Collection: Executive Secretariat, NSC: Country File: Records, 1981-1985

Folder Title: Soviet Bloc Economic and Financial Situation Update: (02/10/1982) (1)

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ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
168514	MEMO	N. BAILEY TO W. CLARK: SOVIET BLOC ECONOMIC AND FINANCIAL SITUATION UPDATE #9 ***PAR 4/8/2013 CREST NLR-748-19-15-1-0***	2	2/10/1982	B1
168519	CABLE		3	1/30/1982	B1
168521	CABLE	281526Z JAN 82	1	1/28/1982	B1
168522	CABLE	282054Z JAN 82	1	1/28/1982	B1
168524	CABLE		5	2/1/1982	B1
168525	CABLE		2	2/1/1982	B1
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168529	CABLE		3	2/4/1982	B1	
168531	CABLE		2	2/2/1982	B1	
168532	REPORT	RE POLAND ***PAR 10/28/2009 CREST NLR-748-19-15-13-7***	5	2/5/1982	B1	B3
168534	REPORT	RE USSR-POLAND ***PAR 10/12/2010 CREST NLR-748-19-15-14-6***	1	2/5/1982	B1	
168535	REPORT	RE USSR (PP. III-IV, 33-34 ONLY) ***PAR 10/12/2010 CREST NLR-748-19-15-15-5***	4	1/1/1982	B1	

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168514	MEMO N. BAILEY TO W. CLARK: SOVIET BLOC ECONOMIC AND FINANCIAL SITUATION UPDATE #9	2	2/10/1982	B1

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MEMORANDUM 858

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168514

NATIONAL SECURITY COUNCIL

February 10, 1982

SECRET

INFORMATION

ON-FILE NSC RELEASE INSTRUCTIONS APPLY

MEMORANDUM FOR WILLIAM P. CLARK

FROM: NORMAN A. BAILEY NB

SUBJECT: Soviet Bloc Economic and Financial Situation Update #9

-- Soviet State Bank inspectors have forced Moscow Narodny Bank to establish reserves against outstanding Polish debt due to it, which has seriously reduced 1981 profits (Tab A). (S)

-- Swiss and Scandinavian banks are cutting off short-term credits to the Hungarian National Bank. Austrian banks are considering a similar move (Tab B). (C)

-- Soviet chemical plants are experiencing serious trouble because hard currency shortages are making it impossible to import feedstocks (Tab C). (C)

-- The private banks expect 1981 Polish debt interest will be made current by February 15, 1982; 1982 interest payments will be "rolled over." A new rescheduling agreement will be signed by end February (Tab D). (C)

-- The Bulgarians are having to use scarce currency reserves to buy pipe from Japan, Yugoslavia and West Germany and oil from Iraq and Libya because the Soviets have cut off pipe and reduced oil supplies (Tab E). (S)

-- The Bundesbank is pressuring West German banks not, repeat not, to establish reserves against the Polish debt. In response, at least one West German bank is establishing a large reserve in its Luxembourg subsidiary (Tab F). (S)

-- The Soviet Foreign Trade Association (Promsyr Proimport) is completely out of funds and can make no payments until July 1982 (Tab G). (S)

-- The financing terms of an export deal with Japan to the USSR have been changed at Soviet request to provide for 180-day payment. In compensation, the Japanese firm has raised the price of the material (Tab H). (S)

SECRET
Review February 3, 2012
Derivative Classification by CIA
DRV D9B1

SECRET

DECLASSIFIED IN PART
NLRR C08-t
BY CN NARA DATE 4/8/13

-- Cuba is causing problems for Japanese trading companies because of Cuban failure to load and pay for goods (Tab I). (S)

-- The Moscow Narodny Bank is still trying to raise money from Arab sources (Tab J). (S)

-- Leading functionaries of the East German Communist party complained bitterly about the East German economic situation to a visiting delegation of West German Communist officials (Tab K). (S)

-- The DIA reports continued deterioration of the Polish economy (Tab L). (S)

-- The Soviet Foreign Trade Bank has assumed two-thirds of the Polish debt to Soviet West European banks (Tab M). (S)

-- A major CIA study of Soviet economic dependence on the West has been published. The summary is attached (Tab N). Among the conclusions: "In the absence of Western loans, Moscow would have no choice but to cut imports back drastically." (S)

-- The Soviet Union apparently sold 50-60 tons of gold during the first two weeks of 1982 alone. This is in contrast to 200 tons sold in all of 1981 (Tab O). (S)

cc: Gus Weiss
Henry Nau
Tom Reed
Don Gregg

25X1

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C O N F I D E N T I A L BUDAPEST Ø49Ø

