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86635 MEMO	DOBRIANSKY TO CLARK RE MOST FAVORED NATION STATUS RENEWAL: ROMANIA, HUNGARY, AND PEOPLE'S REPUBLIC OF CHINA	2	5/24/1982	B1
86637 MEMO	CLARK TO THE PRESIDENT RE MOST FAVORED NATION STATUS RENEWAL	2	ND	B1
86642 LETTER	RR TO CEAUSESCU RE MOST FAVORED NATION STATUS	2	ND	B1
86639 MEMO	STOESSEL TO THE PRESIDENT RE RECOMMENDATION TO CONGRESS FOR EXTENSION OF JACKSON-VANIK WAIVER AUTHORITY	3	5/15/1982	B1
86640 MEMO	DUPLICATE OF 86639	3	5/15/1982	B1

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EAST-WEST TRADE

An end to business as usual

E-WT

A key objective of the Reagan administration is to reduce Soviet economic leverage over the west and to cut the contribution made by western resources to the Soviet military build-up. Is this a belated attempt to bring the west's economic relations with the Soviet block into line with its political and security aims? Or, as some western Europeans fear, a call to economic cold war? In the run-up to the Versailles economic summit and the Nato summit in Bonn, John Plender in this survey takes his own look at the background to the argument and asks whether the west can reach a longer-term consensus on trade and financial relations with the east.

"Commerce is the cure for destructive prejudices; and it is almost a general rule that where there is civilised behaviour there is trade; and wherever there is trade there is civilised behaviour." A charitable verdict on this assertion by the French eighteenth-century political theorist Montesquieu might be that it was, at the best of times, a great oversimplification. Today, in the context of east-west relations, it looks more like a joke in poor taste. The invasion of Afghanistan, the imposition of martial law in Poland, the Soviet military build-up—these are hardly examples of civilised behaviour. Yet they took place after the dramatic expansion of east-west economic relations that flowed from the diplomatic process known as detente. Why did hopes that trade would bring political gains for the west come to so little?

Detente was not, of course, primarily about economics. Its central feature was a recognition by east and west that they shared a common interest in managing relations in such a way as to avoid nuclear confrontation. But the participants identified specific interests in detente that touched directly and indirectly on their economic objectives. For the Soviet Union access to western capital, technology and grain appeared to offer an opportunity to narrow the gap between the economic performance of west and east. With 12-15% of their gnp going into military expenditure, the Russians also had a powerful interest in creating a climate that would reduce the pressure on the United States to undertake research and development on a new generation of technology-intensive strategic weapons. An infusion of western capital and technology was similarly tempting to eastern Europe, whose political leaders sought to legitimise their inherently unstable regimes by delivering the (westernised) economic goods.

On the western side the United States stood to gain relatively little economically from increased trade with the Soviet Union. But Mr Henry Kissinger, one of the main architects of detente, saw in the Soviet requirement for trade an opportunity to exercise political leverage.

The Nixon administration in which he served sought to create a vested interest in co-operation through a network of agreements and arrangements which, while not aiming specifically to change the nature of the Soviet system, could not be broken by the Soviet Union without damaging its own interests. And in eastern Europe Mr Kissinger tried to encourage political autonomy by rewarding behaviour that served western interests, such as Rumania's pursuit of an independent foreign policy.

For their part the western Europeans were equally keen to use trade relations to strengthen those groups in the Soviet Union that had a stake in maintaining the peace. But they placed more emphasis on the economic benefits of detente than the Americans and were anxious to re-establish historic trading patterns that had been subject to sporadic political disruption since time immemorial. (This survey will, incidentally, use the terms west

European and American as a convenient shorthand; the generalisation will not, in all cases, be wholly exact.)

Nobody had expected the Russians to put vital, or even major, interests at risk for the sake of trade. Nor were the advocates of detente very clear on precisely how trade was going to exert a restraining influence, and on whom in the Soviet power structure. The art of foreclosing Soviet opportunities by economic means was, in reality, more a question of metaphysics than mechanics. Yet the ruthlessness with which the Soviet Union isolated what it chose to regard as the main area of detente—Europe—from its adventure playgrounds in the third world was still cause for severe disenchantment in the west, as was the determination with which the Russians set out to protect their society from what they regarded as western contamination. So the Soviet Union reaped its gains from trade at low political cost to itself. Even when the west raised the cost of Soviet adventurism after the invasion of Afghanistan, there was little evidence of restraint. Disillusionment deepened, on the western side, when General Jaruzelski, with Soviet support and co-operation, abruptly cut short Poland's experiment with reform in December, 1981.

Dash into debt

The purely economic consequences of detente were similarly, if not quite so brutally, discomforting for the west. When the economic window opened up at the end of the 1960s the eastern European countries were tempted to pursue economic growth strategies that called for both a high level of domestic savings and net borrowings from the rest of the world. This paid dividends when world markets were buoyant and eastern Europe's hard-currency debts were low. But the oil crisis in 1973 changed the sums. Eastern Europe was heavily dependent on the Soviet Union and on the outside world for oil. It was faced with a sharp adverse shift in its terms of trade while hard-currency export markets contracted under the impact of the recession of the mid-1970s Some countries, such as Czechoslovakia, pulled in their horns and prepared to live with low growth; others, most notably Poland, intensified their import-led dash for "growth."

Western European governments promptly fell over themselves in providing subsidised credit to the growth-hungry members of the Council for Mutual Economic Assistance, better known as Comecon. All, in varying degrees, embarked on a mercantilist race to grab as big a share as they could of the trade on offer. At the same time private bankers, awash with Opec's surplus cash and over-inclined to place hope, in Russia's readiness to extend an umbrella in the event of financial trouble in eastern Europe, committed what must surely be one of the most spectacular misjudgments in financial history when they unwittingly launched an impromptu Marshall plan for the more profligate economies of the east.

Net liabilities of the Soviet Union and eastern Europe with western commercial banks jumped seven times from $6.7 billion in 1974 to around $45 billion in 1980, by which time another oil price hike was causing further economic damage. At that point Poland's debt service obligations on total debts of more than $20 billion had topped 100% of hard-currency export earnings. And at the start of 1981 it needed an estimated $11 billion in hard currency to cover its projected trade deficit and debt service. It was forced to seek rescheduling for both its official and private bank debts.

Total western official and unofficial debt to the Soviet block now amounts to around $80 billion. Poland, like the rake that made no progress, was responsible for running up nearly $30 billion of that figure while running its own economy into the ground. So great are its problems that even if it were able to obtain rescheduling of both official and unofficial debts falling due in 1982 it would still need, on some western official estimates, $4½ billion-5 billion of new credit to meet its remaining hard-currency debt-service obligations. In the absence of a more thorough relaxation of the post-martial law climate than General Jaruzelski and the Russians have so far been prepared to concede, that is out of the question.

In the longer run the only way the Soviet block can meet the debt-servicing obligation on this millstone of is to run down its reserves, bo from the west or earn surplu hard-currency balance of payn its reserves are inadequate and ern bankers too panicky, at le short term, to lend more mone nia is in serious financial troub disease has spread to other m the block. Only a latterday would believe that Poland will its uncompetitive export secto erating the requisite hard curre present decade; or that the rest Europe's short-term economic are other than grim.

Hapless and hungry

It has been argued that, by ta the conduct of an important dim east-west relations, the bankers unwittingly served western politi ests more creditably than may first sight. Solidarity, on this a might not have posed its unique to the claims of communist ideol economic climate in the late 1 early 1980s had been differe ignores the way things were m Poland well before the 1970s. certainly true that the economi sions of Marxist-Leninism have b verely dented by the outcome eastern European dash for gro land was, after all, a country resources, with a labour force quality. The failure of the lead motivate people into making effe of those resources has precipi situation in which hapless Poles food shortages on a scale more fa sub-Saharan Africa than in E hence the west's continuing huma food aid to Poland despite ec

Beware — Russians at play

sanctions after martial law.

The oddest thing about the eastern European financial crisis is that it was largely foreseeable and foreseen. Many economists warned that Poland was getting far too deeply into debt—but to no effect until the country was virtually bankrupt. At the political level Mr Kissinger sounded the alarm in the mid-1970s and called in 1976 for a systematic attempt to develop agreed objectives in western economic relations with communist countries. The increase in debt and the scope for manipulation by the Soviet block of economic relations were among his chief concerns. But it was not until the Soviet invasion of Afghanistan that a wider appreciation dawned in the United States that the low-key western response to Soviet proxy action in Angola, Ethiopia and Cambodia amounted to an invitation to the Russians to exploit any opportunity that arose in the third world. An appearance of "business as usual" was conveying all the wrong signals to a superpower whose economic policies had always been shaped by political and security concerns.

Yet the Carter administration's efforts to seek allied support for America's post-Afghanistan sanctions, which included such measures as the grain embargo and tighter controls on strategic exports as well as the attempted Olympic boycott, contributed to a major crisis in the western alliance. This demonstrated all too clearly how unevenly the costs and benefits of detente had been spread. Seen from the global point of view of the Americans, detente had failed to deliver. But from the regional perspective of western Europe, where the Russians were still on their best behaviour, the new set of relationships with the east continued to hold out some promise of political and economic benefit. So an international crisis that touched a raw nerve in the non-aligned third world failed to become the considerable propaganda victory for the west that it should have been.

No more carrot

Similar problems now confront the west over the current economic crisis in the Soviet block. The west's trade relations with eastern Europe are bound to run down over the coming decade. Private banks, admittedly, may return to lend to the more creditworthy countries such as Hungary, which has just been admitted to the IMF, and Czechoslovakia, when the dust from the Polish and Rumanian crises settles a little. But the financial problems of Poland, and perhaps Rumania too, will take years to resolve. In a deteriorating east-west political climate, the prospects for trade in eastern Europe are dismal and a fair measure of economic reintegration within the block is inevitable. The focus of the west's political and security concerns in economic relations with the east will therefore shift to the Soviet Union itself.

From their regional perspective the western European leaders still believe that trade can make a contribution to stability, even if they no longer expect it to work wonders with Soviet behaviour. Not so the Americans, for whom the period of expanding east-west economic relations in 1969-1975 was, historically, a deviation from the norm. While the Americans may have taken key features of their constitution from Montesquieu, they have never really shared his views on the civilising influence of trade where potential or actual adversaries are concerned. Apart from the recent measures against Poland and Russia, the United States maintains continuing embargos on trade with, for example, North Korea, Vietnam and Cambodia, and has always adopted more stringent national controls on strategic exports than it observes internationally in the Co-ordinating Committee on Export Controls (Cocom).

The Reagan administration is deeply divided on how to tackle east-west economic relations. But hawks and doves alike share a common presumption that the carrot has failed and that resort to the stick was overdue. Even the doves are pushing for policies towards the Soviet Union which to European eyes border on economic cold war. The arguments within the administration are about how hard to push; and over the extent to which it is necessary to carry the Europeans along. The rest of this survey looks at what the west can and cannot hope to achieve through the use of economic sticks and carrots in responding to the political and economic crises in the Soviet block; and asks how readily the pursuit of strategic and foreign policy objectives can be squared with conflicting national interests in the western alliance.

