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CMEA BILATERALISM -- WHY DOES IT MATTER?

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Summary: This paper is prompted by the news that preparations are underway for a summit meeting of party first secretaries of the CMEA member states. The declared purpose of this summit is to find ways to increase CMEA integration. One of the enduring obstacles to economic integration has been the tendency of all CMEA members to trade through bilaterally planned trade agreements (BPTAs). This report argues that while, from a Western microeconomic viewpoint, bilateralism is much more inefficient than true multilateral regional integration, from a wider strategic viewpoint -- in particular a Soviet viewpoint -- bilateralism may be more secure. Therefore, one should be careful before interpreting requests for closer CMEA integration as demands for overall reform. Within the CMEA the important question may be "how can we pool resources and technology without threatening the basic strategic relationships within the bloc? How can we introduce flexibility and hence adaptiveness without inducing instability?" The additional fear of the East European states that integration on the existing pattern would simply intensify their dependence on the USSR is perhaps well-founded, and accounts for Hungarian lobbying and Romanian intransigence. Until bilaterally planned trade is a thing of the past, this feeling is likely to continue.

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Economic Integration. Western analysts often use economic integration in the sense familiar to them, which is to say, as it happens in the West. This ignores a question of types. There are two extremes: completely planned integration, which would model international cooperation on the ideal type of the command economy, and the anarchic integration of a completely free market. In the latter case, the argument goes, integration is achieved by virtue of competition. This leads people to see advantages in cooperation and specialization, in grouping together in appropriately sized

companies, and in access to a wider market. Neither of these extremes exists in practice, and it could be argued that a really free market would see very little integration if it were a competitive system of small producers and if tendencies to monopoly or oligopoly were suppressed; but existing regional integrations like the CMEA or the EEC can at least be placed somewhere on the scale between them. In this case, the EEC, despite a large central bureaucracy and extensive government regulation, tends to be integrated by contact and cooperation between individual companies, be they multinational, national, or local. In the EEC the benefits of integration are mostly reached in a decentralized fashion, through decisions made by individual firms. In the CMEA the mode of integration belongs firmly to the planned end of the scale, planned in the sense of centrally planned, with no integration decisions taken by individual enterprises on the basis of commercial criteria. The measures used to determine the extent or effectiveness of integration in the West may not be really appropriate in assessing CMEA integration, and should only follow the most careful understanding of the purpose of such cooperation.

Among the purposes of regional integration we can distinguish between the aims of efficiency and of survival. Efficiency describes all those features of integration that are economic in inspiration. Specialization in production, the removal of barriers to trade and cooperation in investment projects are all designed to confer a comparative advantage, both inside and outside the region, on the member states. Inside, by erecting a tariff barrier that gives internally produced goods a head start over those imported from the rest of the world, and outside by the efficacies of internal cooperation and coordination.

No one could pretend that the main motive for integration is efficiency. The political will motivating countries to integrate is generally a wish to survive in a competitive world, and economic efficiency may help them do this better. However, once the political impetus is given, then the quality of survival, if it is measurable, is greatly affected by economic factors. In the case of the CMEA, belonging as it does to the planned end of the spectrum, economic integration depends on institutional cooperation and organization. In a centrally planned economy all lines of command lead to the center, so that cooperation between countries requires joint planning at the highest level. Although these countries have frequently entered into cooperation agreements and engage in joint projects, this degree of centralization prevents them from taking full advantage of the "international socialist division of labor" and the potential for extending it.

The main result of bureaucratic centralization is the bilateral trade agreement. Trade must be incorporated into the national plan of both countries as both inputs and outputs need to be decided administratively. This leads to bartering and to financial and commodity inconvertibility. It is impossible under this system for a trading partner to use spare currency to buy more of a particular item. Instead each must barter with its own produce, in advance of need. However, commodities cannot be converted into currency, so what then determines the price of the exchange? There has to be some system of determining the value of these goods, so that they may be exchanged.

