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ECONOMIC IMPLICATIONS OF RECENT EVENTS IN CZECHOSLOVAKIA

Report by the Committee of Economic Advisers

MAIN FINDINGS

The main findings of this study, which is necessarily tentative, may be summarised as follows:

- (a) Motives for military intervention: As far as the motives for the decision of the USSR and four other Warsaw Pact countries to invade Czechoslovakia are concerned, while it is difficult to assess the part played by economic factors, there is no doubt that there were a number of features in economic policies and development in Czechoslovakia to which the Soviet Union was bound to object:
- (i) It had been clearly recognised in the "Action Programme" by the Czechoslovak Communist Party itself that the working of the economy could not have been improved without paying more attention to strictly economic criteria and without a fundamental change in the political system aiming, in particular, at avoiding undue interference by the Party in economic affairs. The economic reforms, as they were envisaged in the "Action Programme", would have deprived the Central Planning Authorities of a large part of their powers and delegated the essential task of short-term planning to the individual enterprises or groups of enterprises. This decentralisation would have entailed a reduction of the rôle of the Party in economic matters, as its influence would be much more difficult to exert on the local enterprises than on the Centre. The intention to choose managers for their technical competence rather than for their political loyalty would also have curtailed the influence of the Party. In addition, the freedom which would have been left to individual enterprises or groups of enterprises to trade directly with the outside world could be

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considered by the Russians as a dangerous opening of the Czechoslovak economy to capitalist penetration. Even more than by the contents of the reforms, the Russians may have been concerned by the political climate of freedom in which they would have been implemented in Czechoslovakia; this may explain why they were more tolerant in the case of Hungary, who has also resorted to far-reaching economic reforms. The Soviet Union was certainly afraid that the reform movement in the Czechoslovak style, might spread to other Communist countries. The Soviet Zone which, in many respects, showed the same economic characteristics as Czechoslovakia, might have been among the first to be exposed to such contamination. The Soviet leaders may also have been concerned at the possibility that, in Russia itself, reformers would press for a greater liberalisation than they were ready to grant.

- (ii) The plan to re-structure the economy involved a certain shift in Czechoslovakia's trade from other COMECON countries to the West. The Russians may have feared that they would lose a supplier of industrial products and equipment, and of uranium, and that the economic links which kept Czechoslovakia within the Soviet orbit would be loosened. In so far as decisions relating to production and foreign trade would have been taken independently by individual firms in the light of economic criteria rather than by politically-orientated bodies, co-ordination within COMECON would have been made more difficult. All the efforts made by the Soviet Union since 1948, to gear the Czechoslovak economy to her needs, might have been compromised. The economic consequences for the Soviet Union would have been limited, but there was a serious risk that, by contagion, other Eastern European countries, following the example of Rumania and then of Czechoslovakia, would have sought their emancipation from a Soviet-dominated COMECON.
- (iii) All these fears of the Russians, and possibly of some other COMECON countries, may have been exacerbated by a hint from the Czechoslovak Authorities that if they could not obtain from the Soviet Union the convertible currency which they wanted in order to buy the equipment to revamp their industry, they might turn to the West for financial support.

- (b) Effects of the military intervention on Czechoslovak economy: As far as the Czechoslovak economy is concerned, the most probable consequence of the military intervention of the other Warsaw Pact powers is likely to be a slowing-down of progress. Not only has the occupation caused some damage, but the far-reaching reforms, which appeared necessary to correct the imbalances of the economy and breathe new life into it, seem now most unlikely. There may be some reforms but they will certainly be framed in such a way that the Party, and indirectly the Soviet Union, can control their implementation. It is uncertain whether they can be very effective now that the liberalisation of the political system, which had started this year, has been arrested.
- (c) Effects on relations between Czechoslovakia and COMECON: As far as the economic relations of Czechoslovakia with the other Communist countries are concerned, there appears to be an effort on the part of the Soviet Union to tighten them. What is known of the recent economic talks in Moscow (9th and 10th September) seems to point in this direction. As regards the economic support required by the Czechoslovak economy, the Soviet Union may be inclined to deny it until the situation is "normalised" in a way judged satisfactory by Moscow. However, in the longer run, the USSR and other Warsaw Pact countries may assist in the restructuring of the Czechoslovak economy, as they may realise that it is in their own interest to maintain Czechoslovakia as a workshop providing industrial equipment and a market for some of their products. They may be anxious, also, to ensure that the image of Communism is not further damaged by repeated economic failures in Czechoslovakia.
- (d) Effects on Czechoslovakia's relations with the West: The future economic relations of Czechoslovakia with the West depend largely on the Soviet attitude and, in this respect, the USSR may very well be in a dilemma. She is likely to prevent a sharp expansion of trade with the West and any resorting to Western loans or direct Western investment. On the other hand, she must realise that modernisation of the Czechoslovak industry could best be carried out by drawing on Western equipment and know-how. She might conclude that putting hard currency at the disposal of Czechoslovakia was the lesser evil.

