

IMPORT DECISION PROCESSES IN CENTRALLY PLANNED ECONOMIES:
THE CASE OF AGRICULTURAL IMPORTS IN
POLAND, EAST GERMANY, CZECHOSLOVAKIA, AND HUNGARY

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Trade problems, organization and policies as practiced by the centrally planned economies of Eastern Europe have attracted considerable attention by Western economists (1,2, 3, 4, 5, 6, 8, 9). The Eastern European economies are a particularly interesting subset of the centrally planned economies when investigating trade behavior because, given their relatively small market size and limited endowments of raw material inputs, they are of necessity very trade dependent. Indeed the intensity of trade problems confronting these countries has motivated them to be innovative in trying to fashion an unwieldy state monopoly trade model inherited from the Soviets into something more flexible and capable of meeting the individual needs of each country.

Recognizing that each Eastern European country has modified the Soviet model in varying degrees, this paper is nevertheless setting out to develop a stereotype trade model which is based in part on the author's knowledge of grain and oilseed trade experiences of Poland, the German Democratic Republic, Czechoslovakia, and Hungary. The insulation of domestic prices from world prices and the hard currency shortage issues

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will be addressed from the perspective of their implication for predicting commodity import behavior in these countries. Before these topics are treated an overview of agricultural import organization procedures and issues is presented to portray the environment in which trade decisions are undertaken in the selected group of countries. This brief summary is undertaken so as to provide background to the reader for purposes of interpreting the analytical section that follows later.

Foreign Trade Institutions and Procedure

Generally in the nonmarket economies fashioned after the Soviet model, foreign exporters deal most directly with the Foreign Trade Organization (FTO) which for all intents and purposes is the operational entity in the State trading monopoly. However, it is inadequate to focus on the operations of these agencies in isolation when trying to delineate how decisions are arrived at regarding the composition, quantities, and sources of imports. Decisions of FTO's are influenced in varying degrees of detail by higher supervisory and planning organs in the planning apparatus and/or by ancillary agencies charged with related functions. Other important foreign trade institutions to be considered include the Ministry of Foreign Trade, the Foreign Trade Bank which is under the supervision of the Ministry of Finance, and the appropriate industrial ministry (in this paper this would usually be the Ministry of Agriculture except in Poland where the Ministry of Food Industry and Purchasing is also involved). Indirectly and sometimes directly, critical decisions on importing questions are made in the Central Planning organ (the State Planning Commission in

Poland, Czechoslovakia, and GDR; the National Planning Board in Hungary) and/or the Council of Ministers, or even in the central committee or national assembly where very broad priorities are often established (for example, to stress improving the diets of the populous by increasing livestock production over the course of a five year plan). An organizational chart presenting this general model is shown in figure 1. Specific agency names and foreign trade organization descriptions for each of the countries included in this paper are shown in Appendix A.

Since FTO's are the operational branch of foreign trade activities this is a logical point from which to focus the delineation of decision processes. In negotiating trade deals with foreign exporters price, quality, delivery, and credit terms are evaluated according to commercial principles by the FTO much as private companies buying products in the West do. An example of a standard contract used by Koospol is shown in Appendix B. The FTO serves as an intermediary between the seller and the domestic end using buyer. It receives purchase orders from end using enterprises. However, it is important to remember that to a lesser or greater extent, depending on the country in question, the FTO's operations are circumscribed by the national economic one-year and five-year plans. The FTO is like a private firm only in the sense that they conclude trade deals by negotiating and carrying out purchases, payments arrangements, and delivery terms. They are independent legal entities with the right to assume contractual obligations (which the State is not liable for). However, it is important to recognize that these bodies are still only instruments in a State foreign trade monopoly and their decisions and operating authority is delegated to them via the Foreign Trade Ministry

or other government ministries. The ultimate operational constraint on the FTO's buying ability is the amount of hard currency appropriated to it from the State Planning Commission via the Foreign Trade Bank. The operational significance along with the economic implications of this fact that the FTO receives a hard currency allocation will be a focal part in the analytical model discussed later in the paper.

To treat how foreign trade planning is implemented would require a detailed treatise exceeding the scope of this exposition. It is important to highlight two additional points, however. The planning process is not a one-way verticle procedure with higher planning organs handing directives down the chain of command from the State Planning Commission to the Ministry of Foreign Trade, Foreign Trade Organization and ultimate production agencies and enterprise, regarding how much or what to import from which source. Rather, several rounds are made in formulating the foreign trade plan with lower organs having inputs in terms of registering needs and making checks of the consistency of foreign trade plans. Secondly, many decisions regarding imports are made that deviate from the guidelines of the plans. Foreign Trade Organizations, appropriate industrial ministries, and end-using enterprises sometimes have the authority to order imports at their own discretion in cases where they have earned foreign exchange by means other than, or above, planned exports and foreign exchange allotments, although this is not the case for major agricultural imports such as grains and oil-seeds. Moreover, the plan is flexible enough to allow for added imports when unforeseen circumstances such as crop shortfalls necessitate imports to meet certain priority needs.

Role of Price in Import Decisions

Empirical evidence regarding the degree of import decision responsiveness to world price movements is limited. Previous studies pertaining to selected Eastern European countries' demand for soybean meal and feed grains suggest little evidence that imports are highly responsive to price variations, although in certain instances price does show a significant negative relationship of limited magnitude (5,7). Results discussed later in this paper also fail to demonstrate such evidence although it will be argued that this may be due partially to problems of measuring such responses since it can be argued that hard currency shortages ultimately require price sensitivity. Also the hard currency constraint has apparently had a modified impact to date on agricultural imports because the authorities have borrowed in international credit markets and reallocated foreign exchange reserves to these commodities at the expense of other sectors.

