooperation is largely dependent on a favourable political and economic climate, achievement of the necessary adjustments, the introduction of proper pricing mechanisms and reshaping of trading patterns following the disappearance of Comecon are the macroeconomic prerequisites for boosting confidence among operators.

It is against such a background that the Community has for the last three years been directly involved in a growing effort to help these countries. As far as industrial cooperation is concerned, it is pursuing the aims of establishing a market economy, stimulating private initiative, exchanges of information and contacts between operators and strengthening our partners' competitiveness on the market while avoiding adverse repercussions for Community industry.

1.1 The need for industrial conversion: restructuring and privatization

Most industrial sectors call for restructuring and privatization. The scale of the task is unprecedented, and numerous factors such as the economic situation, legal obstacles, the state of enterprises, the condition of communications or information infrastructures, the dearth of investors and the social cost of restructuring will undoubtedly make the transition a very long drawn-out process, with the result that a sizeable proportion of industry will remain in state hands for some time yet. Entire sections of heavy industry have to cut back capacity and switch production.

At the other end of the spectrum, sectors that are as yet embryonic need to be developed, chiefly by private initiative. This is particularly so with services and consumer goods; it also applies to the SME base, which needs to be gradually built up.

Furthermore, for political and technological reasons, industry has been able to develop and operate for decades without taking account of the environmental aspects of production and waste disposal. Industrial conversion will therefore have to devote special attention to the environment, which is one of the major priorities for the regions concerned, particularly in view of the harmful effects of the present situation on health.

Community investment will have lasting effects on industry only if reforms are backed up by a drive to develop human resources. The availability of a labour force which can play its part in the industrial renewal and keep pace with changing skills requirements cannot be ensured without an education and training system that reacts effectively to the ongoing economic and social reforms.

1.2 Foreign investment still low, but on the increase

Available data reveal that investment in certain countries has risen substantially, while remaining too low: total direct foreign investment in Central and Eastern Europe and the former Soviet Union stood no higher than some ECU 2.1 billion in 1990. The number of joint ventures in Central and Eastern Europe has gone up, in some countries particularly. The total was near the 25 200 mark at 1 October 1991 (broken down as follows: 10 600 in Hungary, 5 000 in Poland, 4 800 in Romania, 4 000 in Czechoslovakia and 800 in Bulgaria), nearly double the figure of 11 800 joint ventures reached at the end of 1990.¹

Direct investment in setting up a joint venture or in buying or starting up a business is but one method of industrial cooperation between economic operators in East and West. Since 1990, many deals have been struck in industry for licensing patent rights, setting up marketing networks and developing business and administrative services (consultancy, auditing and study contracts, etc.).

1.3 Mutual benefits of industrial cooperation

The surge in industrial cooperation offers the Community an opportunity for supporting transition in Central and Eastern Europe. Such cooperation must involve transferring know-how to Central and Eastern Europe, while broad cooperation in science and technology will also help make industry there more able to adjust, particularly through technology transfer geared to the needs of economic conversion.

It is in the Community's economic interests to ease the transition process in Central and Eastern Europe. The region currently accounts for only some 4-5% of the Community's external trade. A study carried out in 1991² shows the favourable impact that successful reforms in Central and Eastern Europe would have on the European Community: growth along the lines of the newly industrialized countries could boost the region's share of Community trade to 12% in the years ahead and even to over 25% in the coming decades if the countries concerned can reach living standards comparable to those enjoyed in Western Europe.

It is also evident that industrial cooperation which takes full account of the environmental dimension, by tackling the source of pollution, is in everyone's best interests.

1 United Nations Economic Commission for Europe.

2 Institute for International Economics, 'Eastern Europe and the Soviet Union in the World Economy', May 1991.

2. ONGOING HORIZONTAL MEASURES

The July 1990 communication focused chiefly on the horizontal aspects of industrial cooperation with Central and Eastern Europe. The analysis underpinning that paper still holds good today. At its meeting of 15 October 1990, the Council (industry) asked the Commission to keep it regularly informed of the state of progress in its work. It is against such a background that a few examples are given below to illustrate the headway made. These measures have been taken in a variety of contexts.

