International Economic Relations of Eastern Europe and the Debt Problem in the Second Half of the 1980's

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From the mid-eighties on in the majority of Eastern European countries there has been a recurringly growing criticism of certain elements of the existing system of economic management even the entire system on occasion. Declarations stressing the necessity of reforming the economic mechanisms have come into the limelight.[1] This is also related to the fact that the new political leadership having come to power in 1985 has opted for a radical reform of the Soviet economy. Despite its importance, this development alone cannot provide sufficient conditions for the small CMEA economies to be transformed along similar line (Casaba, 1988); Moreover the favourable external impact of the Soviet reform is not enough even to explain the reasons of the new reformist wave. Namely, this has been called for by the aggravation of the system's specific tensions that have been for a long time combined with external disturbances.

On the surface the aggravation of tensions in the socialist countries has appeared as a growth problem. All the more so, since in these countries the rate of economic growth has always been the main indicator of economic success, irrespective of the price to be paid for it. In the long run, however, increases in this price and other limits to growth have caused its rates to decelerate. In the first half of the eighties even those growth targets that were moderate in comparison to previous periods proved to be over-ambitious. Nonfulfillment of these modest aims as well as temporary improvements in the liquidity positions induced East-European governments to elaborate new five-year plans focusing on revitalisation of growth. However the ideas formulated in plan targets proved to be irrealistic again. This is reflected in the statistics for 1987; the average rate of growth in the six countries was 3.2%, i.e. lower than the average of plan-targets for 1987 (4.7%), as well as the average growth registered in 1986 (4.6%). The targets of the original five-year plan could only be fulfilled if in the three years to come the region's average growth

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(1) In accordance with international conventions the term Eastern Europe denominates Bulgaria, Czechoslovakia, Poland, Hungary, the GDR and Romania.

rate attained 6%, while the average target for 1988 is only 4.8% (ECE, 1988; 120).

Slow growth hides deeper-lying causes: structural tensions. From among these foreign trade problems both within the CMEA and in relation to market economies have become especially acute for the second half of the eighties. According to official statistics, the CMEA has accounted for the larger, even a growing share in the foreign trade of this group of countries, especially in exports, without their following and explicitly declared inward-looking strategy.(2) In the CMEA difficulties result not merely from the slow-down of economic growth, but also from the very system of cooperation which relies on the mandatory planning model, as well as on bilateral trade with the Soviet Union. This traditional system is full of tensions, reflected by weakened ability and readiness to export for Transferable Roubles. In East Europe's relations with market economies, the major problem is the renewed growth in indebtedness, a process following several years of consolidation in the liquidity of these countries.(3)

While experience has shown that there is no reform without a crisis, the crisis alone does not yet warrant that a reform will evolve (Szamuely, 1986; 55). On the one hand, in certain countries despite the accumulation of tensions the need for reform has not been recognized. On the other hand, in other cases efforts to reform do not add up to an elaborate, consistent and resolutely implemented program leading to a meaningful change in the norms of behaviour in the entire economic system. In this context one may well ask whether or not those tensions that gave birth to reform aspirations, themselves hinder a radical overhaul of the system.

Among these the debt problem is worth of special attention, just because of the new hike in East European borrowing recent developments in this area. (See Table 1.) However, are quite unlike to that of the seventies; as opposed to that period, the growth in debts does not finance expanding imports. On the

(2) The share of socialist countries in the foreign trade of the economies studied was 60.7% in 1980 growing to 67.0% by 1987 as regards exports and 58.8%, respectively 67.9% in imports. A major change was recorded in Romania's imports (which increased from 37.8% to 62.7%), while both sectors of Polish foreign trade, as well as to a lesser extent Hungarian exports experienced changes that were contrary to the general trend (ECE, 1988: 138). For details of why this cannot be called inward orientation see (Csaba, 1986).

(3) For the aggravation of balance of payments problems in the early eighties and for ensuing responses see (Kaminski, 1988), discussing the evaluation of the new debt hike. He also examines why these countries have obtained new credits in the mid-eighties. For further consideration cf. (Salgó, 1988a).

