Intelligence

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USSR: Facing the Dilemma of Hard Currency Shortages

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A Research Paper

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May 1986

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Directorate of
Intelligence

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USSR: Facing the Dilemma of Hard Currency Shortages [redacted] 25X1

A Research Paper

This paper was prepared by [redacted] the Office of Soviet Analysis. [redacted] 25X1

Comments and queries are welcome and may be directed to the Chief, Economic Performance Division, SOVA [redacted] 25X1

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USSR: Facing the Dilemma of Hard Currency Shortages [redacted] 25X1

Summary

Information available as of 2 May 1986 was used in this report.

Low energy prices, declining oil production, and a depreciating dollar will substantially reduce the Soviets' ability to import Western equipment, agricultural goods, and industrial materials for the rest of the decade. The decline in Moscow's hard currency import capacity—most likely on the order of one-third—comes at a time when Gorbachev probably is counting on increased inputs from the West to assist his program of economic revitalization. [redacted] 25X1

Although projections of future import capacity are fraught with uncertainty, we believe that Moscow faces the prospect of real imports falling to levels comparable to those of the mid-1970s. This estimate allows for some increase in debt to the West, substantial annual gold sales, and an $18 average price per barrel for Soviet crude oil and oil products during 1986-90. It also reflects our belief that Moscow will be unable to increase substantially nonenergy exports, including arms, during this period. [redacted] 25X1

Possibly caught by surprise and uncertain over the degree of the problem, Moscow reacted to last year's fall in oil earnings with increased borrowing and gold sales. By late 1985, however, Soviet traders' purchasing activity had slowed, and by February 1986 planned purchases were being scaled back. While some orders continue, the cutbacks appear to be across the board and are even affecting imports of equipment for oil and gas fields. [redacted] 25X1

These cuts, in addition to dealing with the immediate scarcity of hard currency, will allow the leadership time to implement a more coherent import strategy—one that reflects the long-term nature of the problem. The import pattern that emerges should give a clearer indication of the relative importance of various economic sectors to Gorbachev's program. Gorbachev faces a difficult time in choosing among competing demands for foreign exchange:

- *The modernization program.* While the success of Gorbachev's modernization program hinges on internal factors, his lofty goals imply that some highly specialized imports from the West for such sectors as energy, machine tools, microelectronics, and telecommunications must be continued, if not increased. Import cuts in key intermediate goods such as specialty steels, in turn, could strain already taut production schedules.

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- *Consumer welfare.* A cutback in hard currency agricultural imports would result almost immediately in reduced availability of such commodities as meat, vegetable oil, coffee, cocoa, and some fruits and—depending on the size of the grain crop—could mean slower growth in domestic production of meat, milk, and eggs. 25X1

There are several areas where Moscow could take action to counter the adverse impact of the hard currency cuts:

- *Economic initiatives.* Soviet planners will need to revise the five-year plan to account for reduced imports. Moreover, should current efforts to boost productivity and efficiency falter, they might consider bolder economic reforms to carry out Gorbachev's ambitious capital renewal policy without drawing heavily on resources slated for defense.

- *Western involvement in the Soviet economy.* Prior to the fall in oil prices, Soviet planners, including Gorbachev, were reportedly considering altering the nature of the relationship between Soviet entities and Western firms to enhance the effectiveness of the technology and equipment that the USSR will be able to afford. They recently have shown an interest in joint ventures entailing Western profit sharing and managerial presence, closer engineering and production consultations with Western firms, and the creation of more training facilities with Western participation.

- *Political relations with the developed West.* We believe the Soviets will consider ways—short of real concessions on significant political or security issues—to foster a climate conducive to attracting cheap government-backed credits and Western involvement in the Soviet economy. The Soviets could consider, for example, toning down anti-US rhetoric, relaxing restraints on Jewish emigration, and allowing expanded intra-German ties. Flexibility would be strongly constrained, however, by an expressed Soviet policy aim of reducing long-term vulnerability to Western economic leverage.

- *Relations with Eastern Europe.* Moscow is likely to increase pressure on its East European allies to fill some of the gap in hard currency imports; it may also divert some of its oil exports away from the region. But Eastern Europe is not in a position to provide the scale of support the Soviets require. Moreover, as falling oil prices reduce the value of planned

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Soviet exports to Eastern Europe, the latter will be in a stronger position to resist Soviet pressures for increased exports.

- *Relations with the Third World.* Moscow's policies toward the Third World, including its clients, are not likely to be significantly affected. The hard currency component of military and economic aid has been traditionally kept to a minimum. Hard currency support has been sizable only with Cuba, totaling $700 million in 1984. We expect the Soviets to be more aggressive on the international arms market, including an increased willingness to part with state-of-the-art arms and provide military technicians in order to boost hard currency sales. 25X1

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Downturn in 1985

Moscow's hard currency trade surplus dropped from $4.4 billion in 1984 to under $1 billion in 1985 as a result of declining export earnings. On the basis of preliminary Soviet trade data for the year, we estimate that hard currency exports declined by over 15 percent to $27 billion, the lowest level since 1979 (see figure 1). Falling domestic oil production and weakening oil prices took the largest toll, leading to a 20-percent reduction in earnings from oil exports. The available data further indicate a similar percentage decline in Soviet arms exports, while most other commodities remained at about the 1984 level. In contrast, imports fell only about 5 percent, with most of the reduction coming in the second half of the year.

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Moscow countered the earnings decline through increased borrowing.[1] According to Western financial statistics, Soviet debt to Western banks increased by $6.5 billion in 1985. Although short-term borrowing increased, the Soviets took advantage of their strong credit rating to raise about $2.8 billion in medium- and long-term syndicated loans at favorable interest rates and repayment periods (see appendix A). Moscow also requested some Western firms to arrange for supplier credits or deferred payments for Soviet purchases. In addition, gold sales reached approximately 180 metric tons, compared with less than 100 tons in each of the previous two years, earning Moscow about $1.8 billion. These adjustments, along with cuts in imports, allowed Moscow to rebuild assets from a low of about $8 billion at the end of March 1985 to $12 billion by the end of December, about $2 billion higher than the amount at the end of 1984.

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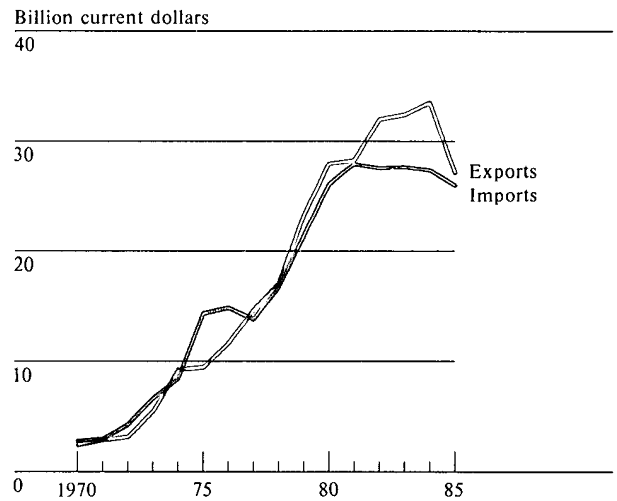
[1] In addition to covering payment for reported imports, Soviet hard currency export revenues are used to meet unrecorded expenditures and debt service obligations. Reported exports overstate actual earnings because of credits—net of repayment—extended to the LDCs. Thus, the drop in hard currency exports last year required the Soviets to look to other sources of funds to a greater extent than had been the case the last few years.