2.1 Activities of the Group of 24 (G-24)

Romania was added to the list of countries qualifying for G-24 coordinated action in January 1991, and Albania and the Baltic States in September. This brings the number eligible to nine.

At the high-level meeting held on 30 October 1991, total commitments by the countries taking part in coordinated assistance to Central and Eastern Europe were estimated at ECU 25.5 billion, of which 73% has come from the Community and its Member States. This assistance breaks down into ECU 6.5 billion in outright grants, ECU 9.8 billion in loans and finance and ECU 9.2 billion in credit and investment guarantees.

Two of the priority areas of action by the Group of 24 have more direct repercussions on industrial cooperation: access to Western markets for products from Central and Eastern Europe and encouragement of investment.

Measures granting freer access to Western markets have been taken by G-24 members. The Community has, for its part, facilitated such access by scrapping or suspending quantitative restrictions, extending the Generalized System of Preferences and negotiating a free trade zone as part of the Europe agreements with Czechoslovakia, Hungary and Poland.

Ways of encouraging investment are studied in particular by the G-24's working party on investment, which discusses and devises initiatives such as the machinery for promoting joint ventures, which is operational, and the setting-up of a Polish development bank. The group is also examining factors hindering foreign investment and is discussing ways of drawing together all the necessary information for promoting investment.

2.2 The Community's PHARE operation

PHARE has a budget of ECU 1 billion for 1992: Hungary and Poland, which have received assistance under this measure since December 1989, were joined in 1990 by Bulgaria, Czechoslovakia, Romania and Yugoslavia (and the GDR until German unification) and in 1992 by Albania and the Baltic States. Of the schemes financed, projects with a more direct impact on industry have taken a larger share in 1991. This is so particularly with restructuring programmes, programmes to promote small business and environmental programmes.

Programmes to support industrial restructuring and privatization adopted so far cover Bulgaria, Czechoslovakia, Hungary, Poland and Yugoslavia. These programmes can include company restructuring studies, assistance to the ministries and agencies responsible and credit facilities. They thus operate on several levels and have multiple effects. Company studies make it possible, for example, not only to carry out the evaluation work proper, but also to develop business advisory services through partnership between consultancies in the West and the East, to provide practical training within the companies themselves and to help these look for foreign partners.

Measures have also been taken to promote small business. These include loan facilities and guarantees, funds for acquiring holdings, training schemes and technical assistance, particularly in management. Five enterprise centres have so far been set up in Czechoslovakia and Poland, along the lines of the business and innovation centres operating in the Community. In Hungary six such centres have been set up on a local basis.

Financial machinery to support private-sector initiatives with a view to setting up joint ventures was approved in January 1991. The scheme is targeted at small and medium-sized enterprises and supplements the programmes already approved in the different Central and Eastern European countries. The aim is in particular to stimulate greater participation of Community SMEs in the creation of private business ventures with partners in Central and Eastern Europe. The machinery makes it possible to help carry out the preparatory work for setting up a joint venture (for example, by co-financing feasibility studies), provide some of the necessary finance, alongside other investors, upgrade skills and transfer know-how. A system is also to be set up to help look for business opportunities.

In the standardization and certification field, technical cooperation and assistance projects are under development. Their aim is to provide the countries of Central and Eastern Europe with the knowledge and the resources they need in order to devise, establish and develop their national standardization, certification, metrology and quality assurance systems.

A regional quality assurance programme for Bulgaria, Czechoslovakia, Hungary, Poland and Romania has been approved and is to be coordinated by the European Committee for Standardization (CEN). It will cover technical assistance for institutional reform, general quality training, the participation of local experts in regional and international committees dealing with standardization, certification and metrology, and an industrial quality drive.

