INTRA–CMEA ECONOMIC INTEGRATION– PROBLEMS AND PROSPECTS (1975 — 85)

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CERTIFICATE

This is to certify that the dissertation entitled "INTRA-CMEA ECONOMIC INTEGRATION - PROBLEMS AND PROSPECTS (1975-85) submitted by Mr. ASHUTOSH SHARMA in fulfilment of six credits out of the total requirement of 24 credits for the degree of MASTER OF PHILOSOPHY of the University, is his work according to the best of my knowledge and may be placed before the examiner for evaluation.

(R.R. SHARMA)
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ACKNOWLEDGEMENT

A study of the Problems and Prospects of Intra-CMEA Economic Integration, based mostly on the secondary sources of material, is an ambitious task. This itself expresses the limitation of this research work. The study is broad based, but attempts have been made to go into the details of the problems, as far as possible. Further research in this area will definitely throw light on various other interesting issues related to the Socialist Economic Integration, which this work has probably failed to focus upon.

During the research work, I had useful discussions with my supervisor, Prof. Arvind Vyas, who had also taken the trouble to go through the draft of my dissertation. I am indebted to him for his comments and suggestions on my work. I must sincerely thank my friend Ms. Archana Tyagi for the extensive discussion which I had with her on certain conceptual issues related to the present study. I am thankful to Mr. Jagdish, without his cooperation, this work would never have been completed.

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CONTENTS

INTRODUCTION:

The Council for Mutual Economic Assistance (CMEA) was created in 1949 by socialist countries of Eastern Europe as an intergovernmental economic organisation with a view to accelerating economic development and establishing a more rational international division of labour among member countries. At present the Council comprises the following countries: Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania and USSR. Representatives of the Democratic people's republic of Korea and the socialist republic of Vietnam have been attending sessions of the CMEA bodies for a number of years. Not long back representatives of People's Republic of Angola and the Lao People's Democratic Republic took part as observers in the work of the thirtieth and thrity first sessions of CMEA held in July 1976 and June 1977 respectively. CMEA co-operations with Yugoslovia, Finland, Iraq and Mexico on the basis of special agreements concluded in the period 1960-1970.

The specific feature of Economic integration within CMEA is that its member countries have a common economic system which is based on public ownership of means of production and planning of national economies. The principal aims of economic integration between the countries members of CMEA, as stipulated in basic CMEA documents, are to promote, by pooling and coordinating the efforts of the member countries, planned development of their national economies, acceleration of economic and technical progress, faster rates of growth in the less industrialized member countries, a gradual evening out of economic development levels, a continuous growth in labour productivity and a steady improvement in the living standards.

In order to meet above objectives, the charter of the CMEA in particular envisages the following:-

(a) To organize all round economic, scientific and technological cooperation among the member countries with a view to ensuring a more rational utilization of their national resources and acceleration of their economic development;

(b) To promote the deepening of the division of labour among the countries of the area through coordination of their national economic plans and arrangements for specialization and cooperation in production;

(c) To assist the member countries in the preparation, coordination and implementation of joint development programmes in the following areas: Industry and Agriculture; trade and exchange of services among the member countries as well as between them and non-member countries; Science and technology.

The oepn character of economic cooperation and integration among the CMEA countries has been expressly stated in the basic CMEA documents,[1] and has been proved by actual links with the countries outside CMEA. The CMEA can also invite non-member countries to participate on a long term basis, in work of the Council's bodies, and to conclude special agreements with CMEA to this end.[2]

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1. Charter of the CMEA, article-II, para 2: "Membership in the Council is open to other countries which share the pruposes and principles of the Council and which agree to accept the obligations contained in the present Charter".

2. Charter of the CMEA, article-XI, "Relations of the Council with other countries": "The Council for Mutual Economic Assistance may invite countries which are not member of the Council, to take part in the work of the Council bodies or carry out cooperation with them in other forms.

   "The terms of participation of non-member countries of the Council in the work of the Council's bodies or their cooperation with the Council in other forms shall be determined by the Council subject to understanding with these countries, as a rule, by concluding agreements."

The expansion of CMEA activities over the years has resulted in the establishment of a rather elaborate organizational structure. At present CMEA comprises the following main organs: session of the Council as its supreme body; Executive Committee, as the main executive body of the CMEA; Committees on cooperation in planning on scientific and technical cooperation and on cooperation in material and technical supply. There are also various standing commissions in such areas as agriculture, chemical industry, foreign trade, monetary and financial matters, construction, electric power, ferrous and nonferrous metals industries, food industry, geology, oil and gas industry, machine building, radio engineering and electronic industry, standardization, post and telecommunications, transport, peaceful use of atomic energy and statistics.

On all questions of economic, scientific and technical cooperation the CMEA adopts recommendations; decisions are taken only on organizational and procedural matters. The recommendations anddecisions of the Council bind only those member countries that have stated their consent to them. They do not apply to countries that have declared their disinterestedness in a given question.

CMEA recommendations are implemented by governments of other competent national bodies in those countries which have accepted them.

In the initial phase, cooperation between the countries members of the CMEA was mainly confined to expansion of mutual trade and organization of scientific and technical cooperation. Since the1950s, growing emphasis has been placed on coordination of national development plans and on furthering international division of labour and specialization in production.

In the late 1960s, the growing industrial potential of the countries members of CMEA and the impact of modern developments in science and technology generated a need within the CMEA for intensification and deepening of economic integration. At the time the CMEA member countries felt the necessity to solve a number of major economic problems. One constraint for example was the need to overcome the consequences of the self sufficiency drive to which most of the socialist countries of Eastern Europe were compelled to adhere in the first two post war decades. Another set of problems was engendered by insufficiently developed relationships between the national enterprises and external markets, predominantly bilaterally balanced trade, differences in the national systems of price formation and insufficient progress in introducing convertibility of national currencies. The development of trade and economic relations within the area has reached a stage when it has become possible, and at the same time indispensable, to intensify and improve economic and technological cooperation between the CMEA member countries with a view to strengthening both national and joint economic complexes, comprising production, trade, scientific and technological sectors.

Taking into account the above considerations and the basis of past experience, the CMEA member countries adopted in 1971, the comprehensive programme for further extension and improvement of cooperation and the development of socialist economic integration by the CMEA member countries (thereinafter referred to as the "Comprehensive programme for socialist integration or comprehensive programme).[3]

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3. Quotations from Comprehensive programme are taken from the English text published by CMEA Secretariat, Moscow, 1971.

In contrast to traditional policy with its predominantly bilateral character, the Comprehensive programme gave a new impetus to the implementation of various multilateral schemes and a new thrust for faster economic development.

Scheme of Chapterization:

Since its creation in 1949, the CMEA has undergone four phases: A dormant phase until 1955; an activation phase from then until 1965; a consolidation period between 1965 and 1970 and a reactivation phase after 1970.[4] It is this fourth phase, which is intended to focus on a ten year period of Economic integration, in which we are primarily interested.

The objective of the research is to critically examine the major issues related to the problems within CMEA and future prospects for Intra-CMEA economic integration in late 1980s. The chapterization scheme that will be pursued by the researcher is as follows:

The first chapter, "Introduction", consists of

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4. Henery Wilcox Schaefer, Comecon & Politics of Integration, (New York: 1972), p. VII.

two parts. First part of the introduction "Road to Integration" will deal with the origin and development of the Intra-CMEA economic integration.

Second part of the first chapter will deal with the factors which are responsible for the stagnation of the integration process and simultaneously it will deal with the "Obstacles to the Integration".

The second chapter will provide a general information and knowledge about the Economic mechanism of socialist economic integration under the title "Mechanism of socialist integration". This chapter is divided into three sub-chapters.

In the first sub-chapter, researcher would like to find out the exact working of the socialist price system. Prices are the root cause of many problems in socialist economies, so it is very important to have the knowledge of price determination in socialist economies. The second sub-chapter under the heading "Exchange rate and Transferable Rouble" will deal in detail with the monetary system of the CMEA countries.

The third sub-chapter under the heading "Bilateralism inconvertibility and Multilateralism" deals each concept in detail. It gives fundamental idea about bilateralism, inconvertibility and multilateralism. It also expalins the different important roles playes by these factors. It shows how important are bilateral relationships in the development of economic integration among socialist economies. And it is more interesting to see that recently socialist countries are heading for multilateral relationship and how inconvertibility is proving to be the biggest stumbling block in the development of foreign trade. The socialist quest for multilateralism and convertibility and its implications on economic integration will be dealt in the end of this sub-chapter.

Thus, after going through the basic information about the socialist economic integration, now we come to the third chapter, which will deal with the problems of Intra-CMEA economic integration. Though there are innumberable problems in Intra-CMEA economic integration, the researcher would like to investigate in detail the following two problems which are the root cause of many other problems.

A. Pricing and Exchange rates

B. Inconvertibility of Transferable Rouble and Bilateralism.

In socialist economies, there is no uniform price system as yet, the bulk of the trade is still bilateral in nature and the rouble is far from being an international currency. Furtheremore, the multilateral clearing system within the CMEA is basically restricted to the trade of consumer goods (soft goods), while capital goods, which are in shorter supply are traded al-most exclusively under bilateral trade agreements.

Thus the chapter will end after thorough examination of the above stated problems. Researcher would also try to give some suggestions and possible solutions to these problems.

Further, after dealing with the problems of Intra-CMEA Economic Integration, in the final and fourth chapter, researcher would analyse the future prospects of CMEA integration and would conclude by giving summary of the whole thesis.

Road to Integration:

A new phase of international cooperation was introduced in the form of Council of Mutual Economic Assistance (CMEA) following the second world war. The purpose of the CMEA was to promote, by uniting and coordinating the efforts of member countries of the Council, the planned development of the national economy, the acceleration of economic and technical progress in these countries, raising the level of industrialization in the industrially less developed countries, a steady increase in the productivity of labour and constant improvement in the welfare of the peoples of the member countries of the Council.

Generally speaking, in spite of many concrete achievements, the CMEA has failed to realise its goals of integration. At the heart of this failure lie the twin policies of bilateralism and inconvertibility, both of which, we shall explore later. For the present, a more general picture is advisable. The basic reason for the lack of economic integration in CMEA seems to stem from the Marxist policy of disregarding market forces, price mechanisms, and competition, which all lead to a neglect of the benefits of international division of labour. It is perhaps the latent recognition of these factors which has prompted relatively recent attempts at economic reforms in CMEA countries. Before we turn our attention to other aspects of CMEA integration, however, we consider the nature of CMEA attempts towards integration.

Serious efforts to make Council a supranational organisation were not extended until 1962 in the form of proposals to the CMEA by Nikita Khrushchev. The earlier charter signed in 1960, was extended by the "Basic Principles of Socialist Cooperation" of 1962, a policy statement which somewhat changed the original purpose, at least in depth. The 1962 statement calls for specialization according to comparative advantages, and for joint planning for the CMEA areas as a whole, thus calling for a supranational planning authority. These proposals were temporarily discarded when they were flatly rejected by Romania in 1964.[5]

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5. Adolf Hermann, "Can Comecon Integrate?", East Europe, 18, (May, 1969), 15.

