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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

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29 September 1971

MEMORANDUM FOR: David G. Shaw
EUR/RPE
Department of State

SUBJECT : Prospects for East-West Trade in the 1970's

1. The attached study on East-West trade is forwarded in response to your request.

2. If we can contribute anything further to the ECONAD discussions on East-West trade to be held in October, please do not hesitate to let us know.

Chief
Office of Economic Research

Attachment
As stated

(S-3815)

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Prospects for East-West Trade
in the 1970's

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Prospects for East-West Trade in the 1970's

Foreword

The discussion of East-West trade below refers to the trade of the USSR and Eastern Europe with the industrial (developed) West. Eastern Europe refers to six East European countries -- Bulgaria, Czechoslovakia, East Germany (Soviet-occupied-zone of Germany), Hungary, Poland, and Romania. All seven countries also are the members (plus Mongolia) of the Council of Mutual Economic Assistance (CEMA or COMECON). The industrial West is composed of the following countries: Austria, Belgium-Luxembourg, Denmark, Finland, France, West Germany (Federal Republic of Germany), Iceland, Ireland, Italy, Netherlands, Norway, Sweden, Switzerland, United Kingdom, Japan, Canada, United States, Australia, New Zealand and the Republic of South Africa. This grouping excludes the OECD countries of Portugal, Greece, Spain, and Turkey (also Yugoslavia) but includes the non-OECD countries of Australia, New Zealand, and the Republic of South Africa.

In discussions of Soviet and East European international payments, only trade involving hard currency is considered. Finland and Iceland are thereby excluded because they conduct trade with the USSR and Eastern Europe on a clearing basis.

Summary and Conclusions

East-West trade grew at average annual rate of more than 10% in the 1960's. In the 1970's the rate probably will run at 7% to 8% -- lower for the USSR than for the East European countries as a group. The reasons for projecting a slower growth in their trade with the West include rising pressures on their supply of agricultural and industrial materials, lack of Western demand for their finished goods, the increasingly large volume of debt to the West which will have to be serviced, and a growing selectivity in machinery and equipment purchases from the West. In addition, the USSR and the East European countries plan to increase their trade with one another at the expense of trade with the West in conjunction with renewed efforts to promote economic integration in CEMA.

The upper limit of the range assumes some impact on the volume of East-West trade by the successful conclusion of a European Security Conference. Such a conference might improve the climate for Western investment and increase Western access to the Soviet and East European market. Western concessions are also postulated -- reductions in tariffs and quantitative restrictions and relaxation of Western export controls.

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If the United States should go about as far as West European governments in relaxing restrictions on trade with the USSR and Eastern Europe -- and in actively encouraging trade -- the US share in East-West trade might increase from the current 4% to as much as 10-15% by 1980, although it is quite unlikely to reach the upper end of the range. Prospects are better for increasing the US share in trade with the USSR than in trade with Eastern Europe, particularly in exports of technology-intensive products.

The growth of US imports from both the USSR and the East European countries is likely to lag behind exports; it is easier for them to sell in European markets. As the scale of their trade with the West increases, they may find the US market more attractive. But for the next few years at least, these countries probably will incur chronic deficits in trade with the US, and expanded US credits will be needed to finance US exports to the USSR and Eastern Europe.

Background

1. East-West trade grew at a rate of 10.3% annually during the 1960's. Western trade with the East European countries grew somewhat faster -- 10.5% -- than trade with the USSR -- 10.0%.* In 1970 Western exports to the USSR and Eastern Europe approximated $6.9 billion and imports were roughly $6.6 billion. The USSR accounts for about 40% of East-West trade and Eastern Europe, 60%. (Tables 4 and 5 in Appendix show the value of East-West trade during the period 1960-1970.)

2. In estimating the growth of East-West trade in the 1970's, projections of Soviet and East European exports to the West (Western imports) have been made by fitting various statistical trends to historical data and by analyzing changes in both supply and demand for major exports of the USSR and the East European countries. Factors considered include plans for investment and foreign trade, limitations on growth of exportable commodities, and prospective developments in Western markets. Merchandise export earnings are the principal means for financing imports, and the ability of the USSR and Eastern Europe to expand exports has been and will be the principal limitation on the growth of East-West trade.

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* Growth rates are based on Western statistics. Soviet and East European statistics indicate a rate of 9.5% for East-West trade (1961-69).

USSR

Exports

3. Soviet exports to the West increased during the period 1961-70 at a rate of 9.1%,* but the rate of increase is expected to drop in the next decade. Soviet exports in 1970 were valued at more than $2.3 billion,** and estimates for 1980 range from $4.1 billion to $4.8 billion, implying an average annual increase of 6 to 7%. These estimates reflect projections both for traditional exports -- oil, lumber, metals, coal, and others -- and for exports which are being or may be developed as a result of Western investments or of agreements such as the natural gas-for-pipe deals. Such exports might include wood and wood products developed in Siberia, nonferrous metals (copper, nickel) from Siberia, and newly exploited iron ore deposits from the Kola peninsula.

4. The following is a tabulation of the possible values of Soviet exports of major commodities in 1980 compared with actual exports in 1970:

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* Based on Soviet statistics. Western reporting on Western imports from the USSR, indicates a 9.7% increase. Soviet statistics are used throughout the discussion on Soviet trade with the West. Tables on Soviet trade with the West based on both Soviet and Western reporting are in Appendix.

** Western reporting indicates $2.7 billion (including transportation and insurance).

Table 1

USSR: Exports to the Industrial West
1970 and 1980

		Million $
Commodity	1970	1980
Petroleum and Petroleum Products	528	800-900
Wood and Wood Products	385	600-700
Coal and coke	131	150-200
Base Metals	209	350-400
Cotton fiber	37	50-100
Furs	46	50-100
Platinum	115 a/	200-300
Diamonds	100 a/	300-400
Natural gas	13	250-300
Machinery and equipment	78	150-200
Other	680 b/	1,100-1,200
Total	2,345	4,100-4,800

a. Estimated.
b. Includes food products, ores and concentrates, chemicals, fertilizers, and other products. More than $300 million of this is unspecified, of which about one-third is nickel. The 1970 total and the 1980 estimate for base metals is thus understated. The 1980 estimate for "Other" allows for an increase in exports of nickel, however.

5. Oil will continue to be the major export commodity in trade with the West. Exports were valued at $528 million in 1970, up by $40 million from 1969 but only $20 million more than in 1968. Constraints in supply and increased demand in both the USSR and Eastern Europe will place limitations on the quantity of oil available for export to the West. However, because of price rises negotiated between OPEC and the international oil companies, the value of Soviet oil exports will continue to rise -- probably at about half the 10% rate achieved in the 1960's -- in spite of a slower rate of increase in the volume of exports. Exports of wood and wood products should rise steadily, if sufficient investments (including Western) are made to exploit additional forest resources and to increase the share of processed goods such as chips, plywood and paper. Japan is the most likely source of Western investment in this sector.

6. Coal and coke exports have changed little in recent years although higher prices in 1970 increased the value of such exports. Much of the coal that the USSR exports is not of premium quality and generally does not fully satisfy current Western specifications. As a result, shipments to industrial Western countries are not expected to grow much in the future. Exports of nonferrous metals (particularly nickel) and platinum group metals have grown substantially in recent years although the platinum group has shown great weakness since early 1970; ferrous

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metals exports have remained at about the same level since 1964. Projections of the fastest growing metal exports are difficult because of their vulnerability to fluctuations in Free World markets. Much of the rise in nickel exports in 1969, for example, was due to depressed Free World supply and high prices resulting from the lengthy strike at the major Western producer. Soviet exports of nickel as well as platinum group metals apparently fell off in 1970. It is believed, however, that over time growing demand again will stimulate Soviet exports of both nonferrous and platinum group metals. Moreover, some form of Western investment in Soviet copper and nickel deposits is expected during the 1970's and some exports could result by the end of the decade.

7. Cotton fiber has been a mainstay of Soviet exports to the industrial West for two decades, but long range export prospects are cloudy because of increasing substitution of of man-made fibers. Exports have been erratic in recent years, falling from more than $100 million in 1967 and 1968 to less than $40 million in 1970. Given the uncertainties surrounding both agricultural production and the uses for cotton in the future, it is doubtful that cotton will be an important export by 1980. Exports of another traditional commodity, furs, have shown no tendency to grow; fur exports have remained at about the same level for the past decade and little, if any, increase is expected during the current decade.

8. Gem diamonds are a relatively new export commodity for the USSR, but exports grew to more than $150 million in 1969, about six times the level of 1965. Sales fell in 1970 as a result of reduced demand in the West, but Western demand should rise again. By 1980 Soviet exports could more than double the 1969 level. The newest export commodity of importance is natural gas. The value of natural gas exports (to Austria only) in 1970 was $13 million. Based on contracts signed with Austria, West Germany, Italy, France, and Finland and a possible deal with Japan, natural gas exports should approach $300 million by 1980.

