CHAPTER 2

THE CHARACTERISTIC FEATURES OF THE CENTRALLY PLANNED ECONOMIES

The socialist bloc and the capitalist bloc are the two trading spheres crystalized since the Second World War. The trade of the socialist bloc countries differs from that of the capitalist bloc countries, because of the socialist bloc characteristics. The institutions, techniques used in the trade of the socialist countries are quite different from those which evolved under the capitalist system. Campell (1966) observes that "most of our fraternity experience a typical sense of frustration", ... Because of the basic fact of scarcity, "much of the logic of our model of allocation and rationality ought to apply even in the socialist economy. But despite the logical relevance of this body of thought, the institutional peculiarities of the Soviet economy make it not very operational". (quoted by Brown, 1968, p.58). The economic model of the centrally planned economies that prevailed before 1960s, still prevails in the Union of Soviet Socialist Republics (USSR) and in other countries except Hungary because of the recent economic reforms. Granick (1975) study confirms that Soviet economic model remained virtually unaltered in Eastern Europe (except in Hungary after 1968).
The characteristic features of the Socialist bloc countries have implications for their international economic relations, and, thus, it is an essential pre-requisite to understand the foreign trade behaviour of the centrally planned economies of the socialist bloc.

2.1. Characteristic Features

2.1.1 Social Ownership of the Means of Production

In the socialist bloc, there is social ownership of virtually all the means of production, and the private property is restricted to small household plots of agricultural land and houses. Most of the non-agricultural enterprises are nationalised. Industrial enterprises, factories, machinery and equipment and in many countries land are the property of the state. Thus, most natural resources and capital are socialized including land, manufacturing industries, banking, finance, etc. In the centrally planned economies, under nationalization of industry, it is logical that, foreign trade also be nationalized. Agriculture is the major exception to the ownership of the state. But the state is able to exercise considerable control over it as the supplier of machinery, fertilizers and the like, and as the major purchaser of agricultural output, and a price setter.
2.1.1.1 Method of Operation

In the socialist bloc countries, the enterprises are operated by the State. The managers of the state enterprises do not depend on market conditions to determine what and how much to produce, to whom to sell, from whom to buy (inputs) and at what prices. In all these matters, the managers have to take orders from the command authorities. The managers of the state industrial enterprises, keep financial accounts and are supposed to finance their expenditures out of revenue from the sale of their products. "Presumably, this method of operation imposes a financial discipline on the enterprises which would not exist if all receipts were automatically handed over to the state treasury and all expenditures were financed by the treasury. In practice, financial discipline is less stringent than under private enterprises for a number of reasons, including the almost unlimited ability of a government to subsidise inefficient enterprises and its apparent aversion to closing them down." (Holzman, 1976, p.5)

2.1.2 Central Economic Planning

Central economic planning is the most important distinguishing characteristic feature of the socialist bloc nations. Central planning has an important bearing on the foreign trade of the socialist countries.
2.1.2.1 Capitalist Bloc and the Role of the Market

In the capitalist bloc nations the enterprises endeavour to work through the market and not interfere with it as a system. The functioning of the market provides the fundamental mechanism for guiding economic processes. Indeed, 'capitalist' and 'market' economies are regarded as synonymous. Exactly reverse is the situation in the socialist bloc countries.

2.1.2.2 Definition of Planning

The term 'planning' has very broad meaning in the socialist countries. The definition of 'planning' cited by Wilczynski (1969) from the socialist text-book is that it is "the system of managing economic processes* involving production, distribution, investment and consumption. Its essence consist in determining economic targets and methods for their implementation, in particular, the allocation of means of production and of labour to different uses. As such, planning is an instrument of economic strategy to achieve the optimum growth of national income or maximum satisfaction of social needs.