The fundamental principles of international socialist division of labour of 1962 was accompanied by the Soviets convincing the other members of the desirability of a multilateral clearing system, a bloc bank, and a collective block currency. By 1966, it was possible to introduce the first coordinated, planning of individual five year plans and in 1970 the International Investment Bank (IIB) began operations. However, Romania was once again blocking integration attempts, and refused to participate in the I.I.B. In July 1971, however, a fifteen to twenty years integration plan for CMEA was finally announced. In spite of Romania's objection to centralised planning, there has been a definite trend in that direction.

The most significant development along these lines was the passing by members in July 1971 of the "Complex Programme" for the further deepening and streamlining of cooperation and for developing socialist economic integration among the member countries of CMEA.

The most important form of Intra-CMEA cooperation has so far been the mutual expansion of regional trade. Such expanding trade has grown at a faster pace than individual domestic production, thus increasing the mutual interdependence of the CMEA economies. Nevertheless, efforts towards closer integration have been persistent, and are certainly not limited totne mutual expansion of trade.

There can be no doubt that by 1975 intrabloc cooperation had expanded from what was once only a mutual trade to areas of joint integration through the coordination of investment plans, specialisation, joint undertakings and financial, scientific and technical cooperation. A special role was played by the International Bank for Economic Cooperation (IBEC), which not only extended economic aid to members at low interest rates, but also, in some cases, allowed for trade surpluses with some members to be used to pay for deficits with others.[6]

Sandor Ausch a Hungarian economist, has claimed that the CMEA has proved vastly superior in several significant aspects to its capitalist counter-parts.

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6. J. Wilczynski, The Economics of Socialism (london, 1970), pp. 195-99.

According to him "Perhaps the most important of all changes was that in the framework of the new system, long term agreements have opened up, and guaranteed markets to the mutual commodity exports of all these countries, among them some rather under-developed ones, which just started industrialization and were endowed with relatively small areas and domestic markets. It is a statistical fact that these latter countries have been transacting ever since much larger net exports of finished goods than any capitalist country at a comparable level of economic development. At the same time most of the raw material needed for their rapidly growing industries could be purchased in the framework of guaranteed supplies. All this contributed to reducing the deficit in the balance of international payments, most characterstically associated with economic growth in this stage of development, thus enabling these countries to avoid many of the well-known economic and political consequences of such deficit".[7]

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7. Sandor Ausch, Theory and Practice of CMEA Cooperation, (Budapest, 1972), p.11.

In view of this criterion, it must be pointed out that CMEA policies have in many ways been detrimental to the expansion of export markets and that they in fact have contributed to severe problems of bilateralism, inconvertibility and balance of paymens, as we shall later discover. Be that as it may, it would be advantageous at this point to determine the factors and their role, which create obstacles to smooth economic integration.

Obstacles to Integration:

It is now 40 years after the founding of CMEA and it will be another 15 years, according to CMEA leaders, before the goals of integration can be reached. Accordingly, the obstacles to integration must be fairly great. They are also numerous, Although some of them are certainly surmountable, it appears as if others are not, at least under the present direction of integration. Significantly, the economic factors represent the biggest of stumbling blocks. At any rate, the major impediments to integration are as follows:-

(a) Question of Supranational Authority:

There is obviously a strong element in CMEA, particularly noticeable in the case of Romania, which insists on complete national sovereignty. In the CMEA convention of June 1975, the President of Romania stressed the necessity of individual state of actions.

(b) Pricing:

The CMEA countries use capitalist world prices in their intrabloc trade, which amounts to an admission of the failure of CMEA along these lines and produces demoralizing effects. On the other hand, it is recognised that capitalist prices are not a reliable guide to intrabloc specialisation and trade, because they do not reflect the conditions of production or exchange under socialism.[8] Such a pricing system makes it impossible for CMEA to evolve its own set of objectively determined prices applicable to bloc-wide trade. That is, because of the aftificial character of the prices and wage structures among the member countries, it is impossible to assess at least rationally, the eomparative production costs.[9]

(c) Suspicions of Exploitation:

The pricing system used in CMEA, although based on world prices, includes adjustment to counteract cyclical and other market distortions. Thus mark up

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8. J. Wilczynski, n.6, pp.200-201.

9. Michael Camarnikow, "Is Comecon Obsolete?", East Europe, 17, (April, 1968), 12.

of 50 per cent or more are common, so that often the member countries change each other well above the prices they could obtain in trade with the capitalist countries. This, combined with the inferior quality of goods, often leads to mutual charges of exploitation, which are particularly strong against the Soviet Union.[10] Countering the USSR claim that the terms of trade have in fact turned against the USSR for the 1966 shift in pricing from the 1957-58 to 1960-64, world averages found the prices of raw materials and fuels being readjusted downward, while the world average of manufactured products increased substantially, a fact which hit the USSR hard in its intrabloc trade.[11] Since then, the USSR found it necessary to raise substantially its price of oil to CMEA members by 130 per cent. This step, taken in January 1975, still leaves the price of oil quite a bit below world prices, but it does represent an effort of the USSR to improve its terms of trade vis-a-vis CMEA members.[12]

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10. Wilczynski, n.6, p.210.

11. Gararnikow, n.9, p.14.

12. "Comrades Unite," "The Economist, 256, (July 5, 1976), 123.

(d) Declining Role of Intrabloc Trade:

As indicated, the CMEA members are increasingly looking to the Western markets. Romania's increased trade with west, for example, has hurt CMEA bloc in two ways: it cuts off an outlet for their production due to the bilateral nature of CMEA trade, as well as reduced the total bloc supply of scarce raw materials and foodstuffs.[13] Underlying this, however, is the implicit recognition that CMEA members are simply not satisfied with the present trade pattern.

(e) Structural Differences:

There are numerous structural differences among the member countries, and these differences are often extremely large and noticeable. The economic productive potential is distributed quite disproportionately. There are tremendous differences in economic performance levels as measured by overall productivity and living standards; the importance of foreign trade as mentioned

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13. John. Michael Montias, "Economic Nationalism in Eastern Europe: Forty years of Continuity and Change", in Eastern Europe in Transition, ed., Kurt London(Baltimore, 1966), p.198.

earlier various considerably.[14] The growth strategy aimed at the rapid transformation of traditional agrarian or semi-agrarian economies has left structural imbalance, and there is an inherent restraint on international resource mobility allowing better allocation.[15]

(f) Integration Methods:

As indicated earlier, because of the principles on which CMEA is based, it is possible to achieve integration only if such integration does not interfere with the national sovereignty of the states involved. More and more, CMEA efforts have been exerted towards the implementation of middle and long term integration; these efforts have mainly stressed structural differences and the development of science and technology. Specific agreement about specialization, which we will consider shortly, are to be hammered out later. In spite of such

14. Heinrich Machowski, "Toward a Socialist Economic Integration of Eastern Europe", in Eastern Europe in the 1970s, ed., Sylva Sinanian, Istvan Deak, Peter C. Ludz(New York, 1972), p.190.

15. Jozef M.P. Van Brabant, Essays on planning, in Eastern Europe(Rotterdam, 1974), p.18.

efforts, neither the specific areas of coordination nor a method of coordination has been worked out. Because of the "Interestedness" clause, coordination in fact be bilateral or multilateral. As it is working out, the only real achievement have been bilateral in nature, with only significant concrete steps having been taken multilaterally.[16] There are basically five forces which have obstructed efficient plan coordination. First, 'CMEA supervised coordination has gone into excessive detail, losing sight of the most important questions of coordinated development. Second, the plans are continually being revised, and individual states are not always willing to accept revisions. Third, implementation of plans has been particularly unsuccessful. Fourth, the plans are so rigid once set that they do not permit flexible decision making. Finally the individual countries have not been willing to concentrate on the vital forces of integration, such as investment plans.[17]

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16. Machowski, n.14, p.192.

17. Brabant, n.15, pp.33-34.

(g) Obstacles to Specialization of Production:

The division of labour and specialization of production which the complex programme envisions are vital to the CMEA, if it hopes to achieve any degree of integration. It would not only help achieve more satisfactory growth rates but would foster intensification of production as well as reduction in capital absorption. Due to the obstacles to integration, however, the outlook for successful specialization is not particularly good. Small quantity production, economically unjustified, continues in many phases of CMEA economic life. Identical machine tools are produced in six member countries, electronics in seven and five members have sugar processing plants.[18] The absence of market mechanisms in the bloc makes it extremely difficult to determine patterns of specialization which would be the most economically desirable. Often, mistaken economic policies or objective difficulties hinder the ensuring of economic, technical

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18. Stanley Zemelka, "The Problem of Specialization in Comecon," *East Europe*, 18, (May 1969), 9.

infrastructural conditions for utilising comparative advantages.[19] As we shall see, a minority of the CMEA members even now think that liberalised market conditions are the only method of successful specialisation, whereas others are convinced that supranational planning can ahcieve it.

Lacking a market mechanism to guide them comparative advantage some how has to be determined by the trade ofiicials. Accordingly, they have resorted to artificial means, specialization agreements. Two types of international specialization agreements have been used by CMEA. Interproduct specialization allocates the production of a commodity to one or several countries, and is usually found in extractive and primary industries. The other form, tnat of intra-product speicialization assigns production accprding to certain specifications, such as size or model. This type of specialization has assumed particular importance in three major

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19. Sandor Ausch, n.7, p.215.

industries: metallurgy, machine building and chemicals.[20]

In view of the many obstacles to specialization there are still only two basic view points as to why specialization has not progressed more rapidly among the CMEA nations. The first centres around the use of world prices in intrabloc trade, whereas the second focuses on the bilateral nature of intrabloc trade.

Thus, we have seen a few obstacles which are causing a great deal of harm to CMEA integration. An adequate integration of CMEA bloc is impossible as long as the economic mechanism does not sufficiently provide for the regional assertions of the categories of commodity value and money, and of the laws of the market related to these categories.

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20. Zemelka, n.18, p.10.

MECHANISM OF ECONOMIC INTEGRATION:

Development of the socialist countries' economic integration implies the balanced formation of economic, organisational and legal conditions and prerequisites for consistent use of the advantages arising from their more active and organic participation in the international socialist division of labour. The formation of these conditions and prerequisites is connected both with an improvement of forms and methods of planning and organisation of economic activity within the individual countries and with an improvement of the whole system of their international economic cooperation.

The functional model[1] of socialist economic integration put into the centre above all the mutual aid in development. The central and East European socialist countries built up their internal systems of economic control along the same lines in 1950s. This

1. Ferenc Kozma, "The Building Stones of Socialist Integration - The National Economic Strategies", in Economic Integration and Economic Strategy, (Oxford, 1970).

system was characterised by obligatory central plans, the separation of producer and consumer as well as of the domestic and foreign markets, all these serving as a basis for strict protection of industrial development. Initially, the coordination of these national economic functional models caused no particular methodological problem especially at the then relatively rudimentary stage of cooperation. The main tasks of industrialization that were to be solved came to the foregound. We encounter the rudimentary elements of plan coordination already at the end of the forties, in the long term trade contracts. By the sixties this developed into direct plan collations of central planning agencies.