9. Other commodities exported to the West now include chemicals, fertilizer, vegetable oil and oilseeds, wheat, ores and concentrates, fish, and other items. Exports of some of these items have increased in recent years and may continue to rise, but others may decline or level off. All of the above items, like the traditional exports, are raw materials and semi-manufactures. Because of Soviet unwillingness to tailor exports to Western markets, manufactured products such as machinery will remain largely uncompetitive in the West for the foreseeable future. Only in sectors in which such efforts are made -- perhaps the manufacture of aircraft such as the YAK 40 and the TU-144 as well as helicopters -- can the USSR make inroads in Western markets. There are no indications that the USSR plans to make serious sales efforts for other types of equipment.

10. Soviet awareness of the need to expand exports can be seen in several recent contracts and in other negotiations noted above in which the USSR has sought to tie repayment to deliveries of the products from the installation built with Western credit. These include the gas-for-pipe deals with Austria, West Germany, France, and Italy; the Soviet-Japanese wood for equipment contract; the proposed oil and gas-for-pipe deals with Japan; and the proposed Western exploitation of Soviet copper at Udokan. Most of the arrangements would ultimately improve earnings, but aside from the gas-for-pipe arrangements and the wood for equipment contract concluded with Japan, export earnings would not be affected in a significant way before the end of the decade.

Soviet Indebtedness

11. Throughout most of the 1960's the USSR bought more than it sold in trade with hard currency countries. The difference was financed in part by selling gold, but mainly by borrowing and by buying on credit. Soviet indebtedness to the West, mainly long-term, has grown rapidly in recent years; it was about $1.6 billion at the end of 1970 and will probably reach $2 billion by the end of 1971 (See Table 2). Soviet trade statistics indicate that during the period 1961-1970 the Soviet hard currency trade deficit averaged $250 million annually. It reached the $500 million mark in 1964 and 1970. Only in 1967 did the USSR achieve a hard currency trade surplus. (See Table 6 in Appendix)

Table 2

Estimated Soviet Drawings and Scheduled Repayments on Western Medium-Term and Long-Term Credits a/ 1959-1970

Million US $

Year	Estimated Drawings	Scheduled Repayments	Interest	Net Credits	Outstanding Debt at End of Year
1959	60	12	0	48	48
1960	125	37	2	86	136
1961	165	70	6	89	231
1962	180	106	10	64	305
1963	140	130	14	- 4	315
1964	170	147	15	8	338
1965	190	149	17	24	379
1966	275	149	20	106	505
1967	305	152	29	124	658
1968	435	206	38	191	887
1969	525	248	59	218	1,164
1970 b/	730	291	69	370	1,603

a. Drawing estimates are based largely on data derived from contracts indicating delivery and credit terms and on Soviet imports of machinery and equipment. In general, early contracts (1959-64) involved 80%-85% credit and 5% interest. A large number of contracts since 1965 have involved 85% credit and 6% interest. Repayment periods for the earlier credits were usually three to five years following downpayment. Typical terms since 1965 have been eight years following delivery of equipment.
b. Preliminary.

NOTE: Soviet outstanding indebtedness calculated by NATO is higher, but NATO estimates overstate the level of debt because they include extensions rather than drawings in its calculations

12. Debt service charges are rising rapidly and were equivalent to about 15% of export earnings in 1970. If, as seems likely, Soviet exports slow markedly, the ratio of debt service to exports will soon surpass 20% and could exceed 25% before long. Two possible projections of Soviet indebtedness to the West are given below, either of which could be well off the mark, but current trends indicate that drawings will be at least maintained for the next few years.

Table 3

Projections of Soviet Indebtedness to Western Creditors a/

Year	Drawings b/	Scheduled Repayments b/	Interest	Net Credit	Outstanding Debt at End of Year
		Projection A			
1970	730	291	69	370	1,603
1971	730	361	86	283	1,972
1972	565	538	99	29	2,099
1973	565	509	126	- 70	2,155
1974	565	545	129	-109	2,175
1975	565	572	131	-178	2,128
		Projection B			
1970	730	291	69	370	1,603
1971	730	361	86	283	1,972
1972	730	359	99	173	2,243
1973	730	551	135	44	2,422
1974	730	607	145	- 22	2,545
1975	730	659	153	- 82	2,616

a. Because of rounding, components may not add to the totals shown.
b. Credits are assumed to be for an average of eight years at 6% interest.

NOTE: Projection A assumes a continuation of the 1969 level plus scheduled pipe deliveries on credit and a fall back to the 1969 level after the pipe shipments are completed. Projection B assumes other exports on credit will replace pipe. Projections beyond 1975 would show increasingly large repayments in excess of drawings.

The following tabulations show the debt service (repayments plus interest) implicit in the two projections, together with projections of exports through 1975 at 7% (the upper limit of export growth estimated).

	Exports	Projection A	Ratio %	Projection B	Ratio %
1970	2,345	360	15	360	15
1971	2,509	447	18	447	18
1972	2,685	537	20	558	21
1973	2,873	635	22	686	24
1974	3,074	674	22	752	24
1975	3,289	703	21	812	25

Soviet credit in the West is good, and Soviet control over the economy and over the use of foreign exchange resources insures that debt obligations can be met. However, the Soviet government probably wishes to avoid the reduction in flexibility which a high debt service ratio would produce. For the USSR a ratio much over 20% probably would seem excessive.

13. If exports increase at a rate much less than 7%, the USSR would have to make difficult adjustments. To hold debt service payments within reasonable bounds, the USSR would have to stop increasing drawings on new credits. Repayments would then soon exceed drawings, and the net flow on credit account would shift from a large surplus to a deficit. This shift on credit account

would mean that purchasing power over imports -- import capacity -- would increase less than exports. These projections depend on many assumptions, any of which could be wrong. Even if the overall projections are correct, those for individual years could be far off the mark. But unless we have grossly underestimated export prospects, it appears that Soviet import capacity will increase much more slowly in the next few years than it has since the mid-60's.

14. If merchandise exports do not grow substantially faster than suggested above, the USSR will have to finance imports by other means or ration its imports more strictly. The USSR has added considerably to its gold reserve since 1965 and now produces more than $200 million annually. If the Soviet leadership feels that it can now part with at least some of its annual production of gold to pay for imports, this would enable the USSR to continue to import more than it exports. Increased net hard currency earnings from tourism -- possibly averaging $100 million annually by the mid-1970's -- will also boost Soviet import capacity, as will increased net earnings from the Soviet merchant fleet, which may rise to about $100 million by 1975. If the USSR chooses to ration its imports more strictly, imports of highly prized Western equipment and technology will be maintained to the extent possible, but there probably will be greater substitution of technology for equipment. The leading candidate for pruning is

the level of manufactured consumer goods, which the USSR have been importing from the West at a rate of about $250 million annually since 1966. The leadership, however, probably feels it has less room for maneuver in this area than it did five years ago; it probably will have even less five years hence.

15. Should the leveling off or decline in import capacity coincide with poor grain harvests and the Soviets have to import large quantities of wheat from the West, capital goods imports would also be curtailed, as they were in 1963-65.

Imports

16. It is assumed that the USSR will continue to look to the West for equipment and technology to modernize its economy and will import goods in short supply not available in the Communist world. Little information is available on plans for Soviet industrial development beyond general statements on the current five-year plan where cognizance is taken, as usual, of the need to achieve increases in production through increasing labor productivity, especially by more rapid introduction of the results of scientific research, modernization of design, mechanization and automation, and standardization and specialization, with attendant economies of scale.

17. In electronics, the program is a logical continuation of that in the last period. In computers, the main task is to establish series production of third generation machines. The USSR has had discussions with some Western companies regarding possible assistance in setting up such production. Assistance would be less in the form of production facilities than of production know-how. If the USSR is unable to obtain such assistance and proceeds on its own, it will still require Western components, peripherals, and application techniques. In components the task is to master silicon device technology on an industrial scale and provide the integrated circuits needed for third generation computers and for miniaturized electronic equipment. The USSR has been looking to the West for such technology.

18. The USSR is interested in procuring from the West telecommunications equipment and the technology to produce such equipment. The USSR requires a whole range of common carrier equipment, i.e., microwave radio relay systems, coaxial cable and associated MUX, telephone switching systems, and satellite ground stations. Data transmission equipment is also required.

