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# CMEA's International Investment Bank and the Crisis of Developed Socialism

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On 1 January 1971 the International Investment Bank (IIB) opened its doors in Moscow. The new bank was an organ of the Soviet bloc's Council for Mutual Economic Assistance (CMEA or COMECON), the organization responsible for multilateral economic interactions among Communist countries. Within six months, this hybrid of state socialism and capitalist finance had loaned \$13 million in hard currency and a total of 43.59 million transferable rubles (the nonconvertible currency unit used within the Soviet bloc) to five industry and infrastructure projects in Hungary and Poland. By the end of the IIB's first year, its operations had expanded to sixteen projects in five Soviet-bloc countries, totaling 181 million transferable rubles, including \$50 million in hard currency.<sup>1</sup> The IIB grew steadily in subsequent years, expanding its borrowing from Western money markets and its portfolio of loans to borrowers in the Soviet Union and Eastern Europe.

The IIB was set up as one of an array of new institutions designed to promote economic integration among the CMEA countries while at the same time helping them to modernize their economies. Offering loans in transferable rubles and hard currency, the bank financed investment projects throughout the Soviet bloc. Approval of loans supposedly came after rigorous and competitive vetting of investment proposals, and the use of credits was supposed to be stringently audited. Despite these innovations, deliberately modeled on capitalist institutions and mechanisms, the IIB failed in its overall mission to invigorate the stagnating economies of the Soviet bloc. The reasons for its failure, intimately tied to the rigidities of the Soviet command econ-

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1. V. Shapovalov and V. Karpich to M. A. Lesechko, "On the 3rd Session of the Board of the IIB," 30 July 1971, in Rossiiskii Gosudarstvennyi Arkhiv Ekonomiki (RGAE), Fond (F) 302, Opis' (Op.) 2, Delo (D.) 897, Listy (Ll.) 5–8; and V. Shapovalov and V. Karpich, "On the Draft Directive to Members of the Board of the IIB from the USSR to the 5th Session of the Board," 10 April 1972, in RGAE, F. 302, Op. 2, D. 999, Ll. 1–3. Although most of the CMEA materials at the Russian State Archive of the Economy are not generally accessible to researchers, the archive's Fond 302 (materials of the Soviet representative to the CMEA) are available and are the main archival sources for this article.

omy, highlight the obstacles to reform of the late Soviet system. The bank's efforts foundered not only because of the Soviet economy's dependence on raw material exports but also, more profoundly, because of the Soviet Communist Party's insistence on maintaining administratively determined prices, central planning, and tight links with the East European satellites. Those fundamental principles of the Soviet system constrained what the IIB could accomplish. From Moscow's perspective, abandoning these core principles would mean abandoning the Soviet experiment altogether. In that sense, the IIB's experience suggests that the late Soviet economic system was fundamentally not reformable.

In 2004 Stephen Cohen attacked the notion that the Soviet Union was inherently unreformable, and he rightly criticized the sloppy definitions and tautological thinking behind many such claims.<sup>2</sup> But Cohen focused on politics, nationalities, and constitutional structure, not economics. As Archie Brown countered,

While . . . some reform of the economy took place in the USSR and other communist states at different times, radical reform posed fundamental problems connected with the operational principles of the system. . . . There was a basic tension between trying to *make the existing economic system work better* and *replacing that system with an essentially market economy* that would operate on *different principles*. . . . Partial reforms could and did take place, but the operating principles of an economic system have to be, *in the main*, one thing or another.<sup>3</sup>

The history of the IIB, by bringing in the neglected dimension of international political economy to the study of the Cold War and the collapse of the Soviet Union, reinforces Brown's point.<sup>4</sup> Although the IIB was a well-intentioned and thoughtful effort to enable the Soviet economy to match the leading Western economies, it collided with structural obstacles built into the very nature of the Soviet system. The aim of the IIB and other market-socialist reforms was to create a more efficient, more effective, and more competitive Soviet-bloc economy, but one still recognizable as a Soviet-style institution. To achieve that would have required abandonment of the defining principles of the Soviet economic system. Any Soviet regime that would have surrendered such principles would have been so different that it could no longer truly be called Soviet. Indeed, even Mikhail Gorbachev, the most radi-

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2. Stephen F. Cohen, "Was the Soviet System Reformable?" *Slavic Review*, Vol. 63, No. 3 (Fall 2004), pp. 459–488.

3. Archie Brown, "The Soviet Union: Reform of the System of Systemic Transformation," *Slavic Review*, Vol. 63, No. 3 (Fall 2004), pp. 493–495. See also Mark Kramer, "The Reform of the Soviet System and the Demise of the Soviet State," *Slavic Review*, Vol. 63, No. 3 (Fall 2004), p. 510.

4. On the relative neglect of political economy, see Bruce Cumings, "Political Economy," in Patrick Finney, ed., *International History* (Basingstoke, UK: Palgrave, 2005), pp. 80–81.

cal of all the leaders of the Soviet Union, never discarded the principles of administrative pricing and central planning. To borrow the terminology of physics and economics, the Soviet economy, and by implication the Soviet system as a whole, exhibited local stability. Like a marble resting in a bowl, small pushes produced only small results and a quick return to the previous state. Similarly, the creation of the IIB had only marginal effects on the basic workings of the Soviet economy. Larger pushes might have taken the marble out of its stable resting place, with results impossible to foresee and perhaps disastrous.<sup>5</sup> A study of this Communist investment bank therefore helps us to understand why the Soviet Union collapsed.

## **The Economic Context**

The decision to create the IIB grew out of two separate but closely related concerns in the late 1960s: a desire to invigorate the Soviet-bloc economies through limited market-based reforms and greater enterprise autonomy, and a renewed effort to promote tighter integration of the bloc's economies. The common thread in the economic policies of all Soviet-bloc countries by the late 1960s was the effort to make their centrally-planned economies function better. The condition of these economies was as yet only troubling, not the crisis it became by the 1980s, but clear-eyed observers saw stagnant productivity, slowing growth, and administrative rigidity and inefficiency. As ideological fervor dissipated during Leonid Brezhnev's long tenure as General Secretary of the Communist Party of the Soviet Union (CPSU), the East-bloc governments tried to demonstrate legitimacy through bureaucratic effectiveness and concrete economic improvements.<sup>6</sup> The attempted solutions, notably the Soviet Union's 1965 Kosygin reforms and Hungary's New Economic Mechanism (approved in 1966 and implemented at the start of 1968), involved some form of market socialism. While maintaining state ownership of the means of production and some central planning, the reforms promised greater autonomy for individual enterprises, more realistic prices, and the

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5. On the trade-off between the relatively limited and predictable benefits of minor tinkering with economic policy and the potentially greater but more destabilizing consequences of radical reform, see Antoni Chawluk, "Economic Policy and Economic Reform," *Soviet Studies*, Vol. 26, No. 1 (January 1974), pp. 98–119.

6. Thomas F. Remington, *The Truth of Authority: Ideology and Communication in the Soviet Union* (Pittsburgh: University of Pittsburgh Press, 1988), pp. 5, 25; and Yitzhak M. Brudny, *Reinventing Russia: Russian Nationalism and the Soviet State, 1953–1991* (New Haven: Yale University Press, 1998), pp. 59–60.

evaluation of managerial performance by sales and profit, not merely fulfillment of specified production programs.<sup>7</sup>

These internal reforms required overhauling CMEA trade. In particular, the relatively small size of the East European economies meant that efficiency through economies of scale required suppliers and markets beyond national borders. The problem, however, was that market socialist reforms actually hindered trade among the CMEA countries. Before those economic reforms took effect, trade had been determined by bilateral agreements setting the general scale of trade between two countries. The fulfillment of those agreements, including the precise assortment of goods, was worked out at lower levels: ministries, trusts, and individual enterprises. So long as profit and loss were essentially irrelevant to the evaluation of enterprise and manager performance, this system worked well enough. Managers were rewarded administratively for accepting substandard or overpriced products from CMEA suppliers or for selling products to CMEA customers below world market price or even below cost. Trade was essentially a matter of political will: So long as the Soviet state was willing to maintain an incentive structure that revolved around fulfillment of administrative directives, international trade based on that structure could continue.

Moves toward market socialism, however, undermined the logic of CMEA trade. Enterprise managers, increasingly judged on profit and loss and given more autonomy to find their own suppliers and customers, had less incentive to purchase substandard inputs at inflated prices or to sell products below world market prices. This was particularly true when the trade partner was foreign and answered to a different government. Market reforms weakened administrative mechanisms, posing a threat to politically-guided trade, particularly with Soviet-bloc partners. Although the 1968 Soviet-led intervention in Czechoslovakia dealt a substantial blow to the hope of ever greater concord among the CMEA partners, the political and ideological fissures revealed by the Prague Spring made it doubly important in Moscow's view to promote economic integration. Even to maintain CMEA trade in the wake of 1968, let alone expand it, required active measures and Soviet initiative. V. Issupov, a Soviet trade representative in East Germany, highlighted the essential problem in 1968:

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7. See James H. Blackman, "The Kosygin Reforms: New Wine in Old Bottles?" *Studies on the Soviet Union*, Vol. 7 (1967), pp. 103–143; R. Evstigneev and V. Kaie, "Khozyaistvennye reformy v stranakh SEV," *Voprosy ekonomiki* (Moscow), No. 10 (1968), pp. 105–112; and Gertrude Schroeder, "Soviet Economic Reform at an Impasse," *Problems of Communism*, No. 20 (1971), pp. 36–46. On the intellectual background to economic reform, see Robert D. English, *Russia and the Idea of the West: Gorbachev, Intellectuals, and the End of the Cold War* (New York: Columbia University Press, 2000), pp. 96–100, 141–147, 165–166.

