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Western Europe: Economic Links With the Soviet Bloc



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An Intelligence Assessment

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May 1983

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Western Europe: Economic Links With the Soviet Bloc



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An Intelligence Assessment

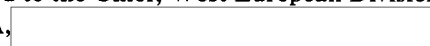
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Comments and queries are welcome and may be
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**Western Europe:
Economic Links With
the Soviet Bloc** [redacted]

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Key Judgments

*Information available
as of 1 April 1983
was used in this report.*

Western Europe's economic links to the Soviet Bloc¹ are dominated by merchandise trade. While other categories of economic relationships, such as flows of services and investments, are generally extremely small, the large loans made to Bloc countries during the 1970s make some West European banks vulnerable to a Bloc default. Although a default by a single country probably would not cause major problems, a Bloc-wide default might force the West European governments to intervene to protect their banking systems. [redacted]

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Even the trade links to the Bloc are relatively small. Last year the Bloc's share of exports from the NATO countries of Western Europe was only 3.2 percent,² the lowest level in at least 20 years; over half of these exports came from West Germany. Imports from the Bloc have held up better, due mainly to purchases of Soviet oil and gas. The Bloc's share of total European NATO imports reached 4.5 percent, its highest level since 1964. [redacted]

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Over the years the Soviet Union has accounted for an increasing proportion of the Bloc's trade with NATO Europe. In the 1960s and early 1970s, the Soviet share of total trade (exports plus imports) was typically about one-third. Last year, for the first time, it exceeded one-half. On the import side, NATO Europe's purchases were increasingly concentrated on the USSR because of its ability to provide oil and natural gas. Meanwhile financial problems forced East European countries to reduce their imports and raised the Soviet share in Europe's exports to the Bloc. [redacted]

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NATO Europe's trade with the Bloc is largely an exchange of capital-intensive manufactures for simpler goods. Exports to the USSR are dominated by machinery and steel, although chemicals and foodstuffs are also important. Exports to Eastern Europe are more diversified. Machinery is still the largest category, but consumer goods, foodstuffs, chemicals, steel, and other semifinished goods are also significant. Four-fifths of imports from the USSR consist of fuels—crude oil, oil products, and natural gas—whereas a wide range of products is imported from Eastern Europe. [redacted]

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¹ The Soviet Bloc refers to the USSR and the East European countries of Poland, East Germany, Czechoslovakia, Hungary, Bulgaria, and Romania. [redacted]

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² All trade data presented in this paper are from Western sources. In all cases the export data is shown on an f.o.b. basis while the import data is c.i.f. [redacted]

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The importance of East-West trade for employment tends to be exaggerated by the West Europeans. For West Germany, where the data are best, we estimate that in 1982 only about 0.9 percent of the labor force depended on this trade for their jobs. The percentage in the rest of NATO Europe was presumably even lower because these countries combined sold slightly less to the Bloc than did West Germany. [redacted]

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The West Europeans still strongly defend their trade with the Bloc and emphatically reject any measures that suggest "economic warfare." They continue to believe that trade with the West will tend to restrain Soviet behavior—although optimism on this score has declined substantially in the wake of the events in Poland and Afghanistan. Proponents of trade with the Bloc now tend to focus more on the economic benefits of such trade.

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Economic ties between Western Europe and the Soviet Bloc are not likely to increase substantially during this decade. Western banks will remain reluctant to boost lending to the Bloc, and Bloc export prospects will be limited by the sluggish economic growth expected in Western Europe. Increased Soviet gas earnings will be offset by declining oil exports. With its access to hard currency thus limited, the Bloc's share of Western Europe's exports is not likely to increase. [redacted]

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The West Europeans may be willing to make some concessions in order to avoid episodes such as last year's dispute over the Soviet pipeline. In particular they might be willing to renounce an additional Soviet pipeline as a means of meeting their gas needs in the 1990s—in part because another pipeline would greatly increase their feeling of vulnerability and in part because projections of gas demand are being revised downward. They might also agree to some further tightening of COCOM rules, especially if the United States can make a strong case that the Soviets have used COCOM-approved material in the past to strengthen their military. Another possibility is a broad framework accord on credits for the Soviet Bloc, although the West Europeans will argue that not much more is needed because of the drastic curtailment of private lending to the Bloc and the OECD consensus agreement last July that raised minimum interest rates on government-backed credits for the Soviets. The West Europeans will attempt to ensure that any agreement implies equal burden sharing among the Western countries and, in addition, does not have the appearance of US imposition of its policies on others. [redacted]

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Western Europe: Economic Links With the Soviet Bloc

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General Attitudes Toward East-West Trade

The West Europeans generally believe that increased trade with the East is both a result and a promoter of detente. The view probably is less firmly held than in the mid-1970s because of the dropoff in exports late in the decade, the continuing Soviet military buildup, and the events in Poland and Afghanistan. Nevertheless, most West Europeans still argue that Soviet behavior will be more restrained if the USSR has a large stake in the international economic system.

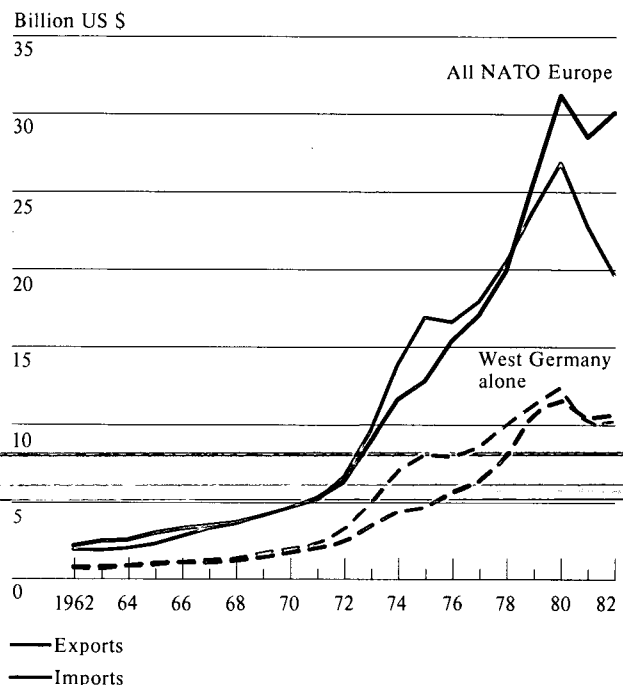
West European governments generally reject the use of economic sanctions against the Soviet Bloc except in very limited cases for the purpose of making a political point. An example would be the very modest trade restrictions imposed by the EC on the USSR in response to the declaration of martial law in Poland. The West European rationale basically is that sanctions may hurt the West as much as the East and, in any event, do not affect Soviet behavior. Underlying this attitude is a strong feeling that the cost of sanctions will not be distributed evenly among the Western countries and that Western Europe in particular will bear a disproportionate share of the burden.

The West Europeans nonetheless do not view trade with the East purely as an economic phenomenon. This is shown, for example, by the participation of the major West European governments in COCOM restrictions on exports that could improve Soviet military capabilities. Even here, however, they tend to take a much narrower view than does the United States in deciding what goods fall into this category.

Trade Patterns

Taken as a whole, the trade of the NATO countries of Western Europe with the Soviet Bloc is relatively small. Over the last two decades the Bloc share of their exports usually has been in the 3- to 4-percent range, with a peak of 4.9 percent in 1975. The mid-1970s export boom was financed mainly by Soviet oil

Figure 1
NATO Europe: Trade With the Soviet Bloc



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earnings and credits from Western banks and governments. Since then the Bloc's share of NATO Europe's exports has fallen dramatically, reflecting the Bloc's attempts to curb the growth of its hard currency debt. Last year the share was down to 3.2 percent, the lowest level in at least 20 years, as NATO Europe's exports to the Bloc declined even in value terms.

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The Bloc's relative decline as a market for NATO Europe's exports is due mainly to Eastern Europe. In the mid-1960s exports to these countries were double

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Table 1
NATO Europe: Trade With the Soviet Bloc, 1982^a

Million US \$

	Poland	East Germany	Czecho- slovakia	Hungary	Bulgaria	Romania	Total EE	USSR	Total Soviet Bloc
Exports	2,078	3,294	1,375	1,941	1,016	1,094	10,799	9,196	19,995
West Germany	873	2,538	773	1,072	486	368	6,110	3,936	10,046
France	442	258	108	198	106	159	1,271	1,558	2,830
Italy	167	125	109	222	163	131	917	1,529	2,446
United Kingdom	230	110	120	132	82	210	885	623	1,508
Netherlands	144	101	87	132	44	52	560	424	984
Belgium-Luxembourg	74	51	63	88	46	48	370	533	903
Denmark	48	30	24	36	7	5	150	86	236
Norway	48	9	18	20	3	15	113	97	210
Spain	40	53	32	25	32	34	216	224	440
Portugal ^b	3	5	3	3	4	8	26	51	77
Greece	9	14	38	13	43	64	181	135	316
Imports	2,366	4,260	1,764	1,538	630	1,883	12,441	17,658	30,099
West Germany	884	2,716	840	755	194	537	5,926	4,669	10,595
France	330	284	172	173	101	386	1,446	2,883	4,329
Italy	289	168	249	301	121	549	1,677	3,632	5,309
United Kingdom	257	242	144	73	35	92	843	1,129	1,972
Netherlands	151	209	128	83	20	99	690	2,518	3,208
Belgium-Luxembourg	106	137	55	34	27	26	385	1,456	1,841
Denmark	106	159	61	35	10	17	388	333	721
Norway	97	183	36	19	1	11	347	225	572
Spain	94	105	30	20	16	112	377	495	872
Portugal ^b	5	11	8	2	1	4	31	96	127
Greece	47	46	41	43	104	50	331	222	553

^a Because of rounding, components may not add to totals shown.

