Definition of Bilateralism

Brabant (1980) defines bilateralism as a foreign trade policy, designed to equate intended exports and imports between two countries, in such a way that, unplanned transactions are avoided, or at least, that actual transactions need not be compensated by means of unanticipated capital movements. In a technical framework, bilateralism as a trade policy, may be defined as a strategy optimizing a welfare function subject to the constraints that no negative products can be generated, available resources cannot be overdrawn, the process finally used must break even and bilateral trade imbalances over a mutually agreed period of time can not exceed a given magnitude, possibly zero.

The Circumstances responsible for Bilateral Trade

This type of bilateral trade policy is generally adopted in the exceptional situations, such as depression, war, post war reconstruction. In the wake of such events, for the survival of the economies, the need for imports becomes imperative. But to pay for imports, countries do not have enough stock of convertible currencies, exportable goods or gold with them. Under these circumstances, the
economies have no choice but have to enter into bilateral trading arrangements with other countries.

6.3 Western Countries and Bilateralism

Wilczynski (1978) argued that, bilateralism is commonly identified with the socialist centrally planned economies (CPEs), but it has been practised by capitalist countries too. In fact, it was first introduced under capitalism during the Great depression of the 1930s. Bilateralism was revived after the Second World War, owing to wartime dislocations and acute shortages of foreign exchange. France and United Kingdom were the main initiators of this practice. In the mid 1950s (the peak of bilateralism in the West), there were 400 bilateral trade agreements covering 60 per cent of the international payments of capitalist countries.

6.3.1 Economic Causes of Bilateral Trade in Western Economies

Following the Second World War, West European countries turned to bilateralism and the financing of trade with inconvertible currencies, chiefly for two reasons:

i) General state of Disequilibrium

Firstly, it was difficult to acquire sufficient hard currency reserves given the general state of disequilibrium and the policy makers' reluctance to deflate economic activity. As a result of the widespread damages caused by the war productive capacities, industrial and
agricultural output, stocks in commodities and foreign exchange diminished excessively; there were also large losses in the stock of non-productive fixed capital, as residential buildings and infrastructural facilities.

ii) Credits from the Bilateral Trade and Payments Agreements

Secondly, Balance of Trade and Payments Agreements (BTPAs) provided for financing trade with short term credits, which would not have been forthcoming, if trade had been conducted on a convertible currency basis.

European Payment Union (EPU)

The Western countries quickly moved to escape from bilateralism through a series of tentative payments arrangements which finally culminated into the establishment of the European Payments Union (EPU) in 1950. By encouraging gradual adjustments in national policies and by raising the percentage of gold and convertible currency payments in intra-European settlements, the EPU succeeded by 1957 to wipe out the traces of post-war bilateralism in Western Europe. "The EPU arrangement was remarkably clear and simple document embodying sweeping and precise commitments of a revolutionary nature which drastically shifted overnight the whole structure of intra-European settlements from a bilateral to a multilateral basis" (Triffin, 1957, p.161).
6.4.1 **The Conditions Assuring the EPU's Success**

It must, however, be noted that the success of the EPU was assured among others, by the following conditions.

i) **American Aid**

The trade imbalances within the EPU group were considerably reduced by the rapid recovery of production greatly facilitated by generous American aid.

ii) **Acceptance of the Disciplines of Competition**

The EPU countries had agreed to give up a large measure of their bilateralism in mutual trade and to accept the discipline of competition.

iii) **Liquidity for Financing the Trade**

The EPU mechanism provided to a great extent the necessary liquidity for financing the trade.

Thus, by 1957 the West European trade was liberated from the stranglehold of post-war bilateralism. "... a few months before the establishment of the EPU only 30 per cent of intra-European trade was free from quantitative restrictions. ... By early 1957 about nine-tenths of intra-European trade was quota free" (Hinshaw, 1958, p.16).

6.5 **Socialist Countries and Bilateralism**

Immediately after the end of the Second World War, the trade among the European countries was governed by a network of bilateral payments and trade agreements.
The nature of bilateralism differs under each economic system. In a capitalist economy it is rather an exception. But under socialism it has become normal and compatible with central economic planning.

