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RECENT ECONOMIC DEVELOPMENTS IN EASTERN EUROPE AND INTRA-COMECON RELATIONS

Note by the Chairman

Please find attached for your attention a revised version of the document which has been discussed on various occasions at previous Committee meetings, most recently on 27th November last, as Document ED/EC/75/71(Revised).

Additional suggestions and modifications have been received from delegations and have been incorporated in the attached version which will now be forwarded formally to the Political Committee for consideration. The Political Committee will examine this document on 16th December next.

Delegates retain the right, of course, to propose subsequent changes to this document at Political Committee level. In this connection the US Authorities maintain a reserve on paragraph 15.

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RECENT ECONOMIC DEVELOPMENTS IN EASTERN EUROPE AND INTRA-COMECON RELATIONS

Economic consequences of the latest developments(1)

Introduction - General pattern of COMECON-USSR relations

1. COMECON is one of the instruments of Soviet economic predominance over its allies. Apart from the integration of these countries in a political-military system which it dominates, the Soviet Union's hegemony is derived from its economic power - its size, its wealth of raw materials - and from the existence in all the East European countries of a strict system of planning of the domestic economies and trade.

2. The complex integration plan, introduced in 1971, placed special emphasis on the co-ordination of planning and co-ordinated production as well as on scientific and technical co-operation. The complex plan will be strengthened over the next five years at the policy level through the attainment by the USSR of a long sought Soviet aim: synchronization of most CEMA-Country Domestic Five-Year Plans with that of the USSR (the Tenth Five-Year Plan, 1976-1980). At the operational level, the harmonization of national Five-Year Plans is accompanied by the introduction of a new pricing system. It also facilitates the attraction of CEMA countries by the USSR into "joint projects" on Soviet territory which become the sole property of the Soviet Union. Plan co-ordination, then, works not only to further increase Soviet economic influence over its allies, but also to develop the Soviet economic infrastructure. At the same time, the Eastern countries derive certain advantages from increased integration which, because it allows for greater specialization, fosters the development of their technology and certain sectors of their economies. Again, in exchange for investment in the development of Soviet resources, they are assured of relatively secure supplies and export outlets for their often not very competitive goods.

(1) This note is based on information which at present remains incomplete and provisional; it may therefore have to be modified later

3. The USSR has every reason to deny its East European partners the right of bilateral negotiation with the EC. The Soviets are aware that COMECON-EC official contacts must lead to a more important status for COMECON which, in turn, will enable the USSR to reinforce its influence within that regional grouping. Moreover, closer COMECON-EC relations would, in the Soviet view promote more rapid availability of much needed Western technology for the Soviet Union, and could reduce the Soviet balance of trade deficit in the shorter to medium term and, perhaps, ensure most favoured nation treatment by the EC for the Soviet Union. Bilateral contacts, however, by the East European nations with the EC could lead to undesirable Western influence on those nations, and to an asymetrical relationship evolving - on the one hand the EC, on the other the individual East European nations - which would connote a loss of prestige for COMECON, and therefore the USSR.

4. The rise in world prices of basic commodities and the recession in the West, which has jeopardised the chances of balancing the East European countries' trade with the market economies, gave the Soviet Union an opportunity early this year to strengthen its economic position in relation to those countries.

5. This policy of economic integration is, however, encountering some resistance from some East European countries which want to safeguard some degree of economic independence and which are accordingly keen to conclude bilateral agreements on trade and technical co-operation with the West. The least enthusiastic over Soviet initiatives would seem to be Romania, Poland and Hungary.

I. Recent Events

6. The terms of East European trade with the West have markedly deteriorated because of the higher rise in the price of goods imported from the market economy countries and because of the inability of the East European countries to adjust properly their own prices for goods of doubtful quality, the demand for which has gone down sharply because of the recession in the West. All these factors have led to a greater deficit in their balance of trade.

7. The strong upward movement in the price of basic commodities prompted the Soviet Union in January, 1975, to raise prices to its allies. This action reduced the competitive advantage which the latter could have derived from the use of low cost raw material supplies from the Soviet Union. These increases, made within the framework of the new intra-COMECON price system are - according to United States estimates - expected to increase the annual import bill of the East European countries by between $1.5 and $1.8 billion.

