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THE EVOLUTION OF THE EXTERNAL DEBT AND BALANCE OF PAYMENTS OF EASTERN EUROPE AND THE USSR SINCE 1970

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I. Introduction

The deterioration during the 1970s of the external balance-of-payments positions of the eastern countries - comprising eastern Europe (Bulgaria, Czechoslovakia, the GDR, Hungary, Poland and Rumania) and the USSR - is demonstrated by the tenfold increase in their total outstanding indebtedness which is estimated to have occurred between 1970 and 1980. More recently, it has become apparent that, for some countries, the levels of accumulated debt can no longer be sustained and that urgent adjustment measures are called for.

This paper traces balance-of-payments developments in these economies over the last decade and examines their potential for adjustment. There are four main sections, the first of which looks at the growth of external debt and the balance-of-payments deficits associated with it. In the second section possible explanations for the area's poor trade performance are analysed. The third section discusses the factors which may affect the ability of these countries to secure adjustment. The findings of this study are summarised in the final section.

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* For footnotes please see page 28.

II. The growth of indebtedness and related balance-of-payments deficits

The estimated level of the net convertible currency debt of eastern Europe and the USSR at the end of 1970 was $7 1/2 billion, or about 1 1/4 per cent. of gross national product. By the end of 1980 the indebtedness of these countries had risen to an estimated $72 1/2 billion, or 4 1/4 per cent. of GNP.[1]

Two phases of debt accumulation may be identified, corresponding to the Comecon five-year plan periods 1971-75 and 1976-80. During the first phase, outstanding debt on a net (assets minus liabilities) basis is estimated to have risen nearly fourfold, from $7.5 billion to $28.9 billion. Among individual countries the growth of indebtedness during this period was uneven, as is demonstrated by the fact that the range of outstanding debt widened from $0.3 - 1.8 billion at the beginning of the period to $0.8 - 7.5 billion at the end of 1975. Whereas, in the majority of countries, the level of debt increased by a factor of 2 1/2 to 3, two countries recorded exceptionally large rises: in Poland net borrowing grew from $1.0 to 7.4 billion and in the USSR, excluding the outstanding debt of the Moscow-based Comecon banks, it climbed from $1.8 to 7.5 billion. In virtually every country, the level of debt relative to estimated GNP was higher at the end of 1975 than five years earlier, the four countries with the largest debt ratios being Bulgaria (11.5 per cent.), Hungary (9.5 per cent.), Rumania (9 per cent.) and Poland (8 per cent.), the Soviet Union maintaining the lowest share (1 per cent.).

In the second five-year period, from 1976-80, the group's aggregate indebtedness continued to expand rapidly. Although the average annual growth rate was, at 20 per cent., lower than in the previous quinquennium, the absolute increase in the level of outstanding debt of $43.5 billion (to $72.4 billion) was twice as large. As in the previous period, the largest absolute gain in net borrowing was recorded by Poland (from $7.5 to 22.1 billion), but in terms of percentage changes over the period larger rises occurred in Czechoslovakia, Rumania and Hungary. Expressed as a share of GNP, net indebtedness fell in only one country - Bulgaria (to 8.5 per cent.), where the absolute level of debt also seems to have declined at the end of the period - and remained unchanged in the

USSR. Elsewhere this measure of the debt burden increased and by the end of 1980 had reached particularly high levels in the cases of Rumania (18 per cent.), Poland and Hungary (both 16 per cent.).

In both five-year periods rising net borrowing from western banks was the major element in the growth of overall debt. At the beginning of the decade, bank borrowing may have accounted for around $1 billion, or as little as 15 per cent. of the group's aggregate debt, the remainder being mainly in the form of supplier credits and loans guaranteed by western governments. By the end of 1975 the share of net bank debt in the total is estimated to have reached 62 per cent., with more than three-quarters of the increase in the group's overall net borrowing over the five-year period being derived from banks.[2]

Table 1

Eastern Europe and USSR:

Estimates of overall net debt in convertible currencies

Countries	Outstanding at end of year									Change in stocks during period	
	1970	1974	1975	1976	1977	1978	1979	1980	1981[1]	1971-75	1976-80
	in billions of US dollars										
All countries	7.5	16.2	28.9	38.9	48.2	58.3	65.3	72.4	80.7	21.4	43.5
Bulgaria	0.9	1.4	2.3	2.8	3.2	3.7	3.7	3.2	2.3	1.4	0.9
Czechoslovakia	0.3	0.6	0.8	1.4	2.1	2.5	3.1	3.5	3.6	0.5	2.7
GDR	1.1	2.6	3.5	5.0	6.2	7.6	8.1	9.6	11.3	2.4	6.1
Hungary[2]	0.7	1.5	2.2	2.9	4.5	6.5	7.3	7.4	7.8	1.5	5.2
Poland[3]	1.0	4.1	7.4	10.7	13.5	17.0	20.1	22.1	22.4	6.4	14.7
Rumania[4]	1.1	2.5	2.4	2.5	3.4	5.0	6.9	9.1	9.6	1.3	6.7
Soviet Union	1.8	1.7	7.5	10.1	11.2	11.2	12.1	13.5	19.5	5.7	6.0
Comecon banks	0.6	1.8	2.8	3.5	4.1	4.8	4.0	4.0	4.2	2.2	1.2

Sources: For 1970: L.J. Brainard as quoted in "Comecon countries' relationships with western financial markets" by M.-E. Sharrer and K. Bolz, HWWA-Institut für Wirtschaftsforschung, Hamburg 1978;
for 1974-78: "Estimating Soviet and East European hard currency debt", National Foreign Assessment Center, Washington 1980;
for 1979-81: "Economic Survey of Europe in 1981", United Nations Economic Commission for Europe, Geneva 1982.

1. Provisional.
2. The Hungarian National Bank has published figures of $5 billion (end-1979) and $5.4 billion (end-1980); the differences between these and the ECE estimates reflect differences in coverage and, above all, the inclusion of gold reserves in the National Bank's figures.
3. Not including convertible currency debt to other Comecon countries, which stood at $2.6 billion at end-August 1981, including $0.7 billion owed to Comecon banks.
4. Including debt to the IMF and World Bank.

Over the second five-year period the group's net liabilities to western banks rose from an estimated $17.9 billion to $44.2 billion (see Table 2).[3] Given the more detailed statistical coverage for this period, gross liabilities and gross assets may be looked at separately. The proportion of outstanding gross liabilities to banks in relation to estimated total debt remained rather steady during the 1976-80 period at 67-69 per cent. Among individual countries, however, the share of bank debt in the total varied widely, indicating differences in preference as regards sources of finance. The estimated contribution of gross borrowing from banks to the increase in overall gross indebtedness over the five-year period was close to 90 per cent. in the GDR, Hungary and Czechoslovakia. The remaining countries relied more heavily on borrowing from other sources, which in most cases took the form of officially guaranteed export credits, but Rumania also had access to loans from the IMF and World Bank. The USSR's reliance on non-bank finance was particularly high, with as little as one-third of its estimated gross borrowing during the period (including that of the CMEA banks) deriving from banking sources.

