FOREIGN INVESTMENT IN EASTERN EUROPE AND THE USSR: CONDITIONS, STRATEGIES AND POLICIES

Report on a joint meeting of management and trade union experts held under the OECD Labour/Management Programme

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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FOREIGN INVESTMENT IN EASTERN EUROPE AND THE USSR:
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(Paris, 8th and 9th November 1990)

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Summary

Under the OECD Labour/Management Programme for 1990, a joint meeting of management and trade union experts on "foreign investment in Eastern Europe and the USSR: conditions, strategies and policies" was held in Paris on 8th and 9th November 1990. The meeting was prepared in collaboration with the Business and Industry Advisory Committee to the OECD (BIAC) and the Trade Union Advisory Committee to the OECD (TUAC).

The overriding objective in all discussions on economic links with Eastern Europe and the USSR is to sustain the historic opening which now exists in these countries to move towards political pluralist democracy. Foreign investment by OECD-based enterprises in the reforming East European countries and the Soviet Union is being actively requested and encouraged. The reasons for this are many: foreign investment is seen as providing technological and managerial expertise, capital, access to export markets, alternatives to state monopolies, etc. -- all with the objective of increasing jobs, productivity and the standard of living in the transition to more open, market-based economies. Although relatively small in scale at present, foreign investment is expected to accelerate. The opening of Eastern Europe and the USSR as a location for multinational enterprise activity will have an effect on corporate strategies and on East-West economic relations.

Participants in the meeting had the opportunity to discuss this trend from three perspectives: the conditions necessary to attract private direct investment to Eastern Europe; the role foreign investment should play to support the moves towards economic and social liberalisation; and the possible implications for OECD countries arising out of increased economic relations with the Eastern Bloc.

Below is an overall report of the discussions of the meeting of experts, prepared by Professor Angus Maddison, University of Groningen (Netherlands), who was designated as General Rapporteur for this activity.

A list of the participants in the meeting is given in appendix.

THE OPINIONS EXPRESSED AND ARGUMENTS EMPLOYED IN THIS REPORT ARE THE RESPONSIBILITY OF THE AUTHOR AND DO NOT NECESSARILY REPRESENT THOSE OF THE OECD.
Introduction

The meeting was held on 8th-9th November 1990 with the participation of management and trade union experts, the Secretariats of the BIAC, the TUAC and the OECD. It was chaired by the Deputy Secretary-General.

The aim of the meeting was to assess the desirability and likely size of the flow of private foreign direct investment to eastern Europe and the USSR, to evaluate its likely impact on the economies of these countries, to review the policy issues involved in the East and the West, and to put the private capital flow into the broader context of Eastern Europe’s needs.

In spite of the newness of these problems and the absence of participants from eastern countries, the meeting was able to command an impressive range of expertise because of the very wide range of business, union, technical assistance and policy contacts which the management and trade union participants had recently had with eastern countries, and from the ability of the OECD Secretariat to brief the meeting both on conjunctural and policy developments, and on more specific problems concerning the legal and regulatory framework necessary to facilitate the flow of private capital. There was a remarkable harmony of viewpoint between the management and trade union experts on the importance of a western effort to help the East, on the gravity of the transition problems, on the limited role which private foreign investment was likely to play in the short term, and on the need to supplement the private capital flow with other measures, on a tripartite basis, of a technical assistance character.

The discussion was conducted under five major headings, the bulk of the detailed discussion being concentrated on items 3 and 4 below:

1) the underlying political and economic reasons for East-West rapprochement and the new interest in foreign investment;

2) the nature of the transition problems faced by these countries, the nature and adequacy of their policy response, and the degree to which their policy efforts need outside support;

3) the nature and adequacy of existing regimes to promote foreign investment, the relevance of existing OECD guidelines in this area, and other considerations affecting the likely flow of investment;

4) problems of revamping work attitudes, organisational and managerial practice in moving from a command economy to one geared to market needs and incentive remuneration, with the resulting problems of bankruptcy and unemployment;
5) assessment of major economic sectors where investment prospects were favourable.