In a country which gives enterprises and associations greater rights to determine the production and export structure independently, it happens more and more frequently that the obligations fixed in state treaties and protocols for export and import are not fulfilled because the centrally-fixed obligations no longer correspond to changed market conditions and to the material interests of the enterprises.<sup>8</sup>

In early 1969, two Soviet economists explained why such problems were arising:

It is a mistake to suggest that the implementation of strict budgetary constraints and profit requirements [*khozraschetnykh elementov*] in internal reforms will automatically, in and of themselves, lead to the creation of an effective mechanism of economic cooperation. We must not forget the qualitative difference between internal and international mechanisms. In the first instance, the broad use of commodity-money relations and stimuli and the increased independence of separate economic units are carried out under conditions in which the state can employ the necessary levers to direct economic development along the needed track. In the second instance such conditions are absent. . . . [A] precondition for the progress of socialist integration must be strengthening the mechanism of planned regulation of the process of economic cooperation.<sup>9</sup>

The question was how to reconcile the contradictory aims of market socialist reforms and increased CMEA trade. Soviet economists and policy-makers, with rare exceptions, saw supranational planning as the answer. They held out the hope of a single plan integrating all Soviet-bloc economies, much as national-level plans already directed the economies of the individual countries. Nikita Khrushchev had briefly mentioned the issue in 1962, but he quickly backed away from it.<sup>10</sup> On 12 November 1968, shortly after the invasion of Czechoslovakia, Leonid Brezhnev hinted at this new direction in a speech to the 5th Congress of the Polish United Workers' Party. While nodding briefly in the direction of national sovereignty and national paths to socialism, Brezhnev argued that "the tasks of further development of the economies of the socialist commonwealth . . . demand that we earnestly take up the expansion and perfection of economic ties among our countries." He claimed that a "broader international socialist division of labor, cooperation, and specialization of production will allow significantly more effective use of social-

8. V. Issupov, "On the Formation of Trade Relations among the Socialist Countries," *Soviet and East European Foreign Trade*, Vol. 5, No. 1-2 (1969), p. 105. See also M. Lesechko, "Novyi etap sotrudnichestva," *Pravda* (Moscow), 21 June 1969, p. 4.

9. P. Alempiev and Yu. Shiryaev, "Ekonomicheskoe sotrudnichestvo stran sotsializma," *Voprosy ekonomiki*, No. 1 (1969), p. 56. See also G. Sorokin, "Problemy ekonomicheskoi integratsii stran sotsializma," *Voprosy ekonomiki*, No. 12 (1968), p. 81.

10. Henry Wilcox Schaefer, *Comecon and the Politics of Integration* (New York: Praeger, 1972), p. 3.

ism's advantages, the quicker development of each of our countries' national economies, and new successes in the economic competition with capitalism."<sup>11</sup> In themselves, Brezhnev's remarks were unobjectionable.

Immediately after Brezhnev's speech, however, the economist Gennadii Sorokin described the preferred Soviet model: a single, integrated, supranational economic plan for the entire Soviet bloc. To Sorokin, an expansion of foreign trade and greater flexibility of prices were worthy aims but inherently limited by small-scale, near-term thinking. Policymakers, he claimed, should instead pursue "the gradual formation of a single structure for the world socialist economy." This "single world Communist economy with a single economic plan" was, he argued, "an objective necessity and strategic goal." Mere coordination of plans was a useful step, he said, but "only a distant approach to a single economic plan for all socialist countries." He stressed that although economic and political realities did not yet permit this single plan to be implemented, there was no escaping the ultimate need, over the next 15–20 years, "not so much for strengthening but for a new organization for planning in general."<sup>12</sup> Sorokin was well aware of the opposition his proposals would generate in Eastern Europe. He was careful to marshal citations from East European economists who agreed that more supranational integration was needed, and he attacked those who "view integrated production as a threat to national independence," an idea he linked particularly with Czechoslovak and Yugoslav economists. Both were safe targets—the Yugoslavs outside the Soviet bloc and the Czechoslovaks now revealed as "openly revisionist." As for the opponents who remained within the bounds of legitimate discourse, Sorokin attacked the idea that socialist integration could be achieved solely through "the market or monetary-financial relations," East-bloc code for relatively free trade. Socialist integration, he claimed, required planning, and they would be misguided if they were to emphasize "market or monetary relations and forget or underestimate plan coordination."<sup>13</sup>

Other Soviet economists echoed Sorokin's comments, establishing a clear Soviet line on problems of economic integration—a line that emphasized central direction and rejected free trade and semi-convertible currencies as means to greater linkage. Ninel' Bautina argued in 1968 that, all things being equal, international trade in the Soviet bloc would be underdeveloped by compari-

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11. L. I. Brezhnev, in *O vnesheinei politike KPSS i Sovetskogo gosudarstva: Rechi i stat'i* (Moscow: Politizdat, 1973), p. 138.

12. G. Sorokin, "Problemy ekonomicheskoi integratsii stran sotsializma," *Voprosy ekonomiki*, No. 12 (1968), pp. 77, 79, 85. Unlike the East Europeans who read Sorokin's proposals, Henry Schaefer downplays the supranational aspects of the proposals. See Schaefer, *Comecon and the Politics of Integration*, pp. 18–19.

13. Sorokin, "Problemy," pp. 80–81.

son to the bloc's domestic economies. The economy within any particular state, she said, was characterized by common ownership of the means of production, something manifestly not the case across national borders. As a result, managing domestic trade was much simpler than coordinating international trade. Only planning and direction could overcome this structural obstacle, she stressed. A single planning organ coordinating all socialist economies would be welcome at some future date, but until then coordination through multilateral agreements was the best solution. Bautina also raised, as an implicit threat, the fundamental asymmetry of the CMEA's political economy. The relative economic success of Czechoslovakia, Hungary, and East Germany depended on subsidized raw materials and energy from the Soviet Union. Moving to market mechanisms that would lead to higher prices for raw material inputs, she warned, might not be as beneficial to the Soviet Union's satellites as they expected.<sup>14</sup> Nikolai Inozemtsev, a member of Gosplan's collegium, agreed that planning was the best solution, arguing in September 1969 that the growing importance of foreign trade—reaching 30–40 percent of national income in some CMEA countries—meant that coordination of national plans was a necessity. In centrally-planned economies, he wrote, “the formation of the basic direction of the economy's development cannot be entrusted to the market just as the national economic plans and mutual economic ties cannot be fully coordinated through the sphere of turnover”—that is, through trade alone. The limited markets of the East European states required the Soviet market to serve as a means of allocating industrial production: “The creation of a modern machine-building industry, and its further concentration and specialization, cannot be handled in isolation in each country.” Transnational or supranational planning was the solution. Production, consumption, and investment grew out of rational decisions about specialization and allocation.<sup>15</sup>

The Poles were the Soviet Union's closest allies in desiring tight economic integration, though achieved through financial and trade-centered integration rather than supranational planning. When Brezhnev gave his speech in Poland in November 1968 endorsing supranational planning, the Polish leader Władysław Gomułka concurred in backing tighter integration.<sup>16</sup> This stance

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14. N. Bautina, “International Socialist Production Relations,” *Soviet and Eastern European Foreign Trade*, Vol. 4, No. 3 (1968), pp. 87–104.

15. N. Inozemtsev, “Koordinatsiya planov: Novyi etap,” *Izvestiya* (Moscow), 25 September 1969, p. 4.

16. Schaefer, *Comecon and the Politics of Integration*, p. 16. In the mid-1960s the Poles also pushed for tighter Warsaw Pact integration as a tool to influence Soviet policy. See Vojtech Mastny and Malcolm Byrne, eds., *A Cardboard Castle? An Inside History of the Warsaw Pact, 1955–1991* (Budapest: Central European University Press, 2005), p. 27.



was spurred largely by changes in Cold War politics produced by the *Ostpolitik* of Willy Brandt, who sought first as West German foreign minister and then as chancellor to expand ties to the Soviet bloc. Polish fears of the Federal Republic of Germany (FRG) and mistrust of East Germany's privileged status vis-à-vis the FRG brought a temporary alliance of convenience with Moscow. In March 1969, for example, a British diplomat reported that Poles described their push for closer CMEA integration as an effort to keep the Soviet bloc intact by preventing East Germany from moving closer to the West. Tighter CMEA integration would also shield against FRG economic penetration. The same Polish source in July 1969 complained bitterly about what he described as East Germany's desire to have the best of both worlds: preferential access to Western markets and cheap East European raw materials. Although the reaction in London was skeptical, confirmation that such views were circulating in Hungary as well came the next month. A British banker signing a loan to expand Hungarian aluminum production had a candid discussion with a vice-president of the National Bank of Hungary. The Hungarian reportedly displayed

a great deal of anti-German bias . . . what worries him more than anything else is the knowledge that East and West Germany are working much more closely together than is generally realized. He asserts, for example, that an agreement has been reached at the Ministerial level between the "two countries" the effect of which is to include East Germany in the EEC.<sup>17</sup>

The Soviet economist Igor' Dubinskii argued openly in 1969 that Western attempts at a differentiated policy toward Eastern Europe had to be met by renewed efforts at integration and unity.<sup>18</sup>

The Soviet Union's desire for supranational economic authority merely underscored that no such authority yet existed. Although the Polish authorities, too, had endorsed tighter integration, the Yugoslav government (an observer in CMEA) feared supranational planning, and the Romanians were likewise opposed to any strengthening.<sup>19</sup> Constructive opposition also came

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17. Kennedy (Warsaw) to Miles (East European and Soviet Department), 31 March 1969, in The National Archives of the United Kingdom (TNAUK), Foreign and Commonwealth Office (FCO) 28/600, Doc. 50; Miles to Kennedy, 9 April 1969, in TNAUK, FCO 28/601, Doc. 51; Kennedy Memorandum of Conversation with Trampczynski, 11 July 1969, in TNAUK, FCO 28/601, Attachment to Doc. 92; and Sir George Bolton (Bank of London and South America) Report, 23 April 1969, in TNAUK, FCO 28/601, Doc. 78. On the Polish-East German tensions within the bloc, see Douglas Selvaie, "Poland, the German Democratic Republic, and the German Question, 1955-1967," Ph.D. Diss., Yale University, 1998.