Table 2

Estimated external positions of individual Comecon countries with western banks

(in billions of US dollars; outstanding at end of period)

Item		1974	1975	1976	1977	1978	1979	1980	1981
All countries	Assets	6.2	6.6	8.1	8.4	10.6	15.4	15.6	15.1
	Liabilities	15.0	24.5	32.7	38.3	47.5	55.9	59.8	60.8
	Net	- 8.8	-17.9	-24.6	-29.9	-36.9	-40.5	-44.2	-45.7
Bulgaria	Assets	0.3	0.3	0.4	0.5	0.5	0.7	0.8	0.9
	Liabilities	1.4	1.9	2.3	2.8	3.3	3.3	2.8	2.2
	Net	- 1.1	- 1.6	- 1.9	- 2.3	- 2.8	- 2.6	- 2.0	- 1.4
Czechoslovakia	Assets	0.4	0.3	0.4	0.5	0.7	1.0	1.3	1.1
	Liabilities	0.4	0.4	1.0	1.6	2.1	3.0	3.6	3.3
	Net	-	- 0.1	- 0.6	- 1.1	- 1.4	- 2.0	- 2.3	- 2.2
GDR	Assets	0.5	0.7	0.8	1.0	1.3	2.0	2.1	2.2
	Liabilities	2.1	3.2	4.4	5.2	6.6	8.2	10.0	10.5
	Net	- 1.6	- 2.5	- 3.6	- 4.2	- 5.3	- 6.2	- 7.9	- 8.3
Hungary	Assets	0.6	0.9	1.2	1.2	0.9	1.2	1.4	0.9
	Liabilities	1.9	2.8	3.8	5.1	6.8	7.8	7.8	7.8
	Net	- 1.3	- 1.9	- 2.6	- 3.9	- 5.9	- 6.6	- 6.4	- 6.8
Poland	Assets	0.5	0.6	0.7	0.4	0.8	1.2	0.7	0.8
	Liabilities	3.5	5.5	8.0	9.7	12.4	15.9	16.0	15.4
	Net	- 3.0	- 4.9	- 7.3	- 9.3	-11.6	-14.7	-15.3	-14.6
Rumania	Assets	0.2	0.4	0.3	0.2	0.2	0.3	0.3	0.3
	Liabilities	0.9	1.0	0.8	1.5	2.7	4.2	5.6	5.0
	Net	- 0.7	- 0.6	- 0.5	- 1.3	- 2.5	- 3.9	- 5.3	- 4.7
USSR	Assets	3.7	3.4	4.3	4.6	6.1	9.0	9.0	8.8
	Liabilities	4.8	9.7	12.4	12.4	13.5	13.4	13.9	16.6
	Net	- 1.1	- 6.3	- 8.1	- 7.8	- 7.4	- 4.4	- 4.9	- 7.8

Source: Bank for International Settlements; author's estimates (see footnote 3 at the end of this paper).

Note: Components may not sum to totals because of rounding.

The gross assets of these countries with western banks are believed to represent the major part of their convertible currency reserves. Of the $9 billion increase in the group's balances between end-1975 and end-1980, $7 billion was accumulated during 1978 and 1979. International financial market conditions were relatively favourable in these years and this factor may have prompted precautionary borrowing in order to build up foreign exchange reserves, for instance in Czechoslovakia and the GDR, where gross deposits doubled during the two years. In the case of the Soviet Union, which accounted for nearly two-thirds of the total rise in deposits, a surge in the value of its gold sales appears also to have been a significant contributory factor.

An important reservation should be made concerning the imputation of borrowing flows from changes in the levels of outstanding stocks of assets and liabilities expressed in US dollars. Since the eastern countries' debts are denominated in a variety of western currencies, the dollar valuation of the debt will itself change in a period of exchange rate adjustment. Since the currency composition of overall debt is not known, either for the individual countries or the group, no attempt has been made here to estimate the valuation effects of the dollar's exchange rate movements in the period under review. However, the BIS has published estimates of the value-adjusted flows between reporting banks and the eastern countries as a group and these are shown in Table 3. Such valuation effects have been considerable: for instance, the weakness of the dollar in 1978 may have accounted for $3 billion of the $7 billion rise in nominal net borrowing from banks and, conversely, the appreciation of the US currency in 1980 resulted in a recorded rise in outstanding debt which was only 60 per cent. of the increase after including estimated valuation effects. For the 1976-80 period as a whole, however, such valuation effects are to some extent mutually offsetting, with the result that roughly 20 per cent. of the total increase in net debt may be ascribed to them.

In both five-year periods the principal cause of the group's growing indebtedness was the deficit on merchandise trade with the developed market economies. Towards the end of the decade, however, net payments on invisibles account became increasingly important and after 1979 exceeded the shortfall on trade account.

Table 3

Eastern Europe and USSR:

Estimated convertible currency balance of payments, 1971-81

Item	1971-75	1976-80	1976	1977	1978	1979	1980	1981[1]
	in billions of US dollars							
Increase (+) in net debt:								
(a) to western banks:								
- change in stocks	16.8	26.3	6.7	5.3	7.0	3.6	3.7	1.9
- as above, adjusted to exclude valuation effects	..	21.9	6.2	3.0	4.0	2.5	6.2	4.7
(b) to all creditors, change in stocks	21.4	43.5	10.0	9.3	10.1	7.0	7.1	8.3
Trade balance f.o.b. with developed market economies[2]								
Bulgaria	- 1.5	- 1.3	- 0.5	-0.4	-0.4	-0.0	-0.0	-0.4
Czechoslovakia	- 1.4	- 3.6	- 0.8	-0.7	-0.8	-0.8	-0.5	-0.1
GDR	- 3.4	- 7.3	- 1.4	-1.3	-1.1	-1.9	-1.6	-1.8
Hungary[3]	- 1.4	- 3.9	- 0.5	-0.7	-1.2	-0.8	-0.7	-1.1
Poland	- 6.8	-10.3	- 3.3	-2.5	-2.1	-1.6	-0.8	-0.5
Rumania	- 1.3	- 1.7	- 0.1	-0.5	-0.8	-0.4	0.1	1.3
USSR	- 7.1	- 9.7	- 4.0	-1.5	-3.3	-1.1	0.2	-1.2
Total	-22.9	-37.8	-10.6	-7.6	-9.7	-6.6	-3.3	-3.8
Other convertible currency transactions[4]								
(a) invisibles balance with developed market economies	- 0.7	-11.9	- 0.8	-1.3	-1.9	-2.9	-5.0	-6.2
(b) gold sales	2.3	10.8	1.4	1.8	2.9	2.9	1.8	4.0
(c) balance with developing countries	2.5	6.5	0.9	1.4	1.5	1.5	1.2	1.2
(d) residual current and capital-account transactions, errors and omissions	- 2.6	-11.1	- 0.9	-3.6	-2.9	-1.9	-1.8	-3.5
Total	-21.4	-43.5	-10.0	-9.3	-10.1	-7.0	-7.1	-8.3

Sources: Bank for International Settlements; Economic Commission for Europe (ECE); ECE Economic Bulletin for Europe No. 33 and Economic Survey of Europe in 1981; author's estimates; see also description of sources for Table 1.

