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European Review

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Special Issue: Focus on CEMA

13 February 1985

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Special Issue: Focus on CEMA

Developments since 1980 have highlighted the importance of economic links and dependencies within the Council for Mutual Economic Assistance (CEMA). These developments have raised questions about the nature and degree of Soviet control over Eastern Europe, whether there are important shifts on the way, and whether and how the West can be a significant factor in the equation. Articles in this issue provide our assessment of the current situation and point to a few likely future trends. 25X1

After years of drift and temporizing, CEMA party leaders gathered in Moscow last June to address the problems that have hindered cooperation throughout CEMA's 36-year history. The summit developed a long-term strategy for the organization, but its interpretation and implementation have yet to be worked out. The need to conclude agreements for the 1986-90 period will increase pressure on negotiators this year, but we expect the inevitable concentration on practical questions will delay implementation of the summit's far-reaching but vague directives beyond the end of 1985. 25X1 [redacted] 25X1

Some articles are preliminary views of a subject or speculative, but the contents normally will be coordinated as appropriate with other offices within CIA. Occasionally an article will represent the views of a single analyst; these items will be designated as uncoordinated views. [redacted] 25X1 [redacted] 25X1

Briefs

Italy

Wage Indexation Referendum [redacted] 25X1

The Italian Constitutional Court recently approved last year's proposal by the Communist Party (PCI) to put the issue of last year's six-month limit on wage indexation before the voters—in effect moving this important economic decision from parliament to the ballot box. Most labor leaders oppose the referendum, including those in the Communist-dominated CGIL, partly for fear that it would further split the labor movement, but the rank and file may ignore their leaderships' concerns. [redacted] 25X1 Rome may be able to work out a legislative compromise that avoids a referendum. [redacted] 25X1

If the referendum comes to the vote sometime this spring, it would probably pass, seriously eroding Rome's efforts to reduce inflation and having other far-reaching implications for economic policy. Rome's cap on wage indexation was a key element in bringing Italy's inflation rate down from 15 percent in 1983 to 10.6 percent last year. By repealing the cap, Rome will not be able to hit its 7-percent inflation target this year. In addition, an estimated $1 billion hike in government personnel costs would hamper Rome's efforts to control a budget deficit that amounted to over 16 percent of GDP last year. [redacted] 25X1

Spain

Basques Make Peace [redacted] 25X1

The Basque regional government and the Basque Socialist Party signed a legislative pact on 30 January, which should break the yearlong 32-32 seat deadlock between the Basque Nationalist Party (PNV) and the Socialist-dominated opposition in the Basque parliament. Among other things, the pact deals with cooperation on terrorism, the economy, the transfer of autonomy powers, and review of the laws governing provincial and regional relations, including the controversial law of the historical territories. Both sides made concessions: the Basque government by formally accepting the Spanish Constitution and agreeing to collaborate on terrorism and the Socialists by yielding on the transfer of power to the regional government and by implicitly committing more help for the troubled Basque economy. [redacted] 25X1

In the area of terrorism, the regional government committed itself to help the Socialists fight terrorism, agreed not to conduct direct political negotiations with ETA, and accepted Madrid's authority to conduct foreign relations (recently ousted President Carlos Garaicoechea sometimes dealt with foreign governments directly). Both sides have hailed it as a step forward in Basque-Madrid relations, and newly elected Basque President Jose Antonio Ardanza's ability to work with Basque Socialist leader Txiki Benegas is a positive sign. Even so, the agreement is vague on key points and could crumble. Significantly, the pact was not negotiated with the PNV, but with the government itself, leaving the PNV free to distance itself from the accord—despite its public support—if it chooses. Moreover, the same splits in the PNV that forced Garaicoechea's resignation will plague Ardanza as he seeks to implement the provisions of the agreement. 25X1

Portugal

Seeking To Limit RENAMO Activities 25X1

As part of its effort to improve relations with Mozambique, Lisbon is seeking ways of legally circumscribing the activities of the Mozambique National Resistance Movement (RENAMO) in Portugal. Mozambican President Machel has publicly complained that RENAMO is supported by individuals within the Lisbon government and has warned that bilateral relations will suffer if strong measures are not taken. Deputy Prime Minister Carlos Mota Pinto is most often mentioned as RENAMO's "Lisbon connection." 25X1

The government is considering ways to prevent RENAMO leaders in Portugal from speaking publicly, but most are Portuguese citizens and enjoy guarantees of free speech. Lisbon is also contemplating bringing criminal charges against RENAMO leaders for the murder of Portuguese citizens in Mozambique. That move may backfire, as it would give them a public forum for airing their views. Moreover, efforts to totally muzzle RENAMO could result in a political backlash from supporters in Portugal. 25X1

Turkey-Iran

Results of Iranian Prime Minister's Visit 25X1

Iranian Prime Minister Musavi's visit to Ankara in January appears to have been a success, according to the US Embassy in Ankara. Agreements were signed committing Iran to buy $2 billion in Turkish goods in exchange for Turkey's purchase of 6 million tons of Iranian oil, as well as for feasibility studies for two pipelines to export Iranian oil and natural gas through Turkey. Musavi promised never to permit Iranian territory to be used by Armenian or Kurdish activists against Turkey, and apparently did not repeat Tehran's complaint that Turkey is harboring counterrevolutionaries. The two sides also signed a cultural agreement permitting the Turks to monitor Iranian cultural activities in Turkey, and banning hostile references to each other in domestic media. 25X1

The chill in Turkish-Iranian relations stemming from anti-Kurdish operations by Turkey in Iraq last year appears to have ended. The visit demonstrates Ankara's playing on Iran's continuing fears that Turkey could edge closer to Iraq. The Turks suspect the Iranians finally agreed to Ankara's request to discuss pipeline projects for fear that a planned second oil pipeline from Iraq would increase Iraqi influence in Ankara. 25X1

Yugoslavia

Officials Censured for Economic Mistakes 25X1

In late January the People's Assembly of the Macedonian Republic voted to sack former senior assembly officials associated with construction of a recently liquidated smelting combine. The announcement said the action was part of an effort to establish "personal and collective" responsibility for the decision to construct the project, but also suggested that allegations of evidence tampering were being investigated. Earlier, Macedonian party chief Pancevski had singled out the combine at a republic central committee plenum as an example of economically unjustifiable investment. Because of numerous cost overruns, heavy foreign debt, and inability to compete on the world market, the plant was forced to close last year after absorbing at least $300 million in hard currency investment funds. 25X1

The targeted officials would be the most senior figures penalized for economic mistakes in post-Tito Yugoslavia. The Macedonian leadership probably intends the penalties to show that it is serious about economic reform, though the censure is largely symbolic since it appears to exclude the senior party officials who approved the project. Macedonian leaders have supported many proposals pushed by Serb reformers, including those for holding decisionmakers accountable for their actions. In this case, however, the accused may have forced the Assembly to react because of the bold destruction of evidence; they may also be victims of another power struggle within the Macedonian leadership. 25X1

Bulgaria

Increased Incentives for Research and Development 25X1

In an effort to spur economic growth through productivity gains, the Bulgarian Council of Ministers has increased bonuses for technology developments and managerial processes that reduce production costs. Cash incentives have been nearly doubled, and managers and workers are to share in bonuses if they cooperate in new production initiatives. In addition, enterprises will receive 1 percent of their foreign currency revenues as an incentive to boost exports. 25X1

The regime hopes that encouragement of domestic research and development will minimize Bulgaria's dependence on expensive Western capital imports. We do not expect these measures by themselves to have a significant impact on industrial productivity as long as funds for research and development are allocated centrally. To modernize production, Sofia will need to combine entrepreneurial incentives with a less centralized investment policy and a willingness to increase capital imports from the West. 25X1

Articles

Perspective: Getting Started on CEMA 25X1

Several months ago, the Deputy Director for Intelligence established a task force to conduct research and produce intelligence on the Council for Mutual Economic Assistance (CEMA), the multilateral economic organization of Moscow and its allies. Our effort is intended to satisfy the increased interest of policymakers in economic ties between the USSR and Eastern Europe. The task force will concentrate on Soviet–East European economic relations, setting aside the three non-European members of CEMA—Vietnam, Cuba, and Mongolia.

