East-West Economic Relations

By Morris Bornstein

FRANKLYN D. HOLZMAN. *International Trade Under Communism —Politics and Economics.* New York, NY, Basic Books, 1976.
CONNIE M. FRIESEN. *The Political Economy of East-West Trade.* New York, NY, Praeger Publishers, 1976.
JOHN P. HARDT, Ed. *Tariff, Legal and Credit Constraints on East-West Commercial Relations.* Ottawa, Canada, Carleton University, Institute of Soviet and East European Studies, 1975.
IANCU SPIGLER. *Direct Western Investment in East Europe.* Oxford, England, Holdan Books Ltd., 1975.

ONE OF THE MOST striking developments in the economies of the Soviet Union and its six East European partners in the Council for Mutual Economic Assistance (CMEA) in recent years has been the dramatic expansion of relations with the developed capitalist market economies. The total trade of these seven Communist states with the 15 leading Western industrialized nations has more than doubled, from US$17.4 billion in 1972 to US$45.5 billion in 1976. However, within these totals, the imports from the West by the seven European members of CMEA have increased faster, from US$9.4 billion to US$26.1 billion, than have their exports to the West, which climbed from US$8.0 billion to US$19.4 billion.[1] To finance the resulting large trade deficits, these countries have borrowed heavily in the West. It is estimated that at the end of 1976 the USSR's debt to the West was US$14 billion, while the total debt of the six East European members of CMEA was US$25 billion — compared with US$4.5 billion and US$8.5 billion, respectively, at the end of 1973.[2]

This rapid growth of economic relations has taken many forms, including contracts with Western firms for "turnkey" projects involving the construction of complete plants in the USSR and Eastern Europe, a formal agreement for Soviet grain purchases from the United States, and active participation of Communist borrowers in Western capital markets. In the West, these developments have focused government, business, and academic attention on a number of issues, including the mechanisms employed by centrally planned economies (CPE's) for conducting foreign trade, the transfer of technology from West to East, the role of Western multinational corporations in the development and trade of Communist countries, and the credit policies of Western private and governmental banks.

This interest has generated a burgeoning literature on the economics and politics of East-West economic relations, which includes the four books reviewed here. While differing in scope, focus, and intended audience, all four illuminate important problems affecting the evolution of East-West economic ties. Franklyn D. Holzman's volume is the most ambitious of them, undertaking in a little over 200 pages to explain how Communist countries conduct foreign trade and to examine relations between the USSR and the East European countries in CMEA, East-West relations, and the trade and aid links of CMEA countries with non-Communist developing nations. The study by Connie M. Friesen is more narrowly focused on domestic and transnational forces affecting the context of Soviet-US "détente" in which East-West trade has developed in the 1970's. The volume edited by John P. Hardt contains four papers on various technical aspects of East-West trade, which were presented at an International Slavic Conference held in Banff, Canada, in 1974. Finally, Iancu Spigler provides a detailed an-

[1] Data supplied to the author in July 1977 by the Bureau of East-West Trade of the US Department of Commerce.

[2] *International Economic Report of the President, January 1977,* Washington, DC, US Government Printing Office, 1977, pp. 64-65.

alysis of one specific form of East-West "industrial cooperation" — foreign equity participation in joint corporations in East European countries.

AS THE REVIEWED volumes make clear, there have been various obstacles to "normal" trade relations between East and West. A number of these impediments appear to be inherent in the very institutions and practices of the centrally planned economies.

In the CPE's, foreign trade is conducted as a monopoly by the Ministry of Foreign Trade through subordinate foreign trade organizations (FTO's) specialized according to product or geographic area, or both. The ministry tries if possible to arrange exports and imports simultaneously through what amounts to a barter approach within the framework of bilateral trade agreements. Because exports are sold by the FTO's, rather than by the actual producing enterprises, the latter have little interest in improving quality to meet world market standards and thereby to expand exports. In turn, imports are sold to the FTO's, rather than to the actual user (to whom foreign suppliers do not usually have access)—making it more time-consuming and expensive for the seller to negotiate contracts.

In a CPE, internal prices are largely irrelevant for international trade. They are determined administratively (and revised infrequently) on a cost-plus-profit basis which does not reflect relative scarcity and fails to balance supply and demand, especially in the case of producer goods. Exchange rates are also set arbitrarily and do not reflect relative price levels and the purchasing power of currencies. Thus, complicated calculations of "foreign trade effectiveness" are of little help in finding a sensible pattern of exports and imports.

