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Recent Trends in East-West Trade
By Gregory Grossman and Gordon B. Grimwood . . . . 6 pages

The New Intra-European Payments Scheme
By Albert O. Hirschman . . . . 5 pages

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Gregory Grossman and
Gordon B. Grimwood

RECENT TRENDS IN EAST-WEST TRADE 1/

The problem of East-West trade has again been thrown into focus by the meeting of the Council of Foreign Ministers during May and June, by the sessions of the Economic Commission for Europe and of its Committee on the Development of Trade in May, and -- most recently -- by the renewed manifestations of the intractability of the dollar shortage. While often looked to as an indication of lessened political tension, the expansion of trade between Western and Eastern Europe 2/ also has strong economic justification. From the point of view of Western Europe the countries east of the "Iron Curtain" constitute a large potential market for their traditional manufactured products, as well as a source of foodstuffs and raw materials. Therefore, in the short run, expansion of East-West trade would present a partial solution to the dollar shortage; it would have favorable effects on the long-term development of their income and trade. From the point of view of the communist satellite countries of

1/ Some recent publications on the subject are:

1. Economic Commission for Europe, United Nations Economic and Social Council, Economic Survey of Europe in 1948, Chapter 7, Section 4, "Trade and Payments Relations Between Eastern and Western European Countries".

2. Economic Cooperation Administration, A Report on Recovery Progress and United States Aid, February 1949, Chapter VII, Section N.

3. "East-West Trade in Europe", The World Today, March 1949, Vol. V, No. 3, pp. 98-108. (This article, signed "N. K.", was probably written by Nicholas Kaldor, formerly in charge of the Research and Planning Department of the Economic Commission for Europe.)

4. "Potentialities for Increased Trade and Accelerated Industrial Development in Europe", a report submitted by the Executive Secretary of the Economic Commission for Europe, dated August 14, 1948. (Restricted)

5. "A Preliminary Study of the Potentialities for the Expansion of European Trade", a report submitted by the Executive Secretary of the Economic Commission for Europe to the Second Session of the Committee on the Development of Trade, dated April 19, 1949. (Restricted)

2/ "Western Europe" here comprises the OEEC group of countries. "Eastern Europe" is understood to include the countries east of the Stettin-Trieste line (including the USSR) and Finland.

Eastern Europe (but to a much lesser degree from the point of view of the USSR proper) the expansion of East-West trade is necessary to maintain the rapid rates of economic development to which the regimes are committed. It must be noted that present consumption standards could probably be maintained in the Eastern countries at a relatively low level of East-West trade, except in Finland and possibly in Czechoslovakia.

Before the war East-West trade was integrated into the network of European and world trade. Germany accounted for one-third of it. The low post-war level of this trade may be traced to the virtual disappearance of Germany's trade, the low levels of production in Eastern Europe, and the non-convertibility of currencies. Political factors are of secondary importance in this connection. The ECE estimates that in 1948 exports from Western Europe to Eastern Europe were 43 per cent of the 1938 volume, and that the opposite flow was only 41 per cent of 1938.1/ The commodity composition of exports from the East also underwent a striking change: in 1938 the three principal commodities -- timber, grain, and coal -- accounted for one-third of the value of all exports; in 1948 they accounted for some two-thirds.

Despite the fact that most of East-West trade is now conducted within the framework of rigidly balanced bilateral agreements, 1948 statistics show a large import surplus of Western Europe in its trade with Eastern Europe, amounting to $395 million or 30 per cent of the total imports. An estimated $250 million of this amount was offset by exports to Eastern Europe from the overseas territories of the respective monetary areas (chiefly the sterling area) 2/; the remainder was offset by invisible current items and by some payment on the part of Eastern European countries in compensation for nationalized foreign assets.

The adjoining table collates for each of the Western and Eastern European countries, respectively, their East-West trade in 1948 and the annual rate of their commitments under the known trade agreements which were in effect on July 10, 1949.3/ It must be emphasized that the "actual" and "commitment" columns are not entirely comparable for the reasons presently indicated, and that the comparison cannot show more than very rough trends and orders of magnitude. The data on actual trade in the table are from the foreign trade statistics of Western European countries, converted at official rates of exchange. Thus,

1/ In this calculation the ECE included Finland in Western rather than Eastern Europe, which tends to raise the percentages. More significantly, trade between Eastern and Western Germany has not been included in either 1938 or 1948; were it included, the decline would be even more striking.