19. Chemicals will continue to be stressed in the current five-year plan as for the past decade. The output of the plastics industry is scheduled to double and some equipment may be imported from the West. The US possesses a high level of technology in the production of some of the more important raw materials,

e.g., polypropylene, polyethylene, and polystyrene. Synthetic rubber and fibers are also to be produced in significantly greater quantities. The USSR will also require substantial amounts of processing equipment to convert the raw materials into finished products, e.g., injection molding equipment. How much the West will provide in the way of equipment for the Soviet chemical industry is in large part a function of the progress of CEMA integration, a process which has moved faster in the chemical industry than in most other sectors. The USSR continues to emphasize the production of fertilizers, but the West probably can expect little in the way of new equipment orders. A heavy carryover of completed but unused fertilizer capacity indicates that large increases in output should be possible in at least the early years of the plan period. By 1975 five large modern ammonia plants ordered in the West in 1969-70 are scheduled to be in operation.*

20. To meet planned increases in oil production, the USSR will be seeking substantial amounts of equipment to find, drill for, and transport crude oil. To find the oil the USSR will need

* Three ammonia plants bought in Japan are valued at $70 million. They are based on US technology -- M. W. Kellogg's -- who will get less than $5 million for the technology.

advanced seismic systems including computer play-back centers and digital field equipment; drill pipe, well-head equipment, remote-control automatic gathering-storage-transfer systems, and possibly off-shore drilling platforms. Other requirements include pipe, valves, and compressors for both gas and oil. Much of this equipment will be for use in cold climates, making it many times more costly than conventional equipment. The USSR also may be interested in acquiring some advanced refining equipment.

21. The Soviet machine tool industry has been incapable of satisfying the expanded needs of the automotive industry. In the past the USSR has purchased substantial numbers of specialized Western machine tools to produce components for cars and trucks. The Kama River plant, the major object of new investment in truck production in the current plan period, will need machine tools from the West as well as various other types of equipment. Equipment will also be needed for expanding and modernizing other motor vehicle plants.

22. To meet planned increases in labor productivity in the coal industry, the USSR intends to increase extraction by the stripping method. Consequently more heavy off-road hauling equipment will be required. Some imports of wood processing and food processing equipment also will be needed from the West.

23. Soviet imports of Western machinery and equipment have increased substantially since 1966, growing from a level of $560 million to more than $1.1 billion in 1970. New orders for Western plant and equipment fell off in 1969 and 1970, although some of this decline reflects the hiatus between the end of one plan period and the beginning of the next. As a result, we estimate that imports of plant and equipment will drop in 1971. It is doubtful, however, that there will be a continued drop in such imports for the balance of the plan period. New orders in 1971 are already higher in value than in 1969 or 1970. On balance it is estimated that imports of plant and equipment will exceed $1 billion annually throughout the current plan period. This figure includes both the more sophisticated variety available only in the West as well as other, more standard equipment which the USSR or its CEMA partners cannot supply in sufficient quantities to meet Soviet plan requirements.

24. In commodities other than equipment it is assumed that the USSR will continue to import much the same items it has been importing, with quantities dependent largely on availabilities in the Communist world. These goods include steel, chemicals (especially plastics), wood pulp, textile raw materials, intermediates, finished products, and manufactured consumer goods.

25. Imports may grow at roughly the same rate as exports -- 6% to 7%. Projecting from the 1970 figure of $2,780 million, the range of 1980 would be $4.9-5.5 billion. This compares with the estimate of exports of $4.1-4.8 billion, implying deficits in this trade. Such deficits are expected from time to time, although it is far from certain that the USSR will be willing to incur such deficits as often as in the past.

Eastern Europe

Exports

26. As with the USSR East European exports to the industrial West are expected to grow more slowly than in the 1960's. A rate of roughly 8% to 8½% annually is predicted for the 1970's, with exports rising from $3.9 billion* in 1970 to more than $8 billion in 1980. This compares with a growth of 10.3% for the 1960's.

27. As an example of what might be considered a "demand-pull" formulation for projecting East European exports to 1980, a recent UN study on Intra-European trade includes prospects for East European exports to Western Europe based upon least squares estimates

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* Western rather than East European statistics are used throughout the discussion of East European trade with the West. A consistent set of data /is not available for all six East European countries.
based on East European sources

of total imports of eleven industrialized West European countries.* Although these figures are intended only "to illustrate the consequences of extrapolations into the future of certain current tendencies and growth patterns," they nevertheless serve as a useful starting point in estimating export trends.

28. Under one assumption, the seven "East European" countries (including the USSR) would retain their 1965-1967 market shares for each of five commodity classes in each of eleven West European countries. Export growth from 1965/1967 to 1980 would be 8.4% per annum, as compared with 10% from 1957/1959 to 1965/1967. An alternative assumption postulates "a continuation of the changes in Eastern Europe's market share for five major commodity group in Western Europe at the same rates as observed between 1957/1959 and 1965/1967." The resulting growth rate for exports is 10.3%, about as fast as in the earlier period. Neither assumption is intended to reflect anticipated changes in East-West trade patterns, although there will undoubtedly be elements of both stability and change where East European market shares are concerned.

* Supplement to Analytical Report on the State of Intra-European Trade, E/ECE/761/Add. 1, 12 February 1970. In this study, the Soviet Union is included as part of Eastern Europe, and several non-European members of the industrial West are excluded.

29. In projecting growth in Eastern Europe's exports to the West for the 1970's, trends of the 1960's are not necessarily indicative of things to come. Certain trends in trading patterns, for instance, have been rather short-lived and have been blunted -- particularly for agricultural and raw materials exports to Western Europe. Furthermore, Eastern Europe will run into serious problems in attempting to broaden Western markets for its manufactures; thus, the declining growth of agricultural and industrial raw materials exports probably will not be offset by export growth from any other product group.

30. Regarding manufactures, Eastern Europe will face supply constraints, sharply rising hard currency costs associated with overcoming product inferiority, and achieving competitive standards of packaging, marketing, and service. These difficulties and the reduced dynamism of food and raw materials exports will thus work to hold down East European exports to about 8% to 8.5% -- somewhat below the growth rate of the 1960's.

31. Agricultural sales will remain a major source of Eastern European hard currency earnings, but as in the past few years, they will gradually decline in importance in favor of the faster growing exports of semifinished goods and consumer manufactures and, to a lesser extent, chemicals and machinery. Exports of crude materials and fuels, although readily salable, probably will also continue to decline as a share of the total becuase they are in short supply in Eastern Europe.

32. The general outlook for East European agricultural sales during the next few years is unfavorable, quite apart from inevitable weather disturbances. West European import quotas on the most important agricultural imports from Eastern Europe are likely to remain, in view of probable future domestic surpluses of dairy products, sugar, soft wheat and other products in the West. East European needs for meat and other higher grade foodstuffs are likely to reduce the growth of available agricultural products for export and, in view of the Polish riots, the East European leaders are likely to take greater pains to meet those needs.

33. By 1980, the largest hard currency earnings for East Europe should come from exports of intermediate manufactures, especially those at the lower end of the processing scale such as primary and semifinished steel products and nonferrous metals and bulk textiles. Eastern Europe also should do well in sales of selected consumer manufactures -- particularly Czechoslovakia and East Germany, which produce the most acceptable clothing, footwear, travel goods, and other items.

34. Exports of a wide range of chemicals have a good potential. Large East European purchases of Western chemical plant and equipment in recent years have provided capacity exceeding even future domestic requirements. Eastern Europe, therefore, can be expected to try to export to the West more basic chemicals, petrochemical components, and pharmaceuticals.

35. Machinery sales will continue to grow, but will remain a very small share of total exports to the industrial West. The Eastern Europeans still will be selling in what to them is ~~a~~ thin, uncertain Western market, and they will be selling at substantial price discounts for most machinery products, particularly those at the more sophisticated end of the scale. Much of the increase in equipment exports probably will continue to be accounted for by the more standardized machine tools, textile machinery, and printing and binding equipment, although the East Europeans have hopes of selling such items as office machines, ships, and electronic equipment in increased amounts.

36. The long-run capability of Eastern Europe to expand exports of industrial products other than semimanufactures will depend to a considerable degree upon how well Eastern Europe can make use of advanced Western technology. The positive effects of Eastern Europe's imports of large amounts of Western investment goods have been inhibited by various East European inefficiencies. A slow rate of technological assimilation tends to maintain the differences in quality of Western versus Eastern products, and it thus continues to be very difficult for the East Europeans to upgrade their export mix by selling a larger share of finished goods.

East European Indebtedness

37. Hard currency indebtedness, particularly the debt structure, is an important determinant of Eastern Europe's ability to import. The debt structure is reflected in the size of repayment obligations. Unfortunately these are not known for all the East European countries and, because of the variety of loan types and maturities, repayments are difficult to project. In the 1960's, the expansion of medium- and long-term Western credit allowed a major rise in East European spending, especially for capital goods. As a result, East European indebtedness came to about $3 billion by the end of 1970. Because the credit was drawn in rather lumpy fashion, repayments are equally uneven, resulting in balance of payments difficulties for some countries. Bulgaria and Romania have had the most difficulty in this respect. It is possible that both countries -- owing about $1.3 billion between them -- have required Western assistance (and perhaps Soviet aid in the case of Bulgaria) to meet maturing obligations over the past two years.