Figure 1
USSR: Hard Currency Imports and Exports, 1970-85



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The sharp reversal of Moscow's hard currency position appears to have taken Soviet planners by surprise. Soviet officials, in fact, may have initially viewed the export shortfalls last year as a temporary event resulting from lagging oil production and severe winter weather. Throughout the summer and early fall, trade officials continued to negotiate and sign major contracts with Western firms for projects to be constructed during the 1986-90 period. The failure to come to grips with the problem sooner may also have been due to some confusion in the Soviet bureaucracy as new appointees to top positions in the State Planning Committee (Gosplan) and Foreign Trade Ministry worked to develop strategies that would incorporate new directions proposed by Gorbachev. By late

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fall, however, Soviet officials were complaining of hard currency shortages The buildup in Soviet assets, in turn, reflected Mocow's taking advantage of favorable borrowing conditions to provide a cushion against future hard currency needs.

Deteriorating Export Earnings in 1986 and Beyond

Slumping Oil Revenues. The sharp drop in world oil prices this year has dramatically altered Moscow's earnings position. Reduced prices, combined with taut availability of Soviet oil for export stemming from production problems, are likely to push Soviet hard currency exports in 1986 down even further than in 1985; earnings from oil and gas could fall by as much as $6-7 billion. The bulk of this drop—about $5 billion—would result from sustained low crude oil prices of about $15 per barrel or less and lower gas prices.[2] Up to another $2 billion could be lost if oil production problems lead to a further drop in the volume of exports. We estimate that oil production will at best remain at the current rate of about 12 million barrels per day (b/d) and could fall to 11.6 million b/d by the end of the year.

As in 1985, oil exports to hard currency countries would probably bear the brunt of any production declines. With few short-term opportunities at home for stepping up the pace of energy conservation or oil substitution, reduction in deliveries to domestic consumers probably would disrupt production at a time when Gorbachev is placing a high premium on boosting economic growth (see inset on the domestic demand for oil). With hard currency shortages of its own, Eastern Europe would be hard pressed to replace Soviet oil deliveries diverted to the West, despite the fall in oil prices. The region already faces tight energy supplies as evidenced by severe shortages in several countries during the past year, and even modest cuts in oil deliveries could seriously undermine the economic performance of several countries.

[2] At present, the condition of the world oil market makes it almost impossible to predict an average oil price for 1986. We have estimated an average price per barrel of $17 for all exports of Soviet oil, which assumes a world crude oil price of $15 for the year and also takes into account the relatively high share of refined products in Soviet exports.

Domestic Demand for Oil in 1986-90

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Domestic demand for oil is likely to remain close to the current rate of 9 million b/d as Gorbachev pushes forward with his industrial modernization program. Most of the easy gains in substituting gas for oil have already been made, especially for boiler fuel in electric power generation. A further decline in the power industry's use of oil is possible—as much as 275,000-b/d oil equivalent by 1990 if coal supplies increase, nuclear power plant construction accelerates, and hydropower generation is not constrained by low water levels. Gas substitution beyond this level—though technically feasible—is likely to be constrained by the lack of feeder pipelines and control instrumentation. On the other hand, increased demand for power generation at thermal power stations to offset shortfalls in any of these areas could reduce the potential gain substantially.

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Forced conservation through reduced oil allocations, though possible, is risky. Most Soviet enterprises lack the proper measurement and control instrumentation to effectively monitor and adjust their expenditure of fuel (either oil or gas). Given the heavy emphasis on rapid output growth in the energy-intensive sectors of the economy, such as machine building and metalworking, it seems unlikely that much forced conservation could occur without seriously jeopardizing Gorbachev's plans for modernization.

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The modernization program will also push up demand for more light fractions in the mix of refined oil products. We estimate that the Soviets will need to refine about 600,000 b/d of additional light oil products (gasoline, jet fuel, diesel fuel) by 1990. Meeting this demand will hinge on the Soviet Union's ability to increase its catalytic cracking capacity. Moscow will need to construct or acquire 15 catalytic cracking units, each with a capacity of 40,000 b/d throughput. The Soviets have built only two such units since 1977. Importing the needed cracking capacity from the West would be the fastest and technically most efficient option, but would cost over $1 billion in hard currency.

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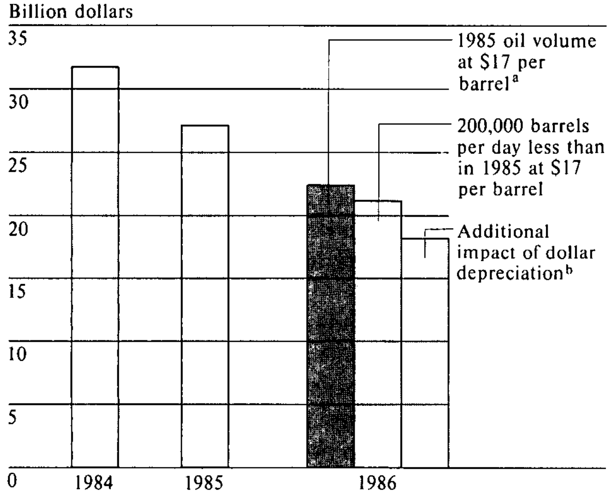
Figure 2
USSR: Hard Currency Exports, With Alternate Estimates for 1986



[a] Assumes a lagged reduction in gas prices and a slight increase in the quantity of gas exports.
[b] Assumes impact of a 20-percent depreciation of the dollar, affecting 70-percent of imports that are in nondollar currencies. Values for 1984 and 1985 are converted from rubles to dollars using the average ruble/dollar rate for the given year. In 1984 and early 1985 the Soviets benefited from a 3-percent dollar appreciation.

[redacted]

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Outlook for Oil Production

Oil production has fallen for two consecutive years, and we expect further declines during the rest of the decade. A massive dose of new investment, such as that scheduled for 1986, could stabilize or even increase production for a short time. But this would only be a stopgap measure; we expect depletion and rising maintenance costs to outrun the introduction of new capacity, requiring ever-increasing allocations of investment each year just to sustain production:

- *New well flow rates have been declining steadily since 1975. We expect this trend to continue as infill drilling is stepped up and nonflowing wells are put on pump.*

- *Rising water cuts, which currently exceed 50 percent in Tyumen' and 69 percent nationwide, intensify production problems. The water problem will worsen as the well inventory expands.*

- *In the long run, new provinces with giant oilfields will have to be found and developed if prospects are to improve. In this context, the Barents Sea may hold considerable potential, but any sizable commercial production from this area is unlikely before the 1990s.* [redacted] 25X1