2/ Exclusive of re-exports from the United Kingdom ($30 million) which already are included in the export total shown in the table.

3/ The British-Soviet trade agreement, although only agreed upon and not finally signed by that date, is also included.

EAST-WEST TRADE, 1948 and 1949
(millions of dollars)

COUNTRY	IMPORTS 1948 Actual 1/	IMPORTS Current Commitments (annual rate)	EXPORTS 1948 Actual 1/	EXPORTS Current Commitments (annual rate)
WESTERN EUROPE				
Austria	76.7	39.0	37.8	39.0
Belgium-Luxemburg	105.7	113.2	94.1	113.2
Denmark	110.5	90.6	76.8	97.7
France	89.1	101.6	51.0	97.6
West. Germany	20.0	86.1	16.7	91.5
Greece	16.5	4.5	12.3	4.5
Iceland	7.7	5.4	9.9	5.4
Ireland	7.1	-	.6	-
Italy	66.8	129.5	70.0	129.5
Netherlands	120.8	122.5	78.5	112.0
Norway	65.5	50.0	52.3	52.0
Portugal	1.2	-	.7	-
Sweden	155.4	111.1	108.7	120.4
Switzerland	75.6	126.8	71.4	90.5
Turkey	22.0	5.0	18.1	5.0
United Kingdom	367.8	330.4 2/	214.2 3/	330.4 2/
TOTALS	1,308.4 4/	1,315.7	913.1	1,296.7
EASTERN EUROPE				
Albania	.7	-	-	-
Bulgaria	11.9	9.6	14.1	9.6
Czechoslovakia	231.8	144.9	273.1	163.4
Finland	228.9	168.5 2/	284.1	157.6 2/
Hungary	50.2	120.5	67.6	121.5
Poland	167.8	294.5	283.1	286.9
Rumania	17.3	22.8	30.5	22.8
USSR	117.0	369.9	255.5	370.9
Yugoslavia	87.4	166.0	100.7	183.0
TOTALS	913.1 4/	1,296.7	1,308.4 4/	1,315.7

1/ Values at the borders of the Western European countries.
2/ Excludes recent U.K.-Finland agreement, amount of which has not been made public, but which may exceed $100 million in each direction.
3/ Includes re-exports.
4/ Total includes Bizonal imports from Eastern Europe reported in RM (or DM) and converted at the rate of 30 cents per RM (or DM).

1948 Western imports (Eastern exports) are c.i.f., and 1948 Western exports (Eastern imports) are f.o.b.; trade commitment data, on the other hand, usually omit this information. Furthermore, the "commitment" columns have two important omissions: (1) they do not include the substantial amount of trade which takes place outside of the trade agreement framework (such as under special compensation agreements or under ordinary commercial contracts) and (2) they do not take into account trade under the several so-called investment goods agreements, which are of several years' duration and provide for the placing of capital equipment orders by the Eastern countries in a number of Western European countries. On the other hand, the "commitment" data for exports of Western Europe (imports of Eastern Europe) include commodity deliveries from the overseas monetary areas of the Western European countries (e.g. from the sterling area), while the corresponding column for 1948 omits these deliveries (which, as indicated, amounted to some $250 million in 1948).

Considering these qualifications to our data, and allowing for incomplete fulfilment of trade agreements as well as for price declines, the real level of East-West trade within the next few months may be only moderately above the 1948 level. The increase for the whole year 1949 over 1948 will probably be even more moderate, as a number of the larger agreements went into effect only in mid-year. In other words, East-West trade may be expected to remain in 1949 at less than one-half the 1938 volume.

The increase in exports from the East in 1949 is to be primarily in terms of commodities other than the three major ones (grain, coal, softwood lumber), and in such lines as meat and dairy products from Poland and non-ferrous ores and metals from Yugoslavia. Of the major commodities, deliveries of Polish coal are to rise from 12 million metric tons in 1948 to 14 million tons in 1949. At this writing it does not seem that Soviet grain exports will be larger this year than last, nor is any significant increase in softwood lumber exports likely.