Table 1. Eastern Europe: Net Debt in Convertible Currency (mil. US $)

	1981	1982	1983	1984	1985	1986	1987[2]
Bulgaria	2,352	2,017	1,312	737	1,549	3,694	4,600
Czechoslovakia	3,528	3,268	2,672	2,132	2,500	3,037	4,000
GDR[1]	13,273	11,118	8,801	6,798	7,036	8,312	10,500
Hungary	7,799	7,222	6,920	7,303	9,468	12,898	15,800
Poland	24,708	23,730	25,170	25,253	28,105	31,805	35,300
Romania	9,857	9,466	8,370	6,557	6,265	5,760	4,750
Total six	61,519	56,821	53,245	48,780	54,923	65,506	74,950

1. Including intra-German debt
2. Preliminary

Source: OECD Financial Market Trends (1988)

other hand, growth of liabilities had recommenced after a period of their reduction. Then, in the first half of the eighties the volume of debts was cut back primarily by the intensive use of administrative methods. Under the present conditions the problem is not only that the possibilities of further import restrictions and forced export promotion are virtually exhausted, but also that prolonged reliance on these methods could positively hinder the realisation of reform blueprints. At the same time, by rendering the economic structure even less flexible, the policy of import cuts makes debt management increasingly difficult. The problem is not that the worsening conditions of obtaining external loans or—in extreme situations—the loss of creditworthiness would automatically call the reform in question. However the severity of external constraints provide less favourable socio-economic conditions for radical systemic changes.

Based on the above considerations we shall seek the answer to two, closely interdependent questions. First, we shall try to reveal the structural factors underlying the present debt situation and its potential risks. Second, we shall survey and evaluate measures that have been adopted in order to ease the debt constraint.

I. Some Important Aspects of the Debt Situation

During the last two years debts in convertible currencies of the CMEA-6 have grown considerably, especially in dollar terms. The region's aggregate gross hard-currency debts grew from 68,693 billion dollars in 1985 to 90,600 billion in 1987; net debts grew from 54,923 to 74,950 billion. Regarding the rate of growth this increase by one-third was about twice as much as the

Table 2. Eastern Europe: Current Account in Convertible Currency (mil. US $)

	1981	1982	1983	1984	1985	1986	1987[3]
Bulgaria	200	400	300	185	−200	−900	−400
Czechoslovakia	−300	0	400	400	500	240	−700
GDR[1]	−600	1,300	1,400	1,100	1,575	780	400
Hungary	−700	0	300	330	−459	−1,400	−900
Poland[2]	−3,000	−2,150	−1,090	−1,170	−550	−550	−700
Romania	−800	−600	−900	1,500	900	1,300	1,700
Total six	−5,200	150	2,210	2,345	1,766	−530	−600

1. Including transactions settled in intra-German accounts
2. Including unpaid interest
3. Preliminary

Source: OECD Financial Market Trends (1988)

figure registered in the developing world during the same period.[(4)]

The growth of debts in dollars can partly be explained by the fact that a considerable, and according to BIS growing share of new loans had been raised in appreciating currencies. At the same time debts obviously grew in real terms, too: similarly to 1986 the aggregated current account of East Europe (see Table 2) showed a deficit in 1987 as well.[(5)]

While the size of the current account deficit hardly increased in comparison to the previous years (it amounted to 600 million dollars according to the OECD), important changes could be observed in its structure. On the one hand, growing debts brought about the growth in repayments obligations, i.e. the deficit was caused less by the import surplus. Or only the latter factor could in theory be beneficial to the growth of the real sphere. On the other hand, new trends have emerged within the region; the positions of those countries that earlier had been considered as being in a better debt situation worsened. Thus, for the first time since 1981 Czechoslovakia registered a current account deficit in 1987; Bulgaria, similarly to 1985 and 1986 had a deficit combined with the doubling of her debts in dollars, while in the case of the GDR the reduction of the current account plus started in 1986 continued in 1987.

(4) The aggregated debts of the less developed countries rose by 17.5% between 1985 and 1988, from 1016.6 to 1194.8 billion dollars (IMF, 1988). For figures concerning the socialist countries see (OECD, 1988).

(5) In theory there is a close relationship between the current account and the evolution of debts. In East Europe the scarcity of published figures, especially of data on credits granted to the developing countries the evaluation of this relationship is far from unambiguous. (For details see (ECE, 1988; 314-316 and OECD, 1988; 17)).

