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A Note on the Soviet-Bloc Clearing Union

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Introduction

During the meeting of the Soviet bloc's Council for Mutual Economic Assistance, which ended June 22, 1957, an agreement was reached on the creation of a multilateral trade and clearing union of member countries of the Council: Albania, Bulgaria, Czechoslovakia, Eastern Germany, Hungary, Poland, Rumania, and the Soviet Union. The accounting unit will be the Soviet ruble, and a special joint banking institution is to be set up to act as agent for the carrying out of settlements under the agreement. This agreement followed the discussions in May 1957 in the U.N. Economic Commission for Europe on a multilateral compensations scheme (see SM/57/45) which made it possible for countries to participate in voluntary and non-automatic compensations of balances arising under bilateral trade and payments agreements between Eastern and Western European countries.

The establishment of the Eastern clearing union, particularly in view of recent revisions by some of the Soviet-bloc countries of exchange rates applied to a part of non-merchandise transactions, might suggest that major changes in the Soviet-bloc trade and payments system are in the making. The expectation has been expressed that the establishment of the clearing union will have multilateralizing and liberalizing effects on Soviet-bloc trade and payments that are comparable to those of the OEEC and EPU on Western European trade and payments. This note attempts to analyze to what extent these expectations are justified in view of the economic organization in Soviet-bloc countries. A more detailed discussion will be given in a study which is under preparation.

1. The formation and structure of prices

In the countries of the Soviet bloc, prices of raw materials, of capital goods, and of consumers' goods are fixed administratively. At the same time, in all these countries wage and salary earners, and small private producers (mostly peasants) can spend their money incomes freely according to their choice. This might suggest that consumers, through changes in administratively fixed prices (which changes they cause by their behavior indicating the assortment of goods they prefer) do exert an influence on the pattern of production. In fact, however, several important characteristics of the economic system of the Soviet-bloc countries, particularly turnover taxes on consumers' goods, absence of the profit motive (in the free market sense) in the operation of enterprises,

absence of interest rates on long-term capital and of prices for services of land as a factor of production, leave only a weak link between consumers' choice and production. While prices of consumers' goods tend to conform to their relative scarcities (without this influencing to any significant extent the pattern of production) prices of producers' and capital goods do not reflect relative scarcities and, for the most part, do not serve to allocate resources. National economic plans, which are drawn up centrally and predominantly in physical terms, determine outputs and, by means of technical coefficients, the inputs of given outputs. Depending on the aims of the planning authorities, prices of producers and capital goods may be fixed so as to conform to or to deviate from the costs of production. Producers' goods that are scarce (in relation to prices fixed for them) are rationed and their prices are not adjusted to conform to demand.

It may be concluded that prices in the Soviet-bloc countries are grossly distorted in the sense that their structure does not correspond (with a tolerably low degree of deviation) to relative scarcities of goods and services. This conclusion may not only be deduced from the economic organization in these countries, but may also be found in an explicit form in recent Polish economic writings. Poland decided to pay attention to the need of having a more rational price structure, and even if her practical progress in this respect may have been limited, the criticism which the present price-fixing system received has been most outspoken and convincing.

Another important consequence of the Soviet bloc planning and price fixing methods is that patterns of price distortions in various countries of the Soviet bloc are different. A common method of administrative price fixing can hardly result in a common pattern of price distortions in these countries.

2. Foreign trade system and the exchange rates

Let it be assumed that there is a uniform exchange rate for, e.g., the ruble, and that any non-Soviet country's merchants have access to the U.S.S.R. market and can buy and sell on it whatever they wish. In view of the price-fixing method, however, this would mean that by paying slightly higher prices than domestic Soviet prices they might import from the U.S.S.R. goods which were in short supply there. This obviously would be contrary to Soviet interests as expressed by the economic plans. A similar situation would exist in trade among the Soviet-bloc countries. As long as the present price-fixing method and the price distortions exist in these countries, their foreign trade cannot be free. In fact, free foreign trade or even trade based on actual domestic prices in the Soviet-bloc countries would tend to destroy the price-fixing method and price structure in these countries and to undermine their economic plans.

In order to permit the complete separation of domestic from foreign prices, foreign trade in Soviet-type economies is a state monopoly which

engages in exporting and importing goods in quantities established by the central economic plans. Foreign trade organizations (as the executive bodies of foreign trade monopolies) have the exclusive right to engage in transactions with foreign buyers and sellers, and all payments are settled through accounts held with central banks. In order to shield domestic (distorted) price structures, uniform exchange rates are not applied to foreign trade merchandise transactions. The foreign trade organizations are credited (debited) by the central banks with the local currency equivalent of the export (import) prices, converted at the official exchange rates, and they credit (debit) the domestic supplier (buyer) of the exported (imported) goods with the domestic price of the commodity.

