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SUB-COMMITTEE ON SOVIET ECONOMIC POLICY

THE PROBLEM OF PRICES IN INTRA-COMECON TRADE

Note by the Chairman

The problem of prices in intra-COMECON trade has preoccupied the Committee of Economic Adviers and the Sub-Committee on Soviet Economic Policy on several occasions (1). The Economic Directorate has thought it useful to prepare for a further discussion of that problem a note mainly based on communist sources and some other information available to the Secretariat.

2. This paper leaves many questions unaswered, and delegations are invited to send their comments and any additional information at their disposal as the subject of prices in COMECON countries may be worth exploring further.

3. The note will be put on the agenda of the next regular meeting of the Sub-Committee.

(Signed) A. VINCENT

OTAN/NATO
Bruxelles, 39

(1) See AC/89-R/68 to R/74 and AC/89-WP/153/series

THE PROBLEM OF PRICES IN INTRA-COMECON TRADE

Note by the Economic Directorate

I. INTRODUCTION

The conception of intra-COMECON trade is based on a bilateral pattern in which trade must be balanced. In the absence of a multilateral system of monetary clearing, any occuring inbalance can be settled only by delivery of goods corresponding in value to the temporary "commercial credit". Money is the accounting unit but not a means of payment in the Western sense.

2. In Communist countries the level of prices has been for a long time the result of political decisions which took little account of costs. However, as economic planning in COMECON countries is becoming more cost-conscious, prices assume a new significance. This is bound to influence prices in intra-COMECON trade as well. Increased contacts with the markets of the industrialised West will also accelerate this development.

3. The price at present used as reference for the settlement of intra-COMECON trade is an average of past world prices adjusted for what the Communists call "undue capitalist monopoly influence". Until 1965, intra-COMECON prices were based on world prices of 1957/58. However, such prices were not rigidly imposed and there was some limited bargaining within the scope of bilateral trade. As of 1st January, 1966, the basis was adjusted to the 1960/64 average world price level. Since raw material prices have declined in the period 1957/64, their suppliers in COMECON trade - mainly the Soviet Union - were more adversely affected while the terms of trade turned in favour of the sellers of finished industrial products - mainly the Eastern European countries. The Soviet Uniom, therefore, wanted to change the price mechanism.

4. During the COMECON conference, which took place in Budapest in April 1967, the main subject was the theoretical and practical question of the development of a "Socialist world market price". The participants of the conference agreed in general that COMECON was a regional market with special regional prices which, however, was not isolated from the world economy as a whole. They further agreed that, in the development of price principles and the fixing of actual prices, COMECON countries should rely to a greater extent on the market mechanism.

5. In the present paper an effort is being made to shed some light on the system of prices which regulates intra-COMECON trade. To this effect, the paper is divided into three sections: one dealing with the pattern of COMECON trade, another with Soviet raw material prices and the last one drawing some conclusions. In order not to burden the paper with too many details, an Annex has been added which contains statistical information about the development of prices for Soviet crude oil, hard coal, iron ore and pig iron.

II. THE TRADE PATTERN

6. Most of the Eastern European countries are highly dependent on supplies of a number of raw materials for their industrial development. Over 65% of their raw material imports are being bartered within COMECON for industrial goods. Eastern European countries have thus so far been assured of a steady supply of raw materials as well as of a secure market for their industrial products which had not to face competition. The Soviet Union, on the other side, is providing most of the raw materials needed(1) and, at the same time, receiving most of the machinery produced by the other COMECON members(2).

7. This system could work fairly well as long as in the sales of machinery and equipment the emphasis was placed on quantity rather than quality. It resulted, however, in an artificially large production of sub-world-standard machinery which so far found an easy market in the Soviet Union. At the same time there has been a drain on Soviet raw material resources; the production costs of these raw materials increased since higher investment was needed for their extraction. This trend was accelerated by the fact that, because of the high capital-output ratio in the branches of the extracting industries, it became more economic for the Eastern European countries to buy raw materials from the Soviet Union rather than to produce them in their own countries.