Economic issues are key to overall Soviet–East European relations. Perhaps less than military but more than political issues, economic questions in the Bloc require a nearly continuous series of decisions. Day-to-day deliveries as well as annual trade protocols often require high-level attention, while long-run plans for cooperation and coordination of economic strategies and policies are key determinants of—or constraints to—national economic plans.

Several developments since 1980 have highlighted the importance of economic links and dependencies within CEMA: the Polish crisis of 1980-81; Eastern Europe's financial and economic problems of 1981-83; Moscow's growing distaste for economic assistance to its allies; and strains between the USSR and the East European regimes over the wide spectrum of political, military, and economic issues that affect their relations. These developments have raised questions about the nature and degree of Soviet control over Eastern Europe, whether there are important shifts on the way, and whether and how the West can be a significant factor in the equation.

The task force intends to address these questions through development of an understanding of the economic dependencies within CEMA. Although our primary objective is research, from time to time we will offer assessments of current trends and developments. We will address—directly or indirectly—questions and issues such as the following:

- How important are East European goods to the USSR? Do the Soviets rely heavily upon certain imports from Eastern Europe? Can the East Europeans fill important gaps in the Soviet economy, such as oil and gas equipment and consumer goods?

- How dependent is Eastern Europe on the USSR? Besides energy, what items are vital to the East European economies? How do the aggregate trade flows affect macroeconomic performance?

- How does intra-CEMA trade relate to East-West trade? What opportunities does Eastern Europe have to find substitutes within CEMA for imports from the West? Has the Soviet Union helped Eastern Europe adjust to its debt problem? Does greater CEMA cooperation imply reduced reliance on Western technology, or will the heightened emphasis on "intensive development" through technology demand a larger role for imports from the West?

- How do economic relations affect the overall relationship within the Bloc? Does Moscow use trade to pressure its East European allies?

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The articles in this issue provide our assessment of current developments in CEMA:

- The analysis of Soviet–East European trade examines trade in real terms to show that—contrary to East European rhetoric and Western concerns—the Soviets have not replaced imports Eastern Europe previously bought from the West.

- The modest momentum from the CEMA summit last June appears to have faded, and the Soviets and East Europeans may miss the chance to incorporate its vague directives in the five-year plan period that begins in January 1986. Similarly, the Soviet effort to wrap up very long-term agreements in the CEMA framework and with each East European country may meet the same fate as earlier attempts to achieve genuine integration.

We consider these conclusions, which together suggest that little has changed or will change, to be preliminary. Soviet determination to make its allies less dependent on the West combined with some easing of the recalcitrance of two of CEMA's problem members—Poland and Romania—could provide a chance for progress in CEMA.

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CEMA: Still Searching for Consensus [redacted] 25X1

After years of drift and temporizing, CEMA party leaders gathered in Moscow last June to address the problems that have hindered cooperation throughout CEMA's 36-year history. The first CEMA economic summit since 1969 developed a long-term strategy for the organization, but its interpretation and implementation have yet to be worked out. The need to conclude agreements for the 1986-90 period will increase pressure on negotiators this year. We expect, however, that the inevitable concentration on practical questions will delay implementation of the summit's far-reaching but vague directives beyond the end of 1985. [redacted]

Review of the Summit

Probably to avoid East European pleas for assistance, Moscow objected in 1980 when Romania first proposed holding a summit. In 1981, however, the Soviets developed their own agenda and seized the initiative in organizing the meeting. [redacted] the Western press reported during 1982 and 1983 that a summit was imminent, but continued disagreements over the agenda led to repeated postponements. According to a senior Polish official in a press interview, members had to rule on 270 proposed amendments to the original draft. An agenda was finally agreed to in the fall of 1983, but Soviet President Andropov's failing health prevented scheduling of the meeting. Immediately after Andropov's death in January 1984, new Soviet leader Chernenko told Romanian President Ceausescu that a CEMA summit was a major priority, and in April the Politburo announced that the meeting would be held. [redacted]

Tensions between the Soviets and East Europeans over a wide range of economic and other issues raised the prospect that the meeting would be openly contentious, but the meeting did achieve some unity. The lengthy preparations—including a series of advance bilateral meetings between Chernenko and East European leaders—helped to settle or at least paper over differences. Soviet spokesmen thoroughly dominated reporting on the summit, and, on the East European side, only a statement by Poland's Premier Jaruzelski on behalf of the East European leaders was published. [redacted] 25X1

The summit adopted general guidelines for economic relations among the CEMA countries and for development of a long-term strategy of economic growth. The leaders emphasized a cooperative solution to the region's problems by accelerating "intensive" development through *productivity increases* based on advances in science and technology—versus "extensive" development, which relies on greater inputs of labor, capital, and raw materials to promote growth. [redacted] 25X1

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The CEMA summit approved and released an economic statement and a political declaration. 25X1
Although it is possible that other agreements were 25X1
approved privately, the general tone and the lack of details probably indicates that compromises were needed to reach a consensus. In this sense, the summit represented East European success—sometimes by combining into coalitions, according to US Embassy sources—in fighting off more demanding Soviet proposals. [redacted] 25X1

On the major issues facing CEMA, some main directions for the future emerged:

- *Soviet–East European trade.* Moscow won grudging commitments from the East Europeans to supply more—and higher quality—food, consumer goods, and machinery in return for continued Soviet deliveries of energy and raw materials. In some instances, the East Europeans are to tailor their investment policies and their industries to supply the Soviet market. 25X1

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- *Technology.* Perhaps the summit's most important step was the decision to develop a blueprint for scientific-technical policy and coordination. Highest priority areas are electronics, microprocessors, and robotics—the same areas that CEMA has emphasized in the past few years and that offer the most promising opportunities for cooperation.

- *Trade with the West.* While the leaders sharply criticized Western sanctions and asserted that the socialist countries "possess everything they need," they declared that the CEMA countries want to develop cooperation with capitalist firms and states. The leaders also revived an old Soviet proposal for an agreement between CEMA and the European Community (EC).

- *Energy.* The only specific reference was to the need for conservation among member states, primarily by introducing more efficient equipment and by restructuring industries to less energy-intensive production.

- *Integration.* The word integration was replaced mostly by the term cooperation, which connotes a more voluntary approach to economic interaction. To facilitate cooperation, the leaders agreed to promote direct contacts among countries by economic units at lower levels and to encourage the creation of joint firms.

Developments Since the Summit

CEMA's knottiest problems survived years of negotiations and a summit meeting without being resolved, and, in the eight months since the summit, lower levels have made little progress in turning vague declarations into an operative consensus. CEMA committees and organizations in each country have been charged to implement summit decisions. Communiques from bilateral economic meetings and CEMA committee meetings have alluded liberally to the summit and have reported discussions of the major issues, but no important new decisions have been announced:

- On the joint investment projects, the East Europeans appear to accept in principle the Soviet insistence on East European investments, but they are continuing to balk at the specific terms.

- The initiative for an agreement with the European Community was delivered formally in October, but it was promptly rebuffed by an EC official as nothing new. CEMA may soon reply to the EC's letter of 1981—a condition set by the EC for resumption of negotiations between the two economic communities.