8. Despite increases in raw material prices for the East European countries (oil: +130%), prices remain substantially lower than world rates (some 40% for oil). The new adjustment mechanism, providing for annual revisions based on a sliding five-year

average, is likely to bring prices increasingly closer into line with world market rates. Existing increases are still sufficiently steep, and indeed may have been carefully calculated. On the other hand, the USSR has no wish to over-depress the economies of the East European countries, to tip the balance of trade too heavily in its own favour or to trigger off an increase in production costs that would undermine the domestic price system and cut consumer purchasing power. Developments of this kind could lead to discontent and social unrest - of a type experienced in Poland in 1970 - from which the Soviet Union and the Communist leaders in the different countries could suffer.

9. In setting the new prices, the Soviet Union has also had to take account of its own particular problems, since it must meet its own growing development requirements, while new indigenous resources are often difficult to harness.

10. The difficulties encountered in opening up Siberia (the remoteness of deposits, the high cost of infrastructure and the reluctance of the West to finance developments) has increased the need for the Soviet Union to obtain the participation of its allies in this mammoth venture.

11. To offset the higher costs imposed on the East European countries, the Soviet Union has accepted an increase in the price of manufactured goods exported to the USSR, which, though substantial, does not in most cases fully offset the financial burden created by the increase in the price of imports. Consequently, Moscow seems willing to help its allies in several ways:

(a) by granting them long-term credits at low interest rates (Hungary has already obtained 10 year credits at 2%);

(b) by agreeing that their trade surplus for previous years should be set against their present or future deficits;

(c) by stepping up its supply of oil and raw materials on condition that its partners take a hand in harnessing Soviet natural resources (e.g. Orenburg gas deposits); investments made by them could be set against the repayments of loans. Future COMECON-country participation in Siberian energy development cannot be excluded either;

(d) by agreeing in principle (Hungarian sources report) to supply its allies, over and above the agreed quota, with increased quantities of crude oil, timber, natural gas, fertilizer and other chemical products at below world prices but nevertheless payable in convertible currencies or in goods obtained from the West;

(e) possibly by transferring gold to its allies at below market prices(1); the scale of such transactions is extremely difficult to estimate.

12. All these measures should mitigate the deterioration of the terms of trade and any deficit in the East European countries' balance of payments.

II. Economic and Political Consequences

13. In the East European countries

The present economic situation (recession - increased cost of energy and raw materials - inflation in the West) has had two main consequences for the East European countries, namely:

(i) that the rate of domestic expansion has dropped, though not uniformly (countries like Romania and Poland which are self-sufficient in some forms of energy and even export these products are less sensitive to outside events than the others); generally speaking, and at least in the short term, the possibility of increased trade with the West will be affected both by the deterioration in the terms of trade and by the fall in Western demand for East European exports; in addition, the need to balance external accounts both with the West and with the USSR carries a risk of stagnation in income, the standard of living and consumption;

(ii) that to compensate for this situation, there is a temptation for the East European countries to co-ordinate more closely and this favours integration within the COMECON; the prime beneficiary of this development is likely to be the USSR which could well derive substantial political and economic advantages from multilateral interplay; it is also to the advantage of Moscow's allies which, faced

(1) Source: Bank for International Settlements, Basle

with manpower shortages and declining capital productivity, could use the increased international specialisation and the integration of their development plans to develop those sectors of their economy in which they are relatively stronger than their partners.

14. In the USSR

The position of the Soviet Union has been strengthened by recent economic developments but there are nevertheless certain factors which it must take into account:

(i) on the one hand, it is finding increasing difficulty in meeting its allies' requirements for oil and raw materials, its own requirements and its need to step up its exports to the West in order to pay for its purchases of grain and equipment;

(ii) on the other hand, while it can tighten its control over the economies of its COMECON partners, it must nevertheless be careful to avoid difficulties and social unrest for those countries.

15. In the Alliance

Individual member countries should remain attentive to current developments in COMECON and the trend towards greater integration between the USSR and its partners in that organization since:

(i) the political and military cohesion of the USSR and the East European countries, as represented by the Warsaw Pact and by the bilateral agreements binding each of those countries to the Soviet Union, would be enhanced by the transformation of what is still the heterogeneous grouping in COMECON into a more fully integrated economic bloc, the different components of which would gravitate round a main "development axis" formed by the USSR;

(ii) if a move of this kind were to take shape during the period of the Five-Year Plan 1976-1980, COMECON would tend to become a privileged instrument of negotiation, acting on behalf of its member countries but primarily under Soviet guidance; this development would make it more difficult for several East European countries to build up their bilateral and economic trade relations with countries of the non-Communist world and to negotiate with the E.C. as such.

