

# Report on Czechoslovakia, Hungary

*Marked contrast noted between two countries; an examination of economic as well as licensing policies*

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In addition to a discussion of licensing in Czechoslovakia and Hungary, I shall provide a brief general economic view of the two countries.



## CZECHOSLOVAKIA

My primary responsibility on the East European Study Project on Industrial Property Rights — Technology, which was jointly sponsored by the U.S. Department of Commerce and the Licensing Executives Society (U.S.A.), Inc., was chairman of the Hungarian delegation, but I have been asked to report here also

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on Czechoslovakia.

After the Russian occupation of Czechoslovakia, the entire social and economic structure of the country turned sharply toward more doctrinaire Communist economic philosophy with an attendant curtailment of economic initiative. One of the most telling symptoms of this is that of all Eastern European countries Czechoslovakia (possibly along with East Germany) has the least indebtedness to the West. In contrast with this the other COMECON countries piled up huge debts to western lenders.

Of all Eastern European countries Czechoslovakia was the most reluctant to receive our delegation. The people there could not imagine why in the world we wanted to visit there and it was practically only in the last moment that we could provoke an invitation and make the necessary arrangements.

The worsening balance of trade of Czechoslovakia and the increasing trade deficit with hard-currency trading partners could indicate that Czechoslovakia might depart from its conservative borrowing patterns and increase its borrowings in the West. The excellent recent harvest, however, would lessen the pressures for importation of seed grain from the United States. Seed grain accounted for two-thirds of U.S. exports to Czechoslovakia in 1976.

The current Five-Year Plan calls for a 6% annual growth rate, and as Czechoslovakia tries to maintain

it, sophisticated machinery and processing technology acquisitions from the West will have to continue at the earlier levels.

For this purpose the State Bank is making available about \$300 million dollars in hard currency for purchases of Western technology and equipment. They expect, of course, to utilize these purchases to produce more goods for sale to the West and, therefore, cut

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their production costs. An incentive is intended by the announcement that if Western sales can be increased, the State Bank will grant increased import credits. These plans, especially in centrally-planned economies, have a tendency to fizzle. Furthermore, a general overall "incentive" which does not reflect back to the profitability at the enterprise level and to the income of the individuals involved, is not really an incentive. The priority-development sectors include machine tools and chemical technology and equipment.

Last year Czechoslovakia purchased a record number of licenses from the West. From a total of 69 licenses, 41 were purchased from the West and 28 from the other COMECON Countries. This total is 19 licenses more than the 50 licenses purchased in 1975. They also sold 28 Czechoslovak process licenses to the West in 1976. U.S. companies sell the greatest number of Western licenses to Czechoslovakia, followed by firms in West Germany, Netherlands, U.K., and Sweden.

### Significance

The Czechoslovaks consider one of their more significant acquisitions a French process for making a vaccine to combat hoof and mouth disease; a German method for building thermal ventilators for diesel motors; a British process for coating coils; and an American process for drilling screws. They also acquired an automated milking system for dairy farms, licenses for producing health-care equipment and drugs and for producing vacuum cleaner components, and know-how for formulation of cosmetic products.

Early in 1977, the Czechoslovak government promulgated a new regulation under which representative offices of western companies can be established in Prague. Among the first companies to establish offices were a dozen from Japan, three from Sweden, two from Italy, and one from Spain. Since then German companies also have moved in. No American firms have applied to establish an office.

In passing on these applications the Foreign Trade Ministry reviews whether the applicant company has

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an existing cooperation agreement in the manufacturing area; whether the company intends to make such an agreement and the extent to which the permit would contribute to boosting the Czechoslovak technology base and, of course, the dollar value of any cooperation agreements with the applicant.

Joint ventures in Czechoslovakia are not possible. They are trying to get around this, however, by a more active fostering of the formation of joint ventures outside of Czechoslovakia, such as for the sale of Czechoslovak-made products.

About two thirds of the American licensing proposals are rejected. One significant factor in the rejection is the American licensor's insistence on denying similar licenses under Western patents and thus prevent the exportation of the product manufactured under the license.

