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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Poland: Cooperative Ventures with Western Firms

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INTELLIGENCE MEMORANDUM

POLAND: COOPERATIVE VENTURES WITH WESTERN FIRMS

INTRODUCTION

1. Poland has become increasingly interested in cooperative ventures with Western firms in the past two years. This memorandum details the agreements entered into and examines the possible economic gains for Poland and the potential interest for US and other Western firms.

SUMMARY AND CONCLUSIONS

2. Cooperative arrangements with Western firms offer Poland a relatively safe and easy way of drawing closer to, and becoming more competitive in, the world market. Poland under Gierek has become increasingly active in seeking such ties. About half of the more than 55 known cooperative agreements, and nearly all of the larger deals, have been signed since he took power at the end of 1970. In the 1970s, most of the payoff from joint ventures will go to the domestic economy in the form of new, higher quality goods and, in some industries, greater efficiency. Over the longer run, exports certainly will benefit from the direct business created by cooperative arrangements and from the new skills and contacts gained from expanding ties with the West. These arrangements, however, will not do much to improve industrial organization and management or to stimulate research and development.

Note: This memorandum was prepared by the Office of Economic Research.

3. The leadership is especially interested in production sharing ventures[1] in such engineering industries as the motor vehicle, construction equipment, and machine tool branches, which play an important part in plans for expanding industrial output and improving the standard of living. Production sharing deals range from simple agreements involving Polish production or assembly of components to major purchases of Western industrial plant, plus long-term technical help, with partial repayment in kind from the output. A distinguishing feature of these arrangements is the provision for interaction on a continuing basis between the Western and Polish enterprises. Poland has also looked to cooperative deals in other fields, including marketing, tourism, and transportation, to increase its hard currency earnings while acquiring new equipment and skills. Of the total number of known agreements, 24 involve production sharing, eight provide for joint marketing, 20 involve cooperative ventures in third countries, and three relate to tourism.

4. Many of the Western firms involved are internationally known and have been involved in the East European market for years. France leads in the number of contracts signed, followed by West Germany, the United Kingdom, Sweden, Italy, the United States, Austria, and Japan. These countries are also the major trading partners of Poland in the industrial West.

5. Production sharing deals have accounted for most of Polish export earnings so far from cooperative ventures. Although earnings are still small, amounting to only US $15 million to $20 million in 1971, they have grown rapidly and represent about one-fifth of total Polish sales of machinery and equipment to the industrial West. Scattered data on individual agreements suggest that earnings will continue to rise, as the Poles expect. Under one of the larger deals (with SMT of Sweden, covering machine tools), Polish deliveries are to total $20 million during 1971-76.

6. Poland has only recently entered into cooperation agreements with US firms. In 1972, production sharing agreements with the Koehring International Corporation and International Harvester and a franchise and technical agreement with Intercontinental Hotels were signed. US firms, having little vested interest in the Polish market, hesitate to negotiate such

1. Production sharing is an arrangement which involves manufacturing or assembly as an integral part of the venture. The term co-production is applied to the more complex and comprehensive of these arrangements. These typically entail the provision of capital and entrepreneurship by the Western partner and the supply of plant, labor, and raw materials by the Polish. Such ventures often acquire Western markets for the joint product. Poland retains nominal ownership of the venture. Less comprehensive agreements require one of the partners to provide component parts for a product or to perform preliminary operations on a product which is then shipped to the other partner for finishing and sale.

agreements with Poland because of the headaches to be faced in dealing with the slow-moving bureaucracy. They are also reluctant to risk their reputation, technology, and markets. Lack of control over production seems to deter US firms even more than it does West European competitors. Nevertheless, more US firms doubtless will become involved, if only in the hope of improving their chances subsequently to sell equipment on regular commercial terms.