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(1) In reciprocal export of raw materials, the share of the Soviet Union in 1964 was 55%, that of the Zone 10.9%, of Czechoslovakia 10.3%. of Poland 8.8%, of Rumania 6.7%, of Hungary 3.8% and of Bulgaria 3.7%.

(2) The Soviet Union imported machinery and equipment from COMECON (in billion rubles) in 1960 1.08, in 1962 1.46, in 1963 1.67, in 1964 1.82 and in 1965 1.9. In 1966 the value of these imports fell to 1.72.

8. The Soviet Union soon started complaining that at the existing price level it was not compensated adequately by its COMECON partners for what it was exporting to them. Prices for Soviet crude oil, hard coal, iron ore and cotton did not, in their view, cover the growing investment costs, whereas the Soviet Union was paying too much for COMECON industrial products which were not up to world standards and which would only find an outlet in the world market if their prices were sharply reduced. At the same time, so they said, the Soviet Union did not participate in the growing share of machinery exports in total intra-COMECON trade.

9. Indeed, in some of the COMECON countries, the share of machinery exports in total intra-area trade has been growing rapidly, whereas it has been stagnating in the Soviet Union.

Percentage of Machinery Exports in Intra-COMECON Trade

	Bulgaria	Hungary	Zone	Poland	CSSR	Rumania	USSR
1955	2.8	37.6	-	17.4	51.1	6.1	17.3
1960	15.2	46.2	56.3	37.4	47.3	16.1	14.1
1965	29.9	42.8	58.6	48.7	56.3	24.5	18.1

In Czechoslovakia, Poland, Hungary and the Zone, this percentage is at present even higher than the share of machinery in the exports of some of the highly industrialised Western countries(1).

III. PRICES FOR SOVIET RAW MATERIALS

10. Some Western economists(2) point to the fact that COMECON countries have in the past and are still at present paying higher prices for Soviet raw materials than prices charged by the Soviets in their trade dealings with the West. In their view, the Soviet Union was exploiting its monopolistic position in COMECOn trade by discriminating against its Communist partners. This argument should be viewed in a broader perspective.

(1) The share of machinery and equipment as a percentage of total exports:

	1955	1960	1965
Bulgaria	2.6	14	25
Hungary	30	38	33
Zone	-	48	49
Poland	13	28	34
Rumania	6	17	19
CSSR	44	45	49
Soviet Union	18	21	20
Netherlands	-	-	23.2
France	-	-	23.5
United Kingdom	-	-	42.0
United States	-	-	38.6

(2) In particular, H. Mendershausen in "The Review of Economics and Statistics" No. 4, 1962.

11. During the period 1956-66, world raw material prices fell by 3%, whereas industrial prices increased by 13%. At the same time, the share of raw materials and fuel in world exports fell from 29.8% in 1955 to 22.9% in 1965 and that of machinery and equipment rose from 18.5% to 24.5%. This rapid growth in world trade of finished goods has been the result of world-wide industrial specialization as well as lowered consumption of raw materials per unit of product due to technical progress.

12. The Soviets admit that the fall in prices of raw materials on the world market was mainly due to these two reasons. However, they claim that the use of modern technology and the rational use of labour cannot ensure a reduction of the costs for Soviet raw materials to the level of world prices. Soviet economists say that specific geographical problems, the unfavourable conditions of some raw material deposits and the problem of transport have to be taken into account when comparing world prices with those in the Soviet Union. Furthermore, one had to bear in mind that the price for a unit of raw materials produced in the Soviet Union has so far been determined by the average socially necessary outlays of labour in average natural conditions. Such a system of uniform average prices necessitated a system of planned State subsidies, which in turn contradicted the principle of cost accounting.

