

CMEA at the Threshold of Fundamental Reforms

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As J. P. Hardt observes the availability of cheap Soviet oil and western credits granted at favourable terms were major external factors that facilitated economic growth in Eastern Europe during the 1970's. These factors of the past growth are no longer present.¹⁾ Nowadays in order to service their debts the CMEA countries are compelled to a net transfer of resources to the West what may continue for the next several years. Moreover, the external environment of the East European countries has been deteriorating as the Soviet Union is calling for an end to CMEA trade deficit with the USSR and the repayment of outstanding CMEA debts owed to the USSR. Austerity and economic reforms seems to be the likely economic policy of the CMEA throughout the 1980's.²⁾

Changes in the allocation of resources and reforms in the planning and management systems are at the core of positive transformations necessary for a more intensive, dynamic growth and economic cooperation of the CMEA countries. Recent changes in the Soviet Union and M. Gorbachv's policy of glasnost (openness) create an exceptionally favourable environment for the complex and deep reforms not only in the Soviet Union but also for the reforms in other socialist countries, as well as financial and trading mechanism of the CMEA.

At the 42 nd Session of the CMEA countries held on 4-7 October 1986 in Bucharest Prime Minister of the Soviet Union N. Ryzkov stated: "Actually in the Soviet Union are conducted works to establish a new comprehensive economic mechanism corresponding to the requirements of an intensive development. Reshaping of the system of cooperation with foreign countries is an organic element of this reform. The reforms will have a decisive impact on the development of the Soviet economy, its economic cooperation with friendly socialist countries and economic integra-

tion of the CMEA."³⁾

It seems reasonable to put forward a thesis that there are exceptionally favourable political conditions and a strong pressure of economic necessity to carry out economic and socio-political reforms in the socialist countries and in the financial and trade mechanism of the CMEA. There are also good prospects for establishing in a near future some new forms of cooperation between the CMEA and the EEC. It is also plausible that the Soviet Union and other remaining East European countries will join the International Monetary Fund, the World Bank and GATT.

42 nd Session of the CMEA concluded that it has entered a qualitative new stage of the economic cooperation and development. At this new stage it is necessary to adjust their economic systems and the financial and trade systems of cooperation to the challenges and opportunities of intensive development and international cooperation. A successful implementation of this adjustment depends to a large degree not only on the economic policy coordination but also on the scope and character of reforms supporting the intensive use of resources, their development and technical innovation.

In Bucharest it has been agreed that the member countries will continue their efforts to create the most favourable conditions for the development to new progressive forms of industrial and trade cooperation between enterprises of the member countries. The first steps in this direction were made during N. Ryzkov's visit to Poland at the beginning of 1987. Both sides have signed an agreement to support the establishment of direct production and trade cooperation between Polish and Soviet enterprises. Similar agreements were concluded between the Soviet Union and Bulgaria, Hungary, CSRS and East Germany. Those agreements are in line with earlier agreements on specialization and cooperation and Complex Program for Scientific and Techno-

1) J. P. Hardt, *Foreign Trade and International Finance of East European Economies: Slow Growth in the 1980's*, Joint Economic Committee, US Government Printing Office, Washington 1986, p. I.

2) Ibid.

3) "Aktualnyje zadaczi socialsticeskowo sotrudnicestwa," Wnieszniaja Torgowlja nr 1/1987, p. 2.

logical Progress of Socialist Countries up to 2000.

In Bucharest N. Ryzkov stated that economic reforms in the Soviet Union are of a decisive importance for the development of the Soviet Union and for the other socialist countries. The reforms are in fact a reflection of decisions made by the 18th Soviet Party Congress to make fundamental reforms and to use foreign economic cooperation and international division of labour to strengthen the dynamism of the Soviet economy.

In October 1986 Institute of the World Economy and Socialist System organized an international conference on ; New Tasks and Problems of Cooperation of Socialist Countries in the limelight of Party Congresses. It is interesting to observe that it is O. T. Bogomolow and J. C. Szirajew directors of leading Soviet institutes that advocated a comprehensive economic reform of the CMEA trading and financial system. They were supported first of all by Polish and Hungarian economists.