7. The size and importance of Polish cooperative ventures could increase if Poland adopts an attractive law permitting direct foreign investment. Polish leaders reportedly would like to have such a law to allow Western firms to invest in projects under the 1976-80 economic plan. A further impetus to cooperative investment would be realized if Western governments pass legislation guaranteeing investment in Poland against political risks.

DISCUSSION

What Poland Wants

8. Poland wants production sharing agreements with Western firms in order to expand production of new types of machinery and equipment for export and for the domestic economy. Other deals involving transport and tourism clearly are of secondary interest to the leadership. Among the most rapidly growing industries in the economy are the machinery industries. The Poles believe that these industries must play a growing part in exports to the West if trade with that area is to continue to expand rapidly in the last half of the 1970s and beyond.

9. Polish efforts since the mid-1960s to promote sales of machinery and equipment to the industrial West have met with some success. Machinery sales in 1971 were about three and one-half times the 1967 level, but they are still quite small, accounting for less than 10% of total exports to the area in 1971. Sales of ships skyrocketed in 1971 and accounted for nearly all of the doubling of exports of machinery to the industrial West in that year. The present level of orders for Polish ships indicates that they will continue as an important machinery export.

10. The Poles attribute the low share of machinery sales to Western prejudice and tariffs and to their own inertia and ignorance of the market. To help overcome these obstacles, they are counting heavily on production sharing and other forms of cooperation. The Polish leadership is looking to the long run – immediate trade prospects are fairly good and

balance-of-payments problems are not urgent – and they are looking as much to the indirect as to the direct benefit of cooperation. Over a decade, the gains from new customer attitudes, new skills, new contacts, and new reputation – reinforced by discreet economic reform – could do more for Polish exports than the business directly generated by cooperative deals.

11. Production sharing deals also reflect changing domestic priorities. The regime has been increasingly anxious to improve the lot of consumers since the December 1970 riots that put Gierek in power. The initial reaction to the riots was to boost worker morale by increasing pay and meat supplies. No less urgent in the longer term, although much harder and slower to fulfill, is the need to put more consumer durables on the market, particularly automobiles; to modernize the transport system; and to begin making up the large arrears in construction of housing, shops, schools, and hospitals while at the same time realizing continued gains in industrial capacity. It is for these reasons that Poland has centered its attention on deals to expand output of motor vehicles and construction equipment.

Development of Production Sharing and Other Cooperative Ventures

12. In the past two years, Poland has stepped up tremendously the pace of establishing production sharing ventures. More than one-half of the 24 known agreements Poland has entered into since 1964 have been signed since 1970, including all of the larger arrangements.[2] Poland is now on a par with Romania in the number of agreements concluded, but still lags behind Hungary and Yugoslavia, the front runners in Eastern Europe. At least six agreements also have been signed on cooperation in machine tools. The largest such deal is that with SMT of Sweden, which calls for a two-way turnover of $30 million during 1971-76.

13. Nearly all of Poland's recent production sharing ventures involve the machinery sectors, primarily the motor vehicle, construction equipment, and machine tool industries. The most important in terms of value are the 1971 arrangement with Fiat that covers the production of a new car, the Fiat 126, and the 1972 deal with Berliet that covers the production of buses. At least six cooperative deals have been concluded in the construction equipment area, two of them with the US firms Koehring International and International Harvester.[3]

2. The author of a recent article in the Polish press claims that Poland now has about 200 "co-production" agreements with the West. Apparently he is including not only all "production sharing" agreements as defined in this memorandum, but also arrangements with Western firms on cooperation in third countries and many straight licensing deals. The Poles probably have more "co-production" arrangements with the West than the 24 production sharing ventures and the 20 ventures covering cooperation in third countries cited in this memorandum, but it is doubtful that the total number of agreements comes anywhere near 200 or even half that number.