13. As a result of the prevailing price system, 80% of the total number of mines and pits in the Soviet coal industry operate at present at planned losses equivalent to more than 20% of the total production costs. In order to secure only a minimum of profitability, the current Soviet coal prices would have to be increased by 20%. those of iron ore by over 35%, those of ore agglomerate by over 50% and the price of manganese ore by 49.5%(1). Some Soviet economists go even to the extremes of advocating an increase of some 260% in the price of crude oil and 370% in the price of iron ore in Soviet trade with COMECON partners(2). It is still uncertain to what level raw material prices will be changed in intra-COMECON trade but there is no doubt that economic reforms which are being currently introduced in Eastern Europe and in the Soviet Union will make wholesale price increases in the raw material producing sectors unavoidable.

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(1) Data published by the Moscow Institute of Economics of the Academy of Sciences of the USSR, 1964, quoted from "Problems of Economics", July 1966.
(2) V. Zukov and Y. Olsevic in "Problems of Economics", March 1967.

14. This does not mean that Soviet economic planners are not prepared to concede that declining world market prices for raw materials should have some influence on COMECON prices. But they are in favour of such a policy only to the extent to which the total requirements of COMECON countries for a given product cannot be covered by internal resources(1). They claim that COMECON combined import needs can be met by reciprocal deliveries to the extent of 97% in the case of coal, 96% in oil and petroleum products and almost 80% in iron ore(2).

15. These introductory remarks (paragraphs 10 to 14) should be kept in mind when examining in greater detail the prices paid by COMECON countries for some of the essential raw materials exported by the Soviet Union. A study undertaken for the period 1955-63(3) shows that in the case of 50 products exported by the Soviet Union to COMECON countries, these countries were paying more than average for 47. For 41 items they paid the highest price charged by the Soviets in their total foreign trade of these goods. Had the COMECON countries been able to buy these commodities at prices charged by the Soviet Union in its trade with the West, they would have saved 7% of the total value of their imports.

16. In order to show the development of prices for raw materials in Soviet exports to COMECON countries and compare them with the prices paid by the West to the Soviet Union, as well as prices paid on the world market, four essential commodities have been chosen (crude oil, hard coal, iron ore and pig iron) for which data is available over a period of ten years(4).

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(1) N. Zotova in "Planovoe chozajstvo", 1967, No. 1 and "Vnesnjaja Torgovlja", 1965, No. 11, page 7.
(2) Consumption of raw materials and fuel in Eastern Europe is at present being covered by intra-area imports to the following degree (in percentage terms):

	Coal	Oil	Iron Ore	Cotton
Bulgaria	82.5	87.5	45.0	65.7
Hungary	65.5	79.0	79.5	61.2
Zone	78.0	94.0	58.7	91.2
Poland	4.1	89.5	70.0	58.6
Rumania	32.1	-	54.5	43.4
CSSR	-	97.0	74.6	59.6

Source: O. Tarnowsky in "Voprosy Ekonomiki", No. 10, 1967.
(3) "Preisentwicklung und Preispolitik Im Sowjetischen Aussenhandel 1955-1963" von Oliver von Gajzago, 1966, on which some of the figures in this paper are based.
(4) For the system of calculation and detailed figures see Annex.

17. In the case of crude oil, the highest average price in the period 1955-63 was paid by Czechoslovakia (although this country was the highest importer) followed by Poland, Hungary and the Zone. In 1959, COMECON countries paid an average 61% more for Soviet crude oil than the industrialised West. The difference in price rose to 115% in 1963 and it was still 101% in 1965. The application of the 1960-64 world price base in COMECON trade, as of 1st January, 1966, has, however, substantially narrowed the price gap which existed in the early sixties between world prices and those paid by COMECON.

18. The highest average price for Soviet hard coal in the period 1955-63 was paid by Hungary, the lowest by Czechoslovakia. COMECON countries bought Soviet coal at rising prices until 1957 when the difference in prices paid by the West to the Soviet Union amounted to 34%. In 1963, COMECON countries had to pay 72% more than the industrialised West. However, prices in Soviet-COMECON trade declined substantially after 1964 and are now at about the same level as average prices paid in Western Europe. As a result of this development, COMECON countries continue to emphasise coal, whereas throughout the world crude oil is being favoured as a prime energy source.