The CPEs are bent on concluding extensive trade agreements to reduce uncertainty inherent in international trade. Since such commitments cannot be expected from market type economies (MTEs), the centrally planned economies (CPEs) conclude these agreements usually with their partners. As defined earlier, bilateralism of the CMEA type is typically concerned with balanced ex ante trade agreements. This kind of bilateralism could be represented in an equation form (Brabant, 1977, p.70).

\[ X_{ij}^t = M_{ij}^t + K_{ij}^t \]

where \( X_{ij} \) is i's export to j, \( M_{ij} \) is i's imports from j, and \( K_{ij} \) is the planned net transfer of capital from i to j. (If \( K_{ij} \) is negative, it means that i receives capital from j. \( K_{ij} \) includes interest claims on previous capital flows, if any. The former is however, more common in intra-socialist trade relations.

6.5.1 The Factors responsible for Bilateral Trade

The important factors responsible for bilateral trade among the socialist countries are briefly as follows:
i) The Central Direct Allocation

The general system has been shown to be one of central direct allocation or command for production and trade. For fulfilling the planned targets, exports are made as a source of foreign exchange to pay for the necessary imports.

ii) System of Material Balances

The key planning instrument regulating short and medium term economic activity in the CMEA economies is the system of material balances.

iii) The separation of Domestic prices from the World Prices

In the centrally planned economies functioning on the basis of directive plan instructions, domestic prices are institutionally, completely separated from those of the rest of the world.

iv) The Disequilibrium Exchange Rate

Due to the irrational price structure the countries have disequilibrium exchange rates, which reduce the trade within the bloc and with the rest of the world.

v) The Role of Money

Trade relations between CMEA economies are conducted in terms of the transferable ruble (TR) which, however, merely serves as an accounting category and does not fulfil the functions of money.
vi) The Efficiency Considerations

The separation of external and internal prices makes it very difficult to take into account efficiency considerations in foreign trade.

vii) The Foreign Trade Monopoly

The socialist foreign trade is strictly under the control of the foreign trade monopolies.

viii) The Avoidance of the Balance

The countries try to avoid an active balance because the interest received on them is very low.

ix) The Quota System

Under the quota system, the surpluses cannot be used to purchase the commodities needed.

All these economic factors are responsible for bilateralism in the CMEA economies. "The bilateral clearing system of the CMEA countries represents a particular type, whose essential features are determined by the prevailing concrete system of production relations, including the system of foreign trade planning based on centrally established export and import directives" (Ausch, 1972, p.155).

6.6 Bilateralism Versus Multilateralism
A Study by Michaely (1962)

Michaely (1962) studied the degree of multilateralism versus bilateralism for the worldwide trade of 65 diverse industrial and less developed countries in 1958.
Only the indexes of multilateral balancing of five main socialist bloc countries are mentioned here (Table 6.1).

6.6.1 Michaely (1962) Index of Multilateral Balancing

Michaely (1962) index, which measures the degree of multilateral balancing in a country's trade to be denoted for each country $j$ by $T_j$, is the following:

$$T_j = 100 \frac{\sum_{s=1}^{n} \frac{X_{sj}}{X_j} \frac{M_{sj}}{M_j}}{2}$$

where $X_{sj}$ stands for exports of country $j$ to any country $s$, during the year, $X_j$ stands for country $j$'s total exports, $M_{sj}$ for country $j$'s imports from country $s$ and $M_j$ for $j$'s total imports - all terms being value magnitudes and all denoted in the same currency. The differences whose sum constitutes the numerator are measured by their absolute magnitudes, regardless of sign. For convenience the index is put in percentage form. It expresses the share of the currency trade which is conducted on a multilateral basis. Table 6.1 shows the indexes of multilateral balancing for the period 1938, 1948, 1954 and 1958. For the sake of comparison of post war and pre war situations, Michaely (1962) has chosen prewar year 1938.
6.6.1.1 Important Observations

From the Table 6.1 if the prewar and the post-war situations are compared, it is apparent that in 1938, the USSR shows a considerably higher level of multilateral balancing in its trade. Almost one-third of USSR's trade is multilaterally balanced but in 1958 only 13.1 per cent of trade of the USSR is multilaterally balanced. Because whatever foreign trade was effected by the USSR before the war was conducted, presumably in convertible currencies, mainly with countries less inclined to bilateral trade policies than the USSR itself. Since the war, on the other hand, after the establishment of the CMEA bloc, most of the foreign trade of the USSR has been