In turn, the currencies of CPE's are inconvertible. This is true in two distinct senses. First, like the currencies of a number of market economies, they are not freely convertible into *foreign currency*. Second, a CPE's currency cannot be freely converted even into the *goods of the given CPE*—because shortages exist when prices are not at market-clearing levels, because producer goods (and some consumer goods) are administratively allocated, and because the foreign trade monopoly controls exports. Thus, revaluations and devaluations of CPE currencies have no effect on trade flows: trade with the West is conducted at world market prices in dollars, pounds, yen, etc., while trade inside CMEA is conducted in the strictly nominal "valuta ruble" unit of account, at a negotiated approximation of world market prices.

Finally, in a CPE, tariffs do not affect domestic selling prices and are thus irrelevant in controlling imports, which are instead determined by the implicit quantitative restrictions embodied in the foreign trade plan. Therefore, in trade negotiations with market economies (where tariff reductions do affect trade flows through changes in prices and quantities), CPE's must offer different concessions, such as specific commitments to increase imports.

BEYOND THESE systemic constraints on the expansion of East-West economic ties, there is also the problem of the nature of the "economic integration" of the USSR and Eastern Europe in CMEA. Western economic theory commonly evaluates economic integration in terms of the relative importance of "trade creation" and "trade diversion" effects. "Trade creation" occurs when members of an economic bloc trade among themselves in goods previously produced domestically, without reducing trade with countries outside the given bloc. In contrast, "trade diversion" occurs when trade is shifted from outside to member countries. As Holzman shows, in the case of the CMEA bloc, "trade diversion" greatly outweighed "trade creation," because members' trade was concentrated within the bloc, at the expense of trade on the world market. As the dominant member of CMEA, the USSR has exerted great economic and political influence over the East European countries. However, the latter—notably, Romania—have resisted Soviet efforts to give CMEA supranational power over plan coordination and production specialization.

The level and content of East-West economic relations have also been restrained by decisions of Western governments to curb "strategic" exports to Communist countries, to curtail imports from them by unfavorable tariff treatment and quantitative restrictions, and to limit credits to them. One should note, however, that relaxation of these restrictions began as early as 1954-55 and has proceeded steadily thereafter, first in Western Europe and subsequently in the United States.

Thomas Wolf's essay in the Hardt volume reviews a number of empirical attempts to measure the extent to which such Western restrictions actually depressed East-West trade, and thus to estimate the possible stimulating effects of their elimination. He finds that these studies confirm that Western restrictions did significantly curtail exports to, and imports from, CMEA countries. But Wolf stresses that these calculations can be regarded as only very approximate estimates, because of severe methodological and data problems, including inadequate disaggregation by countries and by products and failure to test critical though often implicit assumptions. For example, some estimates of trade foregone due to restrictions use a "market-share approach" which assumes that, if a particular East European country has a certain share of a West European import market in which it possesses most-favored-nation (MFN) tariff treatment, the East European country would capture the same share of the US import market if it obtained MFN treatment from the United States. This is usually an unrealistic assumption, because market shares depend on many other factors in addition to MFN treatment.

ALL FOUR BOOKS examine the reasons for the surge of Soviet and East European interest in expanding East-West economic relations in the last decade. A key factor was the slowdown in economic growth in the CMEA area which began in the late 1950's or early 1960's (depending on the country) and which led to a search for ways to bolster economic performance. Policy-makers recognized the need to shift from an "extensive" growth strategy, requiring rapid increases in the non-agricultural labor force and high rates of investment, to an "intensive" approach which stressed increases in factor productivity through improved incentives, better management, and faster technological progress.