A Declining Dollar. Moscow must also contend with a sharp erosion in its buying power caused by the rapid fall of the US dollar. Roughly two-thirds of Soviet exports are priced in US dollars, while about 70 percent of Soviet purchases are made in other hard currencies. As a result, a 20-percent drop this year in the value of the US dollar against the market basket of currencies used to finance Soviet imports would decrease the buying power of Soviet export earnings to a level 15 percent below that of last year (see figure 2). [redacted]

Over the Longer Term. Moscow's reaction to current problems will be influenced to a large extent by its estimates of the long-term outlook for oil exports. At present, the Soviets may not view the problem as long term. [redacted] 25X1 We believe, [redacted] that the Soviets will eventually have to come to grips not only with low oil prices, but also with declining oil production (see inset). Moreover, our projected increases in gas sales of approximately 50 percent will only partially compensate for falling earnings from oil exports as the price of gas—following that of oil—constrains gas revenues. 25X1

[redacted] 25X1

Coping With Revenue Declines

While the USSR is currently in a healthy financial position, Soviet planners have limited options available to offset a sustained fall in oil earnings:

- Soviet assets in Western banks currently amount to $12 billion, and Moscow could probably draw down these assets by as much as $4 billion without seriously jeopardizing its liquidity position.

- The USSR's excellent credit rating among Western creditors offers the possibility of increased borrowing at favorable rates. For example, Moscow could easily raise another $1-2 billion in syndicated borrowings this year and additional amounts from other sources. The Soviets may also push for lower interest rates and longer repayment terms on loans that they negotiate.

- We believe that the USSR—with an estimated 2,800 tons of gold in reserve and annual production of 340 tons—could increase annual sales to 300 tons from recent levels of 100 to 200 tons without disrupting the market, and perhaps discreetly sell an additional 150 tons through futures markets and nontraditional buyers. Sales of 300 to 450 tons in 1986 would raise an additional $1.2-2.7 billion in revenues over the 1985 level of $1.8 billion. (See appendix B for a more detailed discussion of Moscow's gold strategy.)

- The Soviets may even seek to expand arms sales by offering more sophisticated weapons to a larger number of clients, perhaps on a barter basis as a substitute for what normally would be hard currency purchases.

- Moscow also could look to boost other nonenergy exports such as diamonds, chemicals, nonferrous metals, and wood products by offering the goods at prices below market values or via countertrade arrangements. In the long run, Soviet efforts to expand exports of manufactured items—especially machinery and equipment—by offering greater incentives to producers may also have some success.

So far this year, the Soviets have actively utilized several of these options to offset the continued decline in their export earnings. Gold sales through February are estimated at 100 tons or more, and the Soviets have raised about $800 million in syndicated loans in Western financial markets. They also appear to be pressing for government-backed credits with maturities of 10 years or longer and interest rates below 7 percent in an effort to lessen their debt service obligations over the next few years. Although first-quarter statistics are not yet available, Moscow may also have drawn down some of the assets that it rebuilt in the fourth quarter of 1985. 25X1

Moscow, however, is unlikely to continue for long with a strategy of heavy borrowing to limit the fall in import capacity. The leadership, recognizing that East-West lending is a political as well as an economic phenomenon, is loath to put itself in the position of being overly dependent on Western banks and their governments. In particular, Moscow is unlikely to undertake any steps—either by large borrowing or excessive drawdown of existing assets—that would jeopardize its ability to finance key imports such as grain in bad harvest years. 25X1

Other than expanded gold sales, the USSR's options offer little potential to counter declining oil revenues. The level of arms sales is heavily linked to the oil market: we doubt that Moscow can expand these exports greatly as long as depressed oil prices weaken the economies of major arms purchasers in the Middle East. Attempts to boost exports of other nonoil commodities—such as machinery and equipment and raw materials—are likely to have limited success given generally weak demand for raw materials and Western resistance to shoddy Soviet-manufactured items. 25X1

Cutting Imports To Close the Gap

Moscow faces the almost certain prospect of a substantial and sustained reduction in its capacity to

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import from the West in 1986 and beyond. The extent of this reduction, however, is highly problematical, with the price of oil the key variable. In our view, Moscow faces the real possibility that its annual import capacity will be cut by one-third from the 1984 level of $27 billion. The resultant $18 billion annual average hard currency import capacity estimated for 1986-90 (expressed in 1984 depreciated dollars) is based on the following key assumptions:

- Each year during 1986-90 the volume of oil exports declines by 100,000 b/d. The blended price obtained from the mix of crude and petroleum product sales declines from $28 per barrel received in 1985 to an average of $18 per barrel during 1986-90.
- Gas exports rise from 33 billion cubic meters (m^3) in 1985 to nearly 50 billion m^3 in 1990.
- Gold sales increase to an annual average of 300 tons, but arms sales stagnate at the 1985 level.
- Moscow is unable to increase substantially other nonenergy exports for hard currency.
- Borrowing increases, but not past the point where service on existing debt exceeds 30 percent of hard currency earnings.
- The US dollar declines by 30 percent during 1986-90 vis-a-vis West European and Japanese currencies, with most of the decline occurring in 1986. [redacted]

The situation is obviously fraught with numerous uncertainties about the level of Soviet exports, the price conditions Moscow will face, and the financial options to be taken by the leadership:[3]

- In the extreme, if a prolonged oil price war cut oil prices to $10 per barrel, severe oil production difficulties further depressed Soviet oil exports, and other nonenergy exports such as arms declined, Moscow's annual hard currency import capacity could drop to below $10 billion.
- Conversely, if Moscow undertook draconian measures that held the line on oil production and even boosted oil exports by sharply cutting both domestic consumption and deliveries to its Communist clients, it would be able to raise annual import capacity to roughly the 1984 level. To the extent that external factors, such as rising oil and gold prices, work in Moscow's favor, Soviet policies could be less severe and still allow imports to rise. For example, if world oil prices quickly recovered to $20 per barrel, Moscow's annual import capacity would climb by almost $2 billion. [redacted] 25X1

Mounting evidence indicates that Soviet planners are in the process of adjusting the import program for 1986 and beyond to reflect reduced Soviet earnings. 25X1 [redacted] 25X1 The US Embassy in Stockholm reports that the Soviets told a visiting Swedish delegation in April that they need to cut imports from the OECD by 30 percent this year and that imports of consumer goods would be practically eliminated. The Stockholm report is supported by a recent Western press article that quotes Soviet Foreign Trade Minister Aristov as claiming that Western purchases will fall 25 to 30 percent this year. [redacted] 25X1

The decision to cut hard currency expenditures is affecting all types of purchases. The major emphasis at present, however, is cutting equipment imports rather than other items—agricultural products and intermediate goods—needed to meet current output targets: 25X1

- Soviet oil minister Vasiliy Dinkov stated in late January that most of the currently planned purchases of Western equipment for oil and gas fields would be postponed if not canceled [redacted] 25X1

[3] Sensitivity tests on our projections indicate that, except for changes in oil prices or arms sales, changes in the assumptions have only a marginal impact on projections of Soviet import capacity. (See appendix B for details on the sensitivity of the projections to changes in assumptions.) [redacted]

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[redacted] although cuts are occurring, some new contracts are still being signed.

