

East European Economies: Forced Adjustment Forever? *

Pundits and realities

When Eastern Europe began to encounter debt repayment difficulties at the threshold of the 1980s some experts, overestimating the impact of short term factors, painted in black colours the economic future of Eastern Europe. Shortly afterwards, when these countries achieved often substantial export surpluses in convertible currencies and began reducing their debt (the latter except Poland), some experts, including the earlier doomsayers, disregarding the impact of other factors, including system-specific ones, admitted that they had underestimated the ability of centrally planned economies¹ to institute structural adjustment.

The 1980s have not been, however, merciful for the pundits. They barely established their new opinion on CPEs' prowess in this respect when the pattern shifted again. Since 1985 export surpluses declined or turned into deficits, most EE countries reappeared as borrowers on the Eurocurrency markets, and their debt (both gross and net) increased again. The need for yet another explanation

* This article was written before the sharp (although not totally unexpected) acceleration of change in Eastern Europe. However, political change occurring there, although indispensable for economic change, is not sufficient to overcome the ever deepening decline. Without the decisive shift to the market system East European economies will be unable to continuous shifting of resources to most profitable uses, characteristic for market type economies. They will be doomed to continue forced adjustment measures forever, accelerating the decline. Original seminar paper was written while this author was a guest researcher at the Stockholm's Institute for International Economic Studies.

¹ This author uses here the terms East European countries and centrally-planned economies (CPEs) interchangeably. For substantive reasons he prefers the term Soviet-type economies (STEs) to CPEs since it justifiably implies a linkage between the political and economic systems that affect economic performance. Here, however, he chose CPEs for expository convenience, given the extensive use of the term in structural adjustment literature.

became increasingly strong, especially as it was perceived with the passage of time that most if not all of the adjustment was done on the import side. Except in one country (East Germany), exports barely increased in the 1980s in dollar terms (see Table 1).

TABLE 1

CPES' IMPORTS FROM AND EXPORTS TO
THE WEST IN THE 1980S
(in billions of current US dollars)

	Imports from the West			Exports to the West		
	1980	a year of lowest imports (if not 1980 or 1986)	1986 ^a	1980	a year of highest exports (if not 1980 or 1986)	1986 ^a
Bulgaria	1.77	1.86 (1983)	2.66	1.92	1.70 (1981)	1.07
Czechoslovakia	4.21	3.14 (1984)	3.84	3.82	-	3.84
East Germany	6.27	5.96 (1982)	7.96	4.58	-	8.17
Hungary	3.88	3.11 (1984)	4.00	3.27	3.33 (1984)	3.35
Poland	6.92	3.29 (1983)	3.98	6.21	4.54 (1984)	4.50
Romania	4.35	1.48 (1983)	2.17	4.39	-	4.39
Eastern Europe (exc. USSR)	27.43	19.93 (1983)	24.61	24.19	-	25.32
USSR	24.58	23.64 (1982)	27.43	28.13	30.20 (1983)	21.87

^a Extrapolations based on January-September data.
Source: *Economic Survey of Europe in 1986-1987*, pp. 353-354.

The present writer posits that it is system-specific factors that have been of primary importance for both short term forced adjustment in the early 1980s and the lack of fundamental adjustment afterwards. Also he suggests that the timing of certain cyclical phenomena under central planning (investment cycles) and of external disturbances (oil shocks' effects) increased trade surpluses well above the level that could be achieved by forced adjustment alone and hid the effects of continued decline in CPEs' competitiveness. The latter effects, as well as a new expansion phase of the investment cycle, made maintaining the external balance (to say nothing about surpluses) increasingly difficult.

Forced adjustment in semi-monetized economies

The restoration of external balance is usually realized, according to policy prescriptions of the underlying theories, through:

- 1) Expenditure-reducing policies which work through lower domestic absorption of internationally traded goods and
- 2) expenditure-switching policies which change relative prices between tradeables and non-tradeables and, consequently, shift resources from the latter to exports and import substitutes.

Under central planning, as it will be shown below, there exists little possibility to realize a change in the production pattern through price signals. Also, some expenditure switching policies bring about results that are contrary to the expected ones. Thus, the burden of adjustment falls mostly upon expenditure reducing measures. Moreover, it is commands rather than incentives that affect more strongly the level of activity and production pattern. Interestingly, the above is true for all CPEs regardless of the extent of economic reforms.

In the literature on the subject it became almost customary to distinguish between traditional CPEs relying mostly on quantity-oriented commands and modified CPEs that reformed the traditional system by including some market type value-oriented measures. Accordingly, they are called TCPEs and MCPEs respectively in this article.² The latter, by virtue of possessing a larger array of policy instruments are assumed to be in a better position to cope with both internal and external imbalances.

However, the 1980s made a dent in this assumption as well, since MTPEs (notably Hungary, to say nothing about Poland) did not perform any better in adjusting their external balance than their more traditional "brothers" (and both relied heavily on command-type measures).

² See, e.g., M. BORNSTEIN, "Systematic Aspects of the Responses of East European Economies to Disturbances in the International Economy", in: *The Impact of International Disturbances on the Soviet Union and Eastern Europe*, Pergamon Press, New York (1980) and T.A. WOLF, "External Inflation, the Balance of Trade and Resources Allocation in Small Centrally Planned Economies", *ibid.*, same author: "Exchange Rate Adjustments in Small Market and Centrally Planned Economies", *Journal of Comparative Economics*, Vol. 2, No. 3 (1977).

"Do it my way" adjustment in traditional CPEs

Imbalance under central planning is primarily an endogenous phenomenon arising from the distorted structure of incentives that is correlated positively with the volume of value of output but not correlated negatively with the cost of inputs. Enterprise managers are reasonably sure that in the case of excessive production costs or other financial difficulties they will be bailed out through grants, tax reliefs or other forms of the subsidy. Under such circumstances budget constraint of TCPE enterprises remains soft in the sense that the evaluation and subsequent rewards are divorced from their financial performance. The state become the general insurance agency.³

The outcome of such a situation is the state of permanent excess demand on the producer goods market (PGM for short). For all practical purposes the demand curve is vertical (actually in TCPEs the supply curve is vertical, too, since under central planning supply is rigid, independent of either price or demand). However, even if demand is permanently in excess, the level of excess demand varies over time and these variations stem mainly from investment cycles, also endogenously generated within the system. The imbalance may be aggravated by planners' mistakes.