Table 3. Eastern Europe: Debt Service Ratio[1]

	1981	1982	1983	1984	1985	1986	1987[3]
Bulgaria	27	27	24	20	16	31	30
Czechoslovakia	21	20	21	18	17	17	18
GDR[2]	55	48	36	30	30	32	33
Hungary	43	38	36	47	54	61	47
Poand	169	180	138	103	88	61	71
Romania	37	48	37	27	28	29	32
Total six:	67	70	56	46	44	43	40

1. All interest and amortization on medium—and long—term debt in precent of one year's export. Amortization on rescheduled debt is excluded.
2. Excluding transaction with the Federal Republic of Germany
3. Preliminary

Source: OECD Financial Market Trends 1988.

Nevertheless, from the point of view of overall indebtedness, the situation of the East-European region as a whole cannot be considered as dangerous, although there are considerable differences by countries. Various situations and their differences cannot be assessed in a uniform way; much depends on general economic policy factors. It is also true that even the debt situation can be evaluated under different angles. From the point of view of a country's day-to-day management, i.e. from the point of view of its credit standing it is of particular importance to know, how that country is able to repay debts from current incomes and meet obligations related to the payment of net interests. The best indicator for this is the debt service ratio, i.e. all interest and capital repayments on medium—and long—term debts as a percentage of one year's export earnings in convertible currency. This indicator in the six countries fell from 70% in 1982 to 44% in 1985 and 40% in 1987. (See Table 3).

Although this declining ratio indicates that the imminent pressure of debts has been eased, it would be premature to infer far-reaching conclusions from this development alone. Namely, it seems to be necessary to analyze the volume, growth and structure of the current convertible currency incomes of this group of countries, as well as the evolution of their equilibrium and efficiency.[(6)] From among these factors the following are worth to mention:

1. Since 1985 the exports of small East-European countries have been growing at a lesser rate than the volume of world exports. Consequently, the further reduction of the region's share in world exports followed a period of

(6) About this problem regarding the specific features of the socialist countries' foreign trade see first of all (Hewett, 1980).

provisional growth in the early eighties called forth by specific conditions. The region's share in world exports was 5.96% in 1970, 4.01% in 1980 and 4.80% in 1985, and dropped to 4.60% in 1986 and 4.11% during the first nine months of 1987. At the same time the dynamism of these countries' exports in East-West trade decreased more than the average. All this is indicative of the absence of competitive supply of goods and services in this group of countries. Moreover in the given situation the strategy of enforced exports, followed in the previous years could not maintain the earlier rate of export growth.

2. Slow growth and the decreasing share on the world market can be explained by the region's rigid export and overall economic structure. During the eighties lower growth rates registered in market economies were combined with the acceleration of structural changes both on the level of individual national economies and on the micro-economic level. This was true for world trade, too: in the trade of commodities exchange based on natural resources was relegated to the background, while the division of labour in the manufacturing industries, especially in technology-intensive sectors, gained importance (Kádár, 1988). Socialist countries lost ground in these dynamic sectors even more quickly. According to GATT sources at the beginning of the sixties, in 1963, the share of all socialist countries in the world trade of manufactures amounted to 13.4%; by 1985 it dropped to 8.8%. In the same period the developing countries increased their share from 4.3% to 12.4%. This picture is correct even in its details: during the more than ten years that followed the first oil-price explosion the share of the small socialist countries in OECD machinery imports shrank considerably, while that of outward-oriented developing countries increased to a significant extent (Inotai, 1986).

3. Although the debt service ratio compares export revenues to debt-related expenditure, one cannot forego the analysis of imports, a necessity demonstrated by the relationship between current account and debts, even in economic policy has more freedom in controlling it than has in relation to financial obligations. Between 1985 and 1987 the region's imports, including imports from market economies grew more slowly than the world average. This was due partly to the slow-down of import-intensive overall economic growth all across the region and partly to administrative restrictions on trade. As a result, according to ECE estimates the trade surplus vis-à-vis the market economies kept decreasing, while it increased vis-à-vis the developing world. In order words foreign trade contributed to earning convertible currencies to service debts.

4. Although the policies aiming at consolidating the liquidity position of East-European countries have put the emphasis on the quantitative relationship

between exports and imports, in reality there is an extremely important structural interdependence between the two. The import demand potential for commodities produced by market economies, originate from technological and commercial factors. However, since the export performance of East Europe remained modest, the resultant imbalance was bridged through restricting imports. Thus the latter has increasingly been confined to non-competitive goods, serving current needs. Particularly, the decrease in the volume of machinery imports from the market economies, has contributed to the insufficient competitiveness of the region's economies. Furthermore this is not only a structural problem in the narrow sense. In fact, just like their use of other resources, these economies show a low efficiency also in transforming imports into exports (Inotai, 1988).