To attenuate the problems as described above which the East European countries are encountering as a result of their weakened economic position within COMECON and to give them more room for manoeuvre, the individual members of the Alliance have a number of options such as trade accords, agreements on industrial co-operation, export credits (within the limits laid down by the creditworthiness of the various beneficiaries) and the promotion of joint enterprises in the East. In this context commitments made towards third countries in the framework of agreements or international treaties (GATT, Treaty of Rome, etc.) limit the implementation of these options.

RECENT DEVELOPMENTS IN COMECON: THE IMPLICATIONS FOR EASTERN EUROPE

INTRODUCTION

1. Since the adoption in 1971 of the Comprehensive Programme on "Further Co-operation and Economic Integration" of COMECON, the Soviet Union has made slow but unequivocal progress towards realising its blueprint of a Soviet-controlled economic area throughout Eastern Europe. This of course has been rendered easier by the economic disproportion between the USSR and its East European partners as well as the political dominance exerted by Moscow over its allies.

2. The extent to which the East European countries consider their membership of COMECON a privilege or a heavy economic burden is now acquiring significance in both economic and political terms as three additional factors enter the scene:

(i) the new intra-COMECON price policy introduced in January 1975;

(ii) the growing number of "integration projects" on Soviet territory, e.g. the Orenburg pipeline, and East European investment in the exploitation of Soviet raw materials;

(iii) the increased importance of "multinational specialisation enterprises" (e.g. Interatoministrument; Interkhimvolokno; Interatomenergo, etc.) in providing R&D for the Soviet Union.

These factors, moreover, are now operative in a very disturbed economic context - that of the current recession and inflation in the West which are having an effect on East-West, indeed on world trade.

I. NEW ECONOMIC FACTORS IN THE COMMON CONTEXT

A. The Price System

3. Since January 1975, the Soviet Union, in the light of changes occurring in the world commodity markets, has raised the prices of many of its exports - particularly selected raw materials and energy resources - to its East European partners. This unexpected decision reflecting both the new OPEC price pattern and world-wide inflation, is a much more dramatic departure from previous intra-COMECON agreements; it may

represent a greater Soviet awareness of the need to realign prices realistically. Although Moscow may feel that the gap between its export prices to COMECON countries and world market prices is still quite large in favour of the latter, the USSR cannot close this gap entirely as this measure would deprive it of political leverage which it needs to enforce integration more rapidly.

GENERAL ASSESSMENT

Advantages for Eastern Europe

4. While the impact of the price increases will vary from country to country, it is clear that few concrete advantages will accrue to Moscow's East European partners. Little information is available on price rises of raw materials apart from oil (+130%) but the price of the latter will still remain below current world market levels for the foreseeable future. The blow is further being softened by an upward revision of the prices of industrial and consumer goods sold by Eastern Europe to the USSR, although it is not believed that these increases will in any way offset the new financial burden created for the East European countries.

5. Given the growing indebtedness of these countries towards the West (estimated cumulatively to be over $8 billion as of mid 1975), the USSR could have eased the burden by maintaining its low prices or at least by only passing on the marginal costs of new Soviet oil production in the high-cost areas of Siberia. Still the Eastern countries are being somewhat protected price-wise in the oil sector as stated in paragraph 4 by the upward price revision of certain East European exports to the USSR and the extension of Soviet credits via the International Investment Bank (IIB) (details not available). Presumably as a counter-service for such credits, the East European countries will now be required to make investment resources available to help develop Soviet raw materials. While no data are at present to hand on the variations in such investment costs, these will most likely be based, among other factors, on the individual country's investment effort as well as on its politico-economic status within COMECON.

6. It may also be anticipated that in the event of a noticeable decline in the world price of oil and other raw materials that the Soviets will rapidly also readjust intra-COMECON prices to ensure that their allies do not pay either above or at world levels and concurrently to avoid the risk of national discontent.

7. Finally, it must be assumed that Soviet credits will be made available throughout the Eastern countries not merely to avoid the kind of unrest that produced the December 1970 Polish protests; this, however, is bound to raise further the indebtedness of the East European countries, a factor that can only assist Moscow ultimately in its political objective of closer integration.