Investment cycles, a well researched phenomenon,⁴ stem also from excess demand. They arise from the interaction between central planners and enterprises, with the latter overstating benefits and understating costs of various projects in order to "hook into a plan" and the former being unable to cut demand on project-by-project basis and ordering the reduction in planned investment expenditure on percentage basis. Five-year investment plan starts with built-in distortions of underestimated costs (twice - by enterprises themselves and later by the command of central planners) and overestimated capacities. Usually by the end of the second year internal imbalance begins to increase sharply. Since prices do not

³ On the structure of incentives, see, e.g., J. WINIECKI, "Investment Cycles and Excess Demand Inflation in Planned Economies: Sources and Processes", *Acta Oeconomica*, Vol. 28, Nos. 1-2, (1982), while on soft budget constraint see J. KORNAL, "Resource-Constrained versus Demand Constrained Systems", *Econometrica*, No. 4, (1979), *Economics of Shortage*, North Holland, Amsterdam, (1980) and "The Soft Budget Constraint", *Kyklos*, Vol. 39, Fasc. 1 (1989).

⁴ See in particular T. BAUER, "Investment Cycles in Planned Economies", *Acta Oeconomica*, Vol. 21, No. 3, (1978), and J. WINIECKI, "Investment Cycles..." *cit.* and "Distorted Macroeconomics of Central Planning", in this *Review*, No. 157 (1986).

signal anything in TCPEs and shortages are an everyday occurrence, other indicators point to an increase in the level of excess demand. It is:

a) increasing ratio of the yearly value of unfinished investment projects to the yearly value of fixed assets put into commission;

b) increasing inventories (not decreasing as in market economies, since soft budget constraint facilitates inordinate hoarding that aggravates shortage even further); and to a smaller or greater extent

c) increasing trade deficit with the West, because it is mostly from the West that producer goods in short supply can be obtained (this is what Tamas Bauer called "trade symmetrical cycle"⁵ in the sense that it is not necessary *current* consumption that suffers under the impact of exploding investments).

Enters structural adjustment. Cuts in investments are included into the next year's plan with additional shifts in the composition of investments, more often than not increasing the share of resources allocated to completing projects increasing supply of consumer goods. As a result excess demand on the PGM if anything increases (with demand of enterprises being practically unlimited under soft budget constraint and supply being reduced) while that on the consumer goods market (CGM for short) decreases.

Historically, CPEs were able to turn trade deficits into surpluses over the investment cycle.⁶ First, investment cuts reduced demand for imported machinery and capital goods displaying higher import intensity than consumer goods. Second, investment cuts released extra supplies of raw materials and intermediate products, a part of which could be sold on the world market. Additional consumer goods were also shifted to exports; in the latter case imbalance on the CGM decreased only when increased output from new capacities exceeded additional exports of consumer goods. Imbalances on the CGM have been easier to handle economically (although not politically) since households, contrary to enterprises, do not have soft budget constraint and imbalances could be reduced there by price increases as well.

⁵ *Ibid.*

⁶ See, e.g. J. STANKOVSKY, "Determinant Factors of East-West Trade", *Soviet and East European Foreign Trade*, Vol. 9, No. 2 (1973).

According to the received theory adjustment is fundamental if achieved by altering factors that determine supply and demand. But expenditure reducing and expenditure switching measures, *i.e.* plan adjustment, alter current allocation of resources only, since central planners and enterprises start the same game again at the beginning of the next five year plan – with the same consequences. As a system-specific curiosity it may be added that forced adjustment works mainly on the supply side on the PGM since demand of enterprises cannot be much affected under soft budget constraint.

Unremediable obstacles to fundamental adjustment built into the system of central planning are manifold. First of all policy prescriptions and underlying theory expect that resources are shifted to more productive uses. But are there any reasons to expect, as *e.g.* Mark Allen from IMF does, that “in adjusting production structure, the planners would be guided by such indicators as the relative efficiency of different uses of resources”?⁷ In a closed economy with the severe price distortions higher rate of return is by and large useless for central planners in their attempts to reallocate resources more efficiently through plan adjustment.

From the theoretical standpoint, “do it my way”, *i.e.* command-based, adjustment in TCPEs may decrease the external imbalance but is unable to increase efficiency. If it does, it happens by accident and remains unknown to central planners. In reality, however, one may expect that shifts of resources toward the production of consumer goods, such as those realized often in the second phase of investment cycles, somewhat increase efficiency. European CPEs (both TCPEs and MCPEs) are mostly middle-developed economies and are presumably more efficient in producing consumer goods than sophisticated machinery. Thus, the adjustment of that sort is on the average efficiency increasing. It need not be added, however, that such efficiency gain is only temporary, since next investment cycle shifts resources again toward the producer goods resulting in turn in efficiency decrease.

Second, to improve external balance a shift of resources is expected from the non-traded to the traded goods sector in order to increase output in most efficient internationally traded branches (both

⁷ M. ALLEN, “Adjustment in Planned Economies”, *IMF Staff Papers*, Vol. 29, No. 3 (1982), p. 411 (the same expectation that resources will be reallocated to more productive uses is expressed also on p. 400).

import substituting and exporting ones). The author has already dealt with the efficiency as a non-existent determinant of resource reallocation. But the very prescription of the received theory is highly problematic in the case of CPEs (again both TCPEs and MCPEs).

A typical, even if little known feature of these countries is the industrial hypertrophy. As this author showed elsewhere, CPEs have by now a share of industry that is by 1/4 to 1/3 higher than that share in market economies at a similar level of economic development.⁸ Also, throughout the CPEs' history industry has been a privileged sector in terms of resources allocation; it received the lion's share of investments and higher relative wages in industry attracted labor from other sectors. It is now stressed sometimes in Eastern Europe that the undersized and undercapitalized service sector becomes a constraint on general economic and specific industrial performance.⁹

Thus, in CPEs the internationally traded goods sector, or its largest part, *i.e.* extractive and manufacturing industries, is already above the size of that sector elsewhere. Logically, its output of tradeables should be large enough to expand exports and substitute for some imports without further shifts of resources to the already oversized industrial sector. If oversized tradeable goods sector is unable to do both to the needed extent, there must be some other obstacles that obviously make the policy recommendation in question irrelevant for structural adjustment. In fact, in view of what was said about the adverse impact of lagging services its pursuance may even be counterproductive.

A question could be raised whether at least a partial shift of resources toward agriculture could not improve the supply of tradeables. The answer is that the supply could increase but at a very high cost, since collectivized agriculture in TCPEs displays highly disadvantageous input/output ratios. Costs of increasing output are so high that according to some comparative estimates in 1965-1982 period expenditures in Bulgaria increased by 295.3% while value added increased by 2.8%. The same indicators for Czechoslovakia were 111.6% and 11.3%, for East Germany 115.2% and 7.7% and for Romania 218.5% and 32.6% respectively (no comparable estimates

⁸ See J. WINIECKI, “The Overgrown Industrial Sector in Soviet-Type Economies: Explanations, Evidence, Consequences”, *Comparative Economic Studies*, Vol. 28, No. 4 (1987).