A principal touchstone in the approval process for foreign licenses is whether the product of the license could be utilized to generate further production of hard currency income for the Czechoslovak economy.

Czechoslovakia was historically one of the more highly industrialized countries in Eastern Europe and this results in the strange paradox of it having now a great amount of aged equipment, in some cases more than many of its neighboring countries that started later. Therefore, the need for replacing the increasingly aged industrial assets requires the acquisition of greater amount of machinery and technology than in some of the neighboring countries. The Czechoslovak reluctance to get heavily into debt with the West, however, would have a marked tempering effect on this tendency. Credit terms would also play a substantial determinative role in the success of Western businesses to sell chemical and petrochemical equipment, machinery for metallurgical processing, the forestry industry and coal mining, which are some of the sectors in the greatest need for Western equipment and technology. Counterpart purchases or product buyback arrangements are also more eagerly sought by Czechoslovakia, which is very anxious to earn the hard currency for its imports.

Interestingly, the government authorities in Czechoslovakia are more anxious for industrial enterprises to purchase Western technology than the industrial enterprises themselves. This is not so much due to the NIH factor from these enterprises. It is due rather to the high internal cost of the licenses to the enterprises. The cost would considerably reduce their paper profitability and thus the delicate bonus structure on which the enterprise management relies so heavily.

Czechoslovakia consists of two principal parts, the Czech part, or Bohemia, and Slovakia. The third part of the federation, Moravia, is often ignored in the general scheme of things. Participation in the federal structure is jealously guarded by Slovakia and, therefore, in each enterprise, agency or other organization the top-end jobs are divided between Bohemians and Slovaks. Consequently, if the head of an enterprise is a Slovak, his deputy is a Czech, and vice-versa. Another symptom of this guarded chauvinism appears in the Czechoslovak automobile industry. The Tatra and Skoda automobile works are both in Bohemia. A

very obviously Czech official in one of the industrial ministries, bemoaned the fact that serious dislocations would result in the economy if they were to give in to the demands of the Slovaks also to establish an automobile factory in that part of the federation.

Slovakia is considerably less industrialized and a greater investment effort is present in that republic. Therefore, any seller of licenses would do well to consider approaching end-user enterprises and industries located in Slovakia. Textile machinery manufacture is just getting established in Slovakia, and there are strong efforts to establish the manufacture of measuring apparatus, computers, hydraulic machinery, and telecommunications equipment in that republic.

## HUNGARY

The contrast between Czechoslovakia and Hungary is remarkable. Hungary and Poland are the two most liberal societies within the COMECON countries, and this also manifests itself in their ways of doing business.

Hungary has a population of just slightly over 10½ million people. It has a very deficient convertible currency trade balance. This can be illustrated with the not too typical U.S. trade relations which in 1976 included \$63 million of U.S. exports to Hungary and only \$49 million of U.S. imports from Hungary. Therefore, in the past few years the Hungarian economy, which is highly dependent on foreign trade, has not fared too well. This was further compounded by the severe midsummer droughts in 1976. The effects of this might now be reversed by the worldwide good harvest situation in 1977, especially in such an agriculturally-intensive country as Hungary.

An all-encompassing renewed effort is underway in Hungary to transform and modernize industry to enable production of goods that are more competitive abroad. The Hungarian government has taken concrete steps the past year to improve further the climate for Western businessmen. Increased emphasis was put on negotiating double-taxation agreements with various Western countries, the joint-venture law has been substantially modified to encourage the formation of joint ventures with Western partners in Hungary, and great efforts have been made to attract bank representative offices to Hungary.

Despite the fact that in terms of per-capita income Hungary ranks statistically behind the German Democratic Republic and Czechoslovakia among the Eastern European countries, the generally good quality of life and the relative availability of consumer goods is readily apparent in the streets of Budapest. In spite of some serious problems, the economic reform measures introduced in 1968 brought about a great deal of progress. Therefore, the problems to be discussed are sometimes in the nature of teething pains as that country has been cutting its teeth on the New Economic Mechanism. This economic system was born as a compromise and should have been put into effect a great deal sooner. In view of the reforms having been a compromise the economy could not fully rid itself of the internal inefficiencies which are characteristic of centrally-planned economies. This was compounded by

an outdated capital plant and equipment base and a heavy lack of raw materials. Since this leaves just about only increased labor productivity as the sole means of economic progress, the half measures undertaken were far from adequate.