To overcome this problem of the value of the exchange, the CMEA countries use a method that averages world prices over the past few years: in effect, capitalist market prices, with the fluctuations ironed out. This has some undesirable consequences. For one thing, these prices have little to do with the relationship between supply and demand within the CMEA, and do not reflect the relative scarcities of specific types of goods in the communist countries. Furthermore, these prices have little connection with the domestic prices and costs of any CMEA country. The CMEA states also have made little attempt to align or coordinate their domestic price systems with one another, so it is clear that rational calculation is very difficult. Added to this, some goods within the CMEA are, in fact, much more valuable to both trading partners than their CMEA prices suggest. These are called "hard goods," as opposed to "soft goods," and their existence means that bilateral agreements between countries must be balanced according to degrees of "hardness," since no country is going to accept the exchange of a hard commodity for a soft one even if their administratively determined values are the same. In addition, these "hard goods" have a separate real market value in hard currency between CMEA members and can be traded for that value, above and beyond any bilateral agreement.

This system entails immense administrative costs, both in time and effort, and complicates inter-CMEA trade enormously; it also means that trade and planning are based on unreal prices. At the very least this hinders integration, because it makes trade with the Western countries a more reliable source of profit, and a profit that is readily convertible.

Multilateral barter trade, although theoretically possible, is very difficult to arrange. This practical difficulty means that the dominant form of trade for each East European CMEA member is its bilaterally planned trade. The bilateral barter system centers on the Soviet Union rather as the spokes of a wheel do on its hub. The USSR is each CMEA member's biggest trading partner, and thus so forms the hub of this "radical pattern" of dependence. This dependence is qualitatively greater if the composition of trade is taken into account. The East European states are heavily dependent on Soviet supplies of raw materials and fuel, and the evidence increasingly suggests that in recent years they have been effectively subsidized by cheap Soviet supplies, cheap in the sense that the USSR could obtain a consistently higher price for the same materials on the world market.(1) Within the centrally planned economy itself,

(1) See Philip Hanson, "Soviet Trade with Eastern Europe," in K. Dawisha and P. Hanson, eds., Soviet-East European Dilemmas (London: The Royal Institute of International Affairs, 1981). Hanson makes the point that it is difficult to assess who has benefited the most from this subsidy in the last decade. Although the East European economies have been subsidized, the turning of trade toward the Soviet Union has retarded technical change and has been detrimental to the growth of production and income levels in the region.

this radial pattern of dependence is likely to have arisen from a desire for easier political control and the competing fears about national sovereignty that interpret all moves to 'multilateralize' as a threat to autonomy.

Bilateral Dependence on the Soviet Union. Bilateralism is itself a crude form of integration; it links each CMEA member's economy with the USSR. It parallels the centralization of the Soviet economy itself. There is evidence that this centralization is desired by people in the Soviet hierarchy influenced not only by economic but also by strategic considerations. It is a military constraint on any substantial decentralization. Multilateral relations are decentralizing because they allow the CMEA members to make agreements independent of their own planners and of the USSR, and they lessen the control of the central planners in the member state itself. It is interesting to note in this context that the pattern of superficial multilateral relations underlain by a more important radial pattern of bilateral agreements with the USSR is observed in the Warsaw Treaty Organization, as John Erickson has observed:

While it is true that the multilateralism of the [Warsaw] Pact can and does serve wider political purposes, such as arms control and disarmament processes, which can be used to adjust the correlation of forces in Europe as a whole, the basis of the military structure rests on bilateralism, strictly enforced and assiduously nurtured by the Soviet Union, whatever the talk of a "Socialist Military Alliance"(2)

Two important military considerations influence CMEA integration. They can be classified as an internal and an external threat, the one the perceived threat from instability within the bloc and the other the perceived threat from the West. Both are furthered by bilateral economic agreements: existing patterns of integration centered on the Soviet Union mean that the Soviet military-industrial complex can get what it wants. The lack of genuine multilateral relations between the East European members of the CMEA prevents cooperative independence from the Soviet Union. It also prevents decentralization and things (goods, innovations, expertise) passing the USSR by. For a large strategic power, bilateralism, be it military or economic, is a fairly effective method of control.