8. Indeed, it is known that models for cushioning the ill-effects of the price impact are already being devised. Hungary, for instance, will be permitted to use its 1974 Soviet trade surplus of TR35 million to finance roughly 25% of the added raw material costs, while Moscow has agreed to extend ten-year credits on what are reportedly very favourable terms. Apparently, comparable plans are being perfected to assist the other East European countries, especially the GDR and Czechoslovakia which along with Hungary, are likely to experience some realignment pains, at least for the next two years and will clearly have to offset the new burden by more aggressive export drives.

9. Overall the Soviet Union may exercise its economic leverage with care. The USSR would not benefit from social or economic stagnation in Eastern Europe and would appear so far not to be pressing the East Europeans too greatly. For this, the Soviets may be compensated by East European concessions such as greater compliance for economic integration within COMECON.

Disadvantages

10. The new Soviet price increases have clearly arrived at a bad time for the Eastern countries. Moreover, these countries have apparently almost exhausted any possibility of extensive growth. To modernise their economies, all the Eastern countries need rapid evolution which can only be realised by importing high technology, know-how and sophisticated machinery. These economies are suffering from the burden of spiralling Western prices, the more so as since 1970, with the exception of Bulgaria and Czechoslovakia (where trade with the West has hitherto been given a low profile for political reasons), the other Eastern countries have significantly increased their share of imports from the industrial West.

11. The new prices will produce a change in the terms of trade to the disadvantage of the Eastern countries, thus increasing their dependence on the USSR and representing a considerable real cost to the Eastern economies. The price rise, moreover, has removed any competitive advantage hitherto

enjoyed by the East European countries through procuring raw materials at well below market prices from the Soviet Union. US experts rate the deterioration in terms of trade vis-à-vis the USSR as follows over the next Plan period (1976-1980) on an annual basis: Hungary: 11%; Czechoslovakia: 20%; Poland: 16%; Bulgaria: 7%; Romania: 2%. Naturally, the net effect for each country will depend on the import and export product mix.

12. To maintain a given volume of trade with the USSR, Eastern Europe will probably be forced to divert exports from the West in the medium-term to the USSR and thus sacrifice much-needed imports from the West. Calculating the medium-term deterioration of the East European terms of trade vis-à-vis the USSR at ±12% and total Soviet exports towards its Eastern partners in 1974 at some $15 billion, all things being equal, the 1975 deterioration for Eastern Europe could be of the order of $1.5-$1.8 billion. As a result, technological progress will be curtailed and economic growth is likely to be decelerated, while living standards will also be adversely affected.

13. Finally, it is clear that the new pricing system has complicated the co-ordination of Five-Year Plans between the USSR and the six European member countries, and the final 1976-1980 projections may not be completed until early 1976. Although it is not unusual for quinquennial plans to be delayed while Soviet and East European planners co-ordinate their targets, it is admitted that drastic revision of pricing levels has caused special problems, a fact that emerged apparently at the June 1975 meeting of the COMECON Council.

IMPACT BY COUNTRIES

14. The impact of the above-mentioned deterioration annually over the period 1976-1980 can also be expressed quantitatively by relating the changes to the GNP size in the countries involved. The analysis given below is based on US sources and should be regarded as purely tentative at this stage.

(a) Hungary: trade with the USSR is about one-third of Hungary's total trade which equals around one-fourth of its GNP. Here the impact of the terms of trade downturn would be equal to almost 1% of GNP. Although not sufficient to point to an absolute decline in economic activity, the result could affect considerably Hungary's growth and development. A *Financial Times* report dated 11th September reported a Soviet-Hungarian protocol on co-ordination of the next Five-Year Plans of the two countries which provides for a 40% increase of two-way trade with Hungarian imports of oil and other fuels rising by 60% compared with the current Plan period.

(b) Czechoslovakia: again, the impact would seem to be far from negligible with a 1% deterioration of GNP, slightly higher than for Hungary and the most serious in the bloc, due to the fact that oil accounts for a relatively high proportion of the country's imports from the USSR - 17% in 1974 - the largest share for any Eastern country.

(c) Poland: experts assess the Polish erosion of GNP at 0.5% largely a reflection of the fact that this country's trade with the USSR equals only around 8% of GNP. Additionally, Poland's ample coal resources could feasibly permit a reduction in the currently substantial amounts of oil which Poland imports from the USSR. The country also has considerable copper and sulphur deposits for export which, along with the coal, could attenuate the impact of balance-of-payments problems. The indication is that it will be increasingly difficult for Poland to balance its trade with the USSR during 1976-1980 especially in view of that country's ambitious growth programme(1).

