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Hard Currency Indebtedness of the Developed Socialist Countries

by Paul-Günther Schmidt, Mainz*

In recent years the problems of the indebtedness of the communist countries have been driven somewhat into the background by the high foreign indebtedness of many developing countries and the attention attracted by the balance of payments crises in Brazil and Mexico. Yet there are many indications that the need for the socialist debtor nations to adjust their balance of payments policy has not lessened but, to a large extent, simply been deferred. It is therefore not unlikely that the 1980s will witness a new need to solve the problems of those nations and their creditors in the West.

The experts' policy discussions in the western nations have as yet hardly progressed beyond the first stock-taking of the developments which have occurred in the currency relationships between the systems. In particular, the investigation into the causes of the recent debt crises of the communist countries and the strategies adopted by the socialist governments to overcome them is still more or less inadequate. This paper attempts to identify some of the strategic factors leading to the debt crisis of the CMEA countries, to make a critical assessment of their recent energetic endeavours in the field of foreign trade policy to reduce the debts and, against that background, to show the prospects and problems involved in organizing credit relations between the systems in the near future.

Critically High Hard Currency Debts

At the end of 1983 the gross hard currency debts of all the East European CMEA countries totalled approximately US \$ 93 billion. The Eastern bloc's liabilities were therefore scarcely greater than those of Mexico alone, whose foreign debts at that date were US \$ 85 billion, and even less than those of Brazil, whose foreign debts at the end of 1983 amounted to almost US \$ 97 billion. Nevertheless, the "disruptive potential" which could result from a new balance of payments crisis in some East European countries or even in Poland alone is large enough to threaten destabilization of the international financial markets: as the data and indicators for mid-1984 presented in Tables 1 and 2

reveal, the hard currency debts of the socialist countries involve special risks and dangers.

The gross debts of Poland, Hungary and the GDR are particularly high at more than US \$ 680 per head of population. They are well above the average per capita indebtedness of the large majority of the developing countries: only Israel, Gabon, Venezuela, Argentina, Mexico, Algeria and South Korea show higher figures.¹ Moreover, the statistics for the CMEA's liabilities are incomplete because most East European countries are also in debt to the Soviet Union, other socialist nations and the OPEC states. Poland in particular owed the Soviet Union some 4 billion roubles at the end of 1984, mostly clearing debts, and at least another billion roubles to other socialist countries, especially the GDR and Bulgaria.² On the same date the GDR itself owed the Soviet Union alone a net clearing debt of more than 4 billion roubles.³

The assessment of the socialist countries' ability to service their capital is hardly more favourable. Taking exports to the non-socialist nations as a basis of comparison – these provide the only available income for servicing the hard currency debts, apart from

¹ Cf. Herbert Wilkens: The Debt Burden of Developing Countries, in: INTERECONOMICS, No. 2, 1983, pp. 55-59.

² Information received and estimates prepared by the author.

³ Cf. Paul-Günther Schmidt: Internationale Währungspolitik im sozialistischen Staat. Theoretische Grundlegung und empirische Überprüfung am Beispiel der DDR, Stuttgart and New York 1985, pp. 251 f. In the first three quarters of 1984 the GDR achieved an export surplus with the Soviet Union of 190 million roubles for the first time in 11 years. Cf. Moscow Narodny Bank: Press Bulletin No. 971 (16 January 1985), p. 16.

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earnings from services which are almost impossible to estimate – the present level of indebtedness seems to have remained at a critical level. The ratio between debts and exports has indeed improved since the last peak in the balance of payments crisis in 1981 because most socialist countries have reduced their gross hard currency debts and increased their exports to the West and the fall in interest rates since 1981 has considerably eased the burden on the balance of payments of the communist debtor countries; yet the present proportion of export earnings which has to be employed solely to pay the interest and redemption instalments on western credits is still disquietingly large, especially for Poland, Hungary and the GDR. In particular, Poland's balance of payments is likely to deteriorate dramatically when the present rescheduling agreements expire in the latter 1980s and the repayment rates are again dramatically increased, especially since, even now, Poland finds difficulty in meeting its debt servicing payments, which are considerably reduced for the time being, from its current foreign exchange earnings.

