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EASTERN BLOC INDEBTEDNESS TO THE WEST

INTRODUCTION

The primary preoccupation in international trade negotiations, once initial business contacts are cemented, centers on financial arrangements. Nowhere is this phenomenon more conspicuous than in East-West trade, where capitalist nations must deal with the complex monetary systems of centrally planned economies. A particularly intriguing aspect of these financial ties is the question of Eastern bloc indebtedness to the West and the United States attitude toward continued credit extension. For the purpose of this discussion, the Eastern bloc is defined to include the countries of Poland, Romania, Czechoslovakia, Yugoslavia, Hungary, Bulgaria, East Germany, and the Soviet Union.

Revitalized efforts to promote the growth of U.S. exports focuses renewed attention on the role of credit in international trade. The Carter Administration is waging a continuous, though often low-keyed, battle to expand U.S. trade relations with the Eastern bloc. The primary goal rests with the extension of Most-Favored-Nation (MFN) trade status to these countries and the unrestricted use of Export-Import Bank credits in bilateral commercial dealings. Numerous congressional hearings this spring and summer on a wide range of trade-related issues served as a forum for businessmen to urge the U.S. government repeatedly to sever all links between trade and foreign policy concerns. Following a scenario in which the Administration circumvents all security and politically-inspired trade regulations, acceleration of U.S. government credits to the East would likely result.

THE NATURE OF THE DEBT PROBLEM

Soviet bloc (excluding Yugoslavia) debt in 1977 was calculated at $60 billion and with a similar continuous rate of borrowing through 1980, the debt figure is projected at close to $100 billion.[1] The chart below gives a country breakdown of the bloc indebtedness over a five year period. These figures include all private and public credit extensions.

WHAT COMECON OWES THE WEST
Billions of U.S. dollars

	1973	1974	1975	1976	1977 (Est.)
Bulgaria	$ 1.5	$ 1.7	$ 2.4	$ 2.8	$ 3.0
Czechoslovakia	0.9	1.1	1.5	2.1	3.0
East Germany	2.8	3.6	4.9	6.0	6.5
Hungary.	2.0	2.3	3.2	3.3	4.0
Poland	2.5	4.9	7.8	10.8	12.0
Romania.	2.1	2.4	2.8	2.8	3.5
U.S.S.R.	4.0	5.9	11.4	18.0	20.0
Comecon banks.	1.8	2.1	2.8	3.5	4.0
TOTALS	$17.6	$24.0	$36.8	$49.3	$62.0

Data: Chase Manhattan Bank, CIA, FRG Bundes Bank, Morgan Trust, Swiss Bank Corp., Bank for International Settlements, OECD, Economic Commission for Europe, Prof. R. Protes, NCNA, M.C. est.

From: Miles M. Costick, The Strategic Dimension of East-West Trade (Washington, D.C.: ACWF Task Force on Strategic Trade, 1978), p. 26.

Leaving aside a large portion of accumulated debt or principal on credits outstanding (those issued through private commercial banks), it is the official government credits and their continued availability to Eastern bloc countries that requires investigation. The feasibility of these programs is seriously questioned by a growing number of American taxpayers, business analysts, and economists.

Eastern bloc indebtedness to the United States remains an obstacle to potential economic gains the U.S. can expect to receive from expanded East-West trade. A brief look at the eight economies listed above and their credit positions vis-a-vis the U.S. leads to an examination of the serious concern that the debtor-creditor relationship is shifting to the detriment of the U.S. in particular, and the West in general. While the Commodity Credit Corporation agricultural credits (CCC), Export-Import Bank credits, and foreign aid loans are all ostensibly designed to further the export of U.S. goods and services abroad, the key question is at what cost to the United States these programs are being offered to the Eastern bloc nations. Factors requiring attention include the countries' debt repayment potentials, the

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1. Richard Portes, "East Europe's Debt to the West: Interdependence is a Two-Way Street," Foreign Affairs, July 1977.

effectiveness of the credits (i.e., where the money goes), the terms of credit, and existing and future terms of trade and types of trade the U.S. can expect to negotiate with these countries.

POLAND

With a growing total indebtedness to the West - from $2.5 billion in 1973 to a currently estimated $15 billion - Poland is the most vulnerable of the Eastern countries in terms of potential debt servicing hardships. Projections of debt repayments for the next several years range as high as $4 billion annually, a figure equal to the country's total 1977 hard currency exports. The debt service ratio (ratio of repayments of principal plus interest to hard currency earnings) in 1979 is expected to hit 54 percent.