- Drafting of the science and technology program "for the next 15 to 20 years" is going slowly and probably will not be completed on target this year. 25X1

The most significant decision so far is that of the CEMA Foreign Trade Committee which, according to an Embassy Moscow source, last December agreed to continue to base intra-CEMA trade prices on the average of world prices in the previous five years. Official statements following the meeting in January of CEMA's Executive Committee confirm the report. This decision, in fact, counters one of the clear signals of change produced by the summit; at a news conference after the summit, a Soviet official said that CEMA would change its pricing formula to make it more responsive to world prices. 25X1

Heavy Agenda in 1985

On the eve of a new five-year plan period, 1985 promises to be a critical year for CEMA. Probably not since the early 1970s have CEMA officials and regimes in member countries had so many important agreements to conclude. Agreements due to be completed this year include: 25X1

- CEMA's program for scientific and technological cooperation for the next 15 to 20 years.
- Coordination of national economic plans for 1986-90.
- Bilateral trade agreements for 1986-90; as well as more detailed and binding bilateral trade protocols for 1986.
- Coordinated Plans of Multilateral Integration Measures for 1986-90.
- Bilateral programs for economic cooperation through the year 2000 between the USSR and Bulgaria, Czechoslovakia, Hungary, and Romania.
- Joint investment projects for 1986-90. 25X1

Decisions made in 1985 will go far toward determining the degree of cooperation, areas of priority and terms for joint investment, levels and balances of trade, and lists of commodities to be exchanged. These factors, in turn, will be crucial to the development of the East European economies over the medium and long term, and they could be important to the USSR as well. Moreover, the substantive results of talks this year will offer a clear indication of the power of decisions taken at the summit last June to tighten CEMA coordination, redress the trade imbalances of the mid-1970s through the early 1980s, and push the countries toward technological progress and coordination. [redacted]

We expect that progress will be slow and that few major additional changes are in the offing. Judging by previous negotiations, the first priority probably will be to conclude trade agreements because of pressure to establish a basis for continuing foreign trade. The broad outlines of Soviet–East European trade for the next five years were determined last year, but the East Europeans may well plead with Moscow for special consideration to get better terms. Joint investment also is likely to be high on the agenda, because of Soviet impatience, long leadtimes, and the size of its impact on planning throughout the region. [redacted] 25X1

Many of these negotiations are interdependent, so that disputes in one may complicate others. The full agenda of contentious issues and CEMA's chronic slowness probably will push conclusion of some of the agreements into next year or later. Coordination of plans for the 1981-85 period, for example, was not completed until 1982. Negotiations on the most pressing questions may combine with the usual difficulty of reconciling diverse objectives to preclude progress on the more fundamental issues that affect the way CEMA works. [redacted] 25X1 25X1

[redacted] 25X1

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CEMA: Planning for Long-Term Cooperation [redacted] 25X1

The Soviet Union has initiated discussions on a wide array of multilateral and bilateral economic agreements with other members of the Council on Mutual Economic Assistance (CEMA)[1] designed to limit CEMA's dependence on the West and exert tighter control over the East Europeans. These will be long-term arrangements to guide economic relations within CEMA for the rest of the century. Although Moscow can cite these framework agreements as guidelines for cooperation and trade, the commitments appear too weak and nonspecific to ensure that Soviet goals will be met. [redacted] 25X1

Multilateral Programs

Science and Technology. Perhaps the most important result of last June's CEMA summit was the "Long-Term Comprehensive Program for Cooperation in Science and Technology for the Next 15 to 20 Years." Still incomplete, the program has been billed as equal in significance to CEMA's highly touted 1971 Comprehensive Program for Economic Cooperation and Integration. [redacted] 25X1

The program appears to be a Soviet effort to make technology CEMA's primary concern, and aims to coordinate development of high-technology industries. Although it does not rule out a role for Western imports, a major reason is to defend CEMA against Western controls on exports of technology. The program emphasizes cooperation in five key areas—electronics, flexible manufacturing systems, nuclear energy, advanced materials technology, and biotechnology. A basic goal is to avoid duplication of effort and make CEMA's high-technology products compatible by sharing data and research. Although CEMA technology is largely unsophisticated by Western standards, pooling resources could provide badly needed gains in productivity. A more ambitious—and contentious—goal would be to assign certain tasks and responsibilities to individual countries. Most East European countries continue to resist Soviet or CEMA measures that would dictate which industries must be located in which country. [redacted] 25X1

The program appears to be going slowly, and the goal of completing it by the end of this year may not be met. In an unusually blunt public criticism, Czechoslovak Premier Strougal—a proponent of the program—recently noted that "there are instances of serious delay in this work." He recommended that CEMA's Executive Committee review the drafting of the program and urged the Committee to assure that it be accompanied by measures linking it to cooperation in production. [redacted] 25X1

Other CEMA-Wide Agreements. The major accomplishment announced at the October 1984 Havana gathering of CEMA premiers was agreement on "Long-Term Comprehensive Measures for Cooperation in the Sphere of Energy, Fuel, and Raw Materials for the Period Through 1990 and Beyond." 25X1 [redacted] the 25X1 USSR will continue to supply fuel and other raw materials at present levels in return for more and better quality East European goods, greater conservation efforts, and increased investments in joint projects. In addition, members agreed to work out plans for building nuclear power plants through the year 2000. Finally, in January, the CEMA Executive Committee discussed a program for joint electric power development up to the year 2000, and a complex program of cooperation in transport for 1991-2000. [redacted] 25X1

[1] CEMA members include Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania, the USSR, Cuba, Vietnam, and Mongolia. [redacted] 25X1

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Let's make a deal. Senior Soviet officials look on as Jaruzelski and Chernenko sign a program for cooperation through the year 2000.

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Bilateral Cooperation Through 2000

The USSR is also negotiating long-term bilateral agreements with each East European country in science, technology, and economics. Bilateral accords can be tailored to fit the Soviet relationship with each country, and they reflect the reality that CEMA has little real authority as a multilateral organization. Agreements already signed with Poland and East Germany repeat many of the provisions of planned multilateral programs.

Poland. On 4 May 1984, General Jaruzelski and party leader Chernenko signed the "Long-Term Program for the Development of Economic, Scientific, and Technical Cooperation Between the USSR and Poland for the Period Up to the Year 2000." A harbinger of subsequent accords, the agreement covers cooperation in all major areas of the economic relationship.

In machinery, both sides are to modernize existing industries, as well as devote special attention to emerging industries—microelectronics, robotics, and flexible manufacturing systems. Although the agreement specifies some 15 sectors in which each country will specialize, the list does not represent any change from the status quo.

The fuel and energy section guarantees Soviet deliveries of energy. In return, Poland will help with the construction of natural gas pipelines in the USSR and, according to a Polish official, produce machinery to manufacture large-diameter pipe.

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The key innovation is the encouragement of expanded relations between planning organizations, enterprises, and institutes (including the Polish and Soviet Academies of Science). The Polish press has cited several efforts to implement the commitment:

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- Jaruzelski met last September with about 60 Polish enterprises to discuss ways to stimulate further cooperation with Soviet counterparts.
- Beginning in 1985, annual trade protocols will allow some Polish and Soviet enterprises to bypass foreign trade organizations in both countries.

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East Germany. After two and a half years of negotiations, a program for long-term bilateral cooperation was signed on 6 October 1984 by Soviet Minister of Foreign Affairs Gromyko and East German party leader Honecker. Agreement was

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reached at a time of political strains in the relationship with Moscow, one month after the postponement of the Honecker visit to West Germany. Unlike the Polish-Soviet program, the text of the "Program for the Development of Cooperation Between the USSR and the GDR in Science, Technology, and Production for the Period Until the Year 2000" was not published, but the press carried several details of it.

The program is similar to the Soviet-Polish pact:

- The industries specified for cooperation are roughly the same.
- It calls for modernizing manufacturing plants in both countries.
- Energy supplies from the Soviet Union are to be secured in part through East German construction of capacity to produce equipment for the Soviet oil and gas industry.

