Introduction

This volume offers a modest inquiry into the desirability and feasibility of finding common ground among major participants in the world economy that would enable the centrally planned economies (CPEs), Asian as well as European, to become more closely associated with the global economic, trading, monetary, and financial frameworks. Though I focus my lens at an exceedingly vast panorama of a rugged landscape, my ambition is deliberately limited. This objective requires some explanation, which I do in section 1 by briefly painting the backdrop to what motivated me to embark on writing this monograph.

The rather unusual background to this study on the role of the CPEs in organized international economic relations may help the reader to assess the purposes, accomplishments, and remaining lacunae. It certainly clarifies precisely what I hope to accomplish. Because this is a personal statement, I have written it chiefly in the first person singular. In view of the specific objectives of the study, this is meant to be the *singularis modestis*, certainly not *majestatis*, in Myrdal's (1963, vii) sense. This personalized mode emphasizes that the account reflects my understanding of how the international economic framework came about, the current state of affairs, and what could be achieved prospectively by integrating the CPEs more fully into the international economic organizations (IEOs) and the regimes they purport to serve.

1 Backdrop to the study

On 15 August 1986, the Soviet Union unexpectedly requested some form of observer status in the Punta del Este deliberations about the launching of a new round of multilateral trade negotiations (MTNs) slated to commence in September that year. This mild overture to the General Agreement on Tariffs and Trade (GATT)[1] should not have been all that startling. For one thing, the sociopolitical framework of the USSR had been

undergoing measurable changes since mid-1985, including seeking more active participation in global economic and financial affairs. Especially important were the then just announced intentions to introduce more or less far-reaching domestic economic and trade reforms. Possibly more surprising were a sequence of rumors launched and unofficial feelers emitted by highly placed Soviet officials in private discussions and in pronouncements at international meetings in the first half of 1986. These in effect led to some expectation that the Soviet Union would soon seek some association with, perhaps even full membership in, other multilateral institutions, chiefly the International Monetary Fund (IMF or Fund) and the International Bank for Reconstruction and Development (IBRD, Bank, or World Bank).[2] These statements have since been confirmed and denied with various degrees of alacrity, depending upon the particular Soviet spokesperson and the circumstances of the "rumor."

Whatever the intrinsic merit of this stance, the announcement to petition for some form of association with the international trading system (ITS) in place by itself signaled a major modification, if perhaps not yet a full reversal, of the USSR's traditional position regarding global economic cooperation through the institutions and their underlying regimes created after World War II. It could thus have quite important ideological, political, economic, and institutional ramifications, certainly when placed in the context of other changes that had by then been transpiring in the USSR's economy and society.

There was doubtlessly a good deal of political posturing in both the request for accession to the MTN round and in the ill-conceived western rebuff. But there was also good economic logic underlying these developments. Two important concurrent events may be adduced in evidence. First, in connection with the reform of the foreign trading system, which was officially endorsed on 19 August 1986 but had been mooted earlier, it was perfectly logical to explore ways of "normalizing" relations with other countries and some of their institutions. This would have been particularly relevant to widen the maneuvering room for the enterprises, associations, and ministries that henceforth would be entitled to engage autonomously in external commerce. But the eventual impact could have been much more profound if only because there is some, arguably circumstantial, evidence to buttress the conjecture that "participation in the GATT and economic reform feed on each other" (Patterson 1986, 203). In other words, if leaders are keen on the then envisioned – since elaborated – reforms in the Soviet Union succeeding, efforts should be made to facilitate participation in the GATT and perhaps in international economic affairs more generally.

Secondly, the external economic environment in early 1986 was unusually adverse, partly on account of the sharp drop in oil prices and weak global oil demand. This threatened to scuttle the domestic modernization drive envisioned in the five-year plan for 1986–90 before it could get properly under way. In February 1986, Mikhail S. Gorbachev and his team had placed great emphasis on the high priority of the endeavor at the 27th Congress of the Communist Party of the USSR. All-around modernization in engineering sectors was selected as the linchpin of the new five-year plan and the broader-based economic reconstruction envisaged by the current Soviet Administration. The marked shortfall in investment activity and modernization during the first full year of *perestrojka* on account of unanticipated foreign events may have made it imperative to broaden the scope, and perhaps even the depth, of the moves originally envisaged, or at any rate to accelerate their pace of implementation. At the least, the precipitous events of early 1986 compounded the already severe constraints on pursuing comprehensive economic reform with the vigor that had been called for, most notably at that Party Congress.

