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**Article — Digitized Version**

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Intereconomics

*Suggested Citation:* Bolz, Klaus; Plötz, Peter (1974) : East-west cooperation: German experiences, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 09, Iss. 5, pp. 158-162, <https://doi.org/10.1007/BF02927293>

This Version is available at:

<https://hdl.handle.net/10419/139022>

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## East-West Cooperation: German Experiences

by Dr Klaus Bolz and Dr Peter Plötz, Hamburg \*

**Direct cooperation between manufacturing firms on both sides has been recommended as a new approach to overcoming the problems of traditional trade between West Germany and the COMECON states. In spite of a high degree of activity for promoting East-West cooperation, its volume, however, is still relatively low and exaggerated expectations as to future developments must be discouraged.**

**T**he West German trade with COMECON countries still disappoints by its puniness relative to the actual trade potential in Eastern Europe, its huge population and its technological development. No matter how rapidly the volume of this trade has expanded year after year, which secured the Federal Republic's place of pride among all western industrialised countries, this does not affect the truth of the initial observation. For example, the exchange of goods and services with the entire Eastern Bloc is still inferior in volume and value to the Federal Republic's trade with tiny Switzerland. From 1956 onwards, the share which its Eastern trade has contributed to its overall imports has never strayed from the level of about 4 to 5 p.c. The reverse movements of West German exports to all communist countries, whilst exhibiting strong fluctuations, have oscillated between 3.5 and 5.8 p.c.

### **Good Prospects of East-West Cooperation**

The chief obstacle for any further growth of East-West trade has proved to be rigid central planning of Eastern economies and the absence of convertible local currencies, which compels socialist countries to cling to bilateralism. The operation of this principle has partly broken down in practice, because there was no way of avoiding the accumulation of considerable deficits in the balance of trade on the side of socialist countries in many years. Both the quality and the diversity of goods which socialist economies are able to supply placed low ceilings on mutual exchanges of merchandise, and this state of affairs was aggravated by import quotas operated by western

governments. Eastern demand for western manufactures, on the other hand, has stayed permanently high and thus in many years big trade deficits appeared in the international balance sheets of socialist countries.

Neither an increase in the volume of barter trade nor credit expansion can help to overcome these problems of East-West trade, and therefore, in recent years, direct cooperation between manufacturing concerns on both sides has been recommended as a new approach. It is believed that mutual exchanges between East and West will thereby be placed on sounder foundations and, moreover, that they will grow faster in this way. It appears, indeed, that the very great variety of forms that might be found for such cooperation would ensure an improvement in the structure of both Eastern production and Eastern trade through the attendant transfer of technologies, and that it would gradually break the bottlenecks of lack of foreign currency and of investment capital from which the socialist countries suffer. One of the salient facts inherent in such novel arrangements stands out: economic and technological cooperation can afford socialist countries the investment goods required by their forced growth policies without these countries having to pay in full for their purchases in convertible currency, provided the agreements on which such exchanges are based, are drawn up in a suitable form. As a rule, payment for investment goods supplied by the German partner in cooperation will be made through supplies of the goods produced by cooperation — goods that meet western quality standards. Long-term government agreements about the exchange of goods and economic

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industrial and technological cooperation provide the framework within which West German businesses can make agreements on cooperation with eastern organisations or individual factories.

### **Need for Carefully Designed Cooperation Policies**

Admittedly, cooperation is not the magic lamp of Aladin, which could work miracles unaided in bulldozing out of the way existing problems in East-West trade. Significant effects, it is very probable, can be produced only after both the German and the Eastern partners have decided upon a determined and well-designed policy of cooperation. For it is true that, from 1967 onwards, several hundred German companies have made cooperation agreements with socialist countries, but even at a highly optimistic guess, the volume of goods produced under such cooperation projects and exchanged can be assessed as being well below a mere 10 p.c. of the total volume of East-West trade.

Experiences of German companies in East-West cooperation have not been well documented so far. The Hamburg Institute for International Economics has completed a study staged in 1973, which was based on the answers to questionnaires sent out to a number of German firms engaged in such cooperation. These provide, for the first time, hard-and-fast evidence about the structure of cooperation and projects, about the steps which are needed for making cooperation agreements, how these agreements were carried out, how the interests of the German partners were served by them, how negotiations went, and which were the typical difficulties encountered. The numbers given by different quarters on individual cooperation projects show great variation, so that only guesses about them are possible. At the present moment, it may be assumed that about 300 cooperation agreements with COMECON countries are being or have been carried out, of which over 100 with Hungary, about 90 with Poland, approximately 60 with Rumania, only a few with Czechoslovakia and the Soviet Union, and even fewer with Bulgaria and the German Democratic Republic.