An initial approach to the problem was the economic reform movement of the mid-1960's, which sought to increase efficiency through two kinds of decentralization. The first of these, administrative decentralization, involved partial devolution of authority over selected decisions from higher to lower tiers within the administrative hierarchy—for instance, from the ministry to the intermediate "association" (which controls a number of enterprises). The second change, economic decentralization, aimed to give domestic and international market forces a greater role in determining the composition of output, the allocation of resources, and even the distribution of income. But, fearing a loss of control over the economy and society, CMEA regimes proved in practice unwilling to go very far toward either type of decentralization, and only the Hungarian reform was actually implemented to a significant, if attenuated, degree.[3]

Instead, the USSR and the countries of Eastern Europe have turned to East-West economic relations as a politically safer and economically more effective way to modernize their economies, to raise sagging growth rates, and to meet some of the demands of their populations for consumer goods and services. These countries hope to obtain from the West three keys to improved economic performance. The first is sophisticated, up-to-date machinery and equipment not available in the CMEA region. The second is advanced technology, including not only production processes covered by licenses but also entire turnkey plants constructed by foreign firms. The third, and perhaps most important, is credit, which is needed to cover two "gaps." One is the "foreign exchange gap" —a shortage of hard currency to pay for imports from the West. The other is the "domestic savings gap," which exists because the strained Eastern economies lack the capital and labor resources for these additional investment projects (even if they had the technical know-how to carry them out).

In the case of the Soviet Union, a further impetus for interest in expanding East-West economic relations has been the realization that in the last decade Soviet trade with Eastern Europe has on balance been *economically* disadvantageous for the USSR, even if it has been useful as a mechanism for exercising *political* control of the area. Intra-CMEA trade has long been conducted at negotiated prices based on an average of world market prices during an earlier reference period, such as the preceding five years,[4] and during the last decade, world market prices have been rising much faster for raw materials and fuels than for manufactured goods.

Because these changes in world market prices have been reflected incompletely and with a lag in intra-CMEA trade, the USSR has been supplying Eastern Europe raw materials and fuels at comparatively low prices, in return for outdated machinery and poor quality manufactures. If the

[3] For a recent comprehensive appraisal, see this reviewer's "Economic Reform in Eastern Europe," in US Congress, Joint Economic Committee, *East European Economies Post-Helsinki*, Washington, DC, US Government Printing Office, 1977, pp. 102-34.

[4] For details, see Edward A. Hewett, *Foreign Trade Prices in the Council for Mutual Economic Assistance*, Cambridge, England, Cambridge University Press, 1974.

USSR sold these raw materials to the West, it could command higher prices and payment in convertible currency which could be used to buy advanced Western machinery and technology.

Furthermore, it is worth noting that the burden to the USSR of this form of subsidization of Eastern Europe is growing, for two reasons. The real cost of Soviet production of raw materials and fuels is increasing as additional output must be obtained from less rich or more remote deposits, and rising Soviet domestic requirements leave less of total output available for export to Eastern Europe or the West.

LOOKING TO an expansion of East-West trade for help in solving their economic problems, the Soviet Union and the countries of Eastern Europe are constrained by their limited capability to increase exports to hard-currency areas. First, their strained economies have few surpluses available for export outside the CMEA area. Second, the low quality of most of their manufactured goods makes them noncompetitive on the world market. Finally, exports of some goods are limited by Western tariffs, quotas, and other trade restrictions.

Consequently, the availability of Western credits becomes a critical factor. This in turn involves Western assessments of the creditworthiness of the Communist borrowers. As Lawrence J. Brainard notes in his contribution to the Hardt volume,

Lending is an art, not a science. A most detailed analysis of a company's balance sheet or a country's balance of payments can provide much valuable information, but when a loan decision is made, it is the future ability and willingness of the borrower to meet debt obligations that must be forecast. In making this judgment a banker must weigh relevant economic, political and personal data on the borrower. (p. 7)

Debt-servicing ability is often measured by the debt-service ratio, calculated by dividing scheduled repayments of principal and interest by gross earnings of foreign currencies (exports plus invisible earnings, such as tourist outlays). However, such calculations are far from decisive. More important is the extent to which the borrowing country uses the credits to expand its convertible-currency export potential (or to reduce its imports). As the debt-service ratios of the USSR and Eastern Europe rise, Western lending institutions will demand more information not only about the borrowing country's balance of payments, indebtedness, and foreign exchange and gold reserves, but also about how the credit will be used—in particular, about its potential effect on hard-currency trade. Communist governments will thus be pressed to make available information hitherto considered secret.

In order to circumvent convertible-currency shortages and constraints on obtaining new private and government credits, CMEA countries have shown considerable interest in various forms of "industrial cooperation"—establishing a long-term contractual relationship in which a Western multinational firm contributes some combination of technology, machinery, materials, management services, and assistance in marketing the output in the West. One form of these arrangements is the "joint venture," which involves foreign equity participation in a special joint enterprise established under the Communist country's laws. So far, only Romania and Hungary, among CMEA members, have followed Yugoslavia's example in authorizing such ventures. Iancu Spigler examines recent Romanian and Hungarian legislation in an attempt to develop a "theory of the joint corporation" in Eastern Europe—covering its organization, production, investment, management, pricing, financing, taxation, and exports. His detailed explanation of possible implications, complications, and pitfalls contains many cautions for Western firms considering joint venture proposals.