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<td>(...)</td>
<td>12.3</td>
<td>13.1</td>
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</table>

* Average of 1954-58

diverted to countries within the bloc, all of whom follow bilateral trade policies similar to those of the USSR itself. Poland, the second largest country in the CMEA bloc had 40 per cent of its trade multilaterally balanced which was drastically reduced to 19 per cent. The GDR and the Czechoslovakia, the most developed countries in CMEA had respectively 19 per cent and 16 per cent trade multilaterally balanced, found that their trade was reduced to 12 per cent and 7 per cent in 1958. Bulgaria, the least developed country in the CMEA, had only 5 per cent of its trade multilaterally balanced in 1958, against 12 per cent in 1938. The average of the period 1954-58 index of multilateral balancing shows only 6 per cent to 13 per cent trade of the five socialist countries is multilaterally balanced.

6.6.1.2 The Bilateral Trade Policy Studies

Miksell and Behrman (1958) study shows the percentage of bilaterally conducted trade was higher in the CPE's than in either Western industrial or the developing countries. The view is supported by the Michaely study (1962). According to it "Soviet Eastern Europe has the highest level by far of bilateral balancing in international trade. In fact, no single country outside this bloc, Mexico being a borderline case has an index of multilateral balancing as low as that of any country within the bloc. His statistical rank ordering of dependence
on multilateral trade showed that the five CPE's included were at the trough on an average, 9.6 per cent of their trade was multilateral, whereas for the non-communist countries the proportion was 29.2 per cent. Bilateral trade forms as high as 90 per cent, sometimes, even more, of the trade of the Soviet countries. For the 1960s, McKinnon (1979, p. 53) found that only about 5 per cent of Russian trade within the CMEA was multilateral (measured by Michaely, 1962) index, whereas 25 per cent of Russian trade with convertible currency countries was multilateral. Francuz (1969) used the same statistical technique as Michaely (1962) in order to measure multilateralism as a proportion of trade within the Communist bloc. For the five CPEs plus Romania and East Germany he found that only 4.8 per cent of intra-bloc trade was multilateral in 1960-1963, this declined to 2.9 per cent between 1964-1967. Extension of Francuz's (1969) calculation to the 1960-1972 period indicates that multilateral trade remained at about 4 per cent of the total trade within the CMEA (Table 6.2).

Thus, the foregoing studies show that, bilateralism is the dominant characteristic of the CMEA nations in the pre-war and post-war periods.

6.7 The Historical and Economical Justification of Bilateralism

Under the particular environment in which bilateral clearing schemes were promulgated after the War, the
<table>
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<tr>
<th>Year</th>
<th>Bulgaria</th>
<th>Czechoslovakia</th>
<th>Germany Eastern</th>
<th>Poland</th>
<th>Romania</th>
<th>USSR</th>
<th>Mean (Unweighted)</th>
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<td>3.2</td>
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<td>7.1</td>
<td>2.4</td>
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Note: CMEA refers to the Council for Mutual Economic Assistance, sometimes called COMECON.

Note: Statistical Index of Multilateral Trade (Source - Makinnon, 1979)

\[
\sum_{s=1}^{n} \frac{X_{is} - M_{is}}{X_{jc} - M_{jc}} + \sum_{s=1}^{n} \frac{X_{is} + M_{is}}{X_{jc} + M_{jc}}
\]

Contd...
where \( X_{js} \) = exports of country \( j \) to country \( s \\
\( X_{jc} \) = total exports of country \( j \) to CMEA area \\
\( M_{js} \) = imports of country \( j \) from country \( s \\
\( M_{jc} \) = total imports of country \( j \) from CMEA \\
\( n \) = number of countries in the CMEA

original focus was not on trade denial, but rather than on how to attain some orderly exchange in a distorted trade world. It was probably inevitable in the past. Its peak was reached in the early 1950s, As one Hungarian economist observed, "The bilateral system of trading of the early 1950s answered the existing needs of the socialist countries, considering the nature of planning and political relations of the time. In those circumstances, bilateralism was historically and economically justified" (Wilczynski, 1972, p.274).

