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Comecon: its Function as a Soviet Political Instrument

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COMECON:

ITS FUNCTION AS A SOVIET POLITICAL INSTRUMENT

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Dedicated to Jamie, whose faith inspired me;
my parents Richard and Judy, who have always encouraged me;
and my wonderful friends
in the Graduate Program.

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ABSTRACT

Historically, the Soviet Union has had important political interests in securing hegemony in Eastern Europe. Control of this region has allowed the U.S.S.R. to maintain a buffer zone as protection from Western influence.

The Soviets created Comecon in 1949 to aid in the control of the bloc. Through Comecon ties, a relationship built on Eastern European economic dependence on the Soviet Union was formed.

This economic dependency was created and maintained through the use of bilateral barter and inconvertibility of currencies within Comecon. Although these methods proved to be economically inefficient, the Soviets resisted any attempts at reform. The Soviets feared that the economic dependency of Eastern Europe would be lost through multilateralism and convertibility. The preservation of bilateralism and inconvertibility within Comecon therefore ensured Soviet political domination of the region, an important goal of Soviet policy in the Cold War era.

COMECON:

ITS FUNCTION AS A POLITICAL INSTRUMENT

Comecon (the Council for Mutual Economic Assistance) was created by the Soviets in 1949. Its ultimate purpose was political, not economic: consolidation of the Soviet bloc. The Soviet aim was to strengthen its buffer zone through increased economic ties with the Eastern European nations. This buffer zone, devised by Stalin, was to serve as protection from Western invasion and influence.

Historically, the Soviet Union has had important political interests in Eastern Europe. Control of this region has been a principle security goal of the Soviets. This has been particularly significant in the post-World War II era, characterized by the Cold War rivalry between the Soviet Union and the United States.

The stated purpose of Comecon was the coordination of the foreign trade and national plans of its members. Intra-Comecon trade had been based traditionally on inconvertibility and resulting bilateral settlement as established by the Soviets. Such bilateralism forces a country to settle trade with each of its trading partners on an individual basis, resulting in a barter-like system of exchange. This method was maintained by the Soviets as it served their political purpose of maintaining control of the region through economic domination.

This type of trade has been characterized by economic inefficiency. Such methods have served as obstacles in the productive functioning of Comecon and, as many argue, has been a major factor in the dissolution of this organization in early 1991.

Despite many Eastern European efforts to incorporate multilateralism into the workings of Comecon throughout its history, such reform efforts were sidetracked or halted by the Soviets. This reluctance to allow the introduction of market mechanisms within Comecon, stemmed from the Soviet Communist Party's long-standing political interests in maintaining political and ideological control over both Eastern Europe and its own country.

I. Soviet Interests in Eastern Europe

In the post-World War II era, Soviet interest in Eastern Europe largely stemmed from past Soviet vulnerability to invasions through the Eastern European nations, specifically through Czechoslovakia and Poland.[1] As a result, one of Stalin's main concerns was to secure control over this territory in order to prevent future aggression against the Soviet Union.

A secondary interest in securing control of Eastern Europe, was to limit nationality and religious conflicts in

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[1]Karen Dawisha, *Eastern Europe, Gorbachev and Reform: The Great Challenge* (Cambridge: Cambridge University Press, 1988), 18.

the region which had threatened Soviet security in the past.[2] Such historical conflicts had involved Russia throughout both its pre- and post-Revolutionary periods. Examples particularly critical to Soviet national security include the support given by Czechoslovakia's first president, Tomas Masaryk's to the White Russian attempt to overthrow Lenin and the open engagement of the Red Army in 1920 by the Poles.[3]

Consequently, Soviet influence in Eastern Europe was to serve both to prevent Western expansion into Soviet territory and to stabilize the area in order to minimize regional conflicts and instability.[4]

Stalin and the Creation of Comecon

After World War II, the Soviet Union attempted to extend its policy of national autarky and economic isolation to the Soviet bloc as a whole. Each country was aided in developing foreign trade institutions based on the Soviet model of state monopolies.

Following their refusal of Marshall Plan assistance from the United States in 1947, the Soviets organized their own Molotov Plan for the countries of Eastern Europe.

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[2]Ibid.

[3]Ibid.

[4]Ibid, 19.

Between 1947 and 1955, the economies of Eastern Europe became tied to the Soviet economy through a series of bilateral trade and scientific-technical cooperation agreements.[5]

In addition, the Soviets presented the rouble as the clearing currency for the bloc and extended trade credits to the bloc states.[6] Such credits were extended largely according to political criteria, in that often they were offered as a reward to nations for their loyalty to the Soviet Union.[7] These economic arrangements served to establish strong economic ties between the Soviet Union and the countries of Eastern Europe on a strictly bilateral basis. The bilateral ties among the European members of the bloc were much weaker due to the smallness of their economies and similarity in products created.

By modeling the Eastern European political systems after the Soviet communist system, Stalin established uniform and favorable conditions for the political cohesiveness of the region. Yet, in the customary sense, this region was particularly unsuited for economic

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[5]Glen Alden Smith, *Soviet Foreign Trade: Organization, Operations, and Policy, 1918-1971* (New York: Praeger Publishers, 1973), 27.

[6]Ibid.

[7]Ibid., 200.

integration in that it lacked the precondition that cooperation between states be on an equal footing.[8] This condition is necessary because the alternative, different levels of development would call for a number of different economic policies within one regional organization, which would be extremely difficult to achieve.[9]

This inequality between the bloc states can be seen in the diversity of development stages existing in the region. One measure which illustrates this is the nations' varying levels of per capita industrial output at the beginning of Comecon. In 1950, compared to the Soviet Union (the base of 100%), Bulgaria's per capita industrial output was 43%, Czechoslovakia's was 143%, the GDR's was 136%, Poland's stood at 70%, Romania's was 31%, and Hungary's was 78%.[10]

Despite the varied economic composition of the region, Stalin still chose to create Comecon in an effort to propel limited economic cooperation. According to Adam Zwass, the lack of the precondition of equality was actually in Stalin's favor in that he never planned for Comecon to serve

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[8]Adam Zwass, *The Council for Mutual Economic Assistance: The Thorny Path from Political to Economic Integration* (Armonk, NY: M.E. Sharpe, 1989), 14.