Negotiations about joining the GATT would realistically have taken several years because of the stylized accession procedure (see chapter 4). The direct advantages accruing from membership could therefore have alleviated the short-run problems of the Soviet economy in only a minor way, if that. The interpretation that following up on the USSR's request to become associated with the ITS would have helped to "bail [it] out now that it has economic problems" (Dirksen 1987, 229) is without merit. Even if the initiative had in the end been aborted, it could have yielded immediate indirect effects in terms of "good will" and related intangibles whose value should not be underestimated.

Against this backdrop, seeking closer cooperation with the near-global IEOs, such as the GATT, should certainly not have come as a complete surprise. It definitely should not have triggered bewildering alarm signals in western media and government circles, and also in some IEOs. The considerable confusion that beset the formulation of a proper response to the request was even less understandable. As it transpired, western governments, chiefly on the instigation of the United States, whose rebuff squarely reflected a "lack of candor" (Kennedy 1987, 24), summarily dismissed the GATT approach. This was one possible response to the Soviet overture. At least three others could have been taken, namely unconditional accession, conditional admittance, or fact finding and reciprocal exploration of policy positions. The latter could usefully have been undertaken.

This negative response became the official GATT position when the Ministerial Meeting that launched the Uruguay Round, unlike the framework set for the preceding major MTN (Tokyo) round (1973–9), invited only Contracting Parties[3] (that is, countries that are full "members" of the GATT as explained in chapter 4) and developing economies (DEs) that had expressed a serious interest in becoming a Contracting Party to participate (Haus 1989). Others could avail themselves of a new, informal channel by which high-level GATT officials would brief them privately. Both the German Democratic Republic (GDR) and the USSR have been utilizing this communication channel intermittently. Because of the highly placed GATT interlocutors, this is an important, if informal, channel for exchanging views between participants and others.

Even so, the response to the Soviet request was most unfortunate. The premature short-circuiting of the overture may have inadvertently curbed Soviet confidence in the potential support to be garnered for restructuring the domestic economy from properly streamlined international economic relations. If western leaders are genuinely interested in the metamorphosis of Soviet society into what Gorbachev appears to be coveting, the response to the GATT feelers was most regrettable. The warm reaction by, among others, the US Administration (*New York Times*, 28 August 1987, D1, D3) to the more recent Soviet request to join the Multifibre Arrangement (MFA) can be regarded as an implicit admission of the *faux pas* committed in August 1986 (Richter 1988). Finally, the understanding reached between the US and USSR in early December 1989 to admit the Soviet Union as an observer into the GATT, after the conclusion of the Uruguay Round, can be regarded as the definitive admission of an erroneous policy pursued since mid-1986. There are several reasons for this interpretation.

First, it is generally not good diplomatic practice simply to dismiss out of hand an overture in international relations without at least assessing what precisely may be at stake. This holds especially when these relations have been strained for so many years by conditions that do not lend themselves readily to compromise without losing political face.

Secondly, from a strictly economic viewpoint, it has always been problematic to associate CPEs on an equal basis with the postwar IEOs and to implement these deviant approaches to reciprocity. This applies particularly to the GATT because the trade framework of the CPEs rests quintessentially on foundations that are at considerable variance with those that form the backbone of the more general approach to multilateral trading and financial regimes. Given the absence of market-type price signals and supporting institutions in the USSR as basic props for decentralized decision making, and the then still unclear intentions behind the economic

reforms it had just announced, it would have been useful to clarify what precisely was at stake, even if only in its strictly technical context.