Among the other programmes that can have an impact on industry, mention should be made of projects funded under the TEMPUS programme. This programme was launched in 1990 and has already provided valuable assistance, particularly in energy, engineering, the environment, management and the study of foreign languages. Also worthy of note are programmes on reshaping foreign trade infrastructure, assistance for the creation of business registers, development of the financial sector, the creation of systems for compiling statistics and the reorganization and modernization of telecommunications systems.

2.3 Trade and cooperation agreements and Europe Agreements

Since 1990 the conclusion of new agreements has also loomed large in the Community's action and will have major repercussions for economic operators.

Trade and cooperation agreements exist with most Central and Eastern European countries, have been initialled with Albania, Latvia and Lithuania and are under negotiation with Estonia. To these should be added, according to the case in point, textiles arrangements and ECSC agreements.

Europe Agreements with Czechoslovakia, Hungary and Poland were initialled on 22 November 1991 and signed at ministerial level on 16 December. The Agreements are crucial for developing industrial cooperation and cover the following points in particular: the gradual establishment of a free trade zone, economic and financial cooperation, rules on the right of establishment, services, capital movements, the movement of workers, standardization and certification, and intellectual, industrial and commercial property. Emphasis is also placed on cooperation in the field of the environment, in science and technology and in telecommunications; this will provide important back-up for any industrial cooperation. The Agreements also cover textiles and ECSC products, which were previously dealt with in separate agreements. Major provisions on competition are set out in the Agreements, in Articles 63 (competition rules for businesses and state aid) and 65 (public-sector enterprises), and in Article 8 of the ECSC protocol.

The development of a favourable climate for investment is also one of the objectives of the Agreements: establishment of an appropriate legal framework, bringing the Central and Eastern European countries' legislation closer into line with Community law, and arrangements for protecting investments.

2.4 Export credit and investment guarantee promotion schemes

If trade and investment flows are to develop with Central and Eastern Europe, credit insurance instruments must be available to mitigate the risks run by economic operators. The EC Member States have not stood still here: at 30 June 1991, the total volume of export credits and investment guarantees they had granted for operations in Central and Eastern Europe stood at ECU 6.9 billion in official export credits and ECU 0.5 billion in official support for private investment (that is 81% and 58% respectively of the G-24's action in these areas).

The Commission has for its part laid before the Council and Parliament a proposal to set up a Community pool for reinsuring export credits to Central and Eastern Europe (not including the Independent States of the former Soviet Union). Discussions within the Council are currently centring on prior harmonization within the Community of the rules governing export credit insurance (terms, premiums, cover).

2.5 Other initiatives

The Community's financial instruments offer several possibilities for lending to Central and Eastern Europe. In addition to loans for macroeconomic purposes granted to several countries in the region, a total volume of ECU 200 million in ECSC loans is available for Hungary and Poland (and, since recently, Bulgaria, Czechoslovakia and Romania), as well as a total volume of ECU 1.7 billion in European Investment Bank loans. As of the end of October 1991, a total of ECU 285 million had been disbursed by the EIB in loans for projects in Hungary, Poland and Romania, including ECU 125 million for industrial projects.

Correspondence centres have been set up in Czechoslovakia, Hungary and Poland in order to afford businesses there access to the same information network as the Euro Info Centres.

BC-Net, the Community's computerized network offering confidential searches for business partners, is open to Poland and is shortly to be extended to Czechoslovakia and Hungary.

The Business Cooperation Centre (BRE), which helps businesses look for partners on a non-confidential basis, is currently operational in Hungary and Poland.

Other initiatives stand out on account of their importance to the industrial development of the countries concerned. This is so in particular with the concept of trans-European networks¹ and other initiatives that go beyond the Community context, such as the European Energy Charter, the financing opportunities offered by the EBRD, particularly in the private sector, and the relaxation of Cocom's rules, which has benefited above all Czechoslovakia, Hungary and Poland.

1 'Towards trans-European networks: For a Community action programme', communication from the Commission to the Council and the European Parliament (COM(90) 585 final of 10 December 1990).

3. THE INDEPENDENT STATES OF THE FORMER SOVIET UNION

3.1 Background

Whereas several of the countries of Central and Eastern Europe have already made substantial headway in transforming their economies, everything - or nearly everything - remains to be done in the former Soviet Union.