18. I. Dubinskii, "Leninskie idei o sotrudnicestve i sblizhenii sotsialisticheskikh gosudarstv," *Voprosy ekonomiki*, No. 4 (1969), p. 26.

19. Reeve (Moscow Embassy) to Jenkins (Eastern European and Soviet Department, Foreign Office), 24 February 1969, in TNAUK, FCO 28/600, Doc. 33.

from Hungary and Czechoslovakia.<sup>20</sup> Hungarian and Czechoslovak economists generally believed that integration should be fostered through more rational pricing, a convertible CMEA currency, and a free socialist market, not direction from Moscow. Trade would then grow from mutual benefit. In early 1967, the Hungarian economists Sándor Ausch and Ferenc Bartha demonstrated in great detail the economic absurdities created by the CMEA's system of bilateral trade deals, specifying physical units of goods to be exchanged without any calculation of real comparative advantage. Although CMEA trade relied on capitalist market prices as a starting point for its own pricing, trade negotiators were primarily concerned with balancing one national basket of goods against another national basket, not about setting rational prices for any particular import or export. The result was enormous discrepancies in prices for identical products, creating distorted incentives for managers and enterprises. Although broad bilateral agreement had been adequate as long as economic management was highly centralized, market reforms had led to partial decentralization and greater accountability on the part of enterprise managers for profits and losses. The conclusion Ausch and Bartha drew was that the new arrangements "would require the creation of an essentially free COMECON contractual price system based mainly on price agreements between firms."<sup>21</sup>

Radoslav Selucký, a Czechoslovak economist, made similar points in 1968. Reforms, he said, had decentralized economic power and created difficulties for foreign trade, particularly a noticeable drop in the volume of CMEA trade in 1966. The uneven pace of economic reform in CMEA countries also caused problems, with the adoption of enterprise reforms in some countries (particularly Hungary and Czechoslovakia) that had given greater emphasis to market forces. As a result, enterprise managers in these countries were not interested in buying substandard products from CMEA partners or in supplying goods below market prices. Selucký noted that Czechoslovak manufactured goods were more competitive than other CMEA products in both capitalist and socialist markets, and he warned that if Czechoslovak firms exported products to CMEA partners but did not find imports worth purchasing in return, Czechoslovak enterprises would be left without compensation.<sup>22</sup>

The solution for Selucký was a convertible currency entailing "economic calculations and the utilization of commodity-money relations." He hoped

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20. Schaefer, *Comecon and the Politics of Integration*, pp. 23–26, 45–46.

21. Sandor Ausch and Ferenc Bartha, "Theoretical Problems Relating to Prices in Trade between the Comecon Countries," *Soviet and Eastern European Foreign Trade*, Vol. 4, No. 2 (1968), p. 67.

22. R. Selucký, "The Impact of the Economic Reforms on the Foreign Economic Relations of the Socialist Countries," *Soviet and Eastern European Foreign Trade*, Vol. 4, No. 3 (1968), pp. 72.

that CMEA would “confront the question of convertibility of foreign exchange, which—as it seems—sooner or later arises with a greater or lesser urgency in every socialist country that attempts a consistent application of [market principles] and where the percentage share of foreign trade exceeds 20 percent of national income.” He acknowledged that “only some socialist countries have an immediate interest in the convertibility of foreign exchange. . . . The countries that are economically developed, have a large foreign trade turnover, and are attempting to create a planned market socialist economy have a greater interest in solving the problem of foreign exchange convertibility than the other socialist countries.” Selucký concluded by asking “whether the situation is not growing ripe for a fuller application of the mechanism of supply and demand on the COMECON market, which would better enable individual enterprises to react immediately to real market conditions when deciding questions dealing with specialization and cooperation.”<sup>23</sup>

CMEA already had a purportedly convertible currency: the so-called transferable ruble (*perevodnyi rubl'*). Defined at par with the Soviet ruble (officially equivalent to just under a gram of gold), the transferable ruble was supposed to be a medium of exchange, a unit of account, and a store of value for the CMEA economies. Unfortunately, it was not in fact truly money. Though defined in terms of gold, it was not actually convertible into gold. As a unit of account, the transferable ruble suffered from the arbitrary prices inherent in Soviet-style economies. Without real prices, there was no way to determine whether true gains from trade were possible.<sup>24</sup> Furthermore, given the continuing domination of central planning in Soviet-bloc economic systems and the scarcity of high-quality products, holders of transferable rubles could not readily use them to purchase goods, which were instead distributed administratively. Conversely, firms possessing goods to sell had no desire to exchange those goods for useless transferable rubles devoid of purchasing power. The transferable ruble had been designed to enable multilateral clearing, rather than requiring each pair of countries in the CMEA to balance their trade bilaterally with baskets of goods.<sup>25</sup> In other words, Hungary might run a trade surplus with Poland, which might run a trade surplus with the Soviet Union, which might run a trade surplus with Hungary in turn. Those imbalances, the idea went, could be cancelled through CMEA's International Bank

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23. *Ibid.*, pp. 79–80, 86.

24. See particularly Philip Hanson, *The Rise and Fall of the Soviet Economy* (London: Pearson, 2003), pp. 120–121.

25. On multilateral balancing, see Adam Zwass, *The Council for Mutual Economic Assistance: The Thorny Path from Political to Economic Integration* (Armonk, NY: M. E. Sharpe, 1989), pp. 20–21, 42, 54–55.

for Economic Cooperation (IBEC), which had been set up to facilitate the clearing of trade denominated in transferable rubles. However, none of this ever happened to any significant degree. Countries exporting more than they imported found themselves with a surfeit of useless transferable rubles. Loans and credits in transferable rubles suffered from the same problem of purchasing power, and so the CMEA continued to work predominantly through bilateral balancing and barter.

These two competing visions of the CMEA's future, Soviet supranational planning versus Czechoslovak and Hungarian free trade and convertible currency, clashed at CMEA's 23rd Session, in Moscow on 23–26 April 1969. The session included the Communist party leaders of the CMEA countries: Todor Zhivkov for Bulgaria, Gustáv Husák for Czechoslovakia, Walter Ulbricht for East Germany, János Kádár for Hungary, Gomułka for Poland, Nicolae Ceaușescu for Romania, and Brezhnev and Prime Minister Aleksei Kosygin for the Soviet Union, but they failed to achieve any clear resolution. Despite the Soviet Union's dominance within CMEA and despite the sobering display of Soviet power in the August 1968 invasion of Czechoslovakia, Brezhnev did not win decisive endorsement of supranational planning.<sup>26</sup> The Soviet Union, though by far the largest economy in CMEA, had to show a surprising amount of deference to its smaller partners on matters of economic policy. The session's official communiqué stressed "socialist internationalism, complete equality, respect for sovereignty and national interests, and mutual profit and comradesly mutual aid." Rather than designating supranational planning as the "chief method" of achieving these principles, the East-bloc leaders merely gave consent to "the coordination of national economic plans," which had in fact already been part of CMEA's program (albeit nugatory) from the time the organization was founded in 1949. Although the communiqué called for "perfecting current and discovering new forms and methods of economic cooperation," it gave no hint of new directive institutions.<sup>27</sup> Mikhail Lesechko, the Soviet representative to CMEA, conceded in June that any new organizations to promote a division of labor among the socialist countries "cannot and will not have functions of a supranational character."<sup>28</sup>

Without supranational planning, some other mechanism to promote CMEA trade was necessary, and the April 1969 Moscow session created the IIB to do this. Because a fully convertible currency for the CMEA was practically impossible, the path chosen and implemented in part through the cre-

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26. Schaefer, *Comecon and the Politics of Integration*, pp. 50–51.

27. "Kommyunike o XXIII spetsial'noi sessii Soveta ekonomicheskoi vzaimopomoshchi," *Pravda*, 27 April 1969, p. 1.

28. M. Lesechko, "Novyi etap sotrudnichestva," *Pravda*, 21 June 1969, p. 5.

ation of the IIB was what Lesechko termed “intensification of the role of trade and monetary relations.”<sup>29</sup> That could not, however, be limited to bilateral trade agreements among the CMEA member-states. As a means of promoting economic efficiency and international integration through finance and trade rather than administrative direction, the IIB emerged as a compromise aimed at allocating investment capital rationally and competitively and promoting trade through industrial modernization and quality products, all without supranational authority.<sup>30</sup> The IIB was charged with investing in internationally competitive projects that would encourage CMEA integration. Even before the agreement to create the IIB, two Soviet economists had noted wistfully that the nature of property in socialist economies prevented capitalist methods of investment via the purchase of real property. As an alternative, they proposed multilateral, long-term credits.<sup>31</sup> Vilen Karpich, a Soviet financial expert and central figure in later dealings with the IIB, welcomed the bank’s creation as a necessary extension of credit relationships inside CMEA that hitherto had been on an exclusively bilateral basis. “The extension of credits” on a bilateral basis, he wrote, “is not always or not completely connected with the demands of the international socialist division of labor, the development of international specialization and cooperative production.” As East German economist K. Wilen suggested, bilateral credits were inadequate for real coordination of planning and production, which required instead multilateral credit.<sup>32</sup> The IIB was the answer.

The original inspiration for the bank came from Czechoslovakia. Before the April 1969 Moscow session, Czechoslovakia’s public proposals centered on a convertible currency and integration through trade.<sup>33</sup> However, diplomatic sources reveal that a CMEA investment bank was central to Prague’s conception of CMEA integration. In speaking with foreign observers, Czechoslovak diplomats lauded the results of the April summit. British diplomats reported on multiple occasions that their East European counterparts pointed to Czechoslovakia as the originator of the proposal. Indeed, the Czechoslovak foreign trade minister Ludvík Ubl remarked in wonderment that “the Soviet Union had agreed to all the Czech proposals at the meet-

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29. Ibid.

30. Adam Zwass, “The International Investment Bank and the Council for Mutual Economic Assistance,” *Soviet and Eastern European Foreign Trade*, Vol. 9, No. 1 (1973), pp. 3, 8.

