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ECONOMIC COMMITTEE

NATO COUNTRIES' GUARANTEED EXPORT CREDITS TO EUROPEAN COMMUNIST COUNTRIES(1) IN THE LIGHT OF THE CURRENT ECONOMIC SITUATION

Draft report to the Council

On 18th March, 1974 the Council invited the Economic Committee(2) to examine in depth the whole range of problems concerning Western trade with Communist countries, with a view to drawing relevant conclusions. This matter has been discussed by the Committee over the last few months in the light of the changed Western economic situation; it has concluded that one focal issue in East/West economic relations continued to be that of guaranteed export credits. The outcome of these discussions is the subject of the present report.

2. For political and commercial reasons, the Allied countries have demonstrated over the years an interest in guaranteed export credits granted to Communist countries. As early as 5th August, 1959 the Council decided to establish a reporting procedure (3) on such credits of a duration of over 180 days(4).

3. In particular, Alliance members felt that government-to-government credits, or government loans(5), could have a great significance and that it would, therefore, be advisable to consult in NATO before extending them to Communist countries.

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(1) USSR, East Germany (including East Berlin), Czechoslovakia, Hungary, Poland, Romania and Bulgaria
(2) C-R(74)10
(3) C-M(59)75, approved by C-R(59)30, page 10, dated 15.8.1959
(4) These are export credits for which national agencies have given official cover, or which have been financed by national governments, or organizations under their control. (Source : AC/127-D/331, dated 2.2.1971)
(5) In this connection, a distinction should be drawn between extensions related to commodity purchases and those related to a rescheduling of debt service.

In practice, credits extended on a government-to-government basis have remained small, and though information has been received on them, no prior consultation has taken place. During the preparation of the CSCE Allied countries considered the political implications of trade and export credit policies towards the East. They agreed, if the question of credits were raised, to point out to Communist countries that they applied a uniform and open policy to all industrialised countries, including Communist countries.

4. The Warsaw Pact countries, which are substantial importers of machinery and equipment from the West, have availed themselves of guaranteed export facilities which usually accompany such deals. Consequently, the financing of Eastern imports has been considerably eased. An important consideration, however, has been to ensure that the volume of credits extended by NATO countries remained within the limits of the Warsaw Pact countries' capacity to repay their debts.

5. Western credits, in particular NATO countries' guaranteed export credits to Communist countries, have been an important element in the promotion of East/West trade. However, its share in NATO countries' total trade has remained small : in 1959, it accounted for 3.04 % of NATO countries' total trade. In 1972, it went up to 3.4 %(1) and in 1973, to 3.8 %.

6. The Warsaw Pact countries have a long-standing interest in acquiring Western machinery, technology and, occasionally, food-stuffs. Whereas until recently such procurement may have been limited by the low level of hard currency earnings, recently such earnings, at least in the case of the Soviet Union and, to some extent, Poland, have increased substantially, since prices of many basic products, in particular energy, have gone up to unprecedented levels.

7. This development has coincided with drastically changed economic conditions in most Allied countries, faced with serious balance of payments and inflation problems(2). Consequently, monetary policies may have to be fine tuned, interest rates are liable to remain relatively high and internal borrowings expensive. In contrast to this rise in domestic credit costs, interest rates charged on guaranteed

(1) See C-M(73)131
(2) For example, in 1974, it is expected that prices will have risen by 11.5 % in the USA, 14.5 % in the UK and 19 % in Italy.

export credits have remained relatively low. Indeed, in many Western countries, such rates have been traditionally somewhat below domestic ones in order to promote exports. Over the last year or so, however, the discrepancy has grown. This development benefits the foreign borrower while it involves an additional charge for the lending countries. Moreover, the present inflationary situation in the West favours borrowers who incur debts in currencies which may be depreciating fast.