The extremely short-term bank loans of most CMEA countries could prove particularly problematic in future if new balance of payments problems arise. The average term of the bank credits taken out by those countries is considerably shorter than the terms of those taken out by most developing countries. More than 37 % of the Eastern bloc's liabilities to western banks falls due within one year or is extended by the roll-over system. The potential for conflict inherent in this repayment structure has, in particular, been revealed by the balance of payments crises in 1980/81 when the US and West European and subsequently the Japanese and Arab banks suddenly withdrew from Euro-credit transactions with the communist debtor nations. Consequently, the western banks' withdrawal from credit transactions with the Eastern bloc as a result of Poland's and Rumania's payment difficulties almost placed other CMEA countries in a hopeless position in view of their mainly short-term debts.⁴

The continued critical level of some CMEA countries' hard currency debts indicates an urgent need to find a way of overcoming the debt problems. But any blueprint

for an effective therapy requires a fundamentally correct diagnosis of the problem and therefore we must, first of all, give at least a brief history of how the hard currency debts of the Eastern bloc have developed and identify their essential causes.

As is shown by the estimates (Table 3) of the growth in the socialist countries' foreign debts, at the beginning of the 1970s the communist bloc's indebtedness to non-socialist nations was more or less negligible. Up to the end of the 1960s the socialist countries had taken up only relatively small western credits, essentially to modernize their economies and make their export industries competitive on international markets with the help of imports of western technology and capital goods.⁵ It was not until the 1970s that an unprecedented increase in hard currency borrowing took place, which did not, however, cause western creditors any serious alarm as to the Eastern bloc's ability to pay until shortly before the "Polish crisis".⁶ In particular, the "umbrella theory" encouraged the belief that the Soviet Union would step in if another communist country encountered payment difficulties and induced the western banks to supply growing volumes of unconditional credits to those countries such as Poland, Rumania, Hungary and the GDR which were no longer financially sound and creditworthy. Thus, according to the estimates given in Table 3, the CMEA countries' gross debts rose within a mere ten years from just on US \$ 9 billion at the end of 1971 to around US \$ 95 billion at the end of 1981, the peak of the debt crisis.

A differential analysis of the reasons for this really dramatic increase in the CMEA countries' hard currency debts in the 1970s shows that many causes underlie the present problem. Firstly, it has external causes in the form of the changes and increased instability in international economic and monetary relations, which have largely remained beyond the scope of any controls, prognoses and short-term measures applied by the socialist planners of the balance of payments. Secondly, however, there are internal causes which result from developments and decisions in the CMEA countries themselves and, to that extent, are "homemade". The impact of any particular factor upon the individual socialist countries does indeed vary from country to country and, in particular, the manner and extent to which the Soviet Union on the one hand and

⁴ This is true at least for the GDR which was able to cope with at least part of the balance of payments crisis and the western banks' extensive embargo on credits with the help of Soviet clearing credits of approximately 1.7 billion roubles in 1980-82 alone. Cf. Paul-Günther Schmidt, *op. cit.*, especially pp. 278 f.

⁵ Cf. in particular Jozef Wilczyński: *Comparative Monetary Economics. Capitalist and Socialist Monetary Systems and their Interrelations in the Changing International Scene*, London and Basingstoke 1978; Adam Zwass: *Zur Problematik der Währungsbeziehungen zwischen Ost und West*, Vienna and New York 1974.

⁶ In particular, western banking circles assumed virtually a complete elimination of the payment risks for credits to the Eastern bloc. The socialist countries tried to strengthen this impression. Cf., for example, Siegfried Wenger: *Comments on Fekete*, in: Christopher T. Saunders (ed.): *Money and Finance in East and West*, Vienna and New York 1978, pp. 49-54, here p. 53. Only a few western experts gave increasing warnings of the risks and possible payment problems.

the smaller CMEA countries on the other hand are affected differs considerably. Quite a number of the causes of increased foreign borrowing do, however, affect this community of nations as a whole, must to varying degrees be considered typical of the problem of foreign trade relations between the systems and therefore justify a general diagnosis.

Problems caused by External Factors

One of the main problems of adjustment caused by external factors in the 1970s is the shifts in world market prices for raw materials and finished products. Essentially, only the Soviet Union has benefitted from

this trend because of the high proportion of raw materials in its own exports while the other CMEA countries have had to tolerate a downward trend in their terms of trade. Consequently, an especially large and unplanned increase occurred in the foreign exchange spent on imports by those countries such as the GDR, Rumania and Hungary which are particularly dependent upon imports of raw materials and agricultural products from non-socialist nations. The strains on the balance of trade caused by these deteriorations in the terms of trade – especially in 1971/73 and 1979/80 – could not in the short term be adequately funded by increased exports and, as a result, the foreign borrowing of the affected socialist countries rocketed during those years.