6.7.1 The Centrally Directed Bilateralism

Dernberger (1968) commented that the creation of the Soviet bloc, following World War II, led to the imposition of economic power of the Soviet Union over the countries of Eastern Europe. The large reparations, assessed by the Soviet Union, committed much of the member countries' export capacity to trade with the Soviet Union.
In the immediate post-war period the Soviet Union and the member countries trade did not appear to be a long-run phenomena. Moreover, the European member countries were invited to participate in such international organizations as the World Bank, the International Monetary Fund, the United Nations Food and Agriculture Organization. Faced with the threatened loosening of its control over the resources of the member countries that were needed in its own rehabilitation and development, the Soviet Union sought to enforce maximum dependence of the member countries upon the Soviet economy. The member countries were not allowed to join the aforementioned international organizations and an attempt was made to create an intra-bloc market by means of bilateral trade and payments agreements. By 1949, most of the trade of the Soviet bloc was being carried out under the provisions of these agreements. The payments in terms of gold and convertible currencies to market economies was impossible for the CMEA economies during the period and thus the 'radial' trade pattern was adopted. Thus, like many other socialist policies, bilateralism has been partly adopted by choice and partly imposed by the circumstances and it has taken the form of what Vyas (1985, p.31) calls "centrally directed bilateralism".

6.7.2 The Advantages of the Bilateral Trade Policy

Whether the bilateral trade policy adopted by choice or is forced by the circumstances, it has repre-
presented a number of advantages to the Socialist countries in the past. They are briefly discussed below:

i) Bilateral Trade Agreements

The first step towards the resumption of international trade and payments is the bilateral trade and payments agreements.

In the extraordinary circumstances such as those prevail after a war, the countries enter into bilateral trading arrangements with other countries to avoid the payments in gold or convertible currencies. An extreme case of bilateral settlement is a barter transaction, where a certain quantity of goods is exchanged for an agreed quantity of other goods, involving no currency either as a medium of exchange or even as a unit of account. But, in general, bilateral agreements constitute, in effect, a first concrete step away from national autarky and towards the resumption of international trade and payments.

ii) Bilateral Trading Facilitates Economic Planning

The policy of balancing of trade with each partner country and trade agreements specifying the composition of exports and imports in advance facilitated economic planning of the socialist countries. In particular, the clearing settlements enabled central planners to keep their fingers on the pulse of the plan fulfilment processes (Wilczynski, 1972, p.273).
iii) Bilateral Trade an Instrument of Foreign Trade Policy

The balancing of exports and imports with each country also reduced the need for currency transactions to the minimum. Owing to their limited exports capacity (a small range of exportables, low quality, sellers' markets at home), poor marketing techniques and various forms of discrimination encountered in capitalist markets, socialist countries have experienced great difficulties in earning enough foreign exchange, especially hard currencies. Consequently, in trade agreements or in actual trade deals these countries have often endeavoured to adjust the level of imports to their exports. In addition, bilateral trade agreements can be used as an instrument of foreign policy paving the way for political influence.

iv) Safeguarding CMEA's Own Interest

Through bilateralism, a socialist economy is better able to safeguard its own interest against trade barriers and discrimination imposed by trading partners. At the same time it can extend benefits to trading partners on a reciprocal basis.

v) Lead to the Expansion of Foreign Trade

The most common method of bilateral settlement is 'bilateral clearing', that is, the totality of inter-state payments transacted on the condition that claims
(or liabilities) arising in the trade between two coun-
tries may be utilized (or paid for) only through exchanges
transacted between these two countries. In this context,
"compensation of balances" means an accounting between
the central banks of the two countries regarding some past
period, performed in order to calculate the final balance
of bilateral claims and liabilities. Thus, bilateral
payments agreements made it possible for the participating
countries to purchase foreign commodities with their own
currency. Initially, bilateral credits facilitated the
expansion of foreign trade and prevented the claims of
commercial creditors from the danger of being impounded
by the debtor country.

vi) Helps postponing Strict Bilateral Balancing

If in a given period, usually a year, imbalances
occur, they are taken care of by 'swing credits'. Such
credits usually cover 5-25 per cent of the agreed exports
and are interest free". Paradoxically as it may seem the
bilateral payments agreements served the essential func-
tion, through their mutual credit positions, of avoiding
or at least postponing the danger of a strict bilateral
balancing of exports and imports on a barter basis."
(Triffin, 1957, p. 161)

vii) Imparts Great Stability to International Trade

In the Soviet view, bilateral trade agreements are
a highly convenient organizational form and are the
basis for the development of economic co-operation between the USSR and the developed capitalist countries. They impart great stability to international economic relations. There is a close connection between foreign trade plans of the Soviet Union and the trade agreements. Bilateral trade agreements assure the best combination of the national economic interest of the Soviet Union with the interest of its trading partners. Bilateralism is an instrument of a conscious policy of maintaining complete control over the foreign exchange market.