Sergeyev (1963) argues that "the rapid and rational development of international socialist trade is the result of applying definite principles of planning. Planning is

* Economic processes are subordinated to macrosocial objectives laid down by the party.
thus a decisive factor for both the uninterrupted growth of socialized production and the steady development of foreign trade within the world socialist system." Other things being equal, Eastern socialist-bloc foreign trade results differ from those of the capitalist bloc; the central planning provides the primary explanation for the divergence. The high degree of centralization has been one of the striking characteristics of the Soviet economy.

"Despite the interlude of the NEP, the identification of a socialist economy with a centralized economy become so complete that in 1940 Schumpeter was able to write in his famous book "Capitalism, Socialism and Democracy" that 'The type that can be called "centralized socialism" seems to me to prevail so clearly that it would be a waste of time to analyse their formulae' (Schumpeter, 1950, p.272). The planners have a revealed preference for centralized planning due to the historical background of those economies.

2.1.2.3 Historical Background of the Socialist Bloc Countries and the Adoption of the Centralized Planning

After second world war period, the countries of the socialist bloc were having the typical profile of underdeveloped countries. The major task for them was to catch up with the advanced countries, and thus were wishing to industrialize rapidly to transform their economic and social structures rapidly without the support of the capitalist bloc countries. During the early period, the
problem for the socialist bloc countries was the shortage of supplies. There was no need for markets to be created as any surplus commodity could easily be sold. Nove (1964) maintains that the centralized planning and management also enable the concentration of resources in key industries for the initial take-off, crucial to subsequent balanced development. The initial backwardness also means that there is lack of competent managers, so that the centralized, detailed tutelage provides practical management assistance to enterprises. Thus, in the socialist bloc the market mechanism is easily replaced by, or at least supplemented with central economic planning. To escape from the chaotic and haphazard market fluctuations, the planners have a revealed preference for centralized planning.

2.1.2.4 Plan Hierarchy

The East European countries in the socialist bloc and the Soviet Union are often thought of as a unit as all of them have adopted centralized model in which economic processes are dominated by an hierarchical system of planning. Central Planning Authority (CPA) constitutes the peak of the pyramid. Pryor (1963) defines "centralization as the concentration of the decision making function in the highest level of the planning hierarchy". Brown and Neuberger (1968, p.406) described the term 'centralization' as the shorthand expression that includes both
centralized planning and centralized control of economic activities. Thus, centralization means, on the one hand, that important planning decisions are reserved to the systems' directors and, on the other hand, those decisions are communicated to operational units by direct commands or directives. Thus, although labour in the socialist bloc enjoys considerable freedom from directive planning, there is high degree of centralization and control over the determination of wages. But the wage differences in the socialist bloc nations reflect the considerations, such as, training, skill, pleasantness of job and scarcity (demand). The real market through which the supply and demand can seek adjustment, this particular function accomplished anonymously by "invisible hands" in the capitalist bloc nations is performed explicitly by the central planners. In the capitalist bloc, the private enterprises set prices and make decisions regarding changes in output, but in the socialist bloc nations, there is still a strong reluctance to commit the economy too much to anonymous and 'anarchical' market forces. The socialist economists are confident that centralized model can provide a better solution than the market can. Thus, the market mechanism is suppressed to various degrees by planning. It is needless to say, that, there is rigidity in prices and changes in output are much less responsive to changing consumers' needs.
2.1.2.5 Capital Market

In the capitalist bloc nations, there is a wide range of stocks and bonds and financial instruments but it has no counterpart in the socialist bloc nations, that is, the socialist bloc countries lack the capital markets. The State determines the rate of investment and of military spending. The funds to finance these expenditures are raised primarily by taxation. There is no functional relationship between the supply of and demand for capital, that is, the rate of interest has almost no effect on either the supply or demand for capital. Between enterprises and between enterprise and state organizations, market plays an ancillary function.