In this functional model the market automatism have but a subordinate role. The existence of automatism assumes, namely, that it is the economic unit (enterprise, union etc.) that decides on the laternatives of investments, production and sales at least in case of simple reproduction or one not expanded at an outstanding rate. In order that the socialist state, as owner, may relegate to the economic units the decisions belonging to the scope of the simple reproduction and normal expanded reproduction, together with the choice between different procurement and sales markets, the country in question must possess considerable reserves of factors of production and products, including exportable commodity funds saleable at any time and on any market, and also reserves of foreign currency as well as mobilizable production fund at enterprise level (it is a minimum requirement of planned economy to centralise in the scope of global social decisions, those related to expanded reproduction with an impact of structural change).

At present and foreseeably for some longer time still, the economy of the CMEA countries will develop with losely calculated reserves. Particularly, the shortage of those factors of production deserve attention which can be exported profitably at any time to any market (which produce to use the professional Jargen - convertible or hard goods). The 'Softness' of the exportable commodity fund is to be felt in case of some CMEA countries mainly in their trade with developed western countries, but in the case of other also in CMEA relations. A general elimination of all restrictions, without any transition, on the present flow of commodities, investment resources, labour and services within the CMEA would have, under such conditions a differentiating effect on the development of the member countries, mainly through the changes in the terms of trade as well as through the dwindling CMEA markets for the products of some newly developed industries. If we organically link this system of 'National selection' within the CMEA to the markets of capitalist countries (e.g. through monetary channels), the traditional instrument of regional protectionism would prove to be insufficient to secure the political conditions for the industrial development of the countries. Therefore, the CMEA countries are at present not in a position to render their economies open in the classical trade policy meaning of the term, neither towards third countries nor towards each other (not even those countries may be said to be really open in whose system of economic control an organic relationship has been established between the internal and external markets). Even in these countries, central economic policy handles the instruments connecting the external and internal markets extremely carefully, and makes immediate changes as soon as the external market impulses do not stimulate but undermine the development objectives worked out in economic plan.[2] Thus the CMEA integration develops among national economies which are structurally more and more open (i.e. which establish ever deepening division of labour among each other), but which are for the time being closed from the view point of commercial policy (that is on micro level, they are more or less neutralised against external market impulses). Open commercial policy is not a criterion for the functional model followed by the CMEA, which assumes however an opening of development policies.

In so far as, cooperating economies coordinate their development plans and create such conditions in their internal systems of economic control which secure

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2. T. Kiss, "The Development of the form of Economic Relations in the CMEA Integration", in the Market of Socialist Economic Integration, ed. by T. Kiss et.al. (Budapest, 1973).

a harmonious development of the forces of production as well as regional collective protection of the economies, this may in the final analysis be similar to Natural selection from certain respects, this particular functional model also has some net advantages. It produces fewer surprises in actual economic development and in the harmonious shaping of economic development levels than natural selection. This is a view point worth the attention, if we think the characteristic anatomy of the set up in the CMEA regions.

Mechanism of Price Determination:

The most comprehensive study of the process of price formation in the CMEA has been conducted by Hewett (1974)[3], who provides some clear points concerning the principles of price determination which may be summarised as follows:

(a) The rules of price determination are established multilaterally but actual prices are negotiated bilaterally;

(b) Some variant of world market prices (WMP's) is used;

(c) Prices are intended to be fixed or stable over a predetermined period.

In 1949 it was established that prices should be based on current world market prices and be fixed for the period of annual trade protocol. The outbreak of the Korean war saw a rapid increase in WMP's particularly for raw materials, and intra CMEA prices were frozen at 1949-50 level until 1956.

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3. E.A. Hewett, Foreign Trade Prices in CMEA, (Cambridge, 1974).

An attempt to establish rules by which CMEA prices should be governed was initiated in 1958 with the publication of the CMEA price clause, which Hewett argues delineates the areas within which engotiators may manoeuvre. The basic principles of price formation are that prices should be based on some variant of a previous period's WMP's Cleansed of the influence of cyclical, speculative, monopolistic and other factors of a non-productive nature and that a single price should prevail throughout the bloc for a single commodity. In principle, prices should be sufficiently stable to eliminate the influence of short term and cyclical fluctuations in WMP's, but sufficiently flexible to accomodate underlying changes in world supply and demand conditions.

This was led to debates concerning the period over which fluctuations should be considered cyclical or permanent. In practice, prices were supposed to be linked to a 1957 world price base from 1958 to 1965 but for 1966-70 were linked to an average world price for 1960-64, while a similar formula based on average prices corrected by bilateral begotiations, prevailed from 1971 to 1974.

Following the increase in world energy prices it was agreed at a standing commission of the CMEA that certain prices for 1975 should be based on average of WMP's for the period 1972-74 and that thereafter prices should be changed annually on the basis of preceding five year's WMP's. This formula has been renewed until 1985. Finally, prices obtained on this fashion are converted into transferable rouble at the official exchange rate.

In practice, the process is far more complicated. Ausch and Bartha (1968)[4], undertook an empirical investigation of actual price determination in the CMEA in the mid 1960s and found a considerable degree of price variation for identical commodities traded between Hungary and other socialist nations as well as with non-socialist nations. They found that this variation was far greater

4. S. Ausch & F. Bartha, "Theoretical Problems of CMEA Inter Trade Prices", in Foldi, 1969.

than that to be found from similar tests performed with Hungarian prewar trade statistics. Furthermore, in 1964 Intra-CMEA prices diverged considerably from the WMP's on which they were supposed to be based, to the extent that machinery and equipment prices were 25.9 per cent greater and agricultural goods 1.7 per cent greater. They concluded that the divergence of machinery and equipment prices was largely explained by the fact that it is far more difficult to establish documentation for WMP's for finished goods than for raw materials, and consequently actual Intra-CMEA prices for machinery and equipment were not WMP's at all, but were based on some assessment of past domestic production costs.

The divergence between prevailing Intra-CMEA prices and world market prices was therefore greater for manufactured commodities than for basic commodities such as raw material and agricultural produce, and this divergence was opposite of that which would have resulted from supply and demand pressures within the CMEA and operated to the detriment of the less developed, agrarian countries and suppliers of raw materials (Principally

Romania, Bulgaria and USSR).[5]

Furthermore, the prices that CMEA countries obtain for manufactured commodities are frequently below those pertaining in trade between market economies.

CMEA economists therefore, distinguish between 'hard goods' (those which are relatively underpriced in CMEA markets and can be sold on world markets for hard currency) and 'soft goods' (those which are overpriced and difficult to sell on world markets). The degree of hardness differs from product to product and will change from time to time as supply conditions alter. The hardness of the food stuff will be effected by harvest conditions which may cause countries to use hard currency reserves to import from the west, while improved quality standards for engineering products & even consumer goods will result in an increased degree of hardness of the commodities concerned. At the beginning of 1980s, products were considered to range in the degree of hardness from raw materials and fuels,

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5. K. Pesci, The Future of Socialist Economic Integration, (New York, 1981), p.97.

modern high quality equipment and spare parts, engineering products that the importing country cannot manufacture itself, foodstuffs, products of light industry down to just about all other commodities.[6] The divergence of Intra-CMEA prices from the opportunity costs of commodities traded within the CMEA is a principal reason for the failure of multilateral cleaning systems and for the related phenomenon of the bilateral balancing of trade flows of specific commodities. Exporters will be reluctant to deliver hard goods into multilateral accounting system where they may be offset by imports of an equal national value but a far lower real value and will prefer instead to export such items to market economies where they will be paid in hard currencies which can be used to buy other hard goods. For the same reason importers will be reluctant to receive soft goods.

Trade negotiators confront each other in a position in which they will only be willing to export

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6. Ibid., p.137.

hard goods if they can guarantee receiving hard goods in exchange; negotiators cannot concern themselves with matters relating to the supply of exports and imports in isolation, but must ensure that the supply of exports will result in an inflow of commodities greater or equal value to the commodities exported. Particularly, this can only be achieved by bilateral negotiations where details concerning the supply of exports can be directly related to details concerning the supply of imports.

In practice, a multi-tier negotiating system has emerged in which, not only are hard goods largely traded in exchange for other hard goods, but certain categories of goods are only exchanged for similar items. This is largely a result of the domestic price system, which not only leads to differing degrees of hardness but make ti difficult to identify real production costs and compare the value of heterogeneous products. The greater difficulty in identifying real production costs the greater will be the tendency to balance trade bilaterally in narrowly defined product groups according to administrative production categories.

Settlements of Intra-CMEA trade in hard currencies have been increasingly used in 1970s to bypass some of the defects of the CMEA monetary organisation. Such settlements introduce an element of convertibility and multilateralism into Intra-CMEA trade, but fail to tackle the underlying problems of pricing and the production of soft goods and by offering a pragmatic solution to a specific problem may delay a more thorough reform of the system.[7]

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7. Ibid., p.137.

<u>Exchange Rate & Transferable Rouble</u>:

Exchange rates in CMEA countries are not very useful in the sense that they do not serve the purpose that exchange rates serve elsewhere. Although gold standards have been established, they are highly arbitrary and the currencies are generally inconvertible. The gold standard does not reflect the value of currencies and the exchange rates do not reflect the purchasing power of the currencies. In a better economy re-lying on planned foreign trade mechanisms and the foreign exchange restrictions, such reflections are unnecessary, because neither exchange rates nor production costs regulate trade. Generally, trade with the west is settled in capitalist currencies, trade among CMEA members by the leaning rouble and domestic prices of imports and exports are determined administratively. In the latter case, deficits and surpluses are levelled by budgetary procedures.[8]

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8. Bela Csikos-Nagy, <u>Socialist Economic Policy</u>, (New York, 1973), pp.221-22.

In general, the exchange rates have been so established as to insulate the internal economy from the influences from without. At any rate, as long as internal prices are disorderly and world prices are used as the basis for trade, and as long as both the composition and volume of trade are centrally controlled, the exchange rate is reduced to nothing but an accounting device.[9]

Characteristic of the CMEA countries' policies, each of the members has established multiple exchange rates. Thus there are not only different rates for intra bloc trade and non bloc trade, but there are also different tourist rates. Even the tourist rates may easily be multiple, as ain the case of Romania, which has more advantageous rates for tourists who exchange over 50 dollars than for those who do not exchange much.[10] The official basic rates or those

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9. Franklyn D. Holzman, Foreign Trade Under Central Planning, (Cambridge, 1974), pp.143-44.