^b January to November data only for Portugal.

those to the USSR, and this proportion was maintained in the early 1970s as the East Europeans stepped up imports of Western goods to modernize their economies and upgrade living standards. The rising tide of imports was financed largely by credits, which the East Europeans planned to repay through improved export performance. However, systemic inefficiencies coupled with recession and rising protectionism in the West dashed their hopes for strong growth of hard currency sales.

With their debt service obligations increasing, most East European countries began to retrench in the late 1970s and slowed growth largely through steep cuts in investment. Only East Germany held to a growth policy based on rising hard currency imports and debt. In 1981, Poland's economic decline, Romania's financial chaos, and mounting concern among Western lenders over creditworthiness of the Council for Mutual Economic Assistance (CEMA) countries generally forced all except Bulgaria to cut hard currency

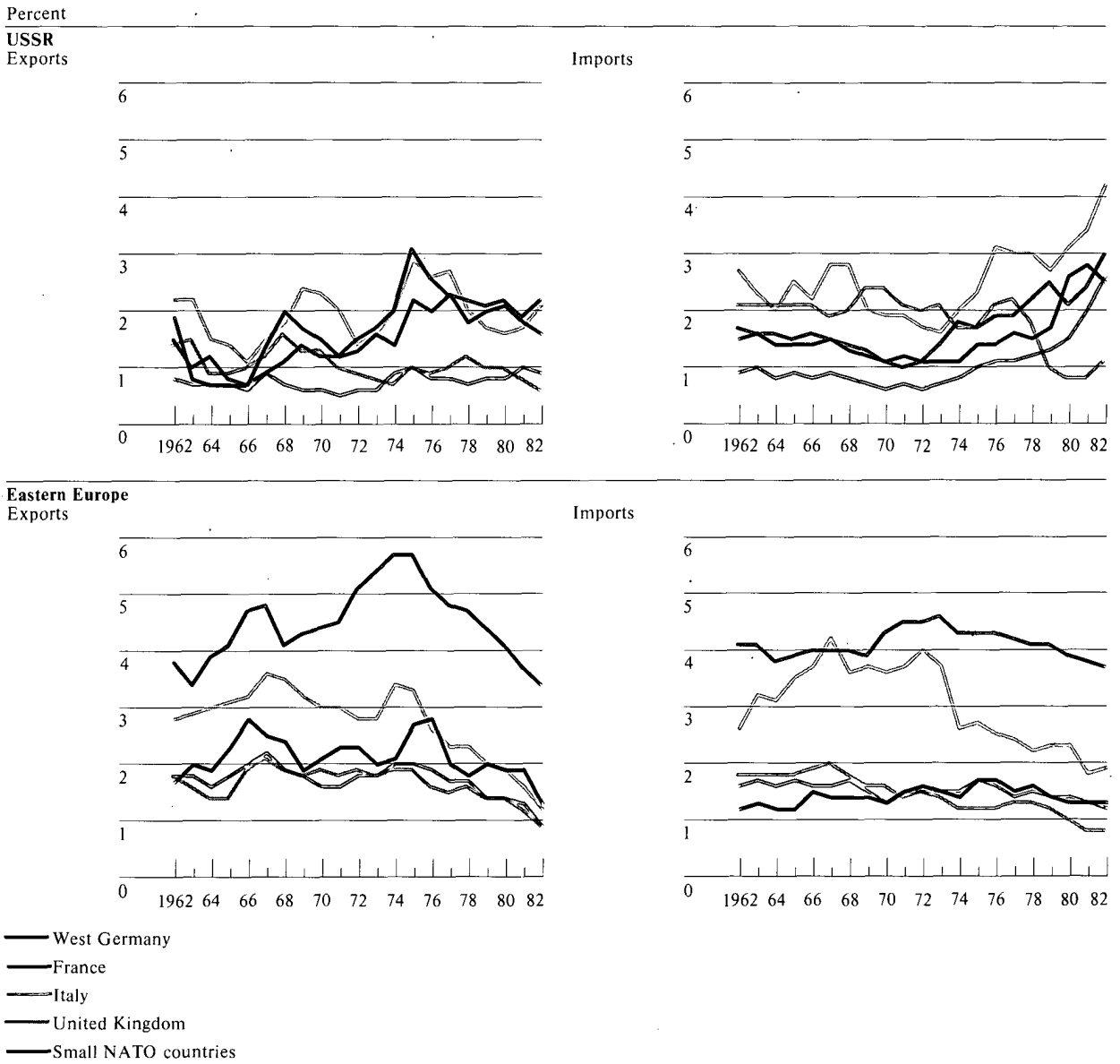
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Figure 2
European NATO Countries:
Trade With the USSR and Eastern Europe



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imports. As a result NATO Europe's exports to Eastern Europe fell sharply in dollar terms—ending two decades of steady growth—and the decline accelerated in 1982. Last year NATO Europe's exports to Eastern Europe totaled \$10.8 billion and accounted for just 1.7 percent of total exports—barely half the percentage recorded in 1974 and 1975. [redacted]

The Bloc's share of NATO Europe's imports has risen in recent years, following a long period of decline during the 1960s and stagnation during the early 1970s. The pickup mainly reflects increased purchases of energy from the USSR. Imports from the Bloc totaled \$30.1 billion in 1982, of which almost three-fifths came from the Soviet Union. The Bloc's share of imports reached 4.5 percent, its highest level since 1964. [redacted]

Higher imports from the East coupled with slumping exports have pushed NATO Europe's trade with the Soviet Bloc sharply into deficit. The \$4 billion surplus of 1975 had by 1981 turned into a \$4 billion deficit, and last year the deficit soared to \$10.1 billion—of which \$8.5 billion was with the USSR. [redacted]

NATO Europe's trade with the USSR is largely an exchange of steel and machinery for fuels. Energy products now account for about four-fifths of Soviet exports to the area; roughly two-thirds of these energy exports consist of crude oil and oil products, with natural gas accounting for most of the remainder. By the end of the decade most energy forecasters expect natural gas to become the dominant commodity as Soviet oil exports taper off and the new gas pipeline comes into operation. Other significant Soviet exports are raw materials, chemicals, gold, and diamonds. West European exports to the USSR are dominated by machinery, especially heavy industrial machinery, and steel products, especially large-diameter pipe. In recent years exports of agricultural products have gained importance, accounting for more than one-fifth of the total in 1981. [redacted]

Trade with the other Bloc countries is considerably more diversified. More than three-fourths of NATO Europe's shipments to Eastern Europe are manufactured goods—primarily machinery, semifinished products (mainly steel and textiles), and chemicals.

Foodstuffs have gained importance as the East Europeans cut back on investment and now account for 15 percent of exports. On the import side foodstuffs and raw materials each account for more than 10 percent, fuels for more than 20 percent, and manufactures for just over half of the total. About one-third of the manufactured imports are semifinished goods, particularly textiles and basic metals, while another one-third consist of clothing and other consumer goods. [redacted]

The Jobs Factor

The importance of exports to the Soviet Bloc for West European employment probably has been exaggerated, at least in purely economic terms. [redacted]

[redacted] we estimate that the total number of West German workers that depend, directly or indirectly, on exports to the Bloc is probably close to 250,000—equal to 1.0 percent of total employment or 0.9 percent of the labor force. While the number of jobs is relatively small, the political significance is magnified by the fact that the jobs tend to be concentrated in industries that are both highly unionized and badly hurt by the current recession. For example, in the steel industry we estimate that 5.9 percent of the jobs (or 15,000 workers) depend on exports to the Bloc, while in the machinery industry the figure is 2.6 percent (26,000 workers). [redacted]

For the other NATO European countries combined, the total number of jobs dependent on exports to the Bloc probably is greater than the 250,000 figure that we estimate for West Germany. Their exports to the Bloc almost matched West Germany's in dollar value in 1982, and the goods they sold probably were, on average, more labor intensive than those of West Germany. It is likely, however, that in each of the other NATO European countries, the percentage of total employment dependent on exports to the Bloc is below the 1.0 percent estimate for West Germany. [redacted]

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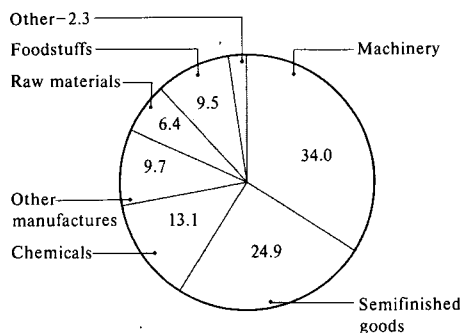
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Figure 3
NATO Europe's Trade With the Soviet Bloc:
Commodity Composition

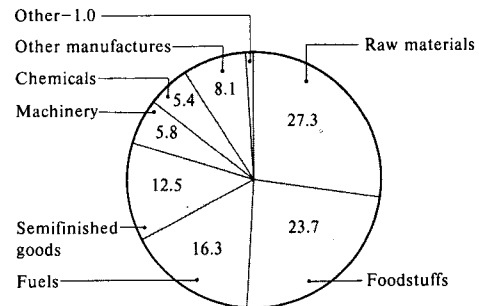
Percent

1970

Exports

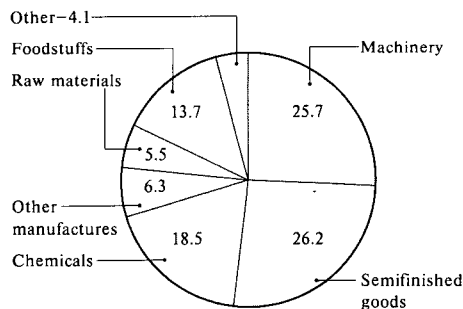


Imports

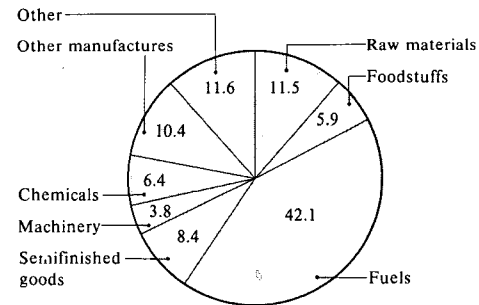


1980

Exports



Imports



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Other Economic Relationships