- (e) Future of East-West economic relations: The future of East-West economic relations depends on the attitude of the Communist countries and on that of the West.
- (i) The Soviet Union will certainly seek to reinforce cohesion within COMECON and could even take advantage of present circumstances to make new attempts to control, through this organization, East European trade with the West. She will probably be more suspicious of certain initiatives which some East European countries might take to strengthen their economic links with the West. Moreover, the military intervention in Czechoslovakia and certain adjustments which might follow in the economic relations between Czechoslovakia and the other members of COMECON might aggravate the problem of resource allocation in the invading countries. Consequently it cannot be excluded that the European Communist countries might in fact wish to obtain more industrial goods and credits from the West, so as to relieve the pressure on their economies.
- (ii) Although Western countries have not so far decided any change in their basic commercial or credit policies towards Communist countries they are adopting a very cautious attitude until the situation becomes clearer. In practice, nevertheless, it is probable that, in the short run at least, recent events will increase the difficulties in developing trade with Communist countries. The uncertain situation which has been created in Eastern Europe could be considered to have increased the risks involved in economic relations with the countries concerned. From a political point of view, it would however be paradoxical to show more caution in dealing with Czechoslovakia and Rumania while, in the case of the other Communist countries, trade and credits were being stepped up.
- (f) Correlation between trade and credits on the one hand and trends towards liberalisation in European Communist countries on the other: Until the Committee of Economic Advisers has completed its study of this question, only very tentative ideas can be offered. East/West trade by highlighting certain shortcomings in the Communist economic system seems to have contributed to the reform movement. For their part too, the reforms are likely to facilitate trade between East and West.

However, if they are to be effective they would entail a certain relaxation of Party control over the economy; to that extent they might contribute to the liberalisation of the whole political system. Credits stimulate trade and create a certain degree of economic interdependence between East and West: their settlement implies that growing exports from Communist countries can enter Western markets. East/West trade has also been a disturbing element in the working of COMECON by demonstrating in many cases Western superiority as regards the quality of goods.

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2. The economic causes and implications of the military intervention in Czechoslovakia are examined in greater detail in the following paragraphs. Previous to this event three main trends had emerged in Czechoslovak economic policy:

- renewed attempts to apply economic reforms;
- an attempt to revise the economic relations with the USSR and to introduce flexibility in the working of COMECON;
- a greater effort to expand economic relations with the West.

3. It has been thought appropriate to consider to what extent these trends may have influenced the USSR and the other four Warsaw Pact countries in their decision to invade Czechoslovakia and to what extent they may now have been altered. The future prospects of East/West trade are also considered. It has to be emphasised that at the present juncture future developments are still shrouded with uncertainty. Not merely is information lacking on recent economic talks between the Czechoslovaks and the Soviets, but the political outlook of Czechoslovakia is doubtful. In these circumstances the future is considered here in the form of possibilities rather than forecasts.

I. THE EFFECTS OF THE SOVIET INTERVENTION ON THE CZECHOSLOVAK ECONOMY

4. The movement towards economic reforms in Czechoslovakia, as in other Communist countries, was primarily prompted by the shortcomings of the centralised economic system in coping with the needs of an increasingly complex industrial society. It seems appropriate, therefore, to describe briefly the performance of the economy before considering the effects of the recent events on the movement towards reforms.

(a) Evolution of the economy

5. While before the war Czechoslovakia was in the forefront of modern industry, with a standard of living comparable to that of the more advanced European nations, it has certainly slipped in the post-war period. It might be said that it is now confronted with two technological gaps, one by comparison with the West and the other by comparison with the USSR. Hence the feeling of frustration in the population.

6. In the period 1961-1965, the national income did not rise by more than 1.8% on the average; it even dropped somewhat in 1963, and there was hardly any increase in 1964. There has been some recovery since 1965 with an apparent high rate of growth: more than 10% in 1966 and 8% in 1967. However, as was stated by the Czechoslovak Central Statistics Office in July 1968, the economy was still "characterised by a state of profound economic imbalance". The rise in output was very deceptive as part of the goods produced were not suited to the requirements of the customers, at home or abroad, and served only to swell stocks.

7. There are many reasons for this. One of the most important was, no doubt, the artificial gearing of the Czechoslovak industry to Soviet needs and, in particular, the neglect of traditional Czechoslovak industries, which used to work for foreign markets, in order to permit the setting-up or the expansion of the industries favoured by the Soviets. At the same time, Czechoslovakia was largely cut off from Western technology, without having real access to the Soviet technology where it is most advanced, i.e. in the defence and space sectors. The centralised and bureaucratic system imposed on the country discouraged initiative, hampered progress in scientific and technical training and led to the misuse of the talents available. Investment was often mis-directed, with the result that much of the present machinery and equipment in Czechoslovakia is obsolete.