10. J. Wilczynski, The Economics of Socialism (London, 1970), p.181.

at which the value of trade in officially recorded, are furthest from equilibrium rates. Because of over-valuation, and due to the need to establish exchange rates which would promote exports and restrain imports, a substantial devaluation of the various currencies will be necessary once internal pricing adjustments can be made. At any rate, two steps must be taken towards the establishment of valid exchange rates if convertibility and multilateralism are desired, first there needs to be further perfection of financial instruments and market relations to establish solid foundations for realistic parity rates; after that is accomplished, the parity rates must be further adjusted to ensure a balance of payments equilibrium.[11]

As the situation stands now and as it has stood since the creation of the CMEA, the national exchange rates cannot be used as a fundamental and direct

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11. Wilczynski, Socialist Economic Development & Reforms, (New York, 1972), pp.276-78.

instrument for comparing the profitability of foreign trade transactions. As a result, this acts as a detriment to the further development of integration and specialisation among the CMEA countries.[12] Complications of all sorts appear though when an attempt is made to establish suitable rates, for most socialist economies feel that a fixed rate of exchange would be incompatible for the CMEA blocs and that instead, a type of exchange rate capable of harmonizing with the deviations in the relative price levels of the different countries would be necessary.[13] This is complicated primarily by two over-riding concerns, the irrational pricing systems in the countries, as well as the fact that their economies are in a transitional period.

The essence of valid exchange rates lies in the construction of economic links between domestic industries

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12. J. Wesolowski, "Monetary and Financial Relations", in The Market of Socialist Economic Integration, ed. T. Kiss, (Budapest, 1973), p.206.

13. K. Kover, "Internal Monetary Systems & Foreign Exchange Systems, in The Market of Socialist Economic Integration, ed., T. Kiss, (Budapest, 1973), p.214.

and the world market. Price relations are so divergent in the CMEA, however, that to apply a single 'realistic' exchange rate to all partners and to all industries would throw the pattern of trade and industry into complete disarray.[14] Still, some progress is being made, if official attitudes can be considered as such.

<u>The Transferable Rouble</u>:

Initially, local currencies were used for intrabloc trade not involving the Soviet Union. By 1955, the Soviet rouble was used throughout the CMEA for intrabloc accounts. Although at the time it was suggested widely that this was due to the instability of local currencies, it was thought later simply to be a step towards the total economic integration of the member countries. The rouble was not at first transferable when used as a bloc currency. Trade was conducted

14. Adof Hermann, "Can Comecon Integrate?, <u>East Europe</u>, 18, (May, 1969), 18.

according to bilateral arrangements, and each pair of bloc countries was to exactly balance its trade with eath other. Only insignificance imbalance occured, and these were settled with either gold or convertible currencies. It was not until 1963, that the IBEC was established and with it, a closed system of multilateral payments. To facilitate this a new transferable rouble was created.[15]

The Transferable Rouble (TR) is not convertible, nor is it the national currency of USSR. Basically, it is merely an accounting device used for clearing trade balances. The TR is created when payment for an export is recorded by IBEC, and is eliminated when payment for an import is recorded. The value of TR depends on the prices of exports and imports of the bloc countries, and varies accordingly. As these prices approach the goal of a single bloc price, which is unlikely in the coming years, the value of TR will approach the value

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15. G.A. Smith, Soviet Foreign Trade: Organisation, Operations and Policy, 1918-71 (New York, 1973), pp. 159-60.

of internal rouble of the USSR.

The multilateral accounting system which has been established in an inward - outward closed system. To the outside world, the system is closed completely since there is no relation whatsoever between the leaning rouble and the monetary system of capitalist world. It is also closed inward, for it is not integrated with the currencies of the members. It is detached from national foreign exchange relations and price relation subsequently, the intrabloc trade is still reduced to nothing much more than barter.[16]

Although the TR has a gold content equal to that of the Soviet Rouble (0.829 rouble = U.S. $1), it is converted into various national currencies throught the use of an exchange multiplier, or a currency coefficient, which depends on the provision applying in the countries concerned. It is, above all,

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16. Bela Csikos-Nagy, n.8, p.220.

not a medium of exchange.[17] Neitner is the TR adequate in its function as a measure of value, due to tne irrational pricing policies of tne member countries. Like the clearing rouble before it, it expresses neither world prices nor domestic market prices.[18] In fact, the transferable rouble is not at all automatically transferable. It becomes transferable only if the transaction partners agree to such transferability. Subject of such agreements, each country needs to balance its accounts only with the group as a whole, instead of individually.[19] The value of TRs then, remains a paper one, and the attempt to make it usable in trade with the west by granting at least partial recovery in gold have been to little avail.[20]

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17. Andor Laszlo, "Monetary Policy: A Help to Fostering International Cooperation", in Convertibility, Multilateralism and Freedom, ed. Welfgang Schmitz, (New York, 1972), p.127.

18. Wesolowski , n.12, p.206.

19. Wilczynski, n.11, p.288.

20. James A. Ramsey, "The Euro-ruble-Competition or Convertibility? Columbia Journal of World Business, vol.3, no.62, (November-December, 1968).

A transferable currency has been defined as one which is convertible only on a regional basis. Under such an assumption, it is perhaps more accurate to term the bloc currency as simply a clearing currency, since it does not even serve the function of accumulating wealth.[21] The rouble is convertible in no sense of the word, and transferable only in a very limited sense. Perhaps more valid assessment is that, to assure eventual convertibility, the only really effective way to improve financial arrangements would be to bypass the transferable rouble accounting system altogether and to settle such domestic expenditure in domestic currencies.[22]

Reform proposals in the area of transferable rouble have been made frequently by the socialist bloc. In their opinion, the main object of transferability is to prevent creditors' balances from being deprived of their usability. Therefore, they contend, exporting countries should have access to their credit balances,

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21. Sandor Ausch, Theory & Practice of CMEA Cooperation, (Budapest, 1972), p.77.

22. Henery Wilcox Schaefer, Comecon & Politics of Integration, (New York, 1972), p.167.

debtors should be made to pay part of the outstanding claims in convertible currencies. Increasing percentages would be used both as to size of debit balances and time outstanding. However, the Polish delegates have not been able to win over support from the remaining members of CMEA. Still, any long term solution must depend on the support of nonbloc members.

Bilateralism, Inconvertibility & Multilateralism:

The problem of financial inconvertibility in east west trade is largely over come by conducting that trade in Western (convertible) countries. This follows the Soviet practice of 1930s and allows the ministries of foreign trade to seek out the best market conditions for the purchase of imports and sale of exports independently of one another.

Soviet and East European trade with the industrial west has therefore tended to be multilateral in character. A comparison of indices for the 1930s indicates that multilateral balancing was a feature of Soviet, not East European trade. The German pursuit of bilateralism in the 1930s forced the East European countries to reduce the volume of multilaterally balanced trade to around 10 per cent. The USSR was also forced into bilateralism in 1934 and 1935 due to the need to reduce its deficits with Germany. Although the absolute volume of trade was substantially reduced in the remainder of the decade the USSR used the trade monopoly to pursue a multilateral policy exporting wood, grain and lumber to the United Kingdom, and importing machinery and equipment from Germany and the USA.

This multilateralism does not extend its intra CMEA trade. The absence of financial and commodity convertibility provides no incentive for one country to accept another East European currency as a means of payment. As a result, in the early 1950s, each CMEA country attempted to balance its trade with other member countries on a strict bilateral basis. Clearing accounts were opened in the state banks of the respective countries and accidental imbalances in the mutual trade of any two countries in one year were offset by a compensating imbalance in a subsequent year. A preliminary attempt to create a multilateral clearing system was made in 1957. Payments for deliveries in excess of those established in annual protocols could be paid into accounts held at the USSR state bank, and, subject to the agreement of all parties concerned, surpluses, and deficits could be cleared multilaterally. Outstanding debt had to be paid by deliveries of commodities detailed in specific list.[23]

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23. G. Schiavone, International Organisation: A Dictionary & Directory, (London, 1983), pp.141-142.

The current system involving the establishment of an international leaning bank - The international bank for economic cooperation (IBEC) and an international unit of account - the transferable rouble (TR, to which the domestic currencies are linked) - was instituted in 1964.

Member countries' accounts with the bansk are held in transferable rouble (TR) are credited and debited by the delivery of invoices to the bank by exporting countries, who simultaneously invoice the importing country.[24] In theory, therefore, debits and credits could be cleared on a multilateral basis without the need for bilateral balancing and it was hoped that a trade surplus arising between say Czechoslovakia and Bulgaria would be offset by deficits arising between say Hungary and Bulgaria and between Czechoslovakia and Hungary.

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24. G. Schiavone, n.23, p.159.

It was not anticipated that these surpluses and deficits would arise in a totally haphazard fashion - but could be planned in advance by the member countries. Member countries were charged that - when concluding commercial agreements .... to ensure the balancing of receipts in transferable roubles as a whole with all other member countries of the bank within any one calendar year of period agreed on.

This di not necessarily imply a strict balance in trade and commercial payments as credit operations were to be included as balancing items.

The crux was that the transferable rouble was ultimately to be financially convertible.

The failure to achieve multilateral balancing emanates as much from the problems of the centrally planned economies themselves, and the nature of foreign system as from inadequacies in the CMEA monetary system.

The production conditions in the CMEA becoming according to Holzman (1979)[25] a high cost, low variety, low quality production region. Domestic price systems linked to average production costs tend therefore to overvalue CMEA products relative to those of the industrial market economies.

Under pure market conditions this would result in the CMEA countries tending towards balance of payments deficits with the west, which will be eliminated by a collective devaluation of the East European Currencies relative to hard currencies, while they remained in approximate correspondence to one another. Quality differences between CMEA and Western producers would be offset by the price difference and the burden of adjustment would be borne by a reduction in real wages.

Holzman (1979) considers it unlikely that price reduction could stimulate sufficient sales to compensate for the lower quality of East European products, and it is highly probable that in practice

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25. F.D. Holzman, "Some Systematic Factors Contributing to the Convertible Currency Shortages of Centrally Planned Economies", (New York, 1979).

any such adjustment process would be met by Western nations by allegations of dumping. Consequently, the CMEA nations attempt to secure balance in trade with the West by the use of physical barriers, exercised by the foreign trade monopoly. The official exchange rates of the East European currencies remain overvalued in terms of hard currencies (which accounts for the existence of special exchange rates for tourists, visitors and so on, which tend to approximate a genuine market rate) and the prices of internationally traded commodities are equated by domestic prices by taxing imports and subsidising exports.

In addition, the financial convertibility of the transferable rouble means that there is no direct link between exchange in Intra-CMEA markets and world markets. A surplus acquired in Intra-CMEA trade cannot be used to acquire products outside the bloc nor need a deficit be paid for in terms of hard currencies. The CMEA region is, therefore, as Holzman (1979) argues, a trade diverting custom union.

The absence of commodity convertibility also means that surpluses acquired in Intra-bloc trade cannot be used to acquire and commodity which has surplus country may wish to acquire and therefore, the provision of exports cannot of itself guarantee a claim on the resources of a third country either inside or outside the bloc. The transferable rouble is effectively a unit of account, the international equivalent of passive money. The operation of passive money in the domestic economy requires the existence of a superior planning authority which can instruct (compel) one enterprise to deliver commodities to another enterprise. While no such supranational authority exists for Intra-CMEA trade, countries operating on the principle of national self interest will only enter into trade agreements, if the value of commodities received in exchange exceeds the opportunity cost of those it provides.