Other categories of economic ties that play a major role among Western countries—such as flows of services and investment—are extremely small between East and West. The major exception is the large debt that the Bloc countries ran up with Western Europe, mostly during the 1970s. Although the West Europeans now find themselves overexposed, we

believe that they could cope reasonably well with a default by any single Bloc country. The greatest exposure is that of West German banks to Poland, and their nervousness has been an important determinant of West German attitudes and policy on East-West issues. Nevertheless, as of last year each of the

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six most heavily involved banks had sufficient loss reserves to write off its Polish loans. In fact, the stronger banks have already begun to do so. Although it seems highly unlikely, a Bloc-wide default would obviously be far more serious, and we suspect it would lead to a major intervention by the West European governments to prevent a banking crisis. [redacted]

The Siberian Gas Pipeline

The acrimonious pipeline dispute arose in part because both Americans and West Europeans initially underestimated the importance that the other side attached to the pipeline. By the time Washington raised strong objections, the West European governments had already committed themselves to the deal, and contract negotiations were well under way. Moreover, the US arguments initially focused on the question of energy dependence on the USSR—an issue that the West Europeans said they had already studied carefully and resolved to their satisfaction. Given the advantages that the West Europeans see in the pipeline deal, however, we doubt that any shift in the timing or nature of the US objections would have altered the outcome. [redacted]

The West Europeans clearly are convinced that the pipeline deal is a good one for them, taking into account their projected energy needs and considering such aspects as the cost and reliability of Soviet gas, the cost of their export credit subsidies, and the export sales for West European industry that are likely to result. And, despite less bullish demand forecasts now than three years ago, they remain convinced that they will need large additional gas supplies, especially in the 1990s. The West Europeans stress that the pipeline will not increase their overall energy dependence on the Soviets because their oil imports from the USSR will fall sharply over the next few years. In our judgment they have not focused extensively on what the additional gas revenue might do for Soviet military power, but they tend to argue that the Soviet military will get the resources it wants whether or not the pipeline is built. They are skeptical that it is in the West's interest to cause cutbacks in Moscow's consumer-oriented and civil investment expenditures that they believe would result if earnings from the pipeline were reduced or cut off. [redacted]

Numerous statements by West European leaders make it clear that their prime energy goal is to reduce their dependence on OPEC. While that dependence has fallen significantly since 1973, a sustained OPEC embargo would still have a devastating impact. In searching for OPEC substitutes, the West Europeans obviously would prefer to find energy sources in the industrial West because of their reliability. It is partly for this reason that they plan to expand substantially their use of coal and nuclear power. The Soviet gas will help reduce dependence on OPEC by substituting for oil in home heating, and to date there have been no alternative gas sources that could match the Soviet offer. West European gas producers have been neither willing nor able to expand production sufficiently in the 1980s, or to boost exploration/development to ensure deliveries down the line; moreover, potential non-European sources—such as Algeria, Nigeria, Qatar, Indonesia, Iran, or Canada—appear too unreliable, too expensive, or both. [redacted]

The West Europeans argue further that the Soviet gas deal is relatively advantageous in terms of security, flexibility, and price:

- *Security.* The deal provides the West Europeans with a 25-year (1984-2008) gas supply from a partner that they clearly consider to be more reliable than OPEC. They have repeatedly stated their belief that Moscow will deliver the gas on schedule both to maintain its hard currency earnings and to preserve its reputation as a reliable trade partner.
- *Flexibility.* The Soviets also agreed to significant flexibility in gas deliveries. Numerous reports confirm that West Germany has a one-time option to permanently reduce the base amount of gas in its contract (10.5 billion cubic meters per year, excluding West Berlin) by up to 20 percent.³ More important, each purchasing country in each year of the contract will have the right to reduce deliveries during that year up to 20 percent below the base amount. This option likely will be utilized during the early years of the contract, when the West Europeans appear to be facing a gas surplus.

³ West Berlin will receive 650 million cubic meters annually under a separate contract signed in March 1983. [redacted]

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Table 2
NATO Europe: Energy Dependence on the USSR, 1980^a

	Primary Energy Requirements											
	Total		Coal		Oil		Gas		Nuclear		Other	
	Million tons oil equivalent	Percent from USSR	Million tons oil equivalent	Percent from USSR	Million tons oil equivalent	Percent from USSR	Million tons oil equivalent	Percent from USSR	Million tons oil equivalent	Percent from USSR	Million tons oil equivalent	Percent from USSR
Total	1,106.7	5.0	259.6	0.8	575.1	6.6	172.4	9.7	39.1	0	60.4	0
West Germany	272.2	6.1	83.5	0.2	130.5	5.5	43.3	21.0	10.1	0	4.8	0
France	198.2	6.2	35.7	2.5	109.3	7.9	21.9	12.2	14.4	0	16.9	0
Italy	142.1	9.2	13.2	5.2	93.4	8.0	23.1	21.2	0.5	0	11.8	0
United Kingdom	201.5	0.5	69.6	0	80.6	1.2	41.1	0	9.0	0	1.2	0
Netherlands	65.5	9.7	4.1	0	29.6	21.5	31.0	0	0.9	0	0	0
Belgium/Luxembourg	50.4	5.1	13.4	1.3	24.2	9.8	9.5	0	3.0	0	0.3	0
Denmark	19.2	7.7	6.1	0.1	13.2	11.1	0	0	0	0	-0.1	0
Norway	24.1	0.6	1.4	0	9.1	1.5	0.9	0	0	0	12.6	0
Spain	75.2	2.3	15.3	0.3	49.9	3.3	1.6	0	1.2	0	7.1	0
Portugal	10.7	4.5	0.5	0.6	8.2	5.9	0	0	0	0	2.1	0
Greece	16.2	4.6	3.5	0.6	11.7	6.2	0	0	0	0	0.9	0
Turkey	31.4	0.6	13.3	0	15.4	1.3	0	0	0	0	2.8	0

^a Because of rounding, components may not add to totals shown.

• *Price.* While the recent decline in oil prices makes the Soviet gas deal appear less attractive than when it was signed, recent reporting from the Paris and Bonn Embassies make it clear that the West European purchasers are still satisfied. We believe that all the contracts are patterned on the one signed by Ruhrgas of West Germany. According to the Bonn Embassy, this contract specifies a minimum deutsche mark price for the gas, which, at the 1 May 1983 exchange rate of 2.46 deutsche marks per US dollar, works out to about \$4.80 per million Btu. On an energy-equivalent basis, this corresponds to oil at \$27 per barrel. For comparison, at the time of signing the price of oil was \$34 and was expected to continue rising. The contract also contains an escalator clause linked to oil prices. Although the link is mainly to heavy fuel oil and heating oil rather than crude, the escalator clause probably would go into effect only when the price of crude rises above \$40. At that point the gas price would begin rising

above the minimum figure, in proportion to any additional oil price increases. The purchasers thus seemed assured of always getting the gas at a price substantially below the energy-equivalent price for oil. The recent drop in oil prices, along with the possibility of further declines, has created an unexpected situation. It appears, however, that the gas contracts also contain an escape clause that permits the purchasers to pay the prevailing market rate for gas should it drop below the minimum price for an extended period. In any event, press and embassy reports agree that the companies buying the gas do not seem to be worried by the drop in oil prices.

Two recent studies tend to support the West European view of the security aspects of their gas contracts. A detailed report by the US Embassy in Bonn concludes that West Germany—usually considered to be the

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West European Gas Options in the 1990s

The key energy question now facing the West Europeans is how they will cover their gas needs in the 1990s and beyond. Although gas consumption has declined for three consecutive years, most energy forecasters believe that this trend will be reversed when economic recovery begins and that consumption will increase by one-third or more by the end of the century. Domestic gas production meanwhile will fall substantially. In particular, production in the Netherlands will drop sharply, due to both declining fields and government policy: The Hague wants to preserve more gas for domestic use and thus does not plan to renew many gas export contracts that expire in the 1990s. French gas production also will fall as its major fields near exhaustion. All told, the West Europeans appear to be facing a gas deficit toward the end of the century that could equal the throughput of one—and possibly even two—Soviet export pipelines. [redacted]

Norway offers Western Europe's only hope of meeting its additional gas needs from domestic sources. Norwegian offshore reserves are large enough, but the gas would be expensive because of the difficult operating conditions. A second problem is the go-slow approach of the Norwegian Government, which does not want the economy to become overly dependent on energy production. The Netherlands could produce more gas in the 1990s than it now plans; if budget deficits remain large, The Hague might be pushed in this direction. Another possible option is a Dutch-Norwegian gas swap, whereby the Netherlands would step up gas output through the mid-1990s and receive Norwegian gas in later years in exchange. We doubt, however, that the economics of such a swap would be attractive to The Hague. Among non-European gas sources, only Algeria seems clearly able to supply large additional amounts of gas at reasonable cost in the 1990s. Buying Algerian gas would not, however, contribute to the West Europeans' goal of reducing their energy dependence on OPEC. Algeria, moreover, has so far established a rather poor reputation for reliability as an energy supplier. [redacted]

most vulnerable country—could cope quite well with an indefinite cutoff of Soviet deliveries even after the new pipeline is completed. The West Germans would accomplish this partly by stock drawdowns and fuel switching, but mainly by exercising their contractual right to step up gas purchases from the Netherlands. In fact, according to the report, with just a few hours' notice Bonn could boost its Dutch imports by more than enough to offset a complete Soviet cutoff—although we do not know how long the higher delivery rate could be maintained. The embassy report also states that the West German pipeline system is capable of redistributing the gas to southern Germany where most of the Soviet gas is consumed. A draft