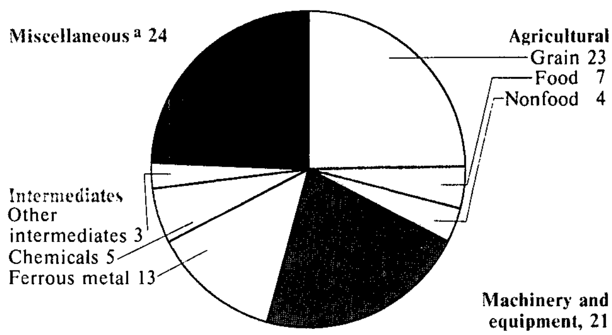
• [redacted] the US Embassy in Moscow report that the Soviets have scaled back plans for two petrochemical complexes, originally valued at about $1 billion each, and an agrochemical plant worth about $400 million.

[redacted]

Other imports are also being cut, but not as extensively as machinery purchases. [redacted]

Figure 3
USSR: Composition of Hard Currency Imports, 1984 25X1

Percent 25X1
1984 = 27.3 billion dollars



[a] Includes raw materials (including fuels), wood and wood products, and consumer goods.

[redacted] 25X1

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These cutbacks, in addition to dealing with the immediate scarcity of hard currency, will allow time for a coherent import strategy to be put into place. [redacted] 25X1 25X1

[redacted] 25X1 The import pattern that emerges over the next 12 to 18 months may bear little resemblance to the established priorities of recent years (see figure 3). Soviet decisions on what imports are cut and which remain should give a clear signal of the importance attached by the leadership to various sectors of the Soviet economy. Reassessing import plans may be further complicated, however, by the damage to the domestic economy resulting from the nuclear accident at Chernobyl'. [redacted] 25X1

Gorbachev's Modernization Program. Because of the relatively small role that trade plays in the economy as a whole, the overall impact of import reductions on

Soviet Dependence on Western Machinery

Although imports of Western machinery and equipment account for only about 10 percent of total Soviet investment in machinery and equipment, these imports have been carefully selected to meet the needs of priority sectors of the economy. Since 1980, purchases for the chemical, energy, and metallurgical sectors have accounted for almost 70 percent of total Soviet orders of machinery and equipment.

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The Soviets often complain that they have been disappointed with the results of Western machinery, but the degree of success in using such imports often depends on whether they must be interfaced with other Soviet-built machines or can be used in a stand-alone manner (for example, turnkey plants). The latter have contributed substantially to growth in output and enhancement of technology in selected industries, notably chemicals, automotive, pulp and paper, and several defense-oriented machine-building industries.

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Imports of Western technology have helped the Soviets overcome some crucial shortcomings in Soviet technology:

- *In the steel sector, purchases of Western technology for rolling operations and pipe production have been particularly important.*
- *In the chemical sector, Western imports have provided key technologies for the production, handling, and storage of fertilizers and for production of plastics and synthetic fibers.*
- *In the oil and gas sectors, recent imports of such items as Western pipe, pipelayers, offshore drilling and production equipment and technology, and well-completion equipment have provided substantial aid to Soviet oil development. In the future, the Soviets will need and probably will continue to buy corrosion-resistant pipe, and production and processing equipment for Astrakhan, Karachagarde, Tengiz, and for offshore needs.*

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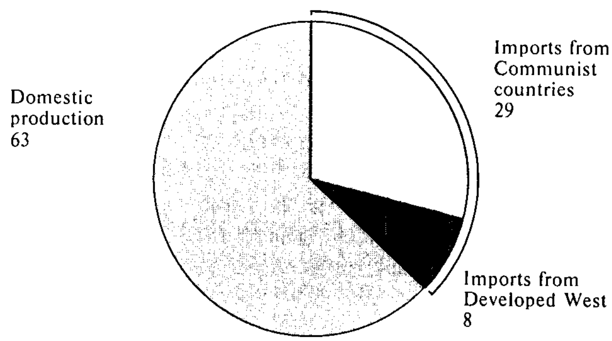
Figure 4
USSR: Share of Machinery and Equipment Imports in Total Machinery Investment, 1984[a]

Percent

Total: 64.3 billion rubles



[a] Assumes a coefficient of 1 for converting machinery prices from foreign trade rubles to domestic rubles.

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economic performance will be limited. The consequences for several key sectors, however, could be quite serious. The share of machinery and equipment from hard currency countries is, according to our estimates, about 10 percent of total machinery investment. Purchases of Western equipment, nonetheless, have been important in improving production in the defense, chemical, metallurgical, oil and gas, and automotive industries (see figure 4 and inset on Soviet dependence on Western machinery). Moreover, the modernization program's lofty goals—when matched against a realistic assessment of the capabilities of domestic industries—imply that some highly specialized imports from the West for such sectors as energy, microelectronics, and telecommunications must be continued, if not increased. In addition, in an era of increasingly tight resources, marginal changes in availability of all resources (including hard currency) become more important.

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Other aspects of Gorbachev's plan to accelerate economic growth are also likely to suffer as import cuts exacerbate already taut production schedules. Shortages of needed intermediate goods and spare parts that have been imported in the past to prevent bottlenecks could slow or even temporarily halt production in some enterprises. Imports of specialty steels, in particular, are important to a number of sectors of the economy, including machine building. In addition, some sectors of the chemical industry require imports of key ingredients such as superphosphoric acid. Imported replacement parts are regularly needed in the energy and mining sectors for pipelayers and heavy earthmoving equipment.

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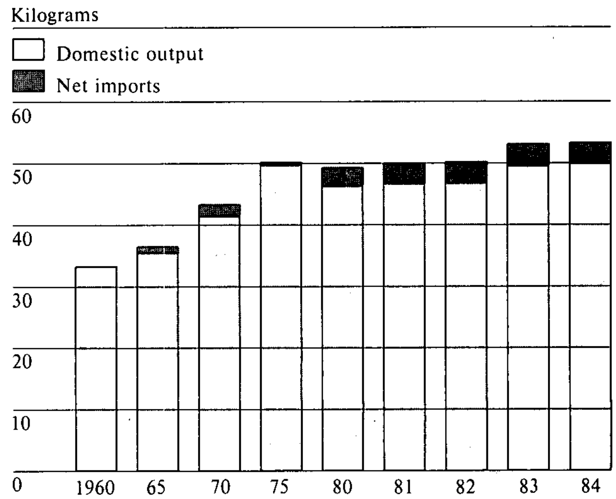
Consumer Welfare. The consumer, too, is unlikely to escape unscathed from import cutbacks. Imported farm products—over half of which have been hard currency purchases—have played a major role in maintaining dietary quality over the past few years, while agricultural production has been in the doldrums. Large grain imports have kept the livestock program on track, while other imports—including vegetable oil, fruit, sugar, coffee, and meat—have added quality and variety to a nutritionally adequate, but traditionally monotonous diet. For example, only by importing record quantities of meat—an average of about 900,000 metric tons annually during the 1980-82 period—did Moscow keep per capita consumption close to the previous record achieved in 1975 (see figure 5). A reduction in imports of hard currency agricultural products—which have averaged $10 billion annually since 1980—would result almost immediately in reduced availability of many commodities. Moreover, in the absence of bumper harvests of grain and other feed crops, import reductions would mean slower growth in domestic production of meat, milk, and eggs. This, in turn, would probably lower worker morale and reduce incentives to meet Gorbachev's call for increased worker discipline.