Centrally planned stagnation

The notion of pulling the economic rug from underneath Marxist-Leninist ideologues has an obvious appeal for Western capitalists. In the case of the Soviet Union, however, the rug is smaller than a prayer mat: trade accounts for only 1½-2% of its gnp. That ideology has also to be seen in its proper context. The Soviet Union never offers hostages to theoretical Marxist fortune where its security is at stake. Though the Russians are always happy to parade ideological justifications, their foreign policy is firmly rooted in pragmatic calculations of national interest.

That is not to say that the Russians are invulnerable, for they have severe problems. Everyone, capitalist or communist, agrees that the prospects for the Soviet economy in the 1980s are bad. The only question is how bad. After the period of high growth during the forced industrialisation of the 1950s and a gradual deceleration in the 1960s and 1970s, the world's second largest economy, with a gnp of around $1½ trillion, is suffering from hardened arteries. On western estimates the Soviet economy will continue to lag behind the United States in absolute terms and its productivity will continue to compare unfavourably with the more dynamic free-world economies because of (among other things):

- So-called "systemic" problems. Central planners pulled off the trick of rapid industrialisation, but are having increasing difficulty in controlling and directing a more complex modern economy. Soviet-style central planning is more effective at promoting quantity than quality, at encouraging risk-avoidance than innovation. There is a lack of competition and lack of flexibility in wage and price systems and the planners themselves are remote from those who work on research and development and the people who use the end-products. This puts a heavy brake on the diffusion of technological progress. So the Soviet Union exports oil, gas and other raw materials and uses the resulting revenue to plug the technological gap. And while at the start of the century Russia under the Czars was a net exporter of agricultural products, the Soviet Union under grossly inefficient collectivist communist management has become a huge importer of grain.
- Slower growth in the labour force. In the 1980s the new labour inputs into the economy are expected to slow down. The labourers will have to come increasingly from the low-skilled people in Central Asia (who, to add to the problem, are disinclined to move to where the work is) and the Transcaucasus.
- The rising cost of exploiting energy resources. The Soviet Union is the world's biggest oil producer. But, like many Opec producers that have failed to establish much comparative advantage in the modern sectors of their economies, the Russians are living off capital: oil exports provide more than half the country's hard-currency revenue.

Western projections of Soviet oil production differ considerably and are highly controversial. But while experts cannot agree on when and at what level Soviet

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Centrally planned and proud of it

oil production will peak, most do agree that oil exports to the west will decline in the 1980s, thus chopping the hard-currency surplus on the balance-of-payments. Higher-cost gas from the remote wastes of Siberia thus becomes the only flexible element in the Soviet energy balance and to overcome the enormous technological challenge of extracting and delivering gas from Siberia the Russians need western co-operation. This change in the Soviet energy economy has profound implications for Soviet political and economic relations with the west, eastern Europe and the Middle East.

Loss leaders

On top of all this, the Soviet Union faces other pressures on its external finances. After a decade in which the terms of trade moved favourably for the Russians, things have suddenly changed. The markets in gold and diamonds are down and the real price of oil has fallen sharply over the past two years. American sanctions since Afghanistan and Poland have been a financial irritant. The Council for Mutual Economic assistance, informally known as Comecon, is becoming a heavy burden.

In its early days Comecon was not much concerned with mutual assistance. Moscow extracted heavy war reparations from Hungary, Rumania and East Germany, while non-enemies such as Czechoslovakia and Poland had to supply goods to the technologically unsophisticated Russians at artificially low prices. Latterly the eastern Europeans have extracted a better deal; and since the 1973 oil crisis they have enjoyed a huge subsidy, since the Russians have raised oil prices by much less than prices have risen in the rest of the world. Officials at the American treasury and state departments estimate that Soviet oil and raw material subsidies to Eastern Europe averaged \$5 billion-6 billion a year in the mid-to-late 1970s and rose to \$10 billion in 1979 and \$22 billion in 1980.

This uncapitalist approach to pricing partly explains why eastern European economies, which are much more dependent on trade with the west than the Soviet Union is, are in such a mess: they have been receiving all the wrong economic signals. Some western analysts believe that Poland's investment in the second half of the 1970s was three times as energy-intensive as most comparable investment undertaken in the west at the time. The result is that eastern Europe's financial relationship with the Soviet Union has been subject to a major reversal. Simultaneously third-world members of Comecon such as Vietnam and Cuba continue to maintain a huge appetite for aid. Small wonder that the Russians have been trying recently to put off paying debts that have fallen due.

These weaknesses should not be exaggerated. Most western analysts are still expecting the Soviet Union to enjoy some economic growth in the 1980s; the point is that the growth will be paltry. Nor do the "systemic" problems, however deep-seated, mean that the Soviet Union is on the point of economic collapse. The Russians can produce gas pipelines, compressors and other sophisticated capital goods: the problem is rather that they cannot produce them in the quantity, quality and time either to meet their own plan requirements or to match the standards required in competitive international markets. As for the pressure on its external financial position, the Soviet Union has vast raw material resources which will, in the medium term, bail it out, just as they did after a similar balance-of-payments crisis in 1975 when a shocking harvest coincided with world recession and a fall in the gold price.

Nor should the significance of Soviet dependence on the west for technology be exaggerated. Technology transfer has qualitatively greater importance for the Russians than, say, the import of consumer products in that it has a multiplier effect throughout the economy. Even so, huge technology imports have not been sufficient to prevent the slow-down in the Soviet economy. So it cannot be assumed that Soviet leaders will sacrifice major political interests for the sake of staving off a technology embargo.

That said, the Soviet Union still wants the technology; it is unable to feed itself year to year; and it is more financially embarrassed than at any point in peacetime since the 1930s. Potential western leverage is thus greater today than it was five or 10 years ago.

A second crucial message for the west is that the Russians are not only more dangerous militarily in the 1980s, but are becoming more dangerous because of underlying economic changes. As Russians demand higher oil prices from eastern Europe, the scope for friction and for re-runs of the crisis within the Soviet block of 1956, 1968 and 1981 will increase. The level of world oil prices will also be higher than it would otherwise have been as eastern Europeans buy more oil from non-Soviet sources. And for the first time the Russians have more than a purely political and ideological interest in the Middle East, where western interests are far greater than their own. The temptation to exert influence in the area by subversion and other means is greatly enhanced. What part can economic weapons play in restraining the Russians in this and other respects?

Pricks and sticks

Economic embargoes have been standard items in wartime arsenals for centuries. Their use in peacetime, however, is a more recent phenomenon: only in the twentieth century have economic sanctions come to be widely used in support of political objectives. Yet their appeal is strictly relative. It is based on the fact that most other available options for dealing with international crises are even less appetising. Faced with a choice between the use of force at one extreme, and doing nothing at the other, most countries will opt for a bloodless form of pressure. The more so in an age of superpower nuclear parity, when any resort to force carries a risk of escalation and increasing economic interdependence, which multiplies the scope for leverage. Sanctions are, none the less, a

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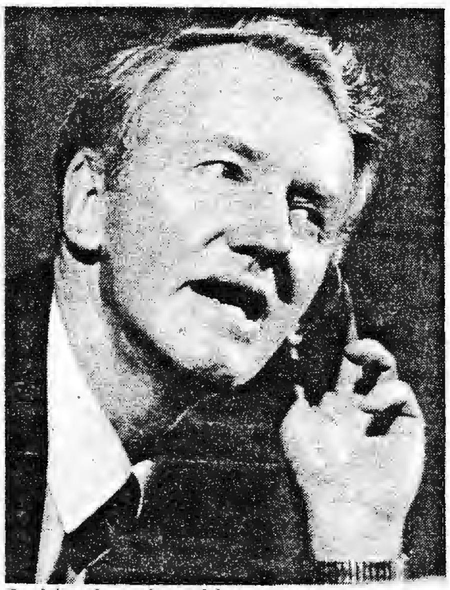


Smithy the adaptable

blunt, unwieldy, unpredictable and, above all, expensive weapon to deploy.

Domestic politics are the first and most obvious obstacle to their effective use. All sanctions, strategic or political, involve a cost to the user, which falls on the balance of payments and on individual firms. Jobs may be threatened in politically sensitive constituencies; businessmen or trade unionists who contribute to party political funds may be alienated. Business lost to another country that does not apply sanctions may be lost forever and this fact will be put very squarely to politicians.

A second crucial obstacle is that few countries have a monopoly of goods whose denial could cause severe damage to the target state. So there usually has to be cooperation between states if sanctions are to do real damage. Needless to say, countries tend to respond to requests for support by declaring that sanctions are ineffective and then fail to summon up the requisite political will to apply them until a process of diplomatic arm-twisting has run its course. Lack of commitment, together with the difficulty of policing and enforcement, then ensures that the embargo springs numerous leaks.

Stiffened sinews

Equally important is the absence of any automatic link between economic deprivation and a weakening of political will in the target country. Most countries that have been subjected to sanctions have in fact shown far greater economic resilience and adaptability (for example, in finding alternatives or developing substitutes for embargoed goods) than expected. Economic sanctions did not curtail Mussolini's Abyssinia adventure before the second world war. Nor did comprehensive economic sanctions within the framework of the United Nations bring Mr Smith's illegal regime in Rhodesia to an end after the unilateral declaration of independence. Hence the frequent assertion that "sanctions never work".

But this begs the question of what sanctions are for. While there are no recorded instances of a country being brought to its knees by this means, there are cases where sanctions have helped bring countries to their senses. By freezing Iranian financial assets, the Carter administration acquired powerful leverage in securing the release of the American hostages: from the moment that Iraq declared war on Iran, it became a matter of urgency for Ayatollah Khomeini's regime to do a deal. Even where sanctions are unlikely to affect a country's behaviour directly, they can still perform a useful function. The denial of western credit to General Jaruzelski's regime both hurts the Polish economy and demonstrates western disapproval and readiness to raise the cost to the Soviet block of unacceptable behaviour. In short, the motive for imposing sanctions is more likely to be to send signals, to deter, to punish, or simply to demonstrate solidarity with an ally, than to topple or crush a foreign government. The problem is to persuade other states to join in, to keep at it and to ensure that those who are not part of the exercise do not undermine it, whether for strategic and political reasons, or for their own economic advantage.

Also important is to avoid strengthening resistance or provoking a dangerous response from the target country. It is salutary to recall that an American economic embargo precipitated Japan's decision to come into the second world war and that the Jackson-Vanik amendment in the United States, which attempted to link the grant of credit and most-favoured-nation treatment to the Soviet Union to the level of emigration by Russian Jews, resulted in Soviet repudiation of the 1972 American-Soviet trade agreement; the number of Jewish emigrants subsequently fell significantly. Note, too, that the embargo on new credit for Poland hits General Jaruzelski and the Polish peasant alike. Domestic economic objectives may also run counter to foreign policy aims. For example, a fall in American interest rates simultaneously helps ease the debt-servicing problem for Poland (against which the west wants to discriminate) and Rumania (which the west wants to reward for pursuing an independent foreign policy).