2.1.2.6 Co-ordination of National Plans

Given that all the CMEA economies are planned economies, the basic tools of their mutual cooperation consist of various forms of plan coordination. The two main aspects of this are a) the actual coordination of the long term plans themselves and b) various kinds of agreements which result from the coordination.

a) Actual Coordination of the Long Term Plans

Plan coordination is one of the chief instruments of cooperation among the member countries. For the rapid development of certain types of production, they have introduced joint planning.
b) Agreements on Economic Cooperation

In the general picture of cooperation of CMEA economies, mainly bilateral agreements played an important role. Initially bilateralism helped the CMEA economies to expand their trade in the face of currency inconvertibility and a general shortage of international reserves.

2.1.3 Foreign Trade Monopoly (FTM)

2.1.3.1 The Term 'Foreign Trade Monopoly'

The term 'foreign trade monopoly' describes the situation in which foreign trade activity is taken over by the state and carried out by the respective 'state organizations' and 'state enterprises'. 'Foreign trade monopoly' is one of the distinctive characteristics of the socialist bloc countries and differs from the market type economies (MTEs) of the capitalist bloc. Kamecki (1966) argues that this distinction is due to the different base of socialism (social ownership of means of production) and capitalism (private ownership of means of production) and to the different purposes and mechanisms of its activity in these two cases. Under nationalization of industry and central planning, it is logical to say that foreign trade also be nationalized and be conducted by 'foreign trade monopoly'. In each socialist country, a foreign trade monopoly has been set up to act as a buffer between the world markets and domestic economy.
2.1.3.2 **Capitalist Bloc - Foreign Trade Transactions**

In the capitalist bloc countries the foreign trade transactions are accomplished by private enterprises. The government role is largely regulatory, protective or macroeconomic. Government takes measures to prevent smuggling, to levy tariffs and quotas, and to maintain exchange rate at parity. The Government policies may be designed to influence the market, but they do not try to supplant it.

2.1.3.3 **Socialist Bloc - Foreign Trade Transactions**

In the socialist bloc countries, the state foreign trade enterprises (FTEs) crowded the private foreign trade companies completely out. Foreign trade is part of the command sector and the command organization, the foreign trade monopoly, is virtually the same throughout the East European countries of the socialist bloc.

Lenin's economic objective was "the independence of the USSR. This, he believed, required the Soviet Union to catch up and overtake the economically developed countries. This, in turn, required industrialization and technical advance. To maintain independence while the backward economy of the USSR was being industrialized, it was necessary to protect the Soviet Union from foreign capital and from paying tribute to foreign capitalists. This protection was to constitute the function of the monopoly of trade" (quoted by Metejka, 1978, p.63). It has been
said that, "economic planning of the type practised in Russia is not feasible without the use of a foreign trade monopoly..." (Holzman, 1974, p.141) In the socialist bloc countries, the leading role and position is maintained by the state enterprises and authorities.

2.1.3.4 The Role of Foreign Trade Monopoly

Foreign trade monopoly is a distinguishing feature of the foreign trade system of the socialist countries. This logically follows from the centrally planned nature of the socialist economies. Every socialist country has, even in the reform period, maintained foreign trade monopoly albeit in a modified form.

2.1.3.5 The Organizations of the Foreign Trade Monopoly

Foreign trade monopoly consists of two parts - i) the trade monopoly, ii) the foreign currency monopoly or valuta monopoly. Pryor (1963) maintains that sometimes a transportation monopoly is also included. These monopolies are spread over several institutions.

Chart 2.1 shows the institutional hierarchies in 'foreign trade monopoly', of Czechoslovakia during the period 1958-1967.

i) 'Trade Monopoly'

The trade monopoly is composed of the a) State Planning Commission (SPC), b) the Ministry of Foreign Trade (MFT), c) the foreign trade organizations (FTOs)
CHART 2.1
STRUCTURE OF PLANNING AND ADMINISTRATION OF FOREIGN TRADE
IN CZECHOSLOVAKIA 1958 - 1967

and, d) various ancilliary organizations such as the chamber of commerce, foreign trade research units, and insurance institutes.

ii) The Foreign Exchange Monopoly or Valuta Monopoly

Besides the planning commission, it includes the ministry of finance, the state bank, the foreign trade bank and the central customs administration.

