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David R. Stone. "CMEA's International Investment Bank and the crisis of developed socialism." *Journal of Cold War Studies* 10:3 (Summer 2008): 48-77. DOI: 10.1162/jcws.2008.10.3.48. http://dx.doi.org/10.1162/jcws.2008.10.3.48 .

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Reviewed by **Peter Rutland,** Wesleyan University *(with an Author's Response by David R. Stone)*

The inner workings of the Soviet economic system now seem very remote, something akin to studying the budgetary policy of the Ottoman Empire, or the taxation systems of Ramses II. Yet it is, after all, a very recent history, and one whose institutions and physical infrastructure are still in play. So David Stone is to be praised for turning our attention to this overlooked topic.

Stone's article examines the record of the International Investment Bank (IIB), created in 1971 to promote greater efficiency and integration among the countries of the Soviet bloc, united through the Council of Mutual Economic Assistance (CMEA, known in the West as Comecon). The CMEA economies were centrally planned at national level, but there was no supra-national planning agency. (Stone notes that a Soviet proposal to create such an agency in 1969 was rebuffed – p. 58.) Trade took place through crude bilateral swaps, via balances in "transferable rubles." This was a virtual currency, an accounting unit that could not in fact be traded, and which could only with difficulty be used to buy actual, physical goods. As a result trade was inefficient and took place at a less than optimal level.

Stone uses archival material to shed light on the rationale behind the bank's creation and the reasons for its failure. The idea behind the IIB (which apparently came from a Czech economist) was to create a bank that could raise capital on Western markets and apply it to competitively selected investment projects. (p. 51) The initial conception was that these projects would promote much-needed industrial modernization. Stone notes the interesting paradox, that market reform in individual CMEA member countries such as Hungary was threatening inter-state trade within the bloc, since profit-oriented firms were not interesting in locking themselves in to Moscow-controlled trade deals .

We will never know whether the IIB could have jump-started a wave of industrial modernization. Because what happened instead was that the bank shifted its focus to a single project: the development of the Orenburg natural gas field in the Urals, and the related Soyuz export pipeline to bring the gas to Czechoslovakia for sale to CMEA countries. The project began in 1975 and was completed by 1978, with the IIB raising most of the $1.5 billion needed for the project from Western banks. By 1979 the Orenburg project accounted for 80% of the bank's lending. (p. 69)

Stone concludes that the failure of the IIB is another piece of evidence in support of the argument that the Soviet economic system was essentially unreformable. That may well be the case. But it is not a cut-and-dried issue. Certainly the IIB was less than optimal in its operations, held against the standard of a private Western investment bank. (Recall that the World Bank now admits that one third of its development loans from that period were wasted due to corruption or incompetence.) But how dysfunctional was the IIB? Did it contribute to the socialist system's ultimate collapse, or alternatively did it actually buy a few more years for the Soviet regime?

Consider for example the bank's abandonment of high-tech projects in favor of the gas export pipeline. Was that a retreat from efficiency promotion, or was it a realistic assessment of the Soviet Union's true comparative advantage in energy exports – especially in light of the quadrupling of world oil price that occurred in 1973? Thirty years later, that Soyuz pipeline is still working, and it is a major source of wealth and political leverage for the Russian Federation. Was "reform" in the abstract the goal behind the creation of the bank? Or was it just another instrument to deploy in Moscow's bid to promote stability and maintain control over its minions? In that case the bank's creation could be taken as a sign of institutional innovation – and of Moscow's ability to lure the West into helping it manage its empire. Stone notes for example that the IIB was able to provide Western loans for countries that were otherwise a poor credit risk, or did not want to subject themselves to Western audits. (p. 64)

The politics of East Europe in the 1970s were very turbulent. Stone does turn up some interesting political nuggets – such as the suggestion that Poland favored further CMEA integration in the late 1960s as a balance to German Ostpolitik. (p. 55) But he avoids direct discussion of the Polish roller-coaster. In the wake of worker unrest in 1970, Polish leader Edward Gierek gambled on a investment boom, fueled by Western loans. This was followed by a devastating crash in the late 1970s as the new production lines built with those credits failed to find markets (in part because of mismanagement, and in part because of the global recession). It would be interesting to learn to what extent Stone thinks the IIB was complicit in Gierek's abortive dash for growth – or did the bank sidestep it?