The willingness to participate in multilateral clearing arrangements will therefore be critically affected by the degree to which prices used in clearing arrangements reflect real opportunity costs. A nation's self interest will be best served by exporting to other CMEA nations those commodities for which the opportunity cost (measured either by the domestic marginal cost or production of where supply is inelastic, the price it could obtain for the commodity on world markets) is lower than the Intra-CMEA price and by importing those commodities for which the opportunity cost (similarly measured) is higher than the Intra-CMEA price.

PROBLEMS OF INTRA-CMEA ECONOMIC INTEGRATION:

In recognition of the past and present unsatisfactory state of affairs, which finds the CMEA nations pesistently trying to overcome the illeffects of inconvertibility and bilateralism, the CMEA monetary problems was at the top of agenda of the 24th meeting of the Council in 1979.[1] Still, achievement of any type of extensive convertibility and multilateralism among bloc members seems to be a difficult proposition. The creation of the CMEA international bank for economic cooperation, although a positive step, was clearly not a sufficient measure to permit free movement of capital or unimpeded flow of commercial transactions.

There is as yet no uniform price system, the bulk of trade is still bilateral in nature, and the rouble is far from being an international currency.

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1. Wolfgang Schmitz, "Monetary Dynamic Forces in East and West: Important Developments in the Seventies," in Convertibility, Multilateralism and Freedom, ed. Wolfgang Schmitz (New York, 1972), p.228.

Furthermore, the multilateral clearing system within the CMEA is basically restricted to the trade of consumer goods (soft goods) while capital goods, tools, machines and factory equipment, which are in shorter supply are traded almost exclusively through bilateral trade agreements.[2]

We should not really be too surprised in our wondering about, why the CMEA has so far failed in its efforts to progress towards a more satisfactory system. For one thing, it took the most advanced capitalist systems some 15 years after the war to achieve convertibility and that with considerable external help. Also, there is quite difference in level of development that marked the capitalist countries and socialist countries immediately followed the war.

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2. Kazimierz Grzbowski, "Organisation and Conduct of foreign trade in countries with State Planned Economies: Comecon," in East West Business Transactions, ed. Robert Starr (New York, 1974), p.130.

Furthermore, the bilateral system of CMEA is such that it would be impossible to switch over to full convertibility even if adequate gold and foreign exchange reserves were available.

For the CMEA to go from bilateral to a multilateral system would require fundamental qualitative changes in the domestic economies of the individual countries, as well as in their external relations. Specifically, they would have to do away with two properties of entire directive plan instructions system - the isolation of domestic price level from international prices and the system of directive export and import instructions.[3]

There are definite advantages to bilateralism. Such a balancing of trade facilitates economic planning and reduces the need for currency transactions to the minimum, which, in light of the shortage of foreign reserves among CMEA countries is a valid consideration.

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3. Sandor Ausch, Problems of Bilateralism and Multilateralism in the External trade and Payments System of CMEA countries; in Foreign Trade in Planned Economy, ed. Imre Vazda & Mihaly Simai (Cambridge, 1971), pp.61,78.

In addition bilateralism is a potent instrument of foreign policy. However, the immediate cause of CMEA bilateralism at the outset was its sheer inevitability. It evades the gains from international trade, since its capacity is dependent on the weaker partner. Of less importance are the administrative costs of negotiation and settlement, the insulation of economies, the protection of domestic industries and so on. Basically, it is a fact that multilateralism provides much more potential for economic growth.

Thus, whatever the positive effects of initial steps towards industrialization and growth taken by the members of CMEA, the long term effects have had a definitely restrictive nature. Several things can be learned from the historical development of convertibility and multilateralism in capitalist world. First is is necessary to largely abolish the administrative import restrictions which were found necessary during and immediately following the war. Second, the least developed countries must receive assistance from those in a more tenable position. Third, relative freedom of intra-regional trade is necessary. Credits to bridge trade deficits and an adequate amount of working capital are necessitated. Such would prove suitable for temporary balance of payments problems, but to prevent permanent, or structural indebtedness, a connection must be created between the system of settlements and a convertible currency.

Underlying all these conditions is the necessity of establishing a sound internal economic system to assure a relative equilibrium. When these conditions are met, regional multilateralism will promote the introduction of general convertibility. In addition, general convertibility requires above all, an equilibrium of international payments realistic rates of exchange, and the existence of substantial currency reserves.[4]

So we see that there are many factors which foster the continuation of bilateralism. Absence of rational price system and inconvertibility are probably

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4. Sandor Ausch, Theory and Practice of CMEA Cooperation; (Budapest, 1972), pp.152-53.

two most important factors. Third factor is the tendency among bloc countries to strive for overall balance of payments, which they mistakenly equivocate with bilateral balance. The subordinate role which 'exports' play to imports is another factor responsible for bilateralism. Under such conditions, there is no strong incentive to create over all export surplus. Another factor encouraging bilateralism is the position of economically stronger countries since it improves their terms of trade.[5] Additionally, the international mechanism of CMEA integration hinders multilateralization in many ways. Interest rates are so low that they encourage deficit rather than surpluses in the balance of payments, particularly since a system of clearing has not been satisfactorily worked out. No country accepts payments from other country voluntarily in the form of balance with a third member, since they cannot use it to but commodity needed to meet their real demands. Under such a system convertibility cannot be established because convertibility

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5. F.D. Holzman, Foreign Trade Under Central Planning; (Cambridge, 1974), pp.148-50.

would imply that all types of commodities could be purchased.[6] As much as this negates attempts towards multilateralism, it also is having the effect of stifling even bilateral trade among the CMEA members.

Accordingly, it would be advantageous to consider more closely some of the problems relevant towards the realization of fruitful and advantageous economic integration among the CMEA members. As we shall see, in spite of CMEA assertions, to the contrary, there seem to be insurmountable blocks along the way, at least in the foreseeable future.

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6. T. Kiss, The Development of the Forms of Economic Relations in the CMEA Integration, in The Market of Socialist Economic Integration, ed. T. Kiss, (Budapest, 1973), p.121.

Problems of Pricing & Exchange Rate:

The basic obstacles to both convertibility and multilateralism is the absence of rational price system. That is, only prices which reflect cost preference conditions can provide a solid basis for the maximisation of gains from international trade based on comparative advantage. Each of the reforms which have taken place has had to deal with this very factor. At any rate, to the extent that the enterprises have been truly given more authority in the decentralization schemes, they are in a better position to reach to changing price and demand functions.

Nevertheless, even considering only the internal relations of socialist economies, it is clear that the functions of production and sales are generally separated from each other. As far as external relations are concerned, the links between domestic and foreign trade prices, have been severed. For the large part, foreign trade organisations have had their performance measured at official domestic prices rather than the actual prices of foreign markets. Since export and import transactions have been centrally planned and dictated, the individual enterprises have not been able to consider existing comparative advantages. Until recently, about 60 to 70 per cent of Intra-CMEA trade was transacted under bilateral ageeements covering a span of five years, in which the prices were fixed. Finally, the system of stable foreign trade prices is not only convenient, but totally necessary considering the institutional elimination of market mechanism that could regulate such prices. Were the prices not fixed and stable, it could seriously disrupt the national plans of the partners, for imbalances could not be easily offset by suddenly changing national plans in midstream to provide the sought after balance.[7]

This break between domestic and external prices among the CMEA member nations has the consequences that their markets are imperfect in the economic sense, anad as a rule do not take part in the shaping of regional prices. That is, since the prices do not reflect cost benefit circumstances, it is recognised that they are less than optimal. The same, of course, is

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7. Sandor, Ausch; n.4, p.77.

true with internal prices. Domestic prices are geared to encourage the consumption of some goods and to discourage that of others, in order to implment the national plan. The system of planned prices is created with little regard for costs of production, prices in other bloc countries, or world prices. When goods are imported or exported, the prices are listed in the accounting system as domestic prices, and the foreign trade sector achieves gains or losses accordingly. The deficit is in essence a subsity to the doemstic producer, and the overall result is that, it is extremely difficult to evaluate the effectiveness of the foreign trade sector.[8]

Socialist economists, as a whole, have agreed that a price reform is a must. Generally, they agree also on the following. Prices must be determined in free competitive markets or derived from the optimal plan. The combination of all resources to production

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8. Laszlo Zsoldos, Economic Integration of Hungary into the Soviet Bloc: Foreign Trade Experience, (Colombus, 1963), pp.15-16.

must be accepted as cost and reflected in the prices. There should be a closer correspondence between retail and producers' prices. Prices must be fairly flexible to respond to supply and demand conditions. Domestic prices of internally traded products must be linked to those prevailing in world markets.[9]

The price reforms in the several countries have, in fact, shown tendencies in these directions. For one thing, the Marxian concept of 'production price' as distinct from 'value' has been adopted. Second, there has been the tendency to raise producers' prices to eliminate the need for planned deficits. Third, marginal concepts have been introduced. Fourth, prices which are centrally fixed are more subject to periodic revision in light of changing costs and demand. Fifth, the degree of insulation between retail and producers' prices have been reduced. Finally, there has been a considerable decentralization in some sectors in the determination of prices.[10]

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9. J. Wilczynski, Socialist Economic Development & Reforms, (New York, 1972), p.78.

10. Ibid., pp.79-81.

Nevertheless, there are atleast five major shortcomings in the context of profit as a criterion of enterprise efficiency in CMEA. There are substantial divergences of the prices from social cost, and this varies in each of the countries. Since the socialist central planning is incompatible with consumer's sovereignty, the consumer's preferences are not fully taken into consideration. Different planned prices are administered for different types of buyers and sellers for identical products. The complex price systems distort the prices, which in the more dynamic economies, have multyplying effects. Although the state initiated price changes have limitations, it is very often that other than economic considerations gain the upper hand.[11]

The process is further complicated by the existence of four sets of prices. Programming prices are used for the construction of internally consistent plans, and for aggregation only. Shadow or accounting prices are used

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11. J. Wilczynski, Profit, Risk & Incentives under Socialist Economic Planning, (London, 1973), pp.105-108.

in investment and foreign trade effectiveness calculations only. Operational prices are used in the process of plan fulfilment, basically as an information carrier. Finally, consumer goods prices are used which are, in principle, market clearing prices for consumer goods.[12] Such a system in which the functions of the price system would be confined to aggregation and control, was much more successful when all producer and consumer goods were strictly rationed, as upon the founding of CMEA. However, the purpose of guiding enterprise managers to correct production decisions, prices must express current relative scarcities, must be kept upto date to reflect their links with current costs, and must above all, be sensitive to supply and demand considerations.[13]

In the 1950s, to thwart price discrimination, the CMEA agreed that members will charge all CMEA trading

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12. J.G. Zielinski, On the Theory of Socialist Planning, (London, 1968), p.13.