Figure 5
USSR: Availability of Meat per Capita[a], 1960-84



[a] Soviet official statistics on meat production are adjusted to conform to Western definitions of retail weight (trim, including slaughter fat and bone, is removed).

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A series of poor harvests would present the Soviet leadership with particularly difficult choices when balancing consumption goals with hard currency constraints. For example, cutting livestock herds to reduce the need for imported grain would postpone achievement of the 1990 per capita meat consumption target. At the same time, hard currency constraints would increase the urgency to successfully implement Gorbachev's domestic policies to improve agricultural performance and reduce waste. Some success here would lessen the impact of import cuts in the long run.

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Long-Term Adjustments

Changing Economic Initiatives. In allocating the burden of import cuts among the various claimants, Gorbachev is likely to factor in hoped-for gains stemming from his efforts to improve worker discipline and economic management. Specifically, he

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would like to eliminate some high-tech imports needed for economic modernization by substituting equipment that either the USSR or Eastern Europe is currently capable of producing. In addition, Moscow is most likely counting on improved machinery production to reduce the scope of equipment it now needs to import from the West. Hard currency outlays for agricultural products and intermediate goods may also be reduced to the extent that Gorbachev's efforts to improve domestic performance on these fronts begin to bear fruit. Weather, as always, will play a pivotal role; a series of good harvests might allow Moscow to cut imports substantially without jeopardizing consumer welfare goals. [redacted]

We doubt, however, that Gorbachev will be able to achieve the necessary improvements through current economic initiatives. Over time, as gains from discipline and management reorganization fall short of expectations, Gorbachev and his lieutenants may give increased consideration to bolder economic initiatives—greater decentralization, increased privatization—that many Western observers feel are necessary to sustain substantial improvements in domestic economic efficiency. [redacted]

With total imports severely constrained, Soviet planners may also take innovative steps to maximize the benefits from the limited amount of imports that can be obtained. [redacted] Gorbachev believes that the USSR must alter the nature of its relationship with Western firms if it is to increase, over time, the effectiveness of imported technology and equipment and find ways to reduce the immediate hard currency cost of imported technology. Soviet officials are most likely to consider coproduction and equity arrangements with Western firms as the most effective way of tapping Western capital and managerial skills. [redacted]

Even before the sharp downturn in oil earnings, Soviet officials had expressed interest in joint ventures entailing Western profit sharing and managerial presence. According to a Western press report, they are even considering joint-venture regulations along the lines of the Hungarian legislation that permits Western equity of up to 50 percent. [redacted] Soviet officials indicated in mid-March that joint ventures were being considered as part of an effort to formulate a plan to streamline the foreign trade infrastructure. The Soviets have also taken an interest in engineering, managerial, and production consultation with foreign experts in the energy and chemical sectors and have shown interest in setting up a training school with courses in drilling, well completion, and operation of offshore oil wells. [redacted] 25X1

Foreign Policy Options. The decline in hard currency imports may also induce Moscow to introduce some marginal changes in its approach to Eastern Europe, the Third World, and the Western Alliance. [redacted] 25X1 25X1

The USSR could turn to *Eastern Europe* to help carry some of the burden of reduced earnings, either by increasing imports above planned levels or decreasing oil exports to the region. Soviet oil exports to the region of approximately 1.4 million b/d—almost 40 percent of total Soviet exports to Eastern Europe—are the linchpin of current bilateral trade ties. Although Moscow has pledged to maintain the current level of deliveries, it may consider diverting oil to Western markets. [redacted] 25X1 25X1

Eastern Europe could absorb a marginal reduction in oil deliveries over the next few years, especially if world oil prices remain low. But the region's economies could not cope with cuts of the magnitude necessary to provide substantial relief to the Soviets. 25X1 Large cuts in oil deliveries would force Eastern Europe to look westward, which runs counter to Moscow's longstanding efforts to increase intra-Bloc trade at the expense of trade with the West. Moreover, such cuts could undermine the ability of the various regimes to maintain the level of stability that has been the rule in recent years. [redacted] 25X1 25X1

The East Europeans have strong economic reasons to resist Soviet pressures for further increases in exports over the planned level. The past several years have

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seen a marked reduction in the size of East European trade deficits with the USSR; by the end of last year, all East European countries, except Poland, had nearly balanced trade with the Soviets. Moscow, moreover, has apparently been successful in getting Eastern Europe to begin repaying outstanding debts. The recently signed trade plans for 1986-90 call for the East Europeans to continue increasing exports—both in quantity and quality—to the point where they will soon be running trade surpluses. The East Europeans agreed to these terms at a time when the CEMA oil price was only marginally above the world price. When the current oil price plunge begins to lower the CEMA oil price, the rate of repayment will accelerate quickly.[6] [redacted]

Soviet economic policies with the *Third World* since the end of the Khrushchev era have been pragmatic, aimed at obtaining the most economic and political benefits while limiting the cost. Economic aid is relatively small and generally tied to Soviet exports, with hard currency outlays kept to a minimum. For this reason, the USSR's policy toward the less developed countries (LDCs) is not likely to change much as a result of Soviet hard currency problems. Moscow will continue to sell arms and offer economic assistance to these countries for economic, political, and strategic reasons. [redacted]

In particular, Moscow will maintain its close ties to client LDCs such as Cuba, Vietnam, and Nicaragua, and continue to supply sufficient trade and aid to keep these economies afloat. It will probably be even more insistent that these countries increase their exports to the USSR and use Soviet aid more efficiently. Such pressures are likely to lead to increased strains in relations between the USSR and these states, but, given their dependence on Soviet assistance and lack of viable alternatives, any fundamental realignments are highly unlikely. [redacted]

The Soviets may focus their economic assistance program with nonclient states even further on selected projects considered to have large economic or political payoffs. They could more aggressively compete for projects in the relatively more advanced LDCs with offers of favorable credits. Such projects would increase Soviet nonenergy exports and earnings from related services and costs not covered by credits. Moscow may also increase its efforts to negotiate barter arrangements, particularly for purchases of desired agricultural commodities. Faced with financial problems of their own, the LDCs may become more receptive to Soviet overtures for barter deals. Finally, the Soviets may become more aggressive on the international arms market and more willing to part with state-of-the-art arms. [redacted] 25X1

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Greater Soviet need for *Western* trade and credits could lead Moscow to take Western attitudes and reactions into account when formulating its foreign policies, but not necessarily to become more accommodating. The likelihood of Soviet flexibility would depend substantially on how much opposition Gorbachev might encounter to such a position within the Soviet leadership, whether he believed that pursuing the issue might be useful in driving a wedge between Washington and its allies, and how vulnerable he perceives his domestic program is to cutbacks in Western imports. In addition, possible flexibility here would be strongly constrained by an expressed Soviet policy aim of reducing long-term vulnerability to Western economic leverage. [redacted] 25X1