8. In view of the foregoing, the main Western trading countries have felt it necessary to re-examine their export credit structures in order to stiffen credit terms. The EEC, the United States and Japan have been considering together ways and means to harmonize conditions on which they grant export credits. As far as extensions to Western industrialised countries are concerned, minimal interest rates have been set at 7.5 %(1), and the maximum duration at three years(2). However, procedural arrangements for this have apparently not yet been finalized. The issue of guaranteed export credits to Communist countries and LDCs(3) is, reportedly, still under review. Agreements reached between the eleven countries mentioned above would most probably be acceptable to other Western countries which also grant export credits. As regards export credit conditions to European Communist countries, it might be opportune to draw a distinction between the Soviet Union and the others.

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(1) This agreement in fact only involves Japan, Italy and France where interest rates were below 7.5 % and the UK and the USA where the interest rate charged was within a range of 7 % to 8 1/2 %.

(2) This maximum duration does not apply to sales of ships and ground stations linked to telecommunications by satellites. The possibility of extending this derogation to sales of aircrafts and nuclear power plants is currently under examination in the OECD.

(3) Available information would indicate that there is a distinct tendency not to consider the initial suggestions put to the eleven countries to distinguish between the industrialized West countries with state controlled foreign trade and LDCs. The dividing line as far as guaranteed export credit conditions are concerned would be the economic wealth of the borrowing countries; it being understood that countries which would still come within the LDC definition would benefit from more favourable terms.

The case of the Soviet Union

9. Among Communist countries, the USSR is the largest beneficiary of NATO countries' guaranteed export credits(1). At the end of 1973, outstanding private guaranteed export credits totalled $ 4.9 billion, of which about 75 % had a duration exceeding five years(2). The service payments on the aggregate debt amounted only to 14 % of Soviet export earnings.

10. Despite a considerable strengthening of its financial position over the last couple of years, the USSR is demonstrating a continuing interest in export credits. This is evidenced by the growing volume of its orders in the West and in Japan for machinery and equipment, which in general benefit from export credits. In NATO countries, such orders jumped from $ 644 million in 1971 to $ 2.2 billion in 1973(3), and in 1974, they would seem to have moved up even higher. The Soviet Union's readiness to increase its borrowings in the West, however, does not inhibit it from attempting to obtain the most advantageous, and even preferential, credit terms(1). A greater harmonisation of these terms would, no doubt, enhance the negotiating position of each allied government and frustrate Soviet endeavours at playing off one exporting country against another.

11. With the onset of large sale industrial cooperation deals, the USSR would normally receive long term, self liquidating, export credits. These in turn would enable the Soviets to exploit more rapidly and fully their vast natural resources. This type of development would ensure outlets throughout the Western world for these resources and further improve Moscow's ability to boost its hard currency earnings - an important component of its credit worthiness.

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(1) No information is available to the International Secretariat on non-NATO countries' credits. One major lender is Japan and Japanese outstanding private credits to the USSR are estimated at $ 400 million.

(2) At the end of 1972, guaranted export credits outstanding to the USSR from NATO countries alone amounted to $ 2.7 billion, while suppliers' credits outstanding to 86 less developed countries amounted to $ 12 billion. This figure, however, does not include private credits extended to LDCs through banks and other sources which at the end of 1972 totalled $ 18 billion (World Bank Annual Report 1974).

(3) See AC/127-WP/387, dated 21st March, 1974

(4) The Soviet Union has already let it be known that, as far as it is concerned, the 7.5 % interest rate on export credits is "out of the question".

The case of Eastern Europe

12. Over the last few years, East European countries' trade with the West has been growing faster than their trade with COMECON. The extension of Western guaranteed export credits has no doubt been instrumental in this development. For instance, such credits outstanding from NATO countries to East European countries amounted to $ 3.8 billion at the end of 1973, of which 54 % had a duration of over five years. Poland and Romania, which have a large proportion of their trade with the West also have the largest volume of credits outstanding, $ 1.4 and $ 1.1 billion respectively.

13. East European countries, furthermore, have been drawing on the Eurodollar market resources. For instance, in 1973, Bulgaria took $ 115 million, Poland $ 420 million, Hungary $ 90 million; in the first three quarters of 1974, the borrowings were $ 85 million, $ 275 million and $ 150 million respectively(1). These small East European countries, in contrast to the Soviet Union, which borrowed only $ 50 million in 1973 on the Eurodollar market, are prepared to pay the full market price to obtain financial facilities.