19. That prices charged by the Soviet Union for raw materials exported to COMECON countries depend on arbitrary (political) decisions rather than economic considerations, can be illustrated by the example of iron ore. For some unexplained reason, the Soviets kept prices for iron ore in COMECON trade at the same level for six years (1957-63), regardless of quantity, distance of transport and, as it seems, even of quality. In 1958, COMECON countries imported on average iron ore at 18% cheaper than the West. In 1960-63 the COMECON price level was already 3% higher than average prices paid by the industrialised West and in 1965 the difference between what the West had to pay to the Soviet Union and what the Soviets charged in their trade with COMECON countries amounted to 63% in favour of the West.

20. Until 1963, the lowest price for pig iron was paid by Bulgaria, the highest by Czechoslovakia and Rumania. In 1958, the industrialised West paid 12% less to the Soviet Union than COMECON countries. In 1963, the difference rose to 107%. No figures are available for the period after 1963.

21. In view of the barter character of intra-COMECON trade, these prices for Soviet raw materials tell only one side of the story, as they do not say anything about the prices paid by the Soviets for the finished products in exchange for raw materials. One should not, therefore, draw hasty conclusions from the fact that COMECON countries have been paying considerably more for most of their raw material imports from the Soviet Union than the industrialised West. One should not overlook that they were paying in local currencies and/or by deliveries of sub-standard machinery. Therefore, we are unable to provide an answer to the

question as to who is paying more overall. What we can say, however, is that since about 1964 prices for raw materials exported from the Soviet Union to COMECON countries are declining, whereas extraction costs in the Soviet Union are rising. The fact has been painfully brought home to the Soviets over the past years that the higher the share of raw materials in their exports, the higher the need for capital investment in order to secure an increase in the export total.

IV. CONCLUSIONS

22. The growth rates of both intra-COMECON trade and that of the Soviet Union with COMECON members declined over the past years(1). The reasons for this can be mainly attributed to the rigidity of the bilateral barter system, but the decline in growth rates is also a reflection of the price system in intra-COMECON trade. COMECON countries are, therefore, at present preoccupied with the problem of how to change this system which is dictated primarily by the desire to maintain a balance of payments in their bilateral trade.

23. The present terms of trade in intra-COMECON exchanges assure the Eastern European countries of an average growth of their economies as long as the share of machinery and equipment in total exports remains high. This is due to the fact that returns from investments in the machinery sector are substantially higher than those in the extracting industry. In their trade with the Soviet Union, COMECON countries are, therefore, expanding their exports of machinery and equipment, as well as their imports of raw materials, whilst simultaneously reducing their exports of raw materials and their imports of finished goods. The Soviet Union, on the other hand, is trying to sell its raw materials at a higher price and to pay less for the finished goods it is receiving in exchange. By disregarding the cost element in one case and applying it as argument in the other, the Soviets are trying to get the benefit of both ends of the foreign trade deal.

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(1) In the period 1960-65, the volume of intra-COMECON trade grew by a total of 48.7%, whereas it increased only by 5.4% in 1966. Total Soviet trade with COMECON countries developed as follows:

1946 =	583 million roubles	1946-1950 =	41.4% annually
1950 =	1,753 " "	1950-1955 =	13.2% "
1955 =	3,267 " "	1955-1958 =	8.5% "
1958 =	4,174 " "	1958-1960 =	14.5% "
1960 =	5,469 " "	1960-1964 =	10,7% "
1964 =	8,232 " "	1965 =	2.9%
1965 =	8,471 " "	1966 =	-0.4%
1966 =	8,437 " "		

24. However, in order not to lose its economic hold on Eastern Europe, the Soviet Union must maintain the present trade pattern in which over 60% of COMECON's foreign trade is based on intra-area exchanges. This implies that the Soviet Union will have to continue to be the main raw material supplier for COMECON while trying, at the same time, to increase the share of machinery and equipment in the trade with its COMECON partners. Prevailing terms of trade will make this a costly affair and it can be expected that the Soviets will try to mitigate the painful economic effects by manipulating the financial side of the foreign trade transactions. There are indications(1) that the Soviets are thinking in terms of changing the exchange rate of the ruble in such a way as to make - in COMECON trade - raw material exports more expensive and Eastern European machinery supplies cheaper.