⁹ See, *e.g.* A. RÁBA, “Hungarian Development - with Bottlenecks”, *Acta Oeconomica*, Vol. 36, Nos. 3-4 (1986).

were made for the Soviet Union).¹⁰ A shift of resources to agriculture would probably increase output of agricultural tradeables but at a very high marginal cost; it would be, then, a shift to a sector of tradeables with a very low rate of return.

Mission impossible: fundamental adjustment in modified CPEs

The term MCPEs has been used with respect to post-1968 Hungary and post-1982 Poland (much more hesitantly to post-1956 or post-1973 Poland). These countries extended the range of policy instruments by supplementing – not superseding! – quantity-oriented commands with value-oriented measures of the type known from demand management in the market economy. It is implied in many modelling efforts and a few structural adjustment-oriented studies that the extended array of policy measures put MCPEs in a better position in coping with arising internal and external imbalances. Although least imbalanced Hungarian consumer goods market may be regarded as giving a qualified support to such implication, equally convincing arguments may be put forward in support of the alternative thesis about the cautiousness of governmental policy, much more sensitive (for historical reasons)¹¹ to consumer satisfaction than in other communist countries as a reason for relatively better balanced CGM.

Whatever the explanation with respect to CGM, excess demand on the PGM remains not much lower than in old days of the stalinist TCPE model. And neither Hungary nor – especially! – Poland have been better able to cope with external imbalance. Hungary, this model reformer in the eyes of many Western experts, was neither able to reduce excess demand on the PGM nor to shift much demand from imports to import substitution nor to increase exports over the

¹⁰ Such comparisons based upon FAO price relatives of agricultural inputs and outputs and GNP per capita estimates for EE countries by Alton *et al.* were made by G. LAZARCIK in: *East European Assessment*, Part 2, Joint Economic Committee, U.S. Congress, Washington, D.C. (1981) and the same: *East European Economies: Slow Growth in the 1980s*, *ibid.*

¹¹ On the 1956 experience of Hungarian communists setting them apart from other ruling communist parties in Eastern Europe, see J. WINIECKI, "Soviet-Type Economies: Considerations for the Futures", *Soviet Studies*, No. 4 (1986).

1980-1986.¹² Situation deteriorated somewhat on the CGM as well. Years 1987 and 1988 were worse still.

Commands in MCPEs continue to function alongside the profit and other market indicators. Formal or informal rationing is rife which made the abolishment of output targets problematic. Surely, if you allocate resources that are perennially in short supply, your suggestions and recommendations as to what to produce are worth almost as much as commands! Whatever flexibility with respect to goods' markets was introduced, it has been accompanied by much stricter command-type control of factor markets. Wage rate growth has been controlled by mandatory norms, while enterprise investments have been restricted not by interest rate – in spite of the fact that *e.g.* in Hungary it rose sharply in the early 1980s to some 8% to 14% range – but by the informal credit rationing as well as by various command-type measures. Most of the prices have been controlled directly, while changes in the so-called free prices have had to be informally justified as well (usually by cost increases).

In Hungary where modifications of the traditional CPE model went the furthest, output targets were superseded by the concept of the "responsibility for supplies". Its vagueness created infinite possibilities for *ad hoc* interventions by bureaucratic bodies. As a result, bargaining between enterprises and their superiors both intensified and changed its timing and scope: instead of bargaining about output growth rates, input norms, etc. enterprises in a reformed economy bargain about taxes, subsidies, wage growth rates, price changes, etc. Also, more often than in the past bargaining took place before accepting plan targets with respect to output. The above prompted Tamas Bauer, a Hungarian economist, to say that his country's economy left the station called "central planning" but did not arrive at the one called "market economy".¹³

¹² On these points see Hungarian economists, *e.g.* A. KÖVES, "Foreign Economic Equilibrium, Economic Development and Economic Policy in the CMEA (COMECON - J.W.) countries", *Acta Oeconomica*, Vol. 36, Nos. 1-2 (1986); M. TARDOS, "Question Marks in Hungarian Fiscal and Monetary Policy (1979-1984)", *Acta Oeconomica*, Vol. 35, Nos. 1-2 (1985), and "The Role of Money in Hungary", *European Economic Review*, Vol. 31 (1987).

¹³ T. BAUER, "The Second Economic Reform and Ownership Relations", *Eastern European Economics* (1984).

These strange hybrids resulted from continuous efforts of those segments of the ruling stratum that exercised control over the economy, *i.e.* party apparatus and bureaucracy, to maintain intact the basically pre-Phoenician features of the economic system. This devotion to direct command-type controls over macroeconomic instruments and the use of the latter to continue to exercise direct control through individualized enterprise-by-enterprise bargaining is dictated by the self-interest of the ruling stratum in communist countries, with a strong dose of economic illiteracy thrown into the bargain.

The self-interest in maintaining an apparently inefficient economic system stems from the fact that present arrangements, or the present property rights' structure (to use Douglass North's theoretical perspective), allows the parasitic ruling stratum to extract the rent, which would be impossible to extract, had the system changed to fully monetized market-type economy. The rent appropriation takes place in the officially authorized way (through the monopoly for *nomenklatura* appointments to well paid managerial positions, formalized privileges, etc.), as well as the officially unauthorized way (through the flow of unpaid or underpriced goods and services from enterprises to the ruling stratum, outright bribes, etc.). Not surprisingly, since it is party apparatchiks and bureaucrats who benefit mainly from both *nomenklatura* appointments and unauthorized rent appropriation, it is they who are most strongly opposed to real market-oriented reform.¹⁴

Thus, it is vital for those who benefit most from the existing property rights' structure of central planning that vertical relationships, *i.e.* dependence of enterprises upon their superiors (bureaucrats and, indirectly, party apparatchiks), are more important for managers than horizontal relationships (market-type contractual linkages with suppliers and buyers).¹⁵ To ensure this kind of dependence *nomenklatura* has been maintained in MCPs regardless of the extent of systemic modifications. Quite logically, since the propensity to obey (or least pretend to obey) commands, recommendations, or

¹⁴ On the subject of the rent extraction by the ruling stratum under communism, see J. WINIECKI, "Pourquoi les réformes économiques échouent-elles dans les systèmes de type soviétique?", *Revue d'études comparative Est-Ouest*, Vol. 18, No. 3, (1987). On *nomenklatura* see in particular M. VOSLENSKY, *Nomenklatura*, New York, Doubleday, and K.D. WILLIS, *Les privilégiés de la nomenklature*, Paris, Presses de la Cité (1986).