6.8 Bilateralism and the Intra-bloc Trade

In the history of the CMEA the period 1949-53 is characterized as the period of bilateral balancing. The economic factors mentioned earlier were responsible for the adoption of these agreements. But, the desire to assure the Soviet control over the foreign trade of trading partner countries may have been a major political factor responsible for the creation of bilateral trade and payments agreements.

6.8.1 The Characteristics of the Intra-CMEA Trade

The intra-CMEA trade is characterised by

1) Obligatory Quota System
2) Structural Bilateralism
3) The Principle of Null-Saldo
4) Bilateralism and Restricted Trade Opportunities for Trade lead to a Pareto Non-optimal Distribution of Resources.
1) **Obligatory Quota System in intra-CMEA Trade**

The central economic authorities of the two CMEA countries agree that in the framework of bilateral trade they will supply and purchase certain quantities of goods. The producing enterprises then have to implement these decisions. A typical trade agreement between any two CMEA countries contains a target for the trade level (exports as well as imports) the projected composition of trade by main commodity groups and a detailed listing of about fourfifths of what will be delivered and at what prices during a given trade period. Although the specification of the anticipated bilateral trade flows has probably become less rigid than it used to be in the early 1950s, all main goods are in principle still stipulated in the trade agreement (Brabant, 1980, p.124).

Some global quotas fix only the value limits of any exports or imports not specified otherwise by the bilateral agreement in question. Their share in the total trade is, however, small.

ii) **Structural Bilateralism**

The system of obligatory quotas and fixed prices transformed the bilateral trade into a sort of barter. There came into existence a system of 'structural exchange', in the framework of which the CMEA countries supply to each other machines in exchange for machines,
raw materials for raw materials. "All these factors have, together with the effects of internal economic mechanism played a part in driving into the background and distorting such categories as prices, market, supply and demand, credit, interest rates, etc.. Nor could realistic exchange rates between currencies operate under such conditions" (Kiss 1977, pp. 174-175).

iii) The Principle of nul-saldo

Each of the member countries strives for balanced trade in principle, for each year of the plan period - for different commodities and commodity groups. In Soviet parlance the practice of balanced trade is sometimes referred to as the principle of nul-saldo ("zero net trade balance" (Vyas, 1985))

6.9 Reduction in Volume of Trade

The result of all these characteristic features of intra-CMEA trade is the reduction in volume of trade.

Aush (1972) argues that, due to the structural bilateralism, there arises the distinction between "hard" and "soft" goods. Bilateral trade agreements create as a lack of flexibility in and sometimes even reduces the volume of trade among the member countries. It is shown by Ellman (1979) with the following figures.
6.9.1 **Multilateral Trade**

The arrows (Figure 6.1) indicate the direction of trade and the volume. For example, A imports 40 units from B and exports 80 units to B. A exports 10 units to C and imports 50 units from C. B exports 50 units to C and imports 10 units from B. Trade is multilateral and each country is in balance of trade equilibrium. Total "trade" volume is 240 units.

6.9.2 **Bilateral Trade**

Under conditions of bilateralism with the export constrained operative, trade will take place. (Figure 6.2) Total trade volume is 120 units. Welfare is substantially less than in the multilateral case.

6.9.3 **Bilateralism with "soft" commodities**

In Figure 6.3 h indicates "hard" commodities and s "soft ones". In a situation of bilateralism with "soft" commodities, the volume of trade is 360 units. This is more than in the multilateral case, but one third of the trade consists of the import of "soft" commodities, i.e., goods that are not much wanted. Hence welfare may be less than in the multilateral case. Softness of much of the trade taking place may be confirmed by the activities of capitalist import-export firms, reexporting the "soft" goods and supplying "hard ones" in exchange, thus introducing elements of de facto multilateralism. Figure 6.3 also
FIG: 6.1 - MULTILATERAL TRADE

FIG: 6.2 - BILATERALISM WITH THE EXPORT CONstrained OPERATIVE

FIG: 6.3 - BILATERALISM WITH "SOFT" COMMODITIES
illustrates how the administrative economy can generate a discrepancy between output levels and welfare levels.