The domestic economic outlook in Poland is gloomy. Effective worker strikes during the past year, similar to those in 1976, jarred the political and economic underpinnings of the government. National income growth in 1978 was the second lowest rate in twenty years. The U.S. Foreign Agricultural Service reports the crops survived the harsh 1978/79 winter in worse condition than the previous year. Eighty percent of the arable land in Poland is in private hands, and yet agricultural modernization is not succeeding very rapidly. The Polish State Board has reported little economic growth thus far in 1979. A large foreign trade deficit may result this year, primarily due to the agricultural setbacks caused by poor weather and ineffective planning. In addition to agricultural problems and growing inflation, Poland suffers from a vulnerable energy supply situation, requiring large-scale oil imports.

Poland's indebtedness to the United States dates back to World War I claims. With an approximate $561 million in debt outstanding, $507 million of which is due and unpaid, Poland should be subject to the restrictions of the Johnson Debt Default Act of 1934, which prohibts individuals and corporations from extending loans to foreign governments which have defaulted on debts owed to the U.S. Exempt from this Act are U.S. government programs which directly support U.S. exports. In dealing with non-market economies, however, the application of this exemption is economically nonsensical when the recipient country has no guaranteed capability of repayment. Thus, debt obligations would continue to mount. Furthermore, Poland is exempt from the Trade Act of 1974 restrictions and therefore participates in the CCC credit program and Export-Import loan program.

As of March 31, 1979 the total official government credits utilized and still outstanding from the Polish government (excluding World War I debts) is $903,576,496. Of this amount, $93,917 is principal and interest due and unpaid from 90 days or more.[2] Broken down by program and rounded to the nearest million the credits are distributed as follows: Foreign Assistance Act and Related Programs, $15 million; Commodity Credit Corporation, Export Sales Program, $741 million; and the Export-Import Bank, $189 million. (See tables.)

Of interest to the United States should be the continued efforts of the Polish government to seek additional loans and credits from any available source. Currently the government is attempting to finalize a $500 million loan through the Eurocurrency market. During the last six months an estimated $3 billion in new credit (total private and public) has been extended to Poland. The availability of these Western credits is probably relieving the Soviet Union from the expensive task of propping up the Polish economy. Instead, the Soviet Union is economically exploiting the bloc countries. Rumors have been circulated that Poland is considering an application to the International Monetary Fund. While participation in the IMF would require that Poland make available financial and general economic statistics kept secret in the past, the IMF's program of debt rescheduling may also be part of the membership appeal.

ROMANIA

The World Bank recently released a study of Romania quoting the annual rate of economic growth between 1950 and 1975 at 9.8 percent. Based on official Romanian statistics, the credibility of the report has been challenged from both within the Bank and outside. A Wall Street Journal editorial, using Bank per capita income figures for Romania and the growth rate of 9.8 percent, extrapolated a 1945 per capita income level which could not have sustained life.[3] While the economy has undoubtedly grown since 1950, there as yet appears to have been no new "take-off." The Romanians have been credited with good economic planning, have encouraged Western investment, and benefit from Black Sea coast tourism, yet the economy remains dependent on Soviet oil and Western financial credits.

Romania is a net importer of foodstuffs, although by 1962 the government had obtained almost complete control of the agricultural sector through collectivization. State farms are currently

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2. These and subsequent debt figures are those officially listed by the U.S. Treasury Department. The total credits still outstanding are the amounts owed on accounts receivable (original maturity of less than 90 days), short-term loans and credits (original maturity of 90 days to one year), and long-term loans and credits (original maturity over one year). Many of the loans and credits have not reached maturity and most of the amounts overdue and unpaid are under negotiation over repayment terms: thus the countries are not technically in default of payment.
3. "Resurrection of the Dead," Wall Street Journal, August 10, 1979. p. 10.

operating and there has been little shift by the labor force out of agriculture since 1964, when 64 percent of the labor force was still employed in this sector. Industrial growth has been notable over the last decade and industrial productivity now accounts for 60 percent of the national income. Another factor linked directly to future economic growth involves energy supplies. Romania has in the past been able to produce enough oil for domestic consumption, while importing crude from Iran for industrial-export-related use. With the Iranian supply nearly shut off and government officials warning that existing oil supplies will be depleted in 10 years, the Romanians have undertaken a large-scale energy investment program.[4] The annual rate of growth in energy production between 1974 and 1976 has been estimated at 4.5 percent, while the rate of growth in energy consumption during this same time period is reported at 7.5 percent.[5] Intensified efforts to increase domestic production become more vital with the Soviet announcement that export supplies will be limited. Although Romania has maintained its energy independence from the Soviet Union by turning to alternate sources, the question of affordability of OPEC oil without Soviet backing could bring about a new dependency.

The United States signed a bilateral trade agreement with Romania in 1975, extending a waiver for MFN trade status. The waiver was recently extended for another year by Congress. Under this waiver Romania is eligible for Export-Import Bank credits and the CCC agricultural credits. At the same time, several cases are still pending against the Romanian government involving confiscation of U.S. property in that country.