31. P. Alampiev and Yu. Shiryaev, “Ekonomicheskoe sotrudnichestvo stran sotsializma,” *Voprosy ekonomiki*, No. 1 (1969), p. 53.

32. V. Karpich, “Razvitie valyutno-finansovykh otnoshenii stran SEV,” *Voprosy ekonomiki*, No. 7 (1969), pp. 107–108; and K. Wilen, “Mezhdunarodnyi investitsionnyi bank,” *Ekonomicheskaya gazeta*, No. 30 (1970), p. 20.

33. Schaefer, *Comecon and the Politics of Integration*, pp. 9–11.

ing.”<sup>34</sup> Soviet leaders evidently wanted to bolster the authority of the post-invasion regime in Prague by deferring to the Czechoslovak proposals, something paralleled by similar considerations within the Warsaw Pact.<sup>35</sup>

The communiqué from the April 1969 session noted that “agreement was reached on . . . setting up an investment bank for the member countries of the CMEA.”<sup>36</sup> After further negotiations, the CMEA’s 24th session, in Warsaw in May 1970, approved terms of an agreement establishing the IIB along with its charter. This agreement was signed on 10 July 1970 by the Soviet Union, Mongolia, Bulgaria, Czechoslovakia, East Germany, Hungary, and Poland, all of which ratified the agreement in short order.<sup>37</sup> At the first meeting of the bank’s governing council in Moscow on 17–19 November 1970, the Soviet official V. A. Vorob’ev was elected the bank’s first chairman (*predsedatel’*), responsible for its day-to-day operations.<sup>38</sup> The sole exception to the Soviet bloc’s membership in the bank was Romania, signaling the later centrality of national sovereignty and bloc politics to the IIB’s workings. The Romanian government feared a back-door introduction of the Soviet economic domination that it had rejected in the early 1960s. Romanian reservations did not last long, however, particularly given the safeguards for sovereignty built into the IIB’s charter. Romania joined the bank on 12 January 1971, less than two weeks after the IIB began operating. Cuba joined the IIB on 24 January 1974, and Vietnam on 30 May 1977.<sup>39</sup>

## The IIB’s Structure and Functions

The IIB’s ultimate authority rested in its board (*Sovet*), made up of one representative from each member-country, each of whom had one vote. Major decisions required unanimity and all other decisions at least a three-quarters majority. The IIB’s charter gave Moscow no more formal power than any other member. Although the Soviet Union, in keeping with its share of CMEA

34. See Reeve to Mallaby, 6 May 1969, in TNAUK, FCO 28/601, Doc. 68; and “Briefing No. 6 for WEU Meeting on Comecon, 5–6 June 1969,” in TNAUK, FCO 28/601, Doc. 80.

35. Mastny and Byrne, eds., *Cardboard Castle*, p. 27.

36. “Kommyunike o XXIII spetsial’noi sessii Soveta ekonomicheskoi vzaimopomoshchi,” *Pravda*, 27 April 1969, p. 1.

37. “Sozdan Mezhdunarodnyi investitsionnyi bank,” *Pravda*, 11 July 1970, p. 1; and “Mezhdunarodnyi investitsionnyi bank,” *Ekonomicheskaiia gazeta*, No. 30 (1970), p. 20. See also Alois Baran, “Origins and Development of the International Investment Bank,” *Soviet and Eastern European Foreign Trade*, Vol. 15, No. 1 (1979/80), pp. 87–88. On Soviet ratification, see M. A. Lesechko to Central Committee, 27 July 1970, in RGAE F. 302, Op. 2, D. 705, L. 1.

38. “Sotrudnichestvo krepnet,” *Pravda*, 20 November 1970, p. 4.

39. *Mezhdunarodnyi Investitsionnyi Bank, 1971–1985* (Moscow: Finansy i statistika, 1986), p. 92.

trade, provided 39.93 percent of the IIB's founding capital of one billion transferable rubles (contributed in annual installments), the USSR's economically dominant role was not matched by the formal, legal power to control the bank. In principle, Mongolia, providing less than half of one percent of the IIB's capital, had an equal voice with the Soviet Union in the setting of policy and the ability to veto major changes. The IIB proclaimed "full equality and respect for the sovereignty of all member countries of the Bank," and the Soviet economic weekly *Ekonomicheskaiia gazeta* hailed the IIB's "principles of equal rights, mutual profit, and respect for national sovereignty." As a result, the IIB was not merely an instrument for Soviet domination, as the Romanian government had feared. The charter took deliberate steps to play up the IIB's independent character, or at least as independent as it was possible to be when based in Moscow with a staff answering to party discipline. Although the IIB's chairman was Soviet, the other personnel were international. The bank's founding agreement and its charter alike stressed that the IIB was not responsible for the debts of its member countries and, more importantly, that its member-countries were not responsible for the bank's debts. The IIB's property and assets were legally inviolable, and its staff enjoyed diplomatic immunity. On paper, all member-countries had an equal voice in its decisions. The bank was to be self-supporting, financially independent, and profit-making.<sup>40</sup> The system was clearly intended to refute any Romanian complaints about possible Soviet domination.

In practice, of course, the Soviet Union's overwhelming economic and political weight spurred the IIB's other members to defer to it. This deference was already clear in the bank's first year. At the meeting of the bank's board on 11–12 November 1971, the Soviet delegation proposed funding seven investment projects with 127.8 million transferable rubles and further evaluating an additional four, a suggestion duly approved by the rest of the board, though none of the IIB's early investments went to Soviet enterprises. This unanimous deference to Soviet wishes was quite apparent to Soviet staffers in the CMEA, who suggested using it more effectively. Karpich wrote to Lesechko:

It is worth noting that during the meeting, representatives of all countries expressed interest, most often unofficially, in possible requests from the Soviet side, emphasizing the need to begin financing projects as soon as possible with bank credits, something that would fully correspond to the bank's missions and would be directed at developing integration in the interests of the majority of the

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40. K. Vilen, "Mezhdunarodnyi investitsionnyi bank," *Ekonomicheskaya gazeta*, No. 30 (1970), p. 20; *Soglasenie ob obrazovanii mezhdunarodnogo investitsionnogo banka / Ustav Mezhdunarodnogo investitsionnogo bank* (Moscow, 1971). See Arts. 13, 15, 16, and 18 of the *Soglasenie* and Art. 3 of the *Ustav*.

CMEA's member countries. In connection with this, it seems worthwhile to expedite the preparation of materials from the Soviet side.<sup>41</sup>

As the IIB developed, its procedures became standardized. Actual day-to-day management of the bank's activities lay with its management (*pravlenie*), headed by a chairman (*predsedatel'*) and three deputies appointed by the board and serving five-year terms. Governments and state enterprises submitted proposals to the IIB, which evaluated their export potential, technological sophistication, and contribution to CMEA integration. The IIB's management, represented by its chairman, brought selected proposals to the IIB's board at thrice-yearly meetings. The board then chose which projects to endorse for financing. The process was by no means a rubber stamp. At the November 1971 board meeting, for example, the management team narrowed thirty-one requests down to twelve proposals, of which the board approved seven.<sup>42</sup>

This vetting illustrates one of the IIB's intended purposes: to provide market discipline in the absence of a competitive market. In capitalist systems, banks aggregate capital from individual investors and savers, pooling funds to achieve more diversified and less risky returns than if they individually loaned their money to borrowers. In centrally-planned economies, with all significant capital in state hands, this aggregation is meaningless—aggregation is inherent in the system.<sup>43</sup> What CMEA policymakers wished to achieve was independence of decision-making, putting a premium on rational and planned international allocation of financial resources. The competitive character of the evaluation process was intended to promote efficiency, as was the bank's power to inspect and oversee the projects it funded.<sup>44</sup> Enterprises and government agencies competed for IIB loans and its scarce hard currency by submitting, in principle, technologically sophisticated projects offering the highest possible return on investment. The IIB itself was set up to carry out rigorous evaluation and to reward successful applicants with large quantities of hard currency, either provided by the member-countries as founding capital or borrowed from Western capital markets.

This effort to establish market discipline in the absence of markets extended to using interest as a conscious tool of fiscal responsibility. The IIB

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41. V. Karpich to M. A. Lesechko, 10 December 1971, in RGAE, F. 302, Op. 2, D. 897, Ll. 9–11.

42. *Ibid.*, L. 9.

43. Soviet-bloc commentators, however, routinely claimed that the IIB's purpose was to aggregate capital. See "Sozdan Mezhdunarodnyi investitsionnyi bank," *Pravda*, 11 July 1970, p. 1; K. Vilen, "Mezhdunarodnyi investitsionnyi bank," *Ekonomicheskaya gazeta*, No. 30 (1970), p. 20; interview with V. A. Vorob'ev in "Bank—sozidatel'," *Izvestiya*, 13 December 1970, p. 3; and V. A. Vorob'ev, "A Comprehensive Program of Socialist Economic Integration and the International Investment Bank," *Problems of Economics*, No. 8 (1975), p. 58.