[9]Ibid., 11.

[10]Ibid., 10.

as a supranational economic authority.[11] The last thing Stalin wanted was to create an institution which had power over to the Communist Party within the Soviet Union.

A more immediate impetus to Stalin's creation of Comecon arose when several Communist leaders in the Eastern European nations announced their intention to create a Balkan or Eastern European association independent of the Soviet Union. This challenge to Soviet hegemony can be seen in a June 1947 speech by the Yugoslavian leader Tito. Speaking to Western correspondents in Belgrade, Tito urged, "the free Balkan peoples" to create "a strong monolithic entity."[12] Further, after visiting Bulgaria in November of 1947, and signing several pacts, Tito remarked that between the two nations "cooperation was so close that the question of federation will be a mere formality."[13] Weeks later, Kostov, the Bulgarian deputy Prime Minister, who was later killed during the Stalinist purges, declared that events would lead "in the near future to the union of all south Slavs and to the creation of a common Slav country."[14]

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[11]Ibid., 14.

[12]Royal Institute of International Affairs: *Survey of International Affairs, 1947-1948* (London, 1952), 175, quoted by Ghita Ionescu, *The Break-up of the Soviet Empire in Eastern Europe* (Westport, CT: Greenwood Press, 1984), 30.

[13]Ionescu, op. cit., 30.

[14]Ibid.

Additional evidence of this ambition appeared in January of 1949 when Bulgaria's First Secretary Dimitrov announced his vision of a federation made up of the Eastern European nations of Bulgaria, Albania, Romania, Yugoslavia Hungary, Czechoslovakia, Poland, and even Greece. This announcement received favorable responses from many Eastern European communist leaders, particularly from the Romanian Communist leaders and the Polish Communist Party.[15] Another supporter of this vision was Rezso Nyers, a member of the Hungarian Politburo, who publicly stated that such a coalition would be much more successful without the Soviet superpower included.[16]

The Kremlin viewed these efforts as zealous attempts to form a South Slav or East European federation and gain independence from the Soviet Union. Even more threatening was the potential of such an organization developing into a rival force to counter Soviet influence in the region. In view of these fears, the Dimitrov incident finally snapped the patience of the Soviets and an admonishing response was published in *Pravda* on 28 January 1948. This article made clear that the Soviet Union saw absolutely no need for such

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[15]Ibid., 30-31.

[16]Zwass, 1989, op. cit., 13.

a federation and would not tolerate the creation of one.[17]

To avoid such a possibility, Stalin implemented "people's democracies", political systems modeled after the Soviet State apparatus, in every bloc state in an effort to create complete uniformity in the region. In addition, each people's democracy was ordered to amend its constitution to clearly state its dependency on the Soviet Union for its creation and continued existence.[18]

These East European ambitions for an independent federation led to a deep distrust of Eastern European motives on the part of Stalin. Josef M. Van Brabant argues that it was apparent at this time that Stalin greatly feared

> that if the region was to fuse the various economies and bolster mutual cooperation, it might lead to an anti-Soviet bulwark. Indeed, joint efforts to come to grips with the most urgent of their common problems without the tutelage of the USSR might have undermined the long-cherished Soviet interest in exercising hegemony over Eastern Europe.[19]

In an effort to safeguard against this, Stalin created Comecon to develop and implement a regional economic policy, with the Soviet Union playing the dominant role. As argued

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[17]Ionescu, op. cit., 31.

[18]Ibid., 33.

[19]Jozef M. Van Brabant, *Socialist Economic Integration* (Cambridge: Cambridge University Press, 1980), 25.

earlier, inequality within Comecon was important to Stalin in that he was strongly opposed to a regional economic policy in which all countries were equals. Equality could not be accepted, because his main objective, in his own words, was "to hold the satellites down, but at arm's length. Unreliable and westernized, they must not be allowed too close."[20]

According to many experts this fear of East European aspirations was also behind Stalin's opposition to outright annexation of these countries. One such proponent of this argument, V. Dedijer, contends that Stalin had the power to annex but lacked the motivation due to his strong distrust of these countries.[21]

This distrust also appears to be behind Stalin's encouragement of national autarkic policies for all the Soviet bloc nations. Despite his creation of Comecon, Stalin encouraged, even forced, these countries to develop according to a policy of national self-sufficiency. Even more paradoxical was the Soviets discouragement of increased Comecon ties.[22] As each nation pursued its own autarkic

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[20]P.J.D. Wiles, *The Political Economy of Communism* (Oxford: Blackwell, 1968), 311 quoted by Van Brabant, op. cit., 25.

[21]V. Dedijer, *The Battle Stalin Lost- Memoirs of Yugoslavia, 1948-1953* (New York: Viking Press, 1979), 101 in Van Brabant, op. cit., 25.

[22]Van Brabant, op. cit., 25.

economic development, Comecon was basically a formality for its first few years, despite the grand intentions established in its charter.