[redacted] concludes that through the mid-1990s West Germany, France, and Italy could all cope with a Soviet gas cutoff. The report points to the relatively large gas storage capacity that should be in place by the 1990s, the large number of industrial gas users with interruptible contracts, and the surge production capacity in the Netherlands. [redacted]

Outlook

Economic ties between Western Europe and the Soviet Bloc are not likely to increase substantially during the remainder of this decade. The surge in trade that occurred in the mid-1970s was financed mainly by increased lending from Western banks and higher Soviet oil earnings following the 1973 OPEC price increase; there is little chance that either of these events will be repeated. The banks clearly do not want to increase their exposure to Eastern Europe, and Soviet oil exports are almost certain to fall over the next few years—perhaps more than offsetting increased earnings from gas exports via the new Siberian pipeline. Bloc exports of raw materials and manufactured goods will be restrained by the sluggishness of economic growth in Western Europe and by continuing high unemployment rates in industries such as clothing and textiles. With its access to hard currency thus restricted, the Soviet Bloc is not likely to increase its share of NATO Europe's exports much above the 3.2 percent figure recorded in 1982. [redacted]

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While the West Europeans are anxious to avoid a repeat of the pipeline dispute, they almost certainly will be adamant on several prerequisites to any agreement on future economic policy toward the USSR: (1) the burden must appear to be shared evenly among the Western countries; (2) the measures must not be applied retroactively, and, (3) the measures must be aimed at Soviet military power, not at the civilian economy. Possible areas of compromise might include:

- *The second strand of the pipeline.* Construction of a second Soviet pipeline would be one way to meet Western Europe's projected gas shortfall in the 1990s, although there are no negotiations in immediate prospect. The West Europeans would be concerned about substantially increasing their dependence on Soviet gas. The gas needs, moreover, perhaps could be satisfied by some combination of other measures: conservation, substitution of other fuels, or expanded gas production in Norway and the Netherlands. Given these possibilities, the West Europeans might be willing to renounce the Soviet option.
- *Tighter COCOM restrictions.* We believe that sensitivity to COCOM issues in Western Europe has increased over the last year or so, in part because of evidence presented by the United States showing that technology transfers have contributed significantly to Soviet military improvements. Nevertheless, the West Europeans will continue to take a much narrower view of the subject than does the United States and likely will agree to only limited changes in COCOM procedures.
- *Tighter credit terms.* There is considerable support—particularly from West Germany—for ending subsidized interest rates on Soviet credits. Paris still strongly opposes the elimination of subsidies, although there is at least some technical-level support for the idea within the French Government. The West Europeans are likely to argue, however, that formal agreement is no longer necessary because US objectives in this area have already been substantially achieved. They will point out that private credit to the Soviet Bloc has been sharply curtailed and that future official subsidies will be much reduced by last July's agreement within the OECD consensus to raise the minimum rate on Soviet credits to 12.4 percent. The subsidy issue has also been defused to some extent by the decline in market interest rates over the past year; it would revive if interest rates turn up again. On two issues the West Europeans are not likely to yield any ground: (1) that export credit guarantees are a legitimate export promotion device, and (2) that the intent of the OECD consensus can be satisfied by charging low nominal interest rates on export credits and inflating the price of the goods to compensate.

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Appendix

Policies and Positions of Major Countries

West Germany

Basic Setting

West Germany's postwar prosperity has been substantially based on foreign trade—probably to a greater extent than for any of the other major Western countries except Japan. In this context it is not surprising that, across the political spectrum, most West Germans favor relatively unrestricted foreign trade, including trade with the East. While East-West trade is valued mainly for its economic benefits, there also has been a feeling—particularly during the mid-1970s—that it could contribute to improved political relations. [redacted]

Underlying Bonn's whole approach to East-West affairs is the long-term goal of national reconciliation. The 1949 West German Constitution enjoins the government to pursue this goal, and the aspiration is overwhelmingly popular. Bonn's decision in 1955 to rearm in support of Western Europe's defense was made in part because the United States, the United Kingdom, and France agreed in principle to support this German national objective. [redacted]

West Germany's trade ties with the Soviet Bloc predate Ostpolitik because of both geographic proximity and historic trading patterns. Prior to the war, the East European countries and Germany were each other's most important trading partners. Thus, for a number of West German firms, trade with the East involved only reestablishing old relations disrupted by the war or temporarily severed by the new Communist regimes. Perhaps even more important, West German firms were already known within the Bloc and the high quality of West German products was well established. [redacted]

[redacted]

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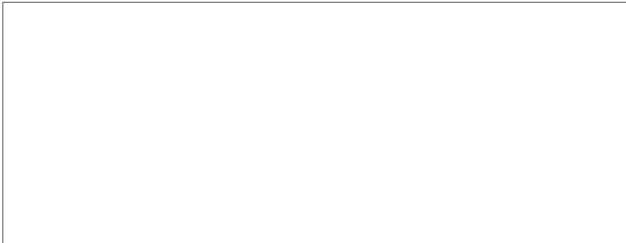
Bonn does not, however, regard East-West trade as a purely economic phenomenon. For example, last summer the Interior Ministry publicly cautioned West German firms to be more circumspect in their dealings with Bloc countries, pointing out the techniques Communist negotiators use to obtain technical know-how free of cost. [redacted]

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interest-free loan—by means of the “swing credit”—although its importance has declined somewhat over the last few years. In 1981 the amount of swing credit utilized by the East Germans averaged about \$240 million.

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this accounted for only 16 percent of their total debt to West Germany, the balance being financed at commercial rates. As for personal contacts, retired East German citizens are allowed to spend up to 30 days annually in Western countries, and many take advantage of this to visit friends and relatives in West Germany. Largely as a result of this traffic, East Germany sent 3.3 million visitors to the West in 1981—more than the other East European countries combined. West Germans are relatively free to visit East Germany, and they accounted for almost 90 percent of the 5.1 million Western visitors to East Germany in 1981.

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The Special Case of East Germany

The Potsdam Agreement of 1945 officially set the stage for trade ties between West and East Germany by calling for Germany to be treated as an economic unit. The Interzonal Trade Agreement of 1951 established rules to govern the flow of goods between the two parts of Germany and, in later years, Bonn implemented a number of other policies aimed at facilitating interzonal trade, including tax relief measures, trade credits, and simplification of administrative procedures. As a result, West Germany has become East Germany’s second-largest trading partner, following the Soviet Union. In 1982, sales to East Germany amounted to \$2.5 billion and accounted for 1.4 percent of total West German exports. From an official standpoint, moreover, trade with East Germany still is not considered foreign trade, and this special status is recognized by the European Community in the Treaty of Rome.

Because of the unique relationship, trade with East Germany is more broadly based than with other Bloc countries. As is the case for other Eastern countries, exports are concentrated in machinery, chemicals, and iron and steel, but consumer goods and fuels each accounted for about 14 percent of goods sold to East Germany in 1982. On the import side, oil—mostly East German refined products going to West Berlin—and consumer goods each account for about one-fourth of goods purchased.

There are also significant personal and financial interactions between the two Germans,

many of which benefit East Germany. For example, the East Germans appear to receive unusually high fees for the services they provide for West Berlin and—to Bonn’s great irritation—they require West German visitors to convert at least 25 deutsche marks daily into East German currency. West Germany also in effect provides East Germany with an

Trade Patterns

For many years West Germany has been the main Western trading partner for both the USSR and Eastern Europe. From the West German side, however, the Bloc has never been a key trading partner although it did gain in importance during the 1970s and now accounts for over 5 percent of exports and over 6 percent of imports. Rising energy prices boosted imports from the USSR particularly rapidly, pushing their share of total West German imports from 1.1 percent in the early 1970s to 3.0 percent during 1982. The recent fall in oil prices probably will cause that share to shrink this year.

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Exports to the Soviet Union consist overwhelmingly of manufactured goods, although foodstuffs have gained in importance recently and now account for 9 percent of the total. The manufactured goods category in turn is dominated by steel and machinery. In 1982 steel sales to the USSR exceeded \$1 billion and accounted for 11 percent of total West German steel exports. Machinery sales to the USSR topped \$1.3 billion; in the subcategory of metalworking machinery the USSR took \$300 million or 9 percent of the total foreign sales.

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Table 3
West Germany: Trade With the Soviet Bloc
and the United States, 1982^a

	World (million US \$)	USSR		Eastern Europe		United States	
		Million US \$	Percent	Million US \$	Percent	Million US \$	Percent
Exports	178,979	3,936	2.2	6,110	3.4	11,347	6.3
Foodstuffs	10,168	335	3.3	638	6.3	326	3.2
Raw materials	4,413	71	1.6	156	3.5	103	2.3
Fuels	6,971	21	0.3	420	6.0	14	0.2
Manufactures	152,903	3,390	2.2	4,772	3.1	10,848	7.1
Chemicals	21,709	387	1.8	1,240	5.7	1,080	5.0
Semifinished	32,201	1,358	4.2	1,350	4.2	1,833	5.7
Steel	9,761	1,056	10.8	434	4.4	1,003	10.3
Machinery	48,869	1,338	2.7	1,711	3.5	3,484	7.1
Metalworking	3,302	298	9.0	315	9.5	283	8.6
Transport equipment	35,039	242	0.7	142	0.4	3,865	11.0
Consumer goods	15,087	65	0.4	330	2.2	585	3.9
Other	4,523	119	2.6	126	2.8	57	1.3
Imports	158,093	4,669	3.0	5,926	3.7	10,602	6.7
Foodstuffs	19,865	32	0.2	757	3.8	2,261	11.4
Raw materials	12,353	357	2.9	482	3.9	938	7.6
Fuels	37,277	3,739	10.0	1,315	3.5	413	1.1
Coal	943	4	0.4	295	31.3	181	19.2
Crude oil	18,443	793	4.3	0	0	0	0
Oil products	10,727	1,428	13.3	1,004	9.4	231	2.2
Natural gas, electricity	7,163	1,514	21.1	16	0.2	0	0
Manufactures	83,281	278	0.3	3,305	4.0	6,938	8.3
Chemicals	12,352	168	1.4	566	4.6	1,191	9.6
Semifinished	21,460	66	0.3	992	4.6	706	3.3
Machinery	19,494	15	0.1	371	1.9	3,863	19.8
Transport equipment	12,132	14	0.1	36	0.3	550	4.5
Consumer goods	17,844	15	0.1	1,340	7.5	628	3.5
Other	5,317	264	5.0	65	1.2	53	1.0

^a Trade with East Germany is included in the Eastern Europe and World totals even though Bonn does not officially treat this as foreign trade. Because of rounding, components may not add to totals shown.