13. John Michael Montias, Central Planning in Poland, (West port, 1962), pp.190-91.

partners the same price for the same commodity, with slight variation due to transportation costs. Those prices, in turn, are based on 'world prices' as previously mentioned, although such world prices are cleansed from the capitalist distortions due to cyclical deviation, monopolistic power and so on. Such use of world prices has not al all been whole heartedly accepted by the member nations, particularly since, according to Marx, any developed country is always in a position to exploit a less developed country. There are some questions however, as to the cleansing effects, since the resultant prices is often far less rational than the original world price. Obviously, the CMEA countries cannot create a rational price system of their own until they individually have rational domestic prices.[14]

As it is, the domestic price formation in the individual countries must take into consideration the trend in the world market prices, while the foreign

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14. Nicolas Spulber, _Socialist Management and Planning: Topics in Comparative Socialist Economics,_ (Bloomington, 1971), pp.11-12.

trade organisations of the countries in the CMEA must take into consideration at least three varying price levels. The domestic prices as well as the two foreign trade price levels (one in the socialist market and on in the capitalist market). Complications of all type arise in the forecasting as well as in the use of these prices.[15]

The use of world prices has many advantages and positive aspects, and some socialist economists contend that there is no better alternative. Those in favour of using world prices contend that the ratios of the prices to each other express the technological levels of the products in relation to the highest of standards, that through price changes, the development trends of the forces of production come to expression; that the direction of the movement of world market prices reflects changes in the international value relations, that the relative prices reflect the national scale of

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15. B.M. Shastitko & Y.S. Shiryaev, 'Interrations with Non-Socialist Markets,' in The Market of Socialist Economic Integration, ed. T. Kiss (Budapest, 1973), p.164.

production as well as the useful characteristics of the products, and so on. Additionally, it makes possible better reactions to price movements, and thus a dynamic rather than static force.[16]

Nevertheless, there are sound reasons why such world prices should be at least modified. It is obvious that the application of world prices with no adjustment cannot always ensure cooperation based on reciprocal advantage. They are subordinated to business cycles, to speculative effects, monopoly interests, inflationary processes and the price wage spiral. For semifinished products and for many finished products, the world prices are not clearly ascertainable. Structural changes in the CMEA as well as long range planning would often be handicapped by the useof world prices, and the optional development of any given country's economy is not necessarily directly corelated to the movements in world prices. That is, the possibility of recognizing the special production conditions in any given nation must be fulfilled by a preference system[17]

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16. Bela Csikos-Nagy, 'Mutual Advantage in the Economic Cooperation', in The Market of Socialist Economic Integration, ed. T. Kiss, (Budapest, 1973), pp.182-83.

17. Ibid., P. 184.

In addition, the use of world prices could definitely be detrimental to intra-bloc trade. All of the bloc countries are in the position of being able to buy and sell in transactions with bloc countries and/or non-bloc countries. It is therefore, obvious that it would be advantageous for a socialist country to sell in socialist markets only when the other socialist countries were buying in capitalist world markets, and vive-versa; that assumes that bloc prices are not precisely equilibrated with world prices.[18]

Socialist prices, while they must remain flexible, must also be somewhat more stable than world prices, particularly during the phase of integration through which CMEA is now going.

Until the mid 1960s, socialist prices were known for their rigidity, and this was considered an advantage. Since then, socialist planners have seen the advantages of flexible pricing. In fact, stability for its own sake in the face of chaning conditions turned out to be a

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18. Zsoldos, n.8, p.20.

handicap. In a dynamic economy, prices must provide guidelines to the continuing process of substitution in accordance with changing cost preference relationship. Consequently, the socialist systems devised four categories of prices based on the degree of permitted fluctuations. Fixed prices are held constant for longer periods and are established generally for the products which have a substantial effect on the cost of living. Ceiling prices are allowed to fluctuate below a maximum level, fixed by state, and generally applied to raw materials and less essential items of household use where competion among sellers is possible and desirable. Free range prices are those for which maximum and minimum limits are set for selected articles so that the prices can move freely within that range. Finally, free prices are those allowed to fluctuate freely according to market supply and demand. In this category are found luxuries and many nonstandardized things.[19]

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19. Wilczynski, n.9., p.88

There are many reasons why an entirely free price system cannot be introduced, even in regard to consumer goods. There are vast shortages on the supply side, and it will be years before the production potential catches up with demand, even assuming the development of a consumer oriented economy. Also there is a problem of the hidden excess of purchasing power, which, if released, would tend to produce a dangerous inflationary spiral. There have been years of acute shortages of high quality consumer goods, and that in addition to the impossibility of any significant private investment in property have created heavily swollen savings accounts in all of the more industrialised members of CMEA. There are net normal saving but unrealised purchasing power. Released, that power would drive prices up considerably. Accordingly, great caution must be used in the gradual releasing of price restrictions in CMEA.[20]

The separation of external and internal prices makes it very difficult to take into account efficiency

20. Michael Gararnikow, Economic Reforms in Eastern Europe, (Detroit, 1968), p.80.

considerations in foreign trade. Efficiency requires a fuller assertion of the world market for which it is necessary that there be an unambiguous relation between domestic and foreign prices so that the profitability of an enterprise producing for export should depend upon the latter.

Under conditions of bilateralism, money fulfils its functions only formally. It is thus neither convertible nor transferable. Given the fact that money does not serve as an universal equivalent, it follows that there is no uniform and effective exchange rate that evaluated foreign exchange activities from the point of view of comparative advantage. Thus production and foreign trade turn over does not adapt flexibly enough to conditions of foreign demand.

The absence of uniform money exposes the limitations of the role of the TR, which as mentioned earlier serves merely as an accounting category. Thus the international mechanism of the CMEA integration has prevented the formation of multilateral trade and accounting relations, has resulted in bilateralism becoming the usual form of connection. All the countries try to maintain complete equilibrium under bilateralism. On the one hand, a passive balance of payments would be favourable for each of them for interest is extremely low. At the same time, each country wishes to avoid an active balance as the low interest received means a loss, while under the quota system, the surplus cannot be used to purchase commodities needed. In this system of ties, multilateral clearing turnover cannot be established. No country accepts 'payments' from another country in the form of active balance with a third country, as they cannot use it to buy commodities needed to meet true demands. Under this system the convertible rouble cannot be established, since convertible currency means that all types of commodities can be purchased for it.[21]

The major contradiction in the cooperation of the socialist world market, of the CMEA, is the limitations, in the operations of market categories and laws, arising from the system of domestic econome(or the functioning of the economic mechanism - emphasis mine)... This contradiction appears in various forms in the field of

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21. T. Kiss, ed., n.6, p.140.

external ties. In the international commodity exchange and monetary transactions, in the lack of satisfactory international cocentration and of capital flows, in the difficulties experienced in industrial branch and production level, specialization and the in coordination of plans.[22]

22. Ibid., p.141.

Problems of Inconvertibility & Bilateralism:

Before 1963, trade between CMEA countries was conducted bilaterally and each pair of countries attempted to achieve a balance as close to perfect as possible. Occasional deviations occured as a result of specially planned trilateral arrangements, planned credits and failure of plans to be fulfilled. Because of heterogeneity of distorted price structures which existed among the eastern countries, engotiations were based on adjusted world prices and usually held stable for at least five years. Domestic prices and currencies of the CMEA countries played no role whatsoever in this process. While each country reported its trade in its own currency, this represented simply mechanical translation from adjusted world prices at some exchange rate and the domestic currency values reported implies prices in fact quite unrelated to the actual domestic price structure. No currency needed to be exchanged since trade was balanced. In fact, trade was balanced because of the desire of each country to avoid bolding the currencies of other CMEA countries - a consequence of commodity inconvertibility and distorted prices.[23]

In 1963, the International Bank for Economic Cooperation (IBEC) was formed. A major purpose of IBEC was to free Intra CMEA trade from the shackles of rigid bilateralism. Toward Intra CMEA trade was to be transacted in TRs and members were encouraged to trade with each other multilaterally settling their imbalances in TRs. But rigid bilateralism remained despite the use of TRs. In particular, the CMEA countries which tended to be in overall surplus insisted on balancing their trade with those which trend to be in overall deficit. With commodity inconvertibility, it mattered not whether countries held Zlotys, roubles and other national currecies of TRs - none of them could be spent freely.

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23. It is probably more correct to say that the country suffered from commodity inconvertibility than that commodity inconvertibility was a characteristic of the currency - for even holders of gold and dollars could not freely purchase products, particularly intermediate products, in CMEA countries, because of the havoc this would wreak on the central plans - See F.D. Holzman, 'CMEA's Hard Currency Deficits and Rouble Convertibility, Economics of Soviet Bloc Trade & Finance, (Budapest, 1987), p.156.

So the search for a multilateral settlement system continued. Section 7 of the comprehensive programme of 1971 was devoted to improvement of currency financial relations. Measures were to be deve-loped and implemented by 1973. The year 1973 came and gone, nothing had been accomplished to significantly reduce bilateralism or achieve convertibility.

TR is a measure of value in the most trivial sense of the term. This can easily be seen by asking first how prices in TRs are set? Prices in Intra CMEA trade are fixed on the basis of world prices freed of the harmful influence exerted by the interplay of speculative forces on the capitalist market which ensures its stability and excludes all influence on it by the crisis like phenomenon inherent in the capitalist currency system.[24] In other words, the relative values of products are based on capitalist relative values as expressed in world markets at some point in time, then adjusted and maintained

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24. Comprehensive Programme for the further extension and improvement of cooperation and the development of socialist economic integration by the CMEA countries, Section 7, article 3 (CMEA Secretariat, Moscow, 1971).

fixed, usually for a period of five years. At this point, these capitalist prices are transferred into TRs at an arbitrary rate of exchange, based on the fact that a TR is declared to be worth 0.987412 grams of gold. The point is that the TR has nothing to do with the relationships among prices, these measures of value flow basically out of the capitalist market. For purposes of CMEA trade, it would not matter whether they remained in dollars, or were translated into TRs.

Another problem arises regarding the validity of the TR as a measure of value when one considers that both the TR and Soviet rouble are declared to be worth 0.987412 grams of gold yet (a) Since the TR was established world prices (hence price in TRs) and Soviet internal prices have changed at different rates[25] and (b) relative prices in the USSR have often been quite different from those used in CMEA expressed in TR.

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25. At this point it should be noted that at least, until the recent rapid increase in world prices, the adjusted world prices used by CMEA were substantially higher than real world prices. See F.D. Holzman, n.23, p.157.

TR is a means of payments only in a trivial sense of the meaning of the term. The power of a currency as a medium of exchange is related to the degree of option that one has in spending it. An American citizen with a dollaw can spend it literally thousands of different ways. The same is true of Soviet citizen with roubles or a Polish citizen with Zlotys. The possessor of a TR is in no such formulate position. As a result of commodity inconvertibility, he can only spend it on a particular product in accordance with advance plans. Each TR is like a ration card - it is designed in advance to buy a particular product.