Khrushchev and the Reactivation of Comecon

In the late 1950s, Khrushchev expanded the role of Comecon in order to implement greater socialist integration; something he saw as very necessary at the time. This belief stemmed, in part, from the formation of the rival European Economic Community in 1958 and from the growing realization that autarkic development was wasteful and inefficient. More importantly, Khrushchev saw Comecon in the same way he viewed the Warsaw Pact, as a forum through which to maintain Soviet control of Eastern Europe, especially following the attempted revolutions in Hungary and Poland in 1956.[23]

The reactivation of Comecon was a shrewd effort by Khrushchev to bind each individual state economically to the Soviet Union to create a situation of dependence. This was especially important in that these nations were increasingly becoming divided both politically and ideologically. Economic leverage, through a system of bilateral dependencies on Moscow, would effectively allow the Soviets greater political dominance over Eastern Europe.

> [E]conomic pressure was exerted by exploiting

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[23]J. F. Brown, *Eastern Europe and Communist Rule* (Durham, NC: Duke University Press, 1988), 146.

> Eastern Europe's dependence upon Soviet raw materials and energy--the Soviets provided trade benefits as rewards for following Soviet policy prescriptions and withheld supplies to punish defiance of Soviet preferences.[24]

The Soviet use of economic leverage can be seen clearly in the case of Poland. Following the Soviet suppression of the Polish October, a near-revolution in 1956, the Poles still showed considerable interest in foreign aid, particularly American aid. Also, Poland was attempting to shift increased exports, especially its chief export coal, to the Western nations.[25]

As a result of the economic agreements and specialization provisions produced at the 1958 conference which revived Comecon, Soviet-Polish economic relations intensified significantly. In 1956, these transactions amounted to 2,562 million roubles which then grew to 2,747 million rubles in 1959.[26] This large trade volume, in comparison, made the American loan to Poland in 1957 of $94 million appear negligible, even with the exchange rate taken

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[24]Anne Henderson, "New Realities in Eastern Europe: Challenges for Russia and the West," in *New Thinking and Old Realities*, eds. Michael T. Clark and Simon Serfaty, (Washington, DC: Seven Locks Press), 36.

[25]Zbigniew K. Brzezinski, *The Soviet Bloc: Unity and Conflict* (Cambridge University Press: Harvard University Press, 1967), 287.

[26]Ibid., 288.

into account.[27]

Also important was the fact that Poland was becoming increasingly dependent on such trade, not only because of its large volume, but also because of its composition. Soviet exports supplied Poland with the majority of its needed imports of natural resources, something Poland was sorely lacking. For instance, in 1957 Poland was dependent on the U.S.S.R. for 100% of its oil supplies, 70% of its iron ore, 78% of its nickel, and 67% of its cotton.[28] Even more important, almost half of the Polish exports to the U.S.S.R. in 1957 consisted of Polish machinery and industrial goods, which represented about one half of total Polish machine exports.[29] These important Soviet-Polish economic links, established through Comecon agreements, had important and far-reaching effects on Poland. Polish leaders could not ignore the political implications of their economic dependence on Comecon ties and more specifically, on the Soviet Union as supplier of raw materials.

Through the reactivation of Comecon, Khrushchev also hoped to make these economic ties of dependency more equitable than earlier Stalinist Comecon ties based on

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[27]Ibid.

[28]Ibid., 288-289.

[29]Ibid., 289.

exploitation of Eastern Europe. During Stalin's reign "Moscow extracted $10-20 billion in reparations, administered unequal joint-stock companies to exploit local resources, and manipulated trade agreements to its advantage" in its dealings with the bloc.[30]

Khrushchev's move to improve the Soviet-Eastern European economic relationship was motivated by his desire to achieve a period of detente with the West, to allow the Soviets time to catch up to American economic and military superiority.[31] For detente to succeed the Soviets needed to improve their image in the international arena and an important part of this was to improve Soviet-East European relations. Improvements in economic relations were attempted by Khrushchev by the establishment of more equal and flexible intra-Comecon ties.[32]

To enhance the legitimacy of Comecon, the exploitative economic ties were replaced by the extension of Soviet economic support to the Eastern bloc nations. Also, the Soviets attempted to create the facade of more diplomatic

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[30]Jonathan R. Adelman and Deborah Anne Palmieri, *The Dynamics of Soviet Foreign Policy* (New York, NY: Harper & Row, 1989), 159.

[31]Ibid., 151.

[32]Ibid., 157.

cooperation in Comecon decision-making and activities.[33] To offset damage done to Soviet-East European relations resulting from the 1956 crises in Hungary and Poland, Khrushchev attempted to improve economic relations even further. Intra-Comecon trade and activities were expanded with terms of trade shifting dramatically in the East European countries' favor.

J.F. Brown argues, "[t]he 1956 crises and their aftermath cost Moscow several billion dollars in loans extended to distressed regimes and the cancellation of old debts."[34] Although these changes established a more equitable economic order in the Soviet bloc, and thereby allowed the Soviets to maintain influence in the region, this was at a very high cost to the Soviets. Although these new ties were costly, Khrushchev saw them as politically necessary. They were apparently successful in that further crises in the bloc during Khrushchev's tenure were avoided.[35]

Comecon Under Brezhnev

Similar to Khrushchev's handling of Eastern Europe, Brezhnev attempted to avoid direct military force and

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[33]Brown, op. cit., 448.

[34]Ibid., 159.

[35]Ibid.

instead tried to use economic, political and cultural ties to maintain influence in the bloc. This indirect method was used to repair damage done to the Soviet international image by the invasion of Czechoslovakia in 1968. It attempted to use new and less costly bases of control in Eastern Europe as opposed to interventionist methods utilizing military force.[36] Toward this end, Brezhnev used a strategy based on Soviet subsidization of Eastern Europe which actually turned out to be quite costly economically but avoided the negative effects on the Soviet international image associated with direct intervention.