[Redacted]

Four-fifths of West German imports from the USSR consist of fuels, and these cover approximately 6 percent of the country's primary energy requirement. Last year West Germany obtained one-fifth of its natural gas imports and 7 percent of its oil imports (crude plus products) from the Soviets at a total cost of \$3.7 billion. Other significant imports were raw materials, gold, and chemicals. [Redacted]

In trade with Eastern Europe (excluding East Germany) manufactures dominate in both the export and import categories. Machinery accounted for more than one-third of total sales in 1982, while chemicals and semifinished goods (mostly textiles and metals)

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were each over one-fifth. On the import side, foodstuffs, raw materials, and fuels each constituted 13 to 16 percent of the total versus 56 percent for manufactures. Consumer goods (especially clothing) and semi-finished goods (especially steel) were the key manufactured items. During this period West Germany was a net importer of steel from Eastern Europe. [redacted]

Trade Promotion

The overall framework for West German economic relations with the Soviet Bloc has been set down in a succession of broad economic cooperation agreements. These accords, however, are little more than declarations of intent; actual projects or deals are negotiated on a case-by-case basis. The first West German-Soviet trade accord was signed in 1958 and called on West Germany to sell, among other things, steel products and various machinery and equipment in return for raw materials, chemicals, nonferrous metals, and oil—the same goods that compose the bulk of trade today. The accord also extended most-favored-nation status in mutual trade. [redacted]

The 1972 long-term Agreement on Trade and Economic Cooperation was the first West German-Soviet trade accord to go beyond simple trade relations into the broader area of economic, industrial, and technical cooperation. It called for establishment of industrial complexes, modernization of individual industrial enterprises, and exchange of patents, licenses, and technical documentation. This agreement also first formalized the system of mixed commissions to investigate specific trade deals. [redacted]

The most recent cooperation accord was signed in 1978 for a 10-year period and may be renewed for three additional five-year periods. Like previous arrangements, it calls for economic, industrial, and technical cooperation between the two countries in a wide range of areas, including raw materials and energy development, construction of industrial plants, joint development and production of goods, and cooperation with firms in third countries. During Chancellor Schmidt's visit to Moscow in the summer of 1980, West Germany and the USSR signed another long-term cooperation agreement intended to "add substance" to the 1978 accord. The agreement, however, did little more than reaffirm the areas of cooperation specified in the earlier accord. [redacted]

Possibilities for intensifying trade and cooperative ventures are examined in the mixed commissions, headed by government officials, and their sector-oriented working groups, usually headed by industry representatives. The working groups act as trade associations and thereby open the door to prospective buyers and sellers. West German businessmen and Soviet officials negotiate specific projects and trade deals; the West German Government does not negotiate for its firms. [redacted]

Credits for financing West German exports to the Soviet Bloc generally carry no special provisions or government subsidies. Financing is arranged through commercial banks and, in effect, at market rates. When the Soviets demand interest rates below market levels, the exporting firm usually makes up the difference between the negotiated rate and the market rate by raising the selling price. The Soviets are well aware of this practice. The West Germans, of course, benefit from the fact that their market interest rates usually are low relative to most other Western countries. [redacted]

Bonn's principal trade promotion device is export credit guarantees. The guarantees are provided by the private Hermes company, operating as Bonn's agent; the government thus sets policy and bears the ultimate risk. It is up to the individual West German exporter or bank to request Hermes coverage, depending on the perception of risk; exports to Western industrial countries are almost never insured. The fee structure is based only on the amount of the export credit, its maturity, and whether the importer is a public or a private entity—not on the country involved. Taking a five-year credit as an example, the fee is slightly over 2 percent in the case of a state purchaser, almost double that for a private entity. The maximum maturity allowed is ten years for LDCs and eight and a half years for Communist countries. Repayments must be made in equal semiannual installments with no grace period. The system appears to operate in a nondiscriminatory fashion, although guarantees for exports to the Soviet Bloc always benefit from the lower fee because the importer is, by definition, a state entity. [redacted]

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In recent years, 8 to 13 percent of total exports have been covered by Hermes guarantees, although the figures are much higher for sales to LDCs and Communist countries. Outstanding guarantees currently total about \$60 billion. As of early 1982 about half of the guarantees went to OPEC countries and one-sixth to the Soviet Bloc. Saudi Arabia was the largest single recipient, followed by the USSR—with about 10 percent of the total. Guarantees for the USSR rose sharply in 1981 and apparently took another upward jump in early 1982. The increases most likely were due to the finalizing of previously negotiated contracts, including some deals related to the gas pipeline. Some West German firms may have hastened their applications for credit insurance in the wake of the Polish crisis fearing that restrictions might be imposed. Shortly thereafter a Bonn spokesman stated that the Soviet share of guarantees would not increase any further. It is likely, however, that East Europe's share of Hermes coverage has continued to rise during the past year due to the increasing reluctance of West German banks to make unguaranteed loans to the area. [redacted]

For the most part the Hermes system operates according to economic criteria. If the risk seems large that a particular country may not repay the loans, Bonn may set ceilings for the guarantees, require larger down-payments, or reduce the percentage of the loan that is guaranteed. Political considerations can play an important role, however. The guarantees provided for Poland in 1981 were based solely on political grounds, as are the special restrictions which currently apply for guarantees for South Africa and Chile. [redacted]

The West Germans are strongly opposed to altering the Hermes system, believing that it enhances the free market rather than interferes with it. They argue that ideally private enterprise should provide such guarantees but cannot because West Germany's foreign trade is so large relative to the size of its banking system. (All West German banks have an aggregate reserve for losses on the order of \$9 billion, equal to about one-sixth of the Hermes guarantees outstanding.) Bonn officials point out that Hermes normally makes a profit and that self-financing guarantee systems are not considered export subsidies, according to GATT definitions. Although Hermes lost about \$300 million in 1981, it edged back into the black last

year and has a cumulative profit for 1949-82 of about \$500 million. The West Germans also note that countries such as France and the United Kingdom provide guarantees—plus direct interest rate subsidies—for a much larger proportion of their exports.

[redacted]

France

Basic Setting

France's pursuit of a "special relationship" with both the Soviet Union and Eastern Europe began in the 1960s under Charles de Gaulle. Over time, this policy became an integral part of the French position in the world, maintained to serve three underlying purposes:

- To foster commercial advantages for French business. Simply put, Soviet and East European buyers of Western goods and services were expected to prefer dealing with firms from the Western country that had the best political relations with Moscow.
- To establish France as the conduit for more communications between West and East. There also was at least the hope that closer Eastern political and economic relations with the West would contribute to internal pressures to liberalize the Communist systems.
- Finally, to highlight France's position in the geometry of world power. French policymakers saw the special relationship with the East as a means of demonstrating France's independence without compromising its membership in the Atlantic Alliance.

[redacted]

Before the Soviet invasion of Afghanistan, few if any French policymakers would have been likely to judge the Franco-Soviet special relationship a failure. Instead, statements of government officials and editorialists alike indicated the judgment that the relationship had increased French stature in the world and even indirectly had stimulated East European reform pressures. Nevertheless, French expectations and ambitions for the relationship have never been achieved

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in practice. This is most obvious in economic terms, given the stagnant Soviet share of French exports. French firms have only rarely benefited from any special preference in dealing with the Soviets, according to the French press and the US Embassy, and the meager follow-on benefits have disillusioned many in the business community. [redacted]

Since Afghanistan, Paris has taken a harder line toward the USSR and references to the special relationship have all but disappeared. The Soviet military posture in Europe and the situation in Poland have increasingly suggested the special relationship's obsolescence and forcibly demonstrated that basic French interests lie with the West. Results from the Giscard-Brezhnev meeting in Warsaw in May 1980 were particularly meager. Giscard apparently hoped to elicit some Soviet movement on Afghanistan, thus lowering East-West tension and confirming an important mediating role for France in salvaging detente. The special relationship, however, proved unequal to the task and emerged badly shaken. [redacted]

The 1981 election of a Socialist government in France marked the end of French pretensions about the special relationship, although overall policy toward the USSR probably has changed little. The French Communist Party (PCF), of course, has long been one of Moscow's staunchest supporters in Western Europe, and it favors much closer economic ties. President Mitterrand, however, is profoundly opposed to the Soviet system and to Soviet actions in Poland and Afghanistan, and he has effectively denied the PCF a significant role in setting foreign policy. [redacted]

