

Schenk, Karl-Ernst

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East-West Trade

Outlook for Industrial East-West Cooperation

by Professor Dr Karl-Ernst Schenk, Hamburg *

The proportion of the foreign trade exchanges between the industrialized countries of the West and the CMEA states which is attributable to industrial cooperation does not so far exceed an estimated 5–10 p.c.¹ Nevertheless it would be wrong to make light of this cooperation, for it is a manifestation of a new strategy in the competition between the systems and designed to bring about substantial structural changes in their foreign trade². Both these aspects are important for an assessment of future prospects and to be discussed here in some detail.

It needs emphasizing first of all that the attitudes of the two economically cooperating systems cannot be understood or explained if the question is regarded as purely economic. In fact these systems are locked in fierce political and military rivalry which is reflected on the economic plane by shifting patterns of competitive and cooperative behaviour.

Students of external economic relations are trying to elucidate the competitive attitudes by drawing on the model of substitution competition. The latter is seen as a process by means of which it is determined which producing countries (and producing plants) may, or may not, in the light of pertaining production and transport costs act as world market suppliers for each particular type of merchandise. The level of costs is seen as the major variable determinant of the trade flows, and measures designed to influence cost levels are according to this school the most important instrument for increasing exports and improving the international competitive position of a country or system.

The wide range of attitudes of western enterprises and eastern governments encountered in reality cannot be explained satisfactorily by reference to this schema. Applied to their attitudes to cooperation in particular such an attempt would play havoc with reality. New concepts of competition going beyond the substitution model must therefore probably be drawn upon to provide an explanation.

The inapplicability of the idea of substitution competition, which has the primary aim of lowering the costs, to the economic relations between East and West seems to be mainly due to two factors:

* Institute of Foreign Trade and the Economics of Overseas Countries, University of Hamburg.

¹ Cf. P. Knirsch, Vom Ost-West-Handel zur Wirtschaftskooperation (From East-West Trade to Economic Cooperation), in: Europa-Archiv, Folge 2, 1973, p. 64.

□ The experience gained with the planning systems of the CMEA countries indicates clearly that costs are of minor importance in these systems as a target area and as an instrument in the planning process;

□ Substitution competition presupposes more than the existence of a fully operational market for goods: not only must the mobility of the goods and the classic production factors (labour and capital) be assured, but so must be the transmission of information about new technologies, markets and new products.

We maintain that there exist no suitable organisational forms or mechanisms for the transmission of this kind of information across the system frontiers. The following might be mentioned as exemplifying such mechanisms: efficient markets for foreign licences; direct foreign investments for purposes of transfer and direct management of technologies, products and marketing techniques; participation in foreign enterprises and international cooperation between enterprises in research and development, procurement, production and marketing. The cost levels do not come into play as a significant factor in the competition between different countries and systems until these forms operate so well that the information which is of crucial importance for economic growth is communicated without significant delay.

According to this thesis modern markets – including external markets – need a first-rate organisational infrastructure before they can function according to the textbook theory of external economic relations. What there exists so far in East-West relations in regard to such an infrastructure, with its manifold cooperative forms and

² Cf. the expressions of expectations to this effect in: Economic Commission for Europe, Analytical report on industrial cooperation among ECE countries, United Nations, Geneva 1973, p. 28.

participation and disposition rights for goods, information and resources, is rudimentary. The governments of the communist countries want its functions, especially as concerns the transmission of knowledge about new technologies, new products and markets, to be generated solely and exclusively through industrial cooperation.

Cooperation as a Strategy

This their intention may be regarded as an indication that the CMEA countries, the Soviet Union included, do not yet feel strong enough to take on the West in genuine economic competition and gain the ascendancy. It makes a great deal more sense to assume that they see themselves at present placed in a preliminary phase, namely the phase of availability competition with the West, in which it must be their aim to acquire the mentioned kinds of knowledge and capabilities.

If one looks back to the fifties, one notices that the hope to overtake the West on the economic plane was at that time much stronger and indeed dominant. It was almost an article of faith with party secretary Krushchev and his leadership team that the West had to be routed in *economic competition* for all the world to see and that it was perfectly feasible to do so in the foreseeable future³. Economic competition, i.e. with the aim of achieving a definite economic success (to wit, a higher per-capita consumption) independently from others had been chosen as the instrument for a non-violent assumption of power all over the world.

The time was not yet ripe for such a strategy as has become clear since, and the strategy had to be altered in the light of deficiencies to which we shall refer briefly. Today it would be more correct to speak of a strategy in which the economic competition has had to cede its former role to the political-military sector. On economic cooperation now devolves the role of making new western technologies and products available to the East for its own use. The economic machinery of the Eastern Bloc countries is to be kept in motion and put into a higher gear in this way until the West has been decisively weakened in political conflicts (Middle East, Portugal) in which the superior military power of the Eastern Bloc acts as a guard against intervention by the West.