During the 1970s, this subsidization of Eastern Europe cost the Soviet Union tens of billions of dollars.[37] One study estimates subsidization to have risen from less than $250 million in the early 1960s to more than $10 billion per year in the early 1980s.[38] This large increase was due primarily to the rapid rise in the world market price of oil after 1973, while the price of Soviet oil and natural resources sold to the Eastern European nations increased at

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[36]Morris Bornstein and Daniel R. Fusfeld, *The Soviet Economy: A Book of Readings* (Homewood, IL: Richard D. Irwin, Inc., 1970), 193.

[37]Ibid.

[38]Michael Marrese and Jan Vanous, *Soviet Subsidization of Trade with Eastern Europe: A Soviet Perspective* (Berkeley, CA: University of California Institute of International Studies, 1983) cited in Henderson, op. cit., 36.

a much slower pace.[39]

An additional part of Brezhnev's strategy to improve Soviet-Eastern European economic relations was to allow greater economic experimentation in the Eastern bloc nations. By advocating such experimentation the Soviets hoped to gain political support from regimes appreciative of less rigid Soviet control. Also, if such experiments were successful, the region would become less of a drain on the Soviet economy.[40]

Brezhnev, like the Soviet leaders before him, also used Comecon ties as economic leverage to achieve Soviet political interests in Eastern Europe. This can be seen in the interesting fact that only the most independent-minded country in the region, Romania, which opposed the Czechoslovakin invasion in 1968, did not receive a net subsidy from the Soviets in the 1970s.[41] Also, immediately following the invasion of Czechoslovakia, Moscow delayed wheat shipments in order to secure its political compliance.[42] Another example is Brezhnev's refusal to sell oil to Romania during the shortage of the 1980s. This

[39]Henderson, op. cit., 36.

[40]Adelman and Palmieri, op. cit., 193.

[41]Ibid., 90.

[42]Ibid.

was probably a direct consequence of Romanian leader Ceausescu's continuous defiance of Moscow.[43] Since the times of the Czechoslovakian invasion and the announcement of the Brezhnev Doctrine, Ceausescu had built up his military to enable it to conduct guerilla warfare. This clearly was done to discourage a possible Soviet intervention. Ceausescu also strengthened Romania's political and economic ties to the West.[44]

As illustrated, Comecon historically was used by Soviet leaders as an economic tool to achieve political purposes. Benefits and subsidies of intra-Comecon trade, such as lower than world prices on Soviet goods and resources, were extended to the Eastern European nations largely according to political loyalty. In this sense, Comecon countries following strict Soviet policy lines received increased trade benefits, while countries deviating from Soviet policies were punished economically with the loss of trade benefits.

II. Functions

Such leverage could only be achieved through the establishment of Eastern Europe's economic dependency on the Soviet Union. To ensure such a dependent relationship,

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[43]Ibid., 91.

[44]Adelman and Palmieri, op. cit., 289.

certain practices and procedures were needed within the context of Comecon activities. This compelled the Soviets to set up and maintain practices within Comecon that would ensure this aim.

To generate maximum control of the Eastern bloc economies and ensure dependency, Comecon was set up by the Soviets to coordinate the national economic plans of its members and to coordinate and direct foreign trade both within and outside the bloc.[45] The Comecon Council served to construct a master plan of the total foreign trade activity of Comecon as a whole. All individual national plans and agreements had to be approved by the Council, according to the requirements of the master plan, before they could be put into operation.[46] In the construction of the master plan, top priority was given to the needs and requirements of the Soviet Union as the dominant nation in the Council.[47] In this sense, Comecon planning was largely guided and controlled by Soviet interests.

Through the establishment of the Soviet Union as the dominant member of the Comecon Council, it achieved a high level of control over the bloc. Not only was it able to

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[45]Smith, op. cit., 205.

[46]Ibid., 206.

[47]Ibid.

retain a large degree of control over its own foreign trade, the U.S.S.R. also gained an influential role in the foreign trade relations of the Eastern European nations.[48]

The inconvertibility of Comecon currencies also enabled the Soviets to ensure control of the bloc was the inconvertibility of Comecon currencies. Such inconvertibility isolated the Eastern bloc economies from trade with the capitalist West and restricted Western influence in the bloc. In addition, this lack of trade with the West avoided the possibility of economic dependency on Western supplies which could seriously endanger the Soviet status in the Cold War. Because inconvertibility was also practiced within Comecon it limited the transferability, let alone convertibility, of currencies between its members. This intra-Comecon inconvertibility enabled the Soviets to preserve bilateralism and the economic dependency it generated.

Another element which preserved Soviet control of the bloc was a system of uncoordinated exchange rates for the Comecon nations. This method did not allow for the evaluation of trade according to comparative price advantages across member nations and therefore isolated the price systems within countries from the influence of other

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[48]Ibid., 207.

countries' prices for the same goods. This allowed Soviet leaders to maintain complete control over the pricing system and the foreign trade transactions within the Soviet economy without influence from Eastern European prices.[49]

Since its beginnings, intra-Comecon trade was conducted through bilateral agreements, as instituted by the Soviets.[50] As a result of inconvertibility within the bloc, this system consisted of barter trade in which each country attempted to balance its trade with each of the other nations and not with the bloc as a whole. This practice of bilateral barter established a pattern in which the foreign trade of each of the European Comecon nations was dominated by links to the Soviet economy. This resulted from the fact that the U.S.S.R. had the largest economy and was richly endowed with natural resources urgently needed by the smaller nations.

Closer dependence, stemming from increased bilateral ties between the Soviet Union and the members of its bloc, allowed the Soviets greater political and ideological control over each nation within the region.[51] Such

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[49]Sandor Ausch, *Theory and Practice of CMEA Cooperation*, trans. J. Racz (Budapest, Hungary: Akademiai Kiado, 1972), 165,.

[50]Marie Lavigne, *The Socialist Economies of the Soviet Union and Europe* (White Plains, NY: International Arts and Science Press, Inc., 1974), 309.