We may take note of some shifts in country distribution. On the Western side, the trade commitments of Western Germany and Italy show the steepest increase over 1948. Both countries have had traditionally large trade with Eastern Europe. For Italy the current commitments imply a return to substantially the 1938 volume of trade with the East, while Western Germany's commitments constitute no more than a small fraction of the trade of all Germany with Eastern Europe before the war.

On the Eastern side the relative decline of Czechoslovakia is noteworthy, a decline which has been caused by a number of production and payments difficulties. The doubling of Yugoslav trade with Western Europe is of course largely a result of recent political events. The USSR also shows a substantial increase over last year's trade, although the comparison on the import side is misleading inasmuch as the "commitments" column, unlike the "actual" column, includes imports of commodities from the overseas monetary areas of the Western European countries. Hungary's trade is scheduled to expand sharply from the extremely low actual level during 1948. Lastly, the data on Poland probably understate the increase in that country's trade with Western Europe. Not only are its coal exports to the West to be one-sixth larger this year than last, but it is rapidly expanding its exports of agricultural products as a hedge against anticipated less favorable marketing conditions for coal.

This moderate expansion in East-West trade is proceeding within the familiar postwar framework of rigidly balanced bilateral trade agreements. The only major area of flexibility is provided by the transferable accounts arrangement with respect to sterling which is available to the major Eastern European countries, and which has been utilized for purchases within the British Empire. Since several Western European countries are also on the transferable accounts list, sterling would seem to present possibilities for placing East-West trade on a more flexible and multilateral basis. However, both the British and the Russians seem to be cool to such prospects, the latter reportedly for prestige reasons and the former fearing violation of transferable accounts rules.1/

In the long as in the short run, the major limitations to an expansion in the volume of East-West trade will continue to be the capacity of the Eastern countries to export. No doubling in this capacity, such as is implicit in the trade projections of the individual OEEC countries, can reasonably be expected by 1952-53. 2/ In contradiction to prewar production patterns, the economic plans of the Eastern European countries -- with the exception of Finland, which has no general economic plan -- place heavy emphasis on industrial development, with much less attention devoted to the development of primary production; at the same time the domestic requirements for the traditional export products will rise sharply as a result of rapid industrialization and urbanization. Collectivization drives may -- at least during a transitional period -- offer further difficulties in expanding exports of agricultural products. There is little prospect for the early reappearance of petroleum in Eastern exports, an important prewar item in East-West trade. Potential exports from the USSR present the greatest enigma. Soviet grain exports are of marginal magnitude in relation to domestic supply and availability depends greatly on the government's stockpiling policy, although in this case, too, growing internal requirements will have to be met. As to softwood lumber, the big unknown is the possibility of the reappearance of exports from the USSR in substantial quantities; otherwise there does not seem to be much likelihood for very considerable increases in the exports of this commodity from Eastern Europe. In coal, on the other hand, export availability in Eastern Europe (mainly in Poland) probably will exceed in 1952-53 the import requirements of Western Europe.

The charge, repeatedly voiced by Eastern European countries, that the restrictions on their purchase of equipment of a strategic nature from Western Europe is primarily responsible for the slow development of East-West trade cannot be taken seriously in view of their low export capacity and their enormous needs for commodities which would not be considered to have strategic significance. However, Eastern representatives are probably at a bargaining disadvantage in

1/ Cf. "Sterling Behind the Curtain", The Economist, March 12, 1949.
2/ The ECE estimates that these plans call for an aggregate volume of trade equal to 75-90 per cent of the 1938 volume.

their negotiations with Western European countries insofar as the latter are able in some cases to obtain (or indicate that they can obtain) the same commodities on a grant basis under the ERP. This bargaining advantage may become more important as demand schedules are met and prices once again become a dominant factor in determining the direction of trade.