¹⁵ There is very extensive literature on the dominant role of vertical dependence of enterprises published in both Poland and Hungary in the 1980s.

even suggestions is much greater if those who issue them hold the power to hire and fire those to whom they are made. Individualized "bargainable" quasi-parameters (wages, credits, taxes, prices, etc.) serve the same purpose of reinforcing the dominance of vertical relationships. Managers and would-be managers are taught the relative unimportance of the bottom line results for the manager's position *vis-à-vis* the satisfaction of his superiors.¹⁶

The foregoing relationship is additionally strengthened by the economic illiteracy of the ruling stratum in all CPEs which is, in turn, rooted in Marxian phantasy of the moneyless economy and direct satisfaction of needs. Since every CPE continually generates various imbalances and creates new uncertainties, central planners react to them by issuing *ad hoc* guidelines aimed at solving (or at least weakening the impact of) the problems of the moment. Party apparatchiks organize "mobilization" campaigns to ensure the management acts in the desired way. However, these guidelines are mostly issued in non-monetized terms, *e.g.* to increase exports in convertible currencies, to decrease likewise imports, to save energy, to save labour, etc. By their very nature of being partial, they adversely affect the bottom line results of the enterprise. Moreover, they are often incompatible with each other, because *e.g.* products for the Western market are more labour intensive than the same products for much less demanding domestic market. Exports require also higher share of imported inputs, etc.

In trying to satisfy these partial, conflicting aims enterprise managers inevitably reduce efficiency and incur financial losses. Given the dependence upon their superiors they most of the time follow the guidelines first and ask for a bail-out afterwards. They are encouraged to do so by their superiors' tactic or open assurance that they will not be left in the lurch.¹⁷

Under the circumstances soft budget constraint reigns supreme. All external (here: IMF) requirements and internal economic policy pronouncements in MCPs regarding strict financial discipline run counter to the fundamentals of the Soviet-type economy based on the

¹⁶ Sources of these uncertainties were pointed out, *i.e.*, by this author, see J. WINIECKI, "The Distorted Macroeconomics..." *cit.*

¹⁷ This author wrote more extensively about the subject in J. WINIECKI, "Soviet-Type Economies and Reform Failures. A Touch of the Socialist Midas", *Intereconomics*, No. 4 (1987).

inseparable linkages between political and economic systems at the micro, *i.e.* enterprise, level. Only the break-up of these linkages may eliminate soft budget constraint and move MCPEs toward fully utilizing that old Phoenician invention, that is money. But the break-up is possible only through the far reaching political change that would remove the hold of the present ruling stratum, particularly the party apparatus and bureaucracy, over the economy.

Without fundamental political change no imitation of market institutions is going to be of much assistance in strengthening soft budget constraint of MCPEs. A case in point may be a bankruptcy law passed recently in Hungary and Poland. Already after its passage Hungarian authorities wrote off the outstanding debt of metallurgical enterprises to the tune of 22 milliard forints, a sum equal to more than two year's output of that industry!

Even more striking – and more general – case in favour of the political change as a necessary condition of the economic change is that of Yugoslavia. The multilevel bureaucratic hierarchy of central planning has been abolished there but communist political monopoly and *nomenklatura* were not. Consequently, they found alternative (market-type!) channels of influence, that is banks whose presidents – nominated through the *nomenklatura* – invariably turned out to be unable or unwilling to resist pressure for credits. The outcome of this *soft credit constraint* has been unviable “political” factories unable to sustain themselves and unfinished (often unfinishable!) investment projects scattered all over the country.

Not surprisingly, MCPEs in periods of growing imbalances are unable to use market-type policy instruments efficiently. Unwilling to move decisively forwards in the direction of the market economy, the ruling stratum, conditioned by its parasitic interests, moves backwards, leaning heavily upon traditional command-type instruments.¹⁸ They have the disadvantage of being able to suppress excess demand in the short term without any possibility whatsoever to permanently improve efficiency but at least they ensure the continuity of rent-

¹⁸ Interestingly, this is also a conclusion reached by T. WOLF (*cit.*) on the basis of his formal model devoid of political variables. A move forward from MCPE to market-type economy turns out to be always the first-best solution but falling back upon command-type measures turns out to be better than relying upon inefficient market-type measures. However, he is not able to explain, why this is the case, since determinants of failure of market-type measures in the fundamentally unchanged political-economic environment remain outside Wolf's model.

seeking activities which is of decisive importance. Herein lies the explanation of the inability of MCPEs to go beyond the forced adjustment characteristic for TCPEs.

How to increase supply of exportables with unknown comparative advantages

In the preceding part of the paper the author stressed a rarely perceived fact: that the tradeables sector in CPEs is already markedly larger relative to non-tradeable sector than in market economies. Thus, any resources shift to the former sector aimed at increased supply of tradeables, as suggested by relevant theories, need not necessarily be successful (and may actually make matters worse). But this oversized sector has been historically unable to compete efficiently on the world market and its ability to increase exports at the time of urgently needed structural adjustment turned out to be pitifully small.

A comparison with another, even more indebted area, *i.e.* Latin America, is instructive here. As the Hungarian economist Andras Köves stressed already in 1986, smaller East European CPEs did much worse in the early 1980s than Latin American countries. By 1984 aggregate exports to the West of six smaller CPEs decreased by about 2.5 billion dollars while those of Latin American countries increased by almost 10 billion. The trade surplus achieved by CPEs resulted only from import cuts. Adding subsequent years (see Table 2) makes the picture even worse. With the possibilities of further import cuts all but exhausted, imports creeping up, and exports stagnating, the surplus began to shrink rapidly. Köves rightly sees all this as an evidence that CPEs are unable to go beyond forced adjustment through restrictive policy measures.¹⁹

¹⁹ “Foreign Economic Equilibrium, Economic Development and Economic Policy in the CMEA (COMECON - J.W.) Countries”, *Acta Oeconomica*, Vol. 36, No. 1-2 (1986).

TABLE 2

TRADE OF SMALLER EAST EUROPEAN CPEs (EXCEPT THE USSR)
AND LATIN AMERICAN COUNTRIES WITH THE WEST
IN THE 1980-1987 PERIOD
(in billions of current US dollars)

Year	Smaller CPEs			Latin America		
	Exports to	Imports from	Surplus (+) Deficit (-)	Exports to	Imports from	Surplus (+) Deficit (-)
1980	21.2	23.7	-2.5	76.5	76.4	+ 0.1
1981	18.1	19.6	-1.5	78.5	82.1	- 3.6
1982	16.7	15.8	+0.9	74.7	66.1	+ 8.6
1983	16.9	15.0	+1.9	77.8	50.9	+26.9
1984	18.7	14.3	+4.4	86.1	57.3	+28.8
1985	18.7	16.0	+2.7	77.7	49.8	+27.9
1986	20.6	19.1	+1.5	70.7	54.0	+16.7
1987 ^{a,b}	20.5	20.6	-0.1	79.6	54.6	+25.2

^a First two quarters (expected annual values).