38. Most of Eastern Europe's debt is currently owed to West European NATO trading partners, but a substantial amount -- perhaps 15% -- is owed to non-NATO partners, principally Austria, Switzerland, Sweden, and Japan. Before the late 1960's much of Eastern Europe's indebtedness could be traced to imbalances with specific trading partners; it was generally "bilateral" in nature.

Since then, however, Eastern Europe's debt has become increasingly "multilateral" as a result of the growing availability of untied medium-term Eurodollar loans (consortium loans, etc.) and refinancing or rolling over existing debt, none of which is linked to particular trade imbalances with -- or specific purchases from -- industrial Western countries. As an extreme example, Hungary recently floated $25 million worth of Eurodollar bonds.

39. All the East European countries will be trying in the next few years to avoid lumpy debt repayments which can cause hard currency crises. They will be bargaining for longer-term credit and tie-in deals for purchases of plant and equipment to keep annual hard currency outlays to a minimum. It is unlikely that any East European countries will try to reduce its debt in absolute terms; indeed, short of putting a freeze on imports from the West it would be impossible to do so. Rather Eastern Europe will be looking to develop or maintain a moderately flexible posture regarding debt service obligations relative to export earnings. To some extent, East European indebtedness has become institutionalized, and debt servicing is looked upon as a necessary evil. So long as East-West trade goes on growing, the debt is likely to increase at least as fast as trade.

40. By 1975, total East European indebtedness to developed Western countries could amount to as much as $5 billion. This projection is based upon estimated growth in trade, estimated

debt servicing, and repayment of debts and other transactions. East Germany and Hungary are expected to increase their debt the most by 1975, followed by Romania, Poland, Czechoslovakia, and finally Bulgaria, which is probably least able to increase export earnings in the West. Projections of each country's indebtedness for the last half of the 1970's have not been made, but it could run much higher.

41. More than half of East German indebtedness to the West of $625 million is made up of its swing balance with West Germany and other debts to West Germany. This portion of the debt is handled differently from other East European indebtedness to the West, because of the unique relationship in trade and other matters between East and West Germany. The swing credits are interest free and, apparently, indefinite in maturity. By the same token it is not possible to project this IZT swing debt because of uncertainities in East and West German relations. East German indebtedness to other industrial Western countries is under $300 million. Along with increased imports, East Germany received increased credit lines of a substantial amount in 1970, probably not all of which has been drawn. It is expected that debts growing out of non-IZT trade will grow considerably through 1975, as that trade becomes a larger share of total East German trade with the industrial West. The value of the debt could reach $600 million, roughly equal to the level of non-IZT exports expected in that year.

42. Czechoslovakia does not have a particularly large debt in relation to its exports, but the debt structure is poor. A significant increase in Czechoslovak sales to Western Europe in 1969 relieved debt repayment pressures somewhat, but in 1970 such exports grew by only about 11%, while imports increased by 27%. Also, in the first half of 1971 imports have grown considerably faster than exports. Czechoslovak hard currency debt repayments in 1969-71 were scheduled at over $200 million. Much of this amount has probably been rolled over, by both buying current imports on credit and simply putting off debt reduction, and by refinancing maturing notes. It is expected that Czechoslovak medium- and long-term indebtedness, now about $375 million, will amount to about $500-600 million by 1975 and will be equal to no more than two-thirds of the value of exports to the industrial West.

43. Aside from Bulgaria, Hungary probably owes less money to Western creditors than any other East European country. Since the mid-1960's, Hungary has apparently undertaken to increase indebtedness at roughly the expected annual rate of increase in its exports to the industrial West, a conservative policy by East European standards. Hungarian indebtedness is on the order of $350-375 million. Hungary has recently made use of substantial untied medium-term Eurodollar credits in the form of Western consortium loans loosely linked to the development, modernization, or expansion of entire industries. Hungarian indebtedness is

expected to increase substantially and may even double by 1975, based on plans to modernize the textile industry, develop pharmaceuticals and expand aluminum processing capacity, all of which will require substantial capital goods imports from the West.

44. Romania's debt position at the end of 1970 was the least favorable in Eastern Europe. Romania owes more to the West than any other East European country ($850-900 million). Although the government has recently cut back significantly on purchases of Western machinery and equipment, the failure to attain planned hard currency export targets in 1960-69, partly because of agricultural failures, left Romania in a tight hard currency position by 1970. An outstanding 1971 grain harvest promises to strengthen its export potential in the months to come, however. The Romanian credit position is buoyed by substantial gold reserves, but resort to sales of gold to meet obligations probably would adversely affect Romania's only "fair" current credit rating. Of all the East European countries, Romania is least willing to seek or receive the backing of the USSR as a lender of last resort. Romania's indebtedness could increase to as much as $1.4 billion by 1975. The structure of its debt should be more favorable, with a larger share of long-term (over 5 years) credits. The Romanian debt picture may improve somewhat if Romania achieves the estimated 11% annual increase in its exports

to the developed West. Although the Romanians probably will run a sizeable trade deficit with the West in 1971-75, it will be far smaller than in the preceding five years.

45. Poland, like the other major agricultural exporters in Eastern Europe, benefited from a substantial expansion of sales to Western Europe in 1969 and again in 1970. Exports rose by about 20% and imports by only 4%. If indebtedness to the United States on PL-480 is excluded, Poland had the most favorable debt/export ratio in Eastern Europe by the end of 1970; Poland's debt was equal to just about one-half of the $1 billion in exports to the industrial West. With its high volume of exports and relatively stable sales prospects in the next few years, Poland is probably in the strongest financial position vis-a-vis the West of any of the East European countries. Projected export growth of 7.5% annually would enable Poland to increase imports from the West at the projected rate of 9.4% per year, while reducing its ratio of debt to exports. At these rates, Poland's debt could reach $900 million by 1975.

46. By the end of 1970, Bulgaria owed perhaps $300 million in the West, about 40% greater than its exports to the West, a seemingly manageable level of indebtedness even if poorly structured. Maintenance of this ratio to 1975 would raise indebtedness to over $400 million and permit a growth in Bulgarian imports from the industrial West of only 4% per year, probably the minimum import

growth the Bulgarians might accept. Bulgaria might be tempted to raise indebtedness somewhat beyond the projected level if its need for Western imports is great enough and if it could arrange Western financing -- and Soviet permission.

Imports

47. Indebtedness notwithstanding, East European imports from the industrial West are expected to grow somewhat more rapidly than exports -- perhaps by 8.5% to 9% to a level of about $10 billion. The present outlook for East European imports from the West is considerably different from what it was in the mid-1960's. Most of the countries are becoming more selective in machinery purchases; most have built up a fairly steady dependence on Western raw and semifinished materials; and most are beginning the decade with greater willingness to increase imports of higher quality food products and consumer goods in order to meet popular demand.

48. The East Europeans are looking twice at the large purchases of machinery that dominated their imports from the West in the 1960's. These purchases have resulted in large hard currency debts for all of these countries, and all of them have found it difficult and costly to assimilate Western technology because of construction bottlenecks, shortages of skilled labor, and the low quality of domestic material inputs. They are beginning to suspect that they lack the resources and experience needed to keep output competitive in the new fields they have bought into.

49. Moreover, East European plans for 1971-75 call for raising the share, already large, of imports of machinery and equipment bought within CEMA. This policy reflects the concern of some countries over the balance of payments but, more importantly, it is indicative of increased East European realism about what imports of Western capital goods can and cannot do. Eastern Europe still wants Western technology, but East European countries have come to the realization that they cannot gain appreciably on Western economic development simply by buying Western plant, equipment and licenses on a straight commercial basis. Attempts are being made to acquire Western know-how through joint ventures, preferably deals that encompass the full range of research, production, and marketing. Such ventures will not come fast enough or in large enough doses to have a pronounced effect on exports or efficiency in the 1970s, but they provide a way for Eastern Europe gradually to acquire advanced technology without substantially adding to indebtedness.

50. These factors should tend to hold down the growth of machinery imports from the West for the next few years. From what is known of East European plans for 1971-75, purchases of Western machinery should rise on the average of roughly 10% a year. At this rate purchases would run about $2 billion by 1975. Projections, however, are very rough, especially beyond 1975.

Machinery imports tend to be lumpy and a few large purchases could be concentrated in one or two years. Moreover for the years beyond 1975 estimates of investment requirements and of the progress of CEMA integration become less reliable.

51. For Romania and Hungary, whose investment programs have been the most dependent on Western machinery, the rate of growth of machinery purchases is likely to fall off in 1971-75. These countries have decided that their imports of Western equipment have been too large to assimilate. Hungary has found that buying machinery to support a policy of import substitution does not pay off. Romania still has a backlog of imported equipment that it is trying to get into operation. As a result, both countries have become more selective. Bulgaria, which depends far less on imports from the West, nevertheless has had a similar case of indigestion and is most unlikely to repeat the big splurge in purchases made in 1966-68. Poland also does not rely heavily on Western machinery, but it is embarking on a modernization program that may sustain the rapid rate of growth of recent purchases, averaging about 25% a year in 1966-69.