8. The Soviet military occupation can only add to these difficulties. Its actual cost is still difficult to estimate. According to a statement made by the President of the National Bank on 30th August, shortfalls in production amounted to 250-500 million crowns per day (industrial production per day was valued at 1.3 billion crowns before the invasion). Total damage to buildings and roads was initially set at about 5 billion crowns. Czechoslovak officials also pointed to the precarious position of Czechoslovak foreign trade, the difficulty in meeting long-term commitments and to the problems of economic relations with COMECON partners. During his recent talks in Moscow (9th and 10th September), Mr. Cernik is said to have raised with his Soviet counterpart the question of compensation for damages caused by the occupation. Reportedly the Russians have turned down such requests.

(b) The movement towards economic reforms

9. One of the main solutions contemplated by the Czechoslovaks to solve their economic problems, was the implementation of economic reforms, but progress had been rather erratic, even before the Soviet intervention.

10. Economic difficulties had led, as early as in 1958, to the first timid reforms. After 1962 the level of output began to fall and more radical changes were envisaged. A new system of planning and managing the economy was approved by the Party in 1964, tested in the course of 1965, applied in industry from the beginning of 1966 and, extended throughout the whole economy on 1st January, 1967. When, however, signs of inflation appeared, the authorities restored most of the previous administrative controls. There was obviously a conflict between those who thought that the difficulties were due to the boldness of the reforms and those who believed that they resulted from their inadequacy and from the fact that they consisted only of half measures.

11. In the wave of liberalisation, which in many fields started at the beginning of 1968, the economic reformers prevailed. The Czechoslovak leaders were prepared to accept the risk involved in the substantial transfer of responsibility for economic decision-making from the Centre to subordinate bodies whose political and economic independence would be guaranteed. For this purpose the plenum of the Central Committee of the Czechoslovak Communist Party adopted in April 1968 an "Action Programme", which should have served as a guide to the Party in implementing this new policy. This "Action Programme" was very outspoken as to the causes of Czechoslovakia's economic decline. It emphasised that the main purpose of the "new society" was not the growth of production in purely quantitative terms which had led to an over-rapid expansion of heavy industry, severe demands on manpower and raw materials, and costly investments. The authoritarian system of management was responsible for the introduction and the continuance of the deficiencies of the economy. In particular, the interference of the Party stifled initiative at all levels.

12. The economic part of the "Action Programme" envisaged the following developments:

- (a) To ensure that all people working in an enterprise should feel responsible for its management, democratically elected organs with special management functions, including the power to appoint executives, were to be set up. This form of Workers' Council would be distinct from trade unions and would include elements from outside.

- (b) Enterprises must be given an opportunity to form voluntary associations on the basis of their economic interests and needs (but they should not leave the combines and form new associations until the government has laid down the rules for this procedure).
- (c) Scope should be provided for economic competition among enterprises, and small private enterprises should be allowed to operate in the services sector.
- (d) In dealing with COMECON countries more emphasis should be placed on economic considerations of costs and profit on both sides.
- (e) Foreign trade should be completely and permanently freed from purely administrative interference.
- (f) Enterprises should be given the right to operate independently on foreign markets.
- (g) The gradual opening up of the Czechoslovak economy to the world market (with a view to achieving convertibility for the Czechoslovak currency) should be carried out in such a way as not to create too many social problems or jeopardize a rise in living standards.
- (h) In order to stimulate initiative at the management and engineering levels, substantial wage differentials should be introduced (which might have caused dissatisfaction among the workers).

13. The Soviet Union has not acquiesced in the "Action Programme". The communiqué of 28th August after the Soviet-Czechoslovak negotiations in Moscow promised "comprehension and support" only of the resolutions of the January and May Plenums of the Central Committee of the Czechoslovak Communist Party. The first stressed the urgency of economic reforms and the second was mostly concerned with the preparation of the 14th Party Congress. The Moscow communiqué does not mention the Communist Party Plenum of April which adopted the "Action Programme".