Thirdly, when such an unusual announcement is issued by a major "outsider" to the postwar global economic framework, it should be worth some effort to assess with dispassion and intelligence to what extent the Soviet Union would have been prepared eventually to revise key aspects of its economic policies and domestic economic mechanisms, including its mutating trade model, so as to make a plausible case for accession. This need not necessarily have been brought up immediately in terms of GATT "entrance fees," that is, the concessions the USSR would have to grant Contracting Parties in exchange for most-favored nation (MFN) treatment under GATT rules, an issue that could have been broached at a more appropriate future time. Even a cogent argumentation of why the USSR desired to request accession and thought this was a viable gambit might have been highly illuminating. The argument in favor of exploration rather than defiance from the start is even more compelling because the Soviet step of August 1986 was not preceded by the usual diplomatic sounding out of major partners about the chances of a favorable response. Diplomatic channels were not even activated in an informal way. This was particularly unusual for two reasons. The well-known opposition for decades of US interest groups to freeing east–west trade from the straitjacket imposed on the basis of political, strategic, and security ingredients, most of which have little to do with "national security" proper (see Hanson 1988), would in any event have complicated matters. Also, ever since the USSR first approached the GATT, reportedly in late 1982 (based on interview material and Pankin 1986), the GATT secretariat has instructed Soviet emissaries first to sound out the key Contracting Parties. This *démarche* reportedly made in the past, which would have provided a perfect excuse for dealing with the Soviet gambit on an informal basis before providing an indirect response at Punta del Este, was not repeated in 1986.

Fourthly, it would at the same time have provided useful pointers to the extent to which key members of the international community are presently prepared to modify important pillars of the international economic environment, including the ITS. As is well known, its multilateral features in particular have been rapidly crumbling in recent years. In fact, the ITS has been disintegrating into multiple systems that are only poorly interlinked. Major and minor shifts in trade policy stances may be required not only to accommodate countries that have traditionally absented themselves from the GATT approach, but also to make the "global" trade system sufficiently flexible to come to grips with realistic preconditions for such wider participation, as argued in section 2. At the same time, it could also

have revealed the potential for hammering out solutions for issues that have arisen since the institutions were first created but that have not so far been tackled in a rounded way. In particular, it would have provided some indication[4] of the degree to which the "world" community, in contrast to the inactivity of the past two decades, may now be prepared to address the so-called new protectionism and revert to multilateralism from the "minilateral" stance (Gilpin 1987, 372) on international economic relations gradually adopted since the late 1960s.

Finally, the curt refusal even to entertain the Soviet request may undermine the GATT's severely tainted aspirations to universality (Kennedy 1987, 25). Although this argument may appear to conflict with the second one above, the two provide a paradox that derives only from the point of departure one may wish to take in seeking to regulate world trade. If as some contend "there is more to be gained by full and universal participation in the international discussions of economic affairs than there is by the exclusion of certain states" (Jackson 1969, 777), then the stance adopted in 1986 was regrettably shortsighted.

2 Motivations for the investigation

It was against this backdrop that I felt compelled to outline a radically different, hopefully more productive, way in which the western community could have reacted.[5] My view centers not on whether the USSR should be permitted to accede or be kept out altogether. Instead, I firmly believe in the benefits of fact finding and exploration rather than defiance from the start. Such an approach seems imperative if there is any justification for making the global economic framework universally accessible; for seeking easement of the traditional east–west conflictive relationship, in economic matters as elsewhere; in devising remedies for the rather awkward way in which CPEs fit into the existing IEOs; and in exploring means of coming to grips with the contemporary economic problems whose nature is quite different from the criteria upon which the pillars of organized international economic relations were erected largely for the benefit of developed market economies (DMEs).

This book is a personal assessment of the answers that might have been forthcoming to some of the aforementioned questions regarding the relationship between the USSR and the GATT had they been ventilated in response to the Soviet overture. Because I do not intend to second-guess what may have been on the mind of policy makers in mid-1986, my answers are phrased largely within a broader framework of economic analysis. This owes much to my abiding intellectual and professional curiosity in examining ways and means of enhancing international

economic security in the postwar period. Stalin is said to have declared during the Yalta conference (quoted in Byrnes 1947, 44) that:

> It is not so difficult to keep unity in time of war since there is a joint aim to defeat the common enemy, which is clear to everyone. The difficult task will come after the war when diverse interests tend to divide the Allies. It is our duty to see that our relations in peacetime are as strong as they have been in war.