By means of such organization and technique, the exchange rate (or rates) are made irrelevant (or in some Soviet-bloc countries almost irrelevant) for merchandise transactions. In fact, they are multiple, disorderly, and only implicit. This system of foreign trade and exchange rates in merchandise transactions seems to be a logical consequence of the Soviet method of price-fixing.1/

In the Soviet-bloc system of foreign trade the volume and structure of exports and imports are not governed by domestic and foreign prices, and foreign prices of Soviet-bloc exports do not correspond to domestic prices. In trade with non-Soviet countries, prices on foreign markets are accepted. In trade among the Soviet-bloc countries, prices are "based" on world market prices, but deviations from them are negotiated. There are indications that some small countries of the Soviet bloc have for some time insisted on accepting world prices for the purpose of foreign trade with other members of the bloc, apparently in order to avoid possible arbitrariness in adjustments in world prices.

While the exchange rate may be irrelevant for merchandise transactions, it is relevant for a number of service transactions such as expenditures by foreign tourists, remittances, etc.2/ The recent adjustment of the "tourist" rates in Poland, Hungary, Rumania, Czechoslovakia, and the Soviet Union are apparently designed to eliminate gross disparities in the purchasing power of these currencies at the consumers' level.

3. Limitations of and conditions for multilateral payments among Soviet-bloc countries

Although the possibilities of multilateralizing payments among the Soviet-bloc countries are limited, some do exist. Clearly, balances arising from tourist and similar transactions could be cleared

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1/ See Marcin R. Wyczalkowski, "The Soviet Price System and the Ruble Exchange Rate", IMF Staff Papers, Vol. 1, No. 2 (September 1950), pp. 203 ff.

2/ It may be interesting to note that even though the exchange rate (in this case an official one) may be completely irrelevant for foreign trade merchandise transactions, a Soviet-bloc country's exchange rate taken as a whole is not irrelevant, since it is relevant in many service transactions.

multilaterally so that only small net balances would remain for inclusion in (bilaterally negotiated) payments on account of merchandise trade. Exchange rates which express with approximate correctness the relative purchasing power of Soviet-bloc currencies (among themselves) in tourist transactions are a condition for the multilateral settlement of this category of balances. It may be assumed that recent changes in the tourist exchange rates in several Soviet-bloc countries tend to correct disparities in the exchange rates and that this could lead to multilateral settlement. However, transactions other than those connected with merchandise exports and imports are not important in terms of total external transactions of the Soviet-bloc countries. A multilateral clearing of such balances would consequently be of little significance.

Multilateralization of payments would be of greater importance if it could be applied to merchandise transactions. The present system of intra-bloc trade does not provide for multilateral payments. For practical purposes, all trade agreements are bilateral and, although provisions for settlement in gold or in a non-bloc currency sometimes appear in them, actual settlement of balances (usually after the expiration of a one-year trade agreement) is made by means of additional deliveries of goods. The question arises as to what extent the recent agreement on the Eastern Clearing Union may correct this situation.

While discussing this problem, it should first be stated that what would appear as a normal procedure in market economies, seems to be impossible for the Soviet-bloc countries: the creditor country cannot buy in any country (of the bloc) according to its choice, any commodity at domestic prices prevailing in the country of purchase. This is impossible for two reasons: first, as was already mentioned, such procedure would probably lead to the export of goods which are scarce in the country of origin, and second, it would mean the absence in the country of origin of a trade (in this case export) monopoly with its rather strictly defined export plan. Under the Soviet-bloc economic system, not only the method of planning and of price-fixing, but also the absence of (at least) quotas of goods that are freely exportable, make a multilateral and free use of balances impossible. (In non-Soviet-bloc countries free import quotas are sufficient.) Therefore, in order to make multilateral settlements possible, something would have to be done with <u>both</u> prices and free export quotas.

In fact, domestic prices are not used in intra-bloc merchandise transactions. Let it be assumed that prices in intra-bloc trade are negotiated bilaterally (which is actually largely the case) and that free export quotas are established by each Soviet-bloc country. Would this make multilateral settlements possible?