The failure of a strategy with stronger economic and competitive accents in the fifties may be said to have been one of "too extensive economic growth" — a growth in production not matching the additional expenditure of capital and manpower⁴. This disproportion was due to inadequate technical progress. The communist governments, in correct assessment of the situation, now endeavour to

curtail competition with the West selectively in the areas in which the purchase of licences and industrial cooperation with the West provide means of adopting new technologies. This involves a new pragmatic concept of competition in the economic sphere where conflicts are deliberately softened, while the modes of conduct in the political-ideological sphere may at the same time be aimed, as they evidently are, at deliberately aggravating conflicts.

One may speak of an economic competition with the object of obtaining from the West certain kinds of goods, technologies, information and resources (availabilities)⁵ which promote the growth of the economy of the system. The idea behind this strategy, whether stated in so many words or not, is that after a phase of successful availability competition it will be possible to embark upon a comprehensive substitution competition with the West, to wrest markets from the West and thus to seal its *political* as well as its *economic* doom.

Intrasystemic Prerequisites

Hence it must be clearly understood that the industrial cooperation is not undertaken for its own sake or in order to advance the living standards of the population in the countries of the Eastern Bloc but with the West as the target. If there are also positive repercussions on the standard of living in the own country insofar as the adoption of new technologies facilitates the urgently needed economies in capital spending and thus an increase in the consumption ratio, so much the better. But ultimately decisive for the future of East-West cooperation are the prospects of success for the political-economic strategy in its entirety and not solely the prospects of economic success. To judge the outlook for East-West cooperation, one has to take rather complex interrelations of a political as well as economic nature into consideration. Among the political aspects one would for instance have to assess, with regard to the internal and external conditions of the USSR and its partners, whether and for how long this strategy could be maintained and prove successful in the political-military sense. The answer depends in large measure upon the western re-

³ Cf. K.-E. Schenk, Wettbewerb und Wirtschaftskooperation der Systeme (Competition and Economic Cooperation of the Systems), in: Probleme der Ost-West-Wirtschaftsbeziehungen (Ökonomische Studien, aus dem Institut für Außenhandel und Überseewirtschaft der Universität Hamburg, Vol. 23, ed. K. Schiller and others), Stuttgart 1976 (in preparation).

⁴ Cf. H. J. Wagener, Zur parametrischen Erfassung des Produktionsfortschritts (On the Parametrical Measurement of Productivity Progress), in: Probleme des Industrialismus in Ost und West, Festschrift für Hans Raupach, ed. W. Gumpel and D. Keese, Munich 1973, p. 201 ff.

⁵ On the concept of availabilities the distribution of which is considered here as the basis of explanation for external economic attitudes, cf. D. Lorenz, Dynamische Theorie der internationalen Arbeitsteilung (A Dynamic Theory of the International Division of Labour), Berlin 1967, p. 85 ff.

action to this strategy and upon other factors outside the scope of our observations.

We shall therefore confine ourselves to the economic segment of the strategy and elaborate at least certain aspects of this part rather than attempt a comprehensive analysis of the chances of overall success. In doing so we presume that for lack of adequate chances of policy harmonization there is no need to consider the possibility of this strategy being thwarted by the West through drastic curtailment of the licence transfers and cooperation. This means: the governments of the western countries will not react with an economic counter-strategy, and they will accept the Soviet option of coping with the Eastern Bloc in political conflicts at changeable focal points (Portugal, Middle East). Looking on the economic aspect, attention will have to be given to the conditions in which the communist countries can expect to derive the hoped-for growth stimuli from cooperation and in which they may perhaps even count on increasing their competitive potential in western markets in the long term.

Conditions for Structural Change and Growth Promotion

As regards the first of these questions, it must be examined in the first place whether industrial cooperation alone (together with the purchase of licences) is capable of fulfilling the expectation entertained in the East that it can take the place and perform the functions of a first-rate system-transcending organisational infrastructure.

Secondly the question needs considering what are the determinants of growth in the communist countries and what influence East-West cooperation exerts on these determinants. This question is the subject of a research project carried out at present in the Institute of Foreign Trade and the Economics of Overseas Countries at the University of Hamburg. The expectations will have to be scaled down considerably⁶.