### **Investment Goods Industries the Trailblazers**

Well over 60 p.c. of all cooperation agreements concluded with COMECON countries deal with the manufacture of capital goods. Second place is held — at a long distance — by consumer goods manufacturers, with only barely above 10 p.c. Well below 10 p.c. are the combined shares of the construction industries, food processing, trading and commerce, the extractive industries producing base materials, production equipment, and

mining (in this order). Within the investment goods sphere, general engineering has claimed about 55 p.c., electrical engineering about 30 p.c., and the automotive industry more than 13 p.c. Most of the consumption goods firms engaged in cooperation are those making textiles and leather goods. All this goes to show that COMECON countries utilise cooperation mainly for building up their own industrial potential.

Adding to the body of companies actually engaged in practical cooperation those which are at present conducting talks on future cooperation and those which have merely displayed a keen interest in such cooperation, the breakdown by economic sectors produces different results: Cooperation (actual and intended) rises to a much higher share in the fields of consumer goods manufacture, it also shows a significant increase in those of commerce and trading, as well as basic materials and producer goods industries. This goes at the expense of the share held by investment goods manufacturers. At a rough guess, the difference between the shares of investment goods and consumer goods industries might slightly diminish, with investment goods still holding pride of place, at over 50 p.c., and consumption goods at well over 20 p.c.

### **Improved Prospects for Consumption Goods**

That this indicated trend may materialise in the future is also shown by a definite interest — though a cautious one — displayed by communist countries in an intensification of cooperation in the consumer goods sector. West German consumption goods manufacturers, who hitherto were underrepresented also in straight East-West trade, harbour hopes for increased trade turnovers and greater chances for East-West cooperations because both annual and long-term planning of socialist countries shows trends towards expansion of consumption goods manufacture and towards improvement of goods supplied to the population. There is all likelihood that mainly the industry making investment goods for light (i.e. consumer goods) industries, but also consumption goods manufacturers themselves, may profit from the inclination to foster a proportionately stronger growth of the so far neglected consumer goods sector. Yet it must not be forgotten that this is only a potential trend indicated for the medium-term future. In spite of the shift in the socialist countries' interests, a sudden jump in the sectoral structure of cooperation does not seem very likely since contacts in this field of cooperation are still relatively weak and it is also hardly possible to build upon existing long-term contacts in straight East-West trade.

A good 40 p.c. of all cooperation agreements were concluded only during the last two years. The first climax of the movement towards cooperation, by numbers of the contracts concluded, occurred in 1969 with almost 20 p.c. of all talks started on cooperation that have until now led to a successful conclusion. The first breakthrough in East-West cooperation had occurred two years earlier, in 1967, when almost 14 p.c. of all agreements were made. The number of contracts concluded in 1970 and 1971, at below 10 p.c. in either case, on the other hand, was remarkably low. It may be the case that the *Ostpolitik* of Chancellor Brandt, which was then only taking off from its starting runway induced either of the two contracting sides, or both, to play a wait-and-see game, which ended only after the signing and ratification of the treaties of Moscow and Warsaw. It appears obvious that the change in political climate persuaded especially the Eastern partner to show willingness to sign more long-term agreements. One of the conspicuous changes after the passing of this watershed was that the number of cooperation agreements made in 1972 for ten years reached a highwater mark of about 50 p.c. True, among treaties made in 1967 and 1968 the same high share of agreements made for ten years was also recorded, but since then, between 1969 and 1971, ten-year agreements were rather an exception. This means, apparently, that a determined turn towards longer-term arrangements has established itself, justifying the expectation that more Eastern and Western partners will, from now on, be willing and able to intensify their joint operations. Longer-term contract periods are to be expected also for the following reasons: There is already a number of companies which will be able to profit from past cooperation experience in the making of new cooperation pacts. But also imitators will now be in a position to benefit from many experiences of the pioneers and thus feel able to pledge themselves for longer periods.