14. It is difficult to say to what extent the programme of economic reforms has influenced the Soviet decision to invade Czechoslovakia. There were certainly some features in the reforms which were bound to cause worry to the Soviets. The transfer of authority as regards short-term planning from a central body to individual firms or groups of firms was certainly one of them. This would have meant that important decisions in the economic field would have escaped the control of the Party. The freedom which would have been left to



individual firms or groups of firms to establish directly trade relations with the outside world was most probably also considered as dangerous by the Russians. They could see in it an opening of the Czechoslovak economy to capitalist penetration. It might be asked why in the past the Soviet Union showed so little concern about the economic reforms which in fact have been envisaged and partly implemented in Czechoslovakia since 1964. The reason seems to be that more emphasis was placed in 1968 than previously on the features just described. Even more, in 1968, the "Action Programme" itself clearly stated that the difficulties of implementing the measures adopted in 1964 were "the persistence of obsolete methods of managing the economy caused by the old political system". There was, in fact, recognition by the Czechoslovak Communist Party that an efficient working of the reforms implied that the Party itself should largely abstain from interfering in economic matters. The whole political context was also different in 1968 from that of previous years. The reforms would have been implemented in a climate of political freedom. Not only less power would have been left to the Party in controlling the economy but, to the extent that the Party would have kept some say, its preoccupations would have been different. The change of leadership which had taken place at the beginning of the year would have reduced Soviet influence on it. This may explain why the Russians were much more concerned about the reforms planned in Czechoslovakia than those adopted in Hungary, although in this latter country they were certainly far-reaching(1). The Soviet Union was afraid that the reform movement, in the Czechoslovak style, might spread to other Communist countries. The Soviet Zone which, in many respects, shows the same economic characteristics as Czechoslovakia, might have been among the first to have become exposed to such contamination. The Soviet leaders may also have been concerned at the possibility that, in Russia itself, reformers would press for a greater liberalisation than they were ready to grant.

(c) Future Prospects

15. What may be said at this stage is that the need for economic reform has certainly not disappeared in Czechoslovakia. These reforms involved many changes, including wage differentials, transfers of manpower, closing-down of inefficient enterprises, reduction of the rôle of the Party, which were certainly not favoured by everybody before the Soviet occupation. Some may have also feared that the move towards liberalisation might increase the economic imbalance between Slovakia and the Bohemian lands by entailing a slowing-down of investment in Slovakia where the returns are lower than in other parts of the country. These various factors explain previous hesitation in the implementation of the reforms. However, it might be

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(1) See AC/89-WP/258, paragraphs 41-45

wrong to conclude that the military presence of the other Warsaw Pact countries has strengthened the hand of the opponents to the reforms; as far as public opinion is concerned the effect could well be the opposite. It is not to be excluded that some de facto improvements in the working of the economic system may be achieved without waiting for official sanction. Perhaps the Soviet Union itself will leave some room for manoeuvre to the Czechoslovak authorities in this field. She has herself implemented some limited economic reforms and, as already mentioned, she has not opposed the more far-reaching reforms adopted by Hungary. But even if some of the economic reforms envisaged are implemented the features regarded as essential by the Czechoslovaks themselves, in particular the loosening of Party control, can hardly be acceptable to the Russians. To what extent economic reforms emasculated in this way could improve the working of the Czechoslovak economy is an open question, the more so, as one important aim of the economic reforms - the overcoming of low working morale and widespread feeling of frustration - can be achieved only if a government is allowed to exist in which the Czechoslovaks have confidence, and with which they can identify themselves. A fundamental problem is whether economic reforms, whatever their contents, can be effective without some corresponding liberalisation of the political system in which they are applied.

## II. THE CONSEQUENCES OF MILITARY INTERVENTION ON RELATIONS BETWEEN CZECHOSLOVAKIA AND THE OTHER MEMBERS OF COMECON

16. It is naturally very difficult, at this stage, to forecast the effects of recent events on COMECON relations, but some indications of the importance of the Czechoslovak economy for other COMECON countries, and of the main causes of dissatisfaction of Czechoslovakia with COMECON arrangements, may help to understand the Soviet reaction to the new Czechoslovak economic policy and to discern the future developments in this respect:

### (a) The importance of Czechoslovakia to the other COMECON countries

17. If the economic relations between Czechoslovakia and the other COMECON countries are looked at from the Czechoslovak angle, it may be noted that about 70% of Czechoslovak trade was conducted in 1966 with Communist countries and, in particular, more than 33% with the USSR herself. The policy of expansion of trade with the West, envisaged by the Czechoslovak leaders, would no doubt have somewhat reduced these percentages in the future. However, it is doubtful whether the shift would have been spectacular. In the case of Rumania, which embarked a few years ago on a policy of economic independence, 47% of foreign trade was still conducted in 1967 with COMECON countries and 28% with the Soviet Union alone.