[51]Brown, op. cit., 448.

dependency not only assured the Soviets of political control of the region, but also served to prevent the development of strong ties between the Eastern European nations themselves.[52]

In establishing Comecon trade and activities on the basis of bilateralism and inconvertibility, Zwass notes,

> the Soviet CMEA experts never showed any enthusiasm for mature monetary relations. They were quite well aware of the difficulties attendant on bilateralism, but considered them the lesser evil compared with multilateral trade free of quotas. Their centrally administered economy with its inherent monopoly on foreign trade and foreign exchange had after all been in operation for a quarter of a century more than in the other Eastern countries.[53]

The Soviets historically have held a strong belief in the importance of the economy being centrally planned, with political power as the controlling force. They felt that their economy was much more controllable under the guidance of the Party, without the interference of "anonymous economic mechanisms" contained within the capitalist economies.[54] Toward this goal, the Soviets clearly favored, both domestically and in intra-Comecon trade, a quota-based foreign trade, with products expressed in

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[52]Henry Wilcox Schaefer, *Comecon and the Politics of Integration* (New York, NY: Praeger Publishers, 1972), 35.

[53]Zwass, 1989, op. cit., 42.

[54]Ibid.

physical units, over trade expressed in variable and abstract monetary values.[55]

The Soviets viewed convertibility as "an alien capitalist concept" which would disturb the functionings of the central plans on which the Soviet economy was based.[56] Foreign trade was to serve merely as a channel for supply in order to support the plan. Comparative cost advantage evaluation was not important to this function. Bilateral barter served this function, without allowing foreign trade to adversely affect the central plan.[57]

Economic Inefficiencies Resulting From Comecon Functions

Although this system served Soviet political purposes by securing Soviet economic domination of the bloc, its methods were significant factors aiding in the collapse of Comecon. Many experts contend such methods hindered intra-Comecon trade and reduced it to essentially an inefficient system of bilateral barter.

Inconvertibility within Comecon made little economic sense. This practice resulted in a condition where money could not be used for business transactions or as a basis

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[55]Ibid.

[56]Ibid., 19.

[57]Ibid.

for the development of effective credit relations.[58] Instead, the bloc currency, the transferable rouble (TR), was used solely as a collective accounting unit. Consequently, intra-Comecon credit merely served as a technical instrument to achieve trade settlements.[59]

Largely as a result of the inconvertibility of the Comecon currencies, bilateral barter was the main form of trade between its members. Although bilateralism reduced foreign distortions on the internal economic plan of the socialist economies, it was extremely inefficient. Bilateral barter limited the volume of intra-Comecon trade due to its strict requirement for equal units of trade between two partners.

At the urging of the Soviets in 1956, bilateral barter became based on long-term agreements instead of previously used annual agreements. This not only retained the inefficiency of bilateralism, but also encouraged low-quality production due to its long-term nature.[60] This latter point stems from the fact that long-term agreements allowed enterprises to avoid upgrading the quality of their

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[58]Adam Zwass, *Money, Banking, and Credit in the Soviet Union and Eastern Europe* (White Plains, NY: M.E. Sharpe, 1979), 160-161.

[59]Ibid., 161.

[60]Ibid., 310.

products due to guaranteed, predetermined prices from their Comecon trading partners. In addition, bilateral barter, with its uncoordinated price and exchange systems, severely limited the exposure of the Comecon members to international competition and resulted in the failure of its national enterprises to produce competitive products for world markets.

This system forced Comecon nations to achieve bilateral trade balances with each individual Comecon country rather than with the bloc as a whole. This arrangement rested on the principle of annual equality of supply of goods and payments between each pair of countries. If there existed any disequilibrium between two Comecon nations, the debtor nation technically had to supply additional goods to the other nation the next year equivalent to the debt. The ability to supply additional goods the next year was extremely difficult for a debtor nation, especially if it was indebted to more than one nation. As a result, this clearing method served as a persistent hinderance to further trade on the part of the debtor nations and served to impede any further expansion of intra-Comecon trade. Subsequently, this led to a very rigid system whereby debtor nations could never escape their predicament and creditor nations were not financially rewarded.

III. Soviet Resistance to Market-Based Reform

In an effort to eliminate the problems associated with bilateral clearing, Comecon initiated a multilateral clearing system on which to base trade settlements in 1963. The International Bank for Economic Cooperation (IBEC) was created to achieve this and the transferable rouble (TR) was introduced as a monetary unit in which payments were to be settled between Comecon nations. Although this currency was transferable between Comecon member nations, it was not convertible outside or even within the Soviet bloc. This meant that surplus TRs could not be used in exchange for foreign currencies outside the bloc. In addition, a Comecon nation could not use surplus TRs from a trade surplus with one Comecon nation to balance a trade deficit with another Comecon member.[61]

The introduction of the TR merely served as a psychological ploy by the Soviets to appease those Eastern European nations calling for financial reform. It served no actual purpose and did nothing to facilitate intra-Comecon trade. Trade payments between the socialist nations were still based on inefficient bilateral exchange agreements.[62]

In 1969, the possibility of introducing limited convertibility was discussed at the Twenty-third Session of

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[61]"Comecon: An Idea Whose Time Has Gone," *The Economist* 13 January 1990, 46.

[62]Lavigne, op. cit., 314.

the Council. Although regional convertibility was considered here, the Soviets declared that the possibility of the TR being replaced by gold or a foreign currency was out of the question.[63]

This strong resistance to even limited convertibility arose from the Soviet fear that it would lead to the dissolution of Comecon, as the European Payments Union had been dissolved.[64] The European Payments Union had been founded in 1950 by fifteen Western European nations and endowed with working capital by the United States. Its basic purpose had been to reinstate multilateralism in Western Europe following World War II. After it had achieved currency convertibility and some degree of multilateralism for its members, it had no further use and was quickly disbanded.[65]

Stalin certainly did not want a similar fate to befall Comecon after achieving even limited convertibility, since he needed Comecon as a tool to aid in the control of Eastern Europe. In addition, Stalin saw limited convertibility within Comecon as a first step toward full convertibility which would certainly reduce Eastern Europe's dependency on

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[63]Ibid., 315.