^b Without trade between the Federal Republic of Germany and GDR.

Sources: for 1980-1984 A. KÖVES, *Foreign Economic Equilibrium... cit.*; for the recent years own calculations on the basis of the same sources, OECD, *Monthly Statistics of Foreign Trade*, Series A, November 1987, *Statistisches Jahrbuch 1987 für die Bundesrepublik Deutschland*.

How to find "saleables" among tradeables (without really trying)

It is system-specific features, reasonably well researched in comparable economic systems' literature that make the (oversized!) tradeables sector permanently incapable of turning out enough tradeables, which would be at the same time saleable on Western markets. Low quality, technological obsolescence, inadequate after-sale servicing and other deficiencies have for decades adversely affected CPEs' exports. It need not be added that this indictment is particularly valid in the case of manufactures, especially differentiated ones. More homogeneous commodities and standardized manufactures have been by their very nature less affected by these features.

Consequently, recommendations of the received theory with respect to fundamental adjustment could be formulated in less broad

terms in the case of CPEs. The shift of resources should take place within tradeables' sector towards "saleables", that is tradeables exportable to Western markets. As it will be shown below, such recommendation, however sensible in theory, is impossible to follow in the real world of central planning. That is, it is possible to produce some more "saleables" but this shift again would have little if anything in common with the fundamental adjustment of these economies.

First, and most important, hopelessly distorted domestic relative prices and severed - or distorted - links with world prices prevent these countries from finding their comparative advantages on the world market. It is possible of course to find "saleables" through the analysis of revealed comparative advantages but then another requirement of the fundamental adjustment, *i.e.* shift of resources to more profitable uses, is going to remain unrealized. Most of price distortions in CPEs - two-tiered price system, investment grants and low interest credits (often turned into grants by easy write-offs), underpriced raw materials and heavy industry semi-manufactures, etc. - make heavy industry goods seem less costly than in reality is the case.²⁰ Thus, there is high probability that such products as steel, bulk chemicals, cement, as well as other raw-material and energy-intensive products, are at best less profitable than official East European calculations may indicate and at worst yield losses rather than gains from trade. This probability is made even higher by the fact that in the case of *e.g.* steel all smaller CPEs import iron ore and some of them coke as well. Comparative advantages (if any) would have to result from greater efficiency of transformation.

This is not the case, though. Analyses of transformation efficiency for Poland and Hungary show both countries to be markedly behind industrialized market economies in this respect.²¹ Neither are CPEs producing higher value added steel products; on the contrary, kilogram prices of steel products imported from the West

²⁰ This point was earlier made by the present author in J. WINIECKI, "Central Planning and Export Orientation in Manufactures", *Economic Notes*, Vol. 14, No.2. It is not new, since the heavy industry product bias in exports was stressed already by Charles Kindleberger as far back as 1962.

²¹ See A. SZPILEWICZ, *Resources for the Future*, Committee "Poland 2000", Warsaw, 1979 (in Polish).

were between 1976 and 1980 about two times higher than prices of those exported to the West (calculations based on EEC customs statistics). For Czechoslovakia, one of the most efficient steel producers at the turn of the XX century, the ratio was even less favourable (3:1).²²

It may be hypothesized that the fall in profitability accelerated since the first and especially since the second oil shock due to much higher oil prices paid by smaller CPEs to the Soviet Union. Gains from exporting many energy-intensive products to the West may have turned to losses at about the same time. Interestingly, empirical studies of Heckscher-Ohlin (H-O) rationality of East European CPEs not always find support for the above hypothesis.²³ This is due to the fact that in the distorted world of central planning distortions of one type may hide effects of distortions of another.

Studies of industrialization and trade in countries that chose import substitution strategy, associated with the name of Bela Balassa, Ann Krueger, and Ian Little, point to excessively capital-intensive export structure of these countries. This structure is irrational from the viewpoint of H-O theory. Smaller CPEs do the same thing. However, they not only export (increasingly at a loss) too capital intensive goods but at the same time they export too labour-intensive goods.

Thus, by departing on both sides from H-O rationality, the export structure of smaller CPEs may look "about right" in terms of its labour/capital ratio. And this in spite of the increasing probability that both too capital-intensive and too labour-intensive goods may be traded at a loss! For it is worth noting that smaller CPEs import also – mostly from the West – raw materials for their labour-intensive goods (hides, wool, cotton). At the same time their ability to add much value is also low at the other end of the H-O spectrum of goods.²⁴

²² Own calculations for COMECON as a whole, *Zabranicni obchod* (Foreign Trade), 1982, No. 12 for Czechoslovakia.

²³ The review of these studies is made in J. WINIECKI, *The Distorted World of Soviet-Type Economies*, Routledge, London, 1988.

²⁴ K. POZNANSKI found markedly lower prices of smaller CPEs for light industries' products (man-made fabrics, textile and leather material, footwear) on the OECD market relative not only to Western Europe but also to NICs (see *East European Economies: Slow Growth in the 1980s*, Vol. 2, U.S. Congress, Washington: 1986).

Without change in the economic system and resultant establishing of real comparative advantages, any expansion of manufactured "saleables" according to the revealed comparative advantages, *i.e.* past pattern of exports, becomes an ever heavier burden to national economies of these countries. Recalculations made by Peter Havlik that imply very much higher costs of Czechoslovak exports to convertible currency countries *vis-à-vis* those to the COMECON countries are an example here. More realistic exchange rates based on domestic costs increased the share of non-COMECON countries from 30% according to official statistics to 53% in 1983. The same figures for 1970 were 35% and 49% respectively, which means that costs of exports to the West increased in the 1970-1983 period relative to those of COMECON countries.²⁵

Havlik's estimates refer to total exports. But the increasing domestic costs of total exports turn attention to the fact that manufactures have rarely if ever become "saleables" to such extent as to increase their share in exports during any forced export expansion. Export surpluses are generated by relatively greater increase in exported commodities. Thus at the threshold of the 1980s when smaller CPEs began its forced export expansion to reduce the debt burden, product structure changed again in favour of commodities, as shown in Table 3.

East Germany, once part of an industrial power, or Romania, a poor agricultural country now as then, that is the richest and the poorest East European CPE, both accelerated commodity exports. Contrary to appearances Poland does not constitute an exception. The increased share of manufactures in 1981 was an outcome of an associated political crisis that resulted *inter alia* in the sharp fall of output and subsequently exports of extractive industry products (coal, copper, sulphur, etc.).

