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Improved Credit Pattern in the Philippines

Reed J. Irvine

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Economic Relations Within the Soviet Bloc

Edward Ames

17 pages

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September 8, 1953

Improved Credit Pattern in the Philippines

Reed J. Irvine

The Philippines, like other underdeveloped countries, has in the past suffered from an excessive diversion of credit into speculative and non-productive channels. The high profits obtainable in real estate speculation and the financing of commercial transactions in the inflationary situation prevailing in the postwar years have tended to diminish the comparative attractiveness of investment in the more productive spheres. While the Philippine Central Bank had fairly broad power to impose selective credit regulations, including authority to impose portfolio ceilings on total or specific categories of bank loans, power to regulate maturities and the type of security required for different types of loans, and power to prescribe minimum capital ratios to different classes of investment, it has pursued a very cautious policy with respect to application of credit controls. It has made no use of most of its powers to regulate credit selectively since its establishment. Nevertheless, progress was made in 1952 toward improving the credit pattern along the lines desired by the Central Bank.

Central bank policy

The Fourth Annual Report of the Central Bank of the Philippines describes the credit policy the Bank has pursued in recent years as one of "selective restriction and selective expansion". By this it means it has sought to discourage the granting of credit for the financing of non-essential imports and speculative business transactions while encouraging the flow of credit to finance socially desirable productive activities. The Bank holds that overall credit contraction is not the most satisfactory means of controlling inflationary pressures in an underdeveloped economy, asserting that such a contraction would be an important factor in "perpetuating the condition of insufficient production and a depressed level of income and employment".

Despite the presence of strong inflationary pressures in the postwar period, the Bank has shunned the use of its broad powers to regulate the overall volume of credit in the Philippines. Only two restrictive credit regulations applying to all commercial banks have been issued by the Central Bank since its establishment in 1949. In the latter part of 1949, it issued a rule requiring an 80 per cent cash deposit to open letters of credit for the import of specified luxury and non-essential items. In the second half of 1951, it ruled that commercial banks would be required to maintain net foreign exchange holdings, excess reserves, cash in vaults, and securities in an amount equal to at least 70 per cent of their outstanding letters of credit. These regulations were designed principally to tighten the financing of imports and relieve the pressure on the Philippine balance of payments. In addition, in 1950 the Central Bank asked the Rehabilitation Finance Corporation to make no further loans for residential construction and ordered the Philippine National Bank,

a government-owned commercial bank, to halt the extension of credit to government agencies and to make no loans to the public for speculative purposes.

The changing pattern of credit

While this cautious policy permitted an expansion of bank credit which continued during 1952, there nevertheless occurred a significant shift in the credit pattern of the Philippines last year as shown in Table I.

Table I
Loans, Discounts and Overdrafts of Other Banks
Classified by Major Categories 1/
1951 and 1952

(In millions of pesos)

	<u>December 1951</u>		<u>December 1952</u>	
	<u>Amount</u>	<u>Per Cent</u>	<u>Amount</u>	<u>Per Cent</u>
Agricultural	184.3	33.9	230.2	39.4
Industrial	38.8	7.1	49.1	8.4
Public Utility	16.6	3.0	13.2	2.3
Commercial	189.4	34.8	156.5	26.8
Real Estate	50.6	9.3	47.7	8.2
Personal & Cons.	23.3	4.3	21.0	3.6
Others	<u>41.0</u>	<u>7.6</u>	<u>66.5</u>	<u>11.4</u>
Total 2/	544.0	100.0	584.3	100.0

1/ Does not include branch offices of Philippine National Bank.

2/ Totals do not add up in some cases because of rounding.

Credit which may be considered mainly "productive", i.e., agricultural, industrial, and public utility, rose from 44 per cent of the total loans, discounts, and overdrafts outstanding on December 31, 1951, to 50 per cent at the end of 1952. Commercial, real estate, and personal and consumer credits declined from 48.4 per cent to 38.6 per cent during the same period.

The category "Others", for which no detailed breakdown is available, rose appreciably, however. If this may be considered essentially a "non-productive" category, the decline in credits of this character would be somewhat less marked, the proportion dropping from 56 per cent to 50 per cent of the total.

Factors influencing the credit pattern

The increase in agricultural and industrial credit and the decline in commercial and real estate credit in 1952 are in accord with the stated objectives of the Central Bank. The Bank's instructions to the Rehabilitation Finance Corporation and to the Philippine National Bank mentioned above are not known to have been altered and may have played a part in bringing about this shift. It is also possible that the Central Bank used its influence to persuade private commercial banks to limit credit for real estate and speculative transactions.

The contraction in the volume of commercial credit undoubtedly also reflects to some extent the slackening of commercial activity in 1952 as the post-Korean boom tapered off. The value of Philippine exports declined by 15 per cent and that of imports by 11 per cent compared with 1951.

Speculative borrowing was probably curbed in part by the combination of declining prices and rising interest rates. The general wholesale price index for December 1952 was 4 per cent under that of the preceding December, and the average for the year was 9 per cent below the 1951 average. Interest and discount rates charged by commercial banks displayed a marked upward trend, as is shown in the following table.

Table II

Percentage Distribution of Loans, Discounts, and
Overdrafts Outstanding of Commercial Banks
Classified by Interest Rate

Rate	<u>December 31, 1951</u>		<u>December 31, 1952</u>	
	<u>Loans & Discounts</u>	<u>Overdrafts</u>	<u>Loans & Discounts</u>	<u>Overdrafts</u>
0 - 4-1/2 %	14.7	19.5	5.1	0.9
5 - 6-1/2 %	42.6	54.2	45.7	70.5
7 -12 %	<u>42.7</u>	<u>26.3</u>	<u>49.2</u>	<u>28.6</u>
Total	100.0	100.0	100.0	100.0

It will be noted that 95 per cent of all loans and discounts and 99 per cent of all overdrafts outstanding were at rates higher than 5 per cent on December 31, 1952, compared with 85 per cent and 80 per cent respectively one year earlier.