(d) GDR: this country's trade with the USSR as a percentage of GNP is a little more than 5%. However, because the deterioration in East Germany's terms of trade with the Soviet Union will probably be relatively large - about the same as for Hungary - the future deterioration ratio to the size of GNP is assessed at about 0.7%(2).

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(1) As regards the next Plan period, on a number of occasions this year the Polish leaders have clearly told the nation that the national income will grow by 40-42% (i.e. an average of 7% a year) as against 62% during the preceding Five-Year Plan (i.e. 10% a year). Salaries, which reflect the standard of living, will reportedly increase by 16-18%, that is about 3% a year or half the average rate of growth of the last five years

(2) Vestnik of 7th October, 1975 reports an agreement whereby the GDR will supply the USSR with chemical/metallurgical complexes over 1976-1980 in return for improvements in GDR fuel/energy supplies. The GDR will also install plant on Soviet territory as payment for additional energy supplies

(e) Bulgaria: apart from Romania (see below) the impact of the price increases will possibly be felt least in Bulgaria, the most "integrated" of the USSR's partners. One reason is that manufactured goods, for which the Soviets are boosting their prices very little, account for a relatively large share of Bulgaria's imports from the USSR. Further, farm produce, for which it is reported the Soviet Union has agreed in principle to pay higher prices (to Hungary also) represents a large share of Bulgaria's exports to the USSR. Still trade constitutes a sizeable percentage of this country's GNP - over 20% - and commerce with the USSR totals around 50% of Bulgaria's total trade. The slight decline in the terms of trade anticipated for Bulgaria could represent about 0.2%-0.4% of its GNP.

(f) Romania: the effect of the new price increase in relation to GNP is considered as minimal in the shorter-term, primarily because the country is more self-sufficient in energy than the other Eastern countries, it imports no oil from the USSR and it may now benefit from its new MFN status granted recently by the US.

15. Obviously, with their centrally planned economies, the East European authorities need not pass on all the price increases directly to the consumers. Nevertheless the greater indebtedness towards the USSR over the next Plan period means additional funds which must be found at the expense of domestic investment growth, already cut by East European contributions to Soviet projects, or deferred wage increases, or through cuts in public expenditure. In any case the difference between East European and Soviet living standards (the former in general are higher at present than the latter), will most probably be somewhat reduced in the medium-term as the Eastern countries experience slower growth, and the USSR, by virtue of its raw material base and ability to procure Western technology is able to maintain its growth rate and thus consolidate its economic and political hold on the area(1).

B. Current and future East-European development of Soviet resources

16. Joint investments for the development of natural resources or the building of plants is no new phenomenon

(1) US estimates of per capita GNP for the USSR and the East European countries in 1974 are $2,185 and $2,575 respectively. However, these indicators may be misleading in that they do not reflect the wide regional differences in living standards in certain of the East European countries and especially in the USSR

within COMECON. What is new in the recently announced practice is the increase in size of the investments provided on credit and the much more varied forms they are taking(1). In the past the East European countries co-operated with the USSR within the Integration Programme primarily by supplying investment goods. From now on their contribution will be increasingly supplemented by actual participation in the construction of a project, sometimes sending their own workers and specialists to the USSR for that purpose.

17. It was decided at the June 1975 COMECON meeting in Budapest that the contribution of COMECON countries to Soviet investment schemes (Annex II) during the next Five-Year Plan period will reach some $10 billion - double the amount for the present period. It is uncertain whether this figure comprises merely investment costs or if it includes raw material deliveries to be made subsequently. In any case, such deliveries will not take place before 1980 at the earliest.

18. Ultimately, such joint investments may, however, be viewed as a logical economic step by the East European countries in that for most of them (possibly with the exception of Poland and Romania), such investments would be inevitable anyway to ensure reliable and stable supplies of vital raw materials, and capital inputs required for this outside COMECON could well have been far higher than will be the case inside the organization(2).

Financial aspects of East European involvement

19. With all the Eastern European countries already spending up to 30% or more of their national income on investments, the additional funds required for joint COMECON projects is a burden of some magnitude on top of that already imposed by the change in the terms of trade and their shares of investment requirements financed through the Investment Bank for Economic Co-operation (IBEC).