1. Provisional.
2. Based on national statistics.
3. Trade balance f.o.b.-c.i.f.
4. Transactions in convertible currencies between countries in the eastern area cannot be included here for lack of data. Although such transactions would cancel out when summed over the group, they may be significant for individual countries. E.g. for 1981, official Hungarian statistics show an overall trade surplus in convertible currencies of $0.2 billion (net of insurance and freight). The difference between this figure and the $1.1 billion deficit shown here for trade with developed market economies may be assumed to represent its surplus with other Comecon countries and developing countries.

During the period 1971-75 each country recorded a substantial deterioration in visible trade with the developed market economies and the group's aggregate deficit widened from $0.8 to 11.2 billion. This development was associated with a shift in the regional structure of trade, and of imports in particular. As Chart A illustrates, between 1970 and 1975 the share of the developed market economies in total imports rose in practically every country, whereas export shares rose by a smaller percentage in some countries and declined in others. The cumulative trade deficit for the five years was $22.9 billion, compared with an estimated rise in total net indebtedness of $21.4 billion, implying a small surplus in other convertible currency transactions.

The components of this residual surplus can be only partially estimated but would have included the proceeds of gold sales (put at $2.3 billion) and a probable convertible currency payments surplus with developing countries (perhaps $2.5 billion), partly offset by a deficit on invisibles account with the developed area. The size of the latter item, estimated at a modest $0.7 billion, disguises a rapid deterioration in the balance during the period from a small surplus in 1971 to a deficit of around $0.8 billion in 1975, which reflected mainly interest payments on the growing volume of outstanding debt.

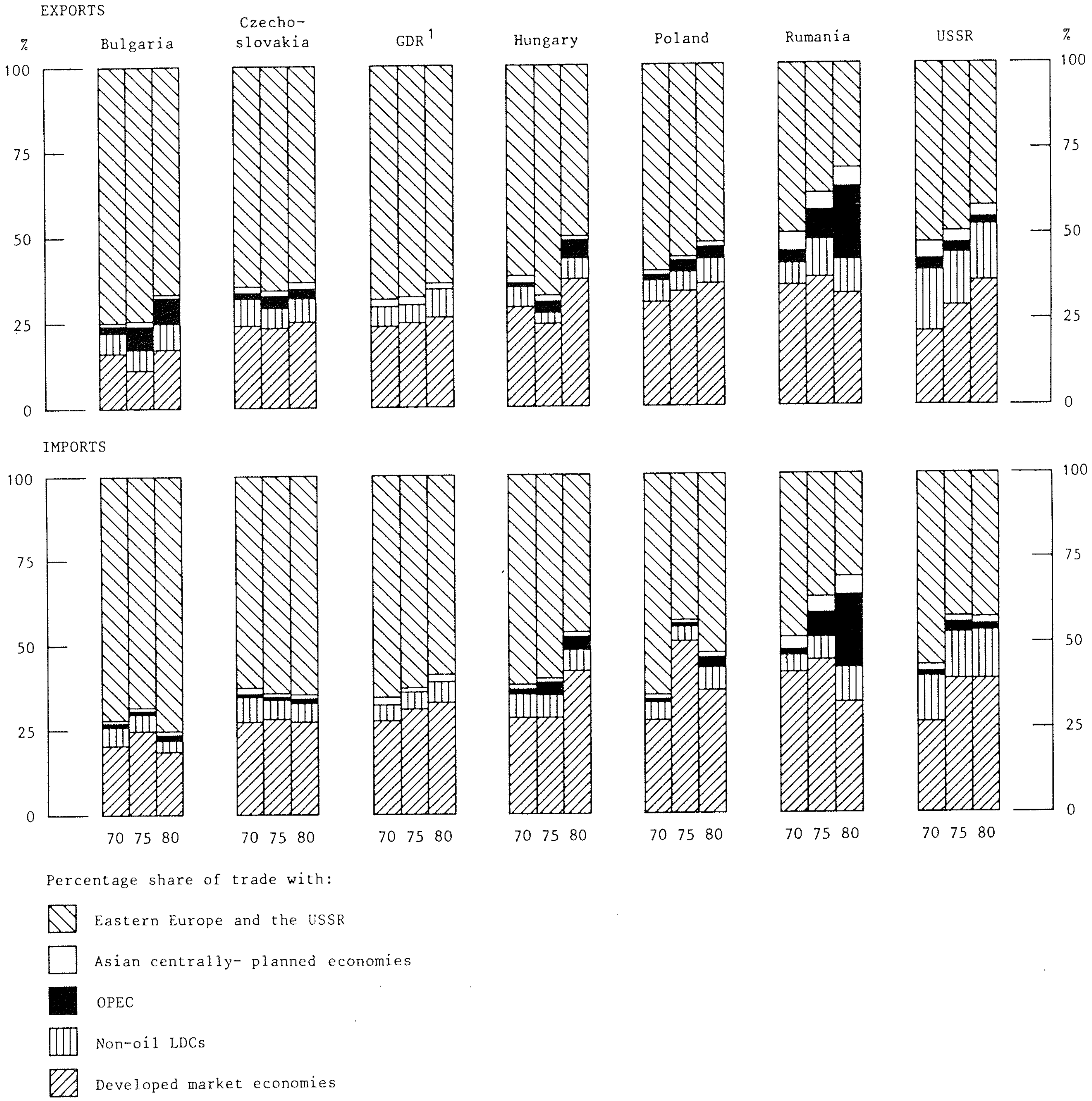
In the 1976-80 quinquennium the group's aggregate deficit in trade with developed market economies rose by nearly $15 to 37.7 billion, compared with estimated total net borrowing of $43.5 billion. By contrast with the preceding period, however, the trend was for the imbalance to diminish, and by 1980 the deficit was one-third of its 1976 level. Among the individual countries in the period as a whole, only Bulgaria recorded a lower deficit than in the previous five years, while in Hungary, Czechoslovakia and the GDR the deficit more than doubled. As in the preceding five years, Poland and the USSR registered the largest shortfalls, together accounting for more than half of the group total.