[64]Ibid.

[65]Zwass, 1989, op. cit., 19.

Soviet economic links and increase Eastern ties to the West.

Although another attempt for the creation of a multilateral settlement system was included in the Comecon Comprehensive Program of 1971, actual implementation was stalled by the Soviets. Section 7 of the 1971 Program discussed possible improvements in currency-financial relations and Article 9 of this document included plans for the development and implementation of methods to expand the use of the TR for multilateral settlements by 1973.[66] Also contained within the Program was the idea of mutual convertibility of the TR and other Comecon currencies, which was foreseen by 1973 through IBEC channels.[67]

Although the Soviets had participated in the creation of the Program and agreed to its provisions, their traditional aversion to such reforms ensured that no progress toward these Program goals would be attained by 1973. Since this time no progress has been made either. The TR never achieved convertibility both within the bloc and outside Comecon.

During the creation and adoption of the 1973 Program, the Soviets had shown mere public support for

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[66]Franklyn D. Holzman, *The Economics of Soviet Bloc Trade and Finance* (Boulder, CO: Westview Press, 1987), 156-157.

[67]Ibid., 157.

convertibility, while the reigning domestic opinion within the U.S.S.R. considered the TR to serve all of its purposes. The common Soviet view in 1973 was expressed by Soviet Finance Minister, V.F. Garbuzov. He stated that the TR "performs all the basic functions of an international socialist currency: measure of value, means of payment, means of accumulation."[68]

The late 1960s saw a Hungarian movement for both domestic market-based reforms and parallel Comecon reforms, including decentralization and convertibility. Because the Soviets feared the loss of power that could come with such reforms they suppressed this movement within Comecon. As a further precaution they also attempted to limit the domestic reform movement within Hungary.

By suppressing this movement for convertibility, the Soviets hoped to avoid increased ties between the Eastern European states and also between these nations and the West. Such ties could reduce the economic dependency of the Eastern European nations on the Soviet Union and even provide them with a possible escape route out of dependent Comecon relations. An additional motivation for suppression of this movement was the possibility of Comecon reform

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[68] V.F. Garbuzov, "The Development of Currency and Financial Relations of Comecon Member Nations," *Soviet and East European Foreign Trade* (Summer 1973), quoted in Holzman, op. cit., 157.

encouraging subsequent domestic reform movements within the U.S.S.R.[69]

At the 1969 Twenty-second Council Session, the Soviet Comecon Secretary, Nikolai Fadeyev, announced an agreement recognizing the need for some type of convertibility within the context of Comecon. Although initially appearing to support this fully, Fadeyev later argued for the absolute necessity of gradual implementation of this reform.[70] In the end little progress was made in the direction of even limited convertibility due to Soviet stalling on the issue. Although the Soviets had agreed initially to this reform, they later refused to allow its implementation. They had supported the reform only in an effort to avoid resentment from the reformist-minded nations, yet they never planned to allow such a reform to be instituted. This deceit channeled the resentment of the reformist-minded nations toward the openly anti-reformist nations, specifically the GDR, and also served to create divisions among the European nations.[71]

The Soviets did realize the inefficiency associated with Comecon relations and recognized the need for reform,

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[69]Schaefer, op. cit., 7.

[70]Ibid., 40.

[71]Ibid., 55.

but they argued that such inefficiency could be solved through operational level adjustments rather than by major institutional reforms, such as convertibility. They felt that reforms toward socialist integration in the areas of production, investment, and scientific-technical research were the necessary solutions for Comecon stagnation and inefficiency.[72]

While the Soviet Union stressed the need for scientific and technical progress within Comecon, it focused little attention on the need for improved intra-bloc trade. This appears to stem from the historical significance Soviet leaders placed on the global competition between socialism and capitalism, especially in the area of scientific and technical progress.[73]

Increased economic ties between the Soviet bloc and the Western nations, particularly West Germany, in the early 1970s, motivated the Soviet Union to call for increased socialist integration within Comecon. This Eastern European turn to Western trade and loan agreements, primarily by the GDR, was especially threatening to the Soviet Union in light of the anti-Soviet feelings in this region prevailing

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[72]Ibid., 81.

[73]Ibid.

following the Czechoslovakian invasion.[74]

Subsequently, efforts were initiated by the Soviets toward greater integration within Comecon. These efforts were solely fixed on specific cooperative endeavors. In fact, any proposals by Comecon members which introduced the combination of traditional planning development methods and any type of market relations processes were rejected by the Soviets.[75]

At a meeting of Comecon's Permanent Economic Committee in May of 1970, no progress was made in the debate over reform of the financial systems of Comecon, including the possibility of convertibility. Here it was argued, most strongly by Hungary and Poland, that a developed currency mechanism was necessary in light of the ineffectiveness of Comecon's bilateral trade. These nations also felt that such currency reform within Comecon was necessary in order to support their domestic reform efforts.[76]

Others, notably the Soviet Union, argued that convertibility was not a feasible idea. The Soviets believed that convertibility and other financial reforms would require more plan-like coordination of the market

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[74]Ibid., 128.

[75]Ibid.

[76]Ibid., 123.

forces of supply and demand. This, in turn, would create a situation in Comecon of dependency on the capitalist world.[77]

In July of 1971, the Twenty-fifth Council Session endorsed the "Complex Program of the Continued Deepening and Improvement of Cooperation and of the Development of Socialist Economic Integration." This established agreed-upon plans for the implementation of intra-bloc convertibility by 1973. Additionally, the goal of eventually using the TR for transactions outside of Comecon was presented.