Second, while the archives can shed some new light on the published record, one wonders about the unreported wheeling and dealing that was so crucial to Soviet

planning. There was a dense web of informal networks that operated in parallel to the formal, paper planning institutions, leading some contemporary Russian economic historians to question to what extent it makes sense to even talk about the Soviet economy as "centrally planned." Stone writes: "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." (p. 74) But there was a third option besides plan and market – the informal networks through which politicians and executives traded favors. Phone calls were made to the Hungarians mandating what percent of their Ikarus buses must be sent to the Soviet Union, or to the Czechs telling CKD Praha how many trams to ship east rather than to potential buyers in the West. The dealing was a two-way street – and there was a widespread suspicion that for all their complaints the Hungarians were the most skilled practitioners in the bloc.

So, there is much for historians to discuss in trying to untangle the true causes of the Soviet system's collapse. These issues are also highly relevant to contemporary political debates, pertaining to the balance between "hard" and "soft" power. The Russian Federation today, like its Soviet predecessor, has an array of tools of influence in its repertoire, from tanks to banks. So it is highly instructive to ponder how the toolkit was used by the previous occupants of the Kremlin.

> **Peter Rutland** is a Professor of Government at Wesleyan University in Middletown, Connecticut. He is the author of *The Politics of Economic Stagnation in the Soviet Union* (Cambridge University Press, 1992) and *The Myth of the Plan: Lessons of Soviet Planning Experience* (Open Court, 1986), and editor of *Business and the State in Contemporary Russia* (Westview Press, 2000). His most recent article is "Putin's economic record: is the oil boom sustainable?," *Europe Asia Studies*, 60: 6, August 2008.

Author's Response by **David R. Stone**, Kansas State University

I am grateful to Peter Rutland for his thoughtful commentary on my article. He raises a number of empirical questions-- the specific dynamics of Poland's debt crisis, Moscow's foreign economic strategy--which cry out for further research. An enormous amount of material remains untapped in Soviet bloc archives. Rutland also raises a number of questions of emphasis and interpretation, but I think that we do not in fact disagree on much. On those issues where we differ, the underlying question strikes me as the standard of judgment to be applied: should the International Investment Bank be evaluated relative to the actual functioning of the Soviet bloc economy, or relative to the hopes invested in the Bank?

For example, Rutland asks whether the abandonment of high-technology projects in favor of resource extraction might have been a wise strategy, and whether wheeling and dealing

might have greased the squeaky wheels of the Soviet economy. In each case, my answer is a qualified yes. Given the enormous structural difficulties involved in economic reform, natural resource extraction probably was a better bet.Given the rigidities and absurdities of Soviet-style central planning, fixing and corruption were necessary (and had been since the 1920s) to keep the system functioning. As a result, when he asks whether I see the IIB as *contributing* to the collapse of the Soviet economy, I respond that I see it as *illustrating* the depth of the problem facing reformers.

But the point I wish to emphasize is not that the IIB muddled through like any other Soviet-bloc economic institution (which it did); instead, I want to stress that hopes were higher. The Soviets and their East bloc counterparts didn't want to settle for resource extraction. They were remarkably frank about the problems they saw in centrally-planned economies and in what they believed the IIB might achieve. They wanted to get beyond investment policy set by fiat and influence. They wanted industrial products competitive in price and quality on world markets. It is this gap between perceived potential and sordid reality that I find particularly intriguing. As former Russian Prime Minister Viktor Chernomyrdin remarked about perestroika, "we hoped for something better, but it turned out like always." It strikes me that the case of the IIB provides a partial explanation for the relatively rapid move under Gorbachev to radical economic reform: moderate economic reform had been tried before, without appreciable result.

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