Romania currently owes the U.S. government nearly one-third of a billion dollars, about evenly divided between accumulated World War I debts and post-World War II credit extension. There remains a $153,126,788 outstanding indebtedness to the U.S. from WW I, of which $135,387,523 is principal plus interest due and yet unpaid. In addition, as of March 31, 1979, Romania has received credits still outstanding from the U.S. totalling $154,547,794 with $32,268 due and unpaid after 90 days. Most of this outstanding credit is linked to Export-Import Bank loans and CCC credits with a minute portion due various U.S. government operations. An example of the growth in U.S.-extended credits is found in the CCC program. As reported by the Treasury Department, the CCC extended $110 million in credits to Romania in fiscal year 1979 as compared to only $23 million in FY78. Furthermore, total CCC credits for FY 1956-78 amounted to only $181,162,000.

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4. "Eastern Europe's Energy Crunch is Here-Official," The Economist, September 8, 1978, p. 89.
5. The World Bank, World Development Report, 1979, p. 139. Subsequent energy production and consumption figures are taken from the same report.

CZECHOSLOVAKIA

Since the political unrest of 1968, the economy of Czechoslovakia has failed to live up to its output potential. An economist for the Chase Manhattan Bank in 1977 called the outlook for continued growth very poor, stating "It is a case of an economy which is poorly managed in the center and the enterprise level."[6] This analysis appears valid as the Czech government this year introduced a new incentive program for managers of companies aimed at spurring production output. But unlike incentive programs of most Western nations, there is a penalty attached to poor growth which makes deductions in company earnings, passing along the burden of ineffective management to the workers.

A dismal overall economic picture emerged in 1978 as the country failed to meet its targeted growth rates. Agricultural productivity, for instance, increased only 1.5 percent in 1978, short of a 3.4 percent growth target. Both industrial trade with the West and agricultural output declined from previous years. The annual average growth rate of GNP per capita from 1960 through 1977 has been reported at 2.6 percent, the lowest among the Eastern European countries. Czechoslovakia is currently selling about one-third of its industrial products to cover the cost of imports.

Czechoslovakia's energy situation remains bleak. Severe winter weather created power shortages as domestic supplies of coal could not be transported. Energy production between 1974 and 1976 grew 2.7 percent; however, energy consumption expanded by 4.2 percent. The country is dependent on the Soviet Union for a large percentage of its energy needs and the Soviets have exploited this situation by raising the price of oil imports. This cost increase is simultaneously being passed along to domestic consumers. Thus the political unrest can be expected to grow as Soviet prices skyrocket with the gradual decline in export supplies. Likewise, the added energy costs will create a decrease in Western commodity imports other than vital foodstuffs.

As with both Poland and Romania, the Czechoslovakian official indebtedness to the U.S. dates back to World War I credits. $379,335,535 is the total principal outstanding with the preponderance consisting of $332,986,605 in principal and interest due and unpaid. As Czechoslovakia has never participated in the Export-Import Bank loan program and is currently restricted under the Trade Act of 1974 from participating in any U.S. government loan or credit extension program, the outstanding post-World War II indebtedness to the U.S. consists solely of surplus property sales. This official credit utilized and still outstanding amounts to $4,878,683. However, the principal plus interest due and unpaid now totals $8,004,243.

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6. "Private Enterprise vs. Eastern Europe," Nation's Business, August 1977, pp. 54-56.

YUGOSLAVIA

Western analysts very carefully monitor the economy of Yugoslavia and its indebtedness to foreign governments. In the early seventies, proponents of extending U.S. government credits to the Eastern bloc felt that with proper support from the U.S. these countries could detach themselves from the economic stranglehold of the Soviet Union. However, despite the independent status of Yugoslavia with respect to the Soviet bloc, the flexibility afforded this economy has not produced encouraging results.

A superficial look at the Yugoslavian economy portrays an unsound pattern of economic growth: an economy plagued with the chronic problems of inflation, unemployment, and growing debt. President Tito, late in 1978, addressed these problems in a major speech declaring these troubles were severe enough to threaten the national unity of his country.[7]

The relatively open economy of Yugoslavia has benefited more than any other Eastern European nation from years of trade relations with the West. The United States has had relations with the country through GATT (General Agreement on Tariffs and Trade) for many years, and Yugoslavia is exempt from the MFN and Export-Import Bank credit restrictions of the Trade Act of 1974, Sec. 402. As early as 1967, Yugoslavia adopted a joint ventures law which has brought over $300 million of foreign investment into the country. The United States has a quarter of the existing foreign contracts.