No bother

In the context of the western alliance the most formidable obstacles to foreign policy controls on trade and finance stem from marked differences in perception and in economic and political interests. The United States has traditionally been more ready than most to use economic measures as an instrument of foreign policy, partly because it can afford to. Exports amounted to 9.9% of its gnp in 1980—a far lower percentage than for the western European allies—and American military, political and economic clout is such that the threat of retaliation does not cause much loss of sleep. Nor does the pattern of American trade make it vulnerable to, or offer much leverage against, the Soviet block, except in a single area, grain, which accounts for 80% of American exports to the east. Since it has already curbed sales of energy-related equipment and technology to the Soviet Union, the United States has used up much of its ammunition in relation to a key area of Soviet economic weakness.

By contrast more than three quarters of western European (and Japanese) exports consist of manufactured goods, machinery and transport equipment. So while the areas of vulnerability to political manipulation are greater in western Europe, the scope for Europeans to exert pressure on the Soviet Union is also more substantial.

Yet attitudes in western Europe to the

Sanctions did nothing for Abyssinia

use of economic measures for foreign policy objectives are very different from those in the United States. West Germany has the Warsaw pact powers on its doorstep; it has its own particular sensitivities over Berlin; its links with East Germany; and it remains the chief western beneficiary of detente. Exports represented 28.9% of West Germany's gnp in 1980. With a string of geographical, political and economic reasons for wishing to keep a low profile in east-west relations, it is not entirely surprising that the Germans have a marked penchant for the carrot rather than the stick. In Bonn discussions on east-west trade start from the position that the Federal Republic has to deal with the Soviet Union whether it likes it or not; and from the knowledge that hard-liners in East Germany would dearly love to see trade links with the west cut back. West Germans argue, too, that sanctions are ineffective. Outside the framework of the United Nations, they prefer to use the softer expression of "economic measures". But they do accept the case for sending signals, and justify their participation in the sanctions exercise after martial law was imposed in Poland partly on that ground.

Britain has less to lose politically than West Germany, but since Afghanistan it has become increasingly wary about getting out in front of the western European pack—witness its less than speedy response to martial law in Poland, compared with its more forthright (and thus not very Euro-sensitive) support for the United States at the time of the Soviet invasion of Afghanistan. Exports represent 28% of its gnp, however, and Britain has more invested directly abroad than any country other than the United States. Where financial weapons are concerned, it is reluctant to jeopardise London's role as an international financial centre. So its approach to sanctions is cost-conscious and pragmatic.

No economic liberal he

The French are predictably individualistic on the use of sanctions. Although they are less vulnerable than Britain or West Germany—exports represent 21% of France's gnp—they are sceptical about the effectiveness of sanctions. With good historic reason: the Napoleonic economic blockade of Britain—known as the "continental system"—did not work, as the prime minister Mr Pierre Mauroy reminded the French National Assembly in January. (It was a monumental system of protection for the French economy and turned smuggling into a growth industry, with predictable results for the embargo.) Yet France does believe in selective sanctions to achieve specific political ends.

Readiness to trade with another country depends ultimately on assumptions about its political and military intentions, as well as the potential for economic gain. There has to be a fair measure of agreement on this score if the west is to reach a set of common objectives in east-west relations. Given the different historical perspectives and national interests involved, it also helps if the inequities in the distribution of costs and risks in any given policy between the allies are not too glaring. The fact that neither of these conditions has been fulfilled goes a long way towards explaining why consensus in the western alliance on how to manage the economic relationship with the east has broken down.

Real-world pressures

The response to the imposition of martial law in Poland last December does not rate as one of the western alliance's more harmonious achievements. While general agreement was reached without undue difficulty on measures to be taken against Poland, the western Europeans complain that there was a lack of consultation over President Reagan's measures against the Soviet Union. The EEC countries promptly slipped into the special gear that they reserve for negotiations on sheepmeat clawback, Mediterranean dogfish and other subjects of passionate community concern, and individually set out to minimise the cost of a tired set of sanctions against the Soviet Union.

For their part the Americans decided that if consensus was so difficult to achieve, they might as well go it alone. After December western as well as eastern Europeans became the subject of American economic leverage. Since economic pressure against allies is just as likely to stiffen resistance as sanctions are against adversaries, the outcome has been disagreeable. Did it really have to happen like this?

Arguably not, for serious efforts had been made within the American administration to prevent a repetition of the earlier crisis in the alliance over sanctions against Afghanistan. In the run-up to last year's economic summit in Ottawa, President Reagan's personal representative, or "sherpa", Mr Myer Rashish, put east-west economic relations firmly on the summit agenda. A pre-summit paper was circulated, asking what kind of economic policy towards the Soviet Union and eastern Europe would help redress the military balance and achieve western objectives in Poland.

The purpose, says Mr Rashish, was to outline a more prudent approach to east-west trade and finance. At the strategic level his paper argued that the main aim should be to slow the transfer of militarily significant technology to the east. At the political level he suggested that the way to avoid acrimonious arguments over the use of economic levers was, first, to institute better and more extensive economic contingency planning and, second, to establish an agreed western position on foreign policy controls over trade and finance. The declared aim was to offer no concessions to the Soviet block beyond those prevailing in normal trade between western countries; also to preserve economic gains from trade with the east while limiting vulnerability to political influence. There was, says Mr Rashish, scope for more co-ordination and sharing of information (which is not at all hard to believe). More ambitiously, he was concerned to establish how far, if at all, the west could influence economic and political behaviour through existing trade and financial relations.

Clausewitz on debt

In addition to this attempt to start work on a coherent policy framework, the Reagan administration enjoyed a useful practical inheritance in the shape of a Nato contingency planning exercise for Poland. In the aftermath of Afghanistan the allies had agreed to put together a set of potential sanctions and a crisis timetable in preparation for trouble. And the American administration also added a further piece of contingency planning of its own by pressing for political conditionality in negotiations for the 1981 rescheduling of officially guaranteed debt to Poland. The 14 other major official creditors eventually agreed on a *force majeure* clause in April, 1981, whereby any country could suspend its part of the rescheduling deal without notice in the event of "exceptional circumstances". This proviso, sometimes referred to as the "tank" clause, was reluctantly accepted by the Poles and was understood by both sides to refer either to occupation or invasion or to the use of violence by the Polish government against the Polish people, whether through military or police action.

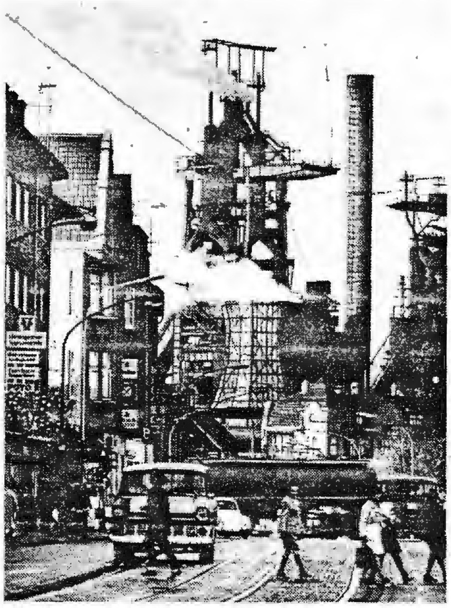
Perhaps predictably, the element of policy planning that caused least friction between the allies concerned strategic controls, which were in any case being considered independently of the Polish crisis. One reason is that Nato members (minus Iceland), together with Japan, find it relatively easy to agree on the importance of not enhancing the Soviet Union's ability to threaten the west militarily or to invade other countries in defiance of international law. Hence the durability of Cocom, the informal committee through which the allies regulate the sale of militarily sensitive equipment to communist countries.

Another is that at this strategic level the potential conflict between national interests is on a small scale. Cocom covers only a tiny fraction of total trade of its members. If the strategic embargo were lifted tomorrow, the result would probably not be a change in the level of overall trade with the east, which is dictated primarily by the availability of hard currency, but a change in the mix of trade towards higher-technology goods. In practice the United States loses most from the embargo.

That does not mean that Cocom's deliberations are all sweetness and light, or that strategic controls are easy to enforce. After the preparation of a defence department report by Mr Fred Bucy, head of Texas Instruments, the United States has placed more emphasis on the control of technology transfer, as opposed to end-products—a point that was reflected in Mr Rashish's pre-Ottawa summit thinking. Since technologies are changing fast and being developed all the time, and the distinction between what does or does not help the military effort is less clear-cut today than it has ever been, this raises problems. So does the fact that more technology is being developed by non-aligned newly industrialised countries (NICs) in the third world. But the failure to control technology transfer is costly. There is evidence, for example, that Soviet missile targeting systems have benefited substantially from western techniques. The result, says America's assistant secretary of state Mr Robert Hormats, is that the United States ends up having to spend more on offsetting improvements to compete with the product of its own earlier defence spending.

Since Afghanistan, Cocom has operated a policy of "no exceptions" for items requiring review. And, as a result of the Bucy report, the Export Administration Act has required the department of defence to establish a list of militarily critical technologies. The results of the Pentagon's work are now providing much of the American input into Cocom, which itself is due to start reviewing its list of strategically sensitive items this year, having agreed on an agenda at a high-level meeting in January.

Some of the critical technologies identified by the United States are not confined to goods directly relevant to weapon systems. So the argument between the allies over reviewing the Cocom list will be about definitions; and the further the Americans seek to move away from items or technologies of fairly direct military significance, the harder it will be to achieve agreement.


Jobs for Germans, levers for Russians

Planning blight

Similar constraints affect foreign policy controls over trade and finance. As the allies move away from the strategic to the political, so it becomes harder to reach agreement. Despite the American attempt, set in train before the Ottawa summit, to establish a common position on east-west economic relations, little was achieved. The Europeans, says Mr Rashish, responded defensively and in some cases emotionally. The row between the United States and western Europe over General Jaruzelski's imposition of martial law in Poland further underlined the practical obstacles to consensus. The original Nato contingency plans, according to Mr Hormats, produced a set of measures ready for use, à la carte, as the need arose. Although the plans envisaged more than one scenario for Poland, the proposed measures covered only the most severe outcome: outside military intervention. This, together with the fact that western intelligence was caught on the hop by the timing of martial law, attracted heavy criticism in the United States. Yet the critics probably underestimated the difficulty of reaching advance agreement. The trouble with contingency planning is that it takes place when the political temperature is below "crisis" level. So it is harder for the participants to confront unpalatable or unevenly distributed costs than it would be when the threats finally materialise and public opinion is aroused.