5. From among the structural features of foreign trade influencing debt servicing it is the frequent linkage between exports and imports on the microeconomic level that is worth to mention. Empirical evidence from the early 80's indicate that more than 10% of the socialist countires' extra-regional trade (including the Soviet Union) was represented by counter-trade deals, a figure more than twice as high as the world average. (OECD, 1985) In contrast to practices in the developing world the Eastern European socialist countries sell mostly manufactured goods in counter-trade. This rather backward means of promoting international exchanges reflect overriding concerns to equilibrate trade at the level of individual deals, as well as problems in the technological as well as in the marketing components of international competitiveness (Törzsök, 1987: 13).

6. In the last decade international trade in services has grown more quickly than that of commodities. East-European countries' have been dragged out of this major trend of the world economy, too. (Ehrlich, 1988: 83) Available statistical evidence is sporadic. However, those of East-European countries that make their balances of payments public indicate that in 1986 the ratio of debts on the so-called other commodities, services and revenues and of commodity exports was significantly lower than in the market economies.(7) And, even abstracting from outlays connected with services, such a low share of inflows from services in total export revenues is quite dissimilar to practices of

(7) In 1986 debits on other goods, services and incomes (without unrequired transfers) in percent of commodity exports were 19.1% in Hungary, 18.5% in Poland and 7.4% in Romania. This picture could be probably modified if data were available separately on the two major groups of trade partners. In the same year this ratio was 68.4% in Belgium-Luxembourg, 40.0% in Denmark, 42.8% in Turkey, 39.0% in Portugal (author's calculations from (IMF, 1987)).

developing nations. In other words, East Europe can rely on this expanding segment of international exchanges only to a much smaller degree than other large debtors.

7. Last, but not least there is a further peculiarity: the region's countries have had resource to external resources almost exclusively in the form of credits. While international economic developments show an expansion in direct foreign investment promoting also exports, in the socialist countries direct foreign investment represents only a negligable share of total external resources and of gross capital investments. At the end of 1985 in the four countries—Romania, Hungary, Bulgaria and Poland—where direct foreign investment was legally permitted it amounted to 120-130 million dollars only.(8) The very limited reliance on foreign capital other than financial credit lead to the current account deficit's immediate increasing debts. This factor coupled with the relatively insignificant inflows from services imply by definition enhanced servicing requirement of a given debt of any period.

In sum, the debt service ratio of the entire region kept improving, although at a more moderate pace than earlier, the structural aspects of debt could not be substantially improved. Both from the commercial and financial points of view East-Europe's participation in the world economy takes more primitive and less dynamic forms. Therefore the onesided preoccupation with improving the current account has lead to some quantitative results. However, it is precisely this drive in this area which, under the present systemic conditions makes the out-of-date structure even more rigid. This leads to the further deterioration of international competitiveness and to the region's further marginalisation in world trade. This trend could not be reversed by the ambitious five-year plans either; expansionary policies followed under unchanged macroeconomic and management structure has obviously lead to further disequilibria. Moreover, experience of previous years indicated, that unlike in several other countries, in East Europe decleration of growth did not induce an acceleration of structural change.(9) Thus, the recent increase of debts in real terms occur-

(8) The figure has been drawn from (Lebkowski-M[illegible]iewicz, 1986); for the sake of completeness it should be added that at the beginning of 1988 the stock value of direct foreign investment amounted to 170-180 million dollars in Hungary alone, as compared to the value of 30-40 billion dollars for 1985. It is also worth to mention that although certain sources give higher estimates, direct investments of these countries abroad are limited, explained partly by the insignificant amount of incomes from investments abroad, as seen under point 7.

(9) Analyzing the Hungarian economy (Bokros, 1987) demonstrates: under the present structural conditions the goals of growth and equilibrium are by necessity in conflict. Discussing the forseeable repercussion of the expansionary policies implied by the

red without being accompanied by the improvement of external economic performance in the countries of the region. In other words increasing debts have served not a well conceived reform plus adjustment policy mix.