Economic integration of East European countries is an objective tendency to internationalize the economic life and a necessity to increase economic efficiency and responsiveness to economic and technical challenges and opportunities. One of the basic tasks of the CMEA is to create conditions for the accelerated and intensive growth of its members and the CMEA as a whole.

If economic integration is understood as a process it is natural it has to adjust constantly to changes in the international and internal environment. These constant changes require also a continuous adjustment of the system of cooperation and economic policy of member countries. Despite a substantial progress registered by socialist countries in their economic integration there is a growing consciousness that the financial and trading system of the CMEA mechanism is becoming obsolete. Since the beginning of the 70's all attempts to adjust the system to the needs of intensive growth and internationalization of economic life have ended in a practical failure.

The most important attempt of a comprehensive reform was "A Complex Program of Further Deepening and Perfection of Cooperation and Development of Socialist Integration of the CMEA Countries" accepted at 25th Session of the CMEA in Bucharest in 1971. This Program was of a general character. Its basic philosophy said that socialist economic integration of an institutional character has to be complemented

by an active trade and financial systems. It advocated a more liberal, decentralized trade and financial relations and a gradual abandoning of bilateral clearing operations and introduction of multilateral ones. One of the basic tasks of the Program was to achieve convertibility of transferable rubel and national currencies at the early 1980's. Actually the Program has not been implemented, however its ideas are still alive.

To make a proper diagnosis and outline some remedies for the future it seems reasonable to ask why the Program has not been implemented despite some evident signs of economic stagnation and extensive growth in the CMEA countries. The answer is that the Program has been related only to the CMEA mechanism. The fundamental weakness of the Program was to advocate a reform of trade and financial system of the CMEA without simultaneous reforms of planning and management systems of national economies. As a result the logic of a new system of the CMEA cooperation has not been compatible with the systems of national economies. An implicit assumption that it is possible to introduce price and income mechanism and such instruments as multilateral exchanges and convertible currencies in trade and financial relations of the CMEA members without simultaneous reforms of their domestic systems was a methodological error. Any system of international economic cooperation is in fact a reflection and outcome of the domestic systems and policies of major members of international community.

The present situation in the CMEA seems to be much more favourable for the reform than it was in the 1970's. This assessment is supported by :

1. Stagnation in the field of specialization and technical progress and a growing understanding of necessary adjustment of economic policy and system to the needs of an intensive growth, technical progress and trade demand.

2. Far reaching institutional and economic reforms in socio-economic life in Poland and Hungary and what seems of the basic importance because of its position and role in the CMEA in the Soviet Union. Although China is not a member of the integrational group, there is no doubt that its successful economic reforms and dynamic growth stimulated East Europeans to look for a new, more effective systems and policies. Basic issues of the CMEA trade and financial reforms.

Consultative meetings on economic policy have been institutionalized to the regular and present character by the Comprehensive Program. The Program states clearly that the CMEA members shall systematically consult each other before drafting national plans and policies. Mutual consultations concern all problems of mutual interest with special reference to cases of multilateral character. As consultations embrace communication and harmonization of national economic policies and basic instruments of their implementation we can conclude they are one of the most important ways of coordination of economic policy of the CMEA member countries.

Nowadays it is the Soviet Union, Poland and Hungary who have entered the path of economic reforms and who are the main proponents of a transformation of the CMEA mechanism and policies. Multilateral consultations of the CMEA member countries take place within Committee on Cooperation in Planning, where programs and consultative meetings are prepared and held. While in the second part of the 1970's CCaP helped to reach conclusions in some important undertakings like cooperation agreements and joint investments now it is more engaged in the consultation and discussion on the reform of the CMEA mechanism. Its interests have shifted from joint investments in large projects undertaken by central authorities to joint ventures carried out by enterprises on their own initiative.

Coordination of economic policies leading to strengthening of economic equilibrium, transformation of seller's markets prevailing in majority of socialist countries into the buyer's one, accelerating of technical progress and increasing elasticity of supply are of a fundamental importance for the future development of economic integration of East European countries. These developments are a necessary precondition for a gradual abandoning of bilateral negotiations of trade agreements which form the mainstay for bilateral clearing operations and form an obstacle to active use of exchange rates and general price mechanism and financial instruments.