6.10 The Need for Multilateral Trade

It was realized that in such a system credit and interest policies could in no way stimulate the development of multilateral trade. As the progress towards socialist economic integration by means of production specialisation and cooperation and plan coordination - the most cherished objective of the CMEA countries - was found to be hamstrung by rigid bilateralism in trade and the need for multilateralisation was recognised. The small, trade-dependent countries especially Hungary and Poland were in the forefront of the reform movement for reforms both in internal economic mechanism and foreign trade apparatus. In the sphere of foreign trade, they proposed but did not succeed in evolving an EPU type schemes for multilateralisation (Bapat, 1984, p.328).

6.11 The Conditions for the Realization of the Multilateral Trade

For the practical realization of a multilateral balancing of international trade following conditions should prevail.

i) An Active Role of Money

An active role of money opens the way toward multilaterality.
ii) **Rational Prices**

Rational prices, reflecting scarcities should prevail in the economy.

iii) **Trading in Physical Terms should be eliminated**

Prescription of production and trading tasks in physical terms should be eliminated for a relatively wide range of products both in the individual countries and in international economic relations.

iv) **The Freedom to the Enterprises**

The enterprises should be allowed to develop their own production and selling schemes on the basis of their existing production capacities, by taking into account external demand as well as their own financial interest.

6.12 **The Recognition of the Merits of the Multilateral Trade**

The merits of multilateralism have been recognised in the CMEA countries since the mid-1950s. In 1950s it was decided to set up bilateral technical and scientific cooperative agencies. Initially, the trade settlements among socialist countries were effected through the U.S. dollar. In 1951, the ruble came into use as clearing currency. But this step did not immediately lead to multilateralisation of trade. It was, however, necessary first step in maintaining the intra-CMEA accounts in a uniform unit of account.
i) The Ad hoc Transfer of Balances from one Bilateral Clearing Account to Another

This possibility is provided for in many intergovernmental trade agreements. In accordance with the stipulations in these agreements, the banks of the contracting countries in agreement with the bank of a third country could transfer certain accounts from the bilateral clearing accounts to the accounts of third countries in payment for goods shipped by them. Conversely, the bank of third countries could pay for imports from one of these countries by transferring funds from their clearing accounts to the bank account of one of the other countries. The CMEA countries also experimented with a few trilateral trade agreements.

ii) The Trilateral Trade Agreements

The second kind of multilateral accounting takes the form of trilateral clearing agreements. At first, trilateral agreements were concluded only sporadically and remained a marginal phenomena. One such trilateral agreement, made in 1949, centred upon the GDR (Figure 6.4).

Figure 6.4 of agreed links shows the GDR was the only country which effectively had multilateral dealings with the rest of the CMEA, except Poland which did not enter the scheme. (Kaser, 1967, p. 59-60)

In addition to the above multilateral settlement agreements were concluded between the USSR, Poland and
FIG. 6.4 THE GDR'S MULTILATERAL DEALING WITH THE REST OF THE CMEA
Finland and between Finland, Czechoslovakia and Poland in 1949. As Figure 6.5 indicates Poland was to deliver hard coal (worth 80 million roubles) and Czechoslovakia farm machinery (worth 20 million roubles) to Finland in return for foodstuffs from the Soviet Union. The Soviet Union was to obtain Finnish prefabricated houses, cut lumber and ships for 100 million roubles. Trilateral clearing agreements were concluded among the USSR, Burma and Czechoslovakia and Bulgaria, GDR and Romania.

The Central Clearing Office

As the CMEA economies were developing rapidly, the need for trade increased. The straight jacket of bilateral settlements hampered further growth of trade. As a result the Eighth Session of the CMEA (Warsaw Session of 1957) concluded the 'Agreement on Multilateral Clearing between CMEA Member countries and created a central clearing office in the State Bank (Gosbank) of the Soviet Union. The terms of the agreement were fashioned after the multilateral agreements concluded in Western Europe between 1947 and 1950 (Zwass 1978, p.117). Trade was still conducted on the basis of planned quotas and bilateral clearing. Thus, the clearing house played a completely passive role in the financing of bilateral balances as it had no funds of its own to finance trade.
FIG: 6.5  THE MUTILATERAL SETTLEMENT
6.14 The 1957 Scheme of Multilateralisation