Table 1
Gross and Net Hard Currency Debts of the USSR and Eastern Europe to the West in mid-1984
(US \$ billion)

Country	Bank Credits	Export Credits Guaranteed by the State	IMF and World Bank	Others ¹	Total	Receivables	Net Indebtedness
Bulgaria	1.76	0.47	—	0.30	2.53	1.27	1.26
Czechoslovakia	2.77	0.69	—	0.40	3.86	1.24	2.62
GDR ²	8.62	1.37	—	1.85	11.84	4.55	7.29
Hungary	6.60	0.25	0.95	0.50	8.30	0.92	7.38
Poland	10.11	3.22	—	11.70	25.00	1.37	23.63
Rumania	4.26	0.74	2.98	1.70	9.68	0.68	9.00
USSR ³	16.87	9.94	—	2.00	28.81	11.53	17.28
Total	50.99	16.68	3.93	18.45	90.02	21.56	68.46

¹ Mainly government credits and placing of promissory notes. ² Including receivables and liabilities deriving from inter-German transactions but excluding receivables from West German and West Berlin banks. ³ Including receivables and liabilities of the CMEA banks.
Sources: Reports of the BIS, Basle, the OECD, Paris, the International Monetary Fund, Washington, the International Bank for Reconstruction and Development, Washington, the Federal Economic Minister, Bonn, the Deutsche Bundesbank, Frankfurt/Main, and the author's estimates.

Table 2
Indicators of the Debt-servicing Capacity of the USSR and Eastern Europe

Country	Gross Debts per Capita mid-1984 in US \$ ¹	Interest Ratio (%) ²	Debt-service Ratio (%) ³	Debts/Export Ratio (%) ⁴	Share of bank debts with terms of less than 1 year (%) ⁵
Bulgaria	280	10	47	84	56.4
Czechoslovakia	250	10	34	92	34.2
GDR ⁶	710	13	58	127	42.9
Hungary	780	16	85	167	44.9
Poland	680	50	80	500	21.3
Rumania	430	14	36	155	23.6
USSR ⁷	110	6	29	71	42.0
Total	230	11	42	123	37.1

¹ Calculation based on mid-1983 population. ² 1984 interest payments (net) as % of exports to non-socialist industrialized and developing countries in 1983. ³ Interest payments (net) and credit repayments in 1984 as % of exports to non-socialist industrialized and developing countries in 1983. ⁴ Gross hard currency debts to the West in mid-1984 as % of exports to non-socialist industrialized and developing countries in 1983. ⁵ Half-yearly reports of the BIS, Basle, on the distribution of maturities of international bank loans, including revolving credits – author's calculations. ⁶ Including inter-German receivables, liabilities, deliveries and purchases. ⁷ Including receivables and liabilities of the CMEA banks.
Sources: Exports to non-socialist industrialized and developing countries deriving from information provided by the Statistisches Bundesamt, Wiesbaden; distribution of maturities of bank debts from the reports of the BIS, Basle; population data from the United Nations: Monthly Bulletin of Statistics, October 1984, Vol. XXXVIII, No. 10; interest and capital servicing and gross hard-currency debts from author's calculations.

It was not until the late 1970s that some CMEA countries made greater efforts to increase their exports in order to reduce their growing short-term hard currency debts. Those efforts were, however, scarcely effective in lessening the strains on the foreign exchange account. This was due not so much to the range of exports of the centrally planned economies, which was always narrow when measured against world market standards, as to the pronounced weakness in the growth of the western industrialized nations. Thus, the CMEA countries were able to sell their exported products on western markets only at comparatively low prices, which merely intensified the existing deteriorating trend in the terms of trade of those socialist countries which are short of raw materials. Consequently, despite a moderate improvement in the volume of exports, foreign exchange earnings could not be increased to the level required for financing increasingly expensive imports. The failure to achieve the plan targets for foreign exchange earnings from exports to non-socialist nations – a failure caused by the recession – therefore resulted in an unplanned, increasing trend in the trade deficit.