The higher interest rates apparently reflected the relatively tight reserve position of the commercial banks. A decline in bank deposits was reflected in a 16 per cent fall in required reserves in 1951, but the continuing expansion of bank credit led to a 49 per cent drop in excess reserves in that year. At the end of December 1951, excess reserves were ₱19 million, or 20 per cent of required reserves. This had increased to 37 per cent by December 1952, but even this figure is low in comparison with the traditional reserve ratios maintained by Philippine banks. Money supply expanded slightly during the year, chiefly as a result of a surplus in the foreign sector and the credit operations of the banking system, but there were persistent complaints about the tightness of money.

On the positive side, the expansion of agricultural credit, which was used mainly to finance sugar and rice production, continued the rising trend of earlier years at a retarded pace. Philippine production of both sugar and rice has recovered steadily in the postwar years under favorable demand conditions, which continued to prevail in 1952. Sugar production still fell short of the amount needed to fill the U. S. quota, and rice production had not yet reached the level of self-sufficiency of prewar days.

The Central Bank does not claim to have directly stimulated agricultural credit in 1952. In fact, it states that the ₱114.6 million it made available to other banks in the course of the year was used largely in the financing of trade. The Bank did play an important role in establishing the new rural bank system which was inaugurated in 1952, but the first bank organized under this system was not opened until December 1952 and could not have influenced credit trends for that year.

Conclusion

The improvement in the credit pattern of the Philippines is encouraging both as an indication of economic stabilization and as a sign of greater concentration on internal economic development. The factors that appear to have played a part in this change have been the slackening of commercial activity, declining prices, rising interest rates, a continuing favorable market for sugar and rice, and the influence of the Central Bank. Although the Central Bank has deliberately refrained from applying the traditional instruments of monetary policy, substantial progress toward its policy objectives was made in 1952.

Economic Relations Within The Soviet Bloc

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Summary

Trade within the Soviet bloc is carried on by means of bilateral agreements, in which specified commodity lists are exchanged at fixed ruble prices bearing no necessary relation to internal prices of the trading countries. Trade and certain other current payments included in these agreements must balance within each calendar year. In addition to this balancing trade, certain other transactions, notably reparations payments, the transfer of profits of satellite corporations partly owned by the USSR, and inter-governmental credits may provide an inequality in the value of goods and services moving in both direction.

The most important feature of these trading relations is the absence of transferability of ruble balances in the clearing accounts which is necessary in order to prevent commodity arbitrage, given the lack of a single set of prices in intra-bloc trade. Rigid swing balance limits must be fixed because of the absence of a market mechanism to help correct imbalances in any country's payments.

The Soviet Union is able to utilize this system to control the satellite economies in various ways. By controlling the composition of reparations payments and by directing joint corporations, the Soviet Union can direct the pattern of output in some satellites. By controlling the composition of trade under bilateral agreements and by dominating the sources of many materials and types of equipment needed by the satellites, it can exercise an equally important, if less direct control over others.

In recent years, total trade turnover among the countries of the Soviet bloc has probably been more than twice as great as the \$2.5 - billion turnover (imports and exports) of the bloc with the rest of the world. Very little is known outside the bloc concerning the trade and payments relationships among the bloc countries. This paper will summarize the principal conclusions which can be drawn from publications of the Soviet bloc as to the manner in which these countries conduct their trade and payments transactions. While the basic information is much less satisfactory than could be wished, it serves to give some clues as to the practices and procedures of the "second world market system", as Stalin called it. 1/

The principal conclusion to be drawn from this analysis amounts to the assertion that the basic equilibrating functions of an international market mechanism do not exist in economic relations within the Soviet bloc. Such a conclusion is in a sense negative, for it states the procedures by which economic relations are conducted without indicating why the volume and direction of trade is what it is, and without indicating what relation there is between the international trade and the internal economic activity of a Soviet bloc country. A later paper will endeavor to explain

1/ In his "Economic Problems of Socialism in the USSR", Moscow, October 1952.

how the planning mechanism of the satellites has been gradually adapted to cope with problems of international trade, and therefore to give more satisfactory answers to the questions now raised.

Trade and payments

Bilateralism of trade - Trade within the Soviet bloc is typically carried out on the basis of bilateral agreements between Ministries of Foreign Trade. A typical Soviet summary of the provisions of such agreements is the following:

"Trade agreements between the USSR and the people's democracies are based upon the principle of equality in the value of commodity shipments in each direction, an equality observable in 6-month intervals over the life of the (long-term) agreements. Within each half-year period the value of shipments of goods by one party may exceed the value of shipments of goods by the other, but at the end of each half-year period of operations under the trade agreement the trade agreement shipments in each direction must be equal. If at the end of the year either party has not made up its deficit in shipments; it receives a three-month period in which to do so."1/

This statement clearly implies a bilateral balancing of trade between the USSR and each satellite. In general, the same terms seem to be used in intersatellite trade, with one difference. Soviet-satellite trade occurs within the framework of five-year agreements, so that annual delivery programs can be fixed by means of protocols to a basic agreement. However, among the satellites only Czechoslovakia has negotiated a general system of long-term agreements. Other satellites apparently must negotiate annual agreements.