In spite of all this Western influence, the economy appears to be on a decline. A current rate of inflation estimated in excess of 19 percent threatens any real economic growth, and unemployment is rising as the number of expatriate workers continues to fall. Since 1973, Yugoslavs employed abroad have dropped by over 100,000 as the Western European economies tighten their domestic policies to combat recessionary pressures, thus expelling foreign workers.[8] The economy is not self-sufficient, as an estimated 38 percent of raw materials and basic material needs are imported. Although the private sector employs approximately 90 percent of the agricultural workforce, its productivity is lower than the social sector which produces one-third of the nation's agricultural output. In a move to combat the rampant inflation the government recently froze prices on all consumer goods and services. Yugoslavia has borrowed heavily from Kuwait and Iraq for needed energy supplies. The growth ratio between 1974 and 1976 with respect to energy production and consumption is 3.6 percent to 3.7 percent. This in itself is not particularly alarming, yet the ratio from 1961 to 1974 was 4.7 percent growth

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7. "Tito Attacks Yugoslav Economic Problems," Financial Times of London <u>World Business Weekly</u>, December 4, 1978, p. 61.
8. The World Bank, <u>Yugoslavia and the World Bank</u>, September 1979, p. 7.

in production and 7.1 percent growth in consumption, thus revealing the sizeable borrowing the government might have undertaken for energy supplies.

Indebtedness to the United States has increased rapidly over the past decade. Unsettled World War I debts amount to $112,253,525 still outstanding, of which $92,683,146 is combined principal and interest due and unpaid. Additional U.S. official credits utilized and still outstanding total $713,227,560 with $51,939 due and unpaid as of March 31, 1979. The largest segment of outstanding principal is from Export-Import Bank credits, totaling close to $490 million. Other programs from which there is principal indebtedness include the Foreign Assistance Act, Agricultural Trade and Development Assistance, long-term dollar sales, CCC credits, and War accounts and Lend-Lease. (See tables.)

President Carter issued a Presidential Determination, September 1979, declaring that Yugoslavia is neither controlled nor dominated by the international Communist movement. Pursuant to the provisions of the Foreign Assistance Act of 1961, as amended, the President authorized $10 million in foreign economic assistance for Yugoslavia in Fiscal Year 1979 in order to further vital U.S. security interests. The specific terms of such aid were not released, yet the current economic situation in Yugoslavia suggests that any assistance will be received and treated as a grant. The amount of assistance involved is insufficient to accommodate the troubled Yugoslav economy and may only complicate a precarious diplomatic relationship should the political situation in Yugoslavia become unfavorable toward the U.S.

New appeals by the Yugoslav government to American and Western European banks for debt rescheduling, while not unexpected, signify the urgency of the country's debt dilemma. The estimated total hard currency debt now stands at $13 billion and without significant refinancing Yugoslavia's debt service burden is expected to reach $2.9 billion by 1982, a debt service ratio in excess of 22 percent.[9] The Yugoslav government reportedly wishes to discuss with western bankers some $600 million in debt obligations due during the next three years. Should the interest rates on these loans be lowered, an ominous trend in East-West financing may emerge.

HUNGARY

Considered one of the safest risks by Western lenders, Hungary's economy, however, suffers from several growing hardships. Like the other bloc countries, Hungary is a major importer of energy and has continued to purchase supplies from the Soviet Union despite the Soviet oil price hikes. Relying on imports to

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9. "Belgrade Seeks Debt Refinancing," The New York Times, September 24, 1979, p. D1.

meet over half of the domestic demand has created a drain on the economy which will likely continue as domestic consumption of energy during the first quarter of 1979 was above projected growth levels. Between 1974 and 1976 the annual growth rate of energy production was only half as great as the growth in consumption, meaning that any reserves were depleted years ago.

While Hungary is more self-sufficient in agriculture than the other bloc countries, it still receives aid through credit programs such as the CCC. The economy functions with a degree of private autonomy in the agricultural sector. Private farm plots for collective farmers provide close to one-third of the gross farm output. A reported need for increased numbers of small farm machinery highlights a common problem of these Eastern economies whose currencies are non-convertible. While imports of machinery from the U.S. continue, there is a problem as Westerners are becoming increasingly suspicious of concession or barter deals. Lack of hard currency prevents major industrial and farm equipment importation. Hungary is a food exporter, yet it also purchases products such as cotton and soybeans from the U.S.

Another familiar economic plight shared by most economies worldwide is growing domestic inflation. Hungary faces a 9 percent inflation rate this year with escalation a real probability as domestic prices are continually raised by the government to meet world market prices. There has been a reported 50 percent hike in bread and electricity cost this year, and an overall 20 percent price hike in food products.[10] Finally, both national income and industrial growth fell short of their 1978 targets.

Hungary has been paying off its World War I debts to the U.S. and as of March 31, 1979 had $495,324 outstanding, but no overdue payments. The total credit utilized and outstanding, excluding WWI debts, stands at $10,091,243 with $20,200 in principal and interest due and unpaid after 90 days or more.