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With these major qualifications, it is nonetheless conceivable that Moscow—while maintaining its sharp competition with the United States in the Third World—might be somewhat more flexible on selected East-West issues in an effort to create a climate more conducive to expanding Western commercial involvement in the Soviet economy. The Soviets could consider, for example, such tactical moves as toning down anti-US rhetoric, relaxing restraints on Jewish emigration, allowing expanded intra-German ties, and improving the atmospherics of Japanese-Soviet relations. [redacted] 25X1

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[6] Oil prices are set within CEMA on the basis of average world prices for the previous five years. If crude oil prices average $15 for the rest of the decade, prices for Soviet oil sold to Eastern Europe will still be above world prices by 1990. [redacted]

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Appendix A

USSR: 1985 Syndicated Loans

Month Signed	Lenders/Arranger	Terms	Value (million US $)
February	Arab-African International Bank, United Bank of Kuwait	Interest rate is 0.5 percent plus LIBOR, [a] and loan is payable in full at the end of five years.	100
	Banco di Roma, Bank of Nova Scotia, Bank of Tokyo, Dresdner Bank, Credit Lyonnais, Instituto Bancario di Sao Paulo di Torino	Interest rate is 0.5 percent plus LIBOR, and loan is payable in full at the end of five years.	100
	Swiss Bank Corp.	Eight-year loan with a four-year grace period at interest rates of 0.25 percent plus LIBOR for first 3.5 years and 0.125 percent plus LIBOR for the rest of term.	91
May	Lloyd's Bank International, Banco Commerciala Italiana, Banco di Roma, Banque Paribas, Sumitomo Bank, Credit Lyonnais	Seven-year loan at interest rates of 0.25 percent plus LIBOR for first 3.5 years and 0.375 percent plus LIBOR for rest of term with a four-year grace period.	210
	Credit Commerciale de France, Bank Internationale a Luxembourg, Kyowa Bank, Yasuda Trust Bank, Banco di Sicilia, Sumitomo Trust, Industrie Bank von Japan	Seven-year loan at interest rates of 0.25 percent plus LIBOR for first 3.5 years and 0.375 percent plus LIBOR for the rest of term with four-year grace period.	67
June	Deutsche Bank	Eight-year loan at interest rates of 0.25 percent plus LIBOR for first three years and 0.375 percent plus LIBOR for rest of term.	350
July	Dresdner Bank	Eight-year loan at interest rates of 0.25 percent plus LIBOR for the first four years and 0.375 percent plus LIBOR for the rest of term with a four-year grace period.	250
August	First Chicago, Arab Bank, Banque Indosuez, Dresdner Bank, Fuji Bank	Untied eight-year loan—no further details.	200
August/ September	Unnamed Japanese banks in London	Three separate loans—no other details available.	104
September	Banque Generale de Luxembourg, Caisse d'Epergne de l'Etate du Grand Duche	No details available.	15.1
	Industrial Bank of Japan	No details available.	23.25
October	Amsterdam/Rotterdam Bank, Tokai Bank, Nederland Banque Nationale de Paris, Lanschot Bondsparbanken	Eight-year loan with four-year grace period and repayable in nine semiannual installments at an interest rate of 0.25 percent plus LIBOR.	60.5
	Union Banques Arabes et Francaises (UBAF)	No details available.	100
November	Societe Generale, Bank of Tokyo, Banco di Sicilia, LTCB, Mitsui Trust Nippon Credit Bank, San Paulo–Lariano Bank, and others	Eight-year loan with a five-year grace period, repayable in seven installments at an interest rate of 0.25 percent plus LIBOR.	85.1
	Japanese bank in London, Moscow Narodny Bank process agent	No details available.	100
	Credito Italiano (Milan); Arranger—Italian bank in London, syndicated by seven Japanese banks	Eight-year club loan, repayable in nine installments at an interest rate of 0.25 percent plus LIBOR.	100

USSR: 1985 Syndicated Loans (continued)

Month Signed	Lenders/Arranger	Terms	Value (*million US $*)
November	First National (Chicago), Morgan Guaranty Trust, Irving Trust, Bankers Trust, Royal Bank of Canada	Part of the loan is committed funds, and remainder is a revolving banker's acceptance to finance grain purchases and other imports. The rate is 0.25 percent over banker's acceptance rate for first two years, and repayments are due six months after drawdown.	500
December	Morgan Grenfell, other Western banks invited to take positions	Eight-year loan at an interest rate of 0.25 percent plus LIBOR, with repayment in nine semiannual installments and a four-year grace period.	148
	National Westminster Bank	Seven-year loan at an interest rate of 0.25 percent plus LIBOR.	200
Total			**2,803.95**

[a] London Interbank Offered Rate.

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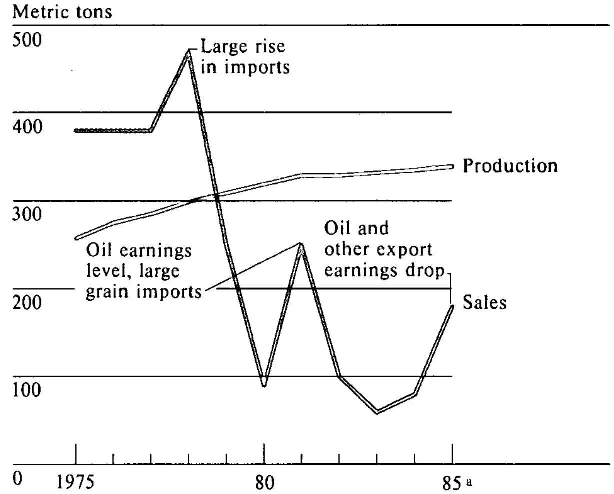
Appendix B

Soviet Gold Marketing Strategy

The Soviets have considerable flexibility with regard to gold sales. We estimate that the USSR produces approximately 340 metric tons of gold annually, although between 1982 and 1984 gold sales dropped below 100 tons per year. By adding new production to its stockpiles, the USSR has built up its reserves to about 2,800 tons. [redacted] 25X1

Analysis of Soviet hard currency balance-of-payments trends indicates that Moscow uses gold primarily as a financing mechanism rather than a trade commodity like oil. The Soviets generally sell more gold when they need a rapid infusion of cash, and less—even when prices are high—when they are in a good cash-flow position. Thus, during the mid-1970s when they needed to finance large purchases of grain and equipment, gold sales were high, whereas in recent years sales have been low as record oil sales to the West have obviated the need for extra cash (see figure 6). The decline in oil export earnings in 1985 sparked gold sales of 180 tons, and we believe a continued fall in oil earnings may well lead Moscow to resume even larger gold sales during the next few years. [redacted] 25X1

Figure 6
USSR: Gold Marketing Strategy, 1975-85



a The data for 1985 is estimated.