Soviet industry is, by and large, highly concentrated. Large enterprises (with a workforce of over 1 000) account for three quarters of industrial output and employment. Soviet enterprises employing less than 200 people account for only about 6% of industrial output. A large number of independent units will thus have to be created and a policy developed for promoting small and medium-sized businesses. The restructuring measures that have to be taken in many sectors are to be seen against a background of severe economic depression.

The level of foreign investment is relatively low, but rising. It grew from ECU 1.3 billion in 1989 to ECU 2.3 billion in 1990. Of the roughly 3 000 joint ventures registered, only a few (around 15%) are genuinely active.

It is now well accepted that industrial cooperation between the European Community and the Independent States of the former Soviet Union is in the interests of both sides. Some of the Independent States are extremely well endowed with natural resources and desperately need to harness them, and this coincides with the interests of Community operators. Appropriate cooperation would make it possible at the same time to promote market principles and prices in the Independent States' exports.

3.2 Measures in hand

The technical assistance programme which was agreed on in principle by the European Council at its meeting in Rome in December 1990 allows some scope for industrial cooperation. The programme was adopted by the Council on 17 July 1991 with a budget of ECU 400 million for 1991; it has been allocated ECU 450 million for 1992. It covers technical assistance in five priority areas: management training for the public and private sectors, financial services, energy, transport and food distribution.

A modest budgetary reserve enables measures to be financed in other areas, in particular the environment and the agri-foodstuffs industries. The concept of management training is taken here in the broad sense and enables some assistance for industrial restructuring to be afforded to the authorities, enterprises or sectors concerned. Some schemes for converting arms manufacture to civilian production can also be implemented in this context.

The dismantling of the Soviet Union calls for a decentralized approach with coordination units in each Independent State.

It should also be borne in mind that the 1989 trade and cooperation agreement with the Soviet Union provided for the development of industrial cooperation. At the meeting of the Joint Committee in May 1991, a subgroup was set up under the agreement to deal with mining questions. The dissolution of the Soviet Union will, however, make it necessary to launch fresh talks with the Independent States. The new agreements will lay the framework for future technical assistance and other forms of economic cooperation.

4. INDUSTRIAL COOPERATION IN CERTAIN SECTORS

This section illustrates how industrial cooperation involving, either directly or indirectly, the Commission or the trade associations representing Community industries is being launched in certain major sectors.

In general, many operators have made contacts in Central and Eastern Europe, coordinated by their trade association, with a view to gaining a clearer picture of how much markets are being opened up in the region and what is at stake economically. Following this exploratory phase, an industrial cooperation strategy has already been framed in many areas of activity. The Commission takes care to ensure that these measures are in keeping with the priorities of the assistance programmes, which are intended in particular to strengthen the private sector and scale down the role of public authorities in company management.

Coordinated measures have been prompted by a variety of considerations, but these can be grouped together into a few typical situations:

- in the specific case of sectors whose restructuring has been made subject to Community disciplines, such as the steel and shipbuilding industries, it is essential to ensure that restructuring of the industrial apparatus in Central and Eastern Europe takes place in a framework that is consistent with the situation in the Community and even worldwide;
- in several sectors that have hitherto enjoyed some protection against imports from Central and Eastern Europe, there is concern to avoid too sudden a shift to free trade. Market liberalization needs to be flanked by industrial cooperation, with special emphasis on training, company management and the introduction of international standards or Community legislation (e.g. in the chemicals and pharmaceuticals industries);
- some of the Central and Eastern European countries have opted for privatizing and restructuring industrial enterprises as part of an overall plan for the sectors in question. This could require financial and technical support from the Commission through PHARE and possibly assistance from Community industry (as in the case of the metalworking and defence industries in Czechoslovakia and the cement industry in Poland);
- recognition by both parties of the potential or of the complementary nature of the new industrial partners - and of the desirability of organizing information exchange and the possible ensuing cooperation - militates in favour of setting up an institutionalized framework at Community level (this is the case of the steel and mining industries);

- certain countries have asked for technical assistance from the Community and consequently its industry in tackling specific problems such as food distribution or the environment, in view of the particularly serious situation they are facing in that area. This also applies to the nuclear industry.