Differences vis-a-vis the Soviet-Polish agreement appear to be mainly ones of emphasis. In particular, the East German program puts greater stress on cooperation in science and technology, in recognition of East Germany's strength in these fields. It emphasizes all aspects of microelectronics—manufacturing, developing new technologies and applications, and exchanging equipment and material inputs.

More To Come. In recent months, communiques from bilateral meetings between Soviet officials and those in Bulgaria, Hungary, Czechoslovakia, and Romania have announced negotiations on programs for cooperation through 2000. We have few details on the status of these preparations, but the Soviets probably would like to sign pacts modeled on the Polish and East German programs by the end of 1985.[2]

[2] Soviet programs for bilateral cooperation through 2000 are not limited to the East European CEMA members. Vietnam in October 1983 and Cuba in October 1984 signed similar "year 2000" programs. The Mongolians and the Soviets announced in November that preparatory work is under way. The East European countries are also negotiating bilateral programs through 2000 with each other. Poland's Deputy Premier Messner, for example, announced last October that Warsaw had concluded agreements with Bulgaria, Hungary, and Romania and was involved in talks with Czechoslovakia and East Germany.

Predecessor Programs: False Starts of the 1970s

The current drive to wrap up agreements that will guarantee and direct cooperation for the long term resembles two major CEMA programs launched in the 1970s with the same purpose. Although they are nominally still in effect, both fizzled after only a few years. 25X1

The Comprehensive Program. *Two years after it was proposed at the 1969 Summit, CEMA adopted "The Comprehensive Program for Further Expansion and Improvement of Cooperation and Development of Socialist Economic Integration Among CEMA Member Countries." The Comprehensive Program, considered one of the most important tracts in CEMA's 35-year history, was designed to stimulate and guide economic integration for the following 15 to 20 years. It called for extensive plan coordination, joint investment projects, and increased multilateral financial relations, including covertibility of the transferable ruble. Progress in achieving these goals has been largely disappointing.* 25X1

Long-Term Target Programs. *In the late 1970s, CEMA initiated long-term programs to single out five areas for special emphasis in applying the provisions of the Comprehensive Program. Programs for energy and raw materials, agriculture and food industry, and machine building were approved in 1978; those for industrial consumer goods and transportation were approved the next year. The Target Programs were accompanied by Soviet bilateral agreements with each East European country. Signed in 1979 and 1980, the bilateral accords also were to cover economic relations through 1990, but these too have shown few concrete results.* 25X1

Obstacles to Integration

Rhetoric aside, there are several reasons to be skeptical that a breakthrough to achieve genuine economic integration in CEMA is in the offing.

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Remarkably similar programs launched in the 1970s with great fanfare were billed as blueprints for CEMA for 15 to 20 years, but they were quickly overtaken by events. The Comprehensive Program for Integration of 1971 failed to offer an attractive alternative to opportunities then opening up for CEMA members to trade with the West. The Long-Term Target Programs of a few years later were designed to inject new life into the Comprehensive Program and to guide cooperation through 1990, but the Polish crisis and Eastern Europe's financial difficulties consumed the economic efforts of the region in the early 1980s and disrupted plans for cooperation. [redacted]

The present drive for increased integration, like past efforts, relies heavily on jawboning. It leaves virtually untouched the chronic obstacles to cooperation: deficient financial mechanisms; the East Europeans' continued desire for a measure of political and economic autonomy; bureaucratic and inefficient management; and discrepancies between the types and quality of goods being offered and demanded. [redacted]

The only significant exception is the seemingly genuine encouragement for improved links among lower level economic units in different countries, particularly the USSR. Previous programs have stalled in part because lower levels ignored the directives of the political and planning authorities. Even this is new only in degree, and there is still sure to be substantial resistance from foreign trade ministries and other entrenched bureaucracies. [redacted] 25X1

Despite the record of false starts and failed efforts, it is too early to write off the present drive as yet another doomed Soviet attempt to exert economic control over Eastern Europe. Lessons from past failures may even offer experience that will improve future cooperation. With some of the countries feeling abused or disillusioned by the results of their turn to the West in the 1970s, there is now a stronger consensus for making cooperation work. The programs probably will be important guides in setting the directions and patterns of economic ties, but, in their present form, they are statements of intention whose ultimate impact will only be determined by more concrete and binding agreements. [redacted]

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Eastern Europe: Trade Relations East and West

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Despite the rising share of the USSR in Eastern Europe's trade in recent years, our estimates indicate that Moscow has not stepped in to replace imports from the West.[1] In terms of the volume of trade, the Soviets in fact have reduced deliveries to Eastern Europe slightly while the East Europeans have met Soviet demands for substantial increases in exports. This has complicated Eastern Europe's efforts to adjust its trade with the West.

Nominal Trade: Declining Deficits

Because of rising costs of energy and special assistance to Poland, Eastern Europe's annual trade deficits with the USSR generally rose through the 1970s to peak at $4.3 billion in 1981. The trend was sharply reversed in 1982 and 1983, as Eastern Europe boosted exports to cut the deficit by almost half. Faced with slower economic growth and rising costs of energy and raw material production, the Soviets began demanding more balanced trade and better quality goods in return for Soviet deliveries. Data through three-quarters of 1984 show that the deficit rose, in part because of higher prices for Soviet energy.

Real Trade: Giving More for Less

Although trade data in value terms show that both East European exports to and imports from the Soviet Union expanded rapidly between 1980 and 1983, estimates of trade volume present a much different picture. These estimates, constructed by using Hungarian price data to deflate trade reported in nominal terms, show that the quantity of goods exported to the USSR has grown rapidly the past two years while East European imports have stagnated.[2] After several years of virtually no growth, real exports grew an average of 9 percent annually in 1982 and 1983.[3] The volume of imports fell about 2 percent in each of these years. Soviet net exports measured in constant 1977 prices have declined substantially since 1981. 25X1

A worsening in Eastern Europe's terms of trade with the Soviets is responsible for the divergence between nominal and real trade. CEMA countries set foreign trade prices at a level equal to the average of world prices in the previous five years. Soviet energy prices—spurred by higher oil costs previously delayed by this pricing mechanism—have outpaced price increases for other goods. According to the Hungarian data, the price of Soviet imports rose roughly 17 percent faster than export prices between 1980 and 1983. Because of this divergence in price movements, and in order to slow the deficits in trade with the USSR that followed, East Europeans have increased exports to the USSR substantially while the Soviets have reduced the volume of their deliveries slightly. 25X1

Energy and Fuels. Energy trade has been the single most important component of East European trade with the Soviets in recent years, accounting for more than half of East European imports from the Soviets last year. In the trade plans for 1981-85, the Soviets agreed to supply 80 million tons of oil annually. These deliveries, however, were cut in 1982 to about 72 million tons when the Soviets reduced deliveries to Hungary, Czechoslovakia, and East Germany. Deliveries continued near this level through 1984. 25X1

In terms of fuel equivalents, total energy supplies from the Soviets in 1983 were less than 1981 levels

[1] West refers to both developed and developing nonsocialist countries. In this article, Eastern Europe refers to only the following six CEMA members: Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania.
[2] Excludes the nonspecified residual in Soviet trade statistics, a large part of which is composed of military equipment and arms.