In contrast to the bilateral clearing, in the 1957 scheme, limits were set to indebtedness (3 per cent of exports to CMEA countries). Only 25 per cent of the limit was to be interest free. The rest was to carry an interest of 2 to 3 per cent. Once the maximum was reached the debtor could no longer purchase goods on multilateral account. Any excess debt was to be paid off through commodity trade within three months following the end of the month in which the ceiling was reached. If the debtor still was unable to repay his debt, he was required to deliver within 30 days one or more of the 14 selected (scheduled) goods. These goods were: hard coal, synthetic rubber, motor tyres, sawn timber, diesel fuel, fuel oil, rolled steel, aluminium salts, grain, sugar, meat and tobacco.

6.14.1 The Operation and the Impact of the 1957 Scheme

The 1957 Agreement was of very limited operation and involved neither subscription nor any special institution beyond the earmarked account at the State Bank of Soviet Union and corresponding balances in members' national banks. One interesting provision of the 1957 clearing scheme was concerning the swing credit to be granted automatically by the clearing bank in Moscow to any member albeit within only one year and very small limits. This was perhaps the first supranational commitment made by the CMEA members in corpore. "The principle
of sovereignty with this miniscule breach was protected by the requirement that the settlement of clearing disequilibria was to be effected by bilateral negotiation" (Kaser, 1967, p.77).

The 1957 scheme tried to create an institution for multilateral settlement and set limits to indebtedness by providing for higher interest charges and settlement in 'hard' goods. Thus, the 1957 scheme was no doubt an advance over the earlier clearing practices, but its impact on the extent of multilateralization seems to be meagre. Brabant (1977) gives several estimates of the extent of multilateralization during 1957-1963 when the 1957 scheme was in force. These estimates prove that only a minor share of intra-CMEA trade was cleared multilaterally. The highest figure available is not more than 3 per cent (Table 6.3).

The 1963 Agreement and the Multilateral Clearing Scheme

The Seventeenth Session (1962) of the CMEA considered the question of revamping the 1957 clearing scheme. It was proposed to create a new payments system to be administered by a regional bank. The Eighteenth CMEA Session (1963) examined a draft agreement on multilateral settlements and the proposed bank's charter. The final agreement and charter was signed by October 1963. The 1963 agreement created an institution and an instrument
Table 6.3: Share of Multilateral Clearing 1957-63

<table>
<thead>
<tr>
<th>Source</th>
<th>Period</th>
<th>Value</th>
<th>Per cent of Regional Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>Novozamaky (1964)</td>
<td>1957</td>
<td>2.4</td>
<td>0.02</td>
</tr>
<tr>
<td>Gosbank (1961)</td>
<td>1958</td>
<td>8.9</td>
<td>0.10</td>
</tr>
<tr>
<td></td>
<td>1959</td>
<td>22.3</td>
<td>0.17</td>
</tr>
<tr>
<td>Novozamsky (1964)</td>
<td>1960</td>
<td>77.7</td>
<td>0.42</td>
</tr>
<tr>
<td></td>
<td>1961</td>
<td>325.0</td>
<td>0.49</td>
</tr>
<tr>
<td>Zolotarer (1970)</td>
<td>1963</td>
<td>n.a.</td>
<td>1.60</td>
</tr>
<tr>
<td>Auch (1972)</td>
<td>1957-63</td>
<td>n.a.</td>
<td>2.3</td>
</tr>
<tr>
<td>Bien (1970)</td>
<td>1957-63</td>
<td>n.a.</td>
<td>2.0</td>
</tr>
<tr>
<td>Carevski (1965)</td>
<td>1957-63</td>
<td>n.a.</td>
<td>1.0</td>
</tr>
<tr>
<td>Kaser (1970)</td>
<td>1957-63</td>
<td>n.a.</td>
<td>1.5</td>
</tr>
<tr>
<td>Mazanor (1970)</td>
<td>1957-63</td>
<td>n.a.</td>
<td>1.0</td>
</tr>
<tr>
<td>Rolow (1974)</td>
<td>1957-63</td>
<td>n.a.</td>
<td>1.5</td>
</tr>
<tr>
<td>Rumich (1972)</td>
<td>1957-63</td>
<td>n.a.</td>
<td>1.0</td>
</tr>
<tr>
<td>Svenikov (1964)</td>
<td>1957-63</td>
<td>n.a.</td>
<td>2.0</td>
</tr>
<tr>
<td>Zwass (1963)</td>
<td>1957-62</td>
<td>n.a.</td>
<td>1.5</td>
</tr>
<tr>
<td>Carevski (1968)</td>
<td>1963</td>
<td>19.7</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td>1957-63</td>
<td>67.9</td>
<td>1.15</td>
</tr>
</tbody>
</table>