Nor does it necessarily follow that the west's contingency plans for Poland failed completely. Part of their purpose was to deter Soviet intervention. And while the decision about which measures were to be used was deferred until the main event, the list of sanctions was sufficiently tough to amount to a credible deterrent. Both the West German and French governments gave clear hints that the future of the Siberian gas pipeline to Europe could no longer be guaranteed in the event of Soviet intervention. As for the "tank" clause on the official debt to Poland, there was no point invoking it since it would have hurt the west more than Poland. Instead, Poland's rescheduling of official debt in 1982 was put on ice and new credit stopped. But, if need be, the "tank" clause could still be invoked.

A more powerful reason for the discordant western response to martial law was that the climate in which the allies were trying to arrive at consensus had deteriorated sharply between the final agreement on Nato's plans in March and the clamp-down in December. The source of much of the trouble was a dispute about economic dependence. For the Americans it centred upon the gas pipeline project. For the Europeans it concerned President Reagan's decision to lift the American grain embargo originally imposed by President Carter after the invasion of Afghanistan.

Lobby power

There is nothing in the bare figures to suggest that eastern trade is of more than minor economic significance for the west. At the start of this decade West Germany, which has the highest level of trade with the east in absolute terms, derived only 2.1% of its exports from the Soviet Union and 4.4% of its exports from eastern Europe. The comparable figures for its imports were 2.4% and 4.2%. On some estimates, the number of West German jobs that rely on trade with the east amounts to as little as 0.9% of the total workforce.

The problem, however, is less one of

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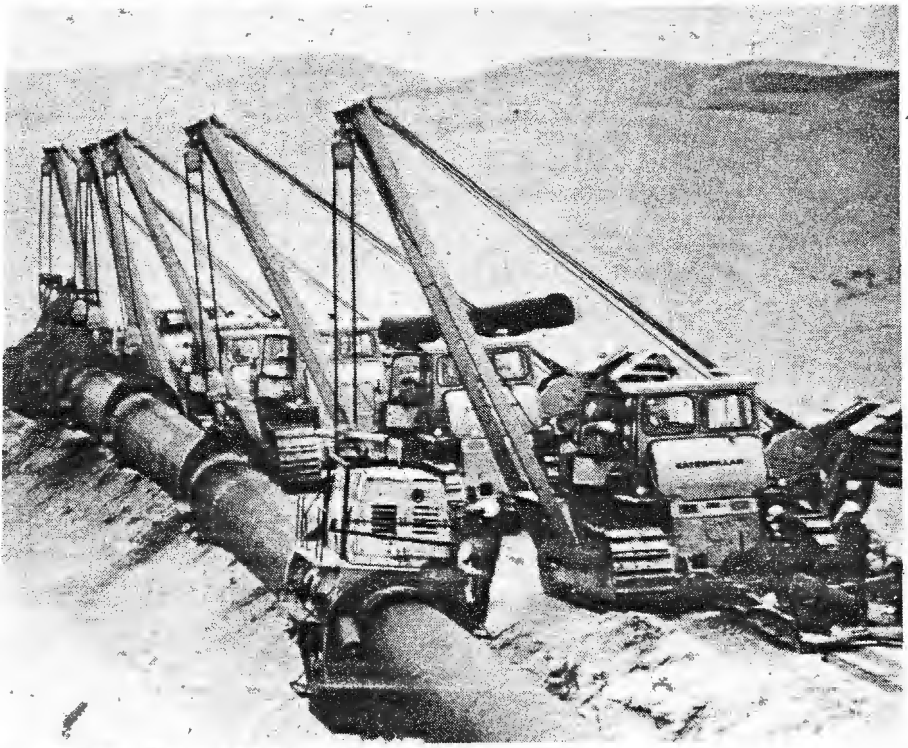


The west gets Russia's act together

dependence than vulnerability. At any given level of trade the Soviet Union can be relied on to look for unilateral advantage and opportunities for leverage. Moreover, trade can establish powerful constituencies and lobbies in western democracies—a problem that the more repressive societies of eastern Europe do not confront directly. The threatened loss even of a single contract may give rise to considerable political pressure if the employment it provides occurs in a politically sensitive area.

In West Germany several major companies derive much of their turnover from the east. Small businesses, to which the Federal Republic has always attached high priority, are particularly vulnerable: some depend almost entirely on business with the east. And vulnerability is magnified in recession, when the risk of bankruptcy for individual firms, and of job losses, is greater.

While it is true that the Soviet block is anxious to import up-to-date technology, it is also a convenient dumping ground for out-of-date western technology and processes. Western workers who might otherwise be sacked because they are employed in uncompetitive sectors thus remain on the payroll. In fact, a significant part of western Europe's exports to the east come precisely from those declining industries that give rise to the biggest domestic headaches for western politicians.

A conspicuous case in point is North Rhine-Westphalia, home of West Germany's steel industry, which is suffering from the highest unemployment in the Federal Republic and badly needs its trade with the east. But at present levels of unemployment in western Europe the Germans are not alone in being potentially vulnerable. The market, admittedly, offers some corrective. According to the Ost-Ausschuss der Deutschen Wirtschaft, the Cologne-based institution that plays a key role in co-ordinating West German trade with the east, firms are diversifying away from eastern trade for all they are worth simply because the prospects for that trade look so grim. Nor is there any evidence that western Europe is more dependent today on Soviet trade than it was five or 10 years ago. What is disturbing, however, is that a qualitative change is about to take place in trade with the east as a result of the European decision to import 40 billion cubic metres of gas a year from Siberia's remote Urengoi fields.

Unnatural gas

Assuming for the moment that this $15 billion Siberian gas pipeline project goes ahead as planned, western Europe's vulnerability will increase sharply. In particular, West Germany will become dependent on the Russians for 30% of its gas supplies in 1990 compared with 3% today, while for France Soviet gas supplies will account for 30% of natural gas usage and 5% of total energy consumption by the same date. It is of no significance that in both cases the total supply of energy from Comecon will not increase significantly as oil and other energy sources decline, for gas is a less flexible form of energy than oil or coal and there is no free market in it.

Admittedly the Soviet Union would be unlikely to turn off the tap *tout court* for unmistakably political reasons except in circumstances of extreme tension. But the Russians have not hesitated to use the "oil weapon" in the past—they did so against Cuba, for example, when their relations with Fidel Castro deteriorated in 1967. And in the meantime the pipeline contract has given them leverage. First, through the work provided by the pipeline itself for firms such as Mannesmann and AEG Telefunken in West Germany, Creusot Loire, Alsthom Atlantique and Thomson in France, John Brown in Britain and Nuovo Pignone in Italy. Second, through gas and credit. The project is financed largely with loans from western banks, on the basis that the principal and interest will be paid out of the revenues arising from the sale of the gas. As a crude indication, $15 billion of credit is equivalent to one and a half times the Soviet Union's hard-currency net debt to the west in 1980 and around a fifth of the outstanding net debt of the whole Soviet block. Once the pipeline is in place and the gas is ready to flow, the west Europeans will have handed over the technology and hardware, but will be dependent on the Russians for gas and cash. And as well as creating an industrial lobby, which may bring pressure for conciliatory policies towards the Russians, the pipeline creates a lobby of bankers. Some members of the American administration also fear that the pipeline will turn into a money machine that will generate huge amounts of hard currency with which to buttress Soviet military might.

In reality the deal is far from one-sided. The Russians cannot turn off the tap without jeopardising their single most important source of hard-currency revenue in the late 1980s and 1990s. And the money machine is no miracle worker. West German industrialists point out that the Soviet Union's additional gas exports to the west will not be enough to offset declining oil export revenues, whether on the estimates of the CIA or the OECD; and that Soviet convertible currency revenue in 1990 will be much lower than today, other things being equal.

Western Europeans argue that they have to diversify away from unreliable sources such as Opec. They are also busily taking measures to limit vulnerability to the east. These include increasing gas storage capacity, installing back-up arrangements such as dual-firing for industrial plant, and ensuring that contracts for supplies of gas from Holland and Norway contain some element of flexibility. But this is not enough to emove vulnerability entirely. Nor to placate the Americans, who have been working to drum up alternative sources of energy to the pipeline. Their proposals include increased American coal exports, with perhaps more Dutch gas through faster depletion policies and additional gas from new finds in Norway. But to the Germans and French these alternatives appeared not to match up to the deal offered by the Russians. While the other European countries deferred their decisions on the gas at American behest, these two countries signed up—the French within a provocatively short period of General Jaruzelski's declaration of martial law. The reluctance to look sympathetically at any American alternative was very largely brought on by America's own decision to lift its grain embargo against the Soviet Union.

Against the grain

American politicians, even more than Europeans, are judged on their ability to deliver the goods to their constituencies. No politician with all the farmers of, say, Iowa on his back would care to display too doctrinaire an anti-Soviet attitude given that sales to the Soviet block accounted, in 1979, for 14% of total American feedgrain exports, and 8% in 1980, even after the partial embargo over Afghanistan.

American farmers need those sales badly. They also need long-term agreements with the Russians on grain; because of past political interference the Russians inevitably turn to the United States last for short-term supplies, so the United States has become the "swing" producer of the grain market. It takes the brunt of the upward and downward swings in world demand, with the result that the boom and bust cycle is magnified in the United States. Yet long-term agreements effectively foreclose many of the political options, since their negotiation is likely to be independent of the Russian crop situation in a specific year.

When President Reagan lifted the grain embargo, his excuse was that it had become "ineffective". Since this argument could be used to rule out virtually any sanctions against the Soviet Union, the excuse carried little conviction in western Europe. Others in the administration argue that grain sales to the Russians reduce the amount of hard currency available for the purchase of western technology to support the Soviet military-industrial complex and that the sales do not give rise to debt problems of the kind that western Europe faces over the pipeline. This argument will not wash with Europeans because it ignores the financial logic of a multilateral trading system.

If the United States runs a hard-currency balance-of-payments surplus on current account with the Russians, everyone else in the system has by definition to run a matching balance-of-payments deficit with them; alternatively, everyone else can run a surplus on current account while extending credit to the Russians, whose adverse current account position would then be made good on the capital account. So there is little point accusing the deficit countries of letting the side down if they sell whatever goods they have available to satisfy Russian demand; or in complaining if other countries extend credit, thus making themselves potentially vulnerable to political pressure, in order to finance a Russian payments deficit.

Strains within the alliance were further increased by American economic policy. Europeans feel that the forecast American budget deficit of more than $100 billion represents a return to former bad habits. That is, it reflects a reluctance to pay for higher defence spending with higher taxes. In the 1960s and 1970s America's alleged fiscal irresponsibility, which arose from reluctance to pay for the Vietnam war and the great society programmes with higher taxes, led to the collapse of the dollar and ultimately to the collapse of the Bretton Woods system of fixed exchange rates. This time the fall-out from fiscal excess is being felt on interest rates. Both the Federal Reserve and Wall Street are operating tight money policies—the Fed through monetary targets, Wall Street by refusing to buy American government bonds except at rates of interest that compensate investors for uncertainty about economic policy and the risk of future inflation inherent in the huge budget deficit. The incompatibility of American fiscal and monetary policies makes for interest rates that are not only high but volatile.