The invisibles account deficit with the developed area is estimated at $11.9 billion for the period. Net payments continued to increase during the quinquennium broadly in line with debt interest charges. By 1980 the total shortfall had reached an estimated $5 billion and for the first time exceeded the trade deficit, by nearly $2 billion. A

Chart A

EASTERN EUROPE AND USSR:

REGIONAL DISTRIBUTION OF TRADE IN 1970, 1975 AND 1980



Source: United Nations Economic Commission for Europe (based on national statistics).

1. Trade share with OPEC is included in the non-oil LDCs share.

country breakdown of invisibles balances for that year shows that Poland had the largest deficit ($1.9 billion), reflecting the fact that it also had the highest debt interest burden, which was, however, partly offset by transfer receipts. The USSR recorded the only invisibles surplus, albeit marginal ($0.2 billion), as receipts from services (transport, insurance and travel) outweighed net interest debits.

Other convertible currency transactions in the 1976-80 period included gold sales estimated at $10.8 billion, a more than fourfold increase over the earlier period which reflected both a sharp rise in the amount sold and higher prices. The chief factor prompting the larger scale of gold exports, which emanate principally from the Soviet Union, appears to have been a succession of poor harvests, increasing the USSR's need for foreign exchange to pay for cereal imports. The main exception was in 1980 when, despite another poor harvest, the need to sell gold was reduced by a surge in Soviet oil revenues following the second oil price shock. Transactions in convertible currencies with the developing countries may have given rise to a surplus for the group in the region of $6.5 billion.[4]

As can be seen from Table 3, in the 1976-80 period the group's convertible currency balance-of-payments deficit implied by the estimated flows discussed above falls short of the estimated increase in debt by just over $11 billion. Part of this discrepancy may be due to valuation changes affecting the estimates of outstanding assets and liabilities such that the changes in stocks overstate the true flow of funds. This was the case for debt to banks alone and it is not unreasonable to suggest that the valuation adjustment to overall debt would be in the same direction. Another possible source of statistical error may be the existence of unidentified capital outflows, most probably in the form of provisions of aid by the Soviet Union to the non-European members of Comecon (Cuba, Mongolia and Vietnam) but information is too scant to permit any meaningful estimates to be made.

III. Factors underlying merchandise trade performance in the decade 1971-80

The previous section showed that there was a close link between the growth of the eastern bloc's debt to the West and its merchandise trade performance with the developed market area. In this section the factors behind the evolution of merchandise trade are examined against the background of macro-economic development. In particular, each of the following four possible causes of poor external trade results are assessed: (i) excessive domestic absorption; (ii) specific supply failures; (iii) inappropriate export structure; and (iv) trade barriers.

(i) Domestic absorption

An indication of the effect of shifts in domestic absorption in real terms can be derived from the relative growth in "produced" and "distributed" Net Material Product (NMP), the difference between which indicates the direction of movements in the "real" balance of trade in goods and services. In the 1971-75 period, policies in the eastern area were generally directed towards the expansion and modernisation of productive capacity through higher rates of investment. In the majority of countries these policies were translated into real expenditure (distributed NMP) growing more rapidly than output (produced NMP) (see Table 4). As a result in most cases the real foreign balance deteriorated. For the six eastern European countries the effects of this deterioration were reinforced by worsening terms of trade. While these observations apply to aggregate external balances - indeed, all countries recorded overall trade deficits during the period, although they varied widely in size - the deficits were in every instance concentrated in trade with the developed countries. The outstanding example of a country which conformed to this pattern was Poland. Growth in real expenditure averaged 12.2 per cent. over the period, compared with national income growth of 9.8 per cent. Even though, unlike its eastern Europe partners, Poland's terms of trade improved between 1970 and 1975, its trade balance worsened the most sharply, from near balance to a $2.3 billion deficit in overall terms, and an even larger deterioration (nearly $3 billion) in trade with the West.

In the 1976-80 period there was a general shift in economic policies. Despite the slowdown in real output growth, the rate of real

Table 4

Eastern Europe and USSR:

Growth of produced and distributed NMP, consumption and net capital formation

	Bulgaria	Czecho-slovakia	GDR	Hungary	Poland	Rumania	USSR
	Average annual percentage changes						
1971-75							
Produced Net Material Product (NMP)	7.8	5.7	5.4	6.2	9.8	11.3	5.7
Distributed NMP	8.1	7.6	5.7	5.2	12.2	..	5.1
Consumption - total	7.3	5.3	5.4	5.1	8.9	..	..
- personal	..	4.8	5.0	5.1	..	..	..
- social	..	..	7.8	..	..	..	..
Total net capital formation	..	8.4	2.9	5.6	16.8	..	..
Pro mem.: Trade balance (in $ billions)							
- overall	-1.0	-0.9	-2.0	-1.4	- 6.4	-0.1	-0.2
- with DME*	-1.5	-1.4	-3.4	-1.4	- 6.8	-1.3	-7.1
1976-80							
Produced NMP	6.1	3.7	4.1	3.2	1.2	7.2	4.2
Distributed NMP	5.2	2.1	3.7	1.9	- 0.2	..	3.8
Consumption - total	7.8	2.5	3.8	3.2	4.5	..	..
- personal	7.4	1.7	4.0	2.7	4.3	..	4.6
- social	8.6	4.8	3.5	5.9	4.5	..	..
Total net capital formation	3.2	0.9	2.6	-2.3	-11.8	..	1.4
Pro mem.: Trade balance (in $ billions)							
- overall	0.6	-3.7	-8.4	-4.2	-10.6	-3.1	19.9
- with DME*	-1.3	-3.6	-7.3	-3.9	-10.3	-1.7	-9.7

* Developed market economies.

Source: Economic Survey in Europe (various issues), United Nations Economic Commission for Europe. Comecon Data 1979, Vienna Institute for Comparative Economic Studies.

expenditure growth was cut back by even more. As a result the real foreign balances of all countries in the region improved but the diversion of more resources towards exports was, with the exception of the USSR, partly offset by further deteriorations in the terms of trade. Only in Bulgaria were improvements registered in both overall trade and trade with the developed area. While the USSR registered a very large overall trade surplus ($19.9 billion), reflecting a strong terms-of-trade gain following the rise in oil prices, adverse volume trends in its trade with developed market countries resulted in a trade deficit with that group which was higher than in the previous quinquennium.

The changing emphasis of economic policies during the 1970s affected not only overall growth rates of distributed national income but also the way in which it was allocated between consumption and investment. In the first quinquennium priority was given to allocations for investment, which generally grew faster than consumption as a result. During the years 1976-80, by contrast, policies were designed to cushion the impact of lower rates of domestic absorption on living standards. Consumption was permitted to grow faster than distributed national income, while net capital formation proceeded at slow or even negative rates (Table 4). The outcome of this strategy at its most extreme is shown by the Polish example, where total consumption grew by 4.5 per cent. on average, compared with a decline of 11.8 per cent. in total net capital formation. More generally, the effects of the policy re-orientation may be seen from the rises in the shares of consumption in domestically available resources between 1975 and 1980 (Table 5).