Source: Brabant, 1977, p. 86.
for multilateralising the intra-CMEA trade. The institution was the International Bank for Economic Cooperation (IBEC) and the instrument the Transferable Ruble (TR).

The multilateral clearing scheme created by the 1963 agreement is as follows (Ruminska, 1982, p.92):

Every CMEA country has an account in the bank in which are registered all payments claims on the other member countries and payments obligations expressed in transferable rubles. From a technical point of view, the accounts are settled multilaterally. The net of all credit and debit transactions on the account represents the net position of a country vis-a-vis all its partners, being thus a payment claim upon or a payment obligation for the bank. For the individual country, it is important then to maintain its balance of payment equilibrium not in relation to each individual partner but in relation to all other member countries taken together.

A deficit country may obtain various kinds of credit from the bank. The most important is the settlement credit which is granted automatically up to a certain limit. Its amount is decided by the bank's Council. Other kinds of credit include the seasonal credit covering deficits caused by seasonal nature of production and sale of certain commodities, credit earmarked for covering deficits provoked by delays in delivery, etc. An interest is generally
payable on the credit obtained. For instance, annual interest rate for settlement credits amount to 2 per cent, only when, however, its total amount (together with seasonal credit) exceeds 25 per cent of the value of trade with other CMEA countries.

6.15.1 The Salient Features of the 1963 Scheme of Multilateralisation

i) Clearing Through the TRs

Clearing will be effected through TR, the socialist international currency.

ii) Clearing Through the IBEC

Multilateral clearing will take place automatically through the IBEC where each member country has one account.

iii) The Extension of Credit by the Bank

The bank will extend credits to bridge temporary differences in the reciprocal flow of payments and to promote supplementary trade and cooperation. Credits will be subject to interest rates which depend on the purpose of the transaction and the duration of the credit.

iv) Trade Agreements

CMEA members are not required to balance their trade bilaterally as formerly in every trade period. The trade agreements are negotiated in two stages.

In the first stage, the members enter into bilateral trade contracts as before but do not necessarily aim at bilateral balancing.
In the second stage, multilateral negotiations take place for settling imbalances arising out of bilateral agreements. Each CMEA country is now expected to attain balance of trade with the region as a whole.

If the 1957 and 1963 schemes are compared, it becomes clear that in practice the new system of clearing has done little to stimulate multilateralisation. Brabant (1977) has collected some data (Table 6.3) and from which he concludes, "in fact the data suggest that the degree of multilateralisation attained since 1964 is approximately of the same order of magnitude as the level secured under the 1957 agreement and does not significantly differ from the levels reached under the formal bilateralism before 1957" (Brabant, 1977, p.94).

**Concluding Remarks**

The foregoing account shows, how the CMEA countries have been taking steps, to multilateralise their mutual trade. The setting up of an international bank of the CMEA, the International Bank for Economic Cooperation (IBEC) and the introduction of the common currency of the CMEA, the Transferable Ruble (TR) were two very potent devices to accelerate the process of the multilateralization of trade. And yet, the result of these two innovations was far from encouraging. Hardly 2 to 3 per cent of the total trade turnover was multilateralised. (Table 6.3)
It would be necessary to look into various other constraints operating in the CMEA economies which hamper the efforts to accelerate multilateralisation. We must look deeper not only into the limitations of the SBEC and TR but the impact of the steps taken by the CMEA, in the field of foreign trade prices, exchange rate, convertibility, and the foreign trade organization set up and strengthened by the socialist countries over the past 30-35 years.

Chapter 7 and 8 seek to take a closer look at the measures taken by the CMEA countries to tackle the emerging problems. It is only then possible to pass a judgement on the practice and problems of the whole socialist foreign trade system. Chapter 9 sets for itself precisely that task.