II. Endeavours to Alleviate the Debt Burden

In recent years the region's countries have introduced several measures which directly or indirectly were aimed at reducing debt burdens. Some of them were focusing on cutting debts, while others attempt at restructuring in compliance with the reform rhetorics mentioned above. However, there is hardly any correlation between the debt situation and reform orientation of a given country. Thus, for instance, in Poland and Romania, the two countries of the region, that have rescheduled their debts, reform is viewed differently: while Romania straightly denies the need for reform, Poland has followed—although with many paradoxes—reform ideas since the beginning of the decade.

All countries facing a serious debt problem have set the task to abate debts in convertible currency. The program of stabilization adopted by the Hungarian government in September 1987 set the aim of curtailing the increase of indebtedness by the end of the decade. Poland also seeks to balance her current account by that date. In the pursuit of preserving the system of centralized economic management Romania procliamed in 1984 not only that the growth of debts would be stopped, but also that all debts would be repaid by 1986, a first target date modified several times since then. Current official statements set this deadline for 1990. However, the policy of enforced debt repayments is opposed by the IMF and not really appreciated by commercial banks.(10)

Prior to 1985 the whole region's debt service ratio had become better thanks to the growth of export volumes. In 1985-87 further improvements took place but signs of exhaustion of the export push have also become manifest. However, the terms of external borrowing differed during these two periods. In the former stage it had been almost impossible to raise new credits, while by the middle of the decade, lending was revived under very favourable terms. This preceeded the emergant new reform-wave, thus getting

present East European five-year plans on current account (Bauer, 1988 and Csaba, 1987) Both argue that the policy of general economic expansion was *ab ovo* a false, even unfeasible policy for the mideighties.

(10) In 1987 Romania refrained even from raising medium—and long-term credits, while the maturity structure of her debts took a turn for worse (ECE, 1988: 313). As regards 1988 Romania undertook to move up payments in order to prove that the necessary means are at her disposal (Plan Econ Report, 1988: 9).

fresh money was mostly not related to the incumbent programmes for systemic change. Thus in 1985-87 the debt service ratio could be decreased basically through the improvement of the structure of outstanding debt. On one hand this could be done by rearrangements in the maturity structure, i.e. by putting off the maturing of debts by repaying them with new borrowings. In fact this is a quasi-rescheduling decided upon autonomously, without external pressure. On the other hand some countries had recourse to currency-conversion, i.e. partly substituted debts in high-interest currencies for low-interest currencies which even with the debt volume increasing contained the size of current interest payments. Obviously, there are important differences by countries as regards debt management and consequently the evolution of the debt service ratio. Between 1985 and 1987 there was an increase in the amount of interest to be paid by countries which had rescheduled their debts, thus having less elbow room in managing their debts. In Poland even the debt service ratio without repayments on rescheduled debts grew from 61% to 71%, while in Romania, whose situation had clearly worsened, it increased from 29% to 32%. In contrast, the Hungarian index fell significantly from 61% to 47% in two years and this had a decisive influence on the trend of the region's overall figure. Meanwhile the appreciation of low-interest currencies led to the growth of debts in dollar terms. All the more so, as currency conversion aimed at improving the maturity structure at a moment, when the revaluating currencies gained ground in the international credit market. Therefore this step can be judged in the context of overall economic policies and not in itself.[11]

Beyond doubt, however, that alleviating the external debt constraint increased the room for maneuvre for policies trying to eschew rather than speeding up adjustment to the world market between 1985-87. However, the recent deterioration of the current account posed novel limits to this type of borrowing, thus restricting the elbow room of the policy of muddling through. And this in its turn, combined with the exhaustion of the policy of enforced exports inevitably lead to further restrictions in the field of hard-currency imports if all other conditions remain unaltered. In fact, there is a danger that austerity measures introduced in the early eighties and still in vigour will pass to the foreground again, although recent experience has shown, that the East-European economies lack precisely those mechanisms by which a new general equilibrium could be arrived at relatively swiftly and efficiently (Wolf, 1985:

(11) This is why I can't subscribe to the straight condemnation of credits raised in strengthening currencies, first of all in yen, as maintained (PlanEcon Trade, 1987). All the less so, as the Eastern European involvement of American banks was on the decline during this period (PlanEcon Report, 1987: 18-19).