Unbenign neglect

While the focus of their attention is primarily, if not exclusively, domestic, both the Federal Reserve and Wall Street are powerful international actors: movements in American financial markets reverberate around the globe, imposing a nasty choice on foreign politicians between higher interest rates or currency depreciation. The choice is particularly galling for Europeans like Mr Schmidt, whose coalition is in a creaky condition, and Mrs Thatcher; both have tightened their fiscal policy in a much deeper recession than the United States has experienced. (It is also galling for east Europeans, whose debt mountain becomes more expensive to service.)

The final explanation for the heightened tension between the allies over the December sanctions, was that the imposition of martial law in Poland changed the balance of the argument in the American administration between the hawks and doves. As long as Solidarity was still active, it was relatively easy for the state department and others to argue the case for differentiation in the economic treatment of individual countries in the east and for a judicious use of sticks and carrots in conjunction with the allies. The crack down on the Poles, involving "heavy and direct responsibility for the repression in Poland" on the part of the Russians, in President Reagan's phrase, gave powerful ammunition to a loose "unilateralist" coalition in the administration, in which the defence secretary Mr Caspar Weinberger is the most prominent member.

Broadly, the unilateralists argue that, if the Soviet Union and eastern Europe are allowed to run current-account deficits in their balance of payments with the west, the result is a net transfer of resources from west to east which makes it easier for the Soviet Union to devote a high proportion of gnp to the military industrial complex. So with the Soviet economy slowing down, its oil production peaking and its balance of payments under strain, a window of opportunity is opening for the west. Why not, runs the argument, impose a harsher choice on the Russians between guns and butter by denying them technology and credit?

The case was put in Mr Weinberger's annual budget report to the congress in February like this:

> Without constant infusions of advanced technology from the west, the Soviet industrial base would experience a cumulative obsolescence, which would eventually also constrain the military industries. The Soviet leaders must know full well by now that their central planning system is fatally flawed. But their system cannot be reformed without liberalising Soviet society as a whole. Hence without access to advanced technology from the west, the Soviet leadership would be forced to choose between its military-industrial priorities and the preservation of a tightly controlled political system. By allowing access to a wide range of advanced technologies, we enable the Soviet leadership to evade that dilemma.

Mr Weinberger's view does not command much support in western Europe, where officials argue that the Soviet economy is too big and complex to permit western countries to impose a simple choice between guns and butter with the limited means at their disposal. They also question whether economic sanctions could ever push Soviet leaders to consider reform when this constitutes a very risky political option for them. And they worry that the denial of technology, which would make it much harder for the Soviet Union to develop its energy resources, would turn the Soviet bear into a less predictable and more dangerous animal.

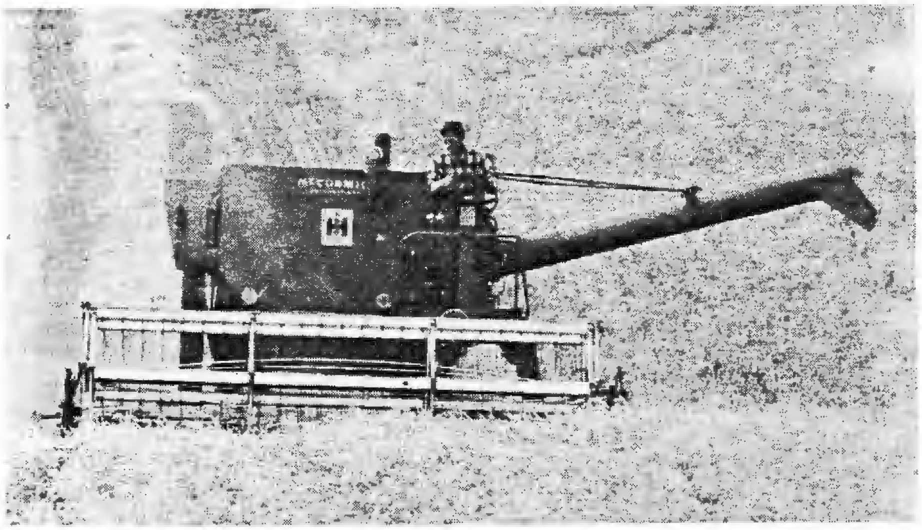
But, as their label implies, the unilateralists are not worried about any lack of active support. They place less value on consultation and cohesion in the alliance than does the state department under Mr Alexander Haig—hence the readiness of the unilateralists to apply leverage to the reluctant Europeans in launching an economic offensive against the Soviet Union.

Bust the east?

The most startling feature of the American policy debate after martial law was that the hawks (not all of whom should necessarily be identified with Mr Weinberger's camp) argued powerfully for the United States to declare Poland in formal default on its debts—a form of sanction which had previously been ruled out in discussions with the allies. Although America's proportion of the outstanding debt was small, most international bank loans carry cross-default clauses. So if one bank calls a default, all the others are likely to follow suit in order to protect their legal position as against other creditors. The unilateralists were thus proposing to borrow everyone else's financial leverage over Poland without so much as a by-your-leave.

This raised the temperature of the debate considerably. Financial leverage is one of the most effective forms of sanction: the consequent withdrawal of credit bites fast, and, since hard currency has always been the main constraint on the Russians' import of western technology, it bites in a vulnerable quarter. The risks for the west in this are high. Officials in Washington argue that the central bank safety net that has been in place since the collapse of the Herstatt bank in West Germany in 1974 could cope with Polish default without too much difficulty; and that a debt collapse in the whole of the Soviet block could be handled at the cost of more inflation as central banks pump liquidity into the world monetary system to cushion vulnerable banks from collapse. But the argument is uncomfortably precise, when the course of events would in fact be hard to predict or control. The world banking system has become increasingly unstable since the oil crisis in 1973 resulted in Opec's cash surplus being recycled to poor countries that lack oil. The more nervous argue that if Polish or eastern European default coincides with another major default by a sovereign borrower, the outcome might be horrific.

On the issue of the pipeline the hardliners saw no reason to help the Europeans make themselves more dependent on the Soviet Union for gas. As well as seeking to ban the sale of General Electric turbine parts and Caterpillar pipelayers for use in the Siberian pipeline, they favoured moves to prevent those holding General Electric licences in Europe from delivering equipment, under their existing contracts, for the pipeline.


Grain power

In the event an alliance between the secretary of state, Mr Alexander Haig, and Mr Donald Regan, the treasury secretary, beat off the challenge from the pro-default lobby on the ground that default would release General Jaruzelski from the pressure of debt service and thus have the opposite effect to the one intended. On the pipeline a more ambiguous compromise was struck, whereby the United States announced an embargo on all exports of oil and gas equipment and technology to the Soviet Union and asked western Europe and Japan not to undermine the measures. As a result there was an implicit threat that General Electric's European associates might be prevented from fulfilling their contracts with the Soviet Union since they no longer enjoyed access to vital turbine components that were to come from General Electric.

The gas deal will none the less probably go ahead. The Europeans see no reason to make such a sacrifice when the United States will not make a parallel sacrifice over grain. As one disgruntled European diplomat put it to your correspondent, "perhaps Europe should declare a grain embargo on the Soviets and demand a non-undermining pledge from the Americans".

Alsthom Atlantique in France has a licence to produce the turbine components which is not affected by the Export Administration Act provisions. So the other contractors have the options of trying to persuade Alsthom to expand its capacity in the event of a stand-off with the Americans.

But the cause of the doves, or "multilateralists", has not been lost. It was as a result of their initiative that America's under-secretary of state, Mr James Buckley, went on a mission around western Europe to sound out the allies on a policy of tighter credit towards the Soviet Union.

In effect, the mission represented a device whereby the multilateralists bought time and elbow room. But the possibility of a politically motivated declaration of default is, as far as senior officials in the Pentagon are concerned, deferred, not cancelled, in the absence of any real change in Poland.

On credit, a political crunch

The senior officials of the American administration who formed the Buckley mission often appeared, according to European diplomats, to be speaking from different briefs and to adopt different shades of emphasis in the course of their European round trip. But they were at one in proposing that credit and the terms on which it should be granted should be seen in the light of the west's wider strategic concerns.

This was not, the Americans said, because they wished to stop trade with the Soviet Union and eastern Europe. But they had doubts about the credit-worthiness of the Soviet Union and were concerned about the leverage that debt created. The specific proposals of the mission were that:

- A mechanism should be set up to monitor an agreed programme to reduce subsidised and guaranteed export credits to the east.
- The Soviet Union should be placed in a special category for all economic purposes and official western credit to it

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What price a half-eaten carrot?

It is not difficult to identify the west's economic interests in eastern Europe. The objective must be to rescue the financial chestnuts from the fire but to avoid easing the Soviet Union's financial burden in eastern Europe while doing so. The debt problems of the eastern European countries have many similarities with balance-of-payments difficulties of the third world and the remedies are much the same.

Debt problems take two main forms:

- Liquidity crises, when countries are temporarily unable to generate enough foreign exchange or domestic savings. Typical reasons are crop failure, falling prices for important exports, injudicious fiscal or monetary policies or the bunching of the maturities of external liabilities. The problem can be solved by further borrowing on non-concessional terms.
- Fundamental over-indebtedness, which arises where a country has used past borrowings imprudently (for example by investing to yield returns below interest costs) and where it fails to accumulate savings and foreign-exchange earnings capable of meeting debt-service obligations. Whereas further borrowing helps a country with a liquidity crisis, it exacerbates the problems of countries that are fundamentally over-indebted. The remedy is an adjustment programme, usually under the auspices of the IMF which imposes "conditionality", designed to strengthen the country's debt-service capacity, which may be combined with the rescheduling of the debt.

Poland is fundamentally over-indebted. Hungary has a liquidity crisis, brought on by a loss of confidence in panic-stricken western banking parlours rather than gross economic mismanagement. The remaining countries of eastern Europe stand between these two extremes.

Where eastern Europe does differ from most of the developing world is that it has largely opted out of the international financial clubs. The Soviet Union did, in fact, take part in the Bretton Woods conference which established the IMF and the World Bank. It originally intended to participate in them, but then changed its mind. Poland and Czechoslovakia, as allied nations, joined, but Poland left in 1948 and Czechoslovakia was thrown out in 1953. Rumania, however, came into the IMF in 1972 partly because of an American desire to reward it for pursuing an independent foreign policy. It was hoped in the west that others might follow. But at the crucial point in the 1970s when eastern Europe was accumulating its mountain of debt, only Rumania and Yugoslavia (which is not a member of Comecon) were members of the fund.