[3] Soviet volume indexes for trade with all CEMA countries show real East European exports to the USSR growing 14 percent in 1982 and 5 percent in 1983. The Hungarian data show steadier increases—10 percent in 1982 and 8 percent in 1983. 25X1

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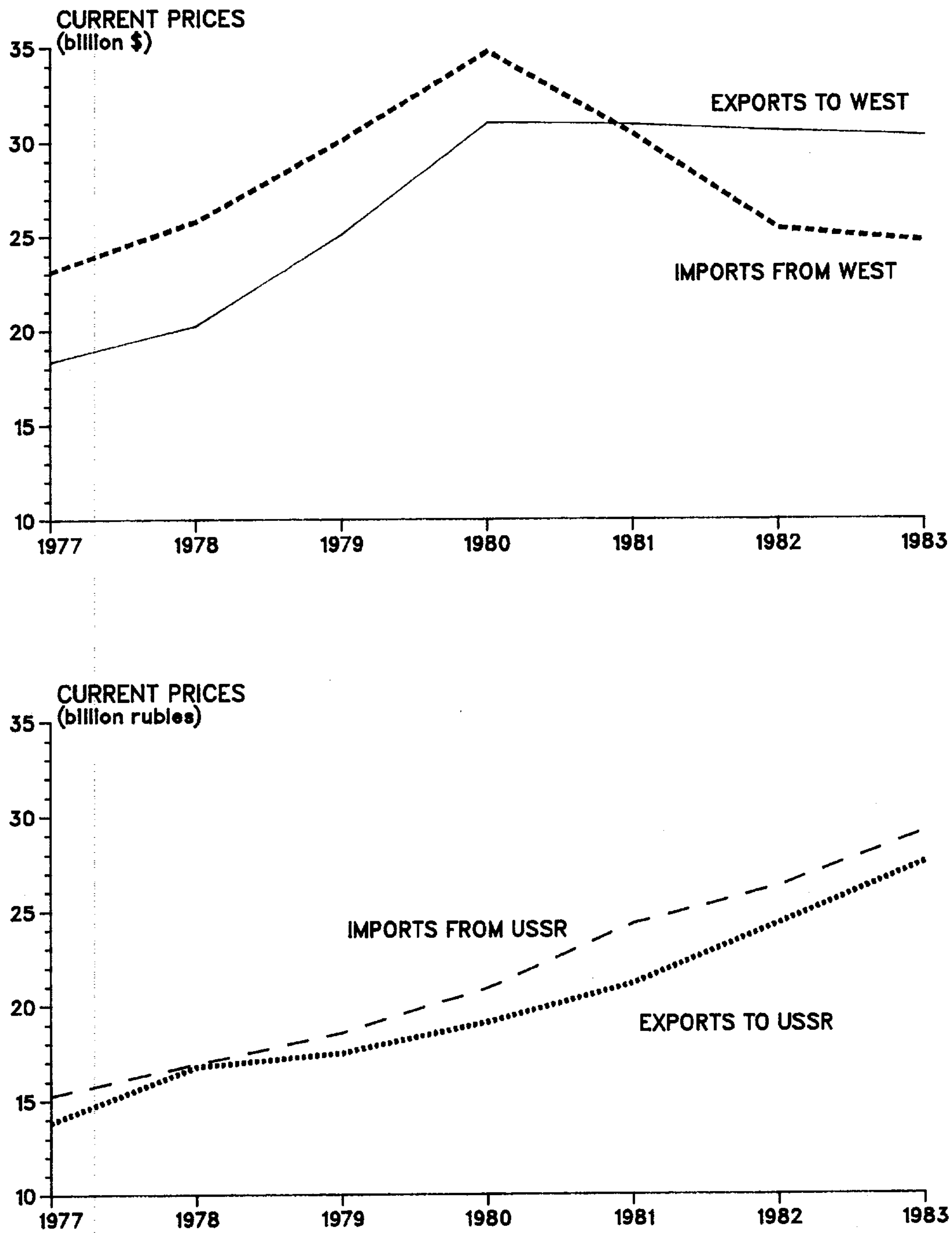
EAST EUROPEAN TRADE WITH THE USSR AND THE WEST



SOURCES: CIA estimates based on East European and Soviet Foreign Trade Statistics

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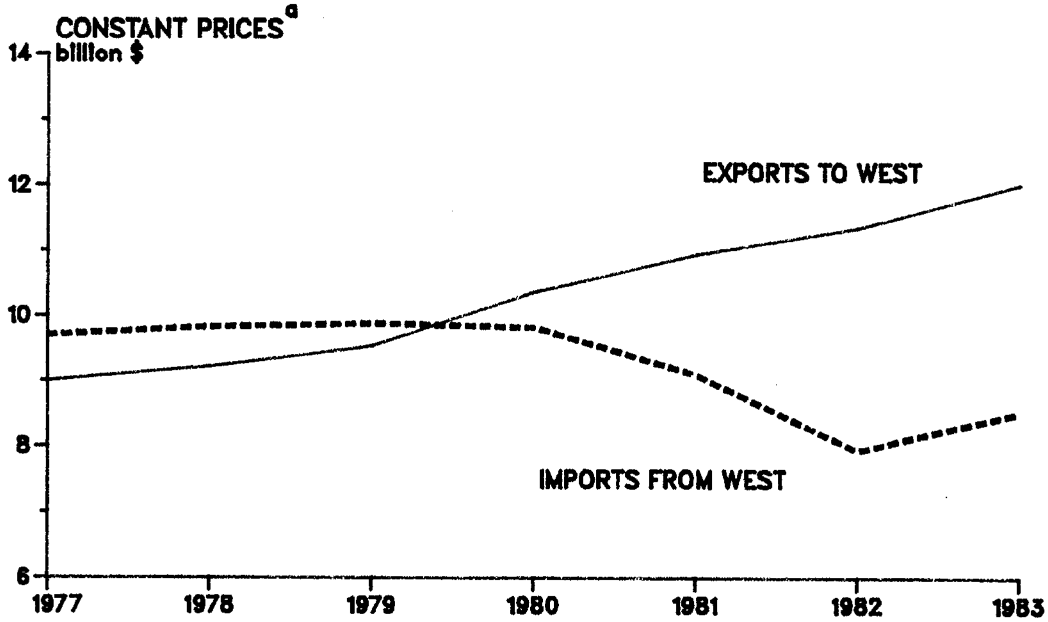
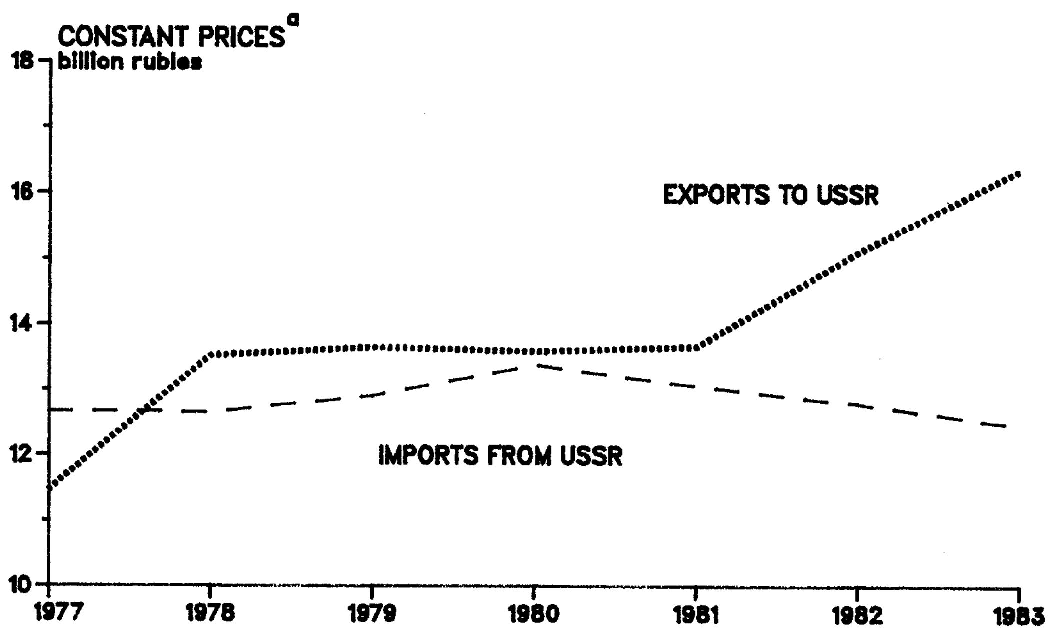
EAST EUROPEAN TRADE WITH THE USSR AND THE WEST





[a] Trade with West in 1970 prices; trade with USSR in 1977 prices.