44. *Soglasenie / Ustav*, Art. 18 of *Ustav*, 19–22.



paid market interest rates in the West for its hard currency borrowing, and any attempt by the bank to charge its own borrowers less than it was itself paying for dollars or Deutschmarks would have been financially suicidal. Even IIB credits in transferable rubles, which were much more subject to manipulation by East-bloc governments and not under the discipline of hard-currency interest payments to the West, could not be set at arbitrarily low rates. CMEA economists understood that the cost of capital would necessitate the charging of interest to enforce discipline and economic efficiency. Karpich had argued in 1969 for the broader use of interest. He complained that the IBEC (the counterpart to the IIB) unwisely provided trade credits that were interest-free or at nominal rates:

Credit can exert influence on the fulfillment of a country's obligations and provide for the mutual interests of debtors and creditors only in the event that the credits are paid off with deliveries at least minimally corresponding to the level of the possible growth from the capitalization of national income. Accordingly, economic effectiveness dictates the need for a certain restructuring of the [IBEC]'s credit system toward the gradual abandonment of the practice of granting interest-free credits, an appreciable increase in interest rates, and the further differentiation [of interest rates] for credits and deposits in accordance with the periods and types involved.<sup>45</sup>

Vasilii Garbuzov, the Soviet finance minister, concurred. He said that although the IIB would not aim at maximizing profits, the charging of interest was essential “to provide for the profitable work of the bank, the observance of payment discipline, and payment for the resources that the bank has attracted.” By 1977, the IIB was charging 3 to 5 percent interest on its transferable ruble loans, a rate low enough for borrowers to afford but high enough to provide the bank with a reasonable profit. Nonetheless, the bank still encountered pressure to offer cheap credit for capital investment. CMEA's less-developed members (Mongolia, Cuba, Vietnam) benefited from artificially low interest rates for loans in transferable rubles (e.g., a Mongolian wool-processing plant was charged only 0.5 percent). The IIB established a special fund of subsidized credit for less-developed countries outside the CMEA.<sup>46</sup>

The IIB's mission included supporting foreign trade both inside the CMEA and with the outside world. In particular, the bank's founding docu-

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45. V. Karpich, “Razvitiie val'iutno-finansovykh otnoshenii stran SEV,” *Voprosy ekonomiki*, No. 7 (1969), p. 105.

46. V. Garbuzov, “Mezhdunarodnyi investitsionnyi bank sotsialisticheskikh stran,” *Pravda*, 11 July 1970, p. 4; Iu. Konstantinov, “Povyshenie roli perevodnogo rublia,” *Ekonomicheskaya gazeta*, No. 8 (1975), p. 20; and Yu. Konstantinov, “Perevodnyi rubl': Opyt i perspektivy ispol'zovaniia,” *Ekonomicheskaya gazeta*, No. 26 (1977), p. 20. For an additional testimony to the salutary effects of interest payments on the borrower, see Alexander Belovič, “The Basic Forms of International Socialist Investment Credit,” *Soviet and Eastern European Foreign Trade*, Vol. 16, No. 2 (1980), pp. 51–52.

ments required all loans to be justifiable in terms of efficient use of resources. The factories built with its loans had to achieve quality and productivity commensurate with the world market, so that they would be suitable for industrial managers under market socialism. In particular, the IIB had no authority to invest in projects intended solely for the benefit of a single CMEA member, but only those of multinational significance.<sup>47</sup> CMEA commentators routinely emphasized the bank's central role in promoting "the international division of labor, specialization, and cooperative production." The IIB was required to take into account general CMEA directives on the coordination of national economic plans.<sup>48</sup>

Finally, one of the IIB's central but unadvertised functions was to serve as a conduit for Western capital to relatively underdeveloped CMEA members. Although the bank did little to transfer capital from richer CMEA countries to poorer, it did serve in its early years as an East-West go-between, providing Western hard currency loans to the poorer members of CMEA. In effect, the IIB concealed poor national balance sheets, so that Poland, Bulgaria, and Romania, with their relatively bad credit risks, could receive hard currency through an intermediary. Although the bank was explicitly not a state organ and not guaranteed, Western bankers regarded the IIB as implicitly backed against default by the Soviet Union's gold reserves, making the bank an attractive partner. That the Soviet Union never declared such a role, and in fact disavowed it during Poland's debt crisis in the early 1980s, had no effect on Western bankers in the 1970s. The IIB's pattern of lending demonstrates a deliberate effort to improve the weaker economies while shielding them from Western scrutiny. Hungary, the country most attractive to Western lenders, received by far the lowest share of hard currency in its borrowing from the IIB. As of 1973, only 13 percent of the funds Hungary received were in convertible currencies. East Germany, benefiting thanks to *Ostpolitik* from easier access to Western capital, received only 29 percent of its IIB loans in hard currency. By contrast, Bulgaria and Poland, probably the least attractive credit risks, received the overwhelming majority of their credit from the IIB in convertible currencies—100 percent and 76 percent respectively.<sup>49</sup> In short, the IIB took hard currency from the West and relayed it to the countries that could least afford to borrow it on their own.

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47. *Soglasenie / Ustav*, Art. 3, pp. 18–20.

48. K. Vilen, "Mezhdunarodnyi investitsionnyi bank," *Ekonomicheskaya gazeta*, No. 30 (1970), p. 20. See also V. Garbuzov, "Mezhdunarodnyi investitsionnyi bank sotsialisticheskikh stran," *Pravda*, 11 July 1970, p. 4; and Yu. Konstantinov, "The Socialist Countries' Investment Bank," *Foreign Trade*, No. 8 (1971), p. 16.

49. V. Vorobyov, "The International Investment Bank: Three Years of Activity," *Foreign Trade*, No. 8 (1973), p. 12.

By the mid-1970s, as growing debt burdens became harder to ignore, the IIB's member countries continued to see the bank as a way around their own financial difficulties. In February 1976 the successor to Vorob'ev as head of the IIB, Al'bert Belichenko, traveled to Romania and Bulgaria. In Romania, Prime Minister Manea Mănescu emphasized Romania's desire for further credit from the IIB but did not want the bank to seek additional capital from its founding members. Romania was equally uninterested in borrowing Western capital directly. Vasile Voloseniuc, the chair of Romania's foreign trade bank, complained that Poland's macroeconomic follies made it difficult for other Soviet-bloc countries to borrow. The Romanians saw the IIB as a welcome alternative to the inhospitable Western money markets. In Bulgaria, Belichenko met with the Communist party leader, Todor Zhivkov, and the chair of the Bulgarian National Bank, Veselin Nikiforov, to discuss the overwhelming weight of hard currency in the bank's loans to Bulgaria. Nikiforov told Belichenko that Bulgaria would not submit itself to the scrutiny of Western financiers, leaving that to the IIB. "In a series of cases," Nikiforov said, "the granting of credit [by Western banks] is contingent on receiving data about the country's economy and finances; in those cases, Bulgaria declines the loan."<sup>50</sup>

## **The Soyuz Pipeline and the IIB**

Although the IIB was supposed to promote industrial development, the Soviet bloc's technological lag limited opportunities for productive integration. As a result, integration of the bloc's economies depended on Soviet wealth in natural resources, in particular natural gas. Soon after the IIB was established, its mission shifted from industrial modernization toward fuel and raw materials, a shift that accelerated dramatically in the mid-1970s with the spike in world energy prices. As oil and natural gas became more expensive, the Soviet Union came to act as what Philip Hanson called a "benign landlord at a time of rapid inflation," offering below-cost rent—cheap energy—to maintain good relations with its satellites.<sup>51</sup> In December 1970, even before the IIB officially began operations, Vorob'ev announced that the bank would provide "loans for joint construction of projects in the raw material and fuel industries, thereby substantially increasing deliveries of raw materials to the bank's member-countries."<sup>52</sup> Projects to exploit natural resources were hardly the so-

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50. A. Belichenko to M. A. Lesechko 2 March 1976, recounting February 1976 visits to Romania and Bulgaria, in RGAE, F. 302, Op. 2, D. 1485, Ll. 2–4, 6.

51. Hanson, *Rise and Fall*, p. 156.

52. "Bank—sozidatel'," *Izvestiya*, 13 December 1970, p. 3.

phisticated development the IIB was designed to achieve, and a group of Soviet economists lamented that far too much intra-CMEA trade involved exchanges of fuel and raw materials for industrial products, boosting turnover but not efficiency. Many Soviet economic specialists saw the IIB as an ideal means for assembling the enormous amounts of capital needed for major infrastructure projects. The East European countries, unable on their own to pay for the extraction of Soviet raw materials, could pool their resources through the IIB instead.<sup>53</sup> By 1977 a Soviet expert on international finance, Yurii Konstantinov, declared flatly that the IIB's loans were directed first and foremost at "capital investments designed to achieve considerable growth in the supplies of fuel, raw materials, and metals," with industrial modernization in second place. In 1980, Alexander Belovič, a Czechoslovak economist, agreed that the order of priorities for socialist investment credit was (1) raw materials and fuels, (2) improving technology, and (3) promoting national specialization.<sup>54</sup>

The IIB's commitment to natural resources at the expense of industrial modernization took a decisive step forward in 1974. On 18–21 June 1974 the leaders of CMEA countries met in Sofia for a festive celebration of the organization's 25th anniversary. In between the endless speeches hailing comradesly cooperation, the assembled heads of government signed an agreement committing the Soviet Union and its six East European allies to develop an immense natural gas field at Orenburg in the Ural Mountains.<sup>55</sup> Simply extracting the gas from the ground and rendering it usable was a major task. Contaminated by high levels of sulfur, the gas required French purification plants to remove the sulfur—itsself a valuable industrial raw material.

The June 1974 meeting did not deal with problems of extraction. The gas field was already producing and delivering gas through local pipelines to industrial centers in the Urals. Instead, the goal was building the mammoth *Soyuz* (Union) pipeline to transport the gas from Orenburg to Eastern Europe. In an era of détente and with the Soviet bloc's growing need for hard currency, Soviet managers explored numerous ways of trading energy for cash. Soviet officials also were exploring pipeline deals to take gas from the Tyumen field, which dwarfed the Orenburg deposit, to Murmansk for export to Western Europe or to Vladivostok for export to East Asia. In the early 1980s, simi-

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53. Yu. Konstantinov, "The Socialist Countries' Investment Bank," *Foreign Trade*, No. 8 (1971), p. 13.

54. Yu. Konstantinov, "Promotion of Economic Integration with the Aid of CMEA Countries' International Monetary and Financial System," *Foreign Trade*, No. 12 (1977), p. 7; and Alexander Belovič, "The Basic Forms of International Socialist Investment Credit," *Soviet and Eastern European Foreign Trade*, Vol. 16, No. 2 (1980), p. 57.