1. The reasons for welcoming reform and rapprochement

On item 1, both BIAC and TUAC submitted written statements which stressed the spectacular character of recent changes which have brought immense challenges and opportunities. These deserve strong Western support to back the transition to pluralist democracy and free elections, the creation of functioning market economies and to consolidate the new peace dividend arising from peaceful co-operation in place of cold war. It was agreed that there was a strong linkage of these political, economic and internationalist goals, and that there should be no delay in manifesting Western solidarity, even where the most efficient paths of co-operation may not yet be clear. It was essential to ensure that the changes in the East were consolidated and enduring so that there could be a realisation of the vision of a united, free and self-confident European continent. On the other hand, the risks of failure through falling living standards, economic breakdown, the appearance of large-scale unemployment, disillusion with democracy and market economies, revival of xenophobia and nationalism were very real.

2. Transition problems

There was general agreement on the breadth and difficulty of the transition problems. These include deep conjunctural problems of stabilisation on which the meeting was briefed by the OECD Secretariat, as well as longer-term problems of adjustment from a command to a market economy and the labour market issues covered under item 4.

The OECD Secretariat's briefing distinguished the situation in Czechoslovakia, Hungary and Poland from that in the USSR. In most respects the situation in the USSR is worse than in the other three countries and the direction of policy has been much less clear and decisive. In the former three countries budget deficits have been reduced, subsidies are down and interest rates are positive. Monetary overhang has been removed. Prices have been liberalised in Hungary and Poland and will be in Czechoslovakia. The social costs and political tensions have been substantial with sharply declining real wages, rising unemployment, and closure of uneconomic enterprises. The oil price rises connected with the Gulf crisis, the ending of old payments and trade commitments in the CMEA, and the reunification of Germany have all disturbed previous patterns of trade. In this context, it was noted that Finnish exports to the USSR had dropped from 25 per cent to 10 per cent of the total. In spite of the commitment to change, the situation is still unpromising for foreign private investors. The large overhang (more than $100 billion net) of foreign debt complicates the payments problems and clouds the outlook for servicing further private investment.

Many experts stressed the large gaps in infrastructure both as a general problem of transition, and as a specific deterrent to foreign private investment. Items frequently mentioned were transport, telecommunications and housing deficiencies, but there were other important areas particularly in the
There were also more severe ecological problems than in western countries, which made other parts of the infrastructure (particularly nuclear energy) unusable.

There was a general political willingness in Eastern Europe (less so in the USSR) to make institutional and legal changes, but there was a very serious lack of knowhow in efficient implementation of such changes with the existing bureaucracy and management personnel, whose legitimacy was questionable and whose willingness and ability to make the necessary adjustments were limited. There were major problems in introducing the accountancy conventions of a market economy, in valuing assets, assessing market demand or assessing investment risks. A market-oriented banking, credit and insurance system had to be created virtually from scratch.

There was a political willingness in East European countries (but not in the USSR) to privatise state assets, but this was not easy to do quickly for most assets could not be accurately valued, and in any case most of the citizens of these countries had no savings available to make substantial purchases. The experts expressed considerable reservations about the risk of assets sales to foreigners which could be interpreted as "predatory" or to indigenous purchases from the old nomenclatura. Such sales could sap the political legitimacy of the private sector, unless they were handled carefully.

Several experts stressed the attractions of the European Community as a trading partner to the East but pointed to the problems arising from the very close and growing integration of Western economies. There was a need to move towards a new pan-European framework, in which Eastern countries had most-favoured-nation access to Western markets. There was general welcome for the European Bank for Reconstruction and Development and the flow of funds from the IMF, World Bank, bilateral sources, and the pentagonal initiative. There was clearly a need for effective co-ordination of these different sources of aid.