Yet it is in fact the instability on the international financial and foreign exchange markets which has also had a detrimental effect upon the socialist countries' balance of payments. The fall in the US dollar's

exchange rate which persisted until 1979 inflated the nominal volume of the hard currency debts because between 30 % and 50 % of CMEA liabilities are in currencies other than the US dollar.⁷ Not only was this exchange rate effect harmful as regards the appearance of the figures; it also damaged the balance of payments strategy of the CMEA countries because the large majority of their exports to non-socialist nations are paid for in US dollars. So, on the one hand, the slump in the dollar's exchange rate devalued the socialist countries' export earnings while, on the other hand, it increased the equivalent of their hard currency debts and made repayments more difficult.

The market rise in interest rates as a result of the new US monetary policy introduced in October 1979 did, however, cause a really dramatic exacerbation of the

⁷ The precise proportion of the non-dollar debts of the CMEA countries is not known. Although 80-90 % of the bank debts are in US \$, by far the largest part of the export credits guaranteed by the state and the other western claims are in German marks, French francs and Swiss francs. So the effects of the exchange rate are most severely felt by the CMEA countries such as Poland, Rumania, the GDR and the Soviet Union which show a comparatively high proportion of non-bank debts (see Table 1). For example, at the end of 1978 Poland's non-US \$ debts were said to be 55 % of its total debts. Cf. Donald W. Green: How the dollar's fall distorted the picture of Comecon debt, in: Euromoney, June 1980, pp. 47-53, here p. 50. Estimates of the exchange-rate effect upon the GDR are available for quite a long period: of the observable rise in gross hard currency indebtedness of US \$ 9.09 billion between the end of 1970 and the end of 1979, US \$ 1.06 billion alone resulted from this exchange-rate effect because of the continual devaluation of the US \$. Cf. Paul-Günther Schmidt, op. cit., pp. 306-308.

Table 3
Gross and Net Hard Currency Debts of the USSR and Eastern Europe to the West 1971-1984
(US \$ billion)

Country	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984 ^a
Gross Debts														
Bulgaria	0.8	1.1	1.1	1.8	2.8	3.4	3.9	4.5	4.5	4.1	3.5	3.2	2.8	2.5
Czechoslovakia	0.5	0.6	0.8	1.1	1.2	1.9	2.7	3.3	4.5	5.2	4.9	4.3	4.1	3.9
GDR ¹	1.8	2.1	2.7	3.8	5.1	6.7	8.3	10.4	12.7	14.2	14.8	13.0	12.8	11.8
Hungary	1.1	1.4	1.5	2.2	3.2	4.2	5.8	7.7	9.1	9.3	9.1	9.0	8.9	8.3
Poland	1.2	1.6	2.9	4.8	8.2	11.8	14.3	18.8	22.5	23.0	23.2	23.9	24.3	25.0
Rumania	1.3	1.3	1.7	2.8	3.0	3.0	3.8	5.7	8.0	10.0	10.2	10.1	9.7	9.7
USSR ²	2.3	3.8	5.4	7.2	14.0	19.1	20.8	23.0	23.9	25.3	29.3	29.4	30.2	28.8
Total	8.9	11.9	16.0	23.6	37.4	50.1	59.5	73.5	85.2	91.0	95.0	92.9	92.8	90.0
Net Debts														
Bulgaria	0.7	0.9	0.9	1.4	2.4	2.9	3.3	3.9	3.8	3.2	2.7	2.1	1.6	1.3
Czechoslovakia	0.2	0.2	0.3	0.7	0.8	1.5	2.2	2.7	3.4	3.9	3.8	3.6	3.2	2.6
GDR ¹	1.3	1.4	2.2	3.0	4.1	5.6	7.1	8.7	10.2	11.4	12.0	10.6	8.9	7.3
Hungary	0.9	1.1	1.2	1.6	2.3	2.9	4.6	6.8	7.8	7.8	8.2	8.2	7.6	7.4
Poland	0.8	1.2	2.3	4.2	7.6	10.9	13.8	17.9	21.3	22.3	22.4	22.8	23.0	23.6
Rumania	1.2	1.2	1.5	2.6	2.6	2.7	3.5	5.5	7.7	9.7	9.8	9.7	9.2	9.0
USSR ²	1.0	1.7	2.6	3.3	10.5	13.9	15.8	16.2	14.1	15.5	19.7	17.9	19.1	17.3
Total	6.0	7.7	10.9	16.8	30.2	40.4	50.3	61.7	68.2	73.8	78.6	74.9	72.7	68.5