#### Licensing Agreements Out In Front

About 40 p.c. of all cooperation agreements are based on licensing arrangements and thus by far the biggest group of all. About 19 p.c. are for technological research and development work, and 16 p.c. for technological specialisation. Well below 10 p.c. of all agreements are about joint production arrangements, as well as for cooperation in third-party countries. Only a negligible number of agreements have been concluded about marketing cooperation and participation. Commission processing agreements show the following peculiarities, being usually of the "mixed treaty" type: they may extend to the issue of licences, commission processing, and specialisa-

tion. In evaluating individual agreements, the authors have classified them according to the most important form of cooperation on which they are based (in a given case, this might be specialisation). Then the share of commission processing remains below 10 p.c. Judging, however, by the isolated evaluation of processing in a mixed treaty, its share jumps to over 15 p.c. The share of licencing agreements also grows, if calculated by this method, whilst the shares of other forms of cooperation decline correspondingly.

#### Predominance of Medium-Sized Companies

Measured in terms of persons employed and size of turnover, most cooperators are medium-sized companies, with 30 p.c. of all agreements having been made by enterprises employing 500–2,000 persons, and 35 p.c. by those turning over DM 50–200 mn annually. Other company sizes, judged both by numbers of employed persons and turnover, represented, with certain fluctuations, between 15 and 20 p.c. of overall volume.

Of the cooperation agreements made by firms employing between 500 and 2,000 people 50 p.c. consist of licencing, 35 p.c. of specialisation and 15 p.c. of other forms of agreements. Also the agreements made by companies of other sizes cover only, in the main, a small number of agreement types. Small firms with up to 250 staff have concluded about 20 p.c. of all agreements, of which one third are licencing arrangements. Those with 250–500 staff (15 p.c. of all agreements) operate half and half in the fields of licencing and research and development. Other forms of cooperation are negligible for them. Companies having a staff roll of 2,000–5,000 people decidedly prefer licencing and, in a number of cases only half as numerous, commission processing. More than 50 p.c. of cooperation agreements made by companies employing more than 5,000 persons cover technological research and development.

#### Main Interest In Market Enlargement

A significant number of cooperation agreements was made in the interest of opening up new sales outlets. In a vast number of agreements, there is a declared and strong interest of the cooperating private company to enter new markets — though also other interests come into play. Either, a West German company would like to use cooperation to establish itself in a socialist national market, or if the German partner was already trading with his eastern counterpart, he might like to use the socialist country in question as a jumping-off ground for entering new markets in other socialist countries. This merges with the

intention to enlarge one's market shares with the aid of East-West cooperation. In about 30 p.c. of all cooperation agreements concluded with companies resident within the COMECON states market enlargement is the dominating motivation.

The preponderance of the two motives described came out clearly in the above-mentioned enquiry among West German traders with the East: When a random bundle of possible motivations was presented to them, many emphasized that their long-term cooperation with COMECON countries was subservient to the objective of opening up new socialist markets. It is conceivable that the reason for this attitude is increased international competition in world markets, which becomes painful to West German exporters. Currency fluctuations and monetary insecurity increase this motivation for companies heavily dependent on foreign trade.

Much depends for German cooperators on the chance offered to reduce their comparable production costs, especially on account of lower wages in the Soviet Bloc. In about 30 p.c. of all the projects examined, the utilisation of cost and/or wage cutting had been one of the decisive motives for concluding the cooperation treaty. For employers who have to pay the exceedingly high wages prevailing in the Federal Republic, and who are faced with the extreme shortage of skilled labour there — which again is a powerful propellant for further wage increases — this is a strong incentive. Low socialist wage levels may benefit the western cooperator under a cooperation arrangement, because he may transfer manufactures with a high labour content to the East.

### **Tedious Negotiations**

As there is no information and service organisation for the purposes of East-West cooperation, the peculiarities of economic organisation in the Soviet Bloc, based on the system of centralised government planning, make it extremely difficult for German companies to find suitable partners for cooperation. Personal contacts, based on existing links in conventional foreign trade, are by

far the most important factor for entering upon prospecting for cooperation. As a rule negotiations for concluding any cooperation treaty may last between six months and two years. The above-mentioned study of the Hamburg Institute for International Economics brought out that successful talks about preparing for an eventual agreement with COMECON countries extended in about 60 p.c. of all cases over six to twelve months, and about in 24 p.c. of all cases over 13 to 24 months. But negotiations may drag on for more years, though this is said to be a relatively rare occurrence — for all COMECON countries in about 15 p.c. of the cases examined. Long gaps in negotiations in train, which end up in a successful conclusion, seem to be relatively rare; of under 15 p.c. of the cases scrutinised, this was said to have been the case. Such interruptions continued for at least five months, and at worst, three years.