The role of the Economic Commission for Europe in furthering East-West trade has so far been constructive and fairly successful with respect to the work of its various technical committes, although the recently formed Committee on the Development of Trade has up to now produced little but a forum for the usual political propaganda. The success of this Committee in creating the necessary mutual confidence and willingness to exchange information will depend largely on the general political atmosphere. Should this much be attained, the accomplishments of the Committee will still be largely limited by Eastern export availabilities. In the longer run, it is by inducing greater emphasis on the development of the traditional export industries of Eastern Europe that the Committee can hope to be most effective in maximizing East-West trade.

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Albert O. Hirschman

THE NEW INTRA-EUROPEAN PAYMENTS SCHEME

After a prolonged, many-cornered deadlock, a compromise agreement on a new Intra-European Payments Scheme was reached on June 30, expiration date of the scheme hitherto in force.

Principal Features of the New Scheme

(1) As heretofore the OEEC countries are going to estimate their balance of payments position with each other; this essential preliminary work has been largely completed, but can presumably be made final only when the country allocation of ECA funds for 1949/50 has been decided.

(2) The countries with estimated surpluses on current account will extend grants ("drawing rights") to the deficit countries by placing at the latters' disposal a corresponding amount of local currencies deposited in counterpart to ECA aid. ECA allocations will continue to be split into "basic" and "conditional" aid, with the conditional portion corresponding to the drawing rights extended by the intra-European creditors to the intra-European debtors.

(3) So far, the drawing rights granted by a creditor to a debtor could be used only within that particular bilateral trading relationship. This continues to hold for 75 per cent of the drawing rights under the new payments scheme. With an important qualification which will be explained below, the remaining 25 per cent will now be usable anywhere within the OEEC area. 1/

(4) The transferable portion of the drawing rights is to be fully backed by ECA dollars. This means that a country to which the drawing rights are transferred will be able to obtain full dollar compensation for its unscheduled export surplus toward other European countries. The dollars will presumably be held in a pool by ECA; but the amounts which are likely to be involved are so small that the scheduled creditor countries, out of whose ECA allocation the pool would presumably be constituted, may not find it too objectionable to contract a direct gold or dollar obligation to those countries to which drawing rights will be transferred.

(5) Belgium holds a very special position under the new scheme, because of the fact that its intra-European surplus is far in excess of its dollar deficit. Its estimated dollar deficit for 1949/50 amounts to $200 million while its intra-OEEC surplus has been estimated at $450-500 million. Were Belgium to receive conditional ECA aid to the full amount of its intra-European surplus, a substantial accumulation of dollar reserves would result. Under the scheme, however, Belgium has committed itself to extend long-term (25 years, 2 1/2 per cent) credits as ECA grants it conditional aid over and above $200 million: the first $125 million of financing above this figure are to be formed by Belgian credits and drawing rights (backed by ECA conditional aid) in equal shares; whereas Belgium will contribute only one-third in credits to the next $75 million of intra-European financing. Any further financing of the Belgian export surplus could come about only through transfers of drawing rights from other creditors and such drawing rights would be fully

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1/ The status of Switzerland in the new scheme remains to be determined. Switzerland has requested to be eligible as a "transferee" for the transferable portion of drawing rights.

backed by ECA dollars; but a ceiling of $40 million has been set for those transfers. 1/ The purpose of this ceiling is to limit both the accumulation of dollars on the part of Belgium and the potential dollar losses of the other OEEC countries, in particular the United Kingdom. Altogether, Belgium will extend credits up to $87.5 (62.5 + 25) million and will be able to accumulate dollar reserves up to $152.5 (62.5 + 50 + 40) million.

Discussion

The new scheme represents a considerable retreat of ECA from its original objectives of full intra-European transferability of drawing rights and of a substantial amount of dollar convertibility, i.e., the right for the holder of drawing rights to exchange them in full or in part for ECA dollars if he so chooses. From the outset of the negotiations, the United Kingdom took a vigorous stand against convertibility and opposed transferability insofar as transfer of drawing rights would expose the original grantor to the loss of conditional aid dollars. The British position stiffened further during the last phases of the discussion as a result of the supervening drain on British hard currency reserves. A by no means negligible portion of this drain consisted of British gold transfers to Belgium ($22 million in the first and $44 million in the second quarter of 1949) as well as of smaller transfers to Switzerland and the Bizone.