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Market specialists believe that Moscow could probably sell as much as 300 tons of gold on the open or "physicals" market in 1986 without much effect on the price—if the sales are spread over the year and among all the geographic markets. [redacted] the market watches the Kremlin's actions very closely and that Moscow would need to be very cautious to increase its sales volume in an orderly and nondisruptive manner. [redacted]

To avoid a substantial price drop on the open market, [redacted] the Soviets would turn to the futures markets to sell any major quantities in excess of 300 tons. Moscow uses the gold futures market to speculate, but—like most players in this market—does not get involved with physically transferring the commodity. With its cash flow currently constrained, the USSR might commit to a sale in the futures market and then—although it would be unusual in that market—actually deliver the gold and take the money. Increased sales in futures would be less likely to cause price ripples than straight market sales above 300 tons, because Moscow is already a large player in the futures market. [redacted]

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In addition to marketing gold on the physicals and futures markets, [redacted] Moscow is increasing its direct bilateral gold sales. [redacted]

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[redacted]. Direct sales take place at a mutually acceptable price and usually without any impact on the market. Although these sales normally show up in the partner country's annual foreign trade data (the Soviets do not report gold sales), the market would not be aware of the trade in a timely fashion. [redacted] 25X1

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The USSR is also looking to gold "swaps," although earnings from this pale in comparison to direct sales. Since Soviet gold is of higher purity than South African gold, Moscow can earn a premium—which averaged about 40 cents an ounce last year—by swapping its gold for a claim on unallocated vault gold, which is then sold on the market. We estimate that the Soviets earned $2.3 million from swaps in 1985 and are likely to earn much more this year. The Soviet Foreign Trade Bank swapped 49 metric tons—for a premium of about $650,000—in January, the most significant quantity observed in one month in recent years. [redacted] 25X1

By using the physicals market, the futures markets, and direct bilateral sales, the Soviets could probably sell an additional 150 tons in 1986—bringing the yearend total to 450 tons—without causing a major sustained price decline, but would have difficulty repeating this. Annual demand for gold, both for industrial use and for investment and stockpiling, is fairly constant. Knowledgeable gold market analysts even view the current fall in oil prices as having a neutral effect on the price of gold. Increased purchasing power of industrialized oil-importing nations will increase demand for gold enough to offset the decline in the demand from the oil-exporting nations. We believe, however, that concerted or repeated use by the Soviets of the various methods to market gold would eventually cause a price adjustment in all the gold markets as word got around that the USSR was selling on a continual basis. [redacted] 25X1

Appendix C

Hard Currency Projections

This appendix provides an estimate of Moscow's capacity to import from the West in 1986-90 and still maintain a sound hard currency position. The estimate is based on assumptions regarding hard currency income streams, Soviet borrowing behavior, and the international financial environment. The sensitivity of this estimate to changes in our assumptions is also examined.

Baseline Projections of Import Capacity

In projections last spring, we estimated that Moscow would need to reduce annual imports by as much as $2.8 billion in real terms by 1990 from the 1984 level of $27.3 billion to maintain its present debt service ratio (dsr) of 19 to 20 percent.[7] Alternatively, if Moscow were to try to maintain imports at the 1984 level, the dsr would have to rise to nearly 35 percent.

Since those earlier projections were made, a number of key assumptions have been changed to reflect more realistic earnings and debt service streams for Moscow in light of recent changes in international markets. Projected oil and gas prices were lowered to reflect a soft energy market expected to continue throughout the rest of the 1980s. Projected arms sales have been scaled back to reflect anticipated weak demand by Moscow's primary arms customers. In addition, the high level of Soviet borrowing in 1985 has constrained Moscow's future import capacity by increasing future debt service payments.

Our earlier projection also did not take into account changes in the US dollar vis-a-vis the currencies of those countries from which the Soviets purchase a majority of their hard currency imports. To get a more accurate estimate of Soviet purchasing power, especially in light of the recent depreciation of the dollar, we have incorporated a dollar depreciation factor into our current projection.[8] 25X1

Using the revised assumptions, we conclude that the dsr would have to increase to almost 90 percent by 1990 if Moscow tried to keep real imports at the 1984 level (see inset for a listing of assumptions and key results). On the other hand, if Moscow continued its conservative borrowing policy, holding its dsr to just under 20 percent, average imports for 1986-90 (in constant 1984 depreciated dollars) would fall to $16 billion—approximately the level of imports recorded in the early 1970s.[9] 25X1

Neither of these scenarios is particularly realistic. In practice, we would expect Moscow to choose a borrowing (dsr)/import combination somewhere between the two extremes. For each percentage-point increase in the dsr by 1990 over the current level, Moscow could finance an estimated $0.8-0.9 billion in additional imports for 1986-90. However, debt in current dollars would also increase about $1.4 billion for the same period. A dsr of 30 percent would allow the Soviets to import $1.7 billion more per year than if the dsr stayed just under 20 percent. Under such a scenario, Moscow would still have to reduce imports to $18 billion.[10] 25X1

[7] The debt service ratio is defined as the percentage share of payments of principal and interest on Soviet debt in total hard currency receipts and is a widely used indicator of a country's financial soundness. The USSR's debt service ratio is very favorable by international standards. By contrast, Mexico's debt service ratio in 1985 was estimated at 45 percent.

[8] Because of the multitude of factors affecting the relative strength of the dollar vis-a-vis foreign currencies—many of which work in opposite directions—exchange rate trends are difficult to project with any degree of accuracy. 25X1

[9] All values in this paper, except where otherwise noted, are in 1984 depreciated dollars. This convention allows for comparisons across time that otherwise would have been difficult to interpret. 25X1

[10] Annual real import levels for 1986-90 are equal to the five-year average. 25X1

Assumptions Underlying Hard Currency Balance-of-Payments Projection

Projections of Exports

- *Oil exports fall from 1.18 million b/d in 1985 to 700,000 b/d by 1990, at a rate of 100,000 b/d per year.*
- *Gas exports rise from 33 billion m^3 in 1985 to 48 billion m^3 in 1990.*
- *Real arms sales show no growth in 1986-90 after dropping an estimated 30 percent in 1985.*
- *Real nonenergy, nonarms exports are held constant.*
- *Real net earnings from invisibles (excluding interest) remain constant.*
- *Annual gold sales increase to 300 tons.*

Projected Price Trends

- *The overall annual inflation rate applicable to exports and imports is 3 percent in 1986-90.*
- *Nominal oil prices decline from $28 per barrel for the mix of crude and petroleum products exported to hard currency countries in 1985 to an average of $18 per barrel in 1986-90.*
- *Nominal gas prices drop from the 1985 level of $119 per thousand m^3 to an average price of $96 in 1986-90.*
- *The nominal gold price continues to grow at the rate of inflation from its 1985 price of $315.*
- *Interest rates average about 9 percent.*
- *The average repayment period is eight years on Western government–backed credits and five years on medium- and long-term commercial credits.*
- *The dollar depreciates 30 percent by 1990, with much of the decline occurring in 1986.*

Key Results of the Hard Currency Balance-of-Payments Projection

- *Nonfuel, nonarms exports will surpass oil exports as the USSR's main hard currency earner by 1988.*
- *Oil earnings as a percentage of total hard currency revenues will decline from 40 percent in 1985 to less than 20 percent by the end of the 1980s.*
- *Arms sales will increase their share of hard currency earnings to almost 25 percent.*
- *Gold and gas sales will become increasingly important sources of hard currency revenues, with their shares climbing to 12 and 17 percent, respectively, by 1990.*

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Our projections are based also on somewhat simplistic assumptions representing our "best guess" about future trends. The level of Moscow's hard currency earnings and ultimately imports could be influenced by Soviet options as well as events totally beyond the control of Moscow. In the next two sections, we examine a number of alternatives to test the sensitivity of our projection to changes in the assumptions.[11]

[11] For purposes of comparison, we have constructed a "baseline" scenario against which all the following scenarios will be compared. Its chief characteristics are a debt service ratio of no more than 30 percent by 1990 with a resulting annual import capacity of $18 billion (in constant 1984 depreciated dollars) for 1986-90.