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14. The major Western countries involved in production sharing ventures with Poland are France, West Germany, the United Kingdom, Sweden, the United States, Japan, Italy, and Austria.[4] In most cases the Western partner firm has provided the capital equipment, technology, and entrepreneurship, whereas Poland has supplied the plant, labor, and raw materials. Poland, however, has sold several licenses to Western firms. The Polish Befama textile machinery works, for example, has signed a long-term production sharing agreement with Ateliers Fernand Goreux of Belgium under which Befama will deliver the technical documentation and 70% of the parts for the production of textile machinery assembled in Belgium.

15. In addition to the 24 production sharing ventures inside the country, Poland is known to have entered into 20 agreements involving cooperation in third countries, eight joint marketing arrangements, and three arrangements relating to tourism (see Appendixes B through D). Poland also has concluded a number of miscellaneous cooperative arrangements such as the 10-year technical assistance agreement with Clark Equipment A.G., an overseas subsidiary of Clark Equipment Company of Michigan, and a joint shipping venture with Australia. Under the 1972 arrangement with Clark, the Polish Stalowa Wola combine is to receive documentation, technical assistance, and production rights for the manufacture of axles for heavy construction equipment and vehicles. The Polish foreign trade enterprise Bumar is to handle sales in Eastern Europe, and Clark International is to take care of sales in the rest of the world. The shipping venture with Australia was concluded in July 1972 after nine months of negotiations. The joint company, which is registered in Sydney, consists of the Polish shipbrokering and chartering company Polfracht and the Australian Woolgrowers and General Traders Pty., Ltd.

16. Poland also has cooperated with the West in the exchange of technological know-how. In September 1972, for example, Ministry of Transport specialists discussed with Italian roadbuilding enterprises the possible participation of Italian experts in highway planning. Prior to this, Polish experts had traded their experience in the use of building materials for Italian documentation on planning and building highways.

17. Although Poland so far has allowed joint ownership only in companies located outside of Poland,[5] future arrangements of domestically

4. Many Western firms also are involved in other production sharing or straight contract deals in Eastern Europe. Fiat, for example, was already entrenched in Poland under a 1966 contract as well as in the USSR, Bulgaria, Hungary, and Yugoslavia. Steyr-Daimler-Puch has several agreements with Hungary on cooperation in production of buses and agricultural machinery. Berliet has an agreement with Hungary on cooperation in bus production. Prior to the signing of a production sharing agreement, the West German firm of Wewag acted as sales representative in Germany for the Polish foreign trade enterprise Metalexport.

5. Polfracht and the Australian Woolgrowers and General Traders Pty., Ltd., for example, share equally in the initial capital of the joint shipping company.

based ownership may be in the cards. A foreign investment law would have been unthinkable under Gomulka, but under Gierek a much more positive and pragamatic approach exists. Poland has recently begun work on a foreign investment law in order not to be left out in any competition for Western capital. Romania, Hungary, and Yugoslavia have already enacted such laws. Poland may also be expecting balance-of-payments strains that might eventually develop if the use of Western credit continues at its present rapid rate. A foreign investment law would permit Poland to acquire at least some Western equipment without adding immediately to the balance-of-payments deficit. At present, however, Poland has little reason for concern over its debt position. Poland's relatively low ratio of debt service to exports of 20% – among the lowest in Eastern Europe – and its relatively strong economy and low dependence on Western imports place it in the most favorable economic position relative to the West of any East European country.

Gains to the Domestic Economy

18. Gains from production sharing arrangements with the West are difficult to measure because so many of the agreements are still in the initial stages. It appears, however, that at least the automotive and construction equipment industries – long given low priority – will benefit greatly from these ventures. Most of the benefits will accrue directly to production rather than to the state of Polish technology.

19. The cooperative venture with Fiat was signed in accordance with Gierek's promise to provide the population an inexpensive small car, the Fiat 126. Annual production is to begin at 3,000 in 1973 and is to reach 150,000 by 1979. The leaders hope to boost the number of automobiles per 1,000 inhabitants from 15 in 1970 to 25 in 1975.