World price considerations may play an active role in import decisions in two respects. Within the range of given foreign exchange allocations to the relevant import decision making unit, import price variations directly influence the physical amounts that can be imported. Secondly, interviews with trade officials and industry personnel reveal that selection of the source of imports hinges upon which prospective seller offers the most favorable price, other things equal. This latter form of price response is again motivated by the importing agency seeking to achieve maximum mileage given a fixed hard currency allocation. However, the decisions by ultimate end users will show minimal response to variations in world prices. Domestic prices continue to be insulated from world prices. Hungary is

usually cited as the centrally planned economy that most closely links its domestic economy to world price movements. Yet in practice the price that end-users pay still bears little relationship to world prices. For example, for compound feeds and ingredients the price is set officially in a manner that washes out the effect of world price movements of feed ingredients during a given year. This is the result of the state reimbursing the user the difference if the import price including transportation charges to the Hungarian border exceeds the official price, while if the import price is below the official price the user reimburses the difference to the state.

Foreign Payments Considerations

Recurring balance of payments deficits have incessantly plagued the nonmarket economies, but in recent years shortages of hard currencies have assumed critical importance in Poland in particular, and to a lesser extent the other countries discussed in this paper have also had to direct major attention to the problem. Over full-employment growth policies, plus an inability to produce goods of a quality that attract foreign buyers, have historically created balance of payment pressures in all the communist countries. Increasing demand by the populace in the nonmarket economies for improved diets and more and better consumer goods produced in the West, plus a need to rely upon imports of Western equipment and technology to bolster economic development objectives, have resulted in rising import requirements. In the case of foodstuffs, and meats in particular, demand pressures due to rising incomes have been exacerbated by prices of these products being maintained at artificially low prices through the mechanism of state subsidies. Shortfalls in agricultural production due to adverse natural causes, development programs that have failed to yield expected

results, and rising energy import costs have compounded the pressures for imports.

While Centrally Planned Economies are not necessarily uniquely exposed to the problems enumerated here, they do invariably share a common dilemma. A characteristic of the communist countries' foreign trade is that, without exception, their currencies are inconvertible in international transactions. In the environment of world markets, this means that the nonmarket economies' currencies are legally and operationally unacceptable for purposes of transfer for other nation's currencies. That is to say, the communist countries' currencies are not accepted in international trade transactions. Furthermore, official exchange rates expressing their currencies in terms of hard currencies cannot be construed as meaningful price relationships.

Inconvertibility is both a product and a cause of extreme balance of payments pressures. The inconvertible status of the nonmarket countries' international financial position has important implications in that it hinders trade with foreign partners, and creates pressures for bilateral as opposed to multilateral trade and payments arrangements. Bilateral trade and payments arrangements consequently play an important role in nonmarket economy trade activities. Faced with inconvertibility and payments pressures, a country is prone to seek trade with other countries with similar circumstances. Consequently, intergovernmental trade agreements, often based on barter type arrangements, are common between the nonmarket economies and less developed countries.²

^{2/} Another consideration is that central planning authorities are partial to bilateral trade agreements since they usually are long term arrangements that reduce economic uncertainty which would otherwise complicate economic planning (see Franklyn D. Holzman, International Trade Under Communism, New York: Basic Books Incorporated, 1976, p.25).

For example Hungary has bilateral accords with Brazil and Peru providing for an exchange of engineering industry equipment, vehicles, machinery, and other items for fishmeal, coffee and other goods. Poland has a 5 year understanding with Brazil to annually receive 500,000 tons of soybeans, and 300,000 tons of soybean meal. Poland and Brazil have also concluded a general agreement involving Brazilian textiles and Polish chemicals, worth \$350 million over three years and another deal valued at \$2.5 billion between 1978 and 1990 with Brazil shipping ore in exchange for Polish metalurgical coal. Agreements with India in the past have involved India exchanging peanut meal for fertilizer.

The fact that inconvertibility and a lack of hard currency leads to bilateralism has implications for the import capacity of the countries in question. Bilateral arrangements are viewed as allowing more trade than would otherwise occur given inconvertibility, but the level of trade can seldom reach as high a level nor claim all the economic rewards of international specialization that could be reaped in an environment of convertible exchange and multilateral transactions. Poland, East Germany, Czechoslovakia and Hungary recognize this. Reforms were instituted in the sixties and early seventies to modify their internal pricing mechanisms so as to reduce or eliminate the insulation of their domestic price movements, which is a necessary precondition of convertibility. These reforms have met with little success to date, however, and the evidence is not encouraging that they will in the foreseeable future (2). Experience has shown it to be extremely difficult to effectively establish decentralized market planning and national pricing schemes which are the conditions necessary if they are ever to rid themselves of inconvertibility.

Bilateral arrangements involving individual firms agreeing to take

part payment in kind rather than receiving hard currency payment are becoming increasingly important also.³ Barter transactions at this level are not extremely common in the literal sense of only two trading parties being involved in an exchange of merchandise for merchandise with no money being involved. If more than two parties are involved switch transactions are on occasion arranged with the seller taking payment in the form of merchandise that is disposed of through a third party frequently referred to as a specialist switch dealer. Both of these forms of trade arrangements are relatively insignificant but a variety of arrangements referred to as countertrade deals have become especially prevalent in transactions with the Eastern European countries.