Hungarian industries which are receiving the greatest amount of attention include aluminum, machine tools, food processing equipment, pharmaceuticals, buses and vehicle parts.

### Surplus Balance

Hungary historically has run a surplus balance with its COMECON trading partners. That trade has generally constituted about two thirds of Hungary's foreign trade. In the last few years, however, the adjustments in the pricing structure between the COMECON trading partners resulted in very high increases in raw material costs. This placed an especially hard load on Hungary. Its intra-COMECON trading balance has begun to fall considerably behind. Unusually strict economies have mollified the impact of the situation to a slight extent only, and Hungary recognizes that its future export growth depends to a large extent on imported Western technology.

As in the case of most COMECON countries, Hungary also finds itself in an increasingly bad pinch with respect to supplies of hard currency. While the preference for compensatory trading deals (especially if the Hungarian party was in the business of selling its own products in the West) always lurked in the background of negotiations, the push is on now for compensatory trading requirements. Guidelines have even been established.

According to the Hungarian Foreign Trade Bank, in the case of sizable deals of around a half million dollars with large Western companies, the Western trading partner is required to agree to buy back Hungarian products in an amount between 10% and 50% of the amount that is payable by the Hungarian purchaser to the Western seller. A subsidiary or a third party can also assume the purchase obligation for the Hungarian goods.

It has yet to be seen to what extent such increased pressures for compensatory trades would be applied outside the sphere of commerce in goods or commodities, such as in the case of transfer of technology.

Tourism is a major money earner for Hungary, which receives slightly more than half of the number of its own population as foreign tourists. Two thirds are from other socialist countries. This ratio will not improve until more suitable accommodations are provided.

A special interest has been expressed by Hungary in obtaining technology with respect to pesticides and herbicides and equipment for applying these chemicals in precise amounts, selected agricultural machinery (the field especially invites cooperation agreements or joint ventures), and food processing machinery. Environmental control is also an important new sector, because Hungary is faced with serious air and water pollution. Hungary exports machine tools and is interested in obtaining technology for numerically controlled equipment. Computers and integrated circuits and similar high technology items are also of great interest to the Hungarians, but U.S. export control

restrictions put a considerable damper on this trade. Historically, petrochemical industry technology and control equipment, and medical equipment and pharmaceuticals have been good prospects for technology trade with Hungary.

Despite generally more sophisticated foreign trading and negotiating techniques of the Hungarians, a great deal of patience is needed, and long delays should be expected by those wishing to transfer technology to Hungarian enterprises. The Hungarians, like many people, prefer dealing with familiar firms and faces, and a great deal of flexibility and imagination beyond the traditional buying and selling, barter and single-shot commission patterns, is required to maintain a continuing flow of business transactions with Hungary.

### Joint-Venture Law

The substantially liberalized joint-venture law permits majority ownership where the foreign partner is in the servicing and financial fields. It also allows joint-venture companies to enter into production in Hungary. These new laws were promulgated in May 1977, and they represent a lead among other COMECON countries in promoting economic cooperation with Western firms. The changes are quite comprehensive. They should open new possibilities for entering into joint ventures with Hungarian companies, with a resulting market penetration for the Western partner throughout the entire COMECON block.

The traditional Communist system of economic management that was employed in the two postwar decades brought only slow economic growth in Hungary. The half measures introduced during the late 1950s have failed to bring about improved results. In 1966, the New Economic Mechanism was approved as a compromise between the liberal and conservative elements of the Hungarian Communist party. It became effective January 1968.