20. It can be anticipated that most joint projects planned or under way will in part require Western equipment, purchase of which must be shared by the Eastern countries. An unequivocal example is the Orenburg project, where much of the equipment

(1) For example Appendix C to AC/127-D/514 contains a list of Czechoslovakia's participation in such projects
(2) See Annex II for information on the much publicised Orenburg gas pipeline (1,700 miles) from the southern Urals to the Soviet-Czech border, and on other large-scale "integration" projects

will have to be purchased from the West which will constitute a considerable financial as well as a manpower resource burden on the Eastern countries.

21. When most long-term credits are provided by one country to another, some reduction of domestic investment capacity is usually entailed, especially when an acute shortage of capital exists as is generally the case with Eastern Europe. Re-financing of credit may help to reduce at least the apparent size of the problem, but the capital-exporting countries, i.e. the Eastern countries providing development credits to the USSR, must then find their own creditors. The resulting "arbitrage" in credit terms may well be to the disadvantage of the East European countries, since relatively low interest rates are usual in intra-COMECON dealings and the re-financing of non-convertible currency loans via the Euro-currency market is highly improbable.

22. In other words the growing diversity of East European investment in the USSR raises serious problems of commensurability; how are the values of these disparate forms of investment to be converted into or recalculated in terms of the transferable ruble? Expenditure actually made in various non-convertible national currencies, wide differences in pricing practices, different approaches to methods of determining wages and costs, the "intrusion" of market-determined elements from the West - all these factors will have to be harmonised into a consistent entity and the burden will ultimately be that of the Eastern European countries rather than of the USSR with its immense natural resources and very substantial gold reserves. The larger this burden, the easier it becomes for Moscow to control and influence its partners.

C. COMECON multinational bodies

23. Production specialisation is a relatively recent addition to COMECON's range of methods for achieving closer integration. The problem is complicated by the differing economic and industrial levels and government objectives in the various East European countries. Romania, Bulgaria and Hungary, for example, wish primarily to strengthen their industrial base and consequently are not keen to accept any significant degree of specialisation unless it brings them relatively quick economic returns. Other impeding factors include the persistent lack of common technical standards and economic criteria which would allow individual members to evaluate the relative profitability of such projects. Nevertheless, under pressures from Moscow COMECON has developed a number of organizations to promote

specialisation and R & D, and to encourage intra-bloc co-operation(1). Indeed, the importance of more co-ordinated R & D within COMECON was emphasized at the June 1975 Council meeting in Budapest.

24. While little is known of the activities of these and other socialist "multinational" enterprises, it is clear that all may make a substantial contribution to the Soviet defence sector as well as providing R & D to key civilian branches of Soviet industry. Whilst the participating member countries will clearly derive some advantages for use at national level, as with the joint ventures described above (B), it is evident that what Moscow's partners transfer in terms of R & D, new technological processes or advanced machinery to the USSR, may be reimbursed by the USSR at a later date, frequently unspecified, once the fruits of the R & D have been applied, but this represents a very real burden in that the East European participants have no choice ultimately as to the destination of their R & D input.

II. ADDITIONAL PRESSURE FACTORS

25. In addition to the three elements outlined above, other factors both very recent in origin or long-standing may also become of crucial importance in Moscow's efforts to achieve a greater degree of hegemony. These include:

(a) US-Soviet Grain Accord: extending from 1st October, 1976 to 30th September, 1981, the US will permit the delivery of a minimum of 6 million tons per year to the Soviet Union of wheat and corn. The Soviets also have an option to buy an additional 2 million tons of grain annually. The US may refuse exports of grain to the USSR should its crop fall below 225 million tons in any year. Deliveries of barley, sorghum, oats, rye, soybeans and rice are not covered by the deal. Some of the US grain purchased for Soviet account could well be re-exported to the Eastern countries, which especially in 1975 are reporting poor harvests (e.g. GDR and Poland).

(1) See Annex III

(b) As a parallel gesture, the USSR will sell 10 million tons of oil annually to the US over the five-year period, or about 200,000 barrels of oil per day: the price of the oil is still subject to negotiation. It is believed that almost any crude oil sales by the USSR to the US would, however, require consumption cuts or further curtailment of Soviet exports elsewhere, despite the fact that the USSR is now the world's largest oil producer with an average annual increase in output of some 25 million tons at least. Almost all of the increment comes from the Tyumen fields of Western Siberia, where the oil has a relatively high sulphur content, whereas the Soviets' projected increase in the low sulphur oilfields is almost nil. This factor alone could well cause problems for the USSR in its endeavour to meet its regular oil commitments to the US.