52. The most advanced countries, Czechoslovakia and East Germany, have been less forthcoming in discussing their intentions, partly because of continued policy disputes. They are probably best able to assimilate Western technology, but have been strongly tempted to try to develop their own, through increased integration

with the USSR and intra-CEMA specialization. Major purchases of machinery are most likely to be made in connection with integration agreements, and for that reason purchases from the West in the next five years are likely to rise more slowly than in the late 1960's. Both countries also have short-term balance of payments problems to solve in 1971-72, and large orders may be put off until later.

53. East European purchases of raw and semifinished materials now account for nearly 50% of imports from the West. These purchases in part fill gaps in supply as, for example, in fertilizers, nonferrous metals, and high protein food supplies; in part they reflect the need for higher quality inputs -- especially chemicals and semifinished steel -- for the new machinery bought from the West in the last decade. The East Europeans increasingly will meet their own needs for some of these products but on the whole will become more dependent on Western materials and spare parts to maintain the imported machinery.

54. The pattern of imports of Western industrial materials probably will not change much in the 1970's. Purchases of chemicals and metallurgical products, which covered over three-fifths of such imports in 1969, will continue to be the largest items. Some of these countries, however, may substantially increase imports of light industrial materials, such as textiles. East European investment plans for 1971-75 indicate some shift away

from heavy industry, except for Bulgaria. The Hungarians in particular intend to overhaul their textile industry during the next five years in order to emulate new Western fashions, and they will need to import not only materials but also new equipment.

55. Purchases of Western agricultural products should continue to depend primarily on the ups and downs of East European weather and output. One other factor, however, may add some stability to the trend: the East Europeans are now more concerned with upgrading the quality and stabilizing the supplies of both fodder and foodstuffs. This development should mean more imports of feed grains, protein supplements, and high grade food products in the 1970's.

56. The East Europeans also will try to expand imports of consumer manufactures during the 1970's. Purchases of light industrial products -- like clothing, leather goods, and small appliances -- still will not account for a significant share of total imports from the West. Most countries have maintained these purchases at 3% to 4% of imports. Except for automobiles, imports of consumer durables -- refigerators, washing machines, stoves -- have been insignificant. Most of these countries now are planning large increases in domestic output of automobiles, largely from facilities already in operation, which could help to balance supply and demand for consumer goods and to ease the need for imported consumer items, except when agricultural shortages occur.

Prospects for US Trade

57. The US has not shared in the growth of East-West trade for the past two decades and in 1970 accounted for about 4% of East-West trade turnover (exports, 5% and imports, 3%). In 1970 US exports totalled $353 million, $118 million to the USSR and $235 million to Eastern Europe and US imports totalled $226 million, $72 million from the USSR and $154 million from Eastern Europe.*

58. The US has not shared in the growth of this trade in part because of the United States' restrictions vis-a-vis the USSR and Eastern Europe. The most important restrictions on trade have been:

a. More stringent export controls than those of our NATO allies and Japan.

b. Prohibitions on government credits and credit guarantees.

c. Denial of MFN treatment (except to Poland).

d. The 50/50 shipping requirement on grains.

e. The embargo on 7 types of Soviet furs.

59. Other factors instrumental in holding down US trade with the USSR and Eastern Europe include public hostility to Communist goods and the aloofness of US businessmen to selling in the Communist

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* US statistics are used in the discussion of US trade with the USSR and Eastern Europe.

market. There are also some economic constraints, e.g., the limited US market for Soviet and East European goods -- mainly raw materials -- which are sold widely in Western Europe, and distance, which limits US participation in the growing trade in semimanufactures such as rolled steel and basic chemicals and in the expansion of imports of seasonal fruits and vegetables. Moreover, there are numerous small joint production, subcontracting, custom processing and switch deals which are common in East-West European trade but are less attractive to US business.

60. Recently some of the US restrictions have been eased or eliminated. There has been a steady decontrol of restricted US exports of goods and technical data; items formerly denied are now being approved, e.g., machine tools for truck manufacturing plants in the USSR; the 50/50 shipping requirement has been dropped and the President recently has been given discretionary authority to approve Eximbank guaranteed loans to Communist countries.

61. In projecting US trade with the USSR and Eastern Europe in the 1970's it is assumed that the remaining major US restrictions will be dropped, that is, MFN treatment will be restored to the USSR and Eastern Europe and US export controls will be reduced more or less to the COCOM level. It is assumed, moreover, that the climate in the US for expanded economic relations with the USSR and Eastern Europe will continue to improve.

USSR

62. United States merchandise exports to the USSR were valued at $118 million in 1970 and have increased about $2\frac{1}{2}$ fold since 1960, an average annual rate of more than 10%. Most of this growth, however, occurred in 1969, with US exports increasing from $58 million to $106 million. The upsurge in US exports to the USSR in 1969 was led by machinery and transport equipment, especially metalworking equipment for the Fiat plant.

63. The commodity composition of US exports to the USSR usually differs substantially from that of most other developed Western countries. Industrial Western exports to the USSR are dominated by manufactured goods, including machinery. Machinery and equipment typically account for 40-50% of total exports to the USSR, manufactured consumer goods about 10%, and steel and pipe, 5-6%. US exports of machinery and equipment, on the other hand, normally account for only about one-fourth of the total (except in 1969 and 1970, when it was about 40%). Crude materials (raw hides, wood pulp) and chemicals usually make up a large part of the remaining share of the total.

64. US exports have previously experienced sharp increases and subsequent declines, e.g., the $125 million increase in 1964 (wheat) and a decline in the next year by $100 million. Similarly the commodity composition of US exports to the USSR has exhibited frequent and often abrupt changes, e.g., soybeans, insecticides,

steel, textile machinery, and other items. US exports to the USSR (or, rather Soviet imports from the US) tend to alter quickly with changes in Soviet domestic production, availabilities in other Western countries, shifting priorities, and the state of Soviet technology. Consequently, any projection of US exports based on past trends in US exports to the USSR is subject to considerable error. Projections based on the US share of industrial Western exports to the USSR might be closer to the mark. The implicit values of Western exports to the USSR in 1980 based on the 6% to 7% increase noted earlier are $4.9 to $5.5 billion. If the US share of this trade in 1980 increases to 10% to 15%, the value of US exports would be $500-800 million.

65. US exports would change in composition, with a greater share for machinery and equipment -- perhaps more than half. Some of the machinery and equipment exports might include automotive manufacturing equipment, deep well drilling equipment, automatic oil transfer and storage systems, oil refining equipment, rolling mill equipment, off-the-road vehicles, electronics (computer equipment, semiconductor manufacturing equipment, testing equipment), instruments, data transmission equipment, and numerically controlled machine tools. These are items which the USSR has expressed interest in obtaining from the West. Because of superior US technology in some of the above lines of equipment and technology, the US might obtain orders from the USSR. The US

probably will continue to export other items not currently affected by restrictions, including raw hides, wood pulp, various chemicals, and other items. If the growing concern of the Soviet leadership for consumer welfare is translated into increased imports of consumer goods from the West, the US may share in such imports.

66. Between 1960 and 1970 US imports from the USSR grew at an average annual rate of 12% -- from $23 million to $72 million. A significant part of this increase took place in 1970, however, when imports rose by $20 million. US imports (Soviet exports) are virtually all in the raw material and semimanufactured categories. Some changes in composition have taken place over time, with chrome ore, residual fuel oil, platinum group metals, and gem diamonds having become more important in recent years.

67. The prospects for the growth for US imports (Soviet exports) are more bearish than for US exports. If MFN treatment were restored to the USSR and other import restrictions were removed, e.g., the fur embargo, there probably would be some growth in Soviet exports, but the commodities on which the USSR depends to earn hard currencies are in the main unlikely candidates for export expansion in the US. These include oil (except residual fuel oil), cotton, softwood lumber, and coal and coke. These major Soviet export commodities probably would not be exported to the US because of quota restrictions, lack of demand, supply constraints in the USSR, or inability to compete in price without

evoking charges of dumping. The most likely candidates for expansion are Soviet diamonds, wood products (plywood), fish products, nickel, and a few other items such as manganese ore, hydrofoils, carpets, and plate glass. Low sulfur residual oil may also be sold in increasing quantities.

68. As a result, the growth of US imports from the USSR would lag significantly behind that of US exports. How much this lag might be cannot be estimated, but annual deficits could be considerable and probably would have to be offset at least in part by US credit. If the US accounted for 10% to 15% of projected Western imports (Soviet exports) US imports would range from $400 to $700 million. The lower end of the range is more likely.