55. "Kommyunike o XXVIII sessii Soveta ekonomicheskoi vzaimopomoshchi," *Pravda*, 22 June 1974, p. 4.

lar discussions about a gas pipeline from the Yamal peninsula on the Arctic Ocean to Western Europe sparked bitter disputes between the United States and its West European allies over dependence on Soviet energy.<sup>56</sup>

There is an important distinction between the Tyumen and Yamal projects and the Orenburg pipeline. The Tyumen and Yamal projects were intended for Western markets, and the Soviet Union expected Western partners to bear the burden of financing them, in large part through "compensation agreements." Western capital and technology used for construction of the pipelines would not be paid for with hard currency. Instead, it was to be repaid with the products delivered by the pipelines.<sup>57</sup> By contrast, the Orenburg pipeline was politically vital for tying the Soviet and East European economies together through energy dependence, but offered little economic payback in hard currency. Both Eastern Europe and the Soviet Union were short of dollars. Financing the *Soyuz* pipeline was accordingly more complex. The IIB took over the task, publicly committing itself in February 1975 to providing the necessary funding.<sup>58</sup>

The *Soyuz* pipeline was a project of staggering scope. It ran 2,750 km from Orenburg to the western Soviet border town of Uzhgorod (now Uzhhorod, on the border between Ukraine and Slovakia). Stretching the entire breadth of the European Soviet Union, the pipeline crossed the Volga, Don, and Dnepr rivers, 160 km of swamps, and 110 km of mountainous territory, running up a 40-degree slope in the Carpathians, at a total cost estimated in the West at \$1.5 billion. Although the partners initially anticipated annual delivery of 15.5 billion cubic meters of natural gas, by the time construction began engineers were aiming for an annual capacity of 28 billion cubic meters. The large diameter (1,420-mm) pipeline was powered by 22 individual compressor stations and ran at a pressure of 75 atmospheres. The entire project, requiring an estimated 30,000 workers, was scheduled for completion in mid- to late 1978.<sup>59</sup>

To tap Eastern European resources, the USSR's All-Union Association for International Gas Industry Construction, the general contractor for the project, introduced a geographic division of labor. The 2,750-km pipeline was split into five sectors from west to east, with Bulgaria, East Germany, Poland,

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56. Anthony J. Blinken, *Ally versus Ally: America, Europe, and the Siberian Pipeline Crisis* (Westport, CT: Praeger, 1987); and Bruce W. Jentleson, *Pipeline Politics: The Complex Political Economy of East-West Energy Trade* (Ithaca: Cornell University Press, 1986), pp. 172–214.

57. On this general pattern, see Hanson, *Rise and Fall*, 121–122.

58. V. A. Vorob'ev interview, "Kurs vybran vernyi," *Izvestiya*, 4 February 1975, p. 4.

59. V. Zakhar'ko, "Na zapad ot orenburg," *Izvestiya*, 26 April 1975, p. 1; A. Vesel'ev, "Gazoprovod Orenburg-Zapadnaya granitsa," *Ekonomicheskaya gazeta* No. 39 (1975), p. 24; "The State of Comecon," *The Economist*, 17 January 1976, p. 79; and V. Vasilets, "'Krasnyi styk': Est' gazoprovod 'Soyuz,'" *Pravda*, 28 September 1978, p. 4.

Czechoslovakia, and Hungary given responsibility for the corresponding sectors. Each country was supposed to provide the laborers to build the pipeline in its assigned sector. In all cases, Soviet workers assisted with exploration, design, and excavation and operated the pipeline when it was completed. Romania, despite being a member of the consortium, took no direct role in construction and instead merely provided funding and materials.

East European construction teams began to arrive by April 1975, but the division of labor caused some friction.<sup>60</sup> Workers were recruited through ideological campaigns and promises of higher pay, and the East German youth organization became a patron of the pipeline and urged its members to volunteer. But working conditions proved difficult, and the East European workers found their higher pay inadequate to compensate them. Several East European economies were already suffering from shortages of skilled labor, and this problem was only exacerbated by the export of workers to the Soviet Union. Governments renegotiated their deals with the Soviet Union, accepting reduced deliveries of gas in return for having Soviet workers take over large sections of the pipeline.<sup>61</sup>

On 27 September 1978 the final link in the pipeline at the Czechoslovak border was completed. The impact on energy supplies in Eastern Europe was enormous. In Hungary alone, imports of Soviet gas were projected to increase by 2.5 times, from 1.7 billion to 4.3 billion cubic meters annually.<sup>62</sup>

The *Soyuz* pipeline fundamentally altered the IIB's mission and operations. The bank's specific role in the *Soyuz* project was arranging necessary credits, particularly in hard currency. The IIB handled financing in transferable rubles as well, easing the construction of the pipeline by setting an artificially low interest rate (2 percent annually) for pipeline-related credits in transferable rubles.<sup>63</sup> With hard currency loans, however, no such flexibility was possible. The IIB borrowed from Western financial markets at commercial interest rates and passed on those rates to its borrowers. Although the bank was intended to promote a broad range of investment projects, the massive *Soyuz* project quickly transformed the IIB into little more than a captive source of finance for the pipeline. The IIB thus ended up promoting develop-

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60. V. Zakhar'ko, "Na zapad ot Orenburga," *Izvestiya*, 26 April 1975, p. 1; and A. Vesel'ev, "Gazoprovod Orenburg-Zapadnaya granitsa," *Ekonomicheskaya gazeta*, No. 39 (1975), p. 24.

61. "Sovmestnymi usiliyami," *Ekonomicheskaya gazeta*, No. 33 (1975), p. 20; Paul Neuburg, "Comecon's Unequal Raw Materials Partnership," *The Times* (London), 6 August 1976, p. 16; and David A. Andelman, "Hungary Loudly Pledges Loyalty to Soviet, Yet Quietly Goes Own Way," *The New York Times*, 10 May 1978, p. 3.

62. "Zasedanie mezhravitel'stvennoi komissii," *Pravda*, 27 April 1978, p. 4; and V. Vasilets, "'Krasnyi styk': Est' gazoprovod 'Soyuz,'" *Pravda*, 28 September 1978, p. 4.

63. Iu. Konstantinov, "Povyshenie roli perevodnogo rublya," *Ekonomicheskaya gazeta*, No. 8 (1975), p. 20.

ment through natural resource extraction, not increased efficiency or improved technology. Although development and exploitation of raw materials had been a nominal part of the IIB's original mission, the member-states had made little effort to include fuel and energy in the bank's portfolio before the 1974 agreement to build the Orenburg pipeline. During the IIB's first two years, its loans and credits were directed overwhelmingly to industry. In 1971 and 1972, 57 percent of the bank's total lending of 279 million transferable rubles went to machine-building, 24 percent to chemical industry, 11 percent to light industry, and 7 percent to transportation. In 1973, large-scale investment in iron and steel altered the picture to some degree. By the end of the bank's third year, 43 percent of its total loans of 588 million rubles had gone to iron and steel, 34 percent to machine-building, 11 percent to chemicals, 8 percent to light industry, and 4 percent to transportation. Fuel and energy were conspicuous by their absence.<sup>64</sup>

The huge amounts of capital required to build the *Soyuz* pipeline overwhelmed the IIB at the expense of all other types of lending. By the end of 1977, nearly 80 percent of the bank's cumulative lending since its creation had gone to energy and fuel, a category that did not even exist at the end of 1973. By early 1979, the IIB had funded 61 separate projects with credits totaling more than 3 billion transferable rubles. Only two projects from the total of 61 were in the fuel and energy industry—the Orenburg natural gas field and its pipeline—but those two projects alone accounted for 78.4 percent of all bank lending.<sup>65</sup>

The pipeline also dramatically altered the bank's relationship to Western capital. Much of the IIB's early hard-currency lending had come from Soviet-bloc reserves, increasingly supplemented by borrowing on Western capital markets. In 1973, for example, the IIB's first publicized borrowing on Western markets had been a relatively small seven-year loan of \$50 million from a consortium headed by Britain's National Westminster Bank and including Bank of America and Bankers Trust.<sup>66</sup> But to finance the construction of the Orenburg pipeline, far larger amounts of Western capital began flowing

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64. Derived from *Survey of CMEA Activities in 1972* (Moscow: CMEA Secretariat, 1973), pp. 71–72, and *CMEA Activities at the Present Stage* (Moscow: CMEA Secretariat, 1974), p. 62, both cited in Dietrich André Loeber, ed., *East-West Trade: A Sourcebook on the International Economic Relations of Socialist Countries and Their Legal Aspects*, 4 vols. (Dobbs Ferry, NY: Oceana, 1977), Vol. 4, pp. 27, 31. See also V. F. Garbuzov, "Razvitie valyutno-finansovykh otnoshenii stran-chlenov SEV," *Ekonomicheskaya gazeta*, No. 7 (1973), p. 20; and V. Vorobyov, "The Growing Activity of the International Investment Bank," *Foreign Trade*, No. 10 (1974), p. 12.

65. A. Belichenko, "International Investment Bank and Economic Cooperation of CMEA Countries," *Foreign Trade*, No. 7 (1978), p. 27; and "Report on Bank Activities," 23 April 1979, in RGAE, F. 302, Op. 2, D. 1759, Ll. 7–15.