Countertrade transactions occur in several forms including counterpurchase deals, and product buy-back or compensation deals. Counterpurchase is the most prominent form of countertrade arrangement. In this case the Western exporter agrees to buy or import products equivalent to some percentage of his sales. Two separate (but linked) contracts are usually signed. The Western supplier usually receives full cash payment but he agrees to buy products from the Eastern firm in a separate but linked contract. Counterpurchase deals usually allow the Western exporter time (usually one year) to select and purchase the specified goods in return. The compensation or buy-back arrangement entails the Western firm providing plant and/or equipment and technology with the agreement that payment or partial payment will be received by the exporter taking part of the resultant output in return.

^{3/}A more detailed description of this variety of arrangements is included in a forthcoming U.S.D.A. publication by Steven C. Schmidt, James R. Jones, Dennis C. Conley, and Arvin A. Bunker.

Trade Hindering Factors

The reasons behind the communist nations' inability to export sufficient amounts to finance their growing import needs can be traced in some measure to their own foreign trade institutions and behavior. Export producing enterprises in the past have lacked incentive to produce for export, or to meet the special requirements of foreign buyers, because they responded to quantitative targets that were usually not differentiated among buyers. Furthermore, the profits of individual enterprises have not been dependent upon exports. Given a policy of taut over-full employment planning, where the enterprises may be able to sell all they produce anyway, the incentive to find export market outlets is lacking. The ingenuity of the enterprise managers has been focused upon attaining inputs, not acquiring access to new markets overseas. To the extent that exported goods require special attention, they make it more difficult for the enterprises to satisfy their assigned targets. Where this applies there is actually a negative incentive to produce for export. Also, there has been little direct communication between producing enterprises and overseas buyers since state trading agencies assume this role. These problems, along with numerous others, have undoubtedly contributed to an unfavorable reputation for the Eastern European economies' manufactured goods in Western markets.

There is hope that some of the difficulties noted above will be at least partially corrected in time. Concerned authorities are giving increased recognition to the problem. If reforms do not correct the problem of low quality production of export goods, the ability of the Eastern European centrally planned economies to generate hard currency through exports will

continue to suffer. This in turn will hinder their ability to procure imports from the West.

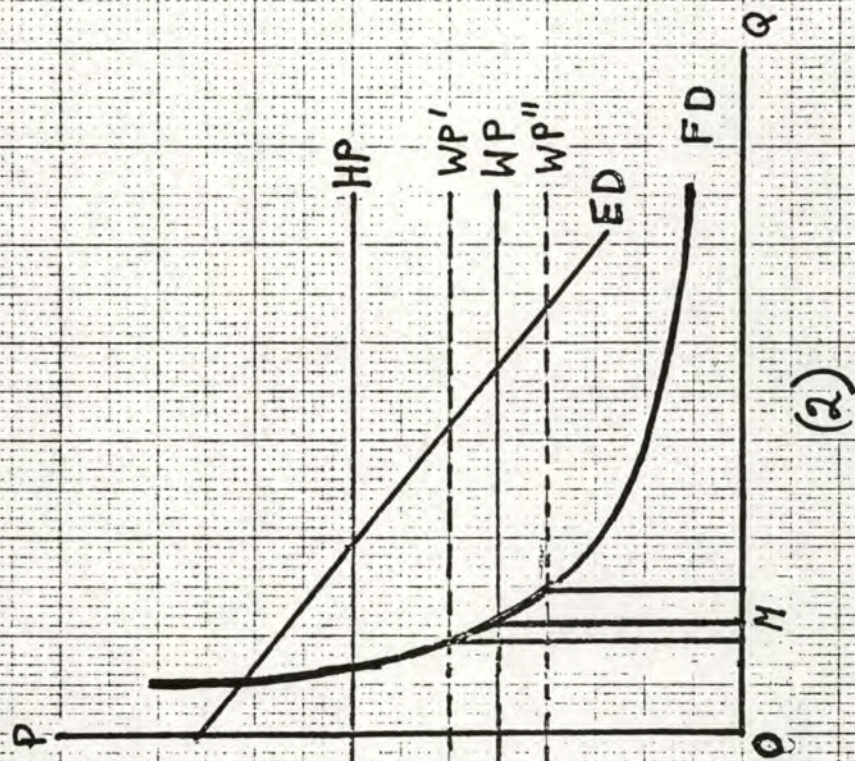
The reputation for poor product quality is by no means the only deterrent to penetration of hard currency markets. The legacy of East/West political differences will undoubtedly continue to impair trade relations. Also denial of most favored nation (MFN) treatment to the German Democratic Republic and Czechoslovakia still remains as an obstacle (Poland, and more recently Hungary have been granted this status).

A number of considerations have been cited as influencing the import decision process in the centrally planned economies discussed in this paper. The number and complexity of factors that enter into import decisions are such that this paper cannot claim to have surveyed them all. Certainly only the surface has been touched in terms of analyzing the implications of these considerations. With this summary as background the paper will now turn to a suggested theoretical formulation of import behavior.