^a Mid-year. ¹ Including receivables and liabilities deriving from inter-German transactions. ² Including receivables and liabilities of the CMEA banks. Sources: Author's calculations; for the data basis and methodology see Paul-Günther Schmidt: Internationale Währungspolitik im sozialistischen Staat, op. cit., Appendix A; 1971-1977 with particular attention to the CIA's estimates: National Foreign Assessment Center: Estimating Soviet and East European Hard Currency Debt. A Research Paper, Washington D.C., 1980.

balance of payments problems. The extent to which the communist countries had been rendered vulnerable by the debts which they had accumulated up till then did not become apparent until these conditions arose. Until 1977 interest rates had been at a temptingly low level, averaging 6 % p.a. for Eurodollars (London), and had induced the CMEA countries to contract more and more loans. Interest rates climbed constantly higher until 1981, however, and worldwide the Eurodollar rate rose to around 19 % p.a. in the summer of 1981. These dramatic and scarcely foreseeable increases in interest rates very probably initiated the balance of payments crises in the socialist debtor countries. In view of the degree of indebtedness which had already been reached, they caused considerable additional and unplanned strains upon the balance of payments which were beyond the means of Poland and Rumania and almost beyond those of the GDR and Bulgaria, especially since, in those circumstances, the western banks were increasingly cautious about granting new credits.⁸

It is thus impossible entirely to reject the socialist countries' argument that the disturbances and instability deriving from the western market economies themselves have played a crucial role in the socialist countries' present balance of payments problems. Changes in the international terms of trade, the weak growth rates of the non-socialist industrialized nations, the devaluation of the US dollar and the really dramatic increases in interest rates on the international money markets during the 1970s did indeed saddle the planned economies with considerable balance of payments adjustment problems. The extent and unpredictability of those disturbances were particularly damaging to economic and credit relations between the systems.

Internal Causes of Indebtedness

The socialist countries' balance of payments problems in the past were not entirely "imported", however, but were to a large extent "home-made". The internal factors were, in particular, the failure of the central state balance-of-payments planning when the general conditions in the world economy were changing, the over-long adherence to the already pursued funding strategy, and, to some extent, the easing of import controls as part of over-ambitious national development plans.

The changes in the general conditions of the world economy in the 1970s revealed that central state planning of foreign trade and foreign exchange is much too rigid and inflexible so that it cannot react effectively to short-term changes in plan data. As the experience of

the GDR and Poland in particular has shown,⁹ state planning in the foreign exchange sector was a downright failure in the face of the complexity and unpredictability of the data relevant to the balance of payments. Applying standardized routines oriented towards the past and employing naive extrapolations of trends, the planning bureaucracy always set its forecasts too low when predicting the foreign prices payable for imports and the interest payable on hard currency debts. The balance of payments which was *ex ante* planned to be in equilibrium on the basis of these (over-optimistic) forecasts regularly showed considerable deficits *ex post*, while in the short term the volumes of imports and exports remained more or less unchanged. Under these circumstances there was no longer any question of a planned development of the balance of payments. A further obstacle in the 1970s was the permanent and more pronounced change in the general situation in the world economy – apart from some short-lasting interruptions – to the disadvantage of the CMEA countries. As a result, the forecasts and plans relating to the balance of payments became increasingly out of step with the actual conditions of foreign trade, which were constantly deteriorating.

Particularly in Poland¹⁰ but also in Hungary¹¹ the sweeping relaxation of import quotas and the conversion to a parametric form of import control also generated a virtually uncontrollable import pull. As in the GDR in 1968 and 1969, the decentralization of the decision-making process resulted in particular in a marked upswing in investment activity and thus a disproportionate increase in imports of machinery, equipment, spare parts and raw materials while the decentralized decision-making processes did not take sufficient account of the cost-effectiveness of those investments and imports for the individual concerns and for the economy as a whole. This resulted not only in an unplanned and almost uncontrollable short-term deficit in the balance of trade with the West but also an increasing burden upon the balance of payments in subsequent years because of the systematically under-

⁸ Cf. *ibid.*, pp. 273 ff. and 305 ff.

⁹ Cf. *ibid.*, pp. 130 ff.