In this case, the inefficiencies of bilateralism are subordinate. That is not to say that they do not matter; after all, one strategic consideration boils down to how well the Soviet sphere can keep up with its competitors, and to that extent military men must be concerned with economic efficiency. It is, however, a mistake to think that this means Western style economic efficiency. Efficiency is efficiency in achieving a declared purpose. In the West this

(2) "The Warsaw Pact -- the Shape of Things to Come?" in ibid.

usually implies satisfying the consumer, be it the electorate or the state. The Soviet military interest in efficiency is most likely to be in the most efficient way of ensuring that resources, products, and technology continue to flow to the military sector. After that, the satisfaction of the civilian consumer, and to some degree even the USSR's satellites' own military needs, is a secondary purpose pursued for the sake of stability.

The whole pattern of integration in the 1970s, after the comprehensive program was inaugurated, began with joint investment schemes, which effectively strengthened the hand of the USSR. Those joint investment schemes that were multinational were nearly all located in the Soviet Union, were designed to further develop Soviet resources, and all increased East European investment in the Soviet Union. This was a time when the East European governments would have preferred to invest in domestic projects in order to increase their ability to export to the world market.

It should be noted that this bilateralist dependence on the Soviet Union is not quite the "feudal" relationship it is sometimes made out to be. As Hannigan and McMillan explain, (3) the advantages, outside of the opportunity cost of investment already described above, are mutual. Even the investment, although in the short term reducing the amounts available for restructuring the East European member's economy, could be said to further this very aim in the long term, as the supplies of fuel and raw materials ensured by participation in the scheme may free money for a later date. Hannigan and McMillan also show that the joint investment projects have contributed little to multilateral specialization in the CMEA, but have served a cruder type of integration, a bilateral type of dependence on the Soviet economy. Along with the disadvantages, in terms of trade, that the Soviet Union apparently tolerates with its CMEA partners, (4) this would indicate the operation of wider political motives above and beyond the requirements of efficiency, at least insofar as the return on the investment is seen as intangible and not strictly financial.

Given these deficiencies of the bilateral approach to trade, there have been some attempts to alleviate the inefficiencies imposed on the CMEA by the existing system. The history of such attempts is long and complicated. The most important, for assessing the moves likely to be made at the forthcoming CMEA summit, are those policy statements made since 1971, since the introduction of the Comprehensive Program.

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- (3) John Hannigan and Carl McMillan, "Joint Investment in Resource Development: Sectoral Approaches to Socialist Integration," in East European Economic Assessment (Washington, D.C.: US Congress, 1981).
- (4) See, in this context, the discussion in Philip Hanson, op cit.

The Root of Present Attempts To Promote Multilateralism -- The 1971 Comprehensive Program. After the last summit of CMEA party chiefs in 1969, attempts were made to work out new forms of cooperation and coordination. These culminated in the Comprehensive Program of 1971. A large and fairly vague document, it nevertheless laid out the future priorities of the CMEA planners. (5) Part of the program was just a catalogue of areas of agreement on the need for common forecasting. This covered the areas of mining, engineering, agriculture, and transportation. More significant were the sections setting out the course of future work for the CMEA as a supranational planning agency. (6) Also significant was the attention devoted to "market measures" for integration. These included a timetable for a degree of convertibility among the CMEA currencies and moves to establish direct autonomous trade links between enterprises. Little has actually been done, to date, on these proposals. The program classified trade goods, for example, under three categories: "important commodities," which are planned in fixed quantities; "fixed value quotas," where the amount should be negotiated after planning between the buyer and the seller; and "nonquota goods," where the trade should be left to direct links between autonomous producers and consumers. The hopes for this last category of trade have not been realized, the volume remains small (around 4%). As long as the transferable ruble (the official CMEA currency) is prevented by bilateral bartering from operating in a freely convertible way, the scope for this kind of independent trade, so important in Western style economic integration, is very small. The two CMEA banks, the International Bank for Economic Cooperation (IBEC) and the International Investment Bank (IBB), were also supposed to promote multilateral trade by issuing trade credits above and beyond those planned, on the basis of merit. This they have done to a certain extent, though not through the transferable ruble, as first planned, but through convertible (hard) currency borrowed from Western banks largely on the strength of the Soviet Union's credit-worthiness.