66. "Moscow Bank Gets Euroloan," *The New York Times*, 21 March 1973, p. 59; and "Soviet Bank Gets Loan from Western Group," *The Wall Street Journal*, 21 March 1973, p. 31.

through the IIB. In September 1975, a consortium led by Deutsche Bank and including U.S., Austrian, British, Canadian, Dutch, and French banks agreed to loan \$260 million to the IIB and syndicate more widely an additional \$130 million in loans with a five-year term and a rate of 1.25 percent over the London Interbank Offered Rate (LIBOR), a standard benchmark. This rate, being slightly higher than Soviet-bloc banks had recently received, reflected a worryingly high volume of East-bloc borrowing. Early the next year, the Dresdner Bank organized an additional loan of \$600 million, although increasing concerns about creditworthiness boosted the interest rate to 1.6 percent over LIBOR.<sup>67</sup> In 1977 the IIB continued to scramble for ever larger tranches of Western cash to feed the pipeline. In January 1977, Bank of America determined that IBEC was a poor credit risk because of its unclear legal status. In retaliation, the IIB syndicated its next loan in Europe through Dresdner Bank and exclusively to European participants, barring Americans. This loan, organized in the summer of 1977 and initially aimed at raising \$400 million, ultimately provided \$500 million over 6.5 years at 1.125–1.25 percent over LIBOR. This rate was less of a premium than the IIB had paid the previous year, but it was still substantially more than the typical spread for West European borrowers, who generally paid less than 1 percent over LIBOR. As an added bonus for West Germany, the bulk of the loan was allocated to the purchase of German-manufactured compressor stations and pipe.<sup>68</sup>

Although West German banks had dominated the management and syndication of previous IIB loans, America's Chase Manhattan took over in late 1977 for final credits to complete the *Soyuz* pipeline. The IIB, in its second major borrowing in a year, asked Chase Manhattan to arrange a \$600 million loan, and by 15 December Chase had assembled a consortium of sixty other banks.<sup>69</sup> That moment was the high point for Western lending to the IIB. By later that year, as individual Western banks grew increasingly wary of ever growing Soviet-bloc borrowing, lending to CMEA countries began to decline. Finding participants for syndicated loans grew ever more difficult, and those willing to join were willing to risk less capital. In 1978 U.S. banks refused to participate in a 10-year, \$500 million loan from Dresdner Bank to the IIB.

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67. "Group Is Syndicating Loan of \$390 Million to Soviet-Bloc Bank," *The Wall Street Journal*, 19 September 1975, p. 26; "Who's Next?" *The Economist*, 21 February 1976, p. 67; and "The Debt That Overhangs East-West Dealings," *Business Week*, 3 May 1976, pp. 118–119.

68. "In the Pipe Loan," *The Economist*, 28 May 1977, p. 100; and "German Bankers Win a Big One," *Business Week*, 20 June 1977, p. 33. For a parallel list of Western loans to the IIB, see Zwass, *Council for Mutual Economic Assistance*, p. 69.

69. "Chase Manhattan Unit Is Asked to Arrange Credit for Soviet Bank," *The Wall Street Journal*, 11 November 1977, p. 27; and "U.S. Bankers in Russia Waiting Out Lull," *The New York Times*, 27 February 1978, Sec. 4, p. 1.



The spreads were quite narrow, offering little return without the sweetener offered by pipeline contracts that West Germans had already won.<sup>70</sup>

This flow of Western money proved a mixed blessing. As loans for the *Soyuz* pipeline passed through the IIB's accounts like a pig through a python, the bank had the task of finding worthy new projects. In 1978 the IIB, after having loaned more than 400 million transferable rubles a year since 1971 (mostly to the pipeline), approved only 100 million transferable rubles for new projects.<sup>71</sup> As Karpich explained, the September 1978 completion of the pipeline heralded an enormous imbalance in the bank's accounts. In 1976–1977 the IIB had loaned 1.5 billion transferable rubles for a variety of projects. But he projected that without the pipeline's enormous appetite for capital, lending would likely fall to just over 100 million rubles in 1979–1980. At the 25th meeting of the IIB's board, the country representatives expressed their deep concern about the dearth of new projects to fill in the gap left by the completion of the pipeline. The IIB had been reduced to borrowing \$130 million from Japanese banks merely to purchase oil for CMEA, a far cry from the industrial retooling it had been created to carry out.<sup>72</sup> In addition, the steady flow of Western credit to the IIB depended on Western confidence that the IIB and the CMEA in general were good credit risks. A precipitous drop in lending undermined this belief, and Western bankers and even CMEA members themselves could evaluate this “as evidence of the weakness of the collective credit system of CMEA members and the transferable ruble.” Western banks might even call in their loans. The weight of dollars in the IIB's dealings left the bank quite vulnerable to Western misgivings about its credit-worthiness.<sup>73</sup>

The Soviet government worried about the IIB's ability to make payments on the hard currency it had borrowed to build the pipeline. The Soviet representative to CMEA's executive committee warned his East European colleagues about the need for prompt repayment to the IIB, and Soviet representatives to the bank itself planned to make the same point.<sup>74</sup> The precise nature of the problem was apparent by early 1979, when Karpich predicted immi-

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70. “The Comecon Debt Mountain,” *The Economist*, 29 October 1977, pp. 75–76; “Chase Manhattan Unit Is Asked to Arrange Credit for Soviet Bank,” p. 27; and “Major US Banks Shun Loan to Bank in Moscow,” *The Wall Street Journal*, 17 August 1978, p. 29.

71. “Deyatel'nost' MIB v 1978 godu,” *Ekonomicheskaya gazeta*, No. 21 (1979), p. 20.

72. V. Karpich to K. F. Katushev, 15 November 1979, in RGAE, F. 302, Op. 2, D. 1759, L. 18; Karpich to Katushev on 25th Session, 5 June 1980, in RGAE, F. 302, Op. 2, D. 1809, Ll. 82–83; and Adelman, “East-West Credit Links,” p. 25.

73. Karpich to Katushev, 15 November 1979 (see footnote 72 supra).

74. On this general pattern, see “Western Bank Lending to East European Nations Involves Broad Mix of Factors,” *American Banker*, 3 January 1979, p. 4. For specific Soviet concerns, see V. Karpich to K. F. Katushev, 30 March 1978, in RGAE, F. 302, Op. 2, D. 1628, L. 7.

nent insolvency. The IIB's outstanding hard currency debts totaled \$2.3595 billion. Although this was less than the \$2.8 billion estimated in the West, a simple projection of repayment schedules forecast that payments to Western creditors would outpace repayments from Soviet-bloc states every year from 1980 to 1984 by \$3.0 million, \$20.2 million, \$75.6 million, \$63.3 million, and \$67.6 million.<sup>75</sup> To be sure, actual default was unlikely, despite the explicit disavowal in the IIB Charter of any government responsibility for the bank's debts, and it turned out that the Soviet Union was never tested on this question. The short-term threat to the IIB's solvency was resolved by 1979 with loans from British and Japanese banks totaling \$850 million on substantially better terms than the bank had managed previously. But that reprieve did not redress the sharp drop in the bank's lending.<sup>76</sup>

## Structural Constraints on the IIB

The enormous volume of lending for the *Soyuz* pipeline and the crisis over its completion hindered the IIB's ostensible purpose and concealed longer-term, structural constraints inherent in the IIB and the system it served. From the very first loans the IIB made, some structural problems were clear. Those sitting in judgment over investment proposals were themselves the promoters of investment projects, an obvious conflict of interest. The IIB's first five loans for projects in Hungary and Poland came under sharp criticism from Karpich and another Soviet finance expert, Vladimir Shapovalov, for falling short of the bank's mission to promote international integration. They had little objection to the expansion of Hungary's Ikarus bus plant, whose output was predominantly (87 percent) intended for export to other Soviet-bloc countries, with clear demand already established. But the remaining projects—electrification of Hungarian rail lines and the acquisition of diesel locomotives, as well as Polish investment in small engines and motors—lacked the international significance and high technological level the IIB was designed to achieve. Moreover, the bulk of the Hungarian railway loan would go to pay the Soviet Union for 70 locomotives. This immediately presented a free-rider problem. The Hungarian government would pay for the locomotives entirely on credit, with no up-front commitment of Hungarian resources, and the 15.5 million transferable-ruble cost would largely exhaust Hungary's commitment to purchase Soviet goods as part of a five-year trade agreement. Shapov-

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75. V. Karpich to K. F. Katushev, 19 March 1979, in RGAE, F. 302, Op. 2, D. 1724, L. 5; and David A. Andelman, "East-West Credit Links Grow," *The New York Times*, 29 September 1979, p. 25.

76. V. Karpich to K. F. Katushev, 6 September 1979, in RGAE, F. 302, Op. 2, D. 1724, Ll. 27–8.

alov and Karpich suspected the Hungarians of trying to get something for nothing: buying Soviet locomotives with Soviet money and escaping further commitments to buy Soviet goods.<sup>77</sup> Matters did not improve as the IIB matured. In fact, when Shapovalov and Karpich reviewed the IIB's activities after its first full year, they found continuing efforts to subvert the bank's ostensible purposes. Discussions with Hungarian and Polish representatives about their projects "bore witness to the borrowers' attempts to achieve the easiest possible conditions for receiving bank credits, putting the material responsibility for any possible hard-currency losses on the bank. In this, the requirements of the founding agreement and the bank's charter are of only secondary significance for the borrowers."<sup>78</sup>

The way the IIB functioned, with the member-states competing for credit, also militated against proper vetting of proposals—the ostensible reason for setting up the IIB in the first place. "Countries are in competition with one another as aspirants for bank credit," Karpich declared. He warned his Soviet superiors that "in a series of cases, a principled and economically-based approach by one country to the question of extending credit to another country was limited by the desire to provide oneself with an ally in discussion of one's own request—put bluntly, the principle of 'you vote for me, and I'll vote for you.'" This shortcoming was evident with a Bulgarian proposal for cigarette production. The Bulgarian National Bank had requested an IIB loan to build a cigarette plant and expand another for an increase in total capacity of 20,000 tons, most of which was intended for the Soviet market. But the USSR had no plans to import additional Bulgarian cigarettes, something the Soviet representatives neglected to mention, presumably in hopes of gaining Bulgarian support for another proposal.<sup>79</sup>

The most difficult issue facing the IIB, an issue inherent in the very nature of the Soviet command-administrative economic system, was the uselessness of the transferable rubles it loaned. From early on in the bank's operations, its management and outside observers alike saw the problem created by loans in a currency that lacked purchasing power. The half-hearted market-based reforms of the 1960s still left most goods distributed administratively, not available for purchase with transferable rubles. Only if national economic plans earmarked goods for export in return for transferable rubles was ex-

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77. V. Shapovalov and V. Karpich to M. A. Lesechko, 30 July 1971, in RGAE, F. 302, Op. 2, D. 897, Ll. 5–8.