The shift from manufactures to commodities would not in itself signify the shift from lower to higher domestic costs of exports.

²⁵ "The Scope and Structure of Czechoslovak Foreign Trade: Effects of applying realistic exchange rates", *Comparative Economic Studies*, Vol. 27, No. 1, 1985. Estimates of that Vienna-based author are supported by various estimates published in Czechoslovakia in the last 20 years pointing to increasing domestic costs convertible currency exports.

TABLE 3

THE SHARE OF MANUFACTURES IN SMALLER EAST EUROPEAN
CPEs EXPORTS TO AND IMPORTS FROM WESTERN EUROPE
IN THE 1965-1981 PERIOD IN %
(calculated in current US dollar)

		EE exports	EE imports
Bulgaria	1964	36.7	84.2
	1977	66.0	92.9
	1981	34.3	93.2
Czechoslovakia	1965	69.4	64.7
	1977	65.3	79.6
	1981	59.7	82.7
East Germany ^a	1965	77.0	34.7
	1977	74.7	81.8
	1981	44.9	73.4
Hungary	1965	43.1	68.4
	1977	59.2	86.2
	1981	56.1	88.6
Poland	1965	26.5	48.1
	1977	43.6	86.4
	1981	54.6 ^b	68.0
Romania	1965	15.3	88.0
	1977	56.6	90.2
	1981	44.4	64.2

^a Excluding Intra-German trade. Its inclusion would not improve the results, though. GDR exports low value added semi-manufactures (steel products, petroleum products, etc.) to FRG and the share of manufactures is not higher, either.

^b The rise in the share of manufactures in 1981 was mainly the result of the sharp fall in the production and exports of coal and other mining products.

Sources: *Economic Bulletin for Europe*, Vol. 37, 1985, p. 335.

Manufactured exports without knowing ones' own comparative advantages are costly enough, as stressed in the preceding paragraphs. Resource-rich countries specialize to often a very large extent in

production and exports of raw materials and products manufactured from raw materials they are endowed with. This is what happened in the past with Sweden, the U.S., Canada or Australia and has been happening with Brazil, Venezuela and some other resource-rich developing countries. But smaller CPEs have long been net importers of energy and raw materials, and even Poland joined the rest becoming net energy importer in 1979.

Consequently, their commodity export expansion is based upon forced cuts in domestic use and exports of their own and/or reexports of raw materials and fuels imported mainly from the Soviet Union. East Germany, the only small CPE that markedly increased its exports between 1980 and 1986 (see Table 1) is a case in point. The increase in machinery and equipment exports in 1980-1984, according to Economic Commission for Europe's estimates, was 0.5 milliard dollars (in constant 1975 prices) but the increase in energy exports was 0.75 milliard dollars in the same period. The former increased by 1/3 while the latter quadrupled! By 1983 energy poor GDR became energy exporter to the West almost equal to Poland and surpassed Romania. The largest increase (about 1.5 milliard dollars) was in the "other production inputs" category comprising both industrial raw materials and semi-manufactures, the latter being already recognized as a (costly) mainstay of CPEs' manufactured exports to the West.²⁶ Such a pattern of specialization in commodities and in their primary processing cannot be profitable in the longer run. Also, it is worth noting, as a Hungarian expert does, that in the case of East Germany factors other than lenient attitude of the Soviet Union to GDR reexports of little processed or unprocessed Soviet oil, play a role in export expansion. Many manufactures from East Germany would not have entered Western markets at all if it had not been for the special advantages East Germany goods enjoy on the EEC market.²⁷

A costly pattern of specialisation is not only typical for little processed exports of imported commodities but quite often also for exports of domestically extracted commodities and little processed manufactures. *E.g.* Poland and Romania have their own fuel reserves but are increasingly high cost producers. According to some energy

²⁶ *Economic Bulletin for Europe*, 1985, Vol. 37.

²⁷ A. INOTAI, "Economic Relations between the CMEA and the EEC: Facts, trends, prospects", *Acta Oeconomica*, Vol. 35, Nos. 3-4, 1986. Inotai regards the 300-500 million dollars' range of benefits estimated by some Western experts as too low.

experts, real coal extraction costs are in Poland three times higher than in the U.S., Australia and South Africa, its main competitors on the West European market. What is worse, extraction costs in a newly opened mining area are again three times higher than average domestic costs.²⁸ And it ought to be added that as far as hard coal is concerned reserves of other smaller CPEs are even less easily mined than costly Polish ones.

Finally, evaluating possible shift of resources to "saleable" commodities we already stressed (above, par. 1.2) the high cost/low profitability feature of agriculture under central planning. A shift of resources would more often than not mean marginal costs much higher than marginal revenues with respect to agricultural output.

High costs, however, do not deter East European countries from exporting food. Romania whose oil and oil product exports make some 50-75% of total convertible currency earnings, exports as much food as possible – half-starving its population in the process – to compensate for the low and declining "saleability" of its industrial products. Other countries, such as Bulgaria or Poland, strip their domestic food market bare of better food products by exporting them for convertible currency. Even in Hungary, regarded as an agricultural success story among CPEs, exports of agricultural and processed food products are barely profitable (according to the official calculations). And, since domestic costs have been rising steadily, some profitability-minded Hungarian experts began writing about the "superfluous agricultural growth".²⁹

The foregoing longish empirical *tour de force* leads to the conclusion that given the system-specific features of CPEs no export expansion, be it manufactures- or commodities-based, is the result of the shift of resources to more profitable uses. To achieve trade surplus, domestic demand must be suppressed in CPEs in a typical forced adjustment fashion. Nothing has changed since the 1960s, where changes in domestic output were variable most strongly

²⁸ See, first of all ALEXANDER SZPILEWICZ's estimates published in numerous journals and papers' collection, e.g. in *Przegląd Techniczny* (Technical Review), 1985, No. 33 and *Zycie Gospodarcze* (Business Life), 1987, No. 48, as well as *Energy Intensity of Important Products*, Engineering Industry's Institute of Management, Warsaw, 1985 (mimeo, in Polish).

²⁹ See, e.g. K. LANYI, "Constraints on Profitable Growth in Hungarian Agriculture", *Acta Oeconomica*, Vol. 33, Nos. 3-4 (1984), and "Hungarian Agricultural Surplus or Superfluous Growth", *ibid.*, Vol. 34, Nos. 3-4 (1985).

affecting export supply³⁰ (that is, nothing except much higher costs of earning one convertible currency unit). A recent study of Hungary – the most modified CPE! – found again that the lower output growth rate, the greater export supply. Significantly, changes in the exchanges rate had no effect whatsoever on the supply of "saleables".³¹ Increased supply of "saleables" is by and large dependent on cuts in domestic demand through decreased investment and/or consumption.