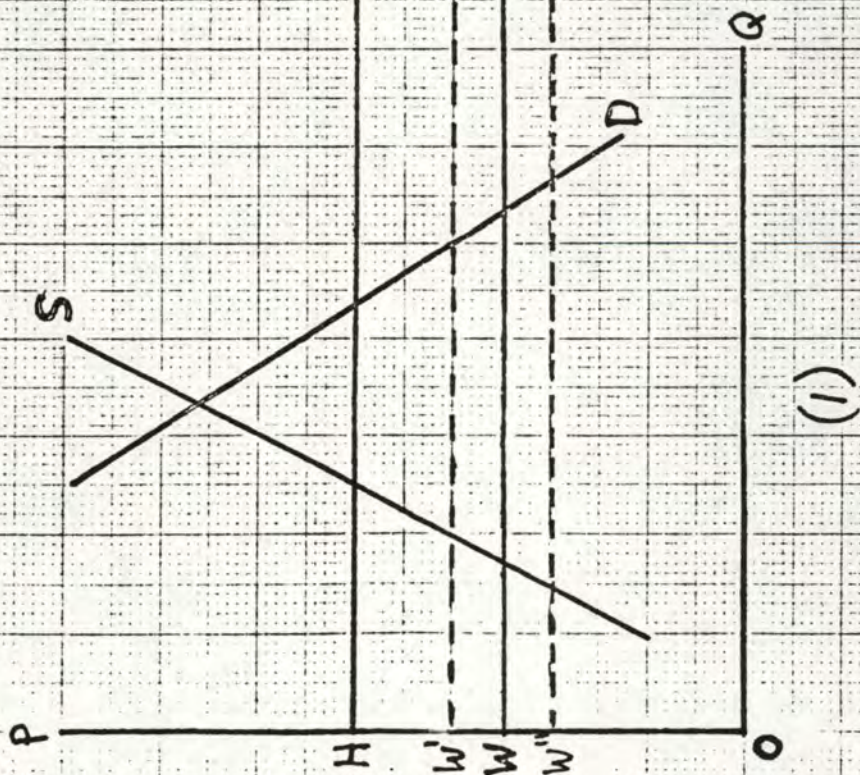
A Theoretical Construction of Import Demand Behavior in a
Centrally Planned Economy Under Conditions of
Foreign Exchange Shortages and Inconvertibility

Figure 1 illustrates visually the implications of world price movements for economic decision makers in a centrally planned economy that has insulated its domestic price structure from world market forces and is rationing limited foreign exchange. The curve ED in quadrant 2 represents what is ordinarily construed to represent the import demand curve derived from the horizontal distance between domestic supply and demand functions in quadrant 1. This curve demonstrates quantities of imports that end users

Figure 2



(2)



(1)

would desire at alternative price levels. In this example end users will arbitrarily be thought of as feed milling and compounding agencies or enterprises as the case may be, although the thought could be extended to livestock producers or even ultimate consumers of meat products, etc. The vertical axes of both quadrants are scaled the same and represent conceptually the official hard currency equivalent of the domestic price.⁴ In this model the curve FD is a rectangular hyperbola which serves a dual purpose of depicting a given hard currency allocation provided to a foreign trade organization and the effective import demand for the country assuming all of the currency appropriation is expended. Henceforth this relation will be referred to as the "currency demand constraint." The foreign currency allocation is assumed to be exogenously determined by a higher level organ such as the ministry of finance or the foreign trade bank.⁵ Initially two price levels are depicted. The CIF world price of the commodity is shown as OW and, by invoking the small country assumption, this can also be viewed as the supply of exports. The other price of interest is OH which is assumed to be the price that is paid by domestic users of the commodity (inland transportation costs, foreign trade organization commission charges, storage, and other marketing charges are ignored for the sake of simplicity).

^{4/} It is important to keep in mind that this official exchange ratio does not necessarily reflect true relative values of foreign currencies and the home currency with the problem of inconvertibility.

^{5/} In the case of high priority commodities authority to make this allocation may even lie in the hands of the state planning commission or the council of ministers in which case the allocation is still exogenous to the model. Cases exist where end using enterprises may use their own hard currency earnings to import, but no example of this is known to apply to grain and oilseed imports and this possibility is ignored in this analysis.

A notable characteristic of the model is that effective import demand is a function directly of the hard currency allocation rather than the difference between domestic supply and demand at a given price any time this allocation is constrained to an amount that lies to the left of the curve ED. In such a case the latter is a pseudo demand curve in that, given official exchange rates and domestic income, end users would be willing to buy alternative quantities of imports lying along the function, but actual imports are constrained to the state monopoly buyer's level of available hard currency appropriations. It is an argument of this paper that this distinction is integral to explaining import behavior in a centrally planned economy.⁶ The model implicitly treats imports as a function of world prices, hard currency availability, and if authorities elect to permit their force to be felt, domestic demand and supply shifters.

Given the world price WP and the hard currency allotment FD imports would be OM. It is sometimes argued that because the foreign price is divorced from domestic price, movements in world prices will not involve variations in import levels. Investigation of the model reveals that this is not the case when conditions are typical of the situation shown where the "hard currency constraint" will not allow purchases to be acquired in that amount. Upward movements to OW "force curtailment of imports and downward movements (i.e.) to OW" permit expansion of imports even though the domestic price paid by end users (OH) is perhaps the same as before.

This rather straightforward model can also be used to explicitly

^{6/}Or any economy in which currency inconvertibility is dealt with by allocating quotas of foreign exchange to specified buyers or sectors.

illustrate how changes in hard currency availability, domestic supplies, or domestic demands impact the quantity of imports. Finally from a methodological viewpoint it will be noted that direct estimation of an import function is more likely to reveal the true import demand relation than if imports are derived indirectly from estimated domestic demand and supply functions since actual imports are directly a function of hard currency allocations rather than a simple residual making up any differences in domestic demands and supplies.⁷

Econometric Import Demand Results

This section of the paper summarizes some of the preliminary results of an econometric analysis of the grain and oilseed import demand functions of the selected countries. Unfortunately problems associated with data availability and the usual econometric hurdles created by multicollinearity, etc., along with the simplifying assumptions built into the economic model, yielded very tenuous results. The results provide only very limited insight into the principle structural relationships that underlie import processes and even these must be viewed with extreme care and skepticism. Nevertheless it is felt that some suggestions may be warranted on the basis of the results. Moreover, it is hoped that the hindsight provided by the findings will be helpful in suggesting improvements that can be made in future modeling efforts.

The original aim of conducting the econometric portion of our study

^{7/}The author hopes to pursue these variations more fully in future work.