¹⁰ Cf., in particular, Alfred Schüller: Die Verschuldungskrise Polens als Ordnungsproblem, in: *Ordo*, Vol. 33, 1982, pp. 3-37; Ota Sik: Die Polnische Krise: Innere und äußere wirtschaftliche Zusammenhänge, in: *Außenwirtschaft*, Vol. 37, 1982, pp. 15-30; Zbigniew M. Fallénbuch: The Impact of External Economic Disturbances on Poland since 1971, in: Egon Neuberger, Laura d'Andrea Tyson (eds.): *The Impact of International Economic Disturbances on the Soviet Union and Eastern Europe. Transmission and Response*, New York etc. 1980, pp. 280-304.

¹¹ Cf., in particular, Alan A. Brown, Marton Tardos: *Transmission and Responses to External Economic Disturbances: Hungary*, in: Egon Neuberger, Laura d'Andrea Tyson (eds.), *op. cit.*, pp. 250-276.

estimated consequential investments and imports and inadequate direction of imports towards the production sectors which were most capable of exporting internationally competitive products. The inconsistencies of the partially decentralized system of incentives, controls and direction seem in this way to have made a vital contribution towards the balance of payments problems of Poland and Hungary.

Yet the main cause of the increase in the CMEA countries' hard currency debts which continued almost unchecked until 1981 must be seen to lie in the fact that the governments of those countries delayed over-long before they were prepared or compelled to switch from a strategy of funding the balance of payments to one of adjusting the balance of payments. The strategy which was adopted by the socialist countries in 1971 in close coordination with the Soviet party leadership,¹² namely that of accelerating national economic development by means of increased loans from the West, should have been discontinued in the mid-1970s in the face of the rise in raw materials prices and the 1973/74 oil crisis. Instead, the socialist governments postponed the decision from year to year and tried to cover their ambitious national development plans on the balance of payments side by means of even larger western loans. Up to the mid-1970s the rises in raw materials prices were still considered to be short-term and, in principle, reversible. The low interest rates, the liquidity of the Eurocredit market and the intense competition between western suppliers, banks and governments to obtain a share of the expanding market with the Eastern bloc meant that the strategy of funding fundamental disequilibria in the balance of payments by further hard currency loans was extremely attractive to the socialist planners.

Consequently, foreign credits were increasingly employed not only for importing technology from the West but, more and more, for funding expensive imports of crude oil and industrial metals. The Soviet Union and the GDR in particular also used suppliers' credits and unconditional Eurocredits to pay for a considerable proportion of cereal and food imports from the USA and Canada which were needed because of the inefficiency

of their own collectivized agriculture. Much too late, namely under the influence of the Polish crisis and the western banks' withdrawal from credit operations with the Eastern bloc, the East European governments abruptly switched their balance of payments strategy in a "zigzag course" which is so typical of communist governments.¹³ Since then, most CMEA countries have adopted an austerity policy as a means of reducing their indebtedness to the western nations – completely contrasting with the course followed unswervingly until 1981. By means of a severe cut in imports and increased efforts to export they aim to achieve balance of payments surpluses which permit repayment of the hard currency debts and are intended to make the socialist countries more resilient to the instability and disturbances caused by the western nations.

Prospects and Risks

The socialist countries have in fact managed to reduce their hard currency indebtedness considerably since 1981 but it is quite certain that some of the funding problems of at least some countries have merely been postponed and are by no means solved. Hungary and Rumania, in particular, have had to call in the help of the International Monetary Fund and Rumania has also had to appeal to the World Bank. Rumania and Poland have passed part of the financial burden on to western creditors and the GDR, Poland and Bulgaria have had to use large credits from the USSR for squaring their balance of payments in order to achieve a sufficient increase in their exports to the West, at least in the short term. In recent years, in fact, the GDR has increasingly gone over to raising loans in developing countries for supplies of raw materials; at the same time it has drastically reduced its own allocation of credits to Third World countries.¹⁴ Almost every socialist country is now in considerable debt to some OPEC nations and has cosmetically adjusted the pattern of published liabilities by restructuring its foreign liabilities.

To that extent, the CMEA countries have again in recent years simply used loans to finance part of the necessary balance of payments adjustment stemming from the seventies, and have thus only once again deferred it to a future date. Moreover, a considerable part of the statistically demonstrable reduction of liabilities to western nations since 1981 is merely a reflection of the strong upward movement of the US dollar on the foreign exchange markets and thus has not been a result of the debtor countries' own efforts. Approximately half of the observable drop in the Eastern bloc's gross hard currency debts can probably be attributed solely to these exchange rate effects.¹⁵

¹² Cf. Paul-Günther Schmidt, op. cit., pp. 265 f.