With the general evolution of the character of plans in Hungary, Poland and recently also in the Soviet Union one can expect a gradual shift in the character of planning and weight ascribed to central planning. In a result of economic reforms the role of long-term planning of strategic character will gain in importance while the coordination based on input output methods will

have to adjust its role to the new mechanism and policies of major CMEA countries.

From the point of dynamic development of international economic cooperation and integration based on specialization it is necessary to reject a bilateral balancing of mutual exchange for given groups of products and limit it to basic and being in short supplies fuels and raw materials. Resignation from bilateral balancing is a precondition for specialization, multilateral trade and payments. However, as has been indicated earlier this depends on achieving a real equilibrium at domestic markets and introduction of an economic mechanism compatible with the logic of the international economic system. It would be unreasonable to expect a smooth functioning of a dual system. Such a lack of compatibility between domestic and international economic systems has been the main reason for the failure of earlier attempts to adjust the CMEA system to the international one.

However, no one can deny that efforts should be made to reform this system. First of all it is necessary to get rid of evident weaknesses and stimulate positive transformations of domestic systems. Between both systems there are clear feed-back effects. A simultaneous reform in the external and internal sphere can ignite positive cumulative changes leading to new allocation of resources and its more intensive use.

One of the first steps in streamlining of the CMEA system could be a devaluation and separation of transferable rubel from the Soviet rubel. An exchange rate of transferable rubel should be based on "basket of convertible currencies" which are of basic importance to the CMEA trade. This separation of the exchange rate of rubel and transferable rubel would not be so important if the rubel exchange rate were a realistic one and the Soviet Union decided to make it convertible for other convertible currencies or gold.

A realistic rubel exchange rate requires an introduction of world market contract prices to domestic prices. This would put an end to the insulation of national economies prices from the tendencies in the world prices. This being a general principle does not preclude a use of stabilizing mechanism for selected articles (agricultural products, fuels and some raw materials) for given periods of time under the mutual agreements between countries, enterprises or their associations.

Price system formation in the intra CMEA

trade is based on the world prices for a five year periods, preceding the current year. This formula of shifting five-year averages brings some stability but at the same time it has some serious weaknesses. Most important among them is that the prices in intra CMEA trade are in fact divorced from the current world trend and therefore decrease an adjustment ability and a proper allocation of resources.

Improvement of intra CMEA price system is a very difficult issue. A change in prices leads to gains and losses of individual countries. It seems that internationalization of economic life leads to closer relation of intra CMEA prices with current world prices. This implies the necessity to reform internal price structures and ways of their formation in all member countries as well as to introduce realistic exchange rates.

A realistic exchange rate of rubel means that it should be devalued from the present 0.65 Rbt to 1 US\$ to the magnitude of 2-2.5 Rbt to 1 US\$. Such a realistic rate coupled with the mechanism of transmission of world market prices on domestic prices would be a milestone in economic calculus closer to real life. This would mean elimination of existing isolation and distortions in the price mechanism and substantially increased adjustment ability of domestic economies to international environment.

The role of international rubel (as opposed to transferable rubel which is not a rubel per se and is not transferrable as well) and its basic functions as an international currency would increase.

The other important step which should be considered is much more difficult. It is a transformation of bilateral clearing to the multilateral one. At present the CMEA members settle their accounts in bilateral clearing, even though technically the International Bank for Economic Cooperation can manage multilateral operations as well. This is because member countries take a great care to assure that mutual trade is balanced, not only in overall trade but also in particular commodity groups, according to their importance. This situation is to a large extent a by-product of seller's markets prevailing in the CMEA. Moreover, if mutual trade is not balanced, then a surplus means an automatic credit to the deficit country that cannot be practically used for purchases of goods of one's choice in the CMEA markets. As credit is automatic and extended at a very low interest rate (below the rate of inflation) it is understandable why the countries

try to avoid an export surplus. No one is eager to increase its exports over imports in a given commodity group.