3. Foreign investment regimes

It was generally agreed that the long-term prospects for foreign investment in Eastern Europe were extremely large and highly beneficial for both the investors and the host countries. The potential market was large, and there were opportunities to develop new products, and update technology in areas neglected for decades. Foreign investment could help transform attitudes to enterprise, improve management and work attitudes, break technological bottlenecks, and help develop new exports. In the short term, however, the uncertainties of stabilisation and transition, infrastructural difficulties, the debt overhang, lack of clarity in the foreign exchange and foreign remittance regime, and in the legal framework governing the rights and duties of foreign investors were all substantial deterrents.

The meeting clearly felt that there was scope for dealing with the latter issue with reasonable expedition given the obvious desire of Eastern countries to promote investment and the availability of OECD’s Guidelines for Multinational Enterprises, the codes for liberalisation of capital movements and invisibles, and the National Treatment Instrument. These had been developed some time ago as a result of considerable international negotiation, and are highly appropriate to meet these new problems. For example, the
Guidelines for Multinational Enterprises cover the whole range of issues which are likely to arise, and in particular are concerned with establishing the longer-term legitimacy of foreign investment by discouraging predatory acquisition of assets in troubled economies, payment of low wages or other infractions of good labour practice. It was highly desirable that they be translated into the east European languages.

There had clearly been progress in Eastern Europe in streamlining procedures for approval of foreign investment, on double taxation, on transfer of profits and preservation of intellectual property rights, but there was need for simultaneous development of contract and commercial law, reforms of accounting, fiscal structures, labour law, and laws governing competition and monopoly.

There was a very strong consensus (though not complete unanimity) that foreign investors should not be given special tax incentives and that those which existed should be repealed. This path would lead to a costly scramble between different East European countries, and would give foreign investors a privileged enclave status which was not in their long-term interests. What was needed were fair and transparent fiscal systems which gave all firms equal treatment. Furthermore, there was a tradition of very strong exercise of discretionary bureaucratic power in the East, and general non-discriminatory liberal guidelines were the best way to eliminate or mitigate this. Discriminatory systems were usually most unfavourable to small companies which cannot afford the overhead costs of protracted negotiation for the right of establishment, profit transfer, etc., and it was felt that the role of small companies could be particularly useful, because of their greater flexibility and capacity to promote small-scale entrepreneurship in the East.

There was also general agreement on the desirability of building new systems of industrial relations based upon collective bargaining within a clear framework of labour law. Foreign investors could help in this respect by observing the OECD Guidelines, and the ILO’s Tripartite Declaration on Multinational Enterprises and Social Policy. Indeed, in some countries, such observance was mandatory for Western investors in receipt of investment guarantees supplied by their governments.

As the flow of foreign investment was as yet rather small there was a general feeling that it was desirable for OECD countries to provide channels for technical assistance to the Eastern countries, on a tripartite basis (including workers, employers and government organisations). In this context, it was noted that the system of "national contact points" envisaged in the OECD Guidelines could be of help in Central and Eastern Europe. There was also support for the idea of an early BIAC/TUAC seminar with East European workers and employers associations to explore these possibilities. There was some discussion of a Swedish-Polish initiative which had succeeded in setting up an association for improvement of Polish management in the private sector, which was an obvious paradigm for other bilateral initiatives.

4. Training and labour market issues

It was clear that the level of education was relatively high in Eastern Europe, but past remuneration systems and managerial practice had provided
little incentive to raise productivity. Managers had had little concern with marketing their products. Overemployment and loafing on the job had been common, with many workers saving their real energy for better remunerated activity in the informal economy. The system of guaranteed employment is now on its way out. Unemployment and bankruptcy were likely to change the attitude of both workers and managers, but institutions for mitigating the social costs of these new processes were not yet in place. Employers associations are beginning to be established and free trade unions had emerged but they had little experience of collective bargaining. There was a clear need for increasing the type of technical assistance which Western unions were co-ordinating through the International Confederation of Free Trade Unions, so that the new unions could put less emphasis on the strikes and political militancy which were appropriate in their struggle for legitimacy, and give more attention to building up normal labour relations.