Expenditure-switching recommended by the received theories stresses the expansion of output of both exportables and importables, while the foregoing analysis ran solely in terms of exportables. But given the extreme version of import substitution pursued in economic policy in CPEs the scope for further import substitution does not seem to be large.

This general assessment does not exclude the possibility of mastering the production of new goods, remaining within the range of comparative advantages CPEs possess. However, there are not command- or market type measures that could conceivably force enterprises to produce new goods under the circumstances where old goods do well enough on a protected seller's market. And in those rare cases that they do not, enterprises can usually count upon subsidies of various sorts.

Also, even if certain goods are available domestically, enterprises will not shift their orders to domestic suppliers as long as there is even a distant possibility of obtaining these goods from the West. They know only too well that such a shift amounts to lowering the quality of output due to lower quality of domestic (or other CPE) inputs and/or domestic (or other CPE) machinery.

More importantly, it means a lot of problems (such as stoppages due to irregular supplies, breakdowns due to the variable quality of inputs and substandard machinery) adversely affecting plan fulfillment, which continues to be the most important variable affecting earnings (and position) of managers. If it had not been for the threat of unfulfilled output targets, associated fall in output quality would not have bothered them very much!

Thus, enterprises even in most reformed CPEs are unwilling to undertake the effort of mastering new production technology and/or

³⁰ See J. STANKOVSKY, "Determinant Factors of East-West Trade", *Soviet and East European Foreign Trade*, Vol. 9, No. 2 (1973), for the 1955-1969 period for all East European CPEs, including the USSR.

³¹ I. TARAFAS, J. SZABO, "Hungary's Exchange Rate Policy in the 1980s", *Acta Oeconomica*, Vol. 35, Nos. 1-2 (1985), for the 1971-1983 period.

turning out new products. Hungary in the 1980s is a good example here. As Marton Tardos points out, neither years of macroeconomic restraint were able to balance supply and demand domestically nor associated import restrictions enticed enterprises to substitute domestic goods for less the easily available imports.³² Of course, disastrous fall in imports from the West to the tune of 30% to 70% may force some *ad hoc* import substitution but at the very heavy quality cost. And although central planners shed only crocodile tears about low quality of consumer goods, they are definitely more concerned about producer goods and nowadays even more about exports.

Data for Poland and Hungary in the 1970s and the anecdotal evidence for all CPEs in the 1980s all convincingly show that, first, imported manufactured inputs to exported goods grew at a higher rate than manufactured exports and, second, where import stream shrank to a mere trickle, exports fell, because their "saleability" on the Western markets has been strongly dependent upon the availability of sophisticated value-adding Western inputs. An alternative to Western inputs – if it exists at all – forces heavier than usual price discounts. It is for these reasons that CPEs both lost market shares and obtained relatively lower prices per unit; these processes have been more marked since mid-1970s.³³

Thus, conventional policy recommendations based upon the received theories of structural adjustment, are not of much help to countries afflicted by central planning. Both TCPEs and MCPEs have to rely on command-type measures to suppress demand to achieve (temporarily) the desired trade surplus. In the latter group reforms created mostly appearances of macroeconomic policy framework, since policy instruments have little impact – if any – upon domestic and external balance.

Whatever happened to CPEs in the 1980s?

The much applauded turnaround in trade balance realized by smaller East European CPEs peaked in 1984. Since then convertible

³² "Question Marks in Hungarian Fiscal and Monetary Policy (1979-1984)", *Acta Oeconomica*, Vol. 35, Nos. 1-2 (1985).

³³ See, e.g. J. WINIECKI, *The Distorted World... cit.*, Chapter VI, and an earlier article upon which that chapter was based "Soviet-Type Economies' Strategy for Catching-up through Technology Import - An Anatomy of Failure", *Technovation*, Vol. 6 (1987). See also A. KÖVES, *op. cit.*

currency trade surpluses became ever smaller. In some countries they disappeared altogether. Debt started to rise again by 1985 (it never ceased to rise in Poland). Only Ceausescu government continued its debt-reduction-at-any-cost strategy through further tightening the belt (on the throat of Romanian population) and ruining the long term prospects of the Romanian economy in the process.

To better understand the rise and fall in CPEs' structural adjustment performance – and associated turnaround in opinions – it is necessary to superimpose the perturbances in the world economy upon the typical CPE investment cycles briefly outlined in the first part of this paper. And, since the pattern of both disturbances and investment cycles repeated itself to a large extent in the 1970s and 1980s, it is worth looking into both periods.

Thus, the first oil shock and the overall rise in relative prices of commodities relative to manufactures in the early 1970s positively influenced Eastern westbound exports consisting mainly of commodities. At about the same time most CPEs discovered the lure of foreign credits and decided to continue with investment expansion throughout the 1971-1975 plan and beyond rather than make the usual mid-term switch to investment restraint. Inevitably, trade deficits increased instead of being turned into surpluses as in the restraint phase of previous investment cycles.

Now, in the 1972-1974 period the size of trade deficits was mostly ameliorated by the improved terms-of-trade of commodities (and basic semi-manufactures) *versus* finished goods (and more value-adding semi-manufactures). Beginning 1975, terms-of-trade reversal accentuated the size of trade deficits. "East European debt problem" made its visible entry upon international scene, although developments in question could have been relatively easily predicted.

One country after another started to cut economic growth in order to cut imports. Forced adjustment began in earnest. Economic growth fell in all smaller CPEs in late 1970s (except, according to official figures, in Bulgaria).³⁴ Trade balance effects were less visible. Although exports increased, imports turned out to be too difficult to reduce in the face of continuing deterioration in the commodities' terms-of-trade and long-term decline in CPEs' competitiveness.

³⁴ Private experts' estimates show not only generally lower growth but also more marked fall in the late 1970s, see T. ALTON and Associates in: *East European Economies: Slow Growth in the 1980's*, Vol. I, U.S. Congress, Washington 1985.

The latter phenomenon is rarely mentioned and lower prices recently obtained by CPEs are sometimes interpreted as a price-for-volume sacrifice concomitant to necessary export expansion. True, CPEs do a lot of price-cutting. Much of it is imposed upon them by their Western partners, given the low quality of even simple standardised manufactures.³⁵ But evidence on increasing costs and decreasing relative prices of CPE manufactured exports, although fragmented, does exist. A good example are the so-called kilogram (unit) prices. The data on such prices of engineering goods obtained by countries and groups of countries on the EEC market for 1965-1890 period are shown in Table 4.