The essential feature was the decentralization of economic management of the country, in which the managers of enterprises obtained greater scope of decision-making authority in the operation and development of the individual enterprises, while the central government authorities retained the overall economic planning responsibilities. Thus, the traditional planning system of developing a mass of detailed targets for each industrial enterprise was replaced by more general economic guidelines covering all general areas of the economy. This provides the overall framework for the managers of enterprises to make their decisions in accordance with the centrally-established broader policies. Prior to the introduction of the New Economic Mechanism, the operation and investments of the individual enterprises were generally financed through the state budget.

In contrast, under the New Economic Mechanism the individual enterprises were expected to be financially independent after an initial grant of state funds and some transitional subsidies. Under the New Economic Mechanism the plan was considered to be compulsory only viewed in its entirety as an overall direction and guideline for the individual economic unit. This is in marked contrast to the exaggerated planning system prior to the New Economic

Mechanism, where the plan was "broken down" not only to each individual enterprise but to each production unit within each division.

Of course, this kind of more generalized long-range planning led to considerable resistance by the established powers who had a vested interest in the retention of the more conservative, doctrinaire variety of Communist planning, such as by the National Planning Office. This office functions as a commission of ministerial rank. Enforcement and implementation of plans is diffused among a number of other ministries and other agencies such as the National Material and Price Control Office. This resistance, coupled with some economic reverses led to a greater re-centralization of the planning functions in 1972, and enhancement of the authority of the National Planning Office and the establishment of the State Planning Commission as an organ of the Council of Minister to coordinate the planning work of the various government agencies involved.

The 1968 price reform which became effective at the time of the New Economic Mechanism provided to production enterprises very substantial increases to eliminate the earlier state funded subsidies and to enable the internal creation of investment funds and profits.

On the other hand, retail prices were left virtually unchanged to avoid any social unrest. Wage increases were not planned to take place until 1975. Thus, the increased disparity between the production and retail prices was absorbed by the state budget through price subsidies to the trading network and to those producers who sold directly to the public. The strain became gradually too much and certain consumer prices were revised upwardly in 1973.

Eventually, the trading enterprises started to pass on the increased producers' prices to the consumers. This led to yet greater subsidies to try to stabilize retail prices. The announced aims of the New Economic Mechanism to bring end-user prices gradually more closely in line with production costs, never fully materialized. Particularly the retail prices of consumer staples were mostly entirely unrelated to the production and collection prices paid to the producers. As the strain on the economy was increasing, price increases were put into effect which were attempted, again by subsidies, to be kept at a lower level for staple food items than in the case of other consumer goods.

To minimize public discontent selective wage increases were allowed in certain industries and there began the steepened climb of the socialist version of the inflationary spiral. Additionally, problems arose under the new pricing system for those enterprises which bought materials at free prices and had to sell output at fixed prices. These enterprises have become unprofitable and had to be heavily subsidized. Due to the lack of profits their means of raising wages were seriously curtailed. The resulting wage disparity among workers in different branches of industry and between different companies also has contributed to social tensions.

The wage reforms introduced in 1968 were intended primarily to contain the purchasing power of the population within planned limits. The profit-sharing

fund was controlled by a progressive rate of taxation on payrolls and on profit-sharing funds. Penalties were imposed on exceeding the average wage limit and this led to some trickery by managers of enterprises which needed relatively highly paid technicians or wanted to maintain or establish higher levels of managerial compensation. These enterprises hired larger numbers of unneeded, unskilled workers at below-average wages to maintain the prescribed level of average wage limit thus swelling the ranks of workers and perpetuating low productivity and intensifying the labor shortage in other enterprises.

### Prevent Incentive

Contradictory policy aims and the egalitarian attitude of some officials and of a large segment of blue-collar workers prevented the generally desirable incentive of adequate wage differentiation. It was believed that a substantial disparity of incomes is incompatible with a socialist society. Thus, an attempt toward resumption of wage differentiation under the New Economic Policy has also exacerbated social tensions and created political problems. Resentment also was created by the much more rapid growth of managers' incomes compared to workers' wages. This brought about an apparent retreat from the profit-linked wage system in several industries and was replaced by the discredited former method of regulating the wage fund from which the total amount of wages of the enterprise are paid out. Then the new national wage schedule with uniform rates of pay was announced for similar work in all industrial enterprises and for equal levels of qualification and achievement.