2.1.3.6 Foreign Trade Operations

In the socialist bloc the operation of the foreign trade is centralized. The planners are supposed to dovetail imports and exports into their annual economic plans, and specifically into their commodity balances. The central planning board takes into account traditional pattern of exports and imports and also probable forthcoming export and import obligations under the long-term trade agreements that each nation has with many other nations. The central planning board develops a set of preliminary exports and imports targets and then the estimates for the national economic plans are established.

The monopolistic organization in the socialist bloc is called the Ministry of foreign trade. It is assisted by foreign trade enterprises (corporation, organization). The relationship between the enterprises and ministries is purely vertical, the orders go down from higher organs to lower organs. Planning and control are centralized in the Ministry of foreign trade and the Ministry sets general policy and is responsible for the carrying out of the
main foreign trade plan. Actual transactions are carried out by the foreign trade enterprises. Among them, the enterprises which are engaged only in trade, have the exclusive right to import and/or export, for a given product or group of products. The foreign trade enterprises carry out most of the commercial aspects of trade; each is assigned a certain group of goods and does not compete against the others. Foreign trade and domestic aspects of trade are quite separate so that the foreign trade enterprises have very little contact with the production enterprises except in the case of very specialized traded goods such as precision machinery. Usually the foreign trade enterprises buy domestic goods from and sell foreign goods to the Ministry and the domestic trading organizations. Each foreign trade enterprise has a part of the overall foreign trade plan to fulfil.

The ministry of foreign trade, the operating organization, stands between the foreign trade enterprises and the central planning board. The targets set by the central planners are checked by the ministry. The Ministry directs and issues instructions to foreign trade enterprises. After the targets are received by the foreign trade enterprises, the ministry transmits back the views of enterprises to the central planners. Then the final annual national plans are passed to the ministry and then to the foreign trade
enterprises. Once the plans are made and received by the enterprises, they have the force of "law".

2.1.3.7 The Consequence of the Foreign Trade Monopoly

a) The Neglect of the Export Sector

Wilczynski (1969) states that "whereas in the developed market economies the emphasis appears to be on exports, in the centrally planned economies, it is imports that occupy the focus of attention. Imports are the starting point of the process, since they are considered as indispensable to meet development targets". The basic principle of international trade enunciated by Lange is that "the fundamental determinant is our need for imports and then we plan to export enough to pay for them". The relative neglect of export sector which this approach is likely to prove particularly for the smaller socialist countries, to be growth inhibiting. It was realised later that "in the economic growth of smaller countries, exports have necessarily an expanding role, and the neglect of the points of export efficiency is bound to entail unfavourable consequences" and "in small and medium size countries, the role of economic growth depends mainly on export capacity, imports are much easier to increase". (Kiss, 1971, p.16).

b) Barter Trade Approach

There is some tendency to take barter approach to foreign trade under 'foreign trade monopoly' system. In
this approach profits on each individual transaction are not important. The importance is attached to the profitability, which is assessed on the basis of "terms of trade", that is, value of imports received for exports sold since both imports and exports are controlled by the 'foreign trade monopoly'.

c) Tariffs Redundancy

Since the foreign trade is in the hands of command organizations, tariffs are unnecessary and, where they exist are redundant, i.e., in the socialist bloc countries the tariffs have virtually no role to play.

2.1.4 Autarky

The term 'autarky' is defined variously [Brown, 1968; Domar, 1968; Wiles, 1968.] Brown (1968) defines 'autarky' as a policy designed to achieve the greatest possible economic self-sufficiency or a policy to reduce trade as much as possible". It is said that, central planners want complete control over all the economic variables relevant to achieving the economic objectives established for them. This is likely to create in the planners an antipathy towards foreign trade.