25. From the Eastern European countries' point of view, the present price mechanism undoubtedly offers certain advantages. These countries are assured of an uninterrupted supply of raw materials at prices which are not subjected to world market fluctuations. They can, furthermore, be sure of a market for most of their industrial products. These are essential elements in a planned economy. However, technical progress is bound to be slow under such conditions. Technical know-how and sophisticated machinery cannot be supplied by the Soviet Union to such an extent as to make it possible for even the technically more advanced Eastern European countries (not to speak of the others) to catch up with the industrialised West.

26. It is, therefore, not surprising that some of the COMECON countries should make it clear that the idea of economic autarchy, be it in one country or within a group, is alien to them. They say that, according to the general line which had been collectively laid down at at conference at Karlovy Varý(2), the policy of peaceful co-existence manifests itself in the economic sphere in the development of international relations and ties. COMECON countries state(3) that they are carrying out this policy according to their needs and according to the extent to which the Western countries are prepared to co-operate. Such a trend indicates that at least some of the COMECON countries like Rumania, Poland, Czechoslovakia and perhaps even the Soviet-occupied Zone of Germany are more inclined to participate in the world-wide division of labour by extending the principle of peaceful co-existence into the economic sphere rather than to try to establish a costly "Socialist market" and limit co-operation and specialisation to the exchange of goods within this thoroughly inward-looking society.

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(1) In particular A. Alekseev in "Vnesnjaja Torgovlja", No. 9, 1967, page 25.
(2) 24th-26th April, 1967. See also PO/67/309, paragraph 8. The relevant paragraph of the Karlovy Varý statement reads as follows: "Ending the artificially created barriers in economic relations between the socialist and capitalist states of Europe would be of particular importance for all states and would be conducive to fruitful co-operation, including broad agreements in the sphere of production and scientific research".
(3) For example, statement by the Polish Deputy Premier and Permanent Representative to COMECON, Jaroszewicz, on 11th May, 1967.

DEVELOPMENT OF PRICES FOR SOVIET EXPORTS OF CRUDE OIL, HARD COAL, IRON ORE & PIG IRON

In order to show the development of prices for raw materials in Soviet exports to COMECON countries and compare them with prices paid by the West, four essential commodities have been chosen (crude oil, hard coal, iron ore and pig iron) for which data is available over a period of 10 years. To make prices comparable and, at the same time, take account of the Soviet currency reform in 1960, old rubles have been taken as a basis. In view of this somewhat arbitrary calculation, figures quoted in this paragraph should be regarded as price indicators reflecting a price trend and not as representing an exact price level.

(a) Crude Oil

Soviet exports to COMECON countries developed as follows (in thousand tons):

	1946	1950	1955	1960	1964	1966
To COMECON	26.4	249	1,663	6,265	13,995	20,998
To non-Communist countries	2.6	-	680	8,992	18,883	24,813

The average prices paid by COMECON countries were (per metric ton FOB Soviet border point of shipment)(1):

	1955-63	1964	1965	1966-67
CSSR	91.31	90.22	79.46	60(?)
Poland	90.23	86.96	75.28	
Zone	79.97	75.63	67.40	
Hungary	88.04	85.36	87.27	
Bulgaria	-	70.92	70.92	

The average price paid to the Soviet Union by the industrialised West was in 1955 57.94, in 1960 44.18, in 1963 39.10. In 1965, Italy and Japan paid 34.89 and the Federal Republic of Germany 40.43. Although these figures show a constant decline in Soviet Crude oil prices, average prices paid in the West(2) have declined even more rapidly than prices paid by COMECON countries to the Soviet Union(3). The application of the 1960-64 world price base to the 1966 COMECON oil transactions has, however,