Having very few national resources and a limited domestic market make Hungary heavily dependent on foreign trade. Due to insufficient investment there was a slow progress in developing the production of export goods that could compete in world markets with regard to quality and price.

The country's foreign trade suffers from a lack of flexibility because much of its trade volume is tied up by long-term bilateral trade agreements with other COMECON countries, mostly in the nature of barter trade. A great many economic regulators are employed by the Ministry of Foreign Trade. They are mostly in the area of foreign exchange multipliers and subsidies, taxes, rebates, remissions, reserve funds, tariffs, quotas, trade licensing, and credit administration.

The foreign trade balance of the Hungarian economy has been rather poor in trading with the West, and recently trade with other COMECON countries has taken a turn for the worse. The lack of most-favored-nations customs treatment by the United States is a continuing serious blow to Hungary's hopes for better foreign trade relations with the United States.

In early 1973 criticism from the conservative side of the Communist political spectrum resulted in a re-examination of the New Economic Mechanism. The public line concluded that the reform principles had proved sound but changes of regulations were needed to make the reform more effective. In the politically sensitive situation better measures were required to deal with the strong inflationary pressures brought about by excessive investment and an unplanned rise

in consumption. This required restraint in the rising wages and incomes and an increase of consumer prices to reduce the drain on the state budget through price subsidies. This resulted in a gradual, unannounced retreat from the reform policies.

### Raw Material

Hungary has precious few raw materials and is dependent mostly on the Soviet Union for raw material requirements. A major aspect of Hungarian inventive activity is geared toward economies in the requirements for raw materials and improving waste material utilization. The planning process of the New Economic Mechanism movement in the late 1960s was based on the availability of low-cost raw materials from the Soviet Union. This large supplier, however, started to increase its sales of raw materials to the West for hard currency and had to find all it could sell to satisfy Western demand and its own needs to find hard currencies to cover its huge imports, including the import of grains. Therefore, a few years ago the Soviet Union began to limit raw material shipments to Hungary and also started radically to increase the price in stages to reach in 1978 the prices prevailing on the world markets. This was a catastrophic shock to the Hungarian economy and has upset all of its long-term plans. This has also markedly contributed to the re-evaluation and retreat from more liberal economic policies, as mentioned above.

270 Scarce hard currency resources have to be spent more wisely, especially in view of the fact that Hungary, as most (but not all) of the other CMEA countries has overextended itself on hard-currency loans from the West. Therefore, nonessential imports were rationalized to the extent that in the first quarter of 1976 hard-currency imports declined 34% from the level of the first quarter of 1975. There is, in fact, a planned decrease in the living standards and official calls for austerity. For example, during the stay of our delegation in the summer of 1976 meat prices were nearly doubled. This was only slightly modified by a general monthly salary raise in the amount of the price of one kilogram of meat.

The purchase of licenses from the West might not immediately feel the effect of this scarcity of hard currencies, because of the economic practices. Nevertheless, in a number of CMEA countries the planned rates of increase of the economy are at lower levels than those planned two decades ago. Western sellers are getting harder terms and banks are more reluctant to finance sales to the overextended COMECON countries. Licensors who are willing to be paid in compensatory trade or in hard cash should do much better than their less flexible competitors.

As indicated in our printed report, the most significant organization that is involved in the procedure of giving advance approval for licensing negotiations is the Ministry of Foreign Trade. This Ministry published guidelines in the March 4, 1970, issue of its official periodical with regard to the type of information that it requires with the application for approval. A full translation of these guidelines is in the appendix of our report, because it is considered to be of potential major use to a Western prospective licensor. This is,

because, in presenting the information about the technology to be licensed and its economic effects, the Western prospective licensor can already be of major assistance to the Hungarian prospective licensee in organizing the initial presentations along the same lines as is required by the Ministry of Foreign Trade for pre-negotiation approval.