¹³ For reasons and definition see *ibid.*, pp. 38 ff.

¹⁴ Cf. *ibid.*, pp. 298 and 410 f.

¹⁵ Cf. United Nations: Economic Survey of Europe in 1983, New York 1984, pp. 207; United Nations: Economic Survey of Europe in 1982, New York 1983, p. 238. Estimates are available for the GDR which show that of the US \$ 1.79 billion reduction in hard currency debts between the end of 1981 and the end of 1983, US \$ 0.77 billion alone – 43 % of the nominal reduction of debt – must be attributed to the strong upward movement of the US \$. Cf. Paul-Günther Schmidt, op. cit., p. 308.

Doubts also arise with regard to the medium-term effectiveness of the balance of payments strategies adopted by some socialist countries. Rumania, Hungary, the GDR and Czechoslovakia in particular have given priority to a reduction of indebtedness to the West and are trying to produce sufficient balance of trade surpluses by curbing imports and increasing exports. In the long run, however, the present, extremely restrictive import quotas cannot be maintained. Not only do they jeopardize the countries' achievement of their ambitious plan targets; they also prevent the continuation of earlier national investment programmes, damage the competitiveness of their own export industries in the medium term and, finally, are a danger to the countries' political stability if domestic supplies deteriorate. The strategy of import curbs which has been adopted cannot therefore be maintained in the medium term. Consequently, the socialist countries will find it difficult to survive without further increases in their exports to western nations. This arouses the problem, however, that Poland's and the GDR's extreme efforts to export are already having considerable adverse effects upon the population's supplies and causing discontent and in the longer term could result in further political destabilization. At least in this regard the communist leaders' room for manoeuvre as regards exports to the West seems to be seriously restricted.

Dependence on International Factors

In the meantime, the future development of the balance of payments situation, and thus the probability of new balance of payments crises in the CMEA countries, depends to a large extent upon international factors which are largely outside the control and influence of the socialist countries themselves. The most important of these strategical determinants are the international terms of trade, especially the relationship between raw materials prices and the prices for finished products, and also the movement in the US dollar exchange rate, future changes in the interest rates on the international money markets and the general economic trend in the non-socialist industrialized nations. If a strong rise again occurs in raw materials prices and interest rates during the coming years and the US dollar again undergoes a marked devaluation on the free exchange markets after having soared upwards in recent years, the debt problems of the East European planned economies would again become extremely serious within a very short time. In such an event the countries most affected by any increases in interest rates would be those such as Poland, Rumania, Hungary and the GDR, which have to cope with heavy interest charges compared to their export potential. The

volume of their remaining hard currency indebtedness has certainly made those countries vulnerable and involves considerable risks for the balance of payments in the event of new increases in interest rates. In addition, any rises in raw materials prices would particularly hit those countries such as Czechoslovakia, Hungary and the GDR which rely heavily upon imports of raw materials and agricultural goods.

The communist debtor nations are, however, at present not only threatened by the risks and instability which may be generated by international commodity and money markets. In the medium term, developments and instability within the Eastern bloc also endanger the equilibrium of the CMEA countries' balance of payments with western nations. The room for manoeuvre available to the East European planned economies for expanding their exports to the West and limiting their hard currency borrowing depends to a critical extent upon the stance adopted by the Soviet Union. Firstly, most of the smaller countries are heavily in debt to the USSR and so, in the last analysis, the balance of payments strategy of Poland and the GDR is determined by whether the Soviet party leadership insists that the credits granted since 1975 are repaid as scheduled in the latter half of the 1980s. Secondly, all the socialist countries are subject to considerable uncertainty as to whether in the next few years Poland will again need help for its balance of payments from the countries forming the "socialist fraternity". Thirdly, the GDR, Poland and other East European countries are facing increasing risks and additional balance of payments burdens as a result of the Soviet strategy introduced in 1981, whereby the volume of raw materials exports in the rouble area is being reduced and payments in hard currency are required for supplies in excess of those internal quotas.¹⁶ Fourthly – but of equal importance – for the GDR in particular a great deal depends upon the results of the US/USSR disarmament negotiations because no other country in the Warsaw Pact is so reliant upon arms imports and is therefore subject to balance of payments restrictions caused by military policy.¹⁷

Consequences and Proposals for Reform

Any realistic appraisal of the instability and risks which can be expected in the next few years must allow for new debt problems for some CMEA countries.