Table One: Summary of Two Stage Least Squares Import Demand Estimates^{a/}

Dependent Variable (Imports)	Intercept	World Price Ratio	Domestic Supply Availability	Livestock Inventory Index	Net Trade Balance with the West
German Democratic Republic:					
Imports of Corn	-3855.19	-164.28 (-0.44)	-0.161 ^b (-3.45)	243.83 ^b (4.38)	-3.10 (-2.08)
Imports of Soybean Meal	-3469.82 ^b	291.77 (0.56)	-5.83 ^b (-2.11)	17.43 ^b (4.73)	-0.16 (-0.136)
Poland:					
Imports of Corn	-2206.81	1024.90 (2.40)	0.036 (0.85)	5.37 (0.20)	-0.47 (-2.44)
Imports of Soybean Meal	-1178.56 ^b	0.22 (0.00)	-0.36 (-1.17)	2.69 ^b (5.67)	-0.12 (-0.28)
Czechoslovakia:					
Imports of Corn	86.18	144.18 (0.33)	-0.03 (0.16)	20.60 (0.80)	-0.637 (-1.29)
Imports of Soybean Meal	-1425.07 ^b	294.67 (1.34)	0.09 (0.44)	6.80 ^b (2.16)	0.08 (0.21)
Hungary:					
Imports of Corn	n.a.	n.a.	n.a.	n.a.	n.a.
Imports of Soybean Meal	-1071.73 ^b	-149.93 (-0.48)	3.14 (1.68)	1.61 ^b (2.87)	0.08 (0.54)

^aThe top number is the estimated coefficient value and the number underneath is the t ratio accompanying that estimate.

^bResults are both statistically significant and correct with regard to expected signs.

was to estimate import demand equations to facilitate forecasting imports in the selected Eastern European economies. However, only the structural version of the model will be discussed in the context of this paper.

Generally the observation period covered the years 1960 to 1979 for grains and 1960 to 1978 for oilseeds. The full model is not presented for the sake of brevity. Only the specific estimates for corn and soybean meal imports are shown. These two commodities represent the bulk of U.S. agricultural exports to the selected countries. The one exception is Hungary who is a significant soybean meal importer, but in most years is a net exporter of corn.

Estimates of coefficients of variables specified to directly determine imports are presented in Table 1. The two-stage least squares procedure was used for purposes of statistical estimation. The t values are only approximately relevant for this procedure. In addition to world price ratios, domestic supply, livestock inventory, and net trade balances with the West, the model included a per capita product index as a measure of income and a population variable. The effects of these two variables are entered into the import demand equation through their influence upon livestock inventories in a separate equation which is not shown here.

Inspection of the model results at face value suggest that to the extent that they can be taken to be reliable, little compelling evidence is offered to corroborate the authenticity of the model hypothesized above. The price variable is insignificant in all instances implying an inelastic import demand. It is conjectured by the author that part of the hard currency effect may be masked by the peculiar specification of the price variable in the model. The ratio of the price of corn to the price of barley

is used here as the price variable. This is unfortunate since most of the variations that have impacted the expenditure of hard currency in the observation period entailed upward movements in both corn and barley absolute price series.

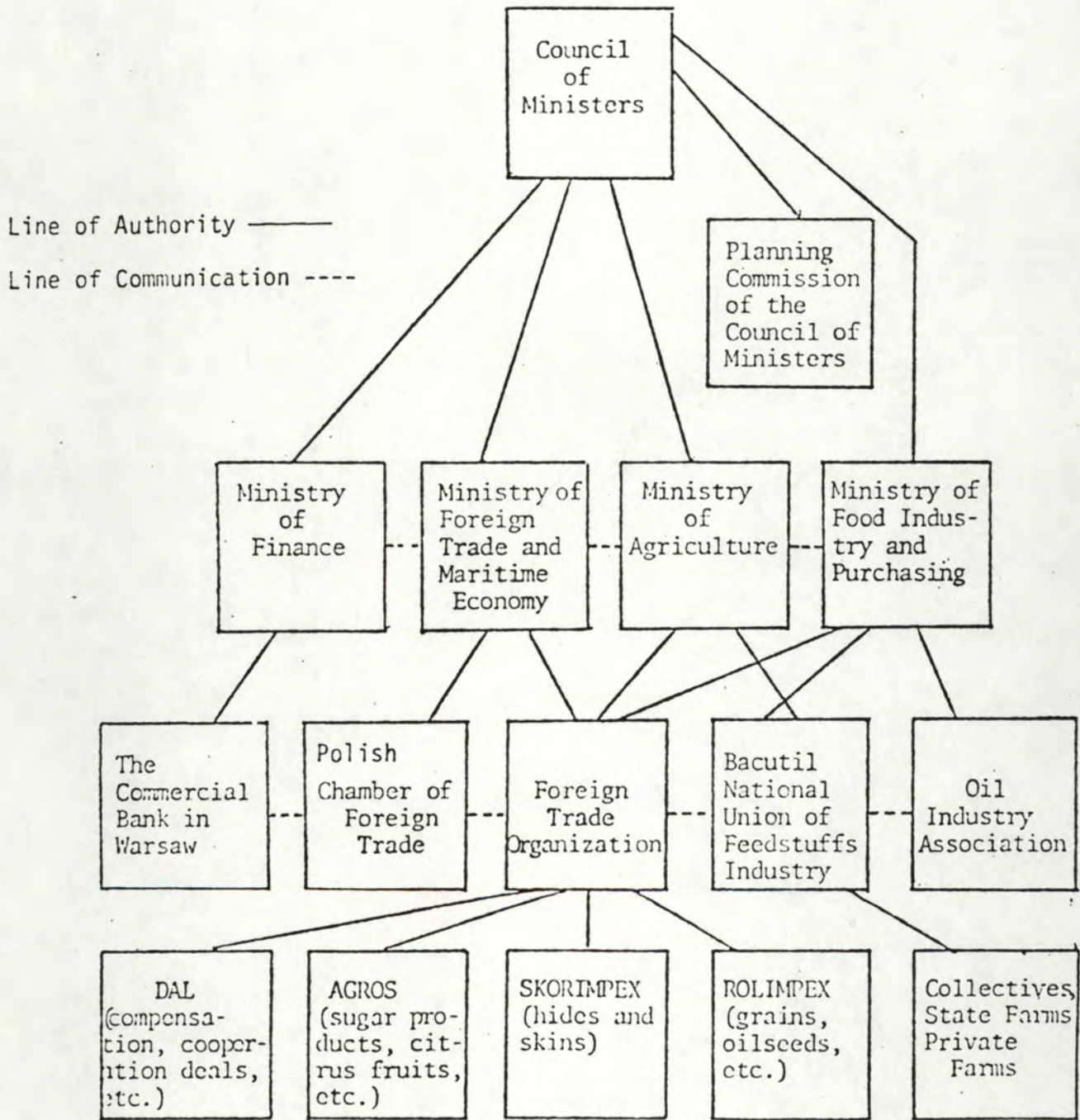
Furthermore, the model as specified did not allow the hard currency effect to be endogenized to account for changes in the hard currency allocation through time. The evidence has been that the authorities in the countries being investigated have by and large allocated additional hard currency for purposes of allowing increased imports of feedgrains and oilseeds to occur. In other words the currency demand constraint function has been consistently shifted to the right during the observation period so that total response of imports to price increases has been muted. The sign reversals associated with the net trade balance variable further suggests that this has been happening. Indeed the livestock inventory variable which is significant reflects the high priority given to building up livestock production. The important question is can this occur indefinitely in the face of continued trade deficits and mounting foreign debt? Unfortunately little is known at this point about how hard currency allocations are determined and interrelated to other political economic considerations in these countries. Hopefully highlighting the hard currency constraint's role in import decisions will in some small way help to stimulate and aid such investigations in future agricultural trade research.