2.1.4.1 Autarkic Tendencies During the Post-World-War Period

After the Second World War, up to 1953, the autarkical tendencies appeared in the socialist countries. The main reason for this was the cold war and its economic consequences. The export of many basic goods to socialist
countries was suddenly subjected to embargoes or restrictions. Socialist countries were then forced to undertake the production of these goods themselves. For instance, the Soviet Union was "forced to push the import substitution to the extreme", which resulted in "autarky". (Gidadhubli, 1983, p.8) Moreover, the existing trade restrictions favoured an autarkical atmosphere and an attempt to become independent of western countries to a greater extent than was then necessary. "In fact, the autarky was not despite, but because of the tutelage: the Soviet directives are attributable both to its standing ideology and to its contemporary practice." (Kaser, 1967, p.17) These tendencies were also fostered by the economic model then prevailing in socialist countries and mainly based on central administrative orders which did not pay proper attention to economic calculation, cost of production * or the capital coefficient. The CMEA countries adopted the Soviet type centralized model of foreign trade, "A mechanical immitation of Soviet development concepts had given rise to autorkic tendencies and had for a long time thrust into the background, the consideration of the efficiency increasing effects of the international division of labour." (Kiss, 1971, p.16) This is expressed in a standard textbook of political economy where it is said that, "foreign trade is merely... a supplementary source of

* The cost of obtaining and transporting raw materials.
aid for the development of production" (Pryor, 1963, p.23).

Immediately after World War II, an article was written by Viner (1953) in which he maintains there is generally a deliberate bias towards autarky in government regulation, and extension of the area and degree of regulation gives the bias a greater scope for operation. Viner (1953) not only claimed that "there is in government activities an inherent irrational bias toward autarky whose practical importance in national economic planning automatically increases." He goes further and claims that, "there is a strong tendency in the logic of national economic planning toward autarky" (Viner, 1953, pp. 84-85).

In an article of 1966 Kamecki refuted the views of Viner and maintained that such claims stem from "misapprehension of the aims of a socialist economy".

2.1.4.2 Testing of the Hypothesis of 'Autarky' different Studies

Was the foreign trade in the East European socialist countries since the war lower than it ought to have been? Whether the autarky was the ultimate objective of these countries? These hypotheses are tested by various economists (Pryor, 1963; Holzman, 1963).

Pryor (1963) relates trade per head to industrial production per head and to population and develops his own formula for 'normal level of trade'. Chenery (1960)
also give his own formula for measuring the 'trade potential'. Pryor (1963) uses which is based on a statistical study of sixty market economies. Chenery's formula produces lower estimates of 'normal' levels, or what Pryor refers to as 'trade potential'. Pryor (1963) calculates the trade potential of the seven East European countries and concludes that, "in 1955, no CMEA bloc nation realized even 50 per cent of its 'potential' trade per capita", using either of the formulas (Pryor, 1963, p.27). But the calculations, however, are for the year 1955 only.

Holzman (1963) maintains that the Russians consciously followed a policy of importing producers' goods which would make them more self-sufficient in the future. In the words of one Soviet Scholar: "... Imports into the USSR are planned so as to aid in quickly freeing the nation from the need to import... " (quoted by Holzman, 1963, p.302).

Holzman (1976) maintains that the foreign trade of the East European socialist bloc nations, particularly that of the Soviet Union, is clearly below the level which would obtain if capitalism prevailed. He argues that the lower level of trade is partly due to the effect of the cold war, but it is also due to specific features of central planning with direct controls. "The result is more popularly called trade aversion than autarky" (Holzman, 1976, p.26).
(1978)
Matejka disagrees with the autarky thesis and basing his conclusions on his studies covering 7 East European socialist countries establishes the result that the East European countries did not pursue a policy of autarky, but a policy of protection for industrialization until 1955, and a policy of trade for development after that.