There are only three known cases where the bloc countries have entered into multilateral agreements. Poland, Czechoslovakia and Communist China each are members of a series of trilateral agreements with the USSR and Finland, and make deliveries to Finland to offset a Soviet current deficit with Finland. In no case does there appear to be a trilateral agreement all three parties to which are bloc members.

Soviet writers sometimes try to give the impression that trade is multilateralized within the bloc. The following two quotations are characteristic. They can be interpreted either as saying that the bloc members having transferable sterling accounts settle among each other in sterling, or that they settle with countries outside the bloc in sterling. The latter interpretation seems the more solidly supported by the available evidence.

1/ Korolenko, Printsipy ravenstva i vzaimnoi vygody v torgovle SSSR s evropeiskimi stranami narodnoi demokratii, Voprosy Ekonomiki Number 3, 1952.

. . . "The Soviet Union and people's democracies are making attempts to expand multilateral clearings. The USSR, Poland and Czechoslovakia, in addition to participating in several trilateral clearing agreements concluded with Finland, participate in a system of transferable accounts in England, which considerably expand the use of the pound sterling in international settlements." 1/

"Along the bilateral clearing accounts between the USSR and the people's democracies, a tendency has appeared in recent years to handle accounts on a multilateral basis, which offers substantial advantages to participating countries. These advantages are so evident that even Finland, which is a capitalist country has deemed it advantageous to join in trilateral clearing arrangements; USSR-Poland-Finland and USSR-Czechoslovakia-Finland. The multilateral--and in particular the trilateral--agreements make it possible to expand trade turnover between the participating countries. The flourishing of the socialist economy of the USSR and the people's democracies, the ever-strengthening economic ties between them, and the existence of a most stable currency--the Soviet ruble--create all the prerequisites for a further expansion of international settlements on a multilateral basis." 2/

All these statements actually say is that 1) there exist two trilateral agreements; 2) the bloc settles some deficits with non-bloc countries in sterling; and 3) multilateralism would permit increases in the volume of trade.

Some Soviet writers make a virtue out of the necessity of bilateralism by arguing that only bilaterally balance trade is equitable, since otherwise one partner receives more imports than the other. 3/ For example,

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- 1/ Evreiskov, Puti ukrepleniya mezhdunarodnykh finansovykh otnoshenii, Voprosy Ekonomiki Number 3, 1952.
 - 2/ Polyakov and Trubenkov, Gosbank i mezhdunarodnye denezhnye raschety SSSR, Finansy i Kredit SSSR, Number 2, 1952. This article was written prior to the signing of the Finnish-Soviet-Chinese agreement.
 - 3/ See Paromov, Formy i metody ekonomicheskogo sotrudnichestva SSSR i stran narodnoi demokratii, Voprosy Ekonomiki Number 12, 1950; Korolenko, Voprosy Ekonomiki Number 3, 1952, op.cit.; Shkarenkov, Ekonomicheskoe sotrudnichestvo SSSR i stran narodnoi demokratii, Planovoe Khozyaistvo, Number 3, 1952.

"In trade with all countries, the USSR does not attempt to sell more than is necessary to pay for its purchases and to cover its other foreign expenditures. This (policy) avoids unfavorable consequences connected with disturbances in trade and payments balances, which lead to foreign exchange difficulties and a worsening of the economic position of countries. Thus the readiness of the USSR to purchase in exchange for Soviet goods the same amount of foreign goods which are the usual object of export of the foreign country in question sets up a favorable basis for mutually advantageous trade." 1/

This statement that trade always balances bilaterally, of course, is not true of East-West trade where the bloc normally shows a surplus in its trade with the United Kingdom and deficits with other sterling countries. It is only technically true even of trade within the bloc, since there are various capital movements and transfers which are outside of the regular trade agreements and therefore technically not covered by statement given above, so that the total movement of goods in each direction between each pair of bloc countries need not be equal.

Non-transferability of earnings - What statements of this kind do indicate is that it is in general not possible for one bloc country to apply earnings in its current payments with a second bloc country to deficits in its payments with a third. In other words, there seems to be no mechanism for transferability of earnings in intra-bloc trade. 2/ The following statement, by an East German economist, emphasizes the relation between bilateralism in trade and non-transferability of currency.

"Large uncovered claims in the accounts arise chiefly on the basis of an excess of exports over imports and take the form of an active balance (in the clearing account-E. A.) or in the form of exchange which, however, cannot be transferred to a third country. These uncovered claims are at the same time a credit which is extended to a partner country which has not met its contractual required deliveries. The formation of such claims creates no danger to the relations between countries with a socialist economy. This

1/ Vneshnyaya Torgovlya, Number 4, 1952, editorial.

2/ There may be, however, some transfers of Free World currency among bloc members. One source says "The transfer in rubles of foreign exchange to another contracting party is made at an agreed rate". (Korolenko, op.cit.) The use of "agreed rate" rather than "established rate" is probably not accidental, and suggests that such transfers are not necessarily made on the basis of the official cross-rates.

was precluded from the start by the fact that deliveries of goods between countries of this type is the result of their economic planning, and short-term temporary (trade imbalances) are quickly compensated by contractual deliveries." 1/

Within the bilateral framework, payments appear to present no particular problem. Trade agreements provide for the establishment of central bank accounts in the name of the respective Ministries of Foreign Trade, to which all transactions are charged. Since the Soviet currency appreciated of March 1950, these have been kept in rubles. An enterprise producing for export under some trade agreement uses the same procedure for receiving payment that it would if it were producing for a domestic purchaser. As in transactions within the USSR, payment is completed within 10 days of the receipt of the payments documents and on the basis of the invoices, whether or not the goods have actually been received. Disagreements arising from discrepancies between the actual goods and the invoices are settled by arbitration tribunals. A Soviet source describes the payments procedure as follows:

"In commercial relations of the Soviet Union with the countries in the camp of socialism and democracy, the possibility of deception is excluded, for the participants of both sides of the foreign trade transaction are state organizations. Hence the major form of settlements between them is not the letter of credit but the simpler and less complicated incasso form of payment, which is more in accordance with the character of their relations. Under this form of settlements, the goods delivered under a commercial transaction are consigned directly to the foreign purchaser and upon arrival are immediately transferred to him. The bills, transport and other commercial documents are submitted by the supplier for in-

1/ Alfred Siebeneichen, Die zwischenstaatliche Verrechnung im Sozialismus, Deutsche Finanzwirtschaft, Number 3, 1953. An apparently contradictory statement by a Bulgarian source states that "Special accounts opened in the banks of contracting countries to carry out payments for goods turnover and for expenses connected with goods turnover are held in rubles . . . The contracting parties make transfers in rubles from one currency to another at the established rate". ("A.S.", Ikonomichesko s'trudnichestvo na stranite v lagera na sotsializma, Finansy i Kredit (Sofiya), Number 9, 1951.) The contradiction is more apparent than real if "contracting parties" is interpreted to mean "trading partners", with the "transfers" referring to entries in two accounts created under a particular bilateral agreement rather than in all accounts created under bilateral agreements.

incasso to the bank of his country, which sends them off to the bank of the purchaser's country for receipt of payment. The payment must be made by the bank within 10 days of receipt of the documents sent incasso." 1/

The operation of clearing agreements is conditioned by the interest of the participants in maintaining a deficit position and by their interest in obtaining as high prices (in clearing rubles) as possible for their exports, or as low prices (in clearing rubles) as possible for their imports.

"In clearing agreements it is possible for one of the countries to receive credit. To the extent that this is possible the debtor country is in a favorable position, since it can make payments in goods little needed by the creditor country. In clearing agreements, exchange rates are fixed for the currencies in which members are compensated. When one of the countries (for instance Fascist Germany) succeeds in raising the rate on its currency, it thereby has the economic power to purchase additional goods offered by other countries. Its aim in so doing will be to raise imports in relation to exports, thereby bringing in goods purchased from the contracting country at low prices." 2/

Such price and trade manipulations, as are implied by this quotation, are possible in the Soviet bloc a) because of the absence of a uniform bloc-wide market price for any commodity, and b) because neither prices nor the quantities of goods moving in trade will be affected by the creditor or debtor states of any country.

Prices - With regard to the prices at which goods are valued in the bilateral clearing accounts, there are numerous statements of the following sort:

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- 1/ M. Polyakov and V. Trubenkov, the State Bank and the International Monetary Transactions of the USSR, *Finansy i Kredit SSSR*, Number 2, 1952. A Bulgarian source states that this form of payment is the usual one in transactions among the bloc members. P. I. Petkov, *Mezhdunarodnite Flashchaniya, Finansy i Kredit (Sofiya)*, Number 3-4, 1951, page 60. This publication appears with great delay, and this issue did not appear until September 1951. It is not known how long this system has been in effect.
- 2/ Petkov, op.cit. The reference to "Fascist Germany" is probably "insurance" by the author, so that he will not be accused of imputing evil designs to the USSR, which appreciated its currency in March 1950. In the Soviet bloc context, "raising the rate on currency" means raising the clearing ruble prices of exports.

"Mutual deliveries of goods between the USSR and the people's democracies are carried out on the basis of just prices, which are fixed by mutual agreement; in determining these prices, a single principle is applied to the pricing of goods of both contracting parties, and any inequality of treatment in barter trade is thereby avoided." 1/

It is not so easy to find out what the "single principle" may be. The most recent information is that 1) all prices are fixed in the agreement, and may be altered only after a year or more has elapsed; and 2) each exporting country must charge the same prices to all bloc countries with which it trades. 2/ In some respects there definitely has been unification of trading terms. Thus in 1951, a standard set of rates for transit rail freight and a standard form for contracts were set up on a bloc-wide basis. 3/ As regards the price of goods, however, there is no indication of how the "uniform price" charged by each exporter is calculated. Furthermore, there is no indication that all exporters of a particular commodity charge the same price. To the extent that different countries receive different prices (in clearing rubles) for the same commodity, transferability of clearing ruble balances becomes undesirable from the Soviet point of view. Transferability would mean that a country would transfer purchases to those countries where prices (in clearing rubles) were lowest. High-price countries would be unable to sell enough to pay for their imports. Since the Soviet Union, in particular, now takes advantage of its bargaining position to charge high prices for its exports, it would then be forced to reduce its imports from the satellites, or to sell its exports on terms more favorable to the satellites.

The absence of a corrective mechanism which would prevent countries from running up indefinitely large surplus or deficit clearing positions is stressed by one of the writers already cited.