TABLE 4

AVERAGE KILOGRAM PRICES FOR ENGINEERING PRODUCTS
OBTAINED ON THE EEC MARKET RELATIVE TO PRICES
OF WESTERN MARKET ECONOMIES IN THE 1965-1980 PERIOD

	1965	1970	1975	1977	1980
<i>World</i>	0.99	0.99	0.98	0.98	1.00
<i>Western MES</i>	1.00	1.00	1.00	1.00	1.00
United States	2.30	3.42	2.51	2.77	2.76
Japan	1.45	1.45	1.05	1.08	0.95
Switzerland	1.83	1.95	2.01	2.06	2.09
<i>CPEs</i>	0.50	0.45	0.36	0.37	0.35
Bulgaria	0.32	0.39	0.35	0.33	0.30
Czechoslovakia	0.47	0.45	0.37	0.35	0.32
Hungary	0.76	0.71	0.51	0.52	0.47
GDR ^a	0.57	0.47	0.47	0.43	0.37
Poland	0.36	0.36	0.35	0.43	0.34
Romania	0.37	0.39	0.37	0.44	0.38
Soviet Union	0.46	0.43	0.29	0.27	0.29

^a Without the intra-German trade.

Source: see J. WINIECKI, *Soviet-Type Economies*... cit.

Although differences in kilogram prices may be regarded as an evidence of differences in the level of sophistication of exports of the same goods or difference in the structure of exported goods (larger or smaller share of more sophisticated, value-adding goods across countries) or differences in both, the meaning of figures in Table 4 is clear. All CPEs, including the Soviet Union, registered continuing fall

³⁵ See, e.g. the OECD study, *East-West Trade in Chemicals*, Paris 1980 with respect to basic chemicals.

in relative prices. Various partial calculations with respect to products and countries for the 1980s point in the same direction, *i.e.* continuing decline.

Interestingly for this author's considerations in the preceding section about imported inputs and export performance, relative kilogram prices briefly improved for a few CPEs in mid-1970s. Since demand conditions in the West did not justify price surge for marginal suppliers that CPEs are, it is probably a greater availability of sophisticated Western inputs for westbound East European exports that raised the relative prices of the latter. This rise was, however, temporary and – with import cuts – prices obtained by CPEs fell again by 1980.

With credits drying up after the Polish request for rescheduling in 1981 and continuing problems with export expansion, something had to give. As it is well known, it was imports that were cut severely and economic growth decelerated further or fell even according to official figures. With sizeable import cuts and stagnant or slightly falling exports, trade surpluses were bound to appear. However, the expected surpluses became bigger due to the coincidental influence of two separate developments.

To begin with, it should be remembered that CPEs, whether modified or not, were usually able to balance their trade with the West over the investment cycle. The availability of credits disrupted the traditional pattern of investment cycles in the 1970s. With the expansion phase extended due to the credit factor practically up to the late 1970s, *i.e.* some 6-7 years rather than 2-3 years as usual in CPEs, the restrictive phase had to last much longer as well. Therefore it was carried over into the 1980s. Since macroeconomic restraint is about the only supply increasing measure available to CPEs, availability of "saleables" was greater than earlier. Also, periods of macroeconomic restraint are those of lower import needs. Simultaneously import cuts in the restrictive phase were easier to make than during an earlier attempt when investment expansion was still going on.

Moreover, not only the timing made surpluses larger than they otherwise could have been, but also world economic developments positively affected the size of these already larger surpluses. The second oil shock again improved terms-of-trade of CPEs, that is exporters of fuel, energy and highly energy-intensive products to the West.

This effort-free bonanza, which improved smaller CPEs' terms-of-trade by almost 20% in the aggregate between 1978 and 1982, lasted

about four years, and by 1985 these countries' terms-of-trade began to deteriorate again. It is no coincidence that convertible currency trade surpluses peaked in 1984.

Slow decline in terms-of-trade turned into a sharp fall in 1986 due to the tumbling oil prices. New oil price developments were in some quarters interpreted as beneficial to smaller East European countries. But the above interpretation is one-sided. It certainly improved CPEs' terms-of-trade *vis-à-vis* the Soviet Union, but at the same time their dual nature – being importers of commodities from the USSR and exporters of commodities to the West – affected adversely terms-of-trade with the latter. By the third quarter of 1986 these terms deteriorated by about 10%. Combined effects of declining competitiveness and tumbling oil prices reduced 1986 aggregate trade surplus of smaller CPEs to less than 1 billion dollars, and 1987 turned out to be even worse.

Yet another factor influenced adversely convertible currency exports. Almost all smaller CPEs expanded in 1980s their trade with left-leaning oil exporters, selling everything from foods to arms. For some CPEs surpluses with these countries were higher than surpluses with the West. But the fall in oil prices reduced the import capacity of the latter. In consequence, not only declining terms-of-trade with the West cut by about half CPEs' windfall gains from the second oil shock, but also CPEs' other markets shrunk considerably.

In conclusion, there was no spectacular failure in the late 1970s in the case of smaller East European CPEs if endogenous phenomena, *i.e.* investment cycles, and exogenous phenomena, *i.e.* oil shocks, are taken into account. The failure to catch-up with the West through technology and related capital imports³⁶ might have resulted in smaller trade deficits if it had not been for the coincidence of rising investments and deteriorating terms-of-trade. (On the other hand they might have resulted in earlier larger deficits if it had not been for the first oil shock and other price developments in the world economy in the early 1970s.)

Thus, there was no spectacular success in turning around the trade balance into surplus in the 1980s, when both investment cycles and oil price gyrations are considered. Without the impact of these factors surpluses would have been much smaller. What is more, these

³⁶ On these issues, see this author's works quoted in footnote 33.

cuts were not accompanied by the shift of resources to more profitable exports or import substitutes. When effects of this forced adjustment wore off, imports began to creep up while exports on the whole stagnated; surpluses shrunk rapidly while indebtedness increased.

Since no reforms helped MCPEs in achieving structural adjustment through other than command-type measures suppressing demand, both groups of countries – TCPEs and MCPEs – should be considered together. When all is said and done, countries afflicted by central planning seem to be doomed to resort to forced adjustment each time trade balance deteriorates. Without no new oil shock in the cards, no windfall gains are expected to relieve them from that constraint, either. And since long term decline of these economies adversely affects also their competitiveness, continuing forced adjustment looks like the only foreseeable future for CPEs. That is, if systemic change is regarded as improbable, a view this author does not share.³⁷

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³⁷ SEE J. WINIECKI, *Soviet-Type Economies... cit.* and *Economic Prospects... cit.*