18. From the point of view of the other COMECON countries, trade with Czechoslovakia, measured in strictly quantitative terms, does not seem to be of overriding importance; in the case of the USSR, the Soviet Zone and Poland, this trade has been, over recent years, of the order of 10% of total foreign trade. Nevertheless, Czechoslovakia provides the main transport links for the industries of Poland and the Zone with their customers in South and Central Europe. For her part, the Soviet Union had derived substantial advantage from her policy of integrating the Czechoslovak economy into the COMECON framework. In the earlier period, the Russians obtained from Czechoslovakia vital supplies of uranium and a great deal of equipment and industrial goods, suitable for retooling and development, not easily available elsewhere. Czechoslovak equipment played a notable part in the industrialisation of certain COMECON members, which eased the Soviet position and made recourse to the West unnecessary. Czechoslovak arms and equipment, made available to developing countries, also helped. In more recent years, this Czechoslovak rôle may have declined slightly, but she still supplies large quantities of capital goods, as well as relatively high quality consumer goods, to the USSR and all other members of COMECON.

19. As already indicated, the economic policy of Czechoslovakia by itself did not involve an interruption of trade with other COMECON countries, or even a very drastic reduction in this trade. This could only have resulted from a decision of the Soviet Union, and possibly other Warsaw Pact countries, to inflict economic sanctions on Czechoslovakia. In this case, these countries would thus have deprived themselves of a market for their exports and also of important engineering products. They could have remedied these losses relatively easily, either by stepping up their own output or, possibly, by buying elsewhere. But it must be emphasised that this would have been an extreme situation and a most unlikely one.

20. Within COMECON there are a number of common installations, such as the pipeline and power grid, in which Czechoslovakia participates. These would not have been jeopardised if Czechoslovakia had succeeded in diversifying her trade geographically. On the other hand, the significance of some organizations, such as Intermetal, might have been weakened somewhat. More generally, Czechoslovak aspirations to change the pattern of industry and trade could have been disruptive of COMECON; they would have amounted to a condemnation of Soviet policy and reinforced the Rumanian argument. This is probably the main reason why the Soviet Union and some other COMECON countries objected to the recent Czechoslovak policy.

(b) Czechoslovak dissatisfaction with COMECON arrangements

21. Until quite recently Czechoslovakia was a pliant collaborator of the USSR and a loyal member of COMECON. The share of her trade directed to socialist and non-socialist countries in the post-war period is as follows:

Geographical distribution of Czechoslovak trade (%)

	<u>1948</u>	<u>1953</u>	<u>1960</u>	<u>1966</u>
Socialist countries				
USSR	16.2	35.6	34.4	33.5
Others	23.4	42.9	37.4	36.7
Non-socialist countries				
Industrialised	45.7	14.9	17.8	20.0
Developing	14.7	6.6	10.4	9.8

22. As far as Czechoslovakia was concerned, the pre-occupation with massive output generally and in particular with engineering goods of the type wanted in other COMECON countries had the effect that though production rose there was no comparable advance in technology. The fairly high level of technology which Czechoslovak industry had at the start, has gradually fallen back during this period. At one time some Czechoslovaks derived consolation from the hope that within the COMECON community at least they would have the task - along with the East Germans - of providing the more sophisticated industrial products. In fact, owing no doubt to this relative decline in their technological prowess, the other countries, while relying on them for a great deal of routine equipment began to look to the West for the more sophisticated products.

23. The excessive emphasis placed on capital goods resulted in a fall in living standards in Czechoslovakia. This is not to say that the Czechoslovaks are worse off than their neighbours, but relative to the past and relative to their productive capacity, living standards have evolved in a most unsatisfactory manner. At one time there was much discussion whether the standard of the more advanced socialist countries should be held back until the others caught up somewhat. The Soviet Union eventually came out against this concept advanced by the Chinese, but in practice the Czechoslovaks have seen their own position within COMECON progressively deteriorate.

24. Over the years the Czechoslovaks, heavily committed to capital production, have delivered to their COMECON neighbours, including the USSR, goods considerably in excess of Czechoslovakia's purchases in these countries. Moreover, largely in response to Soviet suggestions, they have done the

same in many developing countries, sending arms and industrial equipment in excess of their purchases. None of these countries appear to have enough of the goods which the Czechoslovaks would wish to use, and as the balances(1) are inconvertible they cannot be used to buy in those countries which have suitable goods.

25. Finally, there is the circumstance that the Russians after persuading the other COMECON members to rely on them for raw materials complain that these are costly to produce at the agreed prices and have asked their partners to invest in Soviet extractive industries. Not all COMECON members have reacted to this suggestion with equal alacrity, but the Czechoslovaks have dutifully participated in several of these arrangements. The last one entered into was an agreement to supply the USSR with oil equipment and consumer goods to a value of some 500 million roubles to be repaid in Soviet oil in the seventies.

26. Against the background of these facts it can be seen why so many Czechoslovaks, including party members, have come to believe that they, as a nation, have been exploited by their ideological brethren. This explains why they slowly but almost unanimously have come round to wanting new economic policies which would remove the dead hand of bureaucracy from the enterprises and bring about a new structure of industry resulting in a new pattern of foreign trade. Though these aims are essentially economic in character, they are directed against institutions and arrangements of political significance.