TR is a means of accumulation (store of value). It is a means of accumulation, but certainly, not a desirable means of accumulation. If it were a desirable means of accumulation, the various CMEA countries would not strive so hard to balance their payments with each other so as to avoid accumulating TRs. Not only is the very low rate of interest paid to the holders of the TRs undoubtedly for below the social rate of return on investment in all of the CMEA countries, but the existence of commodity inconvertibility and distorted domestic price structures creates great uncertainty regarding the true value which might be realised on each particular TR that one might hold.[26] A store of value at the time of its realization becomes a 'medium of exchange'.

TR serves very poorly the major functions of money. Not having strong characteristics as 'money' it is easy to understand why the introduction of TR was of no assistance in reducing Intra CMEA bilateralism. So long as the CMEA does not have truly convertible currency, CMEA nations will continue to have to trade on a largely bilateral basis.

TR is inconvertible for the same reasons that national CMEA currencies are inconvertible - commodity inconvertibility and price structures which are distorted, therefore, are unrelated to world price. To eliminate commodity inconvertibility and arbitrary prices radical

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26. By extension of above logic, it can be argued that any nultilateralism introduced in CMEA trade by IBEC in transferable roubles should not be attributed to reinherent qualities of the transferable rouble. See F.D. Holzman, n.23., p.159.

economic reforms are necessary which substitute decentralised planning for the central planning with direct controls which dominates the CMEA at present. The establishment of free internal markets and free prices in which both domestic and foreign buyers and sellers can operate, subject only to indirect state controls, would lead eventually to an organic connection between internal and external markets and price structures, as in the case among western countries. This would create necessary conditions for the convertibility of CMEA currencies. It would not be sufficient however, it would also be essential that each country gets itself into approximate balance of payments equilibrium, thereby establishing the conditions for currency as wess as commodity convertibility.

The eilimination of commodity inconvertibility and arbitrary pricing and achievement of payments equilibrium would permit each country to make its currency convertible and would eliminate the need for bilateral balancing of trade. Each currency would then serve in the international market as a measure of value, medium of exchange and store of value. There would, in fact, be no need for a TR if national currencies became convertible, and trade would be conducted in one of the vehicle currencies, say dollars, or if the USSR continued to be major trading partner of most other CMEA countries then the Soviet rouble might assume the role of vehicle currency for the eastern group of nations.

RECENT SCENARIO AND FUTURE PROSPECTS:

In the initial stage of cooperation, the particular kind of bilateralism that emerged in the CMEA countries from the economies based on plan directives had its positive traits, especially from the point of view of the less developed countries, creating as it did, with the rapid pace of industrialisation based primarily on the mobilisation of external resources, secure external markets.[1] Later, however, bilateralism became somewhat of a fetter on the efficiency of trade and economic integration within CMEA.

The pricing and monetary system of the CMEA is basically a reflection of the domestic economic mechanism of the member countries. In the absence of raidcal economic reforms, this has created serious problems like lack of currency convertibility, lack of multilateralism and the absence of money as an universal equivalent.

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1. Sandor Ausch, 'Problems of Bilateralism and Multilateralism', in <u>The Trade and Payments System of the CMEA Countries</u>, ed. Vazda & Simai, 1971, p.45.

Although the monetary and financial mechanism of the CMEA is today a secondary element in production integration, it is an important one. We have seen that it can promote and accelerate cooperation, but it can also impede progress. After the International Bank for Economic Cooperation (IBEC) was set up in the mid sixties, followed by the International Investment Bank (IIB) there was a formal shift to multilateral settlements; an international credit mechanism was established, and a collective currency, the transferable rouble, was born.

As noted above, the major problem in this new socialist international monetary system is that the multilateral system of settlements in the CMEA is deficient in several areas. Although we have created a legal framework and the accounting and financial means for multilateral settlements, hardly any progress has been made toward genuine mulitlateralism. The member countries still try to balance their bilateral trade flows because claims on third countries cannot be used to cover a deficit. The problem of efficiently stimulating an increase in the volume of trade has not been solved, nor has the problem of balance of payments deficits or surpluses. In recent years several proposals and ideas have emerged. It has become obvious that solving the problem of actual multilateral payments is quite closely related to the improvement of the system of foreign trade agreements, to more trade without quotas, and to other economic policy preconditions, including a comprehensive reform of economic control systems.

Recently even more attention has been paid to the quest for progressive forms of economic cooperation between the CMEA countries. New forms of cooperation were considered necessary at the working meeting of the leaders of the CMEA, countries fraternal parties in November 1986, and sealed in the decisions of 43rd CMEA session in October 1987. The session laid down that economic, scientific and technical cooperation would be on three mutually interconnected levels: Intergovernmental, at the level of sectoral management bodies and the level of associations, enterprises and organizations through direct contacts between them.

Undoubtedly, progress in these matters has been made. The new forms of cooperation highlight many outstanding problems of the CMEA member states which were not fully reasized and they are compelled to overcome new difficulties arising.

Some of the outstanding difficulties which I have discussed earlier will find remedial measures and suggestions in the coming pages.

Role of Prices in CMEA:

In the CMEA planned economies functioning on the basis of directive plan instruction, domestic prices are institutionally completely separated from external prices. The economic units are paid for the exported goods at fixed domestic prices, and pay for their imports likewise at fixed domestic prices. This implies that in reciprocal trade prices are separated from international prices as well as from relations of supply and demand.[2]

Prices in bilateral relations amongst the member countries are based on the so-called Bucharest Principle (first adopted in 1958, and later amended in February 1975 - referred to as the sliding price principle). There are two common features characterising the old and new pricing principles: On the one hand, prices used in intra-regional trade are based on world market[3] (Chief supplier) prices for raw materisl (emphasis in original).

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2. Ibid., p.71.

3. World Market prices are used for raw materials sector. In the case of manufactured goods the concept of world market prices is hardly relevent because of the plurality of markets and great differences in quality - See M. Lavigue, 'The Soviet Union Inside Comecon', Soviet Studies, (April, 1983), p.136.

The reason for this that the centre of the world market price is the international value, i.e. it expresses in some way, in the last resort, the socially necessary and recognised inputs taken in an international sense. On the other hand, these prices have to be 'cleaned', since on the world market monopolistic elements, speculations, power relations and extreme cyclical fluctuations assert themselves, from which in the opinion of the highest leadership of all member countries of CMEA - the economies of socialist countries have to be protected. A way to achieve this is the averaging of main market prices of the last five and three years respectively.

Thus on the sliding price basis, contractual prices in Intra-CMEA trade are corrected yearly, beginning from the period 1976-80. As a consequence of this, the contractual prices gradually come nearer the levels and proportions of world market prices - this method of pricing will remain valid for the five year period 1981-85.[4]

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4. K. Pesci, The Realization of the Principle of Mutual Interests in the CMEA Member Countries Trade Amongst Themselves, (Mime, 1983), p.17. See also International Specialization, Moscow, 1983. It should however be noted that there are some exceptions to the sliding price principle in Intra-CMEA trade.

All this raises a serious obstacle to a correct assessment of the economic effectiveness of external economic ties and renders practically impossible the application in full measure of the self-supporting principle in the sphere of foreign economic activity. When enterprises and association are organising direct production cooperation they have no chance of reliably and correctly assessing the economic profitability of their cooperation.

A radical reform of the price formation system prepared now in USSR is called upon to eliminate the above said shortcomings. The principal factors to be taken into account for deciding new wholesale prices should be:-

(a) Full scale macro economic evaluation of mineral natural resources with thought being given to the impossibility of their renewal and use by future generation;

(b) Fuller account to be made of the geological prospecting expenditure and development of new territories;

(c) Full scale macro economic evaluation of renewable natural resources (land, water, forests, the air) with regard for the total outlays need for their renewal and the requirements for keeping the environment clean;

(d) Full scale account of transportation costs;

(e) Reappraisal of the fixed assets and revision of the depreciation standards with a view to encouraging the rapid replacement of obstacle fixed assets;

(f) Charging to the pay roll all sums needed to finance social consumption funds (health, education, social security outlays, etc.).

With due regards for these requirements, the relationship between the new prices of primary goods, materials and finished articles will better correspond to the price relationships existing in other countries. It will make possible to remove or reduce to admissible limits the existing sharp discrepancy between world and domestic prices based on the production costs at Soviet enterprises and secure their comparability. Revision of wholesale prices can come what result in eliminating the uncertainty as concerns the use of contract prices in mutual exchange goods and services accomplished within direct cooperation ties.

There is no doubt that the application of world prices in CMEA economic relations objectively tends to raise the techno-economic standard and quality of products turned out by manufacturers in the socialist countries and lower their cost price. At the same time it will hardly be correct to absolut-ize without exceptions, the principle of world prices for all types of international cooperation. Practice has clearly showed that some of the agreements between the member countries on international cooperation, which in the long term promise advantages to all the participating countries, are fully or partly unfulfilled because of the lack of understanding on the price level for cooperated products. The purchaser, for instance, while referring to the principles of price formation adopted by the CMEA, is not willing to pay amounts higher than those on world market, whereas for the supplier (manufacturer) exports at world prices, specially, when he begins to turn out new products, prove economically unprofitable.

The use of contract prices may be help in such cases. The right of enterprises to fix contract prices by agreement with their foreign partners, proceeding from their own self-supporting basis, is legally confirmed by the law on state enterprises (Association). For instance, the document, Effective measure to improve the work on specialization and cooperation in production, adopted by the CMEA in 1967, provides for the use, by agreement between the partners of prices departing from the world price level. The possibility of using contract prices is also envisaged in bilateral agreements among the CMEA countries on direct ties.

Contract prices, should be applied on a much wider scale and would be of benefit when setting up mutually advantageeus lines of cooperated production to turn out goods in short supply on the CMEA market. In this case the participants in cooperation, guided by their self-supporting principles, could determine the degree of economic profitability of these lines of production, not necessarily for each individual transaction but for entire range of goods and services mutually supplied.

Role of Exchange Rates:

Given the above pricing system, it follows that there is no uniform rate of exchange in the trading system of the CMEA countries; in other words, member countries do not evaluate exports and imports uniformly for the entire national economy. This is a reflection of the fact that trade amongst the member countries is characterised by lack of multilateralism and convertibility of currency. It is important to point out at this point that trade relations between the CMEA countries are conducted in terms of the transferable rouble (TR)[5] which however, merely serves as an accounting category and does not fulfil the functions of money. It might be useful at this stage to outline briefly the role of the TR. In 1964, the CMEA countries introduced a system of multilateral settlement through a centre. Under this system each creditor or tebtor country would settle its account with the International Bank for Economic Cooperation (IBEC). However, the introduction of the TR did not change

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5. A certain amount of Intra-CMEA trade is carried out in convertible currency - for Hungary such trade amounts to roughly 10% of the turnover - for details See K. Pesci, n.4, pp.132-35.

the bilateral character of trade amongst the CMEA countries, further the TR cannot be converted into any currency outside the CMEA clearing system, finally surpluses in TR can be strictly used within a particular bilateral relationship - for example, if country X has a surplus in TR with country Y, it can use these surpluses only with Y and not with country Z, etc. In short, the TR is neither transferable nor convertible - it constitutes neither wealth nor capital. The role of the TR has been aptly summed up as follows:
For the time being the TR can be used to pay only the planned delivery of commodities and the services performed, if they are comprised in theinternational agreements.
It follows that the international money of the CMEA cannot be considered to be general equivalent that is money in the sense that its holder - once he has acquired, it can buy for it one the market almost without limits. The introduction early in 1987 of Differentiated Currency Coefficients (DCCs) into the practice of currency settlements was conceived as a positive step forward in applying self supporting principles in the sphere of external economic ties. Experience has shown, however, that the use of

DCCs in settlements of export-import transactions between enterprises is not free from quite considerable shortcomings. The number of DCCs is too large, which ma s the entire settlement system extremely unwèildy. Moreover, and this is even more important, the use of DCCs, which have individual peculiarities not only as regards individual commodities but individual enterprises as well, conceals the actually existing differences in the economic efficiency of the export and import of individual products and brings elements of egalitarianism into the sphere of external economic ties. As a result the exchange rate loses the role of being an instrument facilitating comparison of the national production costs in individual commodities with the world's average level, while enterprises starting foreign economic relations are not interested materially in improving their export production structure.