A member of Foreign Minister Cheysson's cabinet told an Embassy officer last September that the French and West European view of the USSR is basically pragmatic, while the US view is ideological. Pointing out that Western Europe shares a continent and a long history of relations with the USSR, the official argued that in the absence of trade the USSR would see Western Europe exclusively in military terms. He said that Paris regards the Soviet economy as basically strong and expressed doubts that US sanctions would alter Soviet foreign policy. Even without the revenues from the gas pipeline, he argued, Soviet military capabilities would not be diminished

because the military always gets all it wants. Proceeding from this assessment of the reality of dealing with Moscow, the Mitterrand government strongly believes that the West must achieve military equality with the Soviets. [redacted]

This more pragmatic and hard-nosed posture seems to have shown itself in recent months in the negotiations for the Astrakhan gas project. This huge gas deposit, located near the Caspian Sea, has a high sulfur content and cannot be exploited by the Soviets without corrosion-resistant Western pipe and equipment. Although anxious for a piece of the business, the French—in marked contrast with earlier positions—resisted Soviet demands for low-interest-rate credits. They insisted that the USSR pay the higher OECD consensus rate either directly, or indirectly via an inflated price for the equipment, and they eventually obtained a substantial contract in spite of their firm position. The French attributed this success, in part, to a political decision by Moscow and it is likely that Paris's hammering away on the widening bilateral trade deficit did convince Moscow that a concession was necessary. [redacted]

Despite his anti-Soviet feelings, Mitterrand is as wary of perceived US slights to French sovereignty as de Gaulle ever was. This showed up most clearly in the pipeline dispute in which France took by far the strongest stance against the US sanctions. French officials publicly labeled the sanctions as illegal and an infringement of European sovereignty and described them as an attempt to wage economic war against the USSR. In the end, when the first post-sanctions shipping date arrived, Paris took the lead in ordering one of its companies to violate the sanctions by shipping the embargoed equipment. [redacted]

The French participated in the post-La Sapiniere talks that led to the revocation of the US sanctions, but they insist that they are under no obligation to accept any conclusions flowing from the follow-on studies in the OECD, NATO, and COCOM. This position is due in part to their lingering unhappiness over the sanctions controversy itself, but it also stems from their longstanding insistence on exercising fully their national sovereignty in policy matters. Paris may

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Table 4
France: Trade With the Soviet Bloc and
the United States, 1982 ^a

	World (million US \$)	USSR		Eastern Europe		United States	
		Million US \$	Percent	Million US \$	Percent	Million US \$	Percent
Exports	92,705	1,558	1.7	1,271	1.4	5,215	5.6
Foodstuffs	15,421	515	3.3	296	1.9	607	3.9
Raw materials	3,858	9	0.2	61	1.6	93	2.4
Fuels	3,712	20	0.5	8	0.2	33	0.9
Manufactures	69,245	1,014	1.5	905	1.3	4,477	6.5
Chemicals	11,880	250	2.1	250	2.1	652	5.5
Semifinished	17,412	299	1.7	270	1.6	1,053	6.0
Steel	5,636	218	3.9	70	1.2	514	9.1
Machinery	17,770	416	2.3	258	1.5	1,137	6.4
Metalworking	369	28	7.6	13	3.5	19	5.1
Transport equipment	14,059	13	0.1	82	0.6	1,196	8.5
Consumer goods	8,124	35	0.4	45	0.6	440	5.4
Other	469	0	0	0	0	6	1.3
Imports	115,702	2,883	2.5	1,446	1.3	9,109	7.9
Foodstuffs	12,330	24	0.2	173	1.4	989	8.0
Raw materials	7,627	317	4.2	151	2.0	467	6.1
Fuels	30,874	2,338	7.6	332	1.1	828	2.7
Coal	1,672	7	0.4	102	6.1	579	34.6
Crude oil	19,893	877	4.4	0	0	0	0
Oil products	5,228	823	15.7	230	4.4	228	4.4
Natural gas, electricity	4,081	632	15.5	0	0	21	0.5
Manufactures	64,347	202	0.3	790	1.2	6,803	10.6
Chemicals	9,849	122	1.2	108	1.1	904	9.2
Semifinished	15,599	17	0.1	226	1.4	525	3.4
Machinery	18,226	11	0.1	121	0.7	4,191	23.0
Transport equipment	8,616	45	0.5	39	0.5	520	6.0
Consumer goods	12,057	6	NEGL	298	2.5	662	5.5
Other	524	2	0.4	1	0.2	22	4.2

^a Because of rounding, components may not add to totals shown.

[Redacted]

be willing to accept tighter strategic trade controls, but only if a convincing case for them can be made. Agreement is likely to be limited to narrowly defined items of military significance, and the French will attempt to rally their West European partners to resist perceived US efforts to expand controls on strategic exports into a more broadly discriminatory system. [Redacted]

Trade Patterns

Over the last two decades the Soviet Bloc generally has taken about 4 percent of French exports. A surge in sales in 1975 pushed the figure to its peak of 4.9 percent, but exports have slumped badly during the last two years reflecting hard currency shortages in the Bloc. Exports in 1982 totaled \$2.8 billion, down

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more than a third from the 1980 high. Their share of total French exports was only 3.1 percent—the lowest share since 1965. Exports to the USSR alone have held up slightly better, accounting for 1.7 percent of total exports versus a peak of 2.3 percent in 1977. [redacted]

For the last three years the Bloc has accounted for about 4 percent of total imports, up from 3 percent during most of the 1970s. The increase since 1979 mainly reflects larger deliveries of natural gas from the USSR. France actually had been contracting for Soviet gas for several years, but there was no pipeline to deliver it until early 1980. As a result, Paris arranged a gas swap with Italy, which did have a pipeline link to the USSR: until 1980 Italy took France's Soviet gas, and France took deliveries of Dutch gas contracted by Italy. [redacted]

Exports to the USSR and Eastern Europe are dominated by manufactures—especially semifinished goods and machinery—but foodstuffs account for more than one-fourth of the total. Imports from Eastern Europe are varied, ranging from raw materials to finished consumer goods; more than half are manufactured products. By contrast, imports from the USSR during 1982 consisted almost wholly of fuels (81 percent) and raw materials (11 percent). During this period the USSR provided almost 7 percent of French oil imports and one-sixth of gas imports and accounted for about 6 percent of France's total energy supplies. [redacted]

Trade Promotion

Economic relations between France and the Soviet Bloc are governed by long-term cooperation accords that set general guidelines for trade patterns from which specific scientific, technical, and economic agreements may be worked out. In addition, France and Bloc nations meet periodically at "Grande" and "Petite Commissions." The higher level Grande Commission traditionally reviews the broad range of cooperation in economic, commercial, technical, and scientific affairs. The Petite Commission handles these issues at the working level in specialized industrial groups made up of business and government representatives. [redacted]

The current 10-year economic accord with the Soviet Union—signed during Giscard's trip to Moscow in

April 1979—lays out a program of economic, industrial, and technical exchanges until 1990; it includes compensation deals, trade in and access to French technology, and favorable financial terms. A number of shorter term economic cooperation pacts also were signed: a proposed tripling of commercial trade between France and the Soviet Union by 1985 to match the increase in 1976-80; an improvement in direct communications between the Kremlin and the Elysee Palace; and greater cooperation in scientific, technological, and oceanographic research. Moscow and Paris also resolved to coordinate bilateral and multilateral efforts in the fields of energy, environment, and foreign aid. [redacted]

France traditionally has been a leader in providing package lending and in extending government-backed credits and guarantees at below-market rates. Although not alone in occasionally breaking and often bending the "gentleman's agreement" on export credits, Paris has been one of the most reluctant to tighten the terms of the agreement. French trade officials have expressed the fear that in the absence of attractive financing terms, they would be unable to compete with what they regard as better organized banks or trading houses in the United States, West Germany, or Japan. [redacted]

The French export credit system, which was established in the 1950s, became especially important as a tool of French trade policy following the 1974-75 balance-of-payments crisis. The substantial use of official interest rate subsidies helped to boost exports from a wide range of sectors—especially machine tools and construction projects—at a time of slowing world demand. During 1975-80 the share of French exports financed through the government's export credit program rose from 7 percent to 10 percent. About one-third of total credits go to the Soviet Union and Eastern Europe, covering about the same share of total French sales to the East. In 1980 the US Embassy in Paris estimated the direct budgetary cost of the worldwide export credit program—including interest rate subsidies, insurance payments, and treasury loans—at nearly \$2 billion annually to support about \$10 billion in gross export credit disbursements. [redacted]

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France's export credit system offers a comprehensive range of financing and insurance. The official export bank, Banque Francaise du Commerce Exterieur (BFCE), refinances export-related credits extended by French banks or French branches of foreign banks and lends official export credits. BFCE obtains funds by refinancing with the Bank of France, borrowing from the French Treasury and private banks, and selling its securities on capital markets. Insurance coverage for export credits is provided by the semiofficial export and credit insurance agency Compagnie Francaise d'Assurance pour le Commerce Exterieur (COFACE). French exporters may obtain insurance against political and commercial losses covering 80 to 90 percent of credits extended; French banks are guaranteed against losses up to 95 percent of the value of their direct loans to foreign buyers. In addition, all export credits of at least 18 months are subsidized by the French Government for the full term of the loan. Other important forms of support include protection against losses due to foreign exchange fluctuations and inflationary pressures, as well as the blending of public "concessional" funds with private export credits. [redacted]

The most recent Franco-Soviet five-year export credit agreement was concluded in February 1980. Interest rates on export credits were fixed through September 1981 at a maximum 7.75 percent for all projects between five and eight years. Similar terms were extended to East European countries. The Soviets pressed hard and succeeded in signing contracts for equipment for the gas export pipeline before the low interest rate expired. [redacted]