20. The deal with Berliet of France resulted from a decision made several years ago to build up the bus industry. Berliet is to assist in the modernization of the Jelcz Motor Vehicle Plant, which the Poles hope to turn into one of the major bus producers in Europe. The capacity of the plant eventually will expand to 5,000 buses annually, of which 1,700 will be produced under the Berliet license. Assembly of buses began in December 1972. By 1975, more than one-half of the parts are to be made in Poland.

21. The production sharing ventures with Jones Cranes, Cole Cranes, Stetter, Steyr-Daimler-Puch, Koehring, and International Harvester and the technical assistance agreement with Clark should help improve mechanization of the Polish construction industry, which is at a lower level than in most other East European countries. These agreements provide for cooperation in the production of heavy-duty cranes, concrete mixers, trucks

for construction sites, hydraulic building machinery, heavy tractors and crawlers, and axles for construction equipment and vehicles.

Gains to Exports

22. Poland is exploring four main avenues to generate exports from cooperation deals – production sharing agreements, agreements set up expressly for marketing Polish goods in the West, arrangements providing for sales to third countries, and ventures to develop Polish tourist facilities and earnings. Poland's desire to expand exports – especially those to hard currency areas – by means of cooperative ventures has so far met with only limited success.[6]

23. The Poles claim that exports to the West based on production sharing agreements amounted to $10 million in 1970 and $15 million to $20 million in 1971.[7] This represents less than 2% of total exports to the industrial West in 1971 and about one-fifth of the exports of machinery and equipment. Agreements signed in the last two years, however, should add considerably to Poland's exports. Plans call for deliveries under production sharing agreements to rise to $25 million in 1972 and to "several score" million dollars by 1975. Out of deliveries of co-produced goods in 1971, 41% reportedly went to West Germany, and about 10% each to Sweden, the United Kingdom, and Italy.[8] Poland hopes to boost sales of machinery produced under production sharing agreements to Sweden alone from about $2 million in 1971 to $22 million by 1980.

6. Poland also has signed several compensation deals which are not considered in the text, because they do not involve long-term cooperation in producing or selling a particular line of goods or services. For example, a $135 million credit extended by France in 1969 for the purchases of French licenses and equipment for the electronics, engineering, and steel industries is to be repaid with Polish deliveries of machinery and equipment and of copper. At the time of the extension of a $100 million credit by Japan in 1972, a separate but apparently interdependent agreement was signed whereby Japan would take 2 million to 3 million metric tons of Polish coking coal annually for 10 years. When the contract for a nylon plant from Mitsui of Japan was signed in 1971, a concurrent agreement was drawn up whereby Mitsui would buy machinery in Poland. These deals, although more important than most of the cooperative arrangements, are not production sharing ventures and apparently are not considered by the Poles in calculating export earnings from production sharing ventures.

7. These figures may include exports generated by agreements under which Poland delivers to the licensing firm in the West goods produced under that firm's license. Among such agreements are those with Monark-Crescent (outboard motors) and MacGregor (hatch covers) of Sweden; Leyland (crankshafts) and Napier, Ltd. (turbocompressors) of the United Kingdom; and the 1966 deal with Fiat of Italy. Poland apparently also includes under its earnings such deliveries as those of spare parts to Volvo as part payment for 77 Volvo trucks.

8. The article from which this breakdown was obtained also claims that 16% of the 1971 deliveries under production sharing went to Switzerland. An earlier Polish article, however, stated that as of the end of 1970 cooperation deliveries to Switzerland were minimal. There are no indications that this situation changed significantly in 1971.