SOURCES: CIA estimates based on Hungarian price indices, Statistical Annual of Soviet Foreign Trade, and East European Foreign Trade Statistics

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despite increases in other nonoil energy deliveries. Increased natural gas exports, which rose from 29 billion cubic meters in 1980 to more than 32 billion cubic meters in 1983, partially offset the shortfall in oil. While coal and electricity deliveries have also increased, they account for less than 15 percent of supplies from the Soviet Union.

Machinery and Equipment. The volume of machinery imports from the Soviets dropped by over 20 percent between 1980 and 1983. The largest reduction was to Poland, which imported only 40 percent as much in 1983 as in 1980. For the other East European countries, imports of Soviet machinery and equipment also declined during this period, although imports appear to be leveling off for Bulgaria and Czechoslovakia. According to a Soviet lecturer in Moscow, the volume of Soviet machinery exports fell because of slower growth in East European economies and decreased investment needs; he also claimed that Eastern Europe could not afford machinery imports because of the rising costs of Soviet energy deliveries.

Exports of machinery to the Soviets, on the other hand, have increased by over 25 percent in real terms since 1980, with all East European countries making significant gains. This rapid increase reflects increased willingness on the part of the Soviets to purchase East European machinery to meet Soviet investment needs, as well as the fact that machinery is what the East Europeans are best able to supply. Moscow may have concluded that, although not up to Western standards, East European machinery is easier to assimilate in the Soviet economy.

Food and Consumer Goods. Soviet demands for more of these goods, which comprise roughly a quarter of East European exports to the USSR, apparently had little impact last year; after rapid growth in 1982, East European exports of consumer goods to the USSR fell 4 percent, and food exports declined 6 percent due in part to poor harvests in several countries. Although Soviet exports of food and consumer goods were the only categories of trade that rose in 1983, these goods comprise less than 4 percent of Soviet exports.

Eastern Europe: Share of Imports and Exports, 1980 and 1983

Percent

	Imports		Exports	
	1980	1983	1980	1983
Total	**100**	**100**	**100**	**100**
USSR	35	42	35	39
Other Socialist countries	27	29	29	28
Developed countries	28	21	26	22
LDCs	10	8	10	11

A Helping Hand?

The rapid expansion between 1980 and 1983 of the Soviet share of East European trade at the expense of the West has been cited as evidence that the East Europeans' hard currency debt problems have forced reorientation of foreign trade toward Moscow. An examination of trends in real trade, however, indicates that, at least in the aggregate, the East Europeans have not redirected their trade to the USSR by substituting Soviet products for those previously purchased from the West. The slight decline in imports from the USSR, particularly of machinery and raw materials, refutes this thesis. The East Europeans have not been shy to ask Moscow for support, but the Soviet response generally has been cool. The steep rise in East European exports to Moscow that accounts for the growth in real trade has been necessary to meet Soviet demands for stemming the trade deficits. In short, trade with the USSR appears to have complicated rather than facilitated the East Europeans' efforts to adjust their external accounts with the West.

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Outlook

Trade protocols for 1985 indicate that trade with the USSR will grow more slowly, except possibly for Romania. The types of goods traded, for the most part set by the 1981-85 plan, will be similar to previous years. From information currently available, the Soviets will provide Eastern Europe with the same volumes of oil and gas as last year, although Romania reportedly has contracted to receive additional amounts. [redacted]

CEMA leaders are now concentrating on negotiations for the 1986-90 five-year plans. In these negotiations, which should be wrapped up soon, the Soviets are continuing to press for deliveries of more and better quality machinery, food, and consumer goods. The Soviets plan to maintain the volume of energy and raw material deliveries through 1990 at the levels set this year, [redacted] but these deliveries will be contingent on East European exports and investments. [redacted]

Joint Projects. The Soviets also are pressing the East Europeans for increased participation in joint investment projects. These projects, such as the Yamburg gas pipeline and Krivoi Rog iron ore complex in Western Siberia, will require large outlays of East European resources. Because the details on the volume and timing of East European outlays have not been worked out, the impact on future trade is difficult to assess. But the level of East European participation in these projects will have a large bearing on the development of trade with the Soviets through 1990. [redacted]

At the recent CEMA meeting in Havana, Czechoslovak Premier Strougal said that total investment in CEMA joint projects during 1986-90 could reach 55 billion rubles. An Embassy source in Moscow reports that nearly half of this amount will come from Eastern Europe. According to Soviet and East European statements, participation in these projects takes place on the basis of mutual interest and advantage, implying that East Europeans may have some freedom in choosing to participate. [redacted]

East Europeans have been reluctant to invest because of disagreements over the pricing of their investments and the vague terms attached to Soviet deliveries in return. But the Soviets may have raised the costs of nonparticipation too high to refuse; a Czechoslovak official told the US Embassy in Moscow that the Soviets have made investment in the Yamburg project a necessary condition for maintaining existing gas deliveries. [redacted] 25X1

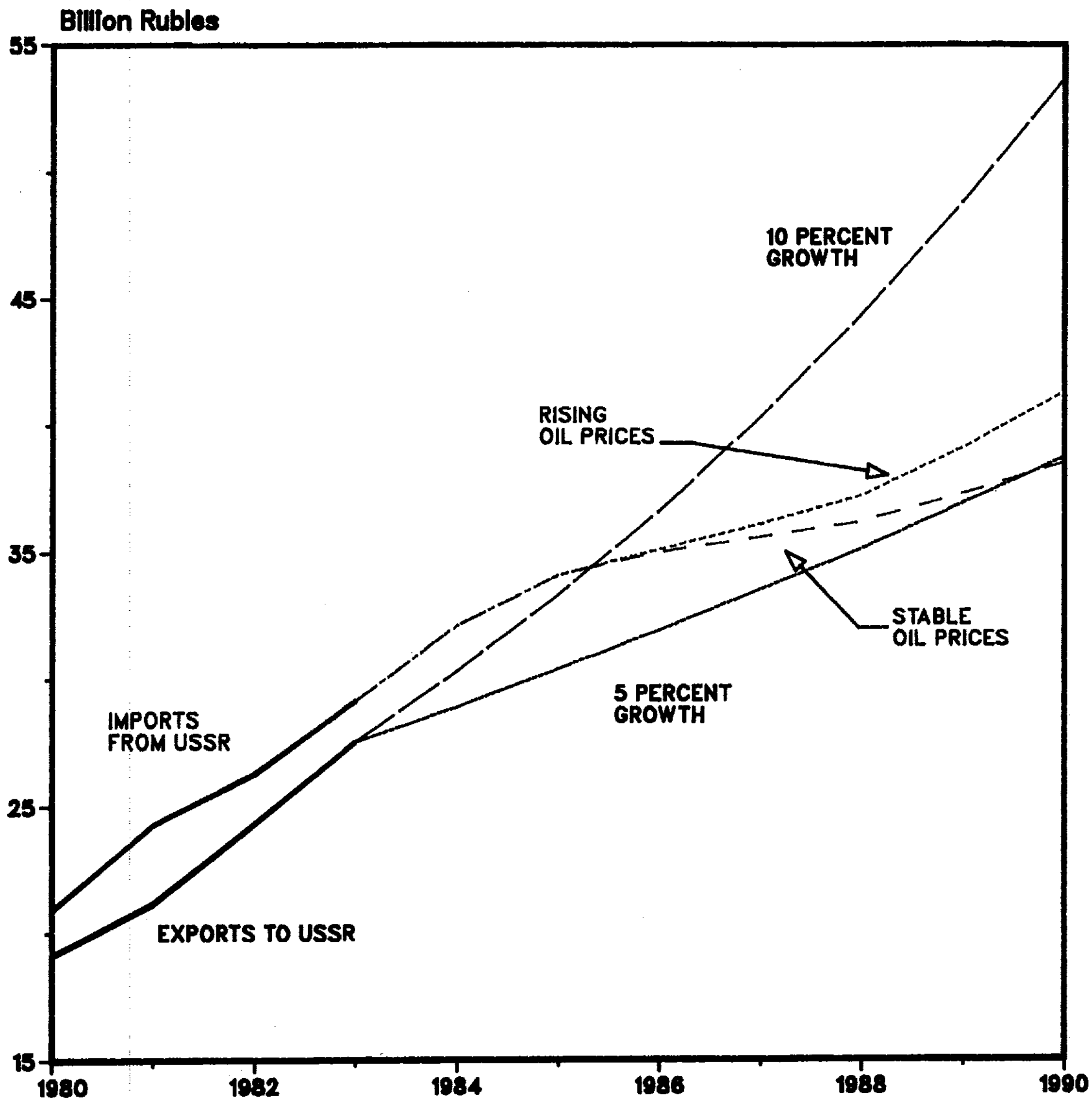
Meeting Soviet Demands. We believe that Eastern Europe could balance trade with the Soviets soon if world oil prices remain stable, and if—as we expect— 25X1 Soviet nonenergy exports and East European exports follow current trends. CEMA planners have decided to retain the moving average formula through the next five years, thus binding Soviet energy prices to movements in world prices. If East European exports continue to expand by 10 percent a year, balance could be reached as early as next year. A slowdown in 25X1 East European exports, however, would postpone balance to the end of the decade. [redacted] 25X1