(c) Future prospects of Czechoslovak relations with COMECON

27. It has been noted that among the many and various criticisms of Czechoslovakia by the invading states, relatively little was said about the economic aspect. This does not necessarily mean, however, that the threat that Czechoslovakia might emancipate itself from COMECON arrangements did not cause serious concern to the Soviet Union and other Warsaw Pact countries. In the Bratislava communiqué there was a brief reference given to COMECON as the instrument for promoting production and specialisation among the socialist countries and it was said that a top level meeting to discuss ways of improving the organization should be held. A Pravda article of 22nd August touched on another aspect of COMECON, namely that it did not merely serve the economic needs of the individual countries but reflected the international situation. The article added that the USSR was responsible for the security and economic independence of the socialist camp. In Soviet eyes COMECON is obviously an essential part of the structure of the Soviet sphere of influence.

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(1) See C-M(68)29, Annex I, Table III

28. The short-fall in production, caused by the invasion and subsequent events, will no doubt be reflected in foreign trade, but this is not likely to be all that significant. Future developments of Czechoslovak relations within COMECON will clearly depend on the Soviet Union's attitude. Since Czechoslovakia's passive resistance has not yet been broken, and the people are still solid with their leaders, the Russians may feel disposed to turn the screw rather than assist. On the other hand, it could be argued that, once the Russians had achieved Czechoslovak agreement to "normalise", they would then show themselves willing to help restore the Czechoslovak economy as they did in the case of Hungary(1).

29. The real issue facing the Czechoslovak nation is the unsatisfactory state of the economy as a result of the deficiencies of the command system and the gearing to socialist neighbours. The Russians and the other members could ease the Czechoslovak position by treating sympathetically their wish to open out more to the world at large like the Rumanians and Yugoslavs. It seems rather unlikely, however, that either the Russians or the East Germans would care to risk this solution, and at the moment the likelihood is that pressure will be put on Czechoslovakia to remain a leading member of the socialist world community. Arrangements may be made within this framework to make things easier for Czechoslovakia; the other members might undertake to give some priority to Czechoslovak requirements, to deliver promptly and to order high quality goods from Czechoslovakia rather than from the West. Some relief might also be given by freeing Czechoslovakia from the obligation of investing in the Soviet Union.

30. Greater use might also be made of Czechoslovak facilities for research and development. In respect of research and production, new forms of specialisation might be accepted by those members of COMECON which can be induced to comply. In the present circumstances, Yugoslavia would almost certainly remain aloof. How the Rumanians would react to pressures of this kind would presumably depend on the degree which the Russians consider it wise to apply.

31. There is a special issue which is relevant in the COMECON connection; that of the credit balances held by Czechoslovakia with other Communist countries. At some point, Czechoslovakia may insist on their liquidation and, if there was an economic conference, she could present a strong case for special treatment by other members. On the other hand, the Soviet Union might argue that these balances do not raise any urgent problems. In any case, their liquidation will necessarily take some time.

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(1) In 1956, following the unrest in Poland and Hungary, the Soviet Union provided economic assistance to COMECON countries in rouble credits and in hard currency loans (the latter amounted to \$193.5 million in 1956/1957).

32. During the recent talks in Moscow between the Czechoslovak Prime Minister and Soviet leaders (9th and 10th September), it seems that a wide range of economic problems were discussed. It has been reported that the Soviet Union would deliver natural gas to Czechoslovakia, who for her part would help to construct a gas pipeline on Soviet territory. The amounts involved in these operations are not known, nor are the terms of the transactions. At first sight, it seems that the agreement is of the same type as that referred to above (paragraph 25), under which Czechoslovakia provides oil equipment to be paid for at a later date by oil deliveries. It seems indeed that there is a deliberate attempt on the part of the Soviets to strengthen their economic links with the Eastern European countries. An example of this is the recent Soviet/Bulgarian long-term agreement for economic co-operation, also involving Soviet gas deliveries.

III. THE EFFECTS OF SOVIET MILITARY INTERVENTION ON THE ECONOMIC RELATIONS OF CZECHOSLOVAKIA WITH THE WEST

33. In order to discuss the effects of military intervention on economic relations with the West it appears appropriate first to recall briefly the rôle these relations have played hitherto and the place accorded to them in the plans of the Czechoslovak reformers.