Table 2.1: Relation between the Growth Rates of Foreign Trade and National Income in European CMEA Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>1950-60</th>
<th>1960-70</th>
<th>1970-74</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>2.10</td>
<td>2.06</td>
<td>2.24</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>1.53</td>
<td>1.85</td>
<td>2.52</td>
</tr>
<tr>
<td>GDR</td>
<td>2.50</td>
<td>2.09</td>
<td>2.58</td>
</tr>
<tr>
<td>Hungary</td>
<td>2.38</td>
<td>2.36</td>
<td>2.52</td>
</tr>
<tr>
<td>Poland</td>
<td>1.08</td>
<td>1.97</td>
<td>2.51</td>
</tr>
<tr>
<td>Romania</td>
<td>1.19</td>
<td>1.40</td>
<td>2.14</td>
</tr>
<tr>
<td>USSR</td>
<td>1.48</td>
<td>1.17</td>
<td>3.04</td>
</tr>
</tbody>
</table>


The data bear out the fact that the growth of the foreign trade of the socialist countries has exceeded the growth of their national income. It is a striking phenomenon which contradicts the hypothesis of autarky. Having recognised the role of foreign trade in their growth
strategy, the socialist countries have been relentlessly pursuing their objective of trade expansion. In fact, the foreign trade of these countries has been one of the most dynamic sectors of their economies during the whole of the post-war period. During 1959-1979 their total trade in current value increased 34 times while the world trade augmented in the same period by 27 times (UNCTAD, 1981, p.60).

2.1.5 Planning Through "Material Balances"

In the capitalist bloc countries, the market performs the task of distributing essential industrial supplies; the same is performed by the central allocation method in the socialist bloc countries.

2.1.5.1 "Method of Balances"

Supply and demand for most intermediate products are balanced quantitatively by direct controls in the East European countries of the socialist bloc nations. This procedure is known as the "method of balances".

The precise degree of differences between the capitalist bloc and the socialist bloc arises due to the adoption of 'material balances method' by socialist countries. At the micro level, the early years of CMEA have been described as a period in which the nations simply engaged in the "barter of residuals in 'material balances'" (Kaser, 1967, p.177). Thus, the system of
'material balances' has been, since the introduction of total economic planning, the primary co-ordinating device for the planning of production and the distribution of goods and materials in all CMEA nations. The material balances have also been a primary link between domestic production and foreign trade.

2.1.5.2 The System 'Material Balances'

The system of material balances and technical coefficients may be calculated in physical terms without the explicit instruction about prices or values. The material balance in physical terms includes more than one particular type of goods. This system of physical planning may be used with a preference system coming from 'above' (planners' preferences) or 'below' (consumers' preferences). That is, the guidelines for planning may come from the consumer or consumer wishes, as imputed by the planners from market surveys, studies of consumer demand elasticities, and so forth.

2.1.5.3 Structure of Material Balances

The system of material balances has been, since the introduction of total economic planning, the primary coordinating device for the planning of production and the distribution of goods and materials in all the CMEA economies. The structure of balances is similar in all the CMEA economies. The structure shown below of balances for both raw materials and fabricated products, equates
supply of each goods available with the demand for these goods.

<table>
<thead>
<tr>
<th>Supply</th>
<th>Demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>Consumption of households</td>
</tr>
<tr>
<td>+ imports</td>
<td>+ Consumption by government organs</td>
</tr>
<tr>
<td>+ decreases in inventories</td>
<td>+ use in further processing steps</td>
</tr>
<tr>
<td></td>
<td>+ increase in inventories</td>
</tr>
<tr>
<td></td>
<td>+ exports</td>
</tr>
</tbody>
</table>

The Process of Material Balance

The process is elaborated by Pryor (1963), Kaser (1967) as one in which each nation goes about formulating its own domestic plans and exporting surpluses that happen to be available in order to pay for the imports needed to eliminate shortages or bottlenecks that may develop. This suggests that trade may have been largely unplanned. But certainly a good proportion of trade must also have been planned into the material balances as each nation strove for balanced development, as was true of the early years of Soviet industrialization when extremely large quantities of machinery were imported (Holzman, 1974, p. 17).
2.1.6 'Overfull Employment Planning' ('Taut Planning')

2.1.6.1 The Term 'Overfull Employment Planning'

"Overfull employment planning means, setting output targets for enterprises and industries which are unrealistic in terms of available resources and possible rates of growth in productivity. It is a sellers' market, that is, enterprises can sell virtually anything they produce" (Holzman, 1976, p.7). Brown (1968) states that in the domestic sectors, taut planning means that the planners attempt to set both input coefficients and resources lower, and output norms higher, than the most likely estimates.