24. Only piecemeal information is available linking specific exports to specific production sharing deals. Exports of furniture parts to IKEA of Sweden probably came to at least $1 million in 1971, and deliveries of digitally controlled machine tools under the agreement with the Swedish state owned firm SMT are scheduled to average $3.3 million a year during 1971-76 – exports of all types of machine tools to the West totaled only $6 million in 1970. An agreement of August 1971 with the West German firm Stetter stipulated that the Polish enterprise Stalowa Wola would deliver mobile concrete mixers worth $5 million over a three-year period. Polish deliveries to the United Kingdom under the 1966 agreement with Jones Cranes were to total about $7 million over a seven-year period. Polish deliveries to Italy under the 1971 Fiat deal could eventually reach an estimated average of $10 million a year, and it is expected that deliveries of bus parts under the Berliet deal will constitute a major share of machinery exported to France. In a case where Poland is supplying the know-how, the Befama textile machinery works expects earnings from Goreux of Belgium to rise to about $3 million in 1973.

25. At least eight joint ventures have been established in Western markets for selling Polish goods in the West and, in some cases, Western goods in Poland [redacted] These ventures will provide Polish exporters with experience in Western marketing practices, but the success of these ventures in increasing Polish hard currency exports is difficult to assess, as Western firms might substitute products marketed by the joint company for those that would otherwise be purchased from Poland. For example, a Western company that entered into an agreement with Poland for marketing machinery might replace part or all of the machinery normally purchased from Poland with machinery imported under the cooperative marketing venture.

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26. The sales volume of Polish machine tools by a French partner – Metalex-France – in a joint marketing venture is known to have increased from 7 million francs in 1969 to 20 million francs in 1971. This company also sells other Polish goods in France, including equipment for the chemical, mining, and construction industries. Metalex-France, established in 1966, represents several Polish foreign trade enterprises on the French market. The company now also represents large French firms in Poland through a technical office set up in Warsaw.

27. Poland has been able to expand somewhat exports of machinery to other Communist countries and to less developed Western countries by joining forces with developed countries in projects such as those with Ensa and Krebs of France for the construction of soda factories in Libya and Turkey. By working closely with Western firms in such deals, Poland also gains some technological and managerial know-how. [redacted] Poland has entered into at least 20 such arrangements.

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28. The development of tourism could yield considerable foreign exchange earnings without as much investment or risk as is entailed in production sharing agreements. Also, Western firms may find such ventures more attractive than production sharing ventures because of the greater assurance of a return on this investment in hard currency. Although the Poles have not yet developed tourist-related agreements to any great extent

25X1 [redacted] they would like to become more active in this area. Toward this end, representatives of the Polish tourist enterprise Orbis visited France in June 1972 to discuss the possible construction of five small hotels in Poland. The deal, if concluded, would include purchases by the French firm of Polish hotel supplies.

US Involvement

29. Joint ventures with US firms or their subsidiaries have only recently gained some importance. In the past nine months, Poland has signed production sharing agreements with the Koehring International Corporation and International Harvester. It has also signed a 10-year technical assistance agreement with Clark Equipment A.G. All three of these agreements involve cooperation in construction equipment. In addition, Poland has signed a franchise and technical agreement with Intercontinental Hotels, a subsidiary of Pan American Airways, for a hotel to be built in Warsaw.

30. US firms hesitate to get involved in production sharing arrangements with Poland for much the same reasons as West European firms. Joint ventures suffer from the usual difficulties of trading with Poland: the slow decision-making process which often results in long and costly negotiations, the inability to deal directly with Polish enterprises, and Poland's increasing insistence on barter deals. Certainly the example of the Berliet deal – which took five years to close – is not heartening to US firms. Moreover, Western firms inhibit joint ventures by their concern to protect their reputation, technology, and markets.

31. The lack of control over the management and production process in a joint venture with Poland seems to bother domestic US firms even more than it does West European firms. US firms also are confronted with some problems not faced by West European businesses. There is still public opposition to buying Communist goods, and the aversion of US dockworkers to handling Communist goods remains a threat. US firms also are faced with the difficulties of conducting, from a great distance, such supervision and control as the Poles permit. While none of these disadvantages is insuperable, together they may well discourage many US firms from becoming involved in joint production arrangements with Poland. On the other hand, those US firms that look beyond the drawbacks may find the access to cheap and plentiful labor and already extant plant capacity enough

to entice them into cooperation deals. If nothing else, the willingness to conclude joint venture agreements may serve as an opening wedge for the generally more desirable straight contract deals.