Such experiments with the creation of joint corporations illustrate the continuing effort of the CMEA states to work out ways of overcoming some of the institutional, financial, and technical impediments to East-West economic links. However, although these and other innovations may show successful results, the future development of East-West economic relations will depend more fundamentally on the decisions which the countries in each group—and especially the respective superpowers, the USSR and the US—take regarding such critical issues as regional integration, transfer of technology, and credits.

Socialist Law and the Soviet Model

By Peter H. Juviler

F. J. M. FELDBRUGGE, Ed. *Encyclopedia of Soviet Law.* Leiden, A. W. Sijthoff, 1973, 2 Vols.
DOMINIK LASOK, Ed. *Polish Civil Law.* Leiden, A. W. Sijthoff, 1973-75, 4 Vols.

LAW IN THE Soviet Union has gained considerable scope and status since the early 1930's. During those stormy years of Stalin's "revolution from above" an influential coterie of Marxist jurists busily set about undermining law and the legal profession, which they viewed as merely remnants of the capitalist stage of history. The precarious state of the law was evident to the first American student at the Moscow Law Institute. In 1934 he found the Institute dilapidated and with "a schedule which changed so often without notice that it became a joke, and no one ever knew from one semester to the next what would be the subjects which would be taught."

Three years later the American student, on returning to the spruced-up Institute for his final year, discovered regularized classroom schedules and a younger student body which regarded law not as a stopgap but as a permanent vocation. Those "legal nihilists" who earlier had proclaimed the "withering away" of law and legal education now were denounced as "wreckers" and swept away in the blood purges. Soviet law was legitimized as a new, "socialist" type of law.[1]

Although reprieved by Stalin's call for "the stability of law," the legal profession still worked under the burden of what Harold Berman has called the "duality of law and terror." Intimidated Soviet jurists commented and adjudicated in the shadow of Russia's long history of extralegal terror and prison camps, and some jurists themselves fell victim.[2]

Khrushchev, by 1956 the most powerful of Stalin's successors, repudiated the "mass repressions" of the past. Nonetheless, Khrushchev's expressions of contempt for lawyers and his plans to supplant much of the professional judiciary with volunteer public peacekeeping—advanced in 1959 as part of his program for "communist popular self-administration"—caused renewed unease among Soviet jurists and began a new chapter in Soviet extralegal history. This chapter, however, proved quite short. Strong opposition and reports of failures caused Khrushchev to limit the popularization of crime prevention to a much narrower range of public participation, although the original objective has never been entirely abandoned.[3]

From the muffled debate over the role of state and law in the period of the transition to communism has emerged the official formulation of Khrushchev's successors. This declares that Soviet law *will* eventually wither away, but that it will do so only under communism, the future of plenty and classless equality, and only when Soviet citizens have fully internalized the norms of communist morality, which are said to be embodied in the law. Until then, one may anticipate the "strengthening of socialist legality and consolidation of the socialist legal order." [4] Thus, Soviet law has developed from a doomed bourgeois relic and temporary

[1] John N. Hazard, letter of Sept. 6, 1937, in Donald D. Barry et al., Eds., *Contemporary Soviet Law: Essays in Honor of John N. Hazard*, The Hague, Martinus Nijhoff, 1974, pp. xxv-xxvi.

[2] See Harold J. Berman, *Justice in the U.S.S.R.: An Interpretation of Soviet Law*, rev. ed., New York, NY, Vintage, 1963, pp. 8, 43-65; and Robert Sharlet, "Gulag: A Chronicle of Soviet Extralegal History," *Problems of Communism* (Washington, DC), May-June 1974, pp. 65-71.

[3] See the reviewer's *Revolutionary Law and Order: Politics and Social Change in the USSR*, New York, NY, The Free Press, 1976, pp. 74-82.

[4] N.G. Aleksandrov, *Teoriya gosudarstva i prava* (The Theory of State and Law), 2nd ed., Moscow, Yuridicheskaya literatura, 1974, pp. 652-54.