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EAST-WEST ECONOMIC RELATIONS AND THE CONVERTIBLE CURRENCY BALANCE OF PAYMENTS OF THE COMMUNIST COUNTRIES

Note by the Acting Secretary General

The attached survey of East-West economic relations, agreed to by experts from capitals during a meeting of the Economic Committee on 23rd-24th June 1982, is forwarded for the Council's information. In view of its comprehensive nature, the Council may wish to note the document at a later date in the course of its discussions of related economic issues.

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SUMMARY OF DISCUSSIONS

Report by the Economic Committee

1. The meeting agreed that whilst the USSR should occupy the bulk of the Committee's deliberations, Eastern Europe was of considerable importance especially if it were grouped into three distinct categories in order of decreasing economic difficulties and risk: Poland and Romania; GDR and Hungary; Czechoslovakia and Bulgaria. The three basic questions of trade, credit and future outlook should be kept in balance: it was more important to gain a common understanding of the problems than to attempt to arrive at precise estimates. Nevertheless, the latter are important because they lead to differences of interpretation and therefore to difficulties in arriving at a common understanding.

USSR

2. In reviewing the commercial balance of trade which deteriorated from $2.5 billion in 1980 to $4.1 billion in 1981, it was generally agreed that in 1981, non-monetary gold sales amounted to some $3-3.5 billion but the estimates of arms sales (including related services) varied considerably. Most nations considered the value of arms sales paid for in hard currencies were in the region of $5 billion. The financial flows stemming from these sales, however, are lower at $2-2.5 billion.

3. National reconstructions of the Soviet balance of payments all included an "errors and omissions" item. However, the size of this item varied considerably between estimates: it was agreed that this issue could not be fully resolved and deserved further study.

4. The substance of these detailed discussions led to the general concept that economic difficulties in the USSR, especially in agriculture, investment, productivity, energy and foreign trade, made it difficult for the USSR to maintain past levels of imports.

5. The problems have been helped in the past by a "windfall" increase in oil prices in the early 1970s, but such a benefit is unlikely to accrue again in the course of the next few years. There is now some considerable oil surplus capacity in the Western markets; it is not very likely that we shall see an increase in prices and gas exports cannot fully take the place of oil in foreign earnings.

6. The underlying weakness - namely the Soviet dependence on oil earnings - is likely to cause increasing strain throughout the 1980s, during which period imports of some 20 million tonnes of cereals per annum are likely to be needed. Even if the recession in the West lifts there is not likely to be any great upsurge in the market for Soviet made manufactured goods. The second big earner of hard currency - arms - has its limits not only because of the capacity of the purchasing nations - 1/2 to 2/3rds of earnings are from LDCs - to absorb continuing large amounts of armaments but because they too, in many instances, benefited from the windfall oil earnings and may have difficulties in meeting growing bills for more modern arms however great their appetites and ambitions may be. Thus the USSR may find itself under growing pressures in its necessary imports of food, industrial plant, or agricultural raw materials factories (fertilizer, superphosphates, etc.) indirectly for the food programme. The fall in the price of gold has also acted against Soviet interests and whilst in 1981 sales were at the unexceptional level of 200-240 tonnes, they were made almost entirely during the last five months of the year and the trend continued in January 1982. These suggest a concentrated liquidity requirement possibly to rebuild assets abroad and that the USSR looks at gold sales as a residual instrument of financing.

7. The USSR will be faced with difficult choices if the above mentioned economic forecasts for the USSR materialise:

(a) It can cut back on exports of oil to Eastern Europe, but this is unhelpful when trying to consolidate their position in CMEA. It can hold down its own consumption and even impose a measure of rationing.

(b) The Brezhnev food programme will require continued imports certainly of cereals and possibly of other foods.

(c) It may have to decide to rely on continued Western willingness to grant credits at least for a considerable part of this decade.

8. It is necessary to point out here that certain delegations felt less pessimistic about the Soviet outlook: forecasts are not very reliable, oil output may not drop as dramatically as the general view suggests and its price may fluctuate, the potential for domestic savings by careful husbanding of resources and by substitution of oil by natural gas is high, and the potential for arms sales will remain significantly high with perhaps some new markets opening up.