32. In any case, government-level efforts to form production sharing and other cooperative arrangements probably will continue on both sides. Mutual interest in cooperation is expressed in the US-Polish agreement on economic, industrial, and technological cooperation signed in November 1972. This agreement states in a general way mutual "readiness to develop all forms of industrial and technological cooperation." In addition to joint production of machinery, Poland has expressed interest in obtaining help in developing its raw material base, notably copper, sulfur, coal, oil, and natural gas. In May 1972, Poland discussed with Standard Oil of Indiana the possibility of a cooperative venture to explore for oil and natural gas deposits in Poland. US firms might find cooperation in raw material development preferable to that in more advanced areas of production because repayment in Polish raw materials would be much more desirable than in Polish manufactures. Similarly, US firms might prefer tourist-related arrangements to production sharing deals because the former offer better assurance of repayment and less risk.

Outlook

33. The Poles are blocked to a large extent in their attempts to expand production sharing arrangements by their cumbersome decision-making apparatus, by the disinterest and leariness of their industrial enterprises, and also by Western hesitation to get involved in such ventures. The Polish leaders are attempting to streamline the foreign trade apparatus in order to facilitate the conclusion of cooperation agreements and normal trade contracts, but they have a long way to go in reducing the red tape to a workable level. Moreover, as long as main plan directives are handed down from the top, the freedom of individual Polish enterprises will be severely limited, and there is no indication that the Poles intend to relinquish a high degree of central control.

34. Still, Poland remains highly interested in joint ventures, and, indeed, following the lead of Yugoslavia, Romania, and Hungary, is considering legislation to permit ownership by foreign firms in Polish enterprises. Presumably the Poles will permit Western firms to participate only up to the 49% permitted by Yugoslavia, Romania, and Hungary. The law reportedly will be passed in time to allow Westerners to invest in projects under the 1976-80 plan. If Western countries were to pass legislation guaranteeing investment in Eastern Europe against political risk, Western firms might be more willing to invest. The United States has already extended coverage under the Overseas Private Investment Corporation

(OPIC) to Yugoslavia and Romania. The United States also is considering the extension of coverage to other East European countries. Japan has the facilities to guarantee investment to Communist countries against political risk but has not yet used them. West Germany has actually granted such guarantees on investment to Yugoslavia.

35. Although Western firms will remain skeptical, many firms will continue to be interested in exploring joint ventures with Poland. Western firms increasingly realize that agreements which generate Polish exports are the best way to assure the winning of a contract. In fact, Poland has stated that Western countries must consider deals involving payment in goods if they wish to increase exports. Also, Western firms recognize that joint venture agreements probably are a good means for attracting further Polish business – the Poles tend to go back to the same firms whether or not they can get the best deal from them.

36. Poland probably will continue to enter new cooperative ventures at least at the same rate as in the past two years. An investment law might help pick up the tempo if it provides for sufficient controls by Western firms over production processes and for guarantees on repatriation of capital and profits. It should be noted, however, that Romania has signed only two agreements providing for joint ownership inside the country since passage in March 1971 of the decree permitting foreign investment. Furthermore, Yugoslavia attracted only $52 million worth of Western investment during the first three and one-half years after the passage in July 1967 of a regulation permitting foreign capital investment in Yugoslav enterprises. Amendments in January 1971 to waive reinvestment requirements together with steps to clarify the foreign investor's right to repatriate all initial capital probably have been largely responsible for the increased rate of investment since then. A total of around $90 million in foreign capital was engaged as of late 1972. Very likely the Poles will encounter similar difficulties in breaking the ice even if they do pass an attractive law. And, like the Hungarians, and probably the Romanians as well, they may be reluctant to admit large amounts of foreign capital when actually confronted with the possibility of doing so.

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