It is clear that without reaching a general equilibrium at domestic markets, abandoning regulation and central allocation of resources one cannot expect rejection of bilateral trade agreements based on commodity balancing and commodity contingents. Without a radical increase in elasticity of supply which is conditioned not only by an introduction of equilibrium prices but also by a much greater mobility of factors of production and demonopolisation of economy, i. e., competition it will be practically impossible to bring about internal and external equilibrium. Therefore it would be also difficult to abandon bilateral trade commodity group balancing and bilateral clearing operations.

The other element of reform which is technical in nature but important for autoregulation mechanisms and departure from the practice to restrict ones exports sales to the planned amount is to bring an interest rate on trade credits to a realistic market level. Extending credits and achieving an export surplus should be profitable to the exporter. At the same time a realistic interest on extended credits could be used as a mechanism, instrument of economic pressure on a deficit country to balance its accounts. This would compel a deficit country to take necessary adjustment measures but at the same time would not limit an export supply.

System of multilateral settlements of trade accounts requires a gradual introduction. As not all East European countries are prepared to accept such a new system because of their different balance of payments position one of the ways to start it is to give the right of the multilateral compensation to the deliveries based on cooperation agreements and joint ventures. The idea put forward by the Polish economists is that an export income of joint enterprises could be used freely to finance imports from the CMEA member countries (i. e., above annual protocols and quota agreements).

The implicit assumption is that :

— contract prices are transmitted to domestic prices paid by enterprises and have an impact on decision-making and specialization of partners,

— exchange rate of national currency to the international rubel enables abandoning of equilization settlements with the budget,

—enterprises base their decisions on economic calculus and financial capabilities.

The export income proceeds deposited at the bank would be interest bearing. The owner could use freely such a fund to buy or to sell a deposited currency to other enterprises above the official rate to get a premium. This proposition is aimed at increasing mobility and flexibility in production, trade and finances.

The basic precondition for a rational operation of such a system, as has been indicated earlier, is an easy access to foreign partners and their readiness to supply products without any restraint. Decentralization of distribution systems and rejecting an old practice to negotiate trade bilateral agreements based on balancing commodity groups means in fact liberalization of trade and exchanges. Polish experience in currency retention quota clearly shows the other socialist countries the way leading to a gradual introduction of currency convertibility. It is obvious that rationality of such a system depends on the simultaneous and adjusted introduction of it by all the CMEA members.

All those partial measures are not substitutes but only complementary steps to the restoration of market mechanism and equilibrium in the CMEA. Therefore, without general comprehensive reforms in socialist countries based on the same logic of active auto-mechanisms complemented by a positive industrial policy the targets of 42nd Session of the CMEA will not be achieved and as J. P. Hardt predicts, the late 1980's and early 1990's would be a period of a slow growth, austerity and socio-economic troubles.

Therefore the general philosophy of economic reforms in East European countries should be to stimulate savings and mobilization of resources, social energy and entrepreneurship for an increase of new, more efficient and more advanced technologically products and an increase of an adjustment ability to respond to changing economic

environment at home and at international markets.

Therefore it is necessary to lift institutional and legal barriers to social initiative and economic activity. Price and income mechanism, decentralization and gradual demonopolization of economy, mobility at factor markets, competition which requires a free entry and exit and a vast pool of small and medium enterprises including private ones are essential to stimulate entrepreneurship, adjustment and innovation. Economic mechanism and calculus at the enterprise level supported by an active positive industrial policies should guide allocation of resource and social energy to the most prospective from the point of dynamic comparative advantage sectors of the economy. Positive industrial policies picking up winners and stimulating restructuring of the economy along the lines of changing comparative advantage is a necessary element of economic strategy to increase savings, efficiency, technological progress, elasticity of supply and maintain economic equilibrium.

A large scale distribution of national income through the budget disturbs functioning of price and income mechanisms. Therefore the small budgets and budget deficits are important preconditions to restrict subsidies and high taxes.

The directions of economic reforms in Poland, Hungary and first of all in the Soviet Union are of a great importance not only for their economies and intra CMEA trade but also for the future of East-West and East-South economic relations. They create new legal and economic opportunities for new forms of cooperation including joint ventures and direct foreign investments. In Poland, for example, small foreign investors founded more than 800 enterprises which employ over 65 thousand workers, i. e., a number comparable to the employment of Japanese investors in Western Europe.