Table 5

Ratio of total consumption to distributed NMP

Countries	1970	1975	1980
	in percentages		
Bulgaria	69.2	67.2	73.1
Czechoslovakia ...	73.1	71.2	75.0
GDR	75.6	77.7	78.9
Hungary	76.5	73.6	78.1
Poland	73.5	64.3	80.2
Rumania	71.2[1)]	65.9[2)]	63.7[3)]
USSR	70.5	73.4	75.3

1) 1966-70 2) 1971-75 3) 1976-80.

Source: Economic Survey of Europe in 1981, UN.

An example of the way in which changes in rates of domestic absorption affected trade flows can be found in the investment sector. Investment in machinery and equipment accounted for a major part of eastern countries' fixed capital formation during the last decade - about 40 per cent. in most cases. In the 1971-75 period the high rates of overall investment growth that were instrumental in raising rates of domestic absorption were reflected in rapidly growing investment in machinery and equipment. Over the same period, the OECD area's trade surplus in machinery and equipment became significantly larger with virtually every eastern country (Table 6), rising from $1.8 to 7.8 billion vis-à-vis the group as a whole. In the 1976-80 quinquennium, as the growth of national incomes slowed and expenditure allocations shifted from investment to consumption, fixed capital formation in machinery and equipment grew less quickly. Reflecting this, the western trade surplus in these goods hardly increased at all with respect to the Eastern Bloc between 1975 and 1980, implying a substantial decline in real terms. Indeed, in the case of Poland, where the investment rate dropped the most sharply, there was a sizable absolute fall in the trade imbalance.

Table 6

Investment and trade in machinery and equipment

Countries	Average growth of investment in machinery and equipment		Balance of the OECD area's trade with eastern countries in machinery and equipment (SITC 7)		
	1971-75	1976-80	1970	1975	1980
	in percentages		in millions of US dollars		
Bulgaria	10.3	1.9	89	464	344
Czechoslovakia ...	8.1	6.9	150	402	545
GDR	2.8	3.9	68	107	127
Hungary	8.6	4.3	106	355	538
Poland	23.1	2.1	179	1,720	1,041
Rumania	16.1	13.8	236	582	630
USSR	7.9	7.2	936	4,204	4,722

Source: Economic Survey of Europe in 1981; OECD Trade Statistics Series C.

(ii) Domestic supply problems

The distinct downward trend of overall economic growth, common to all countries during the decade, coincided with a tendency for outturns to fall short of planned targets which was widespread in terms both of countries and of economic sectors. As can be seen from Table 7, the divergence between planned and actual results for overall NMP growth was a feature mainly of the second (1976-80) plan period; indeed, in the earlier period the majority of countries overfulfilled their targeted growth rates. However, the agricultural sector stood out in both periods, not only because targeted rates of growth were much lower than planned overall economic growth, but also because even these relatively low targets were missed by the majority of countries in the 1971-75 period and by all of the group in the later period.

Table 7

Eastern Europe and USSR:
Comparison of planned and actual economic performance

			Bulgaria	Czecho-slovakia	GDR	Hungary	Poland	Rumania	USSR
			Average annual percentage changes						
Growth of net material product (NMP):									
	1971-75	plan	7.7-8.5	5.1	4.9	5.5-6.0	6.7-6.8	11-12	6.5-7.0
		actual	7.8	5.7	5.4	6.2	9.8	11.3	5.7
	1976-80	plan	7.7	4.9	5.0	5.4-5.7	7.0-7.3	10-11	4.7
		actual	6.1	3.6	4.1	3.2	1.2	7.2	4.2
	1981-85	plan	3.7	2.0-2.6	5.1	2.6-3.2	0.9(e)	7.1	3.4
Growth of gross output by sector:									
1. Agriculture*									
	1971-75	plan	3.2-3.7	2.7	2.4	2.8-3.0	3.5-3.9	6.3-8.3	3.7-4.0
		actual	2.3	3.0	2.1	3.5	3.2	4.7	2.5
	1976-80	plan	3.7	2.7	2.6	3.2-3.4	3.0-3.5	5.1-7.6	3.0
		actual	2.1	1.7	1.1	2.9	0.5	4.9	1.7
	1981-85	plan	3.4	1.8-2.2	1.1	2.3-2.8	..	4.5-5.0	2.5
2. Industry									
	1971-75	plan	9.2-9.9	6.0	6.0	5.7-6.0	8.2-8.5	11-12	8.0
		actual	9.0	6.6	6.5	6.4	10.4	12.9	7.4
	1976-80	plan	9.2	5.7-6.0	6.0	6.0	8.2-8.5	10.2-11.2	6.3
		actual	6.0	4.5	4.9	3.4	4.7	9.5	4.5
	1981-85	plan	5.1	2.7-3.4	5.1	3.5-4.0	..	7.6	4.7

*Annual percentage change of five-year average over previous five-year average.

Source: "Economic Survey of Europe in 1975" and "Economic Survey of Europe in 1981", United Nations Economic Commission for Europe; Wochenbericht 25/81, Deutsches Institut für Wirtschaftsforschung.

There is evidence that the deterioration in the agricultural supply situation in the second half of the decade exacerbated the eastern countries' convertible trade deficit and hence contributed to higher indebtedness. As Table 8 shows, for all the eastern countries except Hungary, the trade balance in food, drink and tobacco moved in favour of the OECD area between 1975 and 1980, and this movement was particularly marked in the three countries where agricultural production fell farthest short of plan, namely the USSR, Poland and the GDR. Vis-à-vis the eastern group as a whole, the OECD area's surplus in these products rose from $1.6 to 6.5 billion, a shift which almost entirely reflected a sharp increase in western exports.

Table 8

The OECD area's trade in agricultural products with the eastern countries

Countries	Balance of the OECD area's trade with eastern countries in food, drink and tobacco (SITC 0+1)		
	1970	1975	1980
	in millions of US dollars		
Bulgaria	- 74	- 94	19
Czechoslovakia ...	30	- 14	231
GDR	29	- 34	660
Hungary	-136	-274	-485
Poland	-204	106	825
Rumania	-107	-106	385
USSR	73	1,972	4,840
Total	-389	1,556	6,475

Source: OECD Trade Statistics Series C.