The fact that prices in intra-bloc trade are negotiated bilaterally, without reference to either domestic prices or official exchange rates, implies that a country may charge different prices to different purchasing countries for a given export commodity (involving not only multiple rates but also disorderly cross rates). This means that clearing balances, although expressed in terms of (clearing) rubles of a definite gold value,

do not represent claims to an unambiguously defined volume of goods. The real value of a given nominal clearing balance depends on the pair of countries trading together, because the prices received and granted in say, Poland's trade with Czechoslovakia may differ from those applying in Poland's trade with the Soviet Union, which in turn may differ from those in Czechoslovakia's trade with the Soviet Union. The purchasing power of clearing balances which are to be transferred and the consequent reduction in claims would have to be renegotiated between the parties to any triangular or plurilateral compensation transaction. So far as balances from merchandise transactions are concerned, no automatic transfer of balances is therefore possible. This would also apply if there was no price discrimination, that is, if an exporting Soviet-bloc country charged the same prices to all its customer countries, because in this case two Soviet-bloc countries exporting an identical commodity might still charge different prices for it.

It may next be assumed that, in addition to free export quotas, identical prices for identical commodities moving in the intra-bloc trade are arbitrarily fixed by a mutual agreement within the framework of the Council for Mutual Economic Assistance. Or, a more realistic assumption would be that the prices prevailing in the Western world market are adopted and published in binding price lists. The (implicit) broken cross rates would be eliminated by the application of uniform prices in intra-bloc trade, although the (implicit) multiple exchange rates would remain. Whereas widely applied disorderly cross rates are logically and practically incompatible with multilateral payments, multiple rates are not. Therefore, balances would be defined unambiguously in terms of purchasing power and hence could be made automatically and multilaterally transferable, as long as there were free export quotas.

Free export quotas would perform two functions: first, they would protect the creditor country by allowing it to use its credit balance advantageously; and second, they would protect the country which was paid with such balances for its exports from exporting goods that might be scarce on its market. The second function is as important as the first since the world market prices (or any commonly agreed prices) obviously would bear no relationship to relative scarcities prevailing in the Soviet-bloc countries, and if they were to be indiscriminately used to determine the volume and structure of foreign trade or the composition of trade used in settling balances, a country might find itself exporting goods which were actually scarce in its economy.

It appears that world market prices are used in intra-bloc trade to an increasing extent. If, in addition, the members of the Soviet-bloc Clearing Union at the beginning of a clearing period submit to their agent lists of commodities which they are prepared to export at uniform world market prices in settlement of any debit balances which may exist at the end of the period, a certain degree of automatic offsetting of clearing balances may result (in addition to possible clearing of tourist exchange).

For the time being, however, world market prices (as an expression of commonly agreed prices for the purpose of intra-bloc trade) are not

generally applied, and there are no free export lists. Therefore, multilateral compensations among the Soviet-bloc countries cannot now be automatic and will not be so in the immediate future.1/ This further limits the practical importance of the Eastern Clearing Union.

It seems that an increased integration of national economic plans of the Soviet-bloc countries, which was extensively discussed at the same time as the Clearing Union arrangement, is of greater practical importance. Coordination of national economic plans would necessarily entail an increase in international specialization and an expansion of intra-bloc trade, and it would require a certain multilateralization of foreign trade flows.2/ Multilateral trade flows would thus be planned as part of the supra-national economic planning of the Council for Mutual Economic Assistance. While bilateral trade between any given pair of countries might not be balanced under the multilateral trade plan, exports and imports and connected transactions for any given Soviet-bloc country would be in balance vis-a-vis all other Soviet-bloc countries. Balances, in terms of clearing rubles, which would have to be settled by multilateral compensations would arise only in the case of deviations from the planned pattern of multilateral trade and would be of secondary importance. Only such balances would enter into the multilateral clearing process which, at least for the time being, would require negotiations between the affected countries as to the purchasing power (prices) and commodity composition (relative desirability of balances) of the claims and obligations to be compensated.

1/ It may be noted that during the negotiations on the ECE multilateral compensations scheme, the Soviet-bloc countries insisted that all compensations be non-automatic and subject to the prior consent of all countries affected.

2/ The only triangular agreements in which Soviet-bloc countries were until now involved were those arranged between Finland and two of the Soviet-bloc countries--on the initiative of the former; and one agreement of 1954, between Eastern Germany and Bulgaria, permitting the latter, with the prior consent of Eastern Germany and third countries, to use credit balances for settlements with third countries.