In March 1978 the United States signed a bilateral trade agreement with Hungary granting MFN status effective July of the same year. Hungary has never participated in the Export-Import Bank credit program, although the Bank has shown interest in supporting industrial projects in Hungary, with credit extensions possible this fall. The largest outstanding principal indebtedness of Hungary is tied to the CCC program. Credits were extended prior to FY75 and were once again extended in FY 1979. The outstanding indebtedness as of March 31, 1979 totals $10,070,247. (See tables.)

BULGARIA

The Eastern country perhaps most closely linked with the Soviet Union, having provided troops for the 1968 Soviet invasion

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10. Financial Times of London, World Business Weekly, August 20, 1979, p. 27.

of Czechoslovakia, Bulgaria maintains a strict command economy. Plagued with the necessity of importing energy and agricultural products, the government in 1979 developed a two-year plan for economic growth. The short-term nature of this program is designed to effectively consider current economic problems. The 1979 and 1980 national income growth percentage targets of 7 percent and 7.2 percent, respectively, may be somewhat optimistic in light of a 4.4 percent annual average GNP per capita growth rate between 1960 and 1977.[11]

Industrial growth in Bulgaria is evident, although in 1977, 41 percent of the labor force was still employed in the agricultural sector. In an attempt to raise the agricultural productivity, in the spring of 1979 the government instituted a program whereby farmers' salaries are based on the profits of agricultural enterprises. This wage-profits scheme also applies to farm managers and scientific experts.[12] Projections for rapid industrial expansion are contingent on future domestic energy supplies. With only 2 percent of crude oil consumption covered at home, intensified research and development is needed. Although energy production growth led consumption between 1974-1976, between 1961-1974 production grew at an annual rate of 3.3 percent while energy consumption was almost triple, at 9.8 percent. The Soviet Union's oil price hikes to importers did not exempt Bulgaria. In May gas prices doubled, raising the price of a gallon to the equivalent of $4.31.[13]

The indebtedness of Bulgaria to the U.S. government is slight as there are no World War I credits outstanding and Bulgaria has never participated in the Export-Import Bank or CCC loan programs. The Trade Act of 1974 prohibits the extension of any U.S. government credits to Bulgaria. There is currently $59,686 in credits utilized and still outstanding, all of which is past 90 days overdue. These credits were issued through the National Oceanic and Atmospheric Administration and the Postal Debt Settlements Program. The danger of U.S. economic ties with Bulgaria lies ahead should official government credit extensions be sanctioned. Neither the Bulgarian economy nor the country's close linkage to the Soviet Union can provide the United States with any potential short-term benefits.

GERMAN DEMOCRATIC REPUBLIC (GDR)

Estimates of East Germany's external debt now range upwards from $3.5 billion; however, rising world prices are expected to further increase both indebtedness to the West and to the Soviet

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11. The World Bank, World Development Report, 1979 (Oxford University Press, 1979) p. 127.
12. Financial Times World Business Weekly, April 23, 1979, p. 53.
13. Financial Times World Business Weekly, June 4, 1879, p. 51.

Union. The GDR is wedged in an awkward competitive battle against the booming West German economy and simultaneous attempts to avoid further dependency on the Soviet Union.

Industrialization in East Germany has progressed beyond the stages found in any Eastern European countries. Despite the growth in the industrial sector, which employs over half of the work force, all efforts to crank up production are thwarted by a serious dependency on imported energy supplies. Eighty percent of GDR oil imports come from the Soviet Union and this will likely continue even with increasing Soviet prices. Between 1974 and 1976 energy production rose annually an average of 0.7 percent while consumption needs rose by 2.5 percent. Immediate improvement of this imbalance is not forecast.

Reports in the summer of 1979 from the GDR ruling party exuded pessimistic economic news. Not only were growth targets for 1979 unmet in the first half of the year, but production losses in the key sectors of food, chemical, and power industries were reported. In addition, government subsidies for rent, gas, and food prices rose 7.5 percent, totaling in excess of $5 billion a year.[14]

The GDR has incurred little official indebtedness to the U.S. government. Credits still outstanding and now overdue in excess of 90 days total $44,436 from Postal Debt Settlements and the National Oceanic and Atmospheric Administration. (See tables.) East Germany is currently ineligible for Export-Import Bank loans and CCC credits under the provisions of the Trade Act of 1974. However, the country continues to borrow in the West European market. France, for example, has recently agreed to extend up to $2.85 billion in low-interest credits to East Germany for the purchase of industrial equipment.

USSR

The Soviet Union has borrowed with relative ease and in growing amounts from the West until recent years, capitalizing on its publicized oil and gold reserves as collateral against extended credits. One noted East-West trade authority estimates that approximately 15 percent of Soviet GNP is currently dependent on trade with credits from the West. However, the future of the Soviet economy remains a controversial issue among Western economists. Much of the skepticism raised by some deserves re-evaluation by U.S. government agencies anxious to participate in bilateral credit extension programs.