14. In the past, East European countries have shown caution in taking up Western export credits. More recently, however, some of them have been increasing their borrowings and would now seem to be approaching the limits of their debt servicing capacity. For instance, in 1973, Romania's reimbursements of its debts to Allied countries equalled about one-half of its earnings from its exports to them; consequently, Romania had to obtain a rescheduling of some of its debts. This development suggests that some East European countries might now represent a greater risk for the lending countries.

15. Excluding purely commercial considerations, the promotion of the expanding trade links of Eastern Europe with the Western economies may be politically desirable. Special measures might therefore be called for to avoid a reversal of this trend and an increase in the degree of dependance of East European countries on the USSR. One such measure could be greater flexibility in the terms of guaranteed export credits granted in future to some East European countries which would take account of the following :

(a) the high level of indebtedness reached by several East European countries which makes it difficult for them to take up new export credits lest this jeopardises their debt servicing capacity in the long run;

(1) IMF Survey, dated 25.11.1974

(b) their reduced purchasing power in world markets owing to global inflation and rising commodity prices. In this connection, until the end of 1975, they are sheltered to some extent by current agreements with the USSR. The new accords, operative from 1976, however, will undoubtedly reflect the phenomena. Although the value of industrial goods exported by East European countries to the USSR is also likely to be raised, it is doubtful whether this will fully offset the increase in the cost of Soviet raw materials and energy;

(c) the possible decline in their export earnings in hard currency, due to the slow-down in the growth of Western economies.

CONCLUSION

16. Current efforts by the European Community, the United States and Japan to agree on world-wide uniform conditions for export credits, while leaving each national authority free to determine the volume of such credits, are to be encouraged. When successfully completed, they should enable Allied countries to reach common attitudes on the conditions of guaranteed export credits extended to Communist countries.

17. Additionally, it may be of value to consider reducing, and possibly eliminating, the discrepancy between interest rates charged on guaranteed export credits and higher ones obtaining in the domestic financial markets. The reason for this could well be justified by the consequent burden imposed on Western lenders particularly as several of them - under present balance of payments conditions - may be growing more dependent on high interest foreign loans.

18. Certain European Communist countries have been insisting on getting export credits on concessionary terms, the latter being asked in some instances, as a quid pro quo for political concessions on their part. On the other hand, it should be noted that the Soviet Union enjoys much improved terms of trade and an enhanced financial position, which should enable it to purchase goods in the Allied countries either for cash, or on credit on the same conditions applicable to non-Communist industrialised countries. Poland may be able to do the same in the longer run, as it disposes of exportable energy resources and some raw materials, in particular copper ore, for which there are attractive outlets in the West.

19. Some of the small East European countries, however, far from benefitting from recent changes in commodity prices, have seen their terms of trade deteriorate and their dependence increase on the Soviet Union as a supplier of essential commodities. Their ability to procure certain types of equipment in the West has been put into jeopardy by escalating prices. The question therefore arises whether it might not be politically desirable to promote Allied countries trade with these nations by maintening and, possibly extending, the flow of guaranteed export credits to them, although their credit worthiness might have to reassessed in the future. Consideration could also be given to easing the conditions on which such export credits were granted.

20. Were this to be the case, the conditions for extending guaranteed export credits to European Communist countries would be determined by their respective financial, commercial and economic positions. Obviously, those countries enjoying improved foreign earnings and terms of trade would be treated on a par with the non-Communist industrialised countries. On the other hand, those considered by the Allied countries to be in a difficult financial position might be granted export credits on easier terms; exceptionnally, these could even be similar to those obtaining for the LDC's.

21. In view of the current economic situation and of the changes which are taking place in international trade relations, the reporting procedure established in NATO on guaranteed export credits to Communist countries remains a very useful source of information for the Allied countries. It gives them an opportunity to exchange views on the level of European Communist countries indebtedness and on the terms of guaranteed export credit to that area. Consultation in the Alliance prior to the granting of government-to-government export credits or loans to Communist countries should be particularly useful in a period of expanding East/West trade relations.