2.1.6.2 The Foreign Trade Plans more Unrealistically Taut than the Domestic Plans

The possible range of estimates in foreign trade is much wider than in domestic production. Taut planning in foreign trade is more manifest in overestimation of export prices and underestimation of both import prices and foreign exchange reserves needed to smooth out short-run fluctuations. Therefore, with taut planning, foreign trade plans are established on the basis of more optimistic forecasts than are objectively warranted (Brown, 1968).

2.1.6.3 Consequences:

The physical planning and tautness of planning aspects of the CPEs lead to a sellers market, a system of incentives for production and not for sale. Under overfull employment
planning, the plans are not drawn upon the basis of what is most likely, but according to forecasts that are more optimistic than facts would warrant. Managers have an incentive to understate their capacity to produce and overstate their input requirements, these by passing inaccurate information to the planners. They concentrate on production and not on sale and pay relatively little attention to timely deliveries and after-sale servicing on their products.

2.1.7 Success Indicators

2.1.7.1 Profits

In capitalist bloc countries, profit is the sole aim of the producers and in order to achieve and maintain a high level of profits, the manager of a capitalist enterprise is motivated on the supply side to keep his costs down and on the demand side to provide a product, which is, or appears to be, superior to the products of competitors and appeals generally to his customers. On the other hand, in the socialist bloc countries, profit is a minor target faced by the managers.

2.1.7.2 Quantity Targeting

Maximization of the profits was of little incentive to the managers as the advantages to be gained from exceeding the planned quantities were much greater. In other words, the output targets are the major goals for
enterprises; managerial bonuses are attached to the fulfilment or the overfulfilment of the targets.

2.1.7.3 Irrational Activities

The priority is given to the fulfilment of gross output and outputs are specified in terms of weight, volume, quantity, etc.. If, for example, the weight is the success indicator then enterprises have an incentive to concentrate their output on heavy items or to produce low quality of outputs and if the volume is a success indicator, the enterprises produce large (numerous) number of smaller items.

2.1.7.4 Checking Agencies

Checking agencies may do little to prevent such irrational activities. Ministerial authorities whose bonuses are linked to the same criteria as enterprises retain a vested interest in enterprise bonus maximization, while local party officials may be reluctant to jeopardise bonuses for the work force. Furthermore, ministerial and party officials may find themselves balanced if an enterprise under their jurisdiction fails to meet its major indicators and may actively participate in the processes they are supposed to prevent (Andrle, 1976; Berliner, 1957).

Thus, the cost reduction is not the concern of the managers. "Under the Stalin model, the enterprise could, in principle, influence its profits only by compressing
its production cost. There was, moreover, little incentive to do this, since the advantages to be gained from exceeding the planned quantities were much greater*^ (Marczewski, 1974, p.117).

2.1.8 **Inconvertibility**

Most of the socialist countries' currencies are inconvertible. Inconvertibility of the currency stems from central planning and is one of the notable characteristics of the socialist bloc economies.

a) **Currency convertibility**

Commonly, currency convertibility refers to the right or possibility of the holder of a currency to exchange it for gold or for "hard" currencies. The socialist countries have the chronic shortage of convertible currencies.

b) **Currency inconvertibility**

In the socialist bloc countries the currencies are inconvertible, it means the currency of the bloc can not be exchanged against gold or "hard" currencies. It is a situation in which the nation in question limits the right of its residents to purchase (exchange domestic currency for) foreign exchange.

c) **Commodity inconvertibility**

The inconvertibility of the currencies of the socialist countries also implies "commodity inconvertibility" (Altman (1960)). It refers to the fact that foreigners
holding CPE currencies cannot use them freely to purchase goods because, under central planning most goods are allocated in advance by the planners. Free access by foreigners (or by their own consumers) to internal markets, especially of producer goods, raw materials, and other intermediate products would disrupt planning.