Recent growth indicators show the Soviet economy lagging behind its targeted 4.5 to 5 percent annual growth rate set for

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14. "East German Output Sags: Goals Unmet," The New York Times, August 8, 1979, p. D-4.

the current five-year plan period. The USSR is still a net importer of foodstuffs. This is vividly portrayed in the recent deals negotiated with the U.S. involving an additional purchase of 10 million metric tons of wheat above the 1975 guidelines over the next fourteen months. Public fear of a repeat of the 1972/73 grain deal with the Soviet Union has been aroused. $550 million in CCC credits were extended for grain purchases with disasterous price hikes in many commodities transferred to U.S. consumers.

Soviet appropriation of in excess of 25 million acres of farmland for non-agricultural use between 1965 and 1977, as recently divulged in a Soviet economic journal, reflects the adverse government interference to which centrally planned economics are always subject. With the key to future industrial expansion linked directly to prosperous agricultural productivity, this type of government program threatens general economic growth.

There appears to be much confusion among intelligence sources in the West concerning the actual size of Soviet oil supplies, the linchpin of the Soviet economy with respect to hard currency earnings. In 1978, CIA Director Stansfield Turner commented on the indebtedness of the USSR stating,

> Moreover, we do not expect Moscow to experience any difficulty in meeting its financial obligations of about $3.5 billion in debt service this year. The picture is expected to change sometime between 1978 and 1982 as declining oil production results in reduced exports of oil.[15]

A new CIA study estimates the Soviet Union will be importing up to 700,000 barrels of oil per day by 1982. The forecast of future Soviet economic growth centers on the continued exploration and extraction of this one resource. Permeating all aspects of western-aided Soviet energy research and development is the dilemma of dependency. The U.S. cannot expect to receive oil from the Soviet Union, however. By financially supporting this project, the U.S. may be supplying the Soviets with a means of maintaining leverage over the Eastern countries who are dependent on this oil. The question of U.S. financial credits to the Eastern bloc countries, in turn being invested in Soviet oil exploration, has been perceptively acknowledged.

The USSR has the largest outstanding World War I debt, with $773,107, 119 now due and unpaid. Total credits utilized and still outstanding from the U.S. government have broken the one billion dollar range. (See tables.)

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15. U.S. Congress, Subcommittee on Priorities and Economy of Government of the Joint Economic Committee, <u>Hearings on Allocation of Resources in the Soviet Union and China, 1978</u>, June 26, 1978, 95th Congress, 2nd session, p. 4.

ADDITIONAL OBLIGATIONS

While it is beyond the scope of this paper to expose the complete debt obligations of these Eastern bloc nations, it must be clearly acknowledged that these governments continue to borrow heavily from Western banks. In addition, and more directly relevant to the use of U.S. dollars, both Yugoslavia and Romania are members of the World Bank. As members, they draw loans that are generally repayable within twenty years, after a five-year grace period, at rates of interest related to the cost of the Bank's borrowing. Yugoslavia is a founding member of the World Bank and has been drawing loans since 1949. As of June 30, 1979, the Bank extended 55 loans to Yugoslavia, totaling $2,267.1 million. Romania received a total of 17 loans as of June 1978, amounting to $882,800,000. The continual quest for Western capital through international lending institutions and private banks by all Eastern governments attests to the vulnerability of their economies.

TRADE PROGNOSIS

A brief glance at the composition of U.S. bilateral trade with the Eastern bloc countries reveals a predominance of agricultural commodities. The lack of hard currency reserves (difficult to obtain since the currencies are all non-convertible on world markets) to purchase technology and equipment and the inability of the command economies to utilize the control of resource allocation profitably have resulted in a lopsided trade account with the U.S. Unless Western nations are willing to encounter losses, the likelihood that the bloc nations will break the barrier into full-scale, self-sustaining industrial exchange appears dim in the next decade, especially as the Soviet economy becomes increasingly restrictive. (See Table 5.)

THE DEBT PROBLEM IN GENERAL

The fundamental economic problems indigenous to the countries examined above remain troublesome and cannot be quickly remedied. All suffer from their position as net importers of foodstuffs (except Hungary) and energy supplies (excluding the USSR). Until agricultural productivity is adapted to the rigidities of the inherent weather conditions and modernization is achieved, these economies will lack the secure base necessary for industrial, as well as general economic growth.

With the liberalization of broad trade regulations in the U.S. under the guise of detente in the early seventies came the suggestion that financial support, through credit extension by the U.S. and Western allies to Eastern European nations would help loosen the Soviet grip on these economies. Contrary to this assumption, their dependency on Soviet oil has continued, and with every Soviet oil price hike the Soviet control over the lifeline of these economies grows.

While the figures for the various countries' outstanding indebtedness to the U.S. were given above, at issue is not the exact amount of credit. What is alarming, however, is the rate of growth in credits as compared to the real economic and industrial growth in most of the nations and their debt-servicing capacity. While it appears the trend in lending is moving away from official government credits towards private commercial lending as budgeting becomes more stringent, there is always the possibility of U.S. credits flowing carelessly in the name of export promotion.