As with previous reform attempts, the Soviets initially appeared to support fully all the provisions and plans contained within the 1973 Comecon Integration Program. They saw it as a firm commitment in the socialist movement toward political and ideological, as well as, economic integration.[78] Such integration was considered by the Soviets to be the "logical continuation of the close and all-round" cooperation of the past.[79] Because the overall plan worked toward the major Soviet interest of improved integration of planning, the U.S.S.R. endorsed it fully.

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[77]Ibid., 143.

[78]Ibid., 182.

[79]*Pravda*, 8 August 1971, quoted in Schaefer, op. cit., 182.

Schaefer notes,

> Thus even those aspects which had not received high priority in the USSR, such as financial reform and the development of the initiative of enterprises and associations, were dully supported.[80]

Yet, ultimate Soviet reluctance to implement reforms it had initially supported was again evident. During later discussions centering on financial reform, including the issue of convertibility, the Soviets contended that such changes could only be considered after a number of substantial planning improvements had been implemented within Comecon. This view included a Soviet argument that

> the extensive development of multilateral coordination of plans and of production specialization and cooperation and the improvement of the organization of foreign trade links will create the preconditions for the extension of multilateral accounting and multilateral balancing of payments effected in transferable roubles.[81]

The Soviets further contended that anything less than an extremely gradual implementation of convertibility would be unsuccessful. Their argument claimed that

> under socialist conditions convertibility cannot operate on the basis of free market relations and cannot function in the manner of the so-called freely convertible capitalist currencies.... The introduction of currency convertibility presupposes simultaneously solving a number of complex problems... problems determined by

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[80]Schaefer, op. cit., 183.

[81]Ibid.

economic and organization preconditions....[82]

The possibility of convertibility with the West was also strongly opposed by the Soviets at this time, although they originally had agreed to the provision contained in the Integration Program calling for eventual convertibility outside of Comecon. According to the Soviet Minister of Finance, "any possibility of convertibility with the West, even for the transferable ruble, which would involve Western currencies in intra-Comecon trade," was out of the question.[83]

By initially accepting and supporting the demands for market-based reforms within Comecon the Soviets avoided incurring resentment from the Eastern European reformist nations. Yet they later sabotaged any efforts to implement such reforms that would lead to a loss in their economic power over the region. By rejecting all Comecon reform efforts involving market mechanisms, the Soviet Union was also rejecting any progress toward real integration of the Comecon economies and efficient trading methods. This stance illustrates the Soviet preference for inefficient economic methods within Comecon for the sake of Soviet

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[82]Yu. Lonstantinov in *Ekonomicheskaya Gazeta*, 48, November 1971, quoted in Schaefer, op. cit., 183.

[83]V. Garbuzov in *Izvestia*, 11 September 1971, quoted in Schaefer, op. cit., 184.

political control rather than a more economically efficient Comecon through the use of convertibility and multilateralism.[84]

During the 1970s and 1980s, the introduction of market mechanisms into Comecon was discussed even more enthusiastically than in previous times. These discussions were primarily at the urging of Hungary and Poland. These nations advocated reform programs which included convertibility of the rouble, along with changes such as decentralization, and price reforms.[85] Such changes were necessary to support domestic reform efforts such as Hungary's New Economic Mechanism program. Yet, as with previous attempts, these reform efforts were terminated by the Soviets since they were incompatible with their political objectives.[86]

IV. Gorbachev's Era of Reform

After coming to power in 1985, First Secretary Mikhail Gorbachev's main objective was to reform the ailing Soviet Union. A primary component of his reform movement was his program of *perestroika*, (restructuring), aimed at rescuing the failing Soviet economy. *Perestroika* included five major

[84] Brown, op. cit., 148.

[85] Ibid., 153.

[86] Ibid.

elements directed at improving the Soviet socialist system. These included programs aimed at decentralization, the self-financing of enterprises, a reformed price system, increased private enterprise, and democratization.[87]

For *perestroika* to succeed the Soviets needed Western credit and technology. To gain aid from the West the Soviet Union had to improve its international image. An important step toward a more conducive international environment to bolster Soviet economic recovery was the improvement of Soviet-Eastern bloc relations.

To improve intra-bloc relations Gorbachev encouraged increased economic independence for the Eastern European nations and the implementation of national economic reform within these countries.[88] Not only would this improve the Soviet image in the eyes of the West, but by motivating the region to become more economically efficient, it would become less of a burden on the Soviet economy.

Through the encouragement of both economic and political reform in the region, Gorbachev allowed the socialist states to practice self-determination. Under this new Soviet policy, remarkable and unprecedented changes took place in the bloc during the democratic revolution in the

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[87]Daniel Ford, "Rebirth of a Nation," *New Yorker* 28 March 1988, 74-75.

[88]Brown, op. cit., 239.

fall of 1989.

At that time, two of the bloc nations, Hungary and Poland underwent radical domestic reforms. Both countries aimed at rapid transitions to market economies in hopes of saving their ailing economies. Czechoslovakia also experienced economic changes toward marketization, although to a lesser degree and at a more gradual pace. The majority of the other Eastern European nations followed the Soviet lead and implemented limited economic reform toward market socialism. They generally felt that socialism could be maintained with slight modifications, and favored gradual reform.[89]

Ironically, such national reform efforts inspired by Gorbachev within the bloc nations aided in the demise of Comecon. Because the various reform efforts were uncoordinated they differed substantially across the bloc countries. As a result, disharmony replaced the historically uniform foreign trade sectors of its members. This uniformity was necessary for the effective functioning of Comecon trading and consequently, intra-Comecon trade became even less efficient.