Eastern Europe

69. US exports to Eastern Europe have been erratic. The value of US exports in 1960 and 1964, for example were higher than in 1969. These ups and downs have been largely a function of East European demand for US agricultural products. Exports in 1970 were valued at $235 million, up about $60 million from the 1969 level. Almost half of US exports consist of agricultural products, a large part of which are feed grains and other animal feedstuffs. Machinery and equipment account for 10% to 15%. Crude materials, coal and steel, and chemicals are also important exports.

70. The growth of US exports to Eastern Europe in the 1970's will depend a great deal upon East European demand for US agricultural products, particularly oilseeds and feed grains; East European need for certain primary products, such as coal and coke, and East European desire for US technology and equipment.

71. The broad commodity composition of US exports to Eastern Europe probably will shift somewhat toward machinery and other industrial products, but agricultural products will still account to for a substantial share. At present, US exports of nonagricultural products are of a marginal nature and the commodity mix is rather fluid. Additional market should develop during this decade. Beyond 1975, sales of machinery and intermediate manufactures should assume a dominant role in US exports to Eastern Europe.

72. If the US accounts for 10% to 15% of projected Western exports to the USSR and Eastern Europe by 1980 of $10 billion, US exports would be in the range of $1-1.5 billion -- an annual rate of increase of 15% to 20%. The value of US exports are more likely to be closer to the lower share postulated, possibly even somewhat less than $1 billion.

73. US imports from Eastern Europe have been rising slowly as a share of the industrial West's imports from the area. They were valued at $154 million in 1970 but the US share still stood at only 4%. Hardly any products from the area have an established

US market. East Europeans tend to sell at very low prices in the US, as they do in Western Europe. Imports of Polish canned hams and shoulders are the conspicuous exception and in value they amount to about 30% of all US imports from Eastern Europe. US imports also incude a variety of manufactured goods such as textiles, glassware, steel, metal manufactures, footwear, clothing, and some machinery.

74. Recent trends in the composition of US imports from Eastern Europe are likely to continue in the early 1970's. Imports of canned pork products (largely from Poland), now almost one-third of the total value, will probably rise slowly because of slackening demand and lack of East European interest in expanding sales by lowering prices. The urgent need to increase domestic sales of better grade processed pork products also is likely to limit the available supply for export. Other imports of food products will not expand substantially. East European efforts to expand food exports are concentrated on beef and beef cattle, especially in the northern countries and Hungary and on fruits and vegetables, especially in the southern countries. Western Europe offers the best markets for these products and pays competitive prices.

75. Prospects for US imports of fuels and chemicals from Eastern Europe are not bright; the growing surplus that the area has for export is readily sold in nearby countries at fairly

good prices. Romanian low sulfur fuel oil is a possible exception, though US imports have declined recently.

76. US machinery imports from the area, now quite small, have little future, even from Czechoslovakia and East Germany. The East Europeans offer machinery at low prices, but price is not the main consideration for machinery imports in the US, and East European products are not otherwise competitive. They help at most to fill a few specialized needs.

77. On the other hand, US imports of iron and steel products at a low level of processing, together with imports of metal products* -- with a large share from Poland -- should continue to rise substantially. Adequate East European capacity is available, quality is acceptable, and price is a key factor for these products in the US.

78. Finally, imports of consumer-related products, from crude materials through finished goods, might increase rapidly with especially large increases from Czechoslovakia and East Germany. Most instances of rapid continuous growth in US imports through the 1960's have been of this kind. Only inertia stands in the way of large increases in US purchases of glassware and other glass products, costume jewelry, ornaments, and novelties; wooden furniture; inexpensive footwear; and knitwear of various grades -- to mention the more interesting possibilities. Textile imports are less likely to grow rapidly, given quality and style

* Including nails, bolts, screws, and the like; hand tools; and domestic utensils.

differences, limitations on supply, and actual or potential quota restraints.

79. Poland, which still accounts for two-thirds of US purchases from Eastern Europe, will continue to have the dominant position, although the Polish share will decline, perhaps considerably. Czechoslovakia's share of the market is likely to remain about 20%. All other countries are likely to increase their shares, especially East Germany, which has a fairly wide range of salable products and is looking for alternative markets to West Germany.

80. Because of the small base, total US imports from the area are expected to rise somewhat faster than West European imports. From 1971 to 1980, US imports are given a better than even chance of growing at least at the rate of the 1960's -- which averaged 10.5% per year -- about as strong an estimate as can be hazarded, given the small scale and marginal nature of almost all sales to the US from the area. A good chance evidently remains that the rate of growth will be significantly higher or lower, though hardly as low as 5% or as high as 20%.* US imports from Eastern Europe in 1980 probably will be in the range of $300 million to $600 million or 4% to 7% of Western imports from

* Either of these possibilities is given less than a 10% chance.

Eastern Europe. As with the USSR, the lower level of projected US imports than of exports in trade with Eastern Europe implies chronic East European deficits.

Constraints on US Trade with the USSR and Eastern Europe

81. Although special US restrictions have played a part in hold down the level of US trade with East Europe, a number of basic economic constraints would hold the US share below that of Western Europe even if US trade with the East were put on an equal footing with Western European trade with that area.

82. The most important constraints on US trade with the USSR and Eastern Europe affect US imports. The US is well endowed in agricultural and mineral resources; unlike Western Europe it does not normally offer a market for Soviet or East European grains, lumber, coal, crude petroleum or natural gas, and it is a relatively poor market for most other mineral products. In the long run, a few Soviet raw material reseves, such as copper, may be developed with Western assistance, and the US might be a market for such commodities if access to Free World supplies becomes more difficult. Distance is another obstacle; in particular it limits US participation in the rapidly growing exchange of semimanufactured goods, such as rolled steel and basic chemicals, with the West, and in the expansion of imports of seasonal fruit and vegetables. A third limiting factor is the lack of deep historical ties between the US and Eastern Europe. Millions of people in Central Europe on both sides of the Iron Curtain

have similar tastes for a wide range of consumer goods and retain a cultural affinity that facilitates business contracts, including joint production and sub-contracting.

83. Another major obstacle to a further rapid growth of US imports from the area is the inertia of Soviet and East European producers and trade organizations. They find it to their advantage to stick to markets that offer the most security. Usually they have a hard enough time to meet commitments in these markets in the face of chronic shortages that seem unavoidable in command economies. For the same reason, their customers, foreign as well as domestic, fight a constant battle to obtain delivery of goods on time and as specified. The West European importers who deal with Eastern Europe put up with a lot of trouble for the sake of the extremely low prices at which they are able to buy in the area. Conversely, of course, the prices are so low in part because so much trouble is involved for importers. The undependability of East European deliveries has made importing from the area as much of a specialized business as exporting to the area. Moreover, tie-in arrangements, processing contracts, and switch deals are common and necessary. The commercial interests and practices of smaller countries deeply involved in foreign trade seem to be better adapted to this way of doing business than are those of the United States.

84. A related difficulty for US imports is that few East European manufacturers actually produce for the Western market. The goods sold in Western Europe are among the highest grade products of Eastern Europe, but they have rarely been designed to meet specific Western needs and preferences. They are thus in general sold more easily in Western Europe, where changes in demand have been less sweeping than in the US. Moreover, the quantities available are often small and are thus of less interest to US than to Western European importers.

85. The continued growth of East-West trade, however, will gradually lower the barriers to Eastern Europe's trade with the US. The area's enterprises and trade organizations are becoming more adept in dealing with the Western market. Specialized production in Eastern Europe (not in the USSR) primarily for export to the West, is likely to develop, whether or not basic changes are made in East European economic institutions and policies. US importers should therefore find it easier and more attractive to do business with Eastern Europe in the 1970's. This process will nevertheless be slow, and it will hardly have a dramatic effect on US imports by 1975. The abrupt changes from year to year in US imports from Eastern Europe that are visible in detailed trade statistics should, however, become less marked. The stabilizing of the trade is an important condition for further growth.

86. The prospects for US exports to the USSR and Eastern Europe appear better than those for imports, although some of the constraints on imports -- such as greater distance -- also affect exports. Eastern demand for technologically advanced products is considerable and the US competitive position for many of these products is strong. This suggests the possibility of a substantial US trade surplus with the USSR and Eastern Europe. Such a surplus could be financed in large part by US export credits, but only for a few years. In the long run, repayments would tend to catch up with credit drawings. The USSR and Eastern Europe would then have either to balance their trade with the US or use surpluses in trade with other hard currency countries to finance deficits in trade with the US. Soviet gold sales are also possible.

Effects of Removal of US Restrictions on Trade with Eastern Europe

87. Of all the US restrictions on trade with Eastern Europe and the USSR, only three have enough long-run significance to affect the volume of US trade with the USSR and Eastern Europe: credit restrictions, export controls, and MFN. The most important legal restriction concerning commercial credit which has significantly limited US exports to Eastern Europe and the Soviet Union -- the Export-Import Bank Extension Act of 1968 -- has prohibited granting of Export-Import Bank guarantees and insurance on loans and credits to those countries. The Export-Import Bank regulations

are currently being liberalized to include, at the discretion of the President, medium-term credit guarantees and insurance to Eastern Europe and the USSR. This move could lead to growth in US sales, particularly of machinery and equipment, in the next few years. With Presidential approval, the mobilization of domestic credit facilities probably would be limited only by the need of US firms to use such credit.