Looking at the financial arrangements in the broader concept of trade, however, the question which quickly emerges is what benefits the U.S. and Western lenders are receiving. Other than perhaps the obvious example of surplus grain sales through such programs as the CCC in the U.S., it is difficult to categorically state that these credit and loan programs are the wisest economic investment of American dollars. These credit programs in the U.S. are not vital to American prosperity. For instance, in fiscal year 1978 only 6 percent of total U.S. commercial agricultural exports received CCC export financing, of which the Eastern bloc received over 50 percent. $1.6 billion in CCC credits were appropriated in fiscal year 1979, of which $578 million went to Eastern Europe (excluding the Soviet Union).

One starting point for a genuine discussion of alternative investments of American taxpayers' dollars is the interest rates prominent in most of the credit and loan programs. The Export-Import Bank this past fiscal year lowered its average cost of a loan from 8.53 to 8.25 percent, an intriguing move in light of the recent increases to 13 percent of the prime lending rate in the U.S.

An interesting approach toward facilitating financial dealings between the East and West was offered several years ago by an economist concerned with the difference in the socio-economic systems of the various countries involved. Albert Masnata, citing this problem, offered the following comment:

> ...the monetary and financial elements do not automatically act as a transmission belt between trade, technical, and industrial cooperation and services of all kinds. This means the machinery of monetary and financial industrial exchange must...be organized more systematically.[16]

He went further to raise the idea of an international clearinghouse for East-West financial transactions. While this approach has

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16. Albert Masnata, "Trade with the East," NATO Review, V. 25, August 1977, p. 28.

much appeal it is not obvious that the eastern economies would be willing to supply the necessary data to organize such a clearinghouse.

CONCLUSION

Any discussion of foreign indebtedness to the United States must fairly conclude by stating that the majority of foreign credits in the short and medium term category are repaid according to schedule. Moreover, the amounts listed above of outstanding principal and interest do not necessarily mean these governments are in default on these credits. However, the sudden surge in Eastern bloc debt to the West in the early seventies rightly focused attention on the potential of repayment, as the workings of these economies remain a closely guarded secret.

An important, yet often ignored, question is how one determines when international lending no longer serves as international credit. As the Treasury Department frequently asserts, extension of credit does facilitate trade, does serve to aid economic growth in underdeveloped nations, and acts to stabilize an international monetary system comprised of diverse national currencies. However, when a situation like the present one is reached, where the creditor and debtor distinction is no longer easily recognizable, the merits of continuing U.S. government credits to the Eastern bloc becomes questionable.

It is the long-term implication of this growing debt that raises the question of debtor-creditor leverage. A Swiss banker was questioned several years ago about the expanding Soviet bloc debt. He commented that "...make a small loan and you have a debtor - make a large loan and you have created a partner."[17] While it has been argued that the Soviet Union would use its debtor leverage only in extreme instances, not wishing to prematurely jeopardize future financial ties with the West, the real dilemma facing the U.S. is that this Soviet leverage is not counterbalanced.

The potential problem of inadequate debt servicing, where foreign credits are not efficiently utilized to promote exports or import substitutions, may be inescapable unless Western nations are willing to engage in less-than-optimum trade deals. The proponents of East-West trade expansion who support the flow of U.S. credits East should take note of the real economic problem, which has been neatly summarized by one author.

> Actually, even the existence of long-term credit does not do much to expand East-West trade, for such

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17. Richard Janssen, "Debt Threat, Soviet Bloc Borrowings From the West Surge, Amid Mystery, Fear," Wall Street Journal, February 22, 1977, p. 20.

> trade is still kept at the level of the Eastern countries' abilities to balance their imports with exports. In other words, long-term credit is usually to be repaid only by supplies of future goods, so Western credits mean virtually the financing of future exports from Eastern bloc countries, for which a market must be found.[18]

The increasing number of concession deals made in East-West trade contracts today supports this conclusion, as does the fact that only through export growth can these non-market economies expect to obtain needed hard currency reserves.

The other question, to which little attention is given, deals with the motive behind the Eastern bloc requests for western credits, specifically the Soviet Union. As suggested by NATO Chief Economist Jacques Billy back in 1978, the motive may be "to stop them from being used in other theaters of economic operations."[19] Absorption of funds the West seems willing to obligate in less than optimum economic endeavors only denies their use in more lucrative projects, both in an economic and perhaps in a security sense.

The discussion of official Eastern bloc debt to the United States must be included in future policy considerations of expanded East-West trade because of its important economic implications. If, as expected later this year, President Carter attempts to facilitate the granting of MFN trade status to the Soviet Union, businessmen should be eager to have all aspects of the "economics" of such a decision thoroughly examined. Once MFN is extended to the USSR, it is possible that credits will flow freely to the USSR, with other non-market economies next in the receiving line. Comparable returns for the U.S. on such long-term "investments," however, may not be as likely.