Probably the most important determinant — to which we want to confine ourselves here — is the structural change or, in a somewhat more general sense, the adjustment of the production system to changed technological conditions, factor availabilities and economic demand conditions at home and abroad. This brings the central economic planning system and its adjustability into focus. This system has been studied many times but never in this particular context. There are many indicators and theoretical arguments to support the thesis that the economic planning system can only begin to operate when the data changes to be incorporated into the macro-economic planning have been compressed into a much simplified pattern and the magnitude of the

changes has been greatly reduced. This means: there are motives operating in the system which lead it to give only a limited response to data changes, to work into the plans only what an (in comparison with the market) undifferentiated mechanism like the central planning apparatus can still just cope with, and to stave off by appropriate strategies and mechanisms whatever other possible changes may be called for. The state monopoly over the foreign trade, the objective constraints on contact by the citizens with world market demands and technologies and the transformation of the trade unions into a planning instrument may be mentioned as examples of such mechanisms.

If this interpretation is accepted, the question would therefore have to be formulated thus: Can the adaptation deficiencies of this system be "cured" by cooperation with the West, so that world market technologies penetrate into production and ensure economic growth? Or, going further, can western technologies and products conceivably be emulated actively and not merely passively, thereby enabling the Eastern Bloc to capture a constantly growing portion of the world market? Before this latter eventuality can occur accelerator effects would have to arise somewhere in the mechanism controlling the development of new technologies and products, perhaps in the eastern enterprise acting as a cooperation partner or else in some other eastern enterprise⁷. The impulse emanating from the technology or information conveyed through cooperation would have to be passed on in an amplified form so that the advantage of the West in regard to the availability of technologies and new products can be eliminated and superseded by a communist availability advantage.

The fact that cooperation is a fairly recent development makes it more difficult to answer this question: it will be at least a decade or two before the described effect can be judged in the light of experience. On the best knowledge available today we deem industrial cooperation between East and West to be well capable of bringing about or furthering structural changes selectively (not on a broad front!) but not of providing the impetus for active emulation. This view is, briefly, due to the expectation

⁶ An initial assessment of the technology transfers is to be found in N. L e i s e, *Transfermechanismen des technischen Fortschritts in und zwischen verschiedenen Wirtschaftssystemen* (Transfer Mechanisms for Technical Advances in and between Different Economic Systems), in: *Probleme der Ost-West-Wirtschaftsbeziehungen*, op. cit.

⁷ Active emulation in this case presupposes that patents of western enterprises used under a licence are independently developed further or circumvented in the East. The western enterprises are of course trying to debar their partner from such action by the cooperation agreement, but it is questionable whether they are always successful in this and if so whether other enterprises in the country concerned are also bound by such constraints.

□ that as the only sanctioned infrastructural measure of any importance (apart from the purchase of licences) cooperation has only limited scope for fulfilling its anticipated role in the adoption of new products, technologies, information and resources; and

□ that the communist planning systems (in their present form!) are incapable, except on a selective basis, of absorbing the impulses emanating from the cooperation and translating them into growth and of transforming such impulses in any but exceptional cases into active emulation.

Economic and Political Consequences

These conclusions should certainly not be regarded as final since the industrial cooperation between East and West has been of such short duration. Nevertheless it seems possible to draw some political conclusions:

□ The limited effectiveness of cooperation across the frontiers between the systems will suggest to the communist partner countries that they should seek out and embark upon other ways for the most efficient adoption of modern technologies and products beside that of cooperation, even though these may involve a heavier drain on their foreign currency resources. The erection, either together with western firms or by these alone, of turnkey industrial plants may be mentioned in this context as a method which is at least as efficient as cooperation. Owing to the high cost of such plants this way is practicable only for the — by virtue of their raw material resources — rich communist countries, and even they will not be able to choose this method in every instance if their market is not large enough to support the necessarily large plant unit sizes (in some industries). On both these counts the USSR occupies a privileged position as the model country *par excellence*.

□ It is conceivable that as a result of political direction the impulses of cooperation will benefit only certain sectors in the communist countries. The western economies may in consequence very soon find themselves exposed to increasing competitive pressure from the East which may be directed rather arbitrarily into certain sectors. If that happens, the western governments may well have to face up to the question whether it would not be better for them with cooperation having this kind of trade-distorting effects to substitute a policy of strict abstinence for the present governmental encouragement of cooperation. If major market disruptions occur, it would even seem possible to charge East-West cooperation with the social costs incurred.

□ A different kind of distortion will occur if the communist countries continue to give preference in cooperation to big western enterprises and even to give preference in trading to big enterprises with whom they are already cooperating. This can be an impediment to properly functioning competition. The resulting costs to their economies might force the governments to give their cooperation policy a new orientation.

It is therefore by no means inconceivable (and we should even say: probable) that the external economic policy which western governments are pursuing at present is actually resulting in preferential treatment for certain communist countries, certain western industries and certain western enterprise unit sizes while imposing an undesirable handicap on others, with unwelcome external political and economic repercussions as a result. If it is thought likely that repercussions of this nature will arise, the western governments will probably review their present benign policies on cooperation in the longer term, and this would affect the outlook for East-West cooperation in a negative rather than a positive sense.

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