The Comprehensive Program stressed three areas of integration: improved plan coordination; joint CMEA investment projects; and cooperation in long-term "target" programs. The joint investment projects have already been discussed under the heading of Soviet dependence, because the East European countries regard them as designed to increase CMEA investment in the Soviet Union at the expense of investment in their domestic industries. Improved plan coordination has meant that consultation before bilateral trade negotiations begins earlier than before, and since 1973 it has meant that most national economic plans in the region contain a special section outlining integration measures. In particular, the plans list the resources allocated for the construction of CMEA joint projects, and it should list those resources devoted to domestic industries with bilateral or multilateral specialization agreements within the CMEA. Again, it should list the commodities received in return for these agreements.

- (5) A fuller discussion of this can be found in Paul Marer and John Michael Montias, eds., East European Integration and East-West Trade (Bloomington, Ind.: Indiana University Press, 1980).
- (6) In deference to East European fears of reduced independence, the CMEA has carefully worded agreements, but even if confined to sectors of industry, the aim is still a supranational organization.

This kind of coordination appears only to standardize the information on joint projects but not to affect the substance of integration itself.

The target programs are a more sophisticated step toward integration. The "targets" are the following sectors:

1. Fuels, energy, and raw materials
2. Machine building
3. Industrial consumer goods
4. Agriculture
5. Transportation

In these sectors member countries are expected to:

1. Jointly forecast production, consumption, and trade patterns for the next 15 to 20 years
2. Coordinate medium and long-term sectoral plans
3. Jointly plan selected key commodities
4. Continuously exchange information.

At first these target programs appeared simply to increase the plans for further East European investment in the USSR. More recent signs indicate that the format is moving away from joint investment in Soviet projects to those that develop export capabilities in Eastern Europe. Compensation of the East European countries' investment by sharing the products has, for example, been replaced by plans for short-term countertrade. Unfortunately, little evidence exists of precisely what these target programs are achieving. Implementation seems to have been full of logistical difficulties, and a lot of the problems -- perhaps differences between the CMEA members -- appear unresolved. It might be that the forthcoming summit is intended to present the fruition of these programs. What is clear is that they have not yet influenced the system of bilateral barter, except in prompting discussion of different solutions to trade and investment problems.

The Coordinated Plan of Multilateral Integration Measures. The first such plan was endorsed in 1975 and the second is currently being implemented. It is perhaps the most realistic CMEA integration measure, designed to achieve a piecemeal improvement in integration. The 1976-1981 plan concentrates on specific targets in a number of fields:

1. Some 9,000,000 transferable rubles to cover transfers of materials and finance in existing joint projects
2. A great number of multilateral specialization and cooperation agreements in the engineering and chemical sectors -- including computer technology
3. Scientific and technical cooperation projects, particularly those improving sources of energy and raw materials
4. Measures to improve the development of Mongolia
5. The detailing of the consequences of the concerted plan

It appears that the 1981-1985 plan has continued to pursue the goals set in the first plan. The coordinated plan is successful in that it will, and perhaps already does, alleviate certain shortages and gaps in CMEA production, but its piecemeal nature makes it an interim measure rather than a real reform. It is only beginning to fill the gaps caused by the bilateral trade system.

Socialist "Multinationals." One other important attempt to overcome the deficiencies of bilateralism should be mentioned. That is the creation of socialist "multinationals" that follow the Comprehensive Program although legally they are not CMEA organizations. They are designed to coordinate joint economic activity in research and development, production, services, and foreign trade. Originally, assets were put at the disposal of some of these enterprises, after which they were expected to become self-financing. Others are directly financed from state budgets. Given the importance of multinational corporations in Western economic integration, those that are formed from the cooperation of individual enterprises, and not centralized state organizations, are the most interesting. They perhaps form a legal and experimental basis for the socialist multinational. It is difficult to avoid the impression that they are still expected to work in a very ad hoc fashion, with a profusion of disparate types, despite their growth in the last 10 years.

Conclusions. This, then, is the pattern against which talk of further CMEA integration should be assessed: An enduring system of bilateral agreements, mainly concerning a barter of products, focusing principally on the Soviet Union. What little has been done to promote joint CMEA investment has tended to emphasize rather than diversify this pattern. This is overlain by ad hoc policies and projects designed to overcome some of the most immediate deficiencies of the highly centralized system, such as target programs and the socialist "multinationals."