The west's best hope of getting its money back from eastern Europe would bring Poland and the others into the IMF as quickly as possible. But this would not serve the west's wider interests. It is unlikely in the present circumstances in Poland that western countries would vote in favour of Polish entry into western

Jaruzelski, carrot-lover

international financial institutions. Some in Warsaw have also gone cool on the idea. The IMF is acutely conscious of the political dimension of the problem. Polish entry would have to mean a return to political liberalisation in Poland.

Even on that optimistic assumption, the IMF would be operating in an unusual climate. The potential strategic gains to the west in the erosion of Soviet hegemony in eastern Europe provide western statesmen with a strong temptation to bend the economic rules by offering financial support on a scale and in a form that does not help the over-indebted country solve its underlying problems.

For most of 1981 one of the west's key objectives was to keep the Polish reform in being. The United States gave a sympathetic hearing to the Polish government's appeal for funds and the allies started to consider a generous financial package for Poland with the aim of buying time. They hoped that negotiations between the Communist party, Solidarity and the Roman Catholic church would pave the way for an adjustment programme involving higher agricultural prices, autonomy for factory managers, more worker participation and the like.

Carrots galore

Whether this proposal, known in Whitehall as the "mega-carrot" would have achieved anything is a moot point. To begin with, it was assumed that the IMF would play a central role. Polish officials were keen to bring in the IMF partly because they thought it would ease their administrative problems in handling their debts. But the chief attraction to them was the money. The Poles calculated that they would enjoy a quota of $700m-900m and access to the IMF's resources to the tune of 450% of the quota—the maximum possible assistance—over three years. They hoped that private banks would follow suit with further funds.

In practice the IMF was never formally a party to the discussions. Senior officials at the IMF felt that the idea was based on an inadequate assessment of Poland's economic difficulties.

Then there was a risk that the official creditors of Poland would simply end up bailing out the private banks. Still more important, the west needed some assurance that it would not find itself bailing out the Soviet Union. So the co-operation of the Soviet Union, a major supplier and creditor of Poland, was essential for the plan to succeed. Yet this involved a fundamental contradiction: the Russians would have enjoyed the right to pull the carpet from under the west at any moment of their own choosing.

Equally difficult was the question of the conditionality imposed by the IMF. At some point Poland was going to have to face a savage deflation as part of a balance-of-payments adjustment programme. For the Polish government it would have been politically convenient to blame the IMF for imposing misery on the Polish people. And there is a wider question about what conditionality really achieves in eastern Europe.

The IMF is undoubtedly on the side of liberal economic values, as against central planning. To the extent that it can help countries to move away from central planning towards economic devolution (which helps undermine the central role of the Communist party) and greater reliance on the price mechanism, there might seem to be some political benefit to the west. In practice, however, conditionality has not worked as well as the west hoped in Rumania, which has received one of the IMF's biggest standby arrangements.

In a command economy the government can do what it wants without having to cope with democratic pressures. But when the Rumanians take steps to slow down imports, they do not take correshould be co-ordinated and controlled.

- There should be a pause on granting further credit to the Soviet Union for some months while these issues were discussed.

The administration also seems likely to press for a united western attempt to limit the growth of counter trade (or barter), which enables eastern Europe to dump uncompetitive products on the west while balancing mutual trade.

The case for co-ordination in the granting of credit to the east is overwhelming in the light of experience in the 1970s. For a start, a laissez-faire approach to the Soviet Union puts pluralistic western countries at a disadvantage, since the Russians can use their bargaining power as a single purchaser to play off countries and companies against one another; this affects credit as much as trade. The IMF is not there to provide a safety net except under Rumania (see next article) and there is no equity capital in the east to cushion western lenders against the considerable risks. And it makes neither political nor economic sense to subsidise the world's second largest economy when such a high proportion of its resources are devoted to the military build-up. Why not, asked the Americans, give the subsidy to more deserving less developed countries?

A small part of the message is taken. Since 1976 the leading industrial countries have operated an informal agreement designed to avoid destructive competition, known as "the consensus". This now operates under the aegis of OECD and sets a floor under interest rates and a ceiling on the maturity of loans. At the start Comecon enjoyed the most favourable rates. But not any more. In October, 1981, the participants agreed to change the status of the Soviet Union from being that of an intermediate country (where the agreed interest rates are 10½-11%), to the relatively rich category (where the going rates are 11-11¼%). Yet this still leaves room for subsidy, because, first, some countries, such as Britain and France, have market rates in excess of these figures at the moment and, second, because governments provide guarantees for private bank loans and run state-owned or state-backed export credit insurance schemes whose premium rates are arguably uncommercial.

While the Europeans are happy to discuss the issues involved it is plain that it will be extremely difficult to reach agreement. The United States is really seeking to persuade the Europeans to drop their mercantilist habit of buying business in recession. It is impossible, however, to move from the OECD consensus arrangement to a pure market system because this would give an advantage to those like the west Germans and the Japanese who have low nominal interest rates. At the same time there is, and always has been, an overwhelming economic case for the west to put its house in liberal order on this score; but it can safely be predicted that many countries will be reluctant to concede short-term national economic advantage without a squabble.

It is probably also impossible to put the Soviet Union in a category of its own within the OECD agreement, because OECD includes neutral countries such as Switzerland, Sweden and Finland. And there is certainly no hope of agreement on a credit pause since this appears to most Europeans to border on economic war.

A more general problem with co-ordinating credit to the Soviet Union is that the west would have to agree on the Russians' creditworthiness. Mr Norman Bailey, director of policy planning at the National Security Council, points out that on any basis the Soviet Union is becoming a poor credit risk in the 1980s as its economy slows down and its external financial position comes under increasing strain. Even assuming that oil prices, production and exports remain relatively high, the Soviet Union's hard-currency debt-service ratio will, on present trends, rise to 25% of exports in 1985 and 68% in 1990, says Mr Bailey. On the basis of low oil exports the Americans envisage the debt-service ratio rising to 47% in 1985 and 116% in 1990. Either way, the Soviet Union would not be a particularly good medium- or long-term credit risk. The Russians could, Mr Bailey suggests, go the way of the Poles.

Energy before debt

Whether the Europeans will accept that argument remains to be seen. Its weakness is that a debt-service ratio for the Soviet Union means something very different from a debt-service ratio for Poland. The assumption underlying the Polish dash for import-led growth was that the modernisation of the economy would increase its foreign currency earning-and-saving capacity and thus allow the country to meet its debt-service obligations.

Admittedly many of the factors that caused that policy to fail can be seen in the Soviet Union, notably the "systemic" weaknesses that create inefficiency and waste, delays and bottlenecks and rates of return far lower than the interest cost of external borrowing. Agricultural inefficiency, leading to a drain on the hard-currency trade balance as a result of grain imports, is another common factor.

But the Soviet Union will be seeking to service debts not primarily from the sale of competitive manufactured goods but from the sale of energy and other natural resources. There is a limit to what Russian inefficiency can do to reduce the quality of natural gas (or, for that matter gold). And since the capital for the development of Siberian energy reserves is likely to come in the form of project financing, whereby the loans are repaid from the revenues generated by the sale of energy, this represents a better banking proposition than balance-of-payments financing to Poland.

For the west, credit is a subsidiary issue. The real question is whether it is in the western interest to help the Soviet Union develop its huge, but increasingly high-cost, energy reserves in Siberia. What is the going market rate for the job? There is no free market in gas. And it is not unusual, in major transactions between western Europe and the Soviet Union, for European countries to trade off a below-market rate of interest in exchange for a more favourable price in other parts of the deal. All that can be said with certainty is that it is a major economic interest of the Europeans that Soviet energy resources should be developed to the full since this will put a brake on the pressure for increased oil prices as the eastern European countries come increasingly into the market; the comparable American interest is much less since the United States is dependent for only 20% of its energy on external supplies. And if the west does continue to help in their development, hard currency from gas revenues will help to make good the financial consequences of inefficiency, muddle and corruption in other sectors of the economy, thus making the Soviet Union a better prospect for bankers.

In the end a compromise will no doubt be struck. The United States, according to Mr Bailey, does not now expect western Europeans all to rescind their gas contracts with the Soviet Union. Its efforts seem more likely to concentrate on building a safety margin into the equation by encouraging the Norwegians, the Dutch and the British to make more gas available, and to slim down the amount of gas that individual western countries take from Siberia. Western Europe's energy producers are sensitive about their national assets. But with oil prices significantly lower than a year ago, the chances that the Americans might gain some accommodation from its European allies have probably increased. In the meantime, any lengthy delay in building the pipeline could cost the Russians the equivalent of several billion dollars. If they are forced to meet that cost by selling gold at prices that are way below the cost of extraction, there is a loss to the Russians in terms of resources as well as a financial squeeze.

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sponding measures to affect incomes, monetary policy or the budget. The IMF has no check on financial flows or balance-of-payments data in the way it has with western countries. Budgets can always be made to balance in eastern Europe. But the IMF may not be producing prescriptions that make sense for the medium term.

At the political level the IMF's efforts have done nothing to make Rumania a more liberal, western-style democracy. And indeed it could be argued that the IMF has made it too easy for Rumania to side-step some of the conditions that might push it farther down the liberal path. Rumania has refused to publish balance-of-payments data that other IMF members provide as a matter of course. This gives a small indication of whether the real difficulty lies in offering carrots to eastern Europe. Arguments over adjustment programmes almost certainly do lead to ministerial re-alignments in countries like Rumania and Jugoslavia. But few in the west have a clear idea of which way conditionality is likely to tilt the balance of political forces in an eastern European country and in whose favour.

It was never, in any case, self-evident that deferring the inevitable economic crunch in Poland was essential to the reforms begun in 1980. What is clear is that an adjustment programme for Poland which involved substantial further borrowings would have carried the risk of creating an even bigger debt problem at the end of the decade, particularly if the conditionality reflected a desire to be nice to the Polish government, or a concern to prevent an undue decline in the living standard of the Polish people. An exceptionally high cost would have been incurred for very uncertain political gains.

Could the "mega-carrot" be revived if there is a return to reform in Poland? Earlier this year at the Madrid conference on Security and Co-operation in Europe (CSCE) Mr Haig dangled the prospect of further official assistance for Poland in the event of good behaviour. But the line in Washington is, realistically enough, that no detailed plans exist at this stage. But if Poland ever does come into the IMF it could be a major political headache. Not in the sense of being a Trojan horse: Polish entry would simply add 1% to the voting strength of the developing country group in the IMF, which currently accounts for around 40% of the votes. But the IMF could well have difficulty in obtaining access to the right data. And the fact that the Soviet Union is a major supplier and creditor of Poland with vital interests at stake would be bound to cast a shadow over proceedings in the IMF in periods of heightened east-west tension.

Who calls the shots?

There is nothing particularly novel about the present tensions in the western alliance over east-west economic relations. The row over the Siberian gas pipeline is a re-run, on a grander scale, of an earlier heated exchange in 1961 between the Americans and the West Germans over the supply of large-diameter oil pipes to the Soviet Union. Although the equipment was not on the Cocom list, the West German authorities felt obliged, in the face of American pressure, to turn away the order.