French-Soviet trade is also promoted by firms set up in France with the participation of Soviet foreign trade organizations. These formal organizations, which are subordinate to the Soviet Ministry of Foreign Trade, are responsible for a wide range of commercial activities including shipping, fishing, insurance, banking, manufactured products, and raw materials. Important French-Soviet joint ventures in France include the marketing firms GISOFRA (heavy machinery and technology), ACTIF-AVTO (tractors and other farm equipment), FRANSOV (fishing), PROMOLEASE (leasing heavy equipment), RUSBOIS (timber), and SOGO (chemicals, raw materials, medicine). French-Soviet joint ventures are

also located in Moscow, representing such sectors as automobiles, electronics, heavy machinery, medical products, and metals. In addition, the wholly Soviet owned Banque Commerciale pour l'Europe du Nord (BCEN, or Eurobank) located in Paris is active in organizing and taking part in consortium loans, in placing bond issues, and in financing East-West trade. Six French banks, including the three largest, have offices in Moscow to facilitate trade. [redacted]

Italy

Basic Setting

Close economic ties between Rome and the Soviet Bloc predate the heyday of detente in the 1970s. In fact, at the height of the cold war, large Italian firms such as Fiat and ENI (the state energy agency) were in the forefront of expanding East-West trade, particularly with Eastern Europe. Rome often opposed EC, NATO, and US attempts to restrict economic relations. With the advent of detente, Italy hoped to exploit the relaxation in tensions to broaden its economic links with the Bloc, to parlay them into improved political relations, and to provide a further underpinning for the international rapprochement already under way. Rome viewed the economic and political interdependence between East and West fostered by detente as an important constraint on Soviet "adventurism" and a buttress to international security. The flowering of detente pushed Rome toward even closer relations with Moscow, as did domestic rapprochement between the governing parties and the Italian Communists during the 1970s. [redacted]

The major Italian political parties have rather different views on East-West trade. The two largest parties generally have favored it—the Christian Democrats to please a large business constituency and the Communists for ideological reasons. The Socialists and Social Democrats, on the other hand, take a strong anti-Soviet stand and have been particularly outspoken in their opposition to the Siberian gas pipeline. The Italian Communist Party (PCI), however, no longer plays as direct a role in facilitating trade with the East as it once did. Until 1976, the Soviet Union

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and other Bloc countries gave preferential trade treatment to four PCI-owned East-West trading firms; the commissions went to PCI coffers. To comply with a 1975 law on political party financing, however, the PCI sold its trading companies to the National League of Cooperatives. [redacted]

Italian-Soviet relations cooled substantially after the invasion of Afghanistan. Rome immediately postponed the January 1980 meeting of the Italo-Soviet Mixed Economic Commission and decided to limit Italian participation in the Moscow Olympics. The government even decided in favor of limited economic sanctions against the USSR, despite pressure from Italian business. Although Rome does not consider such boycotts effective, it apparently was willing to go along in this instance to impress Washington with its reliability as an ally [redacted]

Rome has continued to take an uncharacteristically forceful stance in later encounters with the Soviets. During a visit to Moscow in October 1980—ostensibly to normalize bilateral political and economic relations—Foreign Minister Colombo declared that the Soviets were responsible for the major obstacles to a revival of detente. He called for:

- The withdrawal of Soviet troops from Afghanistan.
- An end to the Soviet threat to Poland.
- The deployment of INF missiles in Western Europe unless Moscow agrees to a sharp reduction of its own missiles.

Soviet-Italian relations deteriorated further in early 1981 when Italian President Pertini implied publicly that Moscow might be behind Italian terrorism. This statement prompted bitter Soviet press criticism of Italy's increasing pro-American stance. [redacted]

Immediately after the declaration of martial law in Poland, Rome announced a "pause for reflection" on the purchase of Siberian gas, even though the contract was just about ready for signing. Italian officials were also relatively receptive to US overtures concerning limiting official subsidies and guarantees on export credits for the USSR. Foreign Minister Colombo, however, stated in early 1982 that, if the Europeans were to be prevented from selling pipeline equipment to the Soviets, then Washington should also embargo

grain sales. The Siberian gas contract remains unsigned in early 1983, although it is now probably being held up mainly by squabbling among the political parties. [redacted]

Trade Patterns

Over the last two decades Italy has oriented its trade somewhat more to the Soviet Bloc than have most other West European countries. Through the 1960s the USSR generally took about 2 percent of Italy's exports and Eastern Europe about 3 percent. The Bloc's export share peaked in 1975 at 6.2 percent, including 2.9 percent for the USSR. Since then the Bloc share has fallen dramatically, averaging only 3.3 percent in 1982. The USSR—down to 2.1 percent—and Poland accounted for most of the drop, but the export shares of all the East European countries were below their 1975 levels. The value of exports to the Bloc was \$2.4 billion for the year, only slightly ahead of the 1975 pace. [redacted]

Although the USSR was only Italy's 12th-largest export market in 1982, sales to the USSR remain quite important to some larger, often state-owned, Italian firms. Among the companies with strong trade ties to the East are Fiat, Italy's largest private employer; Montedison, the troubled chemical giant; Finsider, a state-owned steel producer; and ENI. Pirelli, the tire manufacturer, and Olivetti, a producer of office machines, also have fairly extensive dealings with the East. Energy-related equipment is another important area for Italian-Soviet trade. Nuovo Pignone, an ENI subsidiary, is providing 57 turbines for the Siberian pipeline—almost half of the total needed. [redacted]

Over the last 20 years, imports from the Bloc have usually accounted for 5 to 6 percent of total imports, with a peak of 7 percent in 1967. Imports picked up considerably last year, totaling \$5.3 billion and pushing the Bloc's share to 6.2 percent—the highest level since 1968. The increase was due largely to higher energy purchases from the USSR, which attained a record 4.2-percent share of total Italian imports. [redacted]

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Table 5
Italy: Trade With the Soviet Bloc and
the United States, 1981 ^a

	World (million US \$)	USSR		Eastern Europe		United States	
		Million US \$	Percent	Million US \$	Percent	Million US \$	Percent
Exports	75,246	1,284	1.7	1,185	1.6	5,109	6.8
Foodstuffs	5,597	111	2.0	99	1.8	371	6.6
Raw Materials	1,664	7	0.4	45	2.7	65	3.9
Fuels	4,725	15	0.3	63	1.3	169	3.6
Manufactures	63,181	1,151	1.8	978	1.5	4,488	7.1
Chemicals	5,338	101	1.9	204	3.8	240	4.5
Semifinished	17,725	625	3.5	332	1.9	1,251	7.1
Steel	4,100	441	10.8	78	1.9	548	13.4
Machinery	16,473	365	2.2	328	2.0	975	5.9
Metalworking	975	49	5.0	58	6.0	53	5.4
Transport equipment	7,030	41	0.6	43	0.6	566	8.1
Consumer goods	16,615	19	0.1	72	0.4	1,455	8.8
Other	80	0	0	NEGL	0.1	17	21.7
Imports	88,996	3,085	3.5	1,612	1.8	6,136	6.9
Foodstuffs	10,952	14	0.1	296	2.7	1,250	11.4
Raw materials	9,394	267	2.8	152	1.6	584	6.2
Fuels	30,741	2,631	8.6	397	1.3	842	2.7
Coal	1,440	17	1.2	74	5.1	651	45.2
Crude oil	22,202	1,283	5.8	0	0	0	0
Oil products	4,525	286	6.3	312	6.9	191	4.2
Natural gas, electricity	2,574	1,044	40.6	11	0.4	0	0
Manufactures	37,708	173	0.5	759	2.0	3,451	9.2
Chemicals	7,224	105	1.5	176	2.4	574	7.9
Semifinished	8,468	33	0.4	226	2.7	433	5.1
Machinery	10,272	23	0.2	146	1.4	1,613	15.7
Transport equipment	7,392	9	0.1	105	1.4	562	7.6
Consumer goods	4,352	3	0.1	106	2.4	269	6.2
Other	203	NEGL	0.2	8	4.0	10	4.8

^a Because of rounding, components may not add to totals shown.

Some Italian imports from the East stem from buy-back provisions in past contracts. Montedison pioneered this type of agreement with the Soviets in 1973 when it provided them with seven chemical plants and accepted subsequent Soviet shipments of finished chemical products as payment. The firm signed a similar accord with the USSR in 1980. Although

Italian multinationals can usually absorb such products with little difficulty, smaller Italian firms often find Soviet emphasis on compensation agreements difficult to accommodate.

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Exports to the Bloc consist overwhelmingly of manufactures, particularly semifinished goods and machinery. In 1981 the USSR accounted for about 2 percent of Italian machinery exports and 11 percent of steel exports. While Italian imports from Eastern Europe are widely diversified, fuel accounts for 85 percent of imports from the USSR. As of 1980 the Soviets provided for about 8 percent of Italy's oil supplies (crude plus products) and one-fifth of its natural gas. All told, about 9 percent of Italy's primary energy supply came from the USSR, the highest level of dependence among the major West European countries.

Trade Promotion

Rome's willingness to provide generous state guarantees and subsidized trade credits has been a principal characteristic of Italian-Soviet trade since the early 1960s. Indeed, Italy was one of the first Western countries to offer such credits, and Rome granted Moscow a total of approximately \$3 billion during 1973-79. The Soviets have not been hesitant about pressing the Italians for loans. Faced with a severe balance-of-payments crisis in late 1976 and early 1977, Rome was reluctant to grant additional credits. In response, the Soviet Deputy Minister of Foreign Trade threatened to renegotiate all past contracts, and the Italians eventually agreed to a 7.55-percent interest rate, claiming that the new line of credit was really an extension of previous agreements and therefore permissible under the grandfather clause of the gentleman's agreement on export credits.