88. Some US firms have limited access to European credit facilities through West European subsidiaries, and East European importers can finance purchases of goods directly from the US through use of Eurodollar credit as well. In several instances, usually at the initiative of the East European importer, financing of imports of US capital equipment has come from Western European sources. The limit to this source of funds rests on the nature of each particular deal, money market conditions, and, most important, the overall credit rating of the East European importing country. An expanded volume of US equipment sales probably could be financed by this method.

89. At the present time, US firms can secure machinery orders from Eastern Europe and the USSR in cases where there is clear technological superiority and where lead-time minimization is a factor. Otherwise, Western European (and Japanese) firms can undersell US bidders on the basis of cheaper credit, lower transport costs, and more favorable credit terms. Where US firms have

subsidiaries or affiliates in Western Europe which can provide appropriate equipment to fill East European orders, a US "parent" firm frequently will sell the licensing and technology rights directly, and allow the European subsidiary or licensee to supply needed equipment. If US firms hope to make a dent in the European Communist machinery import market in the 1970's, US credit terms must approximate those available in Western Europe. US exporters must be prepared to offer 8-year to 10-year credit at competitive interest rates, covering single orders for plant and equipment ranging from about $1 million up.

Reduction of Export Controls

90. Decontrol of commodities on the US commodity control list has been progressing over the last few years, and the passage of the Export Administration Act in December 1969 has accelerated the pace of decontrol. Moreover, there has been a tendency toward more leniency in approving items requiring validated licenses (with some exceptions). Thus, in spite of the fact that the COCOM list has been trimmed, the gap between US and COCOM controls has narrowed.

91. The effect of the reduction of US controls to the COCOM level on US exports to the USSR and Eastern Europe probably would be twofold. First, there would be some increase in the value of US exports to the USSR and Eastern Europe of items in

which the US has technological superiority, e.g., computer mainframes and peripherals, semiconductor manufacturing equipment, testing equipment such as oscilloscopes, and data transmission equipment. The conclusion of only a few large contracts could mean a substantial increase in US exports over the currently low level of US exports to the USSR and Eastern Europe,* but if an important share of such orders were filled by US subsidiaries and licensees -- as they often have been in the past -- the increase would be less. In other words, increased access to US technology and know-how would not necessarily lead to a concomitant increase in the export of US equipment embodying this technology.

92. A second effect of the relaxation of controls would be a change in the commodity composition of US exports to the USSR and Eastern Europe. Currently machinery and transport equipment account for about 20% of US exports to these countries and crude materials and agricultural products account for about 60% of the total. As a result of a reduction of US controls some increase in the share of machinery and equipment is to be expected, although it is uncertain what other category or categories would diminish. The category of machinery and equipment itself would also undergo some change.

* The $100 million increase in 1970 in US exports to the USSR and Eastern Europe -- largely agricultural products -- represented a growth of 40%.

If MFN were granted

93. The granting of MFN to the USSR and Eastern Europe probably would not have a significant effect either on the value of US imports from these countries or the commodity composition.* Since the revocation of MFN treatment, US imports from the USSR have been either duty-free or, if dutiable, the rates have been generally low or not significantly different from MFN rates. Duty-free goods such as chrome ore and platinum group metals entering the US from the USSR currently account for about 85% of the total. If MFN were restored to the USSR, it is assumed that goods now subject to US tariff discrimination, but which are currently sold in other industrial Western countries, would be candidates for export to the United States. Major Soviet exports to the industrial West, as noted earlier, would not be exported to the United States, however, because of quota restrictions, lack of demand, supply constraints in the USSR, or inability to compete in price without evoking dumping charges.

94. Roughly two-thirds of US imports from Eastern Europe originate in Poland, which already enjoys MFN status. This leaves about $50 million in imports from other East European

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* Abstracting from politically inspired increases in imports.

countries. Of this total, Czechoslovakia accounts for roughly half. Czechoslovakia is more discriminated against by the US tariff rates than any other East European country. In 1969, for example, the average tariff duties levied on dutiable goods imported from Czechoslovakia was 30%. For Hungary it was 26%; Romania, 24%; Bulgaria, 22%; and the USSR, 14%.* East European exports to the United States are mostly manufactured goods -- textiles, clothing, glassware, pottery, shoes, furniture, and prepared goods -- and carry higher rates than raw materials.

95. Restoration of MFN would significantly reduce the price to US importers for many of these goods, but whether this would result in significantly increased imports is another matter. Whatever increase there is would be delayed because of the preplanned trade patterns of Eastern Europe and the USSR. Eventually, the Eastern European countries could gain more than the USSR if they actively pursued this advantage. However, these countries regard Western Europe as their main market and the US as a remote and marginal one. A number of Western European countries have indicated a desire to remove by 1975 nearly all of their quantitative restrictions on imports from the USSR and Eastern Europe, thereby making the US market less attractive. Given the relatively low value of goods that

* Poland paid on average of 7%

the US imports from the USSR and Eastern Europe at discriminatory rates and other factors noted above, the restoration of MFN to these countries would not result in significant increases in trade.

96. US trade with the USSR and Eastern Europe probably would be somewhat larger in 1975 with the above restrictions abolished. How much larger would a function of the timing of the possible removal of these restrictions, but more important, it would be a function of the purely economic limitations on the development of such trade. The removal of US trade restrictions should help to stimulate US participation in East-West trade, but only as the economic, or commercial, interest on both sides becomes stronger. As the scale of East-West trade increases and both sides gain experience, the interest of US businessmen will rise, along with Soviet-East European capabilities and desire to enter the US market. These concessions would probably begin paying off in trade in a significant way only by the mid-1970's, even if they were put into effect today.

97. Trade with the USSR and Eastern Europe could eventually represent as much as 3% of US trade, if all special US restrictions were lifted. This level of trade, however, could only be achieved after many years. In the interim, US trade

with the USSR and Eastern Europe would undoubtedly be far below this share whatever may be done with regard to restrictions. It took several years for Poland, for example, to take full advantage of MFN treatment for its exports. It would also take some years for the scale of imports to rise to the point ~~that~~ major US traders might become seriously interested in marketing Soviet and East European products in the US. The likelihood that the US will continue to impose somewhat tighter restrictions than does Western Europe on trade with the East for at least several years, and the lags in the response of trade to a lowering of barriers, lead to the conclusion that US trade with the USSR and Eastern Europe is unlikely to be more than 2% of US trade by 1980.

Possible Future Developments

98. A slow-down in the growth of East-West trade is postulated for the 1970's because of changed circumstantance. Substantial Soviet purchases of machinery and equipment on credit in the 1960's have created a sizeable debt to the West, and because the outlook for export expansion is bearish, Soviet import capacity probably will be limited. For the East European countries, the principal forces leading to the rapid growth of trade in the 60's -- the desire for Western equipment and technology, expanded Western credit and East European exports of agricultural and industrial raw materials -- have weakened.

99. For the USSR there continues to be a strong demand for Western equipment and technology and its imports of these items should remain at a high level. For Eastern Europe, there will probably be a slow-down in the growth of imports of Western machinery and equipment, not only because of increasing indebtedness, but also because some of them have found it difficult and costly to assimilate Western technology. Acquisition of Western technology and equipment without incurring a high level of indebtedness might come about through joint ventures. Thus far East-West industrial cooperation has been in the form of small, limited types of ventures involving joint production or subcontracting, which have generated a meager volume of trade and marginal benefits to East and West. Romania and Hungary passed laws recently permitting minority foreign ownership and this may encourage Western investment. Deals that encompass the full rage of research, production, and marketing would enable East European countries to obtain Western know-how and would presumably give the Western partner a direct interest in stimulating East European technology and exports. It is doubtful, however, that major joint ventures will come fast enough or in large enough doses to have a pronounced effect on overall East European exports or efficiency in the 1970's.

100. There is little likelihood that the USSR would consent to foreign ownership in the Soviet Union, minority or otherwise, regardless of the outcome of the Security Conference. There are a number of opportunities for Western cooperation with the USSR, however, which would involve an exchange of Western capital and entrepreneurship for Soviet raw materials. Possible projects involve the exploitation of Soviet raw materials such as copper, nickel, gas, oil, and timber and the building of a pipeline from the Tyumen oil fields to Nakhodka. Western equipment and know-how would be provided on credit and repaid with the commodities exploited. The potential is considerable, but large injections of Western capital would be necessary and the pay-off would be slow in coming.