78. V. Karpich to M. A. Lesechko, 10 December 1971, in RGAE, F. 302, Op. 2, D. 897, L. 10.

79. V. Shapovalov and V. Karpich, "On Draft Directive to USSR Members of Council of IIB for 5th Session of Council," 10 April 1972, in RGAE, F. 302, Op. 2, D. 999, L. 3; and V. Shapovalov and V. Karpich to M. A. Lesechko, "On Draft Directive to USSR Members of Council of IIB for 5th Session of Council," 26 May 1972, in RGAE, F. 302, Op. 2, D. 999, L. 13.

change possible. This problem had been subtly apparent from the time the bank opened. Yuri Konstantinov had commented in 1971 that the IIB, to function properly would require careful integration with national economic plans.<sup>80</sup> Unless the bank's loans were matched by equivalent commitments in national plans to provide goods to match credits, the transferable ruble itself was meaningless for immediate purchases, let alone loans.<sup>81</sup>

CMEA did try to give the transferable ruble greater purchasing power. The official communiqué reporting on the results of CMEA's 28th Session in Sofia in June 1974 claimed that the member countries were devoting more attention in their national plans to the resources required for integration.<sup>82</sup> Although the communiqué did not explicitly link this new integration to the IIB, later references indicated that the meeting specifically directed the CMEA members to earmark production for IIB projects.<sup>83</sup> Later that year, Vorob'ev observed that "the bank will compile plans for the development of credit activity in close coordination with the national economic plans of member nations, so that as a result of the coordination of these plans the credits issued will be backed by material and technical resources. All this lends a more purposeful character to the bank's long-range credit planning."<sup>84</sup>

Nevertheless, good intentions and a clear understanding of the nature of the problem meant nothing. The lack of goods for the IIB's loans to purchase could have been fixed only by adopting supranational planning or by permitting real markets along with truly convertible currencies to provide purchasing power across national borders. But because free markets, free prices, and convertible currencies were all incompatible with Soviet-style economies of the era of developed socialism, the problem of "goods coverage" (providing products to match ostensible purchasing power) was bound to worsen over time. The system required precise bilateral balancing of imports and exports; otherwise, one country would accumulate goods and raw materials, while another would accumulate only empty purchasing power in transferable rubles. In March 1978 the Soviet delegation to IBEC's governing council planned to raise the issue of goods deliveries, arguing that "successful functioning of multilateral accounting systems is possible . . . only on condition that the Bank's member countries observe the principle of balancing mutual deliveries and payments in transferable rubles." Otherwise, creditor countries would find

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80. Y. Konstantinov, "The Socialist Countries' Investment Bank," *Foreign Trade*, No. 8 (1971), p. 16.

81. On this general problem, see Zwass, *Council for Mutual Economic Assistance*, pp. 58–59.

82. "Communiqué on 28th CMEA Session," *Pravda*, 22 June 1974, pp. 1, 4.

83. A. Belichenko, "The International Investment Bank: An Important Instrument for Socialist Economic Integration," *Foreign Trade*, No. 8 (1976), p. 27.

84. V. A. Vorob'ev, "A Comprehensive Program of Socialist Economic Integration and the International Investment Bank," *Problems of Economics*, Vol. 18, No. 8 (1975), p. 58.

themselves “with huge profits, which are not provided with equivalent goods.”<sup>85</sup> Matters had not improved by 1980, when Karpich declared that “the problem of providing IIB transferable ruble credits with goods remains the most complicated problem in trade-accounting relationships between countries.” He urged the Soviet representatives in CMEA to take the lead in ensuring that purchasing power was matched by production.<sup>86</sup> The Czechoslovak economist Alexander Belovič highlighted the same problem:

Experience in this field [of international credit] shows that carrying out construction work with credits in transferable rubles depends on prompt deliveries of the necessary machinery, equipment, and materials. That is to say, the main problem is the commodity content of the credits in transferable rubles that the bank provides for investment projects to be carried out in member countries and the supplying of machinery, technical equipment, and other requirements.<sup>87</sup>

Shifting the IIB's operations toward transferable rubles and away from dollars was a difficult task that underscored the bank's central problem, one far more profound than a lack of investment opportunities. Most of the CMEA members had no desire to borrow transferable rubles. In November 1979, Karpich acknowledged this point, which he attributed to “the fact that such credits [in transferable rubles] are not really provided with goods, that is, guaranteed planned provisions for the delivery of machinery and equipment for approved projects with payment in transferable rubles from IIB credits.” In 1979, Hungary, Poland, and Vietnam had requested loans totaling \$171 million but had received only \$91 million after painful and lengthy negotiations. Poland anticipated requesting \$1 billion in credits over the next five years. The demand was for loans in hard currency, not transferable rubles. Karpich lamented that “in a series of cases the country representatives have expressed only their lack of interest in receiving credits in transferable rubles.” The worst example was Mátyás Timar of Hungary, one of the architects of the New Economic Mechanism and president of the National Bank of Hungary, who “refused a loan of 33 million rubles because the Hungarian request for \$38.5 million was refused.” For the Hungarians, getting nothing was preferable to getting a loan in transferable rubles.<sup>88</sup> By 1980, as the international debt crisis worsened, Soviet-bloc states that had been cut off from Western capital hoped to increase their imports of goods from the Soviet Union, defer-

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85. V. Karpich to K. F. Katushev, 30 March 1978, in RGAE, F. 302, Op. 2, D. 1628, L. 8.

86. V. Karpich to K. F. Katushev, 6 June 1980, in RGAE, F. 302, Op. 2, D. 1809, Ll. 82–3; and V. Karpich to K. F. Katushev, 24 July 1980, in RGAE, F. 302, Op. 2, D. 1809, Ll. 216–219.

87. Alexander Belovič, “The Basic Forms of International Socialist Investment Credit,” *Soviet and Eastern European Foreign Trade*, Vol. 16, No. 2 (1980), p. 75.

88. V. Karpich to K. F. Katushev, 15 November 1979, in RGAE, F. 302, Op. 2, D. 1759, L. 19.

ring payment and accumulating meaningless and unredeemable debts in transferable rubles. As for the IIB, Karpich reported that Czechoslovakia, Poland, Romania, and Vietnam were insisting that it expand its hard-currency lending to satisfy their increasing needs.<sup>89</sup>

Thus, after nearly a decade of the IIB's operations, its efforts to integrate the CMEA economies had reached an impasse. The CMEA members clamored for their own investment bank to provide them with Western currency from Western banks to purchase Western goods. By the early 1980s, the sense of malaise was general. A remarkable position paper for official use only in 1981 surveyed the sad state of CMEA since the 1969 meeting that created the IIB. The document noted slowing economic growth, stagnant CMEA trade, expanding hard-currency debts, and increasing dependence on capitalist technology, all of which were acquiring a "sharper character" and being exploited by anti-Soviet forces. Eastern Europe's efforts to promote growth had been essentially reduced to the import of subsidized Soviet energy.<sup>90</sup>

The suggested remedy comes as no surprise to anyone familiar with reform initiatives during the brief rule of Yurii Andropov. The "acceleration [*uskorenie*] of scientific and technical progress" was deemed the key to success. As for CMEA itself, the Soviet Union was willing to provide subsidized energy to facilitate industrial growth in Eastern Europe and maintain peace within the bloc. But in return, Soviet officials expected due consideration for the common good, including an "economic conception of the international socialist division of labor that will precisely determine the place and basic directions of specialization of each member country of the CMEA, taking into account its possibilities, general interests of the commonwealth, and the need for effective and balanced development of the national economy." In turn, this goal required the restructuring of CMEA industries through "coordinated capital investment" and better harmonization of national five-year plans. The final goal was what the document called a "socialist common market" in which "goods and labor would freely circulate . . . on a planned basis."<sup>91</sup> In other words, the free movement of goods and people would be achieved only through more closely directed and centralized planning, rehashing the ideas circulated and rejected twelve years before. The IIB, created to avoid supranational planning, had come full circle and now supposedly required supranational planning to make it work.

The IIB, then, represents in microcosm the difficulties involved in squar-

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89. V. Karpich to K. F. Katushev, 6 June 1980, in RGAE, F. 302, Op. 2, D. 1809, L. 85.

90. "Proposal of the Soviet Side for Principled Direction in the Deepening of Socialist Economic Integration," 15 December 1981, in RGAE, F. 302, Op. 2, D. 1888, Ll. 152–154, 156.

91. *Ibid.*, Ll. 156–157, 160.

ing the circle of Soviet economic reform. Although the IIB continued to exist and indeed survived the fall of Communism to become a commercial enterprise in post-Soviet Russia, it never fulfilled its role as a key element in modernizing and revitalizing the Soviet-bloc economies. Unless the IIB and, by implication, the Soviet Union were to admit defeat and function solely as a conduit for Western capital, the bank's loans in transferable rubles needed to have purchasing power. That would have required a retreat from centralized planning of production and distribution so that the transferable rubles could find goods to buy and the firms that received transferable rubles could have used them in turn. The resolution of "goods coverage" also would have required meaningful prices so that transactions in transferable rubles reflected real value. The CMEA countries had for years explored price harmonization, but price differences across economies were actually increasing in the early 1980s. Even as Hungary, and to a lesser extent Bulgaria, moved toward relatively free prices for some goods, the Soviet Union insisted instead on a common methodology for determining prices administratively.<sup>92</sup> The Soviet bloc was thus caught in a conundrum. Improved economic efficiency required dismantling centralized planning and freeing prices. As Gorbachev's reforms would show, such steps posed the threat of total systemic collapse. More concretely in the early 1980s, when Poland was embroiled in an economic and political crisis, the abandonment of central planning and the freeing of prices would have raised the question of what was left of the Soviet system at all, and what concretely would link the more prosperous countries of Eastern Europe to the Soviet Union. The experience of the IIB showed the concrete limits of marginal reform. Real improvements in the Soviet economy required more radical reform than was conceivable in the early 1980s. When radical reform did become conceivable under Gorbachev, it destroyed the system it was intended to save.

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92. A. N. Komin, deputy chairman of USSR State Committee on Prices, to N. V. Talyzin, deputy chairman of USSR Council of Ministers, 15 October 1981, in RGAE, F. 302, Op. 2, D. 1888, Ll. 138–43.