Motivated by these national economic reforms and their

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[89]Jeffrey Sachs, "Poland and Eastern Europe: What Is To Be Done?" in *Foreign Economic Liberalization*, eds. Andras Koves and Paul Marer (Boulder, CO: Westview Press, 1991), 236-237.

impairment of effective Comecon relations, the Forty-third Council Session, held in 1987, proposed a parallel reform program for Comecon. This program included provisions for radical reform of the policies, instruments, and institutions of Comecon. Most interesting was the fact that the Soviet Union, in an apparent reversal of policy, was the strongest proponent of this program.

Reforms suggested by the majority of its members, most notably the Soviet Union, included a broadly-agreed goal of revising key mechanisms of planning, monetary, and financial cooperation. Despite the broad agreement for the necessity of such reforms, members could not agree on a number of economic issues related to the specifics of designing and implementing such changes. Controversy focused on the critical issues of limited regional currency convertibility, a revised price-setting mechanism, and the specific role of capital movements within Comecon.[90]

Progress toward resolving these controversies was achieved at the Comecon Session in January 1990. Here three market reforms intended to improve Comecon efficiency were agreed upon and officially adopted. These reforms included measures to conduct trade in convertible currency beginning in 1991, and a revision of the cooperation system to be

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[90]U.N. Bureau of Economic Affairs, *World Economic Survey, 1988* (NY: U.N. Publications, 1988), 118.

prepared.[91] The third reform which called for the application of world prices to Comecon trade without traditional time lags would do away with the "Moscow principle." This principle had established the setting of Comecon prices according to annual adjustments based on the average world price of the previous five years.[92] As a result intra-Comecon trade became based on distorted prices that had no accurate relation to world prices.

Despite general agreement for adoption of these reforms, a minority of the Comecon members, namely Hungary, Poland, and Czechoslovakia, instead called for the demise of Comecon. Although these reforms would eventually improve the economic potentials of all the member states over the long-term, these Eastern European nations felt that this reform program was not enough. Although beneficial in some regards, these reforms would not enable Eastern Europe to escape its historical economic dependency on the Soviet Union. The Soviets, on the other hand, called for the survival of Comecon under these reforms along with a new plan for price setting. The new price system would require Comecon prices to be based on current world prices and to be

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[91]"Assessment of the Economic Situation and Reform Process in the Soviet Union," *European Economy*, (December, 1990), 62.

[92]Martain Schrenk, *The CMEA System of Trade and Payments: Today and Tomorrow* (Washington, DC: The World Bank, January 1990), 61.

calculated according to a new accounting system utilizing convertible currencies.

As illustrated above, the unilateral national reform efforts in the bloc both necessitated and served to impede efforts toward Comecon reforms which, at the time, were very necessary for its survival. Because each nation was at a different stage of domestic reform and was pursuing differing goals, the Comecon members found it difficult to agree on a strategy for Comecon reform that was satisfactory to all.

In the face of such strong demands for an end to inefficient Comecon relations, the Soviet Union finally supported financial and monetary reforms toward market mechanisms. Because the continuation of Comecon and its economic ties were contingent on such radical reforms, the Soviets acted to dramatically reverse their historic stance to save the organization. This historic reversal in Soviet policy was an unsuccessful effort to save Comecon and retain some control of Eastern Europe in the face of growing cleavages within the bloc. Domestic demands for reform and independence from Soviet influence in the satellite countries posed a major threat to the bloc and the continuation of Comecon relations.

This attempt to save Comecon by the Soviets ended in failure with the termination of Comecon in 1991. The reforms adopted at the 1990 Council Session, including the introduction of hard-currency trade within Comecon in 1991, proved unsuccessful. This hard-currency trade reform failed primarily because of the Soviet lack of hard currency to import food and consumer goods after selling its oil and gas to Eastern Europe.[93]

The change in the Soviet position on market-based reform within Comecon was a case of a futile effort made much too late. After years of historical inefficiency due to inconvertibility, this Soviet change in policy to keep Comecon alive was not enough. By the time the Soviets moved to support the reformist nations, these Eastern European nations no longer wanted to remain in Comecon.

V. Conclusion

Throughout its history, the leaders of the U.S.S.R., with the exception of Gorbachev, resisted or undermined every attempt toward convertibility and multilateralism within Comecon due to important political reasons. By allowing such reforms, the Soviet Communist Party effectively would have been relinquishing control over the economies of Eastern Europe.

To maintain political control of the bloc, the U.S.S.R.

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[93] "Comecon Sets Date for Dissolution," *Financial Times* 20 May 1991, 2.

retained the bilateral workings of Comecon through the use of inconvertibility in an effort to individually bind each of the members to the Soviet Union. These bilateral ties between Moscow and each of the Eastern European nations eliminated the possible formation of strong economic ties among the Eastern European nations which could have been used to gain independence from Soviet control. Through the dependency of each nation on the Soviet economy, the Soviets were able to utilize economic leverage through Comecon to influence the politics of this region. So, although multilateral trade was more efficient, the Soviets preferred the political gains achieved through bilateralism within Comecon.

In addition to the economic leverage gained through bilateralism, this method also shielded the Comecon nations from Western trade and influence. The economic isolation of the bloc was an important Soviet aim to avoid Eastern dependency on Western capitalist nations. The political aim of control of Eastern Europe, achieved only through the bilateral workings of Comecon, were the ultimate ambitions of the Soviet Union and allowed it to maintain its buffer zone and effectively challenge the West in the Cold War.

The use of inconvertibility and the resulting bilateralization of intra-Comecon trade allowed the Soviets to maintain political control of the bloc. Yet these methods proved to be economically inefficient and unsustainable over time. The Soviets, by organizing Comecon to achieve political aims over economic efficiency, planted the seeds of its destruction.

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