I shall therefore discuss the stance during and after World War II on the international economic order, including the position of the Soviet Union in these postwar negotiations; the traditional standoffish attitude of key CPEs toward these organized multilateral economic relations; the evolution of the association of the CPEs with the basic pillars of that order, including their involvement in international trade and finance; and the potential for mutually reinforcing economic reform in the CPEs and coming to grips with the chronic need for revamping the international economic order, given the ongoing changes in the environment for global economic cooperation.

It is difficult to specify precisely where the topics treated here belong. This volume touches upon macroeconomics, comparative economics, economic reform in CPEs, economic history, international economic relations, commercial and financial diplomacy, political science, and even international law. But its subject is in fact none of the latter. Its hybrid form can perhaps best be described as a study in international economic diplomacy, as Richard N. Gardner (1969, ciii) labeled his seminal study of Anglo-American relations in the 1940s. But I have no ambition to compete with his monumental investigation, if only because east–west economic relations by themselves offer sufficient complexity. For one thing, my focus is the CPEs and the future, rather than what happened in the past. Also, I am more concerned with what could be contemplated in terms of coordinating the economic policies of various groups of countries than with the motives and objectives of policy makers in key countries at any one moment.

The second major concern that brought me to this study is the erosion of the liberal international economic order established after World War II. There has been a significant transformation in the key determinants of the global economy, resulting in a reversal of the trend toward liberalization of trade and multilateralization of finance through official institutions. The principles of multilateralism, unconditional MFN treatment, and casting national priorities, at least in part, with a view to their global implications, as heralded in the Bretton Woods system (BWS) of international economic relations, are being displaced by bilateralism and discrimination. For these and other reasons, the liberal international economic order has been rapidly

receding under the impact of profound structural changes in the international distribution of power, in supply conditions, and in the effectiveness of demand management. In its wake, a mixed system of "nationalism, regionalism, and sectoral protectionism is replacing the [BWS] of multilateral liberalization" (Gilpin 1987, 395). These developments have been reflected in the ascendancy of the nation state and of national economic power in international economic relations, the growing struggle for world markets, and the benign or malevolent mercantilist successes of Japan and the newly industrializing developing countries (NICs). For example, with the collapse of the fixed exchange rate system and the management of fluctuating exchange rates largely in line with national objectives and constraints, conflicting interests have given rise to intense clashes over exchange values and other monetary issues, particularly among the larger, most advanced DMEs. As some argue (Gilpin 1987, 394), these developments may be attributed to the decline in the hegemonic role of the United States and the emergence of divergent national interests among the advanced countries, which have so far found only partial reflection in modifications of the organizations established to regulate international relations. There is hence a need to reevaluate the international economic order, especially now that the CPEs appear to be willing to play a more constructive role therein. To clarify this, some preliminary remarks on east–west relations and participation in IEOs may be appropriate.

Before doing so, however, recall that the international economic environment, especially as regards the European CPEs, has been changing dramatically since mid-1989. This has had its drawbacks for meeting the goals set for this volume, particularly the outlook for the participation of reforming CPEs in the IEOs. It may therefore be useful to be aware of the fact that this manuscript was completed in August 1989. I was afforded the opportunity to add only minor changes in early December 1989, upon verifying the copy editing. The ongoing extraordinary mutations in Eastern Europe may soon relegate the "hard-core" features of CPEs, as discussed mainly in chapter 2, to the dustbins of economic history. The adoption of more market-oriented policies, institutions, and policy instruments would facilitate the speedy and fuller integration of Eastern Europe into the global economic framework. Nevertheless, one should not lose sight of the fact that most of the technical economic opportunities and problems of associating the CPEs more fully with the international regimes in place remain to be addressed head-on, regardless of the political events in Eastern Europe or the prospect of associating the area more closely with one of the Western European integration schemes.