Of the reasons cited for poor results in agriculture, perhaps the most common is unfavourable weather conditions. While the importance of this factor cannot be denied, it might be argued that a high sensitivity to the weather is itself to some extent indicative of agricultural inefficiency. Grain production remains of crucial importance in farming output, both for human and animal consumption. Attempts to improve the quality of food consumption for the population by increasing livestock production were generally held back by poor crop harvests and, although in all countries the average share of livestock in total agricultural output rose somewhat in the 1976-80 period, to between 44 and 60 per cent., this was partly at the expense of increased imports of fodder. Disparities between countries as regards grain production, which were already large in the 1971-75 quinquennium, became even larger in the 1976-80 period (Table 9). In terms of yields per hectare, the USSR was well below the average, followed by Poland, while Hungary was the highest by a fair margin. As regards grain output per capita, all countries except Poland managed an improvement in the second half of the decade but the resulting levels of output were diverse, with Hungary again the highest at 1.2 tonnes - more than double the output of the GDR and Poland, which were at the bottom end of the scale.

Table 9

Eastern Europe and USSR:

Selected indicators of productivity in industry and agriculture

		Bulgaria	Czecho-slovakia	GDR	Hungary	Poland	Rumania	USSR
Industry								
Ratio of gross output to fixed assets (average annual percentage change) ...	1971-75	- 0.6	1.1	0.1	- 1.5	1.0	- 0.3	- 1.1
	1976-80	- 3.6	- 1.5	- 1.0	- 4.3	- 4.2	- 0.8	- 2.9
Gross output per employee (average annual percentage change) ...	1971-75	6.2	5.9	6.2	6.1	7.3	6.2	5.8
	1976-80	4.4	3.7	4.4	4.5	4.3	5.8	2.8
Agriculture								
Total grain yield (in quintals per hectare)	1971-75	33.1	33.9	35.7	35.0	25.1	24.1	14.7
	1976-80	35.4	36.9	35.4	41.6	24.5	30.1	16.0
Total grain output per capita (in kilograms)	1971-75	865	647	516	1,104	636	718	727
	1976-80	905	674	544	1,196	564	892	785

Source: Economic Survey of Europe in 1981, United Nations Economic Commission for Europe.

(iii) Export structures

The emphasis of the discussion so far has been mainly on factors affecting import structures. However, it is often argued that a principal cause of the Eastern Bloc's poor trade record with the West is the inappropriateness of export structures. The high rates of investment and the rapid growth of investment goods imports, which featured in virtually all of the eastern countries in the early 1970s, might have been expected to improve their export potential in manufactured products. The extent to which this improved potential was translated into a shift in the export structures towards manufactures is indicated by Table 10. Owing to the lack of sufficiently detailed statistics from eastern sources, the composition of convertible currency exports is based here on OECD area import data. The figures show how the countries which began the 1970s with relatively small industrial bases - Bulgaria, Hungary, Poland and Rumania - achieved notable shifts in their export structures towards manufacturing during the decade. In the remaining countries the weight of manufactures in their developed country exports declined. The particularly sharp drop in the USSR

Table 10

The OECD area's trade with eastern countries in manufactured goods (SITC 5 to 8)

Countries	Shares in eastern exports (OECD area imports)			OECD area's trade balances		
	1970	1975	1980	1970	1975	1980
	in percentages			in millions of US dollars		
Bulgaria	39.4	47.5	42.4	173	795	871
Czechoslovakia ...	67.3	66.4	62.7	102	451	163
GDR	78.3	71.3	69.9	- 7	155	28
Hungary	43.2	54.2	60.1	246	889	1,082
Poland	32.7	36.8	50.2	262	3,213	1,431
Rumania	40.2	46.9	49.9	350	831	778
USSR	26.0	18.8	16.0	1,557	8,292	11,477

Source: OECD Trade Statistics Series C.

reflected the surge in the value of its mineral fuels exports, which accounted for over 70 per cent. of the total in 1980 compared with only one-third ten years earlier. Although, in absolute terms, the increase in manufactured exports was impressive, rising for the group as a whole from $2.4 to 15.8 billion between 1970 and 1980, none of the countries had achieved a surplus in trade in these goods by 1980 - indeed, in the USSR, Hungary and Bulgaria, larger deficits were registered in that year than in 1975.

As another indicator of the eastern countries' trade performance, a comparison may be made with the so-called Newly Industrialising Countries[5] (NICs). Between 1970 and 1980, the shares of the two groups of countries in the OECD area's total imports (based on OECD data, excluding intra-OECD flows) remained broadly unchanged. However, market shares in manufactured goods diverged considerably between the groups: that of the eastern countries fell from 17 to 13.5 per cent., while the NICs' share increased by one-half, from 40 to 62 per cent. The comparison is relevant because in certain manufactured commodities - chemicals, metal goods and footwear for instance - the two groups have been in direct competition.

A number of reasons have been advanced to explain why the composition of exports from the eastern countries does not correspond more closely to the productive structures and capacities of the eastern economies. One argument is that what might be termed a "comparative disadvantage" exists for the Eastern Bloc with respect to sales of manufactures to the West and that this can be largely attributed to inappropriate patterns of specialisation and to deficiencies in product quality and marketing. As far as the last aspect is concerned, more intensive efforts have been made in recent years by the eastern countries to arrange a larger proportion of trade under "economic co-operation" or "countertrade" agreements. These headings embrace a variety of types of deal, all of which essentially involve some form of barter. The eastern country agrees to purchase goods from a western exporter on condition that the latter accepts, in full or partial settlement, the delivery of eastern products (or, more rarely, services). A substantial increase in countertrade arrangements took place in the second half of the 1970s, particularly in the trade of the GDR and Rumania. Such arrangements still account for a relatively small proportion of total East-West trade, probably not more than 15-20 per cent., but the shares appear to vary widely from country to country.[6] A recent OECD study[7] argued forcibly against the growth of countertrade, chiefly on the grounds that its development would accentuate bilateralism in East-West trade and thereby have negative effects on the expansion of trade between the two zones.

As a means of limiting the use of scarce convertible currency, however, countertrade schemes may be advantageous - at least in the short run - for the eastern countries. Moreover, they may be less likely to aggravate protectionist tendencies in western countries, for instance by avoiding accusations of "dumping".

(iv) Trade barriers

The existence of trade barriers is another of the factors which has been suggested to explain the persistent commodity imbalance in East-West trade. Although, almost by definition, central planning mechanisms effectively limit the quantity or value of imports of large ranges of products from the West, discussion of protectionism in the context of Eastern Bloc trade usually relates to barriers against eastern exports. Such barriers have taken a variety of forms, including bilateral and global quotas, anti-dumping duties, minimum price levels and the outright prohibition of certain products. As well as affecting finished manufactures, such as footwear and clothing, western restrictions have also been applied to semi-processed eastern exports, of which chemicals, iron and steel and textiles are examples. Agricultural products are subject to import controls in a number of western countries, a notable example being the levies imposed by EEC member countries.