(c) COMECON currencies: during the period 1976-1980, it is a COMECON intention to establish the pre-requisites for a single exchange rate for each COMECON country's national currency; the date for the actual introduction of this single rate is to be determined soon afterwards. It should be recalled that currently the "transferable" ruble is merely an accounting unit devised to enable COMECON members to balance their trade multilaterally, and whose parity in relation to national currencies has not been defined. Each COMECON member has an account in transferable rubles with IBEC in Moscow, utilising it to balance commercial exchanges with other members. In other words, the IBEC acts like a clearing house, centralising all operations, and enabling multilateral settlements in transferable rubles. This system which is theoretically adapted to the needs of an economically sealed and fully centralised complex has, in fact, turned out to be clumsy and disadvantageous. The transferable ruble as an accounting unit merely reflects the exchange of goods and is neither convertible in any COMECON national currency nor in that of any third nation. Not only does bilateralism tend to isolate in practice intra-COMECON trade from the remainder of the member nations' economies, it also hinders external COMECON trade.

(d) COMECON pricing: prices in transferable rubles are set by mutual agreement on the basis of "world prices from which the noxious influence of cyclical factors characteristic of the capitalist market" have been eliminated(1).

(1) Section 4, Article 28 of the Complex Programme

In fact this principle has not been adhered to: prices are based on world levels of an earlier period (primarily 1964 price levels) and so have little to do with current world rates - a difference which became especially marked in the case of raw material prices in the period 1973-1974 and which partially explains the upward revision in 1975. In other words, the current imperviousness of the system isolates COMECON national prices arrangements which bear no relation to those operative on world markets(1).

26. Clearly until COMECON goods are allowed to be exchanged freely from one country to another it is hard to see how the ruble can become truly transferable. Unfortunately for the Eastern countries, the USSR is so much less concerned with external trade than its COMECON partners (Soviet foreigh trade: 5% of GNP, compared with around 30% of GNP for the East European countries) that for Moscow commerce and exchange matters have a relatively low priority apart from the marginal although important need for Western advanced technology.

III. COMECON INTEGRATION: CONSEQUENCES AND FORECAST

(1) Overall trends: in the shorter term, it would seem that most developments within COMECON, i.e. specialisation, finance or trade, will continue to be worked out bilaterally between the USSR and its partners. On the other hand, the problems raised by the new pricing system, the economic necessity of the East European countries to invest more actively in the USSR, the problem of internal currency prices, and of course national frictions will all contribute to impeding the attainment of Moscow's goal of economic integration in the foreseeable future.

(2) Living standards: confronted with the greatly increased import costs from both the West and the USSR, there will be a need for far tighter efficiency in planning if living standards are not to fall to those of the Soviet Union. This need is already being felt and reflected in a higher degree of central control in such areas as imports and investments - all to Moscow's satisfaction. Indeed, there may be an inevitable longer-term rapprochement of Soviet-East European living standards due to the slowdown in East European growth and the concurrent

(1) Presumably more detailed information on the impact of the new pricing system will become available at the start of the next Plan period (1976-1980)

slow but steady upturn in Soviet standards, despite the obviously wide regional differentials in the USSR both in terms of social conditions and in income - for example, indices established for earned income in 1973 (USSR = 100) varied from 65 for Azerbaidzhan to 128 for Lithuania(1).

(3) Planning: on the other hand, the COMECON drive towards closer integration of planning is also giving management broader decision-making powers aimed at greater profitability. The COMECON trade price system will almost certainly be restructured in the medium-term with the aim of stimulating production and boosting exports to the West.

The thrust towards integration nevertheless calls for considerable conformity in planning procedures and economic practice, and as Moscow's influence grows within the bloc, the chances seem diminished for the type of national economic experiment that characterised the 1960s in Eastern Europe.

(4) COMECON's external image: it is in external COMECON policy where the USSR would like to reflect the image of an internally integrated COMECON speaking to the outside world. Again the Romanians fear that this voice would inevitably not speak for the special interests and needs of the less developed COMECON members: hence the Romanian resistance to supranational contacts unless supplemented by national ones. Romania tends now to find itself isolated in its opposition to tighter Soviet control and may well be forced to accept some form of compromise.