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Appendix A

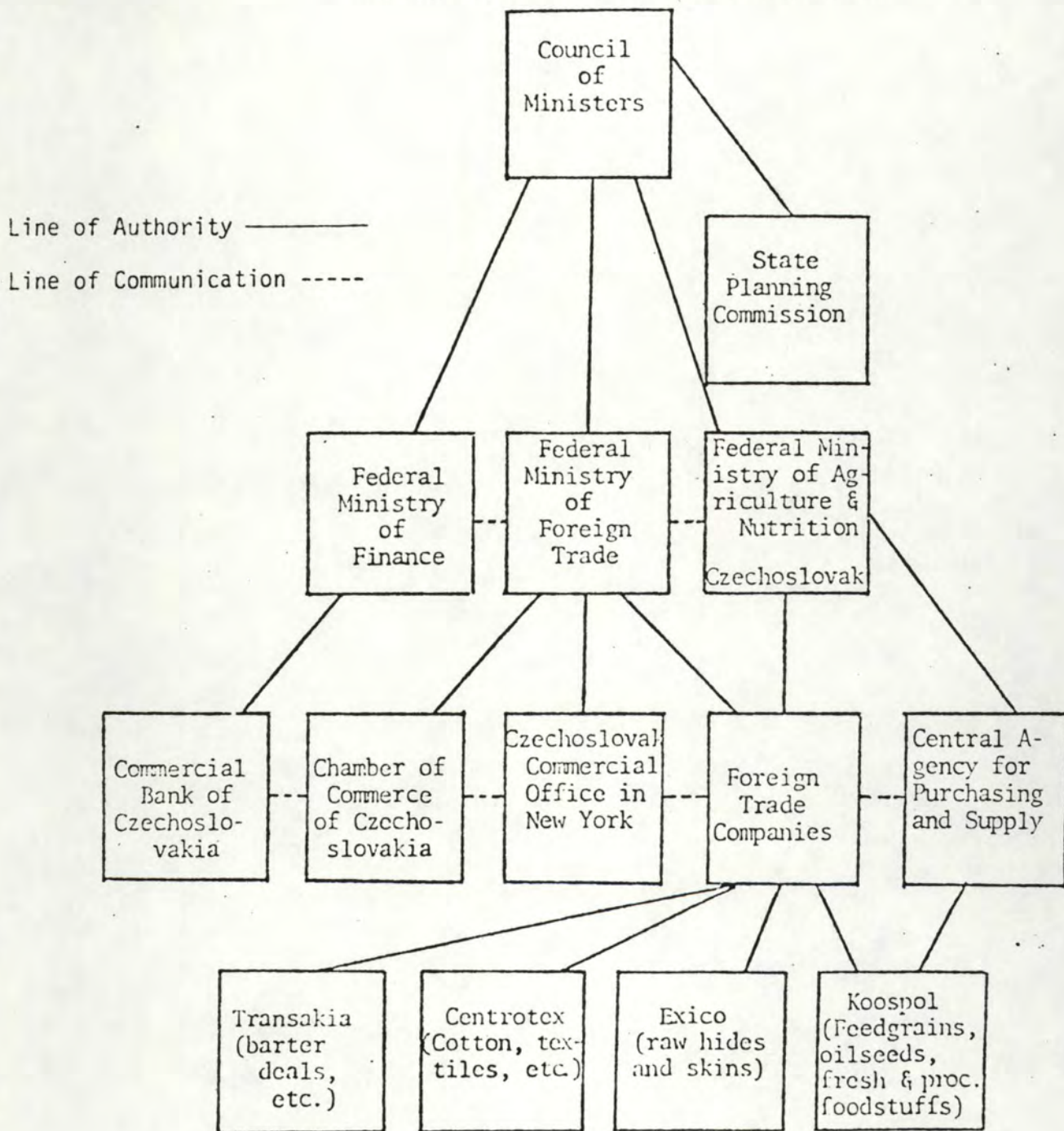
Agricultural Import Structure
in the Polish People's
Republic*



* As it applies to the agricultural import decision.