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18. John S. Garland, Financing Foreign Trade in Eastern Europe, Problems of Bilateralism and Currency Inconvertibility, (New York: Praeger Publishers, 1977), p. 106.
19. Richard Janssen, op. cit.

Table I

Indebtedness of Foreign Govts. to the U.S. Arising From World War I (March 31, 1979)

Country	Obligation Plus Interest to Date	Total Outstanding	Principal and Interest Due and Unpaid
Czechoslovakia	$399,469,627	$379,335,535	$332,986,605
Hungary	5,651,599	495,324	----------
Poland	583,364,766	560,718,468	507,399,523
Romania	157,917,795	153,126,788	135,387,523
USSR	781,857,431	773,107,119	773,107,119
Yugoslavia	114,842,298	112,253,526	92,683,146

Table II

Consolidated Outstanding Credits/Official Foreign Govt. Obligors and Foreign Private Obligors (Exclude W.W.I Debt, in U.S. Dollars as of March 31, 1979)

Country	Credit Utilized and Still Outstanding	Principal and Interest Due and Unpaid 90 Days or More
Bulgaria	$ 59,686	$ 59,686
Czechoslovakia	4,878,583	8,004,243
Germany (Dem. Rep. of E.)	44,436	44,436
Hungary	10,091,243	20,200
Poland	903,774,124	93,917
Romania	154,547,794	32,268
USSR	1,126,440,106	769,224
Yugoslavia	713,258,770	51,939

Table III

Long-Term Loans and Credits, Outstanding Principal Indebtedness (March 31, 1979)

Czechoslovakia	
Surplus Property Sales	$ 4,869,868
Hungary	
Commodity Credit Corporation	10,070,247 (15,766,152 as of July 1, 1979)
Poland	
Foreign Assistance Act	15,307,907
Commodity Credit Corporation	699,458,145 (741,372,882 as of July 1, 1979)
Export Import Bank	188,810,444
Romania	
Commodity Credit Corporation	81,390,429 (98,176,065 as of July 1, 1979)

Table III (Continued)

Export Import Bank	$ 73,125,083
USSR	
Export Import Bank	451,664,570
War Accounts and Lend-Lease	674,000,000
Yugoslavia	
Foreign Assistance Act	43,087,462
Agricultural Trade Dev. Assistance	104,228,210
Long-Term Dollar Sales	154,821,107
Commodity Credit Corporation	25,564,054
Export Import Bank	489,747,949
War Accounts and Lend-Lease	6,988

Table IV

Accounts Receivable of U.S. Government Agencies

Country/Program	Total	Principal Outstanding	Principal plus Interest Due and Unpaid 90 Days
Bulgaria	$59,686		
Postal Debt Settlements		$20,176	$20,176
National Oceanic and Atmospheric Adm.		39,510	39,510
Germany (Dem. Rep. of E.)	$44,436		
Postal Debt Settlements		$40,786	$40,786
National Oceanic and Atmospheric Adm.		3,650	3,650

Source for All Figures Above: Office of the Assistant Secretary of the Treasury for Economic Policy, Status of Active Foreign Credits of the United States Government, March 31, 1979 (U.S. Government Printing Office: Washington, D.C.).

Table V

A. Agriculture's Share of U.S. Exports to Eastern Europe, 1978
(U.S. $ millions)

Country	Total Exports-Direct plus Transhipment	Agriculture's Percent of Total
Bulgaria	$ 48.2	82.8
Czechoslovakia	109.0	74.0
German Democratic Rep.	219.3	92.5
Hungary	98.5	53.5
Poland	692.1	74.5

Romania	323.1	47.3
Yugoslavia	491.7	26.0

Source: U.S. Foreign Agriculture Trade Statistical Report, USDA/ESCS, Export Sales Dept., USDA/OGSM; in FATUS, June 1979, p. 7.

B. U.S. Exports/Imports By Commodity Types
(U.S. $ millions)

Country	Exports			Imports		
	Agricultural	Manufactured	Total	Agricultural	Manufactured	Total
Bulgaria	39.89	7.80	47.69	16.20	3.14	19.34
Czech	77.11	26.28	103.39	6.17	51.60	57.77
GDR	153.96	14.28	168.24	2.72	30.27	32.99
Hungary	52.68	44.20	96.88	31.94	36.38	68.32
Poland	503.48	141.60	645.08	155.18	257.31	412.49
Romania	148.54	118.89	267.43	31.38	212.90	244.28
USSR	1,686.55	467.48	2,154.03	12.64	152.79	165.43

Source: "U.S. Trade Status with Communist Countries," U.S. Dept. of Commerce, Industry and Trade Administration, March 1, 1979.