101. Another important reason for the projected slow-down in the growth of East-West trade is related to CEMA integration. In the 1970's there is expected to be greater coordination of national economic plans in CEMA and intra-CEMA trade is scheduled to grow more rapidly at the expense of trade with other areas. All CEMA countries plan not only to increase the share of their trade with other CEMA countries, but also to raise the share of imports of machinery and equipment bought within CEMA. The plans for greater intra-CEMA trade are in keeping with renewed efforts or most members to promote CEMA

integration, and chances for achieving progress appear to be better now than they have been in the entire history of the organization.

Possible Communist Concessions

102. Central planning and the concomitant planning of foreign trade will continue to be features of Communist economies regardless of the outcome of the conference. An important aspect of these centrally planned economies is the "foreign trade monopoly." Foreign trade organizations form a bureaucratic layer between Eastern and Western consumers and producers. There have been some deviations from this arrangement, as for example, in Hungary, but these have done little so far to minimize bureaucratic delays in foreign trade decision making and in concluding transactions.

103. As a concession to the West, the CEMA countries might permit more direct access by Western firms to Communist producers and consumers This has been done in the past on a limited scale. Even the USSR in recent years has permitted greater Western access to officials of Soviet enterprises and industrial ministries,* but the foreign trade transactions still must be handled by the foreign trade ministry. Greatly increased access

* This has been chiefly at the behest of the USSR State Committee for Science and Technology rather than the Ministry of Foreign Trade which has been stubbornly resisting in the name of the sanctity of the foreign trade monopoly.

will facilitate negotiations and tend to ameliorate the aggravations caused by having to deal with superfluous layers of bureaucracy. This in itself may encourage more Western businessmen to seek markets and goods in the USSR and Eastern Europe.

104. Another concession might be the establishment of minimum quotas for Western goods. The Soviet Union and the East European countries could guarantee markets for Western goods, probably for specific categories of goods. Such a concession could be offered in exchange for increased access to Western markets (reduction of quotas or tariffs). The ability of the individual CEMA countries to guarantee markets varies considerably, and the impact of such arrangements cannot be assessed. Such quotas, however, would be consistent with the desire of Communist countries to minimize the share of unplanned foreign trade.

Possible Western Concessions

105. The export controls administered under COCOM might be further reduced consistent with Western security considerations. How much of a concession this would be is difficult to judge, however. COCOM International List I (consisting of items with both civil and military end use) has been reduced regularly in recent years and is about to be reduced further at the List

Review scheduled to begin in Paris in October. Presumably many sophisticated electronic items will remain on the list following the review, including high powered computers. Given the demand for such computers in the USSR and Eastern Europe and the apparent inability of these countries to produce third generation machines on a large scale, further decontrol of computers might generate a considerable volume of business with the Communists.

106. Another major concession by the West would be the reduction of quantitative restrictions (QR's) in Western Europe (as well as tariffs in the US). In recent years, QR's *vis-à-vis* the USSR and Eastern Europe have been reduced but the impact appears to have been minimal. In many instances the relaxations were for goods which are not important Soviet and East European exports. Moreover, liberalization of quotas for the Soviet and Eastern Europe goods apparently has been less than for OECD countries. Some West European countries have expressed an intention to remove most of their QR's on imports from the USSR and Eastern Europe by 1975. If liberalization is aimed largely at important Soviet and East European exports commodities, some rise in such exports probably would take place.

107. With the probable expansion of EEC to 10 countries in the next year or so, it is difficult to assess what impact the EEC Common Agricultural Policy would have on agricultural exports of the USSR and Eastern Europe. Some concessions to the USSR and Eastern Europe might have to be made because agricultural goods are important foreign exchange earners for Eastern Europe.

108. It is highly unlikely that the growth of East-West trade will substantially exceed the growth rates postulated above. Indeed, the upper end of the range estimated for 1980 assumes that the East will have made some meaningful concessions to stimulate Western investment and that the West will have significantly reduced quota and tariff restrictions and relaxed export controls. Given the fact that Western economic integration is moving ahead rapidly and that integration of the CEMA countries now shows greater promise than ever, a dramatic increase in East-West trade would be likely only if concessions are made that now appear to be beyond the limitations imposed by the Eastern and Western economic and political groupings.

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APPENDIX

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Table 4

USSR: Trade with the Industrial West
1960-1970

Million $US

Year	Soviet Statistics: Exports	Soviet Statistics: Imports a/	Western Statistics: Exports b/	Western Statistics: Imports a/
1960	983	1,080	1,081	976
1961	1,069	1,093	1,211	1,050
1962	1,115	1,283	1,285	1,249
1963	1,218	1,400	1,414	1,289
1964	1,282	1,734	1,494	1,607
1965	1,438	1,601	1,712	1,397
1966	1,711	1,742	1,935	1,475
1967	1,886	1,782	2,195	1,587
1968	2,051	2,143	2,322	1,896
1969	2,230	2,495	2,458	2,277
1970	2,345	2,780	2,733	2,603

a. f.o.b.

b. Western imports, c.i.f., except US (f.a.s.); Canada and Republic of South Africa (f.o.b., inland point of shipment); and Australia (f.o.b.).

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Table 5

Eastern Europe: Trade with the Industrial West
1960-1970

Million $US

Year	East European Statistics		Western Statistics	
	Exports	Imports a/	Exports b/	Imports c/
1960	1,502	1,675	1,462	1,534
1961	1,628	1,923	1,549	1,669
1962	1,667	1,866	1,635	1,695
1963	1,862	1,977	1,834	1,789
1964	2,118	2,456	1,999	2,194
1965	2,343	2,579	2,288	2,366
1966	2,665	3,175	2,561	2,933
1967	2,846	3,385	2,749	3,137
1968	2,975	3,466	2,888	3,180
1969	3,383	3,839	3,296	3,576
1970	N.A.	N.A.	3,886	4,270

a. Bulgaria, Czechoslovakia, East Germany and Poland, f.o.b., Hungary, c.i.f., Romania, unknown but probably c.i.f.
b. Western imports, c.i.f except US (f.a.s.); Canada and Republic of South Africa (f.o.b., inland point of shipment), and Australia (f.o.b.).
c. f.o.b.

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Table 6

USSR: Hard Currency Trade
1960-1970 a/

Million $US

Year	Exports	Imports b/	Balance
1960	744	1,017	- 273
1961	866	1,060	- 194
1962	917	1,181	- 264
1963	960	1,278	- 318
1964	1,011	1,545	- 534
1965	1,326	1,544	- 218
1966	1,482	1,746	- 264
1967	1,691	1,600	+ 91
1968	1,893	1,988	- 95
1969	2,105	2,425	- 320
1970	2,196	2,696	- 500

a. Based on Soviet statistics; includes all Free World countries which conduct trade in hard currency with the USSR.
b. f.o.b.

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Table 7

Selected Soviet Commodities in Trade with the Industrial West 1970 a/

Exports	
Total	2,345
Crude Oil and Petroleum Products	528
Coal and Coke	131
Wood and Wood Products	386
Cotton fiber	37
Base metals	209
Food	121
Furs and Pelts	46
Other	336
Unspecified b/	551
Imports	
Total	2,780
Machinery and Equipment	1,099
Base metals	236
Chemicals	214
Wheat and Flour	122
Manufactured consumer goods	280
Other	593
Unspecified	236

a. Based on Soviet statistics and classifications.
b. Largely platinum group metals, gem diamonds and nickel.

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Table 8

East European Exports to the Industrial West 1969 a/

	Bulgaria	East Germany b/	Poland	Hungary	Romania	Czechoslovakia
Total trade	181	825	834	425	420	613
Food and live animals	68	134	272	175	121	84
Beverages and tobacco	19		6	5	3	2
Crude materials, inedible, except fuels	23	58	134	46	84	80
Mineral fuels, lubricants	1	54	141	19	42	56
Animal and vegetable oils and fats	5	20	5	7	16	4
Chemicals	8	72	40	20	21	38
Intermediate and semimanufactures	37	176	127	70	74	168
Machinery and equipment	6	116	21	22	13	85
Consumer and other finished	11	153	42	50	36	73
Other	3	18	46	11	10	23

a. Based on Western Statistics; SITC Categories.
b. Including East German trade with West Germany.

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Table 9

East European Imports from the Industrial West, 1969 a/

	Bulgaria	East Germany b/	Poland	Hungary	Romania	Czechoslovaika
Total trade	239	903	768	395	613	587
Food and live animals	7	120	55	29	13	44
Beverages and Tobacco	1	19	8	1	--	5
Crude materials, inedible, except fuels	11	71	59	26	31	42
Mineral fuels, lubricants	2	20	9	1	14	3
Animal and vegetable oils and fats	--	9	6	2	3	3
Chemicals	34	127	112	85	49	94
Intermediate and semimanufactures	85	279	198	118	171	111
Machinery and equipment	87	213	253	102	299	228
Consumer and other finished manufactures	9	31	28	20	20	39
Other	3	14	45	11	13	18

a. Based on Western stistics; SITC Categories.
b. Including East Germany's trade with West Germany.

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