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- 1/ Korolenko, Voprosy Ekonomiki Number 3, 1952, op.cit.; Paromov, Voprosy Ekonomiki, Number 12, 1950, op.cit.; Shkarenkov, Planovoe Khozyaistvo, Number 3, 1952, op.cit.; "A.S.", "Ikonomicheskoe s'trudnichestvo na stranite v lagara na sotsializma, Finansy i Kredit (Sofiya), Number 9, 1951 (this issue is dated October 1952).
 - 2/ Dudinski, Ukreplenie i razvitie mirovogo demokraticeskogo rynka, Voprosy Ekonomiki, Number 6, 1953.
 - 3/ Klochek and Viryasov, Ekonomicheskoe sotrudnichestvo stran lagerya sotsializma, Vneshnyaya Torgovlya, Number 2, 1952; Cheklin and Viryasov, Torgovo-ekonomicheskie dogovory i soglasheniya SSSR s narodno-demokraticeskimi stranami, Vneshnyaya Torgovlya, Number 11, 1951.

"Whereas under capitalism there is a clear dependence between the exchange rate and internal prices, under socialism this has been overcome; exchange rates have no influence on internal prices, and internal prices have no effect upon the exchange rate (or parity). The consequence of subordinating the prices of imported goods as well as the prices of exported goods to economic plans is that the influence of the exchange rate and foreign prices upon internal prices disappears . . . Since socialist money is not a means of international payments and since the exchange rate has no effect on commodity imports and exports or on the level of internal prices, the relation between the exchange rate and internal prices completely broken, and there is therefore no connection between the balance of payments and the value of socialist money. Even if a socialist country were permitted in its plan for foreign trade turnover to accumulate a passive balance of payments which would be settled in gold and foreign exchange reserves, this would have no effect on the value of its own money." 1/

These peculiarities of international trade in the absence of any price mechanism make it necessary to introduce the strict system of swing ceilings and annual quotas described above. The differentials among the export prices of the different countries operate against the establishment of transferability of earnings. Both the absence of transferability and the need for control over balances (to prevent excessive creditor or debtor status) make it easier to operate a rigidly bilateral system than one in which only the over-all trade balance would be controlled. Soviet writers, it is true, claim that since all bloc trade is calculated in clearing rubles and since the ruble is technically on a gold standard, transferability should be possible.

"The question of the relation of Soviet currency to gold has now not only great theoretical interest, but also a practical interest. At present the foreign trade turnover of the Soviet Union, according to data of the customs organs, exceeds 18 billion rubles a year, that is in comparable prices it is more than about (sic) three times the prewar level. The overwhelming bulk of this annually growing trade turnover is in trade with countries of the democratic camp. Having a fixed gold content--the Soviet ruble is an exceedingly reliable means of settling payments among individual states which are members of the camp of socialism." 2/

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- 1/ Alfred Siebeneichen, Die zwischenstaatliche Verrechnung im Sozialismus, Deutsche Finanzwirtschaft, Number 3, 1953.
- 2/ Review of Z.V. Atlas' "Ukrepnenie denezhnykh sistem SSSR i stran narodnoi demokratii" by Gusakov, in Finansy i Kredit SSSR, Number 1, 1952. A later article by Atlas (O nekotorykh voprozakh teorii sovetskikh deneg, in Voprosy Ekonomiki, Number 7, 1953) argues along similar lines.

This statement, of course, assumes that the problem of transferability is related solely to the definition of currency units in terms of gold. The problem, however, is not that the unit of account is ambiguously defined in terms of gold, but rather that it has represented different amounts of goods, depending on the particular pair of trading countries considered; and that the amount and direction of trade is not in any way connected either to prices or to balances of trade.

Trade within the Soviet bloc is thus carried on without a price structure which tends to equalize the clearing ruble prices of goods sold by the various countries, and without a market mechanism which can affect the movement of goods in such a way as to bring about balancing of payments. To compensate for the lack of such a mechanism, the bloc has tended to develop international allocations systems which serve somewhat the same purpose. These will not be discussed in this paper, the remainder of which will be devoted to an analysis of capital and invisible transactions, and to a discussion of how the system of trade described above can be utilized by the Soviet Union to control satellite economic activity.

Bilateral trade agreements as an instrument of control - These represent a powerful control instrument in that the satellites must produce what the Soviet Union desires to import. The contents of such trade agreements are determined almost unilaterally by the Soviets, export obligations to the USSR receive high priority treatment in the satellites, and the importance this trade has steadily increased. Industries have been created in the satellites to meet Soviet needs, and other pre-existing industries are virtually dominated by current production for the USSR. Soviet purchases also furnish a pretext for the presence of large economic missions in the Soviet Embassies and for the presence of Soviet advisors and inspectors in satellite industry with functions which include the collection of economic data and the exertion of varying degrees of influence on production processes.

In addition to these obvious control aspects, more subtle controls are involved in the trading system which has evolved. The basic principles of trade between the satellites and the USSR are indicated in the following quotations, which stress 1) bilateral balancing; 2) satellite dependence upon Soviet raw materials exports; 3) integration of trading agreements with long-run plans; and 4) rigid scheduling of deliveries under the clearing agreements:

"Trade between the USSR and the satellites . . . is based upon an equality of shipments in each direction. The Soviet Union ships to the people's democracies mainly industrial equipment and raw materials necessary to fulfill economic plans and to carry out the industrialization of these countries." 1/

1/ Ivanov, Razvitie ekonomiki i vneshnei' torgovli stran narodnoi demokratii, Vneshnyaya Torgovlya, Number 10, 1949.