3 East–west economic relations

Anyone surveying the broad field of east–west economic relations from, say, the Russian revolution to the present will be struck by the number of times that western politicians and businessmen, and sometimes also eastern statesmen and political leaders, have announced that now east–west trade is poised for a major take-off. If anything, such assurances have persistently failed to materialize. Whenever a spurt occurs, it tends to be highly unstable, unpredictable as to its strength and duration, and thus unreliable as a gauge for firm commercial and investment decisions. East–west trade cannot blossom predictably for a number of reasons (Hanson 1986, 407–9). There are many that could be cited. I shall touch only upon the most important ones, which I divide into two groups.

Basic institutional, systemic, and economic obstacles

There would appear to be five critical issues here. First, the CPEs are all at a substantially lower level of development than the advanced market economies (MEs) and much less exposed to external competition than the most dynamic DEs. The backbone of the dynamism in postwar trade in the case of the former group has been provided overwhelmingly by within-group intrasectoral commerce. Some members of the latter group have displayed a great deal of poise in capturing market shares in DMEs. They have done so largely with products that would not "make" it in CPEs for policy reasons, but also because of the rather modest income levels and confined consumption patterns in these economies.

Secondly, east–west relations are strongly influenced by political hostility and suspicion, which, although not precluding trade, certainly compress the arena within which fruitful commercial relations across the systemic divide can be solidified. This is perhaps most pronounced in interactions between the two superpowers, given the xenophobia in the USSR and the self-righteousness that at times dominates US foreign economic policy (Lavigne 1979, 65ff.). Various western strategic trade controls, trade denial for reasons that have little to do with security or economic fair play or other rational considerations, and Soviet reluctance to provide economic information or to sign away part of its sovereignty, whether in a humiliating manner[6] or in a more businesslike fashion, are the sort of phenomena that impart east–west trade its peculiar character.

Thirdly, MEs and CPEs have different economic systems that create fundamental hindrances to trade expansion (Wilczynski 1969, 21–4). Here one needs only to reflect upon the limited information value of prices in

CPEs for identifying trade opportunities. Currency inconvertibility, although not absolutely forbidding, is certainly a core obstacle to smooth commercial relations between market and planned economies. Also, trade in CPEs has traditionally been conducted by state enterprises guided by the state monopoly of foreign trade and payments (MFT), on which more in chapter 2, whereas trade on the western side has been conducted largely by private firms.

Fourthly, systemic obstacles constitute one factor that has thus far limited the movement of capital and labor between east and west, even though from a rational economic point of view there are considerable opportunities in allowing especially risk capital to move eastward and labor the other way. The CPEs have traditionally shielded themselves against such flows, even when a demonstrable positive contribution to their growth effort and maturation process could be documented.

Finally, the east–west divide is much more fundamental. Insulation not only is against movements of traditional production factors, but also extends, perhaps in an even more pronounced way, to all foreign influences – especially ideas, at any particular time, almost regardless of their nature – that might undermine some cherished aspect of the socialist society that policy makers feel ought to be attained by all means.

Statecraft, military threats, and east–west relations

Perhaps of even greater concern than the above systemic and philosophical obstacles to buoyant east–west trade is the fact that east and west have been opposing blocs – economically, politically, strategically, and philosophically – at least since the Cold War erupted in the second half of the 1940s. For that reason, east–west relations involve more than the simple calculation of economic benefits. Rather than being capable of reduction to the pure economics of external trade and finance, east–west economic relations belong to "economic statecraft," as David A. Baldwin (1985) termed it and Philip Hanson (1988) recently elaborated upon so illuminatingly.

Economic statecraft is defined by Baldwin as "all of the economic means by which foreign policy actors might try to influence other international actors." But Hanson (1988, 6–7) has made a plausible case for restricting its meaning to "a policy instrument used by governments." Although this narrowing of the purview of economic statecraft is useful, if only to preclude getting bogged down in picayune, citizen-inspired protests (such as the refusal of longshoremen to unload Soviet ships at a time of east–west tensions), it inadvertently omits some of the essence of economics. In what follows, economic statecraft is understood as the complex of economic