9. There is also a need to take into consideration softening grain prices brought about by abundant harvests in North America, Europe and Australia. This would enable the USSR to import more for less money and reduce Soviet hard currency needs. Nevertheless, a stagnation in foreign trade is foreseen leading to a hard currency deficit at least for the next few years until the gas pipeline to Western Europe is in operation.

EASTERN EUROPE

10. As for Eastern Europe, it was considered that Bulgaria and Czechoslovakia were in the most satisfactory positions from a financial point of view. The debt is reasonable, the balances are improving through disciplined import policies, Soviet help and restrained borrowings, but Czechoslovakia has thereby foregone part of its export competitiveness. The country is engaged in a process of slow recession which will compromise its future development.

11. Hungary and East Germany seemed to be in a situation leading to increasing Western bank concern. Much of the large Hungarian debt was short-term. There was some loss of confidence on the part of Western bankers and the credits were not renewed. Imports will have to be cut - and there seems to be room for this - and a rescheduling may have to be considered towards the end of 1982 unless sufficient bridge financial facilities can be made available. For East Germany there were differences in views relating to commodity trade. Although slightly declining in gross terms from 1980 to 1981, the net debt was still growing and the debt/service ratio deteriorating. However, the East Germans were conscious of their problems, were making cuts in hard currency imports and attempting to increase exports but, in the face of competition especially from the Far East in such typical markets as electronics, textiles and tools.

12. The two remaining countries, Romania and Poland, were in the worst positions. Romania was facing a basic structural problem resulting in a severe liquidity deficiency and arrears of $1 billion at the end of 1981. The fundamental problem is Romania's lack of realism in planning, an overdeveloped petrochemical sector with dropping oil production to feed it. However, recent IMF views tend to be less pessimistic on possible adjustments over the medium-term. Poland is the most heavily laden country where considerable rescheduling has been agreed for 1981 by Western banks; interest payments for 1982 will be required and it may be that a financial gap of some $2 billion will have to be bridged by loans though it was too hard to see who would provide such funds. If rescheduling is not effected the gap will be some $9 billion. One question is how much do the Poles really think they have to pay in order to avoid formal default and keep the West on a string. For 1982 they are likely to pay the banks rather than governments on a selected bank basis.

13. For Eastern Europe as a whole, the difficulties of one country are bound to have effects in the borrowing powers of the others: lack of confidence in one is bound to generate a similar reaction to the others. Moreover, if one bank is suddenly frightened by the prospects of mounting indebtedness and possible failures to meet interest payments, other banks are likely to follow suit in the spirit of traditional banking prudence. A general consideration is also the extent to which the Soviet Union will help its East European partners and Western faith in the "umbrella" theory has vanished. Apart from Soviet help, there seems little prospect of replacing trade with the West by trade within the CMEA but this is perhaps more possible for the Soviet Union to import certain goods, particularly machinery and transport equipment from Eastern Europe, than it is for the East European countries to substitute with each other trade formally carried out with the West. In addition, the countries are more interested in self-protection and pursuing egoistic policies than in mutual aid. These have been factors that have affected particularly relations with Poland where only grudging help has been given, in spite of the Polish appeals and the Soviet persuasion attempts: the East Europeans have suffered disturbances in their economies through the failures of the Polish economy, not least of all by those failures brought about by the inability to meet delivery schedules based on imports of Western raw materials.

OUTLOOK

14. The view was expressed that the opportunities for solution of these East European and Soviet problems by trade with the LDCs were very limited, certainly the oil exporting countries were able to purchase hard currency goods, but they preferred Western manufactures. Markets with the other developing countries are small because those countries already face severe tight foreign exchange problems. Moreover, the development of counter-trade between East and South would be difficult to achieve.

15. What all these problems really amount to is that the Soviet Union and the East European countries can expect lower rates of growth or even negative growth, especially on a per capita basis. Undoubtedly, the degree will vary from country to country depending on the political circumstances. The East European reactions to foreign trade problems is a legitimate area for constant monitoring and concern on the part of the NATO countries.

(Signed) J.-N. GIBAULT
Chairman