"The volume of foreign trade turnover and the ever-increasing output of material goods in the countries of democracy and socialism are closely connected. Developing at a rapid tempo, the economy of these countries shows increasing demands for raw materials and equipment produced either inside the given country or abroad; at the same time the possibility for the export of goods produced within the country increases." 1/

"Agreements on mutual deliveries of commodities determine the amounts of the basic articles which are to be shipped in the course of 4 to 5 years, and long-term agreements as a rule determine the shipment of industrial equipment, including the deliveries of entire factories." 2/

"The fulfillment of conditions on the assortment of goods, their volume and delivery dates, as well as all other points in the trade agreements, are firmly guaranteed by the agreements concluded among the governments. An important means of strengthening the planned character of trade turnover among countries of the socialist camp is the condition of equality of payments in each direction, which assures the observance of delivery dates by each party, and other forms of economic mutual aid. Firm obligations in foreign trade agreements and their undeviating fulfillment within precisely determined periods can be undertaken and carried out only by governments with planned economies." 3/

A number of Soviet statements exist to the effect that the Soviet Union ships mainly raw materials and capital goods to the satellites, receiving in exchange mainly finished goods other than capital goods. The following interpretation could therefore be made of these statements. First, the satellites are dependent upon the USSR for a number of raw materials (including cotton, wool, iron ore, manganese, chrome, fertilizers, etc.), and the greater their own output the greater their imports must be. Second, if the Soviet Union falls behind in its deliveries for some reason, output in the satellites must drop below plan or may even decline. A drop in output will affect satellite shipments to the USSR, and may act automatically in such a way as to prevent the satellites from building up credit balances in the USSR. The Soviet Union, therefore, by cutting down its deliveries to the satellites, can restrict their output in particular lines, without building up a substantial payments deficit, and without causing Soviet output to suffer.

1/ Klochek and Viryasov, Ekonomicheskoe Sotrudnichestvo stran lagerya sotsializma, Vneshnyaya Torgovlya, Number 2, 1952.

2/ ibid.

3/ Paromov, op.cit.

Should a satellite fall behind in its deliveries, the USSR can use the threat of suspending shipments of raw materials as a practical means of forcing compliance. Since the satellites have small reserves of Free World exchange, and since their own raw materials supplies are in many ways limited, a failure of the USSR to make deliveries of materials might mean a non-fulfillment of domestic output plans. Since such a failure is an important political matter, foreign trade as well as domestic planning authorities will endeavor to meet their delivery quotas in order to make possible the continuation of output at home.

This schematization unquestionably oversimplifies the control which the USSR can exercise over the satellites by varying the over-all volume of barter trade and delivery rates. Yugoslav experience since 1950, however, may be suggestive. Yugoslavia imports many of the same materials that the satellites do, and the size of the foreign aid pipeline and current deliveries have been the source of considerable concern to the Yugoslavs. Even relatively small changes in the rate of aid shipments can have an effect upon Yugoslav industrial output. Since a number of the satellites are in a stage of development similar to that of Yugoslavia they may in a like manner be affected by changes in the rate of their imports.

Trade transactions probably make up a larger portion of the total balance of payments within the Soviet bloc than they do in the case of other trading countries. There are, however, various service payments and capital transactions which enter into the balance of payments of a Soviet bloc country, and the remainder of this paper will summarize the information available concerning them.

Service transactions

During 1948, the entire Soviet Bloc negotiated a series of bilateral agreements on what the Soviet bloc press calls "technical aid" and "technical collaboration"; these include most of the service items in the intrabloc balance of payments. These include the establishment of joint chambers of commerce, the organization of trade fairs, the exchange of technical experience, and technical aid. 1/

Joint chambers of commerce exist in a number of instances. Since there has been a steady merging of foreign trade and economic planning functions in the satellites, the chambers of commerce probably have only a minor role in promoting trade. Their functions presumably are propagandistic. Trade fairs are periodically held in the various bloc countries. It is difficult to assess their importance. Since the available

1/ See, for example, Korolenko, Ekonomicheskoe sotrudnichestvo SSSR i stran narodnoi demokratii, Vneshnyaya Torgovlya, Number 9, 1949; and Ukreplenie ekonomicheskikh otnoshenii mezhdu SSSR i Stranami narodnoi demokratii, Vneshnyaya Torgovlya, Number 5, 1950.

evidence indicates that bloc security regulations make foreign travel as difficult for Soviet bloc citizens as for Free World officials, trade fairs may actually serve a useful function in acquainting the technical personnel with types of industrial equipment produced elsewhere in the bloc, and may compensate, to some degree, for the limited amount of contact among technical personnel in the various countries.

"Exchange of scientific and technical experience" is achieved in principle on a bilateral basis. The treaties signed in 1948 between each pair of satellite countries called for the establishment of joint commissions, consisting of five members on each side. These commissions were to meet twice yearly in the respective capitals, in alternation, to make recommendations to the respective governments on the exchange of information. These treaties were in general for a period for five years, and can be renewed without further negotiations. 1/

The terms of reference of the commissions make it clear that these are at best advisory bodies, which can perhaps outline the subject matter on which exchange could take place, but which probably do not actually distribute material themselves or have any active function of providing a channel for working--level contacts. It appears that only a few of the commissions have actually been activated, probably because other channels have been more effective.

"Mutual scientific and technical aid", in contrast to the foregoing programs, appears to be the main vehicle for handling services among bloc members. The principal features of this program relate to a) loans of skilled personnel; b) training programs, including sending of students abroad; and c) licensing of patents. These features of bloc economic relations appear to have been largely developed since mid-1950. Soviet literature before that date did not spell out this type of aid in any detail, while in 1952, considerably more detail is given. 2/

Loans of skilled personnel appear to amount in practice mainly to the sending of Soviet technical missions to the satellites. Published examples include missions for exploration and exploitation of natural resources 3/ the "exchange of productive experience and advanced labor me-

1/ Korolenko, Printsipy ravenstva i vzaimnoi vygody v trgovle SSSR s evropeiskimi stranami narodnoi demokratii, Voprosy Ekonomiki, Number 3, 1952.