Convertibility. -- In advocating convertibility of drawing rights from the outset, i.e., the liberty of intra-European debtors to exchange the drawing rights for dollars as of the moment the drawing rights are granted, ECA probably asked for too much. Under present conditions most drawing rights may well have been thus exchanged by the debtors thereby forcing intra-European trade back into bilateral balance. But it would have been highly desirable to obtain a provision permitting the intra-European debtors to convert into dollars a portion of any

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1/ Belgium will extend credits only to the Netherlands, the United Kingdom, and France. As the allocation of conditional aid to Belgium over and above the first $200 million is tied to the simultaneous utilization of credits, it appears that the whole second $200 million tranche of intra-European financing made available by Belgium is reserved to the above three countries. The drawings of the other countries will have to be accommodated by the first $200 million and by possible transfers of drawing rights to Belgium that can be contained within the $40 million limit. In this connection some technical questions will be raised:

(1) What will happen if some of these other countries do not utilize their drawing rights while France, the United Kingdom, and the Netherlands have already utilized their portions of the first $200 million tranche? Will then Belgium have to start giving credit to these three countries before the first $200 million drawing rights are exhausted?

(2) How is the allocation of the $40 million maximum amount of allowable transfers to be administered? Is it going to be made available on a "first come, first served" basis or according to some rationing scheme?

drawing rights unutilized at the end of a given period. This would have given them some incentive to reduce their intra-European deficit.

Transferability. -- Transferability of drawing rights within the OEEC area is considerably whittled down and hamstrung in the new Agreement if compared to original ECA objectives although some advance from the exclusively bilateral character of the 1948/49 scheme has been achieved. Assuming intra-OEEC trade to expand somewhat from last year's level (about $7 billion excluding Switzerland) and drawing rights to remain at last year's level ($810 million) it can be estimated that only about 2 to 3 per cent of total intra-OEEC trade will be affected by the transferability provisions. But even this very limited degree of transferability that has been introduced is further curtailed by the special provisions affecting Belgium:

(a) transfer of drawing rights to Belgium are limited by the $40 million ceiling;

(b) transfers of drawing rights away from Belgium to other OEEC countries are made unlikely by the fact that the transferable portion of drawing rights granted by Belgium will be utilized in conjunction with drawings on the Belgian credits that are being made available. By exercising their right to transfer these drawing rights Belgium's debtors would therefore deprive themselves of the opportunity to utilize credits granted by Belgium.

Transferability of drawing rights has a double objective. One is to make possible a correction of errors in forecasting the bilateral surpluses and deficits. In this respect, the transferability of 25 per cent of the drawing rights may be of real value since it may be sufficient to take care of all but the more glaring misjudgments. 1/

The other, more important function of transferability of drawing rights is the introduction of more competition among European suppliers. 2/ It is with respect to this function that the new scheme does not seem to hold much promise.

1/ It must be remembered, however, that forecasts of balances among countries with a large and comparatively well balanced intertrade are subject to a considerable margin of error. Often an error of 10 per cent in estimating gross payments from one country to another will be sufficient to change the sign of the estimated balance.

2/ Since most net debtor countries are also creditors in relation to some countries and since drawing rights are fixed on a bilateral basis, competition will take place not only among the net creditor countries. Furthermore, the net debtor countries will be able to compete for the drawing rights originally allocated to the net creditors.

For competition and pressure on prices to make themselves felt in the grantor country it is not necessary for the recipient of drawing rights actually to transfer them, but it is essential that he be given the possibility of bargaining with the grantor country armed with the weapon of transferability. As the new scheme stands, this weapon will be available to the debtors only for the last quarter of their forecast deficits or, on the basis of the figures given above, for the last fortieth of their estimated purchases in the creditor countries. Since, in addition, the new scheme contains no provisions rewarding the debtor for non-utilization of drawing rights, the new scheme will suffer essentially from the same defect as the old one: it invites the debtor to utilize the major part of his drawing rights at all cost, regardless of the prices asked by the creditors. It can only be hoped that the current change in world economic conditions will accomplish what the new mechanism of the payments scheme cannot possibly hope to achieve by itself.