There was also a general feeling that Western countries could help with technical assistance in training, particularly in helping to train the trainers, and to train management. A tripartite approach was highly desirable, with Western governments helping to finance such arrangements. It would be worthwhile for the Eastern countries to set up national productivity agencies, themselves on a tripartite basis, as contact points (by analogy with the role such agencies played in Western Europe in the late 1940s and in the 1950s -- when the concern was with acquiring knowhow and skills from the United States). A beneficial part of such training arrangements could be six-month courses in Western countries, on the lines Sweden was arranging with the Baltic republics of the USSR.

5. Assessment of major types of investment potential

The meeting did not go into a great deal of detail about specific areas where investment opportunities are most favourable. There are obviously areas like insurance, banking, hotels and tourism where there are important gaps in the East European economies which foreign investment is showing a willingness to fill, but there are other areas of urgent East European need in infrastructure or the environment where this is not likely to happen, and where Western governments might well focus their transitional assistance programmes. Rather than focusing its attention on specific areas, the feeling of the meeting was that the most urgent issues were establishment of general non-discriminatory regimes to promote private foreign investment, and for Western technical assistance on a tripartite basis to fill those gaps in Eastern training, managerial and union expertise to which foreign private investment could make only a limited contribution.
ANNEX I

LIST OF PARTICIPANTS

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Jean Luc

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Herbert

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Mrs. Rosemary
Flows of foreign direct investment (FDI) to the countries of central and eastern Europe over the next few years are likely to be small relative to their external capital needs, partly because of deficiencies in infrastructure and basic business services in the region. This was one of the informal conclusions of a recent meeting of management and trade union experts held at the OECD.

Under the auspices of the OECD’s Labour/Management Programme, a meeting was held on 8th-9th November 1990 to discuss conditions, strategies and policies for foreign direct investment in the countries of central and eastern Europe. The OECD programme provides a framework within which labour and management experts can meet with the OECD Secretariat to explore subjects of current importance related to the overall work programme of the Organisation.

The meeting, which was chaired by Robert A. Cornell, Deputy Secretary General of OECD, brought together senior management and trade union experts from a wide range of OECD countries. Professor Angus Maddison, University of Groningen, acted as Rapporteur of the meeting.

Participants discussed key issues related to FDI in the countries of this region, in particular: the underlying political and economic reasons for East-West rapprochement, the nature of the transition problems faced by these countries, the success of their present stabilization programmes, the role and likely contribution of FDI and a variety of training and labour market issues associated with the transformation from centrally-planned to market-oriented economies.

It was generally felt that the likely flows of FDI to the countries of the region over the next few years will be small relative to their external capital needs which have been exacerbated by the Gulf crisis. There have been important and positive developments in the legislative framework for FDI throughout the region, but potential investors still need assurances (particularly in areas such as transfer of profits, protection of property rights and dispute settlement) that the commitment to liberalisation is clear and lasting.
Deficiencies in infrastructure and basic business services still constitute major obstacles to investment. On the other hand markets in central and eastern European offer considerable prospects for expansion of business activities and productivity gains by making better use of a highly motivated and educated workforce. The major contribution of foreign direct investment to restructuring lies in its catalytic effects through technology transfer, the spread of know how and management skills, marketing and accounting practices, and the exposure of the emerging corporate sector to a competitive environment.

Participants discussed the role of the OECD investment instruments in increasing the flow of FDI to these countries. The Code of Liberalisation of Capital Movements and the National Treatment Instrument provide the benchmark and direction for progressive liberalisation and the Guidelines for Multi-national Enterprises can promote confidence between host governments and foreign investors.

The pressing need for institution building (employers organisations and trade unions) and training was highlighted by participants. Efforts from all sides are needed here in order to strengthen and develop the basis for transformation as well as to deal with the frictions likely to arise from the process of adjustment. Co-operation between the social partners and an efficiently functioning industrial relations system are crucial to the success of these efforts. It was suggested that future meetings on the topics discussed during this session should include labour and management experts from central and eastern European countries.

[A final report on the discussions is being prepared by Professor Maddison and is expected to be published in the early part of next year.]