4.1 Steel

The steel industry in Central and Eastern Europe is facing an extremely difficult situation, with its long-outdated technology and drastic cut-backs in output (up to 30% less than in 1989). Output in the countries concerned stood at some 50 million tonnes, roughly one third of the Community total. Preliminary studies nevertheless indicate that restructuring the industry will require capacity to be slashed by a third, at least 300 000 job losses and a minimum investment of ECU 50 billion. Unlike the countries of Central and Eastern Europe, which have traditionally exported to the Community, the former Soviet Union, with a capacity of 150 million tonnes, has been a net importer of Community steel (tubes in particular). Because of this and the fact that an institutional framework is being set up to allow more structured relations, the development of cooperation with the former Soviet Union in the steel industry is lagging behind somewhat.

With all the Central and Eastern European countries, the Community has institutional relations that provide a basis for industrial cooperation. Such relations are governed by ECSC agreements which supplement trade and cooperation accords. Contacts with these countries date back to the Community steel crisis, when the first voluntary-restraint arrangements for exports to the Community were concluded in 1978.

The direction recently taken by this cooperation, which the Commission departments concerned have prepared in conjunction with the Community industry, while keeping the Member States informed, is to offer countries in the region the experience and advice of Community experts in the restructuring and management of steel enterprises.

The measures envisaged involve helping enterprises with their business assessments and, where appropriate, framing national restructuring plans, organizing seminars in Central and Eastern Europe or periods of training in the Community for managers from Central and Eastern Europe, seconding Community experts to enterprises in the region and preparing specialized documents and publications. They are financed from the part of the PHARE budget earmarked for restructuring and privatization programmes.

After a shaky start, the first schemes of this nature got off the ground in 1991. A study of the restructuring of the Czechoslovak steel industry is in progress and will enable it to adjust to the market economy. The first management training seminars began towards the end of 1991 in Poland, and similar schemes will follow in other countries in 1992.

Given the scale, diversity and urgency of the task at hand, further steps should now be planned:

- structures should be created for centralizing and exchanging information with Member States and other economic operators (including financial institutions) so as to coordinate action more effectively;
- steel contact groups should be set up to hold regular discussions between the Community and the Central and Eastern European countries;
- the suggestion could be made to the Central and Eastern European countries that they look into the possibility of setting up appropriate machinery to coordinate the restructuring of their steel industries, to ensure that they do not duplicate investments or each adopt an excessively bilateral stance in their industrial and commercial relations with the Community;
- as far as the Independent States of the former Soviet Union are concerned, cooperation can go ahead partly on the basis of the technical assistance programme (in the training field particularly) and under the auspices of an ECSC contact group which is being set up.

4.2 Mining and metalworking

The mining and metalworking industry has considerable economic and strategic significance in all the Central and Eastern European countries, with certain subsectors playing a key role: this is the case with copper in Poland, industrial ores in Czechoslovakia and Hungary and, above all, the huge mining wealth of the former Soviet Union. These mineral resources offer Europe a more diversified source of raw materials supplies.

Cooperation will have to take into account the pricing problems which arise in trade with the Community and the need to restructure or modernize the industries. The state of the metalworking industry in Central and Eastern Europe is similar to that of the steel industry. Restructuring will need to draw on industrial cooperation in at least three areas: technical and managerial staff training, plant modernization and the provision of finance. Other areas where cooperation will be needed are the analysis of domestic and international markets, marketing and distribution. Special attention will have to be devoted to the environment in cooperation projects in the mining and metalworking industry.

A subcommittee on raw materials and mining was set up in 1991 under the trade and cooperation agreement with the Soviet Union. Structures of that nature could possibly be set up with the Central and Eastern European countries on the basis of future association agreements.