Dollar Backing of Transferable Drawing Rights. -- An important point of discussion closely connected with the issue of transferability was the question whether, and to what extent, transferred drawing rights should be "backed" by dollars, i.e., whether a transfer of drawing rights from the original grantor to another country should result in a corresponding loss of conditional aid to the former or, possibly, in some extension of credit on the part of the latter. The British point of view was that transferability of drawing rights should not be tied to transfers of conditional aid dollars. The British held that -- just as direct convertibility of drawing rights into dollars at the option of the debtor -- such an arrangement would have highly restrictive effects both on the readiness of the creditors to extend drawing rights and on their subsequent commercial policies. Belgium, on the other hand, held out for full dollar backing of the transferable portion of the drawing rights-and won, but only after the British had succeeded in sharply reducing both the portion of drawing rights that can be transferred in general, and in particular the amount that could be transferred to Belgium. According to press comments, ECA has won at least one point in securing full dollar backing for transferable drawing rights. Actually, the objective of ultimate dollar balance of Europe requires that the payments scheme should not become a device making it just as easy for some European countries to earn additional dollars in Europe as in the United States. 1/ This, however, is precisely the result of the adopted principle of full dollar backing of transferable drawing rights. In order to make additional exports to other OEEC countries less attractive to, say, Sweden, than additional exports to the United States it would have been desirable to require Sweden to finance a portion of its unscheduled exports to Europe by credits and to obtain dollar payment only for the remainder, rather than for the full amount of drawing rights transferred to it. At present, however, this defect of the scheme is not very important because of the small degree of transferability achieved.

1/ This point is made specifically in the statement of Mr. Hoffman on the Payments Plan, released to the press on July 7.

Belgium's Special Position. -- The one undisputable virtue of the new scheme is that it has provided for new Belgian credits. In view of Belgium's stubborn resistance to any such suggestions in the past, this is a welcome development. The price paid for it in the scheme is the permission given to Belgium to earn dollars far in excess of its actual dollar deficit. The resulting accumulation of dollars by Belgium will have to be financed (indirectly) through the ECA appropriation, so that the net volume of goods currently available to the OEEC countries through ECA aid will be diminished by this amount. If, however, the OEEC countries other than Belgium are considered as one group and the U. S. and Belgium as another, the arrangement is seen in a more favorable light. The OEEC-minus-Belgium countries will be compensated for the loss in dollar commodities by an equivalent amount of Belgian goods and will furthermore receive Belgian credits which might not have been forthcoming without the additional ECA dollar aid to Belgium.

There is some question, however, about the full validity of this argument. Belgium might have been forced to extend intra-European credits in any event by its continuing domestic marketing difficulties which are no doubt in part responsible for the magnitude of the estimated Belgian intra-European surplus.

Conclusion

Three lessons seem to emerge from the negotiationsof the new Intra-European Payments Scheme and their outcome:

(1) The scheme that has resulted from months of discussion is still essentially bilateral in character, and the failure to have achieved substantial advances towards increased competition and multilateralism will lend increased significance to the other attacks on the European problem presently under consideration: liberalization of commercial policies and exchange rate adjustments.

(2) ECA's weakness in the negotiations was due in part to the effect of the "conditional aid" system in strengthening the bargaining position of the intra-European creditors; with the wisdom of hindsight, one might say that an offshore purchase system for financing intra-European balances would have had a welcome effect in strengthening the bargaining positions of both the intra-European debtors and ECA.

(3) More fundamentally, the nature of the final compromise can be ascribed to the fact that ECA had to bargain with every one of the main participants in the scheme and was forced to make concessions each time so that the sum of the concessions was, in the end, considerable. If ECA had been confronted by a unified OEEC viewpoint, the resulting compromise would probably have been closer to its initial position. From a narrowly Machiavellian point of view it has sometimes been argued that the United States has no interest in the emergence of a unified European area. Actually, the current experience demonstrates that, as long as we are dealing with the European area as a whole, our interests can only be served by a consolidation of that area which would assure us equality in negotiations in place of our present position as a minority participant.