Throughout most of the period under review there was a general easing of protectionist barriers in the West; only towards the end of the 1970s did protectionist pressures begin to re-emerge. It is very difficult to assess the impact of western import controls on the export performance of the Eastern Bloc and even more difficult to measure their effect on the trade of an individual eastern country. The fact that the eastern countries as a group reduced their share of the market for western imports of manufactures between 1970 and 1980 might be ascribed to the erection of trade barriers later in the period. On the other hand, the NICs faced a similar pattern of easing and then tightening of trade restrictions and nevertheless managed to improve their market position. An examination of the widely differing application of tariff and non-tariff barriers to trade in western countries over the last decade is beyond the scope of this paper, but there are few indications that protectionism has been an important factor in limiting eastern export performance in the period covered here.

IV. Factors affecting the adjustment potential of the eastern countries

Over the past year or so it has become evident that the accumulation of convertible currency indebtedness by the Eastern Bloc has reached the point in certain countries at which it can no longer be sustained. Against the background of the severe payments difficulties of Poland and Rumania, a major change of attitude has come about on the part of western lenders towards the eastern countries in general, with the flow of new credits being reduced significantly. So far as commercial lending is concerned, the more cautious sentiment of western banks is evidenced by BIS statistics, which show a fall of $1.9 billion (excluding exchange rate effects) in their gross claims on eastern countries in the six-month period ended March 1982, in striking contrast to the more than $5 billion rise recorded a year earlier. The combination of a more limited availability of western finance and persisting deficits on current external account in most eastern countries points to an urgent need for further adjustment measures to reinforce the progress towards lower rates of domestic absorption which was made during the 1976-80 period.

Even without any further increase in convertible currency debt, the amount currently outstanding represents a heavy burden on the current account. In 1981 the deficit on investment income account with western countries, estimated by the UN to have been $8.5 billion (which may have been smaller to the extent that Poland and Rumania fell into arrears on interest payments), was close to the group's entire estimated external payments deficit in that year. While some relief is now being obtained from lower interest rates, given the size of the outstanding debt the adjustment problem is how to cover, and perhaps more than cover, the deficit on investment income with a surplus in the rest of the current account. With little prospect of obtaining any significant increase in the net income from other non-merchandise trade items (principally transport, insurance, tourism and transfers), which together yielded an estimated surplus of under $2.5 billion in 1981, the onus of adjustment must fall on the merchandise trade account. The required improvement can come about in either of two ways, from exports or from imports, or from a combination of both.

In the short term at least, exports would seem to hold less promise. The reasons for this are twofold. Firstly, current world economic conditions do not bode well for a sustained recovery in the near future. World trade has been stagnating and market growth largely confined to certain specialised product areas, such as micro-electronics, in which the eastern countries are scarcely represented. A marked decline in the growth of eastern exports to the West has already occurred: having risen in value by over 20 per cent. in 1980 (excluding Poland, where there were exceptional factors), the group's exports grew by only 3 per cent. in 1981.

Secondly, the eastern countries' competitive position in world markets appears to be a relatively weak one, especially in manufactured goods. The comparison with the NICs drawn in the previous section serves as an illustration of how lack of competitiveness has adversely affected the Eastern Bloc's market share in manufactures over the past decade.

At the root of this problem lies the fact that the eastern economies operate at comparatively low levels of efficiency. Meaningful international comparisons are difficult to make because of inadequate, or non-existent, data. However, available statistics point to shortcomings in the efficiency with which at least one important input is utilised, namely energy. As can be seen from Table 11, the amount of energy consumed in the eastern countries, either in terms of GNP or per head of population, on the whole compares unfavourably with levels of consumption in selected countries in the NICs and in the OECD groupings. This unfavourable position may have arisen partly because of the tendency in Comecon countries for industrial output to be concentrated on large-scale heavy industries, the products of which are prone to be relatively energy and material-intensive.

Improving the level of economic efficiency can be regarded as the key to the achievement of greater export competitiveness. However, it is difficult to see how a solution to the efficiency problem could be found in the context of the Soviet system of central planning, which is the model for the Comecon area. In many respects, this system is not conducive to greater efficiency. The centralised planning and direction of an economy is an extremely complex and cumbersome operation. In the USSR alone, there are 48,000 output plans (plan "positions"), relating at varying levels of

Table 11

Comparative indicators of energy consumption in selected countries, 1980

Countries and groups	Amount of total energy consumed: Per US dollar of GNP	Per head of population
	in kilogrammes of coal equivalent	
Eastern countries		
Bulgaria	1.350	5,680
Czechoslovakia	1.110	6,480
GDR	1.030	7,410
Hungary	0.920	3,850
Poland	1.420	5,590
Rumania	1.970	4,590
USSR	1.230	5,600
Average	1.240	5,600
Selected NICs		
Hong Kong	0.340	1,430
Korea	0.930	1,420
Mexico	0.880	1,770
Portugal	0.470	1,100
Singapore	0.940	4,220
Spain	0.470	2,530
Yugoslavia	0.780	2,050
Average	0.680	1,870
Major OECD countries		
Canada	1.010	10,240
France	0.370	4,350
F.R. Germany	0.430	5,730
Italy	0.510	3,320
Japan	0.370	3,690
United Kingdom	0.610	4,840
United States	0.920	10,410
Average	0.660	6,860

Sources: 1981 World Bank Atlas; 1980 Yearbook of World Energy Statistics, United Nations, New York, 1982.

aggregation to 12 million produced items. Each plan "position" must be related to financial, labour productivity, wages and other plan targets. Because of the complex network of relationships between output and material supply, there is little room for flexibility in the plans once set, even though changing conditions might make plan alterations desirable. One of the most important consequences of the planning model is that prices are administered centrally and do not reflect demand, scarcity or utility. The lack of a rational pricing system has undoubtedly led to misallocations of resources and to waste.

The achievement of greater efficiency, and hence more competitive exports, must therefore be seen in terms of major reforms, introducing strong elements of market economy into the planning system. Such reforms would need to embody three main elements: firstly, the decentralisation of planning and management to the level of individual enterprises, with strong incentives for a better allocation of resources; secondly, a new price-setting mechanism, so that prices would come nearer to reflecting supply and demand conditions, not only domestically but also in world markets; and thirdly, following from the last point, the introduction of a commercial exchange rate through which export and import prices would be directly related to domestic prices. Unfortunately, the adoption of these principles cannot be expected to yield rapid positive results. In Hungary, this direction of reform was first taken as long ago as 1968 subsequently intensified in the mid-1970s. Yet, in spite of some remarkable progress in improving the current-account position, further adjustment measures will be needed.

With the scope for expanding exports severely restricted in the short run, the solution to the immediate problem of closing the deficit on current account must lie essentially in constraining imports; in other words, in further cutting back real domestic absorption. The fall in absorption during the 1976-80 period was achieved largely at the expense of slow, or negative, rates of capital formation while consumption was permitted to grow further. This is not an unusual policy response to evolving external payments difficulties, in particular not if the balance-of-payments constraint is judged to be temporary and to be caused by factors beyond the control of the authorities. However, as curtailment of investment normally suggests a reduction in future output potential, the cut-back in absorption now required should be accompanied by a reallocation of resources from consumption to investment. This would imply that the onus of adjustment would have to fall on living standards - an unwelcome prospect in any country, but perhaps especially so in the eastern context, where increasing levels of welfare have apparently come to be regarded as a basic right.