2.1.9 Pricing and Exchange Rate

The capitalist or the market type economies require prices for allocation of resources of the economy. Centrally planned economies having planning through material balances (quantity terms) and the CPE prices reflect central planners preferences rather than consumers preferences. The prices in the socialist bloc are not scarcity prices and thus they do not reflect opportunity cost.

2.1.9.1 Three Principles of Pricing

Before the reforms of the 1960s, the pricing was governed by three principles.

a) The first was that the price was based on the labour theory of value in its Marxian interpretation where only labour is accounted in the cost of production and no proper charges for rent, interest and profits are included. It means prices systematically underestimated costs.
b) To promote industrialization, the basic industries were subsidized and there were discriminatory taxes leading to irrationality of prices.

c) The socialist economies maintained constant or fixed prices.

2.1.9.2 Disequilibrium Prices

Unlike the capitalist prices, prices in the socialist bloc countries are disequilibrium prices, that is if they are freed, they would not equate supply and demand, as the economies are centrally planned with direct controls. Prices are either constant or fixed and are largely insulated from market forces operating through supply and demand.

2.1.9.3 The State of Price Confusion

The state of price confusion in the socialist bloc is freely admitted:

"... prices, as is known, do not equate with adequate completeness and precision the socially necessary labour outlays for the manufacture of goods. Prices of means of production are mainly below value while the prices of many consumers' goods are above value. Moreover, the prices within each of these departments (sectors) also diverge from their value. The numerically equal outlays of social labour are expressed in different prices." (Holzman, 1976, p.10)
2.1.9.4 **Exchange Rate**

The socialist bloc countries operate the disequilibrium exchange rate system which is the well-known characteristic feature of these economies. So long as prices are disorderly and world prices are used as the basis for international trade, and the composition and volume of trade is determined by direct controls and administered by a foreign trade monopoly the exchange rate remains merely an accounting device.

2.1.9.5 **Socialist Bloc - Disequilibrium Exchange Rate**

Disequilibrium exchange rate in the socialist bloc countries is inevitable because i) the prices do not reflect scarcity and are internationally not comparable and ii) the purchasing power parity doctrine does not hold good.

In the centrally planned economies the exchange rate reflects planners choice and not that of market. Consequently, the exchange rates are not of practical importance as the central planners use the direct controls to plan and implement foreign trade. In other words, the exchange rates are not indicative of the purchasing power and are of little relevance in the planned socialist economies.

2.1.10 **Bilateral Trade**

Bilateral trade is one of the important characteristics of intra-CMEA trade. It results from the currency and
commodity inconvertibility, in the socialist bloc. Due to the foreign exchange problem the countries of the socialist bloc are noted for their preference for bilateralism.

2.1.10.1 Bilateral Agreements and Foreign Trade

To facilitate the integration of foreign trade into overall economic plan, the socialist economies prefer to sign bilateral trade agreements with foreign governments. The agreements may cover a period from two to six years, and are subsequently supplemented with more specific annual trade protocols.

Institutionally, the high degree of bilateralism is accomplished by means of annual and long term trade and payments agreements that attempt, within limits and after taking account of credits, to keep trade between the two participating countries in balance, over the period in question. These agreements are implemented, of course, by direct governmental controls over the level and composition of imports and exports.

In this chapter, we have attempted a rapid survey of the characteristics of the socialist economies. We have seen that, most of these characteristics essentially flow from the centralized planning which is the main form of organisation of these economies. In fact, it is impossible to think of the foreign trade of socialist
countries without centralized planning and its related features. In the following chapters we shall try to unravel in greater detail these interrelationships and their consequences for the future of the socialist foreign trade.