Thus is is necessary to consolidate currency coefficients and reduce their numbers and in fact eliminate their individual character. This work should be done within coming two or three years, so that by the time the reform of wholesale prices is completed there will be a uniform currency rate for all exports and imports or at least a few exchange rates for two or three currency areas.

Simulatneous solution of the price formation and of exchange rate questions and the establishment of two closely connected (from the standpoint of external economic ties) and economically justified norms will make it possible to assess the economic efficiency of cooperating enterprises and bring the self supporting principle fully into the sphere of foreign economic ties.

In this way the bas-ic conditions will be created for making socialist enterprises and association economically interested in developing new forms of cooperation with their partners within the bloc.

If established, the economically sound exchange rate for the rouble backed up by similar measures in all CMEA countries, would bring nearer the solution of one more important problem in the sphere of the socialist countries' international cooperation, namely the task of a change over the mutual convertibility of CMEA countries currencies.

Thus the monetary system of the CMEA countries is determined basically by the domestic economic mechanism characterised by centralisation, priority to physical indicators, relative autarky of the price system - in short commodity and value categories are pushed into the background. The overall conclusion seems to be that the requirements of multilateralism and regional transferable currency cannot be reconciled with an economic system based on plan directives.

Towards Multilateralism:

According to standard international trade theory, bilateralism leads to waste since it either constraints the volume of trade to the export potential of the country with a greater export potential to accept goods which it does not want to buy very much (i.e. the so-called 'soft goods'). The argument was developed vigorously in the context of Intra-CMEA trade by the late Hungarian economist Ausch (1971, 1972). In the trade between the member CMEA countries, bilateralism leads to two particularly unfavourable consequences: firstly, it introduces the distinction between 'hard' and 'soft' goods (it is important to note that the distinction between 'hard' and 'soft' goods makes sense only in the context of bilateral trade - if trade were multilateral the distinction would obviously disappear). If there is a market for hard goods in the West, then each member country strives to export hard goods for convertible currency; otherwise trade in hard goods[6] takes

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6. It is important to note that not all hard goods have a market in the West, e.g. beef, spareparts, surgical instruments, etc., of which there are shortages in the CMEA countries. These shortages are related to the functioning of the domestic economic mechanism of the member countries. For a powerful analysis of shortage in a socialist economy see Kornai (1988).

place within the framework of 'special constructions' . in convertible currency within CMEA, secondly, it creates a lack of flexibilityin, and sometimes even reduces the volume of trade amongst the member countries. For example, within the framework of bilateral quotas for commodity turnover, the countries exchange commodities of different priority according to a determined nomenclature. In case where they can not obtain commodities of fundamental importance from their partners their interest in expanding exports of commodities with higher priority disappears. The country which develops its exports more rapidly finds itself with surpluses in turnover with the other countries cannot obtain any commodities for this surplus and must want for the following period in order to eliminate its surplus balance. In the next period, this country will endeavour to increase its imports from the other countries to a suitable extent, and if this is not possible it will limit its own export. Through IBEC the form of multilateral clearing account used by the CMEA countries since 1964 has for the time being not produced the expected results because of the trend toward bilateral balancing and because of the strict quota agreements.[7]

Recently, within CMEA, trade settled directly in convertible currency has considerably grown. Commodities exchanged within CMEA that are settled in convertible currencies are 'hard' commodities - goods that can be sold on the world market for convertible currency at normal world market prices.

Many consider the emergence of trade settled in convertibe currencies a positive development. They see such settlements as an advance for multilateralism in terms of the development of market and money relations within the CMEA. It is also a positive development in the sense that it creates a mutually acceptable way of engaging in trade that was not possible using the transferable rouble, At the same time, it reduced the effect of the traditional bilateralism in trade and finance that restricts mutual trade. Thus settlements in convertible currencies have increased the extent of mutually

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7. See T. Kiss, The Development of the forms of Economic relations in the CMEA integration, in The Market of SocialistEconomic Integration, ed. T. Kiss, (Budapest, 1973), p. 140.

advantageous international socialist division of labour. They help eliminate the investment contribution tied to some commodities purchased with transferable roubles; but they do strengthen trade in physical units, since instead of linking commodity groups, this exchange links specific kinds of commodities.

As opposed to traditional clearing in transferable roubles, convertible currency trade has the advantage that in the interest of expressing comparative advantages, trade primarily takes place at world market prices and uses world market contractual conditions. Trade in convertible currencies provides the countries with a commonly accepted price. But this positive feature vanishes as soon as more complex manufactured products are traded. Trade in these commodities rarely occurs because of the difficulties in agreeing on prices for these goods. That is why this system cannot be used in all trade.

Consequently, the CMEA members, in their efforts to expand reciprocal production specialization and commodity turnover, need to work out a new a more flexible system of inter-state economic agreements based on the principle of multilateralism suitable for putting the system of multilateral settlement into practice.[8]

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8. Ibid., p.142.

Role of Transferable Rouble & Convertibility:

1. The use of convertible currencies has not been institutionalised in the current system of payments and accounting among the CMEA member countries. Although convertible currency settlements are thus external elements they have existed in economic relations within the community from the outset, mainly for credits and some accounting transactions.

2. The experience which the CMEA accumulated in the area of national currency convertibility is highly useful in the light of present economic requirements of the bloc now being increasingly active in international trade.

The internationalization of economic ties, the deeper international division of labour, especially within the CMEA framework, and development of socialist economic integration, objectively tend to broaden the sphere of using both national currency in international monetary relations and the national currencies of other countries and international means of payment in the internal economic turnover of the socialist state.

3. Because of this, adjusting the member countries' convertible currencies balance of payments has become an urgent task. However, our question is whether expansion of the country's convertible currency trade at the expense of trade in transferable roubles can be of assistance in this process.

4. Currency convertibility under socialism has characteristic distinctions from currency convertibility under capitalism. First, it may only be viewed as a balanced process under the control of the state. Second, its regulation is not the principal means of monetary policy, but only one of its economic instruments supplementing other economic methods regulating the economic mechanism.

To introduce the rouble's convertibility into foreign currency it is necessary to create appropriate organisational and economic conditions envisaging equal rights for all subjects dealing with the socialist state's monetary activities, government agencies, management bodies, associations, enterprises, organisations and physical persons.

Economic factors facilitating the introduction of the rouble's convertibility into foreign currency consist in setting up an effective mechanism enabling the subjects dealing with economic activity to uninterruptedly exchange their money resources in national currency for other currencies and vice-versa. This can be done, however, given the free exchange of the rouble for foreign currency by juridical persons, introduction of a real exchange rate for the rouble and the optimal liquidity level for exchange operations.

The deterioration in the terms of trade that has occured for the smaller CMEA countries since the midseventies and the enormous increase in recent years in the community's need for convertible foreign exchange have led to large hard currency debts and balance of payments deficits among member countries. This has occured as business conditions in the capitalist world have become more difficult and in some cases as capitalist credit has been tightened. The member countries like many other countries on a similar level of development were also unprepared for the increased demands of exporting to the West, including choices on product development and flexibility in marketing. However, a growing indirect trade in convertible currency has emerged with in the CMEA which in contrast to direct trade, is a natural part of technological development.

5. It should be pointed out that if the situation remains the same, present trade conducted in convertible currency will neither cease nor increase substantially. However, indirect trade will rise. Second, while transferable rouble trade will decline further in the member countries' total foreign trade because of the need to increase exports to the West, this in itself does not entail an end to increases in transferable rouble trade or an absolute decline in this trade.

6. There is very remote possibility of making transferable rouble, convertible in either intra-CMEA or east west trade so long as present methods of central planning with direct controls dominate CMEA practice. Radical economic reforms would also render it unncessary, since the reforms required for Transferable Rouble, convertibility would lead to convertibility of the nation currencies of Eastern Europe.

7. Intra-CMEA trade in hard currencies also affects the future of the transferable rouble system. From this point of view, whether the members succeed in making the transferable rouble truly multilateral is a question of secondary importance, for even if they succeed the transferable rouble will continue to be closed system just as difficult for outside partners to enter is clearing systems in general. It will still not be convertible with Western currencies, and it will hinder the CMEA countries from participating in the world economy with increasing flexibility and weight using their own financial instruments. If the joint monetary institutions are maintained, the transferable rouble - in the long run - must become 'convertible', that is a new convertible CMEA currency must be developed. This currency will have to be genuinely convertible. Clearing accounts will then have to be replaced by a system of convertible currencies. Thus, if over the long run the socialist countries want to assume a role in the world economy in keeping with their influence in world politics, and if they want to make use of their national currency or common foreign exchange, ultimately they will have to move to a form of convertibility.

Conclusion & Final Observations:

For economic, ideological, traditional and last but not the least, military reasons the USSR is not likely to abandon in the forseable future her system of planned economy based on directive plan instructions; although even there the system tends towards flexibility. This fact itself sets certain objective limits towards a system of mulitlateralism. For political as well as economic reasons the USSR will also, for a long time to come, strive for bilateralism in her trade with capitalist countries. Profound changes will have to occur in the world's entire economic pattern to induce the USSR to enter into multilateral trade with the latter and to introduce convertibility either on the basis of the capitalist reserve currencies which are undergoing a crisis, or on that of system described above (the rouble as the world's thrid reserve currency) or based on a uniform world reserve currency to be stablised sometime in the future. Until then the USSR will rely on her immense economic resources and gold reserves, most probably prefer centrally directed bilateralism.[9]

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9. Sandor Ausch, n.1, p.45.

Finally, there is an urgent need for introducing a radical reform of the internal economic mechanism in the member countries (with the possible exception of Hungary) for increasing the efficiency of integration in CMEA. Thus the transformation of the domestic economic management system of the CMEA countries ought to move in the direction of reducing direct plan instructions, the increased operation of commodity and money relations, the economic autonomy of enterprises and increasing the scope of their decision rights.[10] As mentioned earlier these are essential requirements for the realisation of multilateral trade (within CMEA) and convertibility and transferability of currencies.

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10. T. Kiss, n.7, p.119.

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