

The Economics of Transition

International Economic Relations

Functional Autarky

- With the exception of the USSR, the smaller socialist countries were not sufficiently endowed with natural resources to afford self-sufficiency
→ trading necessary for them with broad range of partners (also from capitalist countries), but
 - despite their efforts they could never become fully-fledged members of the international economic system

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State Monopoly of Foreign Trade

- Specialized state organizations (foreign trade organizations or **FTOs**) were handling all foreign trade relations
- FTOs dealt with foreign partners and domestic firms
- FTOs were **specialized in products** (each country had 40-60 different FTOs)

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Foreign Trade Planning

- Foreign trade was treated as an activity secondary to domestic trade
- Imports were given priority over exports
 - If domestic resources appeared to be insufficient, **imports were planned**
- Consequently, country was supposed to **increase export to pay for imports**
- To achieve balanced exports and imports, **each FTO** was ordered to finance imports through equivalent exports

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State Monopoly of Foreign Trade

- Specifics of dealing with **FTOs**:
 - First, the right **FTO** had to be **identified**
 - Seller **could not deal with the final buyer**, all trades had to be arranged through FTO
 - Bureaucratic negotiations lasted weeks or months

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Comecon - History

- **Council for Mutual Economic Assistance** (CMEA or **Comecon**) founded in 1949 by the USSR, Bulgaria, Czechoslovakia, Hungary, Poland, Romania
- Later Albania, German Democratic Republic, Mongolia, Cuba and Vietnam
- Members of **Comecon** traded mostly within **Comecon** (e.g. Eastern European countries in late 1980s conducted 60-75% of overall foreign trade within **Comecon**)

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Comecon – the Origins

- Was created as a response to the launching of the Marshall plan in 1947
 - The implied international economic relations among socialist countries:
 - shaped the domestic economies by aligning the Eastern European countries
 - isolated them from the outside world

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Comecon - Prices

- Intra-Comecon **prices**:
 - Average of the world market prices during last five years
 - **Fixed** for upcoming **five years**
 - After the 1973 oil shock, **prices** were revised **every year**
 - Settlements made in so-called 'transferable ruble' but no actual payments occurred

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Comecon - International Specialization

- Comecon was mainly supposed to ensure coordination of the national plans
 - It never achieved this goal
- USSR leaders failed to involve partner countries in any supranational scheme
 - very few multilateral specialization agreements achieved (car manufacturing, nuclear industry, computers)

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Comecon – disadvantageous for everyone

- Comecon was:
 - neither a market
 - nor a supranational instrument of planning
- Did at least anyone benefit of it?
 - In the period of oil crisis the price mechanism at work caused that East European Countries were purchasing Soviet oil for lower than world prices
 - Soviets could sell the oil with profit to Western countries

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Comecon – disadvantageous for everyone

- In addition relative price of Soviet oil in terms of low quality goods from East European Countries was much lower than similar relationship on Western markets
- However, Eastern European economists claimed that the trade within Comecon perpetuated an obsolete production structure
- Likely conclusion: everybody had been loosing

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Inconvertibility of the Socialist Currencies

- The currencies of the Eastern European countries and of the USSR were not convertible
 - they could not be purchased or sold against other currencies at a single exchange rate without restrictions and for all purposes

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Inconvertibility of the Socialist Currencies (cont.)

- Usual definitions take it for granted that the domestic currency is always convertible into goods
 - this kind of convertibility did not exist in socialist countries (commodity convertibility, at high prices, existed fully on kolkhoz-type market)
- The reforms in Eastern Europe moved closer toward commodity convertibility, however this was never achieved
 - it would have implied a free market, liberalization of domestic trade and of prices → **the end of central planning**
- System of **multiple exchange rates** for **different purposes** existed

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Inconvertibility of Currencies

- Consequences:
 - How to select the best “basket” of exports which would cover the required imports
 - No link between domestic and foreign prices (**relative prices of goods in one country** were could be very **different** from relative prices in the **other country**, especially compared to the West)
 - Though reforms promoted enterprises to export on their own account, overvalued domestic currency was deterring enterprises from seeking foreign outlets
- Problem: **how to find ‘realistic’ official exchange rate** without introducing market?

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Looking for a “realistic” exchange rate

- How does one find the right parity for the domestic currency?
- Various methods were developed to estimate the purchasing power parity from a basket of exported goods
 - the ratio of domestic to foreign prices yielded an exchange rate expressing the average amount of domestic costs required to earn one unit of foreign currency

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Trade with South

- On ideological grounds:
 - developing countries and especially “socialist-oriented” countries were meant to have priority in economic cooperation
- Commonly accepted view:
 - East-South relations were just a variety of North-South relations (commodity pattern was the same)
 - socialist countries were purchasing primary products
 - they were selling manufactured goods
 - prices paid were in line with world prices in all cases where they could be computed

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Trade with South (cont.)

- Socialist countries claimed that trade should be considered as an assistance
 - because it was linked with cooperation that helped the South to industrialize and hence to develop
- Controversies of assistance:
 - aid was small percentage of the GNP
 - official development assistance (ODA) low in comparison with Western countries
 - aid extended on harder terms than Western ODA
 - aid was economically tied (the recipient to choose the equipment)

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Trade with South (cont.)

- aid was politically tied
 - Cuba, Vietnam, Mongolia and Cambodia absorbed 70% of total aid in 1980's
- aid was oriented mainly toward the building of heavy industry
 - promotion of socialist strategy of development

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East-West Relations

- Frequently, an importance of political element in the developments of former East-West trade is being stressed
 - Economic relationships were created with an intension to politically affect the other side via economic linkages
(Conference on Security and Cooperation in Europe (CSCE) and its conclusions)

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East-West Relations (cont.)

However, the facts suggest that East-West trade strictly adjusted to the economic interests of both parties

- Examples of the coincidences of interests:
 - 1970's - need for modernization by East European countries –
1970's - need to invest petro-dollars (money earned for selling the oil)
 - 1980's - need to purchase equipment to develop energy resources by USSR –
1980's - need to buy oil and natural gas by Western Europe

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The Collapse of Comecon

- Comecon dissolved in 1991
- Trade balances between the countries had to be settled
 - the USSR net debtor, the GDR net creditor
 - again the problem: what exchange rates to use to convert the debts into dollars?

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Rapid change of trade pattern

- Foreign trade quickly re-oriented from former socialist countries to market economies
- The case of the Czech Republic

	1989	1990	1991	1992
Exports to transition economies	50%	41%	35%	21%
Developed market economies	37%	44%	55%	68%
EU	26%	31%	43%	53%
Germany	16%	18%	27%	33%

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