Concern over the global impact of American economic policies also goes back a long way. The argument used to be about the price of the dollar; now it is about the cost of money. The likely size of President Reagan's 1983 budget deficit suggests that the United States has yet to learn that it no longer lives in a world where it can spend freely to promote its own national interest without incurring longer-term political and economic costs.

The aspirations of the "unilateralists" in the administration carry a strong echo of 1971, when President Nixon's secretary of the treasury, Mr John Connally, scrapped dollar convertibility. In doing so he berated the allies for sharing too little of the defence burden, and introduced a package of measures which were regarded in Europe and Japan as coming close to an American declaration of economic war on the other industrial democracies. And today the Haig-Weinberger argument on how best to manage relations with the Russians retains many similarities with the arguments between Mr Zbigniew Brzezinski, President Carter's national security adviser, and Mr Cyrus Vance, his secretary of state.

Yet the background against which the arguments are taking place has changed in fundamentally important ways. To start with, the world has become a more dangerous place because of the Soviet military build-up. And the balance of economic power between the United States and Europe has altered in favour of the Europeans. The combined gross domestic product of the European partners in Nato is now roughly level with that of the United States—and the Europeans know it. It is both more important to establish a common policy towards the Soviet Union and much harder to bring such a policy into being.

One overwhelming obstacle is the lack of agreement in the American administration on what economic policy towards the Soviet block can actually achieve. Another is that those objectives on which all members of the administration do agree are not, as we have seen, necessarily acceptable to western Europeans. West Germany, France and the United Kingdom are willing and able to incur some economic cost to send signals to the Soviet Union and to indicate their solidarity with the United States when there is a need to respond to unacceptable Russian behaviour. But they also believe that economic interdependence with the east on balance serves western interests more effectively than an economic offensive against the Russians.

Compromises may prove uncomfortable for both sides of the alliance. Conventional wisdom has, in the past, suggested that the United States can only bring limited economic pressure to bear on the Soviet Union on its own, since most of the economic levers are in European hands. But that underestimates the extent of potential American leverage. Apart from their grain power, which they do not use for what Europeans regard as domestic political reasons, the Americans retain a vicarious hold on European trade with the east through technology licensing agreements.

The same is true to an even greater extent of debt. The Soviet block's huge accumulation of debt may only be owed in very small part to American official and unofficial creditors. But the interlinking of loans through cross-default clauses means that the Americans enjoy disproportionate leverage over both the Soviet block and its fellow creditors in the west. They can enlarge the economic offensive against the Soviet block unilaterally and, very substantially, at western Europe's expense. Agreement with the allies is less important to the Americans in this respect than in the past.

Against that background, and in the light of earlier mistakes in handling the economic relationship with the east, it would make sense for western Europeans to oblige the Americans in two ways. They could give a fairer wind to American proposals on limiting vulnerability to Soviet pressure over Siberian gas than they have been willing to do so far. And they could seek to make the best of the process of consultation and co-ordination over credit that the Americans wish to see emerge from the Buckley mission. Yet this requires a rare combination of realism and a readiness to keep an eye firmly on what unites rather than divides the alliance well beyond the forthcoming summit meetings. The challenge for western diplomacy, after the bruising arguments in the alliance over the past year, is formidable.

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ID	*Document Type* / *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86635	MEMO DOBRIANSKY TO CLARK RE MOST FAVORED NATION STATUS RENEWAL: ROMANIA, HUNGARY, AND PEOPLE'S REPUBLIC OF CHINA	2	5/24/1982	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86637	MEMO CLARK TO THE PRESIDENT RE MOST FAVORED NATION STATUS RENEWAL	2	ND	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
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1

THE WHITE HOUSE

TO THE CONGRESS OF THE UNITED STATES:

In accordance with subsection 402(d)(5) of the Trade Act of 1974, I transmit herewith my recommendation for a further 12-month extension of the authority to waive subsection (a) and (b) of section 402 of the Act.

I include as part of my recommendation my determination that further extension of the waiver authority, and continuation of the waivers applicable to the Socialist Republic of Romania, the Hungarian People's Republic, and the People's Republic of China will substantially promote the objectives of section 402.

This recommendation also includes my reasons for recommending the extension of waiver authority and for my determination that continuation of the three waivers currently in effect will substantially promote the objectives of section 402. It also states my concern about Romania's emigration record this year and the need for its reexamination.

RONALD REAGAN

THE WHITE HOUSE

June , 1982

RECOMMENDATION FOR EXTENSION OF WAIVER AUTHORITY

I recommend to the Congress that the waiver authority granted by subsection 402(c) of the Trade Act of 1974 (hereinafter "the Act") be further extended for twelve months. Pursuant to subsection 402(d)(5) of the Act, I have today determined that further extension of such authority, and continuation of the waivers currently applicable to the Socialist Republic of Romania, the Hungarian People's Republic, and the People's Republic of China will substantially promote the objectives of section 402 of the Act. However, I am concerned about Romania's emigration record this year and suggest it be reexamined. My determination is attached to this Recommendation and is incorporated herein.

The general waiver authority conferred by section 402(c) of the Act is an important means for the strenthening of mutually beneficial relations between the United States and certain countries of Eastern Europe and the People's Republic of China. The waiver authority has permitted us to conclude and maintain in force bilateral trade agreements with Romania, Hungary, and the People's Republic of China. These agreements continue to be fundamental elements in our political and economic relations with those countries, including our important productive exchanges on human rights and emigration matters. Moreover, continuation of the waiver authority might permit future expansion of our bilateral relations with other countries now subject to subsection 402(a) and (b) of the Act, should circumstances permit. I believe that these considerations clearly warrant this recommendation for renewal of the general waiver authority.

I also believe that continuing the current waivers applicable to Romania, Hungary and the People's Republic of China will substantially promote the objectives of section 402 of the Act.

Romania: Emigration from Romania to the United States has increased substantially since the waiver has been in effect. In 1981, nearly 2,400 persons emigrated from Romania to the U.S. This is nearly six times the pre-MFN level of emigration and represents an optimum number of emigrants under U.S. immigration procedures in effect that year.

However, I am gravely concerned about the Romanian Government's failure to improve its repressive emigration procedures and the significant decrease in Romanian Jewish emigration to Israel, which is disturbing. This emigration has dropped from an annual rate of 4,000 prior to the 1975 extension of MFN to Romania, to the current (1981) low level of 972. Furthermore, contrary to the 1979 agreement with American Jewish leaders, Romania continues to maintain a considerable backlog of unresolved long-standing emigration cases. This backlog at present involves at least 652 cases. Also, contrary to the 1979 agreement, the

Romanian Government has not improved its emigration procedures. The process is cumbersome and plagued with obstacles for those who merely wish to obtain emigration application forms. All these factors demonstrate Romania's negativistic emigration policy which clearly contravenes the intent and purpose of the Jackson-Vanik Amendment.

In waiving the prohibition of MFN renewal for Romania this year, I have weighed the above factors within the context of the satisfactory state of overall U.S.-Romanian relations. However, I intend to inform the Romanian Government that unless a noticeable improvement in its emigration procedures takes place and the rate of Jewish emigration to Israel increases significantly, Romania's MFN renewal for 1983 will be in serious jeopardy.

Hungary: Hungary's performance during the past year has continued to reflect a positive approach to emigration cases. The majority of Hungarians seeking to emigrate receive permission to do so without great difficulty. Few problem cases arise and these can be discussed constructively with the Hungarian Government. Most difficult cases ultimately are favorably resolved. The relatively liberal Hungarian domestic situation seems to defuse any pent-up demand to emigrate and the actual number of citizens who apply to leave Hungary is apparently small.

People's Republic of China: During the past year, China has continued its commitment to open emigration, exemplified by its undertaking in the September 1980 U.S.-China Consular Convention to facilitate family reunification. The Convention was approved by the Senate on December 17, 1981. The instruments of ratification were exchanged on January 19, 1982. U.S. Foreign Service posts in China issued over 6,920 immigrant visas in FY-1980, and over 15,293 nonimmigrant visas for business, study, and family visits. The comparable figures for 1980 were 3,400 and 15,893, respectively. More than 8,000 Chinese are now in the United States for long-term study and research (approximately half of this number is privately sponsored). As has been the case for the past several years, the numerical limits imposed on entry to the U.S. by our immigration law continue to be a more significant impediment to immigration from China than Chinese Government exit controls. The Chinese Government is aware of our interest in open emigration, and extension of the waiver will encourage the Chinese to maintain liberal travel and emigration policies.

In light of these considerations, I have determined that continuation of the waivers applicable to Romania, Hungary, and the People's Republic of China will substantially promote the objectives of section 402 of the Act.

THE WHITE HOUSE

MEMORANDUM FOR THE SECRETARY OF STATE

SUBJECT: Determination under Subsection 402(d)(5) and (d)(5)(C) of the Trade Act of 1974 -- Continuation of Waiver Authority

Pursuant to the authority vested in me under the Trade Act of 1974, (Public Law 93-618, January 3, 1975; 88 Stat. 1978) (hereinafter "the Act"), I determine, pursuant to Subsection 402(d)(5) and (d)(5)(C) of the Act, that the further extension of the waiver authority granted by Subsection 402(c) of the Act will substantially promote the objectives of Section 402 of the Act. I further determine the continuation of the waivers applicable to the Socialist Republic of Romania, the Hungarian People's Republic and the People's Republic of China will substantially promote the objectives of Section 402 of the Act.

This determination shall be published in the Federal Register.

B

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86642	LETTER RR TO CEAUSESCU RE MOST FAVORED NATION STATUS	2	ND	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86639	MEMO STOESSEL TO THE PRESIDENT RE RECOMMENDATION TO CONGRESS FOR EXTENSION OF JACKSON-VANIK WAIVER AUTHORITY	3	5/15/1982	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86640	MEMO DUPLICATE OF 86639	3	5/15/1982	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
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D

COPY RECEIVED AS OF 5/24/82 19

DANIEL P. MOYNIHAN
NEW YORK

United States Senate
WASHINGTON, D.C. 20510

The President
The White House
Washington, DC 20500

Dear Mr. President:

We want to share with you our concern about the severe oppression suffered by Christian groups in Romania, the tremendous decline in Romanian Jewish emigration in recent years, and the major cultural and social deprivation experienced by the Hungarian minority in Romania.

You will soon be making a recommendation to the Congress on the renewal of Most Favored Nation trading status for Romania. We urge that before you make the recommendation U.S. officials engage in serious and intensive discussions with the Romanian Government, making clear that your Administration shares the Congressional view of the need for Romania to humanize its treatment of religious and cultural minorities, and to raise the rate of Jewish emigration to the level of the years prior to the granting of MFN to Romania.