Source: Compiled from Interviews with Trade and Industry Officials in Poland (September, 1979).

Agricultural Import Structure
in the Czechoslovak Socialist Republic*

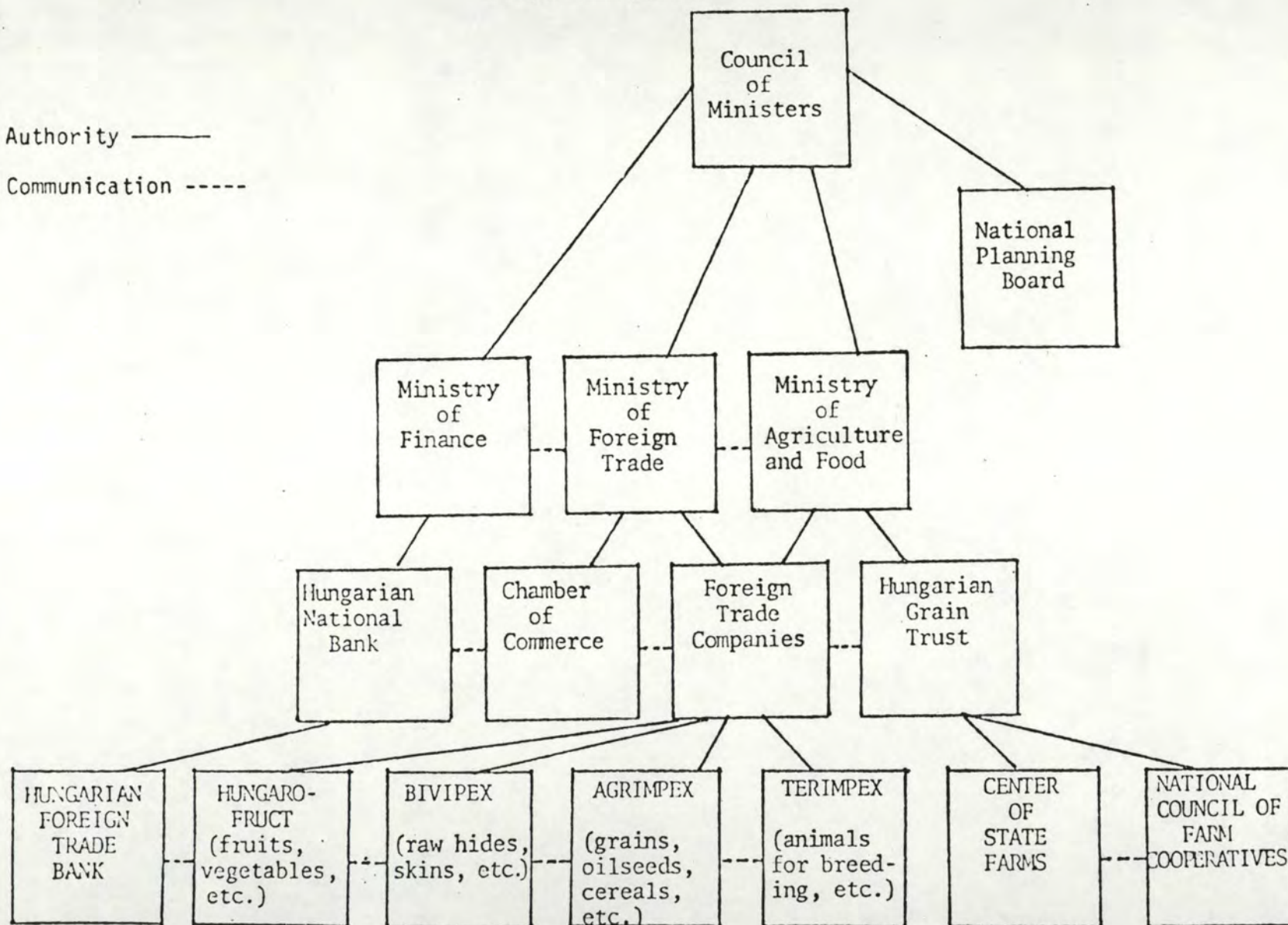


*As applied to agricultural import decisions.

SOURCE: Chamber of Commerce of Czechoslovakia, Your Trade Partners in Czechoslovakia, 1978, plus personal interviews with trade and industry officials. (Sept. 1979)