¹⁶ According to reliable information received by the author.

¹⁷ Between 1970 and 1982 alone the GDR's accumulated deficit from the arms trade was almost US \$ 4.0 billion or approximately 42 % of the accumulated deficit for its entire foreign trade, while the Soviet Union, Czechoslovakia, Poland and Rumania achieved considerable surpluses from arms exports. Cf. Paul-Günther Schmidt, *op. cit.*, pp. 88 ff.

Poland especially could be in a precarious position, particularly in the event of a strong rise in interest rates on the international money markets. But Rumania, Hungary and the GDR also seem to be still at risk if raw materials prices again increase strongly in the next few years. A collapse of the US dollar on the foreign exchange markets – which is quite possible – or even a renewed weakening of the expansive forces in the industrialized market economies would also in the short term intensify the balance of payments problems of the communist debtor countries. Yet even if general conditions in the world economy remain more or less unchanged, developments within the Eastern bloc and on a national level will probably cause renewed pressure on the balance of payments; once again, this applies particularly to Poland.

Although the prospects presented in this paper may seem pessimistic, some conceivable, practical and realistic strategies for remedying the situation do exist if the identified problems and risks are taken into account and allowance made for the obviously limited flexibility and problem-solving capacity of the centrally planned economies of Eastern Europe. Any such strategy for overcoming the debt problems of the socialist countries would in particular have to include five components: a renunciation of the import-curbing policy, further increases in exports, new long-term hard currency credits, the active assistance of the Soviet Union in consolidating the balances of payments of the East European CMEA countries and, finally, fundamental economic reforms throughout the Eastern bloc.

First of all, the socialist countries must modify their strict policy for curbing imports. Although a more economical employment of foreign exchange is just as welcome as an examination of the expediency of the import-intensive capital projects which have been planned or initiated, in practice the import-restricting policy not only results in a somewhat arbitrary discrimination against certain projects for purely bureaucratic reasons, but also increasingly threatens the functional capacity of the socialist countries' economic system and the stability of their political system and has a considerable detrimental effect upon international economic cooperation.

Secondly, in the medium term only a strategy which is more intensively designed for increasing foreign exchange earnings from exports can come into question. Yet, since the potential for increasing exports is limited, the highly-indebted CMEA countries will, thirdly, in the next few years need further new hard currency credits with the maximum possible terms. In

the interest of the stability of the western monetary system western banks, governments and supra-national organizations should not a priori reject the applications for such credits. It will be necessary to ensure, however, that these new credits improve the maturity structure of the CMEA's liabilities, help to increase the debtor countries' ability to export and are not wasted as they have been in the past.

Fourthly, as the main beneficiary of the increases in raw materials prices in the 1970s, the Soviet Union can and must be expected to assist in consolidating the foreign debts of the East European CMEA countries. The help which the Soviet Union has so far provided for the balances of payments of Poland, Bulgaria and the GDR is quite out of proportion to the West's contributions. In addition, the USSR left to western creditors the main burden of funding the balances of payments and regulating the debts during the peak of the recent balance of payments crises. If the balance of payments problems of some CMEA countries again become more serious in the next few years, the supra-national organizations and western banks, suppliers and governments cannot be expected to cope alone with the funding problems while the Soviet Union insists upon prompt repayment of earlier loans.

Fifthly – but by no means least important – a fundamental reform of the directive system of the centrally planned economies is necessary if the socialist countries' debt problems are to be overcome. Hungarian and Polish experts and politicians in particular appear to be increasingly aware that the necessary incentives and innovatory stimuli for any lasting improvement in the system's economic efficiency can be generated only when the strictly centralist control is subdued. The first attempts at reform have been applied but not resolutely continued in Poland and Hungary. To some extent, the reform operations were inherently inconsistent and have produced more unsatisfactory results and greater instability than the centralist control methods. In other countries such as the GDR, the political decision-makers lack the courage or room for manoeuvre to switch to decentralized controls; instead, they are content with half-hearted reorganization and with curing the symptoms. The socialist countries should not, however, overlook the fact that only fundamental and propitious economic reforms appear to be appropriate for restoring at least some of the confidence of potential western lenders in the planned economies' ability to service their debts and for again rating those countries as creditworthy – with all the due circumspection which may be needed in future.