Documents and other information reaching the Helsinki Commission, private organizations such as Amnesty International and Radio Free Europe, demonstrate beyond doubt the seriousness of a situation previously underestimated in official quarters in Washington. They indicate ample use of prisons, labor camps and psychiatric facilities by the Romanian authorities in the apparently deliberate harassment of Baptists, Pentecostals, Orthodox and other religious groups, the exclusion of believers from educational institutions and jobs; forced assimilation of two and a half million Hungarians and the remorseless diminuition of their educational and cultural facilities; extraordinary obstacles placed in the way of would-be emigrants, including job dismissals and demotions, intimidation, military conscription, and the lengthy separation of families and affianced couples. In a region of the world noted for the general deprivation of human rights and civil liberties, Romania has distinguished itself by enforcing the separation of more affianced couples than in all of the rest of Eastern Europe, including the Soviet Union, put together.

Though section 402 of the 1974 Trade Reform Act relates expressly to emigration, we believe emigration performance has a broader significance as a visible measure of a government's commitment to other basic human rights. We have therefore been alarmed by the precipitous drop in Romanian emigration to Israel from an annual rate of three to four thousand in the years before the 1975 awarding of MFN status to Romania to barely one thousand in recent years. The first three months of 1982, moreover, show a monthly average of only 54, compared with 250 to 350 just a few years ago.

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The monthly rate of Romanian emigration to the U.S. during 1980 and 81 was over 200; Israel, with a far larger Romanian family base than the U.S., should not have less.

Accordingly, we would urge the Administration to note the Recommendations of the Senate Finance Committee in the Fall of 1979 following the hearings of its International trade Subcommittee:

> to initiate discussions with Romania intended to lead to more specific assurances regarding emigration, such as those which preceded the granting of MFN to Hungary . . . . The Committee understands the difficulty of such an undertaking but nevertheless believes a renewed, more aggressive effort must be made.

We would also draw your attention to Senator Henry Jackson's 1981 message to the International Trade Subcommittee, with which the rest of us wholeheartedly agree:

> It is necessary for the Romanian (authorities) to do much better with regard to emigration to Israel . . . . They should more than double the annual number they are approving for emigration to Israel.

Finally, we remind you that there are a number of instances of Romanians who have been trying to emigrate to join family members in the West for as long as a dozen years. These long unresolved cases simply must be resolved if Romania is to continue to enjoy Most Favored Nation trading status.

MFN was granted to Romania in 1975 in hopes it would encourage freer emigration and greater freedom at home. Since then, however, emigration has fallen off and repression at home has continued unabated. We hope that your Administration will be able to report to Congress greater progress on these issues than we are currently aware has been made. At this point, we are unpersuaded that another extension of MFN for Romania will have the desired effect.

Sincerely,

Bill Armstrong
William L. Armstrong

Daniel Patrick Moynihan

George J. Mitchell
George J. Mitchell

Jesse Helms
Jesse Helms

James A. McClure

Carl Levin

Charles E. Grassley

Christopher J. Dodd

Mack Mattingly

Robert W. Kasten, Jr.

H. John Heinz, III

Roger W. Jepsen

Dennis DeConcini

Howard M. Metzenbaum

J. James Exon

John P. East

Claiborne Pell

William S. Cohen

Edward Zorinsky

Patrick J. Leahy

Steven D. Symms

Rudy Boschwitz

Alfonse M. D'Amato

** This letter is still being circulated in the Senate for further signatures. The above reflects all the signatures as of May 24, 1982.

22

II

23

Memorandum

TO: Dr. Richard Pipes, National Security Council

FROM: Howard Squadron, Chairman, Conference of Presidents of Major American Jewish Organizations

DATE: May 19, 1982

Since Congress first approved MFN for Romania in 1975, Jewish emigration has steadily declined and now seems frozen at just under 1,000 persons a year.

Although that decline can be partially explained by the shrinking pool of would-be emigrants, an additional reason for the decline is the Romanian government's policy of active discouragement of all emigration, taking the form of harrassment and even intimidation of applicants.

Emigration to Israel has dropped from 2,372 in 1975, to 1,982 in 1976, 1,347 in 1977, 1,141 in 1978, to 991 in 1979. It rose slightly in 1980, to 1,043, but dropped again last year to 973. The number of persons leaving this year does not provide much encouragement.

In 1979, the Conference of Presidents reached an agreement with the Romanian government which the Conference hoped and expected would facilitate emigration. That agreement created a mechanism by which the Presidents Conference would, on a regular basis, receive lists of Jews seeking to emigrate, which could then be brought to the attention of Romanian authorities for favorable action. However, there continues to be large backlogs of cases, some of them going back as far as 1978 and 1979. This year the backlog is 652 names, but since the President's Conference has not received any lists since last October, it may be that the backlog is actually larger.

The 1979 agreement also carried the understanding that there would be no official obstacles to Jews seeking to leave or to obtaining application forms in the first place. Our experience since that time, however, suggests that would-be Jewish emigrants continue to face impediments.

We believe that MFN has been a useful tool for the United States to encourage Romania to continue its relatively independent foreign policy. We also believe that MFN is useful as leverage to induce the Romanians to relax their emigration policies. However, we do not believe that this leverage has been used as effectively as it might be.

We would hope that the President's message to Congress on Romanian MFN will reflect our concerns with Romania's performance. We would also hope that what the President will say will encourage the Romanians to improve their performance substantially between now and the deadline for Congressional approval of another renewal. We believe that this is the optimum time for the Romanians to make that improvement, before the pressures of the Congressional hearings on MFN are brought to bear.

HS/bas

III

25

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

3396

MAY 26 1982

MEMORANDUM TO: MICHAEL O. WHEELER

FROM: Philip A. DuSault

SUBJECT: Extension of Jackson-Vanik Waiver Authority

This responds to your request of May 17 for OMB comments on a proposal by the Department of State that the President waive the prohibitions of the Jackson-Vanik amendment for Hungary, Romania, and the People's Republic of China. This would extend MFN tariff treatment to these countries for an additional year.

OMB supports the State analysis of the importance of extension of MFN treatment to the U.S. trade relationship with these countries. As to whether the extension of the Jackson-Vanik waiver will encourage emigration from Eastern Europe and promote East-West policy objectives of the United States, we defer to the National Security Council.

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THE WHITE HOUSE

TO THE CONGRESS OF THE UNITED STATES:

In accordance with subsection 402(d)(5) of the Trade Act of 1974, I transmit herewith my recommendation for a further 12-month extension of the authority to waive subsection (a) and (b) of section 402 of the Act.

I include as part of my recommendation my determination that further extension of the waiver authority, and continuation of the waivers applicable to the Socialist Republic of Romania, the Hungarian People's Republic, and the People's Republic of China will substantially promote the objectives of section 402.

This recommendation also includes my reasons for recommending the extension of waiver authority and for my determination that continuation of the three waivers currently in effect will substantially promote the objectives of section 402.

RONALD REAGAN

THE WHITE HOUSE

June , 1982

RECOMMENDATION FOR EXTENSION OF WAIVER AUTHORITY

I recommend to the Congress that the waiver authority granted by subsection 402(c) of the Trade Act of 1974 (hereinafter "the Act") be further extended for twelve months. Pursuant to subsection 402(d)(5) of the Act, I have today determined that further extension of such authority, and continuation of the waivers currently applicable to the Socialist Republic of Romania, the Hungarian People's Republic, and the People's Republic of China will substantially promote the objectives of section 402 of the Act. My determination is attached to this Recommendation and is incorporated herein.

The general waiver authority conferred by section 402(c) of the Act is an important means for the strengthening of mutually beneficial relations between the United States and certain countries of Eastern Europe and the People's Republic of China. The waiver authority has permitted us to conclude and maintain in force bilateral trade agreements with Romania, Hungary, and the People's Republic of China. These agreements continue to be fundamental elements in our political and economic relations with those countries, including our important productive exchanges on human rights and emigration matters. Moreover, continuation of the waiver authority might permit future expansion of our bilateral relations with other countries now subject to subsection 402(a) and (b) of the Act, should circumstances permit. I believe that these considerations clearly warrant this recommendation for renewal of the general waiver authority.

I also believe that continuing the current waivers applicable to Romania, Hungary, and the People's Republic of China will substantially promote the objectives of section 402 of the Act.

Romania - Emigration from Romania to the United States has increased substantially since the waiver has been in effect. In 1981, nearly 2,400 persons emigrated from Romania to the United States. This is nearly six times the pre-MFN level of emigration and represents an optimum number of emigrants under U.S. immigration procedures in effect in that year. Continuation of the waiver will also contribute to maintaining a framework for dialogue with the Romanian Government on emigration procedures, emigration to Israel, binational marriages, and other humanitarian problems.

Hungary - Hungary's performance during the past year has continued to reflect a positive approach to emigration cases. The majority of Hungarians seeking to emigrate receive permission to do so without great difficulty. Few problem cases arise and these can be discussed constructively with the Hungarian Government. Most difficult cases ultimately are favorably resolved. The relatively liberal Hungarian domestic situation seems to defuse any pent-up demand to emigrate and the actual number of citizens who apply to leave Hungary is apparently small.

People's Republic of China - During the past year, China has continued its commitment to open emigration, exemplified by its undertaking in the September 1980 U.S.-China Consular Convention to facilitate family reunification. The Convention was approved by the Senate on December 17, 1981. Instruments of ratification were exchanged on January 19, 1982. U.S. Foreign Service posts in China issued over 6,920 immigrant visas in FY-1980, and over 15,293 nonimmigrant visas for business, study, and family visits. The comparable figures for 1980 were 3,400 and 15,893 respectively. More than 8,000 Chinese are now in the United States for long term study and research (approximately half of this number is privately sponsored). As has been the case for the past several years, the numerical limits imposed on entry to the U.S. by our immigration law continue to be a more significant impediment to immigration from China than Chinese Government exit controls. The Chinese Government is aware of our interest in open emigration, and extension of the waiver will encourage the Chinese to maintain liberal travel and emigration policies.

In light of these considerations, I have determined that continuation of the waivers applicable to Romania, Hungary, and the People's Republic of China will substantially promote the objectives of section 402 of the Act.

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THE WHITE HOUSE

MEMORANDUM FOR THE SECRETARY OF STATE

SUBJECT: Determination under Subsection 402(d)(5) and (d)(5)(C) of the Trade Act of 1974 -- Continuation of Waiver Authority

Pursuant to the authority vested in me under the Trade Act of 1974, (Public Law 93-618, January 3, 1975; 88 Stat. 1978) (hereinafter "the Act"), I determine, pursuant to Subsection 402(d)(5) and (d)(5)(C) of the Act, that the further extension of the waiver authority granted by Subsection 402(c) of the Act will substantially promote the objectives of Section 402 of the Act. I further determine the continuation of the waivers applicable to the Socialist Republic of Romania, the Hungarian People's Republic and the People's Republic of China will substantially promote the objectives of Section 402 of the Act.

This determination shall be published in the Federal Register.