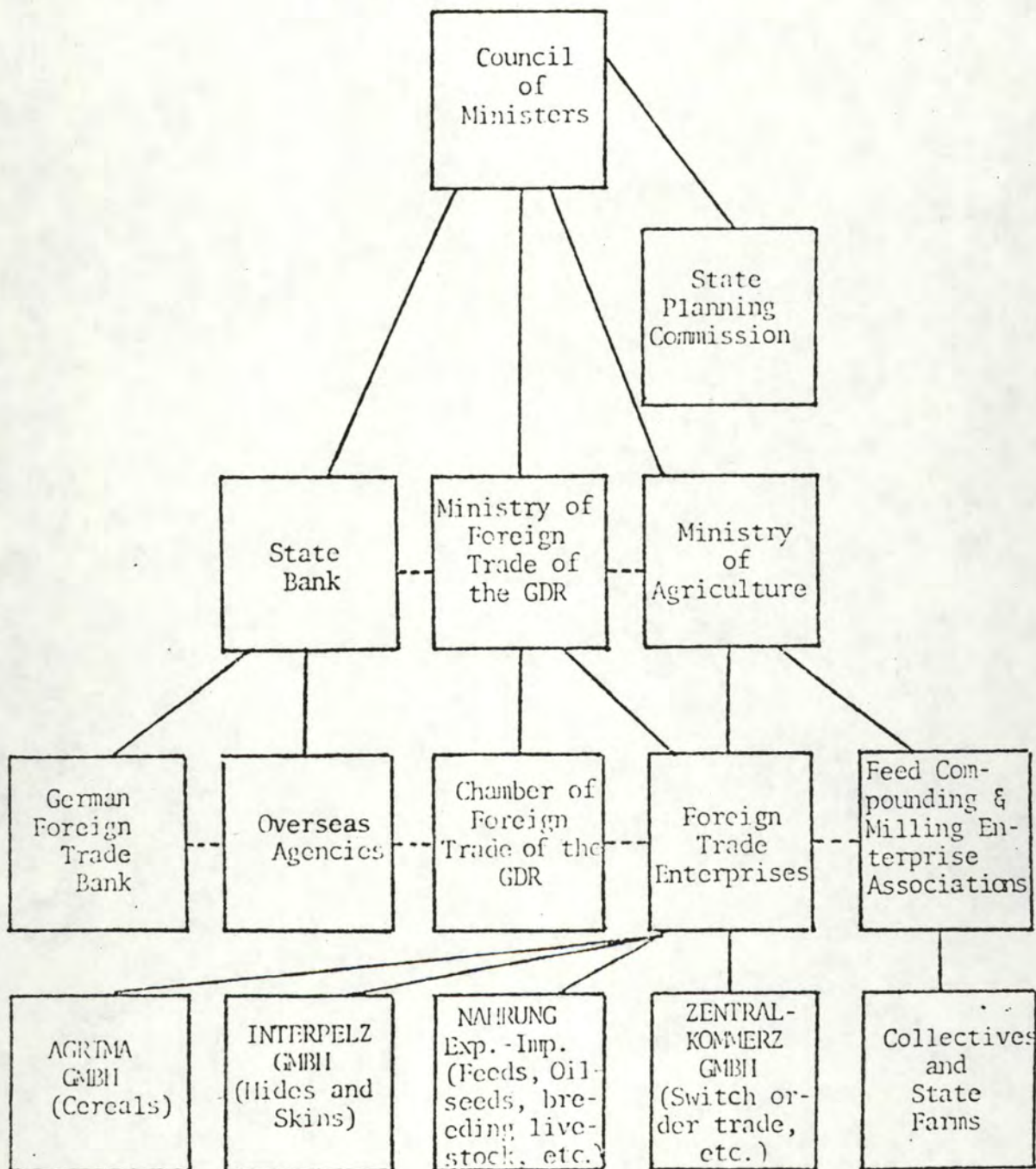
Agricultural Import Structure
In the Hungarian
People's Republic

Line of Authority ———
Line of Communication - - - -



Sources: Hungarian Chamber of Commerce, Directory of Hungarian Foreign Trade Companies, Budapest, 1977; Business Guide Hungary, Budapest, 1977 and personal interviews with government and trade officials, (September, 1977).

Agricultural Import Structure
in the German Democratic Republic*



*As applies to agricultural import decisions.

SOURCES: Chamber of Foreign Trade of the German Democratic Republic, GDR Foreign Trade, 1977 and personal interviews with trade and industry personnel in GDR (September, 1979).

Appendix B

Standard Contract Issued by Koospol Stating Terms
to Be Met by Grain Exporter

Re: General Contractual Conditions on Yellow Corn/Hard Winter

Wheat - Basis C and F

Seller

Buyer : Koospol a.s., Leninova 178, Praha 6

Commodity : No. 3 US Yellow Corn - max. 15% moisture

Quality : Final at loading according to US Grain Inspection certificate, US Phytosanitary Certificate and Veterinary Certificate.

Quantity : metric tons 5% more or less in sellers option at contract price, delivered weight without prorata.

Price : US \$/per metric ton

Delivery period : Delivery in Hamburg from to both dated included.

Parity : C and F Hamburg free out berth Rethe-Speicher. In case vessel will discharge at another berth than Rethe-Speicher seller will reimburse to the buyer US % 2,--/mt.

Packing : In bulk

Payment : at first presentation of documents with Ceskoslovenska obchodni banka a.s., Praha
The documents must be remarked: "Final destination Czechoslovakia".

Documents have to contain:

- 1/ Commercial invoice in 5 copies
- 2/ 2/3 Bill of Lading
- 3/ Copy of registered airmail letter to E. Clemens, Borgfelder Strasse 34, 2000 Hamburg 26 confirming that following documents have been sent to their address: 1/3 B/L, Original Phytosanitary Certificate and Veterinary Certificate.
- 4/ Copy of Charter Party
- 5/ Copy of Phytosanitary Certificate

Appendix B, continued.

- 6/ Certificate of Origin
- 7/ Weight Certificate
- 8/ Inspection Certificate
- 9/ Veterinary Certificate

Discharge : Demurrage/Despatch as per Charter Party. Daily discharge rate 4.000 mt wwdshex

Insurance : to be covered by buyers

Arbitration : At Gafta in London under the arbitration rules No. 125 of which both parties admit to have knowledge.

All other terms and conditions as per Cafta contracts No. 27/30.