Moscow apparently believes Eastern Europe has 25X1 weathered its financial crisis and domestic economic difficulties sufficiently to begin improving the quality of exports to the USSR, but we believe Eastern Europe will be hard pressed to divert goods to the Soviets and still export enough to hard currency markets to keep creditors at bay. For the time being, Soviet leaders apparently are willing to gamble that most East European countries are resilient enough, politically and economically, to handle these strains. [redacted] 25X1

Each of the East European countries likewise faces tough, albeit narrower, choices, based on the strength 25X1 of their economies and their willingness to pursue policies at odds with Moscow. They can agree to bind themselves closer to the USSR and forgo Western ties, thereby falling further behind the West with outmoded technology and a ponderous economic system, or they can try to forestall attempts at closer integration and risk not only the ire of Moscow but the hard realities of world markets. [redacted] 25X1

Poland and Romania, the countries with the most serious economic problems, seem most willing to forge 25X1 closer ties with the USSR to obtain economic support.

SOVIET–EAST EUROPEAN TRADE PROJECTIONS[a]



[a] Projections assume: (1) world oil prices either stable or increasing five percent annually, (2) five percent annual increases in Soviet nonenergy deliveries, (3) level oil and coal deliveries, (4) nine percent annual increases in the volume of gas and value of electricity imports (5) exports growing five and ten percent.

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Moscow showed during the Polish crisis that it is willing to extend substantial aid to shore up an ailing East European ally. Hungary and East Germany, the countries with perhaps the healthiest economies, are being pressed the hardest, but Hungary appears determined to pursue its policy of economic reforms at home and continued ties with the West. Bulgaria and Czechoslovakia, politically and economically close to the Soviets and financially independent from the West, are likely to defer to persistent Soviet demands.

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It is possible that Soviet economic policy could have the eventual effect of making East European economies more self-sufficient rather than dependent on the USSR. The Soviets may allow the East Europeans to undertake systemic reforms, and import Western technology and machinery to upgrade export sectors so that the region can meet Moscow's demands for better quality goods. Weaned from cheap Soviet oil, East European economies will be forced to become more energy efficient.

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Glutted Western Markets and the Cost of Moscow's Empire 25X1

One Analyst's View

This article does not represent a DI or CIA position; it is solely the view of the author. It has not been coordinated or reviewed.

Conventional Western analysis of Soviet subsidies to Eastern Europe has overstated the appeal to Moscow of diverting to hard currency markets the oil and other raw materials now sold to Eastern Europe. The softening of these markets in recent years has made such diversion less lucrative and less feasible.

The Oil Price Subsidy
Studies in recent years by Jan Vanous and Michael Marrese have estimated that the USSR's assistance to Eastern Europe has been as high as $19 billion in 1981.[1] They have singled out concessionary oil sales as the major East European economic benefit from Soviet trade. Most Soviet oil sales to CEMA countries are for soft currency at prices dictated by the CEMA pricing formula, which, since 1976 has calculated the price in any given year as the average of world market (OPEC) prices in the previous five years. The price of Soviet oil in 1979, for example, was the average of 1974-78 OPEC prices. The combination of the lag built into the pricing mechanism and rising OPEC prices meant that CEMA benefited from the purchase of Soviet oil beginning with the first oil shock in 1973. The East Europeans had to pay steadily rising prices for Soviet oil, but the subsidy provided by the difference between OPEC and Soviet prices greatly cushioned them and allowed them to postpone the adjustment to the hikes in oil prices. This subsidy peaked in 1980 when the West paid $30 a barrel for OPEC oil and Eastern Europe paid the equivalent of $12 a barrel for Soviet oil.

This subsidy has fallen sharply in recent years, a fact analysts have been slow to recognize. OPEC prices have slumped, while CEMA prices have continued to climb because the years newly included in the formula have represented higher prices than the years being dropped from the formula. In 1984 the $30 a barrel CEMA price exceeded OPEC's $29 level so that the direction of the price subsidy was reversed in Moscow's favor. The CEMA price will continue to rise as long as the price in the fifth year (the previous year) exceeds the price in the first year (five years before the current year). Thus, the CEMA price has increased again in 1985, further widening the subsidy to the USSR.

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A more serious error than the belated awareness of the closing—and recent reversal—of the gap between OPEC and CEMA oil prices is the simplistic method of calculating the subsidy. Analysts have regarded the oil price break to Eastern Europe as an opportunity cost to the USSR, under the assumption that Moscow could earn the OPEC price if it chose to divert oil from Eastern Europe to the West. Vanous and Marrese state that the true opportunity cost of selling oil to Eastern Europe in 1983 was $21 billion in hard currency—a figure obtained by multiplying the OPEC price of $29 by the volume of oil delivered to Eastern Europe. 25X1

Some Soviet officials have seized upon the Vanous-Marrese formulation to highlight the cost of supporting Eastern Europe. At a symposium with American economists in Moscow last June, a Soviet economist presented a paper entitled "Methods for Calculating Soviet Subsidization of CEMA Countries," which detailed the various forms of economic assistance from the USSR. Obviously relying heavily on work by Jan Vanous and Michael Marrese, the Soviet estimated that Eastern Europe 25X1

[1] Jan Vanous and Michael Marrese have published several studies in recent years on Soviet subsidies to Eastern Europe. Their most complete statement is found in *Soviet Subsidization of Trade With Eastern Europe—A Soviet Perspective*, Berkeley, Calif.: Institute of International Studies, University of California, 1983.

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Calculations of Soviet Opportunity Costs

	Present Export Structure	Effect of Diverting Oil From East to West	
		Conventional Analysis: No Price Effect	Present Analysis: Oil Price Falls $3/Barrel
OPEC price *($/barrel)*	29.0	29.0	26.0
Sales to Eastern Europe *(million b/d)*	1.4	0	0
Sales for hard currency *(million b/d)*	1.4	2.8	2.8
Annual hard currency earnings *(billion $)*	14.8	29.6	26.6
Hard currency gain *(billion $)*	0	14.8	11.8

saved $25 billion in fuel costs from 1975 to 1983 because of cheaper Soviet energy supplies. He stated that "Soviet losses can be measured by the opportunity cost of exporting the corresponding goods to capitalist markets," and assessed the damage to the Soviet economy as the potential contribution to Soviet growth of Western equipment imports that could be purchased for that amount of hard currency. Even the Hungarian economist Koves, while critical of Western studies of subsidies, accepts the assumption that Soviet oil could be easily diverted to Western markets.