So far the discussion has been in terms of the eastern countries as a group. But both the degree of adjustment required and the potential to adjust vary considerably from country to country. What, then, can be said about the positions of the individual economies?

The Soviet Union can be set apart from the other Comecon countries for several reasons. In the first place, its external debt is much lower in relation to its economic size, being equivalent to probably less than 1 per cent. of GNP. Secondly, its dependence on foreign trade is much smaller. Thirdly, its indigenous mineral wealth allows it to export large quantities of commodities, such as oil and gold, for which problems of competitiveness do not arise. Moreover, it has remained a highly centralised economy, which carries a number of disadvantages in terms of the improvement of efficiency, but at the same time allows the authorities to carry out import restrictions through administrative measures. The only serious limitation to this comes from the substantial import needs of cereals and food which arise out of the very low efficiency of Soviet agriculture.

Turning to eastern Europe, Bulgaria and Czechoslovakia appear to have been relatively little troubled by debt management difficulties. In both countries, the amount of outstanding debt is relatively low, Bulgaria having achieved a sizable reduction in its indebtedness in recent years. Furthermore, current-account imbalances have not been large in either case. The two countries do not seem, therefore, to be faced with major adjustment problems.

The remaining countries - the GDR, Hungary, Poland and Rumania - are all experiencing difficulties, although in widely varying degrees. Poland and Rumania have been unable to service their debt and are currently involved in rescheduling negotiations. In both countries, major shortcomings in economic management seem to be at the root of the problems which have necessitated the forced adjustment process now in progress. This seems to be particularly severe in Poland and has given rise, in conjunction with other developments, to political unrest.

The position of the GDR and Hungary is somewhat different. Their economies are more diversified (this applies in particular to the GDR) than those of Poland and Rumania and cut-backs in domestic consumption would not appear to be unmanageable. The GDR has by far the highest level of national income per head of any Comecon country and, as a result, the adjustment there should be more akin to that in a western country, from the point of view of the sacrifices to be undergone. Despite a comparatively high debt burden, Hungary may not be badly placed in terms of adjustment potential either. More than a decade of attempts to improve efficiency through the increased use of price mechanisms may well begin to yield results in manufacturing and services. In addition, the country is more than self-sufficient in agriculture, where the benefits of price reforms have already been felt. An adjustment process has been underway since 1978, which by now appears to have almost eliminated its overall deficit in convertible currencies. A further programme, in support of an IMF stand-by credit, is expected shortly to be agreed with the Fund.

It may be concluded that the acute, short-term adjustment difficulties are to a considerable extent centred on two countries, Poland and Rumania. Elsewhere, the situation should remain manageable, although the longer-term adjustment problems will not disappear. Even if there is successful short-term adjustment through lower domestic absorption, there seems little prospect that the Comecon countries could resume borrowing from the markets on the scale witnessed in the 1970s. To maintain their access to western imports they will need, therefore, to improve their export performance in manufactured goods. This is likely to be a lengthy and difficult task, particularly if there is little improvement in the general economic climate.

V. Summary

The steep rise in the eastern countries' debt in convertible currencies over the last decade was essentially the result of deficits incurred in merchandise trade with western market economies. In recent years, while these deficits have tended to diminish, the reduction has not been fully reflected in the current-account balance owing mainly to a steadily widening gap in the invisibles account as the interest costs of servicing the external debt have mounted.

Underlying the region's poor trade performance, high rates of real domestic absorption in the early 1970s were associated with ambitious investment programmes which relied to a large extent on imports of machinery and equipment from the West. As far as the industrial sector is concerned, this investment appears to have been insufficiently geared to matching export requirements, and competitiveness in western markets suffered as a result. At the same time, disappointing agricultural yields meant that the eastern countries remained heavily dependent on imports to maintain food supplies. While the current payments position of the group was undoubtedly aggravated by unfavourable trends in the world economy, there seems to be little evidence that protectionism had any significant adverse effect on eastern exports during the period under review.

With little near-term prospect of any appreciable further borrowing by the Comecon countries on western markets, the need to bring current accounts back into equilibrium has become paramount. As the scope for boosting exports in the short run is limited, the brunt of the immediate adjustment will have to be borne by imports. Poland and Rumania appear to be the countries where the burden of such adjustment will be particularly heavy, but in all countries the process will probably be a lengthy one and cannot be expected to lead to a return to western lending on the scale seen in the last decade.

Footnotes

1 Most eastern countries do not publish statistics of their overall external debt; in any case, no national sources cover the period back to 1970. The data used in this paper are independent western estimates, drawn from three separate studies. The estimates are believed to be reasonably reliable and consistent, but are presented here without any specific or implied endorsement.

2 These estimates are based on data collected by the BIS, certain adjustments having been made to allow for changes in coverage. Changes in individual countries' net positions vis-à-vis banks are not available for this period, because the statistics were collected in this by the BIS only from end-1974.

3 The figures shown in Table 2 are the result of certain adjustments made to the original BIS series in order to ensure (as far as possible) comparability with the estimates of total indebtedness. The "residual" category, which is present in quarterly reported data largely because the positions of Swiss banks are not broken down by individual countries, was allocated according to each country's share in total assets and liabilities as reported in the half-yearly BIS maturity survey; the latter's coverage is slightly different but it does give a full country breakdown. Another adjustment was made to smooth out the end-1977 series break caused by the expansion of the reporting area to include Austria, Denmark and Ireland, and by the inclusion of domestic currency trade claims held by French and British banks. This was done by "discounting" the end-1977 (new series) outstanding assets and liabilities back to 1974 using percentage changes in stocks derived from the old series, i.e. it was assumed that net lending by banks in the newly included countries expanded at the same rate as that of other reporting banks.

4 This figure is based on an estimated annual surplus of $1.2 - 1.5 billion given in Financial Market Trends No. 18, page 6, OECD, Paris, March 1982.

5 Brazil, Greece, Hong Kong, Korea, Mexico, Portugal, Singapore, Spain, Taiwan and Yugoslavia.

6 The countertrade shares of individual countries' trade with the developed western economies in 1978 were estimated as follows: Hungary 5-10 per cent.; Poland and Czechoslovakia 11-20 per cent.; USSR and Bulgaria 15-20 per cent.; GDR and Rumania 21-30 per cent. See F.L. Altmann, Countertrade with CMEA countries: the West German example, Economic and Financial Aspects of East-West Co-operation, Perspektiven, Vienna, 1979.

7 East-West trade: recent developments in countertrade, OECD, Paris, 1981.

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