Our Hungarian informants were quite emphatic that the only official approvals that are required are obtained by the prospective Hungarian licensee prior to negotiations and, once these are obtained, then no further approvals are required and the prospective licensor is also assured about the availability of funds. If the negotiations progress toward a higher compensation level than the approved ceiling in the pre-negotiation approvals, a hiatus in the negotiations may be a tipoff that the prospective Hungarian licensee had to go back for approvals raising the previously approved ceiling. The prospective foreign licensor may then be well advised diplomatically to try to assist the prospective Hungarian licensee by providing arguments that would assist the presentation of the supplemental presentation of the Hungarian party to the ministry. Thus, part of the prospective licensor's initial pre-negotiation selling job is to help the Hungarian prospective licensee to do a selling job on the Ministry of Foreign Trade and on any other organizations on whom the Ministry may call for consultation.

### Guidelines Apply

The pre-negotiation approval is prescribed in Decree 14/1961 of the Ministry of Foreign Trade (published in No. 12 of 1961 of the Ministry's periodical *Kulkereskedelmi Ertesito*), 2, Section (1). The 1970 guidelines provide for the submission of information required by the Ministry. The original law and the form that was prescribed are no longer in effect, but the guidelines reproduced in the appendix to our report still apply.

Although it is claimed that the only approval for license agreements is the pre-negotiation approval, when the agreement is to be put into effect an import license will also be required. We were told that this was never denied once the import license is required in connection with a license agreement in which a pre-negotiation approval was already obtained, because the import license merely serves to facilitate allocation of foreign currency reserves. The import license is then usually granted within a month. A Western negotiating party would be well advised to offer to cooperate with the Hungarian party in preparing the documentation required for the pre-negotiation approval and then insist on seeing the pre-negotiation approval once it issued.

Of course, if the approval contains price ceilings when the price has not been negotiated as yet, or information about competitive bids, then the Western party should merely request an excerpted translation of those parts of the approval which can be disclosed by the Hungarian party without competitive disadvantage. We were told that in 85-90% of the cases the application for approval and recommendations of the end user are accepted by the Ministry of Foreign Trade. The Ministry claims to interfere only if the proposed license does not fit the macroeconomy of the country or the microeconomy of the company.

Quality control of products is not only permitted but is welcome, because they view it as a form of technical assistance.

Indexing of payment terms to provide for inflation is negotiable.

In the printed report we discussed at some length the first U.S.-Hungarian joint venture called Radelcor. Special concessions in taxation and otherwise can be obtained when the formation of a joint venture is imminent. The flexibility of the Ministry of Finance is illustrated by the fact that the founding document of the Radelcor joint venture with Corning Glass Works from the U.S.A. shows the results of negotiating an exemption from dividend taxation for the duration of the joint venture.

In view of the two-tier forint-hard currency conversion rate (commercial and noncommercial) the Western party should attempt to negotiate for the currency conversion designation which is most favorable to him. The most favorable rate structure for a foreign investor would be using the commercial rate (currently \$1 is about Ft.41.30) for conversion of the Western partner's capital contribution to a Hungarian joint venture, and the noncommercial rate (currently \$1 is about 20.65) for conversion of the repatriated profits.

This kind of two-tier rate structure would seem to be too difficult to accomplish since it may be deemed by the Hungarian party to be an unreasonable demand. Therefore, if there is a capital contribution in the form of money, machinery or technical information by the Western partner, and also the joint-venture exports to the West should be valued in hard currency and the latter should never be converted to forints. Thus, choice of the more favorable commercial rate could be used to evaluate in forints the capital contribution of the Western partner, while there will be no need for conversion in the accounting of the hard-currency profits. Of course, if repatriation of forint profits converted to hard currency would be a concern, then these other considerations would also have to be taken into account when selecting a conversion rate.

Hungarian patent applications are frequently characterized by the large number of inventors named. This is because one of the few ways left to become really rich in Hungarian terms (other than being a physician or a small private entrepreneur) is to become an inventor or coinventor of a successfully utilized invention. This is rarely abused by engineering and research supervisors and some patent agents who force their way in as coinventors. On the whole, however, the Hungarian patent system enjoys great popularity.