2/ Compare the types of "economic collaboration" listed by Korolenko in his 1949 and 1950 articles cited above with those listed by Shkarenkov, Ekonomicheskoe sotrudnichestvo SSSR i stran narodnoi demokratii, Planovoe Khozyaistvo, Number 3, 1952.

3/ From the context of these reports, it could be concluded that these missions took place mainly in connection with the Soviet-Chinese treaty of 1950, which called for the establishment of joint corporations for developing Chinese petroleum and ferrous metals resources. However, the uranium deposits in East Germany, Czechoslovakia and Bulgaria may well fall into this category of project.

thods"; and the design of plants and the installation or operation of new equipment. 1/ In addition, Soviet experts in military, security and administrative problems are attached to the satellites.

A Soviet source 2/ states that thousands of satellite students are enrolled in Soviet educational institutions. Intersatellite student exchange appears to be of much less importance. One reason for this situation appears to be the existence of rigid security controls in the individual bloc countries.

It is not clear how the financial aspects of these various "service" transactions operate. A Bulgarian source indicates that diplomatic, trade and military missions as well as students studying abroad are supported by the country of origin, and that funds are transferred by means of payment orders in a procedure differing from that in commodity transactions. 3/ The missions here referred to seem to be the permanent representation of the various countries rather than the special missions in the "mutual aid" programs. A Soviet source speaks of contracts dealing with "mutual aid" in the same context as trade contracts. 4/ One of the contributing factors in the Soviet-Yugoslav disputes prior to 1948 was the Yugoslav assertion that Yugoslavia could not afford to maintain at its own expense a Soviet technical military mission, especially since the salaries of Soviet officers far exceeded those of their Yugoslav counterpart. The Yugoslavs have published numerous claims to the effect that Soviet personnel abroad were paid by the satellites at rates equivalent to those prevailing in the USSR and far in excess of those in the satellites. Although Soviet published sources say that the USSR "sends" technical missions "at the request of" the satellites, 5/ they have not claimed that the USSR pays for the expenses of the missions. In contrast, Soviet publications speak of the transfer "without compensation" of licenses, blueprints and technical documentations to the satellites. 6/ Since the Soviet Government would have to pay the salaries of specialists, but would not have to pay royalties or license fees within the USSR, it presumably would seek to have the satellites pay the expenses of missions but would not have any direct reason of the same kind to obtain royalties or license fees for processes used abroad. To the extent that the more developed satellites, such as Czechoslovakia, have retained patent protection of inventors, this procedure might work to their disadvantage.

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- 1/ Albania, Rumania and Bulgaria, in particular, as the least developed of the satellites, appear to have the most extensive staffs of Soviet engineering personnel in their plants.
 - 2/ Shkarenkov, op. cit.
 - 3/ Petkov, P. I., Mezhdunarodnite Flashchaniya, Finansy i Kredit, (Sofiya), Number 3-4, 1951.
 - 4/ Choklin and Korolenko, Torgovo-ekonomicheskie dogovory i soglasheniya SSSR s narodnoi-demokraticeskimi stranami, Vneshnyaya Torgovlya, Number 11, 1951.
 - 5/ For example, Paromov, Formy i metody ekonomicheskogo sotrudnichestva SSSR i stran narodnoi demokratii, Voprosy Ekonomiki, Number 12, 1950.
 - 6/ Korolenko, 1952 article cited above. See also V. Goryunov, Mazhdunaradnye ekonomicheskie svyazi kitaiskoi narodnoi respubliki, Vneshnyaya Torgovlya, Number 3, 1952.

The benefits which the satellites gain from the hiring of such Soviet "services" probably varies from country to country, and also according to the type of service in question.

At one extreme, Soviet industry is undoubtedly more advanced than that of Albania, and Soviet engineers can therefore make a contribution to Albanian economic development; at the other extreme, it is doubtful whether Czechoslovak or East German industry greatly benefits from the application of Soviet engineering methods. Likewise, considering administrative rather than engineering services, Albania or Bulgaria might benefit from the use of relatively developed Soviet accounting and statistical services, while the advice which the Soviet Union might give to a satellite government wishing to increase the efficiency of its police force might be considered as less of a social blessing.

Capital movements and transfers

Capital movements and transfers within the Soviet bloc arise in connection with reparations, with the operations of Soviet economic interests in the satellites, and with international loans.

Reparations have been paid the USSR by East Germany, Rumania and Hungary under the terms of the armistice and peace treaties. Hungarian reparations were completed in January 1953; East German reparations will end at the end of 1953. No announcement has been made concerning the end of Rumanian reparations (which were to have been completed, under the terms of the peace treaty of 1947, at the end of 1952), but it is likely that they will probably be completed in the next year or so. Under somewhat similar conditions, Poland and Bulgaria have been paying the USSR from current output to compensate the USSR for its claims on former German assets located within the territories of these countries.

Reparations payments are made in kind, and are credited to special accounts. They amount to a planned export surplus by the paying country. During the postwar period, the USSR at various times has either reduced total outstanding reparations obligations, or has permitted changes in scheduled payments. Of these instances, the most notable was the termination of East German reparations, announced in August 1953. Such changes would presumably affect the size of the export surplus of the particular satellite with the USSR, and therefore would affect the internal balance of the satellite economy, and in particular its budget position.