Internal Factors

At present, there is considerable uncertainty surrounding prospects for Soviet exports during the 1986-90 period. Resource availability and Soviet priorities will be the key determinants of the actual level of exports. As the scenarios below will show, we believe that Moscow will have little opportunity to return exports to 1984 levels. 25X1

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Oil Exports. Because of the importance of oil revenues as a source of hard currency earnings, the level of oil exports will be the most important internal determinant of import capacity. Each 100,000-b/d change in oil exports from the baseline estimate changes earnings by 2 percent (see table). Should 25X1

Variations in Average Annual Hard Currency Earnings and Imports [a]

	Hard Currency Earnings	Hard Currency Imports
	Billion US 1984 depreciated dollars	
1984	34.5	27.3
Baseline projection (annual amounts) [b]	24.4	17.8
	Percentage change from baseline	
Internal factors		
Oil export volume remains at the 1985 level of 1.18 million b/d	+7	+10
Oil exports decline by an additional 100,000 b/d per year	−2	−4
Fifteen-percent diversion of oil from East to West	+7	+10
Nonfuel exports grow 10 percent annually	+5	+7
Gold sales for 1986 increase to 450 tons	+1	+1
External factors		
Oil price rises to its historical high of $36 per barrel [c]	+28	+41
Oil price drops temporarily to $10 per barrel [c]	−7	−11
Arm sales increase by one-half	+11	+15
Arm sales are cut in half	−11	−16
Gold price increases 50 percent	+6	+8
Gold price declines by 50 percent	−6	−9
Dollar depreciation is 10 percent less than baseline projection	0	+7
Dollar depreciation is 10 percent greater than baseline projection	0	−7
Gas sales increase 10 percent	+2	+2
Interest rates fall 3 percentage points	−1	+6
Interest rates double	+4	−10
Inflation doubles	NEGL	+3
Inflation is halved	NEGL	−1

[a] Assuming all changes in hard currency revenues are reflected by changes in import levels.
[b] For purposes of comparison, we have constructed a "baseline" scenario against which all the following scenarios will be compared. Its chief characteristics are a debt service ratio of no more than 30 percent by 1990 with a resulting annual import capacity of $17.8 billion for 1986-90.
[c] Assumes a lagged proportionate change in gas prices.

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Moscow be able to keep hard currency oil exports at the 1985 level, earnings could climb by 7 percent, resulting in a $1.8 billion improvement in annual import capacity. In addition, Moscow has the option to sell more oil on the hard currency market at the expense of deliveries to its Communist allies as it did in 1981 when faced with hard currency shortages. A 15-percent reduction in oil exports to these Communist countries during 1986-90, for example, could earn Moscow an additional $1.6 billion per year, resulting in a 10-percent improvement in hard currency import purchasing power over the baseline projection.

Nonfuel Exports. Gorbachev has indicated that nonenergy exports will grow during 1986-90. If he is successful and annual growth reaches 5 percent, these exports will only return in nominal terms to 1982 levels by 1990 because of the estimated 25-percent drop over the last three years. In the unlikely event that Moscow could increase the annual growth rate to 10 percent, however, the Soviets could boost earnings by 5 percent, allowing them to increase imports by more than $1 billion per year.

External Factors

Perhaps even more uncertain are the projected trends in world market conditions that will affect the USSR's revenues and expenditure stream over the next five years. In particular, price and demand conditions for Soviet exports have fluctuated widely over the last 10 years.

Energy Prices. Realized energy prices, which, according to some analysts, might vary by as much as 50 percent from our assumed levels, could significantly revise the level at which we think Moscow could import over the next five years. For each dollar change in the price of oil from the baseline assumption—with a proportionate change in the gas price—the USSR stands to lose or gain an average of $500 million per year in 1986-90.

If, as some forecasters are predicting, a price war temporarily plunges the oil price to as low as $10 and then keeps it below $20 through 1990, the Soviets will face an additional 7-percent drop in their hard currency earnings—assuming gas prices follow with a proportionate change. As a result, imports would have to be reduced 11 percent from baseline levels and over 40 percent from 1984 levels, to just under $16 billion, to maintain a dsr at or below 30 percent by 1990. Alternatively, if a serious disruption in the world oil supply sent prices of both oil and gas up to historical highs for the 1986-90 period, the Soviets could raise imports to over $25 billion. 25X1

Arms Sales. Another important contingency centers on the hard currency market for arms, which currently supplies Moscow with almost 20 percent of its hard currency earnings. Financial difficulties could well force the major Soviet customers to reduce arms purchases by half, lowering annual Soviet earnings by about another $2.6 billion below the baseline. As a result, annual imports would be reduced from baseline levels to $15 billion. On the other hand, a 50-percent increase in arms sales could raise annual earnings and imports by like amounts. 25X1

Gold Prices. Our projection is relatively less sensitive to changes in the gold price assumption. For example, a 50-percent change in the price of gold would generate only a 6-percent increase or decrease in revenues. Nonetheless, the 8-percent rise or 9-percent decline in imports associated with such a change in the gold price could be important when considered on the margin. 25X1

Interest and Inflation. Changes in assumed levels of interest and inflation rates, like changes in gold prices, result in relatively less variation in import capacity levels. For example, a 3-percentage-point decline in interest rates would boost import capacity by only 6 percent above the baseline for the period. Similarly, import capacity would decline by 10 percent in the unlikely event interest rates were to double. Variations in the assumed level of inflation would have little effect on Soviet import capacity—3 percent or less—because of its offsetting impact on both import and export prices. 25X1

Dollar Depreciation. Estimates of the depreciation of the dollar vis-a-vis other major currencies for 1986-90 and the resulting impact on Soviet purchasing power

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are based on arbitrary assumptions. In the event depreciation is 10 percent less than we now assume, Soviet purchasing power could be 7 percent better than our baseline case. Conversely, if depreciation is 10 percent worse, Moscow could stand to lose an additional 7 percent in purchasing power over the period. 25X1

Gas Sales. The growth in projected earnings from gas sales will not be sufficient to offset the decline in estimated revenues from oil exports. This assumption, however, is based more on projected Western demand for Soviet gas than on the USSR's ability to supply additional quantities. In the event Western demand is higher than we now think likely, the Soviets stand to gain an additional $400 million per year for each 10-percent boost in exports. Over 1986-90, such an increase would allow Moscow to raise imports slightly over baseline levels—by less than $500 million annually. 25X1

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