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This situation which on the level of day-to-day management was conducive to a further centralisation of decisions on resource allocation, has given rise to reform ideas in economic theory of the majority of the region's countries (with the exception of Romania and the GDR). These theories cognize the threats posed by prolongued centralization to the economic system's ability to function. Recent official statements in most cases point to the need to enhance the role of economic levers, as well as to increase the decision making competences of firms all across the economy.[(12)] It seems, however, that the measures adopted to date aim only at easing local tensions in a more or less isolated way. This is the general framework of measures instituted in external economic relations.

Coutries that opted for reform have introduced incentives trying to counteract the immanent (system specific) counter-interest in selling under competitive norms. Hungary has recently created the legal framework for decentralizing her foreign trade organisation. In 1988 private entrepreneurs have been licensed to export their own products directly. Although more than 600 companies have been licensed to trade abroad, most of the sales has remained with specialized foreign trade organisations (FTOs) (Salgó, 1986). In Poland companies have the right to keep a part of their hard-currency earnings. They can spend it either on import or sell it on the—restricted—domestic free market of currencies, in theory, without limitations. On the base of a decision of April 1988, in Bulgaria a currency market was introduced. This is seen as a measure alleviating bottlenecks resulting from the tightly centralized import allocation regime. In Czechoslovakia the Foreign Trade Act was amended this year so that the system of export licensing was simplified. Some companies were entitled to trade on their own, i.e. excluding FTOs. According to current deliberations, domestic prices will—after their revision—be based on world market prices, and the introduction of a single commercial rate is also on the agenda. Nevertheless, these measures alone do not seem likely to promote export activities and especially to improve the ability to export. Since these measures are part and parcel of an overall concept of gradualist and particular change, no wonder that they remain alien, sometimes disfunction bodies in a qualitatively unchanged overall environment. (E. C. E., 1988: 4).

To a certain degree this applies to direct foreign investment in these countries, too. With the exception of the GDR there are legal provisions in each

(12) As to what "reformed" socialism would look like according to current declarations (OECD, 1988: 20-21).

East-European country for direct foreign investments. In the present situation these countries are motivated by two major considerations. One is that direct foreign investment allows for drawing on external resources without increasing external debt. The other is that unlike financial credits, direct foreign investment is immediately tied to projects promoting sales for hard-currency (Illés, 1988: 22). Therefore as international experience indicate, they can play a major role in providing additional competitive exports.

This suggestion, however, is far from molding management practices immediately. Although the number of joint ventures increased considerably in 1987 (especially in Hungary) several factors have limited the size of direct foreign investment into these countries.(13) First, detailed legislation in Eastern Europe remained rather bureaucratic and internationally hardly competitive. Therefore, recently novel liberalizing measures had been adopted. Poland introduced a new decree in June 1988 giving uniform treatment to joint ventures and the so-called Polonia Companies (Sadowski, 1988: 5-6). In Hungary, the Law on Corporate Association, enacted from 1st jaunary 1989 will create bettter conditions for joint ventures. Especially, becuase from the same moment joint ventures with minority foreign participation need only to be registered, not licensed any more. In case of majority participation, only one permit—that of the National Bank—will be required instead of the present two. Several bilateral agreements on the mutual protection of investments have been already signed by the Hungarian Government.

More favourable legal provisions, however, represent only a necessary, but not a sufficient condition for attracting more direct foreign investments. Experience has shown that direct foreign investments are concentrated in those countries which follow export-oriented policies and adjust the domestic rules of the game to international standards. This is a far cry from the current state of the art in Eastern Europe, a factor limiting greater reliance on importing more working capital.

Moreover, as experience of the developing countries has demonstrated: direct investment is not an alternative to financial credits, but a complementary source.(14) Not only is there a great similarity between the criteria that companies take into account when they decide about direct investments abroad and the banks' rating of country-risks, but the inflow of direct investment can

(13) According to an ECE survey in 1987 there were 111 joint ventures in Hungary, 19 in Poland (excluding the socalled Polonia companies), 15 in Bulgaria and 3 in Czechoslovakia. (Mehr, 1988: 19).

(14) For more details see (Andreff, 1987) who shows that the bulk of direct foreign investment is concentrated in the most indebted developing countries.

improve the other possibilities of raising external resources either directly or by promoting export capacities (Köves, 1988).