34. The West takes a smaller share of Czechoslovakia's foreign trade than of the trade of the USSR, of the four other invading countries and, of course, of the trade of Rumania. In 1966 the share of the industrialised West was 20% in the case of Czechoslovakia, 21% in the USSR, 23% in the Soviet Zone, 23% in Bulgaria, 25.5% in Hungary, 29% in Poland and 34% in Rumania. Between 1960 and 1966 the West's relative share of Czechoslovakia's trade increased by 2% as it did in the USSR, Hungary and the Soviet Zone. In the same period, this share increased by 10% in Bulgaria and Rumania.

35. Among NATO countries, the Federal Republic of Germany is by far the most important supplier of Czechoslovakia. In 1967 it accounted for 39% of the European NATO countries exports(1) and for about a quarter of the exports of Western Europe as a whole. However, this share is only very slightly higher than the Federal Republic's share of European NATO countries' exports to Hungary and smaller than her share in these exports to Rumania (49%). The Federal Republic's share in all European NATO countries' exports to the East European countries, other than the Soviet Zone, is 37%.

36. Compared to most other East European countries Czechoslovakia seems to have been cautious in taking up Western export credits. At the end of 1967 the outstanding

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(1) See Table IV in Annex I to C-M(68)29

government guaranteed private export credits to Czechoslovakia amounted to \$152 million(1) or \$10.6 per inhabitant. This figure is lower than in the other Eastern European countries with the exception of the Soviet Zone and in the USSR, as shown in the table below. It has, however, to be noted that the real Czechoslovak indebtedness may be greater than these figures suggest as no information is available on private credits not guaranteed by governments and credits from countries outside NATO.

Outstanding government guaranteed private export credits from NATO countries: per inhabitant and as a percentage of the GNP of Communist countries benefiting

Country	Outstanding credits on 31.12.1967 (million US \$)	Outstanding credits per inhabitant (\$)	Outstanding credits as percentage of GNP
USSR	1,017.4	4.2	0.3
Soviet Zone of Germany	144.2	8.3	0.5
Czechoslovakia	152.0	10.6	0.6
Hungary	117.1	11.5	0.6
Poland	428.0	13.4	1.2
Rumania	626.7	32.5	3.5
Bulgaria	281.0	33.9	3.3
TOTAL	2,766.4	8.2	0.6

Sources: Outstanding private credits guaranteed by governments: AC/127-D/254  
Population and GNP (Western estimates): AC/89-WP/258, Table I, page 35.

37. In view of these facts it would seem difficult for the USSR to argue that Czechoslovakia's present trade with the West should be reduced although they might press for a reduction of the relative share of the Federal Republic on political grounds.

38. The expansion of trade with the West played an important rôle in the programme of Dubcek's government. The planned change from heavy to light industry and the modernisation of obsolete plants were to be based to a large extent on imports from the West. In order to be able to pay back the

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(1) See AC/127-D/254



loans and credits this would make necessary, exports to the West were to be promoted and in the long-term the competitiveness of Czechoslovak industry was to be stimulated by a gradual opening up of the Czechoslovak market.

39. Before the military intervention, Czechoslovakia asked the Soviet government for a hard currency loan. The Soviets seem to have evaded the issue and it was at that stage that the Czechoslovak leaders started probing into the possibilities of obtaining a loan from Western sources. The idea of attracting Western investments through joint industrial ventures was also broached by the Czechoslovaks.

40. Apparently the Russians fear the political and economic consequences of an expansion of Czechoslovak trade with the West while, so far, they have reluctantly resigned themselves to such a development in the case of Rumania. On 2nd September, "Pravda" carried an article by a certain V. Ivanov, who reminded Czechoslovakia of her dependence on the supply of Soviet raw materials and of her rôle in creating the material and technical basis for Communism in the Soviet Union. The writer slipped in a warning that only political simpletons in Czechoslovakia could dream of widening the framework of Czechoslovakia's economic exchanges with the capitalist countries, since this could only lead to economic dependence on foreign capital.

41. However, should such considerations lead the Russians to prevent an expansion of trade between Czechoslovakia and the West, this would, to some extent, be contrary to the economic interests, not only of Czechoslovakia, but also of the Soviet Union. The Russians themselves have called for an increase in deliveries of manufactured instead of capital goods from Czechoslovakia. They therefore clearly have their own interests in the reconversion and modernisation of Czechoslovak industry. The trouble is that this modernisation could best be carried out by drawing on Western equipment and know-how.

42. It is not possible, at the moment, to predict what kind of compromise the Russians will arrive at between their political and their economic interests. It would seem improbable that they will allow the Czechoslovaks to go ahead in seeking Western loans or experimenting with some kind of direct Western investment. On the other hand, it is not to be excluded that they might consider it preferable to put the hard currency necessary for the modernisation of Czechoslovakia's industry at the disposal of that country, rather than have her plan for an increase of exports to the West which could eventually pay for the imported machinery.