The bilateral trade agreement prevents effective calculation of value and hence effective trade integration between the CMEA countries. The desire to balance trade through these agreements leads to two classes of goods -- hard and soft -- which are undervalued and overvalued, respectively, by the CMEA price system. This leads to a type of multilateral trade using hard currency gained from exports outside the CMEA, to buy "hard" goods from one another. It also diminishes interest in joint investment projects inside the CMEA, which take away resources that could be used to increase domestic hard currency exporting ability. Thus, the bilateral trade agreement can be seen to have considerable economic disadvantages in that it prevents full use of the potential in the division of labor (specialization of production) among the CMEA countries. It has been the case that it offers certain strategic advantages to the Soviet Union, facilitating control and command in the event of a crisis and ensuring supplies to the military-industrial complex in general. What attempts are made to overcome the inefficiencies of this system depend on the relative perception of internal and external threats, the one to stability, the other to security. Both affect the region's ability to survive in a competitive environment. Up to now, measures

to promote multilateral integration have been piecemeal and sparse rather than comprehensive (despite the name of the 1971 program). This suggests that the external threat has been perceived to be greater than the problems caused internally by an inflexible CMEA system.

In this respect, it is significant that the renewed requests for an economic summit have been aimed, on the Soviet side at least, at reinforcing existing channels and organization. The motive behind the desire for greater regional integration seems to be a wish to increase the barriers against the outside world, to increase the region's autarky. Insofar as internal integration is mentioned, the Soviet Union appears more anxious to attract innovations and high technology products for itself, and concerned to strengthen trade ties, i.e., economic dependence, between itself and its East European partners. This is quite consistent with a strategically motivated "bilateral" structure.

Where this picture is complicated is not in Soviet thinking but in the legitimate fears of the East European countries that their national autonomy is threatened by any strengthening of the existing system of centralized integration. Their independence, such as it is, can only remain unhindered by greater CMEA integration if the process takes place in a decentralized fashion, i.e., through market mechanisms and independent contact between producers and consumers, without the intermediation of the national planning authority. This is articulated clearly only in Hungary at the moment, and lies behind the many articles dealing with the need for a comprehensive reform of the CMEA published in Hungarian journals. In particular, it leads the Hungarians to demand currency convertibility as a first step, since without that, bilaterism will persist as the only means available to balance trade. This convertibility would, however, mean trading at world market prices, and it is doubtful whether many other countries, aside from Hungary, would agree to that.

The second problem caused by bilateral bartering and a centralized system of integration has already been touched on in talking about dependence on the Soviet Union. Because integration is achieved institutionally and hence specialization is agreed upon or planned in advance, it tends to fossilize existing levels of development. This fear is voiced mainly by Romania, and has been one of the root causes of Romanian resistance to the CMEA all along. With a planned system, the exchange of manufactured products from the more developed CMEA countries for raw materials from the less developed members tends to become codified. Yet, because each individual country has been aiming at an ideal of autarky, or self-sufficiency, the investment of each country is aimed at balancing its internal economy. So the underdeveloped country has invested in manufacturing and processing industries, while the more developed has devoted resources to expanding and improving its extractive industry. It is clear that this mitigates against an efficient division of labor among countries, and that the less developed countries would suffer most if any supranational CMEA authority were to decide who should

produce what on a comprehensive scale. The primary producers, like Romania, would become ossified in the role of raw material supplier and dependent on the other CMEA countries for a lot of manufactured products.

These conflicts between perceived national interest, ideology, and the demands of different groups are not confined to the CMEA alone. However, the phenomenon of bilateralism, a consequence of the centrally planned economy, makes the resolution of the conflicts particularly difficult. In the rest of the world, they are eroded by the thousand and one ways in which integration can take place, gradually, over time and in a piecemeal way. In the CMEA case, they must be overcome all at once.

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CORRECTION to Ralph Kinneer, "Bonds and Shares -- Creeping Capitalism or Creeping Socialism?" RAD Background Report/214 (Hungary), 7 September 1983, page 4, footnote (10), line 4: the figure should be 35,000 million.