To date the changing trade relationship has had only a marginal impact on export credit policy. Before 1980 Rome periodically extended credit lines for Soviet purchases of Italian capital goods. Following the Afghanistan invasion, Rome suspended credit negotiations for a time, then resumed issuing credits on a case-by-case basis. In particular, a large credit was approved to finance Italian exports of equipment for the Siberian pipeline. Rome continues to subsidize these credits. Mediocredito Centrale, a public institution, doles out subsidies equal to the difference between OECD consensus rates and commercial financing costs. The 1980 budget, for example, gave Mediocredito \$425 million to provide credit subsidies for exports to non-EC countries. Despite Rome's

desire to promote Italian exports, the cost of providing these subsidies has become a contentious issue as fiscal problems have mounted.

United Kingdom

Basic Setting

Great Britain's trade and financial links with the Soviet Bloc remain more limited than those of any other major West European country.

British officials emphasize the importance of continued economic and political contacts. They have told US representatives that such contacts help to maintain at least a minimal level of detente and demonstrate to British voters, to neutral countries, and to smaller NATO Allies that the West is not inflexible in dealing with the Soviets. There is little concern about the potential leverage Soviet economic and political ties could have because of the low level of trade. Moreover, Britain is not dependent on the Soviets for strategic minerals or for energy, and relatively few British workers depend on Soviet trade for their jobs.

Given the relatively thin economic relationship between the two countries, we believe London is more concerned about the potential for Soviet influence inherent in the economic relationships other West European nations, notably West Germany, have with the Soviet Union. Foreign Office officials have expressed agreement with the widespread European perception that commercial ties make the Soviets more conscious of the risks of certain actions, notably intervention in Poland, but they doubt that a threatened cut in Western business ties would deter Moscow from action it believed essential to protect its vital interests.

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Despite misgivings about the possible implications of growing West European-Soviet trade, both British politicians and government officials essentially see sanctions as an ineffective weapon. In the Foreign Office view, sanctions work better as a threat than they do when put into practice. There is both a philosophical and practical dimension to the British view:

- The British have traditionally argued that the political nature of a regime should not affect trade relations; the sanctions imposed on Argentina and Rhodesia are regarded as "special cases." During the Iranian hostage crisis London backed off from sanctions under Conservative pressure.
- Representatives of all major parties have expressed the view that it is almost impossible to monitor enforcement of sanctions, a skepticism acquired through experience with various forms of sanctions in Rhodesia, South Africa, and Iran.
- The British see little hope that other Western nations more dependent on trade with the East would be willing to support sanctions over an extended period of time. This feeling was reinforced by the recent Falklands experience, when Britain's EC partners quickly moved to resume trade as soon as hostilities ended.

Despite these misgivings, the Thatcher government took a fairly firm stance after the Soviet invasion of Afghanistan. In the wake of the Soviet move, London cut off intergovernmental trade talks, participated in the EC grain export curb, and declined to renew the \$2 billion 1975 Wilson credit agreement. While the Soviets had not made extensive use of the Wilson arrangement—they had drawn only \$1.2 billion before it expired—they nonetheless offered them credit terms below the OECD consensus because it was negotiated prior to the 1976 "gentlemen's agreement" on export credits. London did not, however, impose any restrictions on pipeline-related negotiations, and, in September 1981, John Brown Engineering signed a

contract with the USSR to provide 21 gas turbines, about one-sixth of the total needed for the pipeline.

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London's response to the declaration of martial law in Poland was moderate, restrained perhaps by self-interest and by a public that reacted to the situation in Poland more with interest than with indignation. The Thatcher government agreed with Washington on the need to send a clear political signal to the Soviets and thus announced a package of sanctions in February 1982. Most of the measures chosen were symbolic, however, such as travel restrictions on Soviet diplomats. The most significant step was London's decision to support the idea of reclassifying the USSR as a rich country within the OECD consensus. This step, agreed to in July 1982, means that the Soviets will face higher interest rates and shorter repayment periods for export credits in the future.

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London's primary concern in the wake of Poland was the prevention of splits within the Alliance, both to maintain a united front against the USSR and to avoid being forced to choose between its Common Market partners and the United States. Throughout the sanctions crisis the British tried to play a calming and mediating role, pushing for compromise that would be acceptable on both sides of the Atlantic. Nevertheless, Thatcher emphatically stated her unhappiness with the sanctions and on the key issue of existing contracts sided firmly with Britain's continental neighbors. Taking the position that signed contracts must be honored and that US efforts to block those contracts were an unacceptable infringement on British sovereignty, Thatcher ordered the British firms involved to ignore the sanctions.

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Trade Patterns

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Of the four major West European countries, the United Kingdom depends least on trade with the Soviet Bloc. In the 1950s, when Western trade with the East was recovering rapidly, Britain kept pace with other West European countries; as late as 1963, the Soviet Bloc accounted for about 4 percent of UK imports and 3 percent of exports. In the 1960s, however, Soviet imports increasingly centered on

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Table 6
United Kingdom: Trade With the Soviet Bloc and
the United States, 1982 ^a

	World (million US \$)	USSR		Eastern Europe		United States	
		Million US \$	Percent	Million US \$	Percent	Million US \$	Percent
Exports	97,219	623	0.6	885	0.9	13,054	13.4
Foodstuffs	6,991	39	0.6	123	1.8	664	9.5
Raw materials	2,267	49	2.2	45	2.0	79	3.5
Fuels	19,594	9	NEGL	66	0.3	5,420	27.7
Manufactures	65,322	516	0.8	640	1.0	6,668	10.2
Chemicals	10,712	105	1.0	190	1.8	725	6.8
Semifinished	13,901	122	0.9	121	0.9	1,362	9.8
Steel	2,264	34	1.5	15	0.7	261	11.5
Machinery	30,766	232	0.8	240	0.8	3,250	10.6
Transport equipment	914	12	1.3	27	3.0	161	17.6
Consumer goods	9,029	45	0.5	63	0.7	1,170	13.0
Other	3,047	9	0.3	13	0.4	223	7.3
Imports	99,674	1,129	1.1	843	0.8	11,620	11.7
Foodstuffs	13,248	11	0.1	44	0.3	741	5.6
Raw materials	6,325	218	3.5	144	2.3	835	13.2
Fuels	12,956	740	5.7	46	0.4	355	2.7
Coal	392	2	0.4	23	5.8	135	34.4
Oil, crude and products	10,983	738	6.7	23	0.2	219	2.0
Natural gas, electricity	1,581	0	0	0	0	2	0.1
Manufactures	64,914	142	0.2	607	0.9	8,907	13.7
Chemicals	7,319	32	0.4	67	0.9	753	10.3
Semifinished	17,262	42	0.2	229	1.3	1,075	6.2
Machinery	27,968	51	0.2	122	0.4	5,029	18.0
Transport equipment	666	NEGL	0.1	5	0.8	147	22.0
Consumer goods	11,699	17	0.1	184	1.6	1,903	16.3
Other	2,232	18	0.8	2	0.1	784	35.1

^a Because of rounding, components may not add to totals shown.

heavy machinery and industrial equipment, mainly from West Germany and Japan. Moscow's poor grain harvests and its need for pipe and drilling equipment to boost energy production also shifted imports from the United Kingdom to the United States, West Germany, and Japan. As a result, Britain's share of Soviet trade has slipped fairly steadily in relation to most other Western countries. []

Trade with the Soviet Bloc remained sluggish during 1982. Exports to the area declined by one-fourth to \$1.5 billion, while imports picked up to almost \$2 billion. The Soviet Union accounted for just 0.6 percent of total exports and 1.1 percent of imports, while Eastern Europe accounted for just under 1 percent of both exports and imports. []

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British imports of Soviet goods last year consisted mostly of crude oil and oil products (65 percent) and raw materials (19 percent); manufactured goods accounted for only 13 percent of the total. Imports of Soviet oil and products are confined to lower grades and will decline in importance as energy conservation measures and increases in North Sea production push down British demand for foreign energy products. Soviet attempts to increase sales of manufactures and finished goods in the United Kingdom have been largely ineffective. Britain's dependence on the Soviet Union for strategic minerals is practically nil. [redacted]

British exports to the USSR last year fell mainly in the categories of machinery (37 percent), chemicals (17 percent), and metals (11 percent). Machinery exports are largely industrial and power-generation equipment. Steel and unprocessed nonferrous metals make up the largest part of the metals category. [redacted]

Machinery accounted for roughly one-fourth of exports to Eastern Europe; other important export categories were chemicals, foodstuffs, and semifinished goods. In sharp contrast to trade with the USSR, almost three-fourths of imports from Eastern Europe consisted of manufactured items. The main subcategories were semifinished goods, consumer goods, and machinery. [redacted]

Trade Promotion

British Government support for export financing is handled by the Export Credits Guarantee Department, which is responsible to the Secretary of State for Trade. It insures credits and can also subsidize them so as to guarantee the lending banks a commercial rate of return. All ECGD operations require the consent of the Treasury, but in practice only questions involving new credit policies, large amounts, or especially long terms are submitted to the Treasury. ECGD provides credit insurance to exporters and guarantees of repayment to private banks (either suppliers or buyers) for export credits. It accepts 90 percent of the risk of the buyer's failure to pay and 90 to 100 percent of the political risk on comprehensive insurance. On bank guarantees, ECGD accepts 100 percent of the risk. [redacted]

Over the last two years British banks seem to have adopted a more cautious attitude toward lending to the Bloc. The switch is based mainly on economic considerations, with banks typically trying to shorten maturities and in some cases refusing new short-term loans and rollovers. [redacted]

The government, however, appears hesitant to tighten credit restrictions against the Bloc despite concerns about the level of Western credit exposure to the USSR. British officials have expressed their concern that the US approach would place a disproportionate share of the burden on the West Europeans and their skepticism of the impact credit restraints would have on Soviet military capabilities. The government believes that reducing the subsidy element of official guarantees also would give low-interest-rate countries a large advantage in manufacturing trade. British firms, hard pressed by a profit squeeze and only partially regaining the losses in export competitiveness suffered over the last several years, will push the government to continue its current program. [redacted]

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