Such a policy would obviously imply some increase in the USSR's exports to the West, or sales of gold, but the Russians might find this to be in their political interest, to the extent that they would preserve their economic hold over Czechoslovakia, who would continue to export to COMECON countries instead of having to direct her future sales towards the West in order to refund capitalistic loans.

IV. FUTURE OF EAST/WEST ECONOMIC RELATIONS

43. The future of East/West economic relations depends on the attitude of both Communist countries and the West. The Soviet Union will certainly endeavour to reinforce the cohesion of COMECON and may even take advantage of present circumstances to make new attempts to control through this organization trade between East Europe and the West. She will probably be more suspicious of certain initiatives which East European countries might take to strengthen their economic links with the West. She might calculate that the example of Czechoslovakia will inhibit, at least for some time, the resistance of other COMECON countries to her demands. The extent to which she would succeed in this respect is difficult to foresee and may vary from country to country, Rumania being probably the most reluctant one.

44. Moreover, the intervention in Czechoslovakia inevitably involves certain increases in the expenditure of the invading countries and to this extent aggravates the already acute problem of the allocation of resources between military efforts, investment and consumption. In so far as the invasion of Czechoslovakia has involved troops and transport which normally help to bring in the harvest in the USSR it can also have an unfavourable effect on the cereal crop. Furthermore, it is not ruled out that certain economic arrangements may be arrived at between COMECON and Czechoslovakia so as not to expose the latter's economy to further failures. In these circumstances, the European Communist countries might wish to have more industrial goods and credits from the West so as to lessen the tension which these burdens will impose on their economies.

45. The economic and financial measures taken by member governments of the Alliance towards the five Communist countries which intervened in Czechoslovakia continue to be followed from a strictly economic angle, by the Committee of Economic Advisers(1). Information so far available indicates that some official economic contacts have been postponed and there has been no official representation at some trade fairs in the invading countries. The members of the Alliance are adopting a very cautious attitude until the situation

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(1) AC/127-R/232, Item I

becomes clearer. In this respect a distinction is made between Czechoslovakia, Rumania and Yugoslavia on the one hand and the five aggressors on the other. The uncertainties of the situation may, apart from any political change, aggravate the practical difficulties of contacts and lead to a temporary slow-down in the conclusion of new deals.

46. In the long-term no western country has so far taken the decision to alter basically its commercial and credit policy towards the Communist countries. On the basis of recent trends in East/West trade and of volume of credits already granted to Communist countries, it was foreseen, before the events in Czechoslovakia, that trade between member countries and Communist Europe, especially the USSR, would substantially expand in 1969. Unless the political situation deteriorates further, a certain increase seems likely as contracts already signed will no doubt be implemented.

47. A special problem arises from the uncertainty created in Eastern Europe by the events in Czechoslovakia. Economic relations with the countries of this region might now be considered as involving additional risks. Some might think, for instance, that these risks have increased more in the case of Czechoslovakia and of Rumania than in that of the invading countries. However, from a political point of view, it would be paradoxical for the West to show more caution in its dealings with these first two countries, while in the case of the other Communist countries trade and credits were being stepped up.

48. The Committee of Economic Advisers has also decided(1) to study whether a correlation exists between trade and credit agreements on the one hand, and trends towards liberalisation in European Communist countries on the other. This study will necessarily take some time and it would be rash, at this stage, to venture more than very tentative ideas on this matter inspired by previous studies of the Committee:

- (i) It seems that East/West trade has highlighted certain shortcomings in the Communist economic system and has thus contributed to the reform movement. This is a cumulative process to the extent that the economic reforms - at least if more freedom is left to individual enterprises in the field of external trade - foster the expansion of economic relations between East and West. It appears also that the reforms cannot be effective unless there is some relaxation of the grip of the Party on the working of the economy. This is a case where economic necessity may lead to some liberalisation in the broader political context.

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(1) AC/127-R/232, Item I

- (ii) As to credits, over recent years they have been an important stimulant to East/West trade. They have also resulted in some economic interdependence between East and West: to repay these credits Communist countries have to step up their exports and the West, if it wants to be reimbursed, has to open its markets to more Communist goods.
- (iii) East/West trade has also been a disturbing element in the working of COMECON: it has introduced a yardstick for comparison which proved to be detrimental to the Communist economic system, in particular as regards the quality of goods. East/West trade offers also an alternative to which both the USSR and the Eastern European countries have increasingly resorted over the last few years.

However, the real problem raised by the correlation between trade and credit arrangements and the trends towards liberalisation in European Communist countries is perhaps less economic than political. Among many others, two relevant questions seem to be: How far is the Soviet Union willing to go on tolerating liberalisation in Eastern European countries? How far is the Soviet Union prepared to go in liberalising her own society?

(Signed) A. VINCENT  
Chairman

OTAN/NATO,  
Brussels, 39.