(5) The Romanians remain the outsiders to some degree, although it is ambiguous why Moscow permits this. The Romanian fear is the realistic one that, however equitable Moscow's integration plans may be in theory, the disparity of economic strength between the Soviet Union and its East European partners could and in the longer-term probably will lead to their being woven into a fabric of total economic dependence on the USSR, whereas the converse is unimaginable.

(6) Armaments: although little data are available on the armaments sector, the extensive co-operation envisaged in the next Plan period in most branches of civilian engineering is bound to include R & D in a number of fields which relate to defence needs. There is every

(1) cf. footnote (1), page 6

reason to assume that the Soviets will continue to exploit the armaments output potential of their COMECON partners increasingly over the next five years, especially in an attempt to ease the burden from the Soviet Union's own military sector.

Additionally, despite the lack of data, it may be assumed that the stationing costs of Soviet troops in the East European countries, whilst ostensibly carried by the Soviet Union, must represent a considerable burden for the countries themselves, especially as regards infrastructure costs. There are indications that the USSR would like to see a stronger financial commitment by the Eastern countries (especially the GDR) towards supporting Soviet forces on their territories, but this is likely to become an issue of dissension in the current phase of economic difficulties.

The aggregate data presented in this brief report on COMECON's evolution unequivocally indicate that the six European COMECON partners of Moscow (i.e. including a very reluctant Romania) will continue to be forced into a tighter economic dependence on the USSR, although this is not to deny the economic benefits which the East European countries will clearly continue to derive from COMECON membership. Nevertheless, in view of the overwhelming dependence of the Eastern countries on Soviet energy and raw materials, the USSR emerges increasingly as the main beneficiary within this regional grouping.

THE ORENBURG PIPELINE PROJECT

When completed the pipeline will enable the Soviets to continue to meet the greater part of East European requirements. All six Eastern countries will be involved, over 25,000 skilled and semi-skilled workers will reportedly be employed in the USSR on the construction, and each country is responsible for financing its own contribution.

The Orenburg gas pipeline project has been praised throughout COMECON as a model of international co-operation and integration within the bloc. The project presents certain characteristics which will probably typify other such joint ventures. These include:

(1) the East Europeans' need for dependable energy (raw material) source;

(2) the Soviet Union's possession of a hitherto undeveloped source;

(3) East European investment in the development of Soviet resources with repayment to be made by future deliveries from them;

(4) large-scale direct involvement of foreign nationals in work on Soviet soil.

The form in which the "integration" aspects of the Orenburg project are achieved in the COMECON context are essentially a series of bilateral co-operation agreements between the USSR and the individual Eastern countries; therefore the USSR retains complete control over the project as the common link with a Soviet organ (Soyuzintergastroy) as the supreme directorate for the project.

Other "integration" projects either planned or under way, presumably on the same structural basis and involving all or most of the Eastern countries include:

(1) the Ust Ilimsk pulp combine;

(2) the Kiyembay asbestos mining/enriching combine;

(3) the Kursk metallurgical combine;

(4) the Vinnitsa (Ukraine)-Albertirsa (Hungary) 750 kilovolt power transmission line as part of the projected COMECON unified power system.

While very little information is to hand on other joint investment projects on Soviet territory, it is known that these include plans to construct major enterprises to produce yellow phosphorus ammonium phosphate, titanium dioxide, isoprene rubber, plant for timber development and coal mining.

SOCIALIST MULTINATIONAL ORGANIZATIONS

The following were among the main organizations in existence at the end of 1974:

(i) Interatomininstrument: co-ordinates applications of nuclear R and D, manufactures measuring instruments, apparatus for radioisotope measurement for nuclear medicine, and special instruments for isotope laboratories;

(ii) Interatomenergo: assures co-operation in production and exchange for all equipment used in the construction of nuclear power plants;

(iii) Intertekstilmash: co-ordinates research, fabrication and after-sales service of textile machinery, also for standardising an industry which directly reaches the consumers and whose supply is far from meeting a growing demand;

(iv) Intertalonpribor: designs apparatus in diverse measurements fields including linear, mechanical, thermal, electronic and the frequencies sector;

(v) Interkhimvolokno: research into chemical fibres, co-ordination of supply of equipment and raw materials to this industry.