The terms of the reparations clauses in the peace treaties are similar to those in ordinary bloc trade, in that the reparations are valued at a set of prices differing from the internal prices in existence either in the USSR or the satellite. The peace treaties provided for payments equal to stipulated values of goods in 1938 dollar prices, subject to various corrective factors which are presumably the object of Soviet manipulation. The "1938 dollar" of the peace treaties may be considered as an equivalent to the clearing ruble in bilateral trade agreements, and it is probable that after rubles came to be used as the clearing unit of account the reparations accounts were similarly revalued.

The reparations accounts provide the USSR with an important means of controlling satellite economies, since the USSR can control their commodity composition as well as the clearing unit prices at which they are valued. In this way it can influence the channels of development of the individual countries. Finland, although not a Soviet bloc country, is an example of the consequences of Soviet control in this respect, since the Finns have developed a large machinery industry in the postwar period solely for the purpose of meeting Soviet reparations obligations. Since this industry is not competitive in world markets, it can exist only on the basis of Soviet orders. The rapid postwar development of the Czechoslovak and East German machinery industries are probably analogous to the Finnish case.

Soviet property in the satellites consists of joint corporations owned by the USSR and the satellite government. They consisted originally of German assets in Hungary, Rumania and Bulgaria which the USSR claimed under the armistice and peace terms. These corporations are in fact dominated by the USSR, for although their boards consist of equal numbers of Soviet and satellite citizens, the general manager, who makes all operational decisions, is a Soviet citizen. ^{1/} In Rumania, virtually all of the oil, metal and machinery industries are operated by joint corporations; in Hungary oil, aluminum and other industries are similarly organized. In East Germany, 132 so-called "SAG" corporations were set up by the USSR in 1947. These differ from the joint corporations in that they are apparently entirely Soviet property, but their functions are basically similar to the joint corporations.

The corporations are important instruments of Soviet control in that they constitute important elements in the economic activity of the satellites which are subject to direct Soviet decisions and policy; to this extent they limit directly the ability of the satellite governments to make independent economic plans. The output of the corporations, insofar as it is exported, enters into the clearing agreements on the same basis as the output of domestic satellite enterprises. The portion of the profits accruing to the USSR, however, may be transferred to the USSR, presumably by providing for an export surplus by the satellite in its bilateral accounts with the USSR.

Credit transactions - Several types of credit arrangements exist within the bloc. Under the trade agreements, swing credits are set up by the central banks of the various countries, and an automatic credit is granted within limits established in the agreement. As noted above, these credits are supposed to be repaid within the calendar year, since current payments are supposed to balance bilaterally.

A second type of credit is a short-term ~~inter-governmental~~ loan. These reflect a failure to balance trade within a given calendar year, as provided in the trade agreements, and are apparently supposed to be liquidated within a year or two. The third type is a medium-term inter-

^{1/} See, for example, Hungary: a Case Study of Soviet Economic Imperialism, by Howard J. Hilton, Jr., State Department Bulletin, August 27, 1951.

governmental loan (5 to 10 years) for the purpose of purchasing specified units of capital equipment. The most publicized loans of this type were made by the USSR to Poland (in 1948) and to China (in 1950) for financing development projects. Czechoslovakia is the only country other than the USSR to have made such loans. All of the satellites except Hungary 1/ have borrowed from the USSR on either a short-or medium-term basis. The loans are ordinarily repayable in commodities and not in gold or foreign exchange. 2/ They thus fit in with the presumption that there is generally no transferability of currency within the bloc. In the case of the long-term loans, it is sometimes specified in the agreement that at least part of the output of the completed plants will be exported to the USSR until repayment has been completed.

Financial controls - The principal financial control which the USSR can exert over the satellites (apart from its control over its loans to them) is its ability to control the terms of trade by manipulating the ruble prices in the bilateral agreements. By raising the ruble prices of its exports, it can reduce the amount of goods which it delivers to any satellite relative to the amount it receives from them. The satellites are hardly in a position to retaliate. In fact, two of the victims in satellite "purge trials" (Kostov in Bulgaria and Loebel in Czechoslovakia) were convicted in part because they had attempted to bargain with the USSR on prices in the bilateral agreements.

The exchange rate has only a minor role in economic relations among bloc members. Only the expenses of official missions are directly affected by changes in the exchange rate. The function of the exchange rate in the Soviet-type economy, as has been pointed out in an earlier paper in this Review, 3/ is largely to determine the internal monetary consequences of a particular trade program and not to affect the trade program itself. Consequently, it may be supposed that Soviet interest in the exchange rates of the satellites is marginal.

Conclusions

The foregoing discussion has emphasized the bilateral nature of relations among members of the bloc, which is associated with the absence of a system of uniform prices in trade. Given this lack of a unified price system, there must be non-transferability of currency if goods are to move in channels desired by the bloc authorities. Capital movements, where they exist, are narrowly identified with particular movements of specified lists of goods. Given the absence of an international market, it is not possible to determine from a study of trading methods how a country in the Soviet bloc decides how much it wants to import or how much it can export. Even on the extreme assumption that all trade is planned by the USSR, it is not possible to determine how the USSR

1/ Cheklin, and Korolenko, op. cit.

2/ Shkarenkov, op. cit.

3/ The Exchange Rate in Soviet-Type Economies, March 24, 1953.

decides what or how many goods should move between any two countries. Prices are fixed by administrative procedure, and apparently have no direct connection with the amount of trade moving between any pair of countries. It follows, then, that if there is any explanation of the process whereby a country's "need" to import or export is to be determined, it must be related to the corresponding internal planning problem: how much of any particular commodity does a country "need"? Analysis of international trade, like analysis of the internal economy of a Soviet-type country must be based upon the operation of a planning system independent of a market mechanism.

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