This assumption is a serious error. For it to be valid, the USSR must be a price taker on the world oil market, particularly after adding oil presently sold to Eastern Europe. Although Soviet oil traders generally have been cautious and willing to follow OPEC's lead in pricing, the Soviets have supplied a significant share of the West European market, probably enough to influence prices significantly by abrupt and large volume changes. The addition to existing sales to the West of the 1.4-1.6 million barrels per day sold to Eastern Europe in the past decade would have been a substantial "new source" of oil and would have depressed prices even during periods of strongest demand. 25X1

This is even more true in the present fragile oil market, which would be unable to absorb 1.4 million b/d of additional oil—the amount Moscow now supplies to Eastern Europe—without serious disruption. OPEC oil ministers had great difficulty reaching an agreement to lower the quotas by this amount last October, and there are recent indications that that agreement may be unraveling. If Moscow brought this oil to Western markets, prices would probably tumble, including the price of the 1.4 million b/d that the USSR now sells for hard currency. 25X1

Moscow's significant market power means that opportunity costs in the form of forgone hard currency revenues are less than assumed in the conventional estimates of the burden of empire, because the alternative of selling oil to the West is much less lucrative and feasible than has long been believed. 25X1 Not only would the Soviets have to accept lower prices from additional sales, they would have to discount present oil sales. If Moscow shifted all of its oil exports from its allies to Western markets, the price of oil would fall and erode the gains from diversion. Each $1 reduction in the price of oil would reduce the Soviets' gain by about $1 billion annually. Conventional analysis holds that the USSR is forgoing nearly $15 billion a year in hard currency by exporting oil to Eastern Europe; I believe Moscow is forgoing only about $12 billion annually because adding 1.4 million b/d could reduce the gain by some $3 billion, on the arbitrary but plausible assumption that additional oil sales would depress the world market price to $26 per barrel. 25X1

Caveats

The above discussion concerns only the price component of Soviet economic support for Eastern Europe. It does not address benefits associated with, for example, the overpricing of Eastern Europe's exports of manufactured goods to the Soviet Union. Moreover, the scenario—that Moscow would abruptly stop shipments of fuel and raw material to Eastern Europe in favor of hard currency markets—is an extreme one. It implies a need for hard currency so desperate that Moscow would risk a precipitous collapse of East European economies. A more plausible Soviet move would be to reduce exports to Eastern Europe in small amounts over a long period of time, which would give Western markets—and the East Europeans—more time to adjust to the shifts. Moreover, the East Europeans would enter the market as buyers to absorb some of the increase in supply, although limited financial capacity would keep the amount low. 25X1

Implications

Thus, Moscow is sacrificing less to support Eastern Europe than is generally believed. This, along with a strong hard currency position, may explain the relative stability of Soviet oil deliveries to its allies in recent years. Moscow apparently diverted some oil from Eastern Europe to earn hard currency in 1982, but weak Western markets probably were a factor inhibiting further shifts. Continued glutted oil markets would not necessarily deter Moscow from diversions in the future, but the potential for disruption should argue against abrupt and massive cuts in deliveries to Eastern Europe to earn hard currency. In present circumstances, with oil production having declined slightly in 1984, a more appealing alternative may be to divert oil to the home market rather than to the West. The relevant measure of the opportunity cost to the USSR of supplying oil to Eastern Europe is the impact on the Soviet economy of "losing" oil that could satisfy the needs of industry and consumers. 25X1

This analysis should be considered a significant modification to, rather than a rebuttal of, the widely held view that Eastern Europe enjoys favorable terms in its purchases of Soviet oil. Even though CEMA prices now exceed OPEC prices, for example, Eastern Europe does benefit from exchanging its relatively low quality goods for Soviet oil. Previous estimates, however, have overstated the costs to the USSR by belatedly taking into account the catching up of CEMA to OPEC prices and by neglecting the difficulties Moscow would have in selling oil in glutted hard currency markets. Discussions of Soviet opportunity costs should consider more carefully the Soviet position, both current and potential, in Western markets. 25X1

The analysis also applies to other Soviet exports to Eastern Europe. Moscow's second-leading export, natural gas, offers even fewer promising opportunities for hard currency earnings. The Soviets are having difficulty in nailing down commitments for the quantities that West European buyers agreed upon several years ago. The price situation is more complex than for oil, but it seems likely that even deeper price reductions would be necessary to increase hard currency sales of gas. Moreover, unlike oil, natural gas exports require a complex and expensive transport system, which would make it much more difficult to divert exports of gas quickly from Eastern to Western Europe. 25X1

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Economic News in Brief

Western Europe

[redacted]

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Spain's exports surge: Madrid estimates real exports rose 20 percent in 1984, helping to turn the current account deficit of $2.5 billion in 1983 to surplus of $2 billion . . . export performance also drove real GDP growth up 2.5 percent in accordance with Madrid's goal . . . a slight erosion of price competitiveness and strengthening domestic demand may slow real export growth to 4 to 5 percent next year, but the current account should show another surplus. [redacted] 25X1

Canada denies nuclear reactor contract: Officials of the Canadian firm AECL say no contract has been signed with Ankara for a nuclear power reactor, according to the US Embassy in Ottawa . . . Ankara's announcement in January had implied that AECL had won contract . . . ambiguous government statement may have been intended to put pressure on other bidders to sweeten proposals. [redacted] 25X1

European Space Agency participation in US space station program: Contribution will be a space laboratory called Columbus . . . ESA also plans to develop more powerful Ariane rocket . . . cooperation with United States allows West Europeans to upgrade technology while pursuing their own projects. [redacted] 25X1

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Looking Ahead

February

Norway

Trial of the Norwegian official arrested last year for spying for the Soviet Union, Arne Treholt, begins in late February. 25X1

March

Western Europe

Madrid and Rome are the **first stops on Soviet Foreign Minister Gromyko's swing through Western Europe** in late February and March . . . visit to The Hague, Brussels, and London are under discussion . . . tour will be an opportunity for anti-INF demonstrations. 25X1

Poland

The Polish Government will raise food prices in March as part of its plan to hike overall retail prices by 12 to 13 percent this year . . . chance of major protests reduced because the regime has engaged the public in discussions for months and has promised payments to at least partially compensate for the increased cost of living. 25X1

Italy

Prime Minister Craxi hopes his **visit to Washington** on 5-6 March will boost his popularity at home as he prepares for nationwide local elections in May . . . Craxi's Socialists want to score at least 15 percent of the vote . . . less than that could weaken his control of the party and his grasp on the premiership. 25X1

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France

Cantonal elections set for 10 and 17 March . . . will elect representatives to recently enhanced departmental and regional assemblies . . . rightwing opposition parties likely to win significant overall victory. 25X1

Canada

Canadian Prime Minister Mulroney will convene a National Economic Summit of provincial government, business, and labor leaders on 22-23 March . . . he wants to form a consensus to support trimming the nearly $30 billion federal budget deficit . . . likely to be tough sledding, because provincial and labor leaders place job creation ahead of deficit reduction. 25X1

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Hungary	**The Communist Party** holds its **13th party congress** in Budapest starting on the 25th of March . . . the congress will probably endorse further economic reform and may see the elevation of younger officials to senior party posts. 25X1
Belgium	**Brussels** is to take **"final" decision on INF deployments** in March . . . Flemish Socialists will hold mass meeting in Antwerp on 23 March . . . debate on INF all but certain. 25X1
Spain **Portugal**	**EC Summit in Brussels on 29-30 March** probably will wrap up **membership negotiations with Spain and Portugal** . . . agricultural and fishing issues only remaining key obstacles . . . target for entry of 1 January 1986 still feasible but requires summit success. 25X1