The idea of "perfect complementarity", of merger, i.e. the proposal to convert debts into equities (Andreff, 1987) has been formulated in the more indebted socialist countries in the context of their policy reform. Still, one should not forget that this possibility presents itself only there, where the entire debt portfolio has been reasessed newly (with severe discount) by rescheduling. It is hardly by chance that since September 1987 American banks, together with 32 other countries have agreed to this formula only in the case of Poland. Meanwhile it might well reflect a value judgement on overall Polish economic conditions that such a conversion has not taken place yet.

III. Foreign Economic Relations: Possibilities of Solution

By the end of the eighties the credit standing to the East European economies has become increasingly uncertain, although in varying degrees by countries. Moreover, partly because of the growing difficulties in attaining a surplus in hard-currency trade and partly due to the size of debts, it would certainly be difficult—if at all possible—to curtail the further growth in East European debts, unless isolation and the acceleration of the region's marginalisation in the world economy is accepted (Köves, 1988). Meanwhile it is growingly cognized, that a fundamental improvement in the debt situation is conditioned on a radical reallocation of internal resources through new institutions. All the more so, as the major cause for concern is not primarily the volume and growth of external debts, but the inadequate debt servicing capcity of the East-European economies, reflecting the lack of comprehensiveness of their export profile.

Under these circumstances the need for radical changes in the system of economic management is coupled with the urgent task of stabilizing the economies.[15] There are two separate but interdependent issues. In fact, it is necessary to follow a series of preventive action, in order to retain the present elbow room in deciding over policy issues. The room for maneuvre is on the decrease, however it still is significantly above those for rescheduling states.

As it occurs to me, for the time being the "adjustment policies" of the last four years have failed to create a foundation for the above summarized thor-

(15) This is not asserted in the more indebted developing countries only, but also in countries with relatively little debt. For instance in Czechoslovakia economists of the Academy of Sciences insist on the necessity of two-stage development; the first stage would be focused on creating the equilibrium (Klacek, 1987: 489).

ough-going overhaul. Therefore there is a latent risk that short-term constraints ensuring from the debt situation will get the upper hand again. Moreover, there is a further danger of economic policies' following a wide range of conflicting objectives instead of some priorities stemming from a consistent economic philosophy. This might equally endanger both stabilization and reform endeavours.

Despite the variety of East European views on particulars, some fundamentally new issues emerge in the present phase of economic reforms. From among these two are worth of particular attention:

—All reforms having been introduced up till now retained an institutional setup, that ensured the predominance of centrally set structural policy priorities over autonomous company decision. The principal instruments of this were the central allocation of investments and the state monopoly on foreign trade and foreign exchange alike. Therefore no wonder that measures to decentralize remained contradictory and partial in both fields in Hungary. However if a full-fledged capital market could come into being, this institutions would by definition enhance Hungarian companies' responsiveness to signals of the external markets. Condition for direct reign investment would also, of course, improve qualitatively.

—Eonomic relation with the socialist countries represent a highly controversial issue for countries intending to promote reform and expert orientation. Unlike in the mid-sixties Hungarian reforms can't even expect changes along the same—marketizing—direction in the integrational mechanism of the CMEA. Meanwhile, first of all due to limitation on the Soviet supplies, the current tension of intraregional trade will most probably not decrease either. Therefore Hungary must invent special arrangements for her CMEA trade, ones being fundamentally dissimilar to the overall mechanism of foreign trade, promoting the domestic economy's integration to the world economy. In other words, if conditions for an expansion of competitive exports are to be created, this presumes a parallel reassessment of trade mechanism and policies with both main commercial areas (Köves, 1988). In a way, such a parallel reassessment has become an imminent task by now. Over and above the official Hungarian criticism of the present system of CMEA cooperation,[16] this task gains in urgency by the proposed liberalisation of hard-currency imports in Hungary from 1989 on. This in many ways will make it indispensable to reassess

(16) At the recent, 44th Session of the CMEA the head of the Hungarian delegation, deputy Prime Minister József Marjai stated: "If no radical change is carried out in the field of commodity-money (market) relations, the CMEA cooperation will not promote, but limit the necessary structural change in socialist countries". (Marjai, 1988: 2)

relation with the CMEA (Salgó, 1988b). The main reason is that import liberalisation is inconceivable without global—monetary—demand restriction, which is incompatible with enterprises deliveries based on state undertaking of obligations.

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