Negotiating procedures are tedious, energy- and time-wasting, and apparently hardly conscious of the costs involved, when talks may be protracted for years. In most cases, the subject matter of the negotiations in hand makes coming to an agreement so complicated, but sometimes this is caused by unacceptable demands of the socialist — and in rare cases — also the West German partners, by inescapable red tape, which is again germane to the socialist system, and by the lack of negotiating know-how.

With this background, it cannot surprise that many offers of cooperation made by either the eastern or the western proponents never lead to an agreement. There are a great number of projects which are found, already after a short round of negotiations, to be impracticable. Experts agree in the view that far less than 10 p.c., possibly only between 3 and 5 p.c. of all cooperation proposals submitted ever reach the winning post of the race. This is the case especially when sectors of production having an extremely high capital and research content are to be joined up on the required high level of technological research and development work.

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German cooperators agree that the most difficult hurdles for any cooperation are unexpected delays during the initial phase of starting up an agreed project. Every fourth object of cooperation suffers from this disease. Why that should be so can only be surmised. There may be a block because the contents of a given agreement have not been mapped out with sufficient clarity and in sufficient detail. Starting up a building project of a planned production run is the last moment in which a general agreement has to be concluded by executive orders as to actual work to be done. But there may be other snags embedded in the notorious habit of desiring to make last-minute changes and adjustments. Frequently, agreements made verbally are difficult to transpose the practical day-to-day running of a production plant, and this again causes delay. Filling a framework agreement with practical life, and supplementing it by amendments to an agreement's wording, may be much easier for a western partner than for a socialist manager, since as many as 20 p.c. of the companies questioned reported that their eastern partners lack flexibility in making on-the-spot decisions, and thus create problems. Especially during the initial stages of any cooperation project, western partners will probably find this low flexibility particularly worrying.

#### **Difficult Initial Phase**

Also during initial periods, communication between the two partners to adjust to each other's way of thinking must be a major difficulty. 20 p.c. of all the cooperation projects were delayed because partners could not make each other understand, or sufficiently inform each other, what they actually wanted. Another major problem bedevilling the initial phases of cooperation is said to be inferior quality of promised sub-assemblies and materials needed for completing the projected plant, when such materials are to come from eastern suppliers. Insufficient flexibility in decision-making, difficulties over communication and exchanging information, as well as inferior quality of subcontracted work, all seem to be true reasons for delays in the initial stages of carrying out agreed cooperation. All these types of problems seem to be of approximately equal frequency. And in about 20 p.c. of all the investigated cases, periods of payment and delivery were not adhered to, but delayed deliveries weigh somewhat heavier in the scales than unpunctual deliveries.

A small number of cooperating companies reported about the problems mentioned, especially those rampant during the early days of carrying

out a contract: Inferior quality of management and staff; violations of market delimitations, agreements on quantities, and precision and quality standards; sales difficulties of goods produced under cooperation agreements with the East; disputes about competence; inferior quality of research facilities; lack of essential spare parts; shortage of skilled and essential labour; difficulties in obtaining finance, especially foreign currency finance; long transport delays; lacking willingness to work of labour; frequent changes of staff; difficulties in accounting for the contributions made by either partner to the overall value of given products and/or services, and illegal use of licences. There remains one major problem to be mentioned: the failure of the eastern partners to adhere to agreed completion dates.

The complainants have not mentioned one problem that might have been feared: Local government agencies in the East have not unduly interfered with the completion or the running of any project. Aggravating interference, it is true, seems to be unlikely, because most COMECON countries are very keen on extending cooperation with western companies, which results in their offering every kind of support. It may also be possible that the many months during which negotiations drag on give a certain protection against local interference by socialist government agencies, which must have been informed of any project going for a long time ahead.

#### **Prospects**

In spite of a high degree of activity for promoting East-West cooperation, exaggerated expectations as to future developments should be discouraged. The test period for this kind of East-West cooperation will be over only after all the interested sections of the western economy have accumulated sufficient experience. It will also be necessary, before this transition period closes, for the Federal Republic to conclude a larger number of cooperation agreements with the Soviet Union and with East Germany and to have operated them for a sufficient length of time to be able to draw on its own experiences there. That cooperation of this kind will surely meet some of the expectations can be seen from the changing structure of West German imports from Hungary and Poland. State-Secretary Rohwedder in the Federal Ministry of Economics guesses that the proportionate rise in deliveries of machines from these two countries has been caused by increased cooperation with them. The structural development of trade with those eastern countries whose degree of cooperation with the West is poor has remained unsatisfactory.