(1) To make comparison possible, prices are stated in old rubles throughout. In order to arrive at corresponding US dollars at the official rate of exchange, divide by 4.
(2) For Kuwait crude oil cif the United Kingdom 0.80-0.97 specific gravity.
(3) From 22.63 dollars (90.52) in 1958 to 19.19 dollars (76.76) in 1960 and 17.03 dollars (68.12) in 1966.

substantially narrowed the price gap which existed in the early 60's between world prices and those paid by COMECON. The price difference in 1967 between world prices and the higher ones paid by COMECON countries for Soviet crude oil of comparable quality should be something less than 10%.

(b) Hard Coal

Soviet exports developed as follows (in thousand tons):

	1946	1950	1955	1960	1964	1966
To COMECON	21	67	2,520	7,314	14,603	13,392
To non-Communist countries	425	93	1,541	4,067	7,933	7,323

The average prices paid by COMECON countries were:

	1955-63	1964	1965
Hungary	68.49	n.a.	n.a.
Rumania	67.85	n.a.	n.a.
Poland	66.14	66.4	62.0
Zone	64.41	59.4	57.6
CSSR	62.11	57.2	55.0

Average prices paid to the Soviet Union by the industrialised West were in 1955 46.76, in 1960 40.10, in 1963 34.19. In 1965, Belgian coal sold at pithead was priced at 35 dollars (140) a ton while German coal from the Ruhr was costing 15.6 dollars (62.4) per ton. The price of coal imported from the United States by the EEC countries in early 1966 was about 12 dollars a ton (±48). It can be argued, however, that the coal in the West is of better quality but, from the COMECON countries' point of view, Soviet coal is cheaper since it has not to be paid for in hard currency. As a result, COMECON countries continue to emphasise coal, whereas throughout the world crude oil is being favoured as a prime energy source.

(c) Iron Ore

Soviet exports developed as follows (in thousand tons):

	1946	1950	1955	1960	1964	1966
To COMECON	792	3,226	8,818	14,841	21,709	24,014
To non-Communist countries	-	-	-	341	891	2,104

Average prices paid:

	1955	1958	1960	1963	1964	1965
Rumania	38.02	47.01	46.98	47.05	n.a.	n.a.
Poland	35.19	46.92	47.00	47.02	n.a.	n.a.
CSSR	38.00	47.00	46.97	47.02	46.64	43.12
Zone	38.00	40.41	39.97	39.81	n.a.	n.a.
Hungary	38.00	47.01	46.99	46.41	n.a.	n.a.
Non-Communist countries	-	56.21	49.39	28.21	n.a.	n.a.

For comparison, Swedish ore delivered cif Rotterdam in 1964 was just over 10 dollars a ton (40+). However, Soviet ore which has a forgeability of 53% contains a very high percentage of silicon oxide and causes a high consumption of limestone and coke in blast furnaces. This accounts, for example, for the high running costs of the Czech metallurgical industry - as the Czechs themselves admit.

(d) Pig Iron

Soviet exports developed as follows (in thousand tons):

	1946	1950	1955	1960	1964	1966
To COMECON	11.5	385	552	928	1,485	2,118
To non-Communist countries	1	8	597	807	1,564	2,048

Average prices paid:

	1955	1959	1963	1965-63
Mongolia	225	342	290	327
Rumania	204	291	278	267
CSSR	215	290	285	272
Zone	207	270	267	261
Poland	287	227	275	249
Hungary	218	288	283	245
Bulgaria	202	262	247	234
Industrialised West	178	172	127	n.a.
Developing Countries	200	228	195	n.a.

It is evident that COMECON countries paid considerably more for Soviet pig iron than the West. Within the COMECON group, Rumania and CSSR had the disadvantage of 11 rubles/ton and 17/ rubles/ton respectively as compared with the average price paid by the other COMECON countries.