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USEC
PARIS ALSO FOR OECD
E.O. 12Ø65: GDS 1/29/88 (SCARLIS, BASIL G.) OR-E
TAGS: EFIN, EGEN, CEMA, EEWT, HU, PL, SZ
SUBJECT: REPORT OF SWILL BANK CUTOFF OF CREDIT LINES TO HUNGARY
REF: A) BUDAPEST 472; B) BUDAPEST 447; C) 81 BUDAPEST 7Ø58;
D) 81 BUDAPEST 6663 ALL NOTAL

1. ~~(C)~~ ENTIRE TEXT.
2. CITIBANK REPRESENTATIVES (PROTECT) NOW VISITING BUDAPEST HAVE TOLD THE ECON OFFICER THAT SWISS BANKS BEGAN EARLIER THIS MONTH TO TERMINATE SHORT-TERM LINES OF CREDIT FOR THE NATIONAL BANK OF HUNGARY. WITHOUT BEING MORE SPECIFIC, THE AMERICAN BANKERS ADDED THAT SCANDINAVIAN BANKS HAVE RECENTLY REDUCED DRASTICALLY THEIR EXPOSURE IN HUNGARY AND THAT AUSTRIAN BANKS ARE CURRENTLY REVIEWING THEIR LENDING POLICIES.

3. REGARDING CITIBANK'S OWN POLICIES, THE AMERICAN BANKERS SAID THEY ARE HERE IN BUDAPEST TO ASK TOUGH QUESTIONS AND WILL NOT BE OFFERING THIS TIME ANY NEW CREDIT LINES, BUT CITIBANK HAS NOT MADE ANY DECISION TO REDUCE ITS EXPOSURE.

4. COMMENT: IN REFTELS AND PREVIOUS MESSAGES, WE HAVE REPORTED THE NATIONAL BANK'S CONCERN OVER ITS ABILITY TO CONTINUE BORROWING MEDIUM-TERM FROM WESTERN BANKS, INCLUDING ITS ACCESS TO BANK-TO-BANK CREDITS. ALTHOUGH ALSO WORRYING OVER CONTINUATION OF SHORT-TERM CREDIT LINES, NATIONAL BANK OFFICIALS HAVE TOLD US THAT, AS OF EARLIER THIS WEEK--IN CONTRAST TO THE CITIBANK REPORT, NO WESTERN BANK HAS ACTUALLY CUTOFF ACCESS TO SHORT-TERM FUNDS.

5. BUT HUNGARIAN BANKERS HAVE EXPRESSED IN DRAMATIC TERMS CONCERN ABOUT THEIR ABILITY TO CONTINUE BORROWING FROM THE WEST, ASKING RHETORICALLY WHETHER THE U.S. GOVERNMENT WOULD ALLOW THE ONLY REFORM-ORIENTED SYSTEM IN EASTERN EUROPE TO BE "STRANGLED" THROUGH AN ARBITRARY CUT IN SHORT-TERM CREDIT LINES. THE BANK'S FIRST DEPUTY PRESIDENT, JANOS FEKETE, IS REPORTEDLY PUTTING ON A BRAVER FRONT, SAYING THAT IF HUNGARY CANNOT BORROW ARAB MONEY THROUGH WESTERN INTERMEDIARIES, THE NATIONAL BANK CAN CIMPLY GO DIRECTLY TO THE GULF BANKS. (THAT ASSUMES, OF COURSE, THAT ARAB BANKERS ARE LESS CAUTIOUS THAN THEIR WESTERN COUNTERPARTS).

6. REGARDING FEKETE'S U.S. VISIT (BEGINNING FEBRUARY 2), WE HAVE HAD A NUMBER OF INDICATIONS THAT THE HUNGARIAN BANKER'S MAIN PURPOSE IN GOING TO WASHINGTON IS TO REQUEST U.S. GOVERNMENT ASSISTANCE IN KEEPING OPEN HUNGARY'S CREDIT LINES TO THE WEST. WE HAVE BEEN TOLD BY NATIONAL BANK OFFICIALS THAT FEKETE WILL LINK HUNGARY'S ABILITY TO CARRY ON WITH THE REFORM PROCESS TO THE CONTINUED FLOW OF WESTERN CREDITS. MOREOVER, FEKETE MAY SUGGEST THAT U.S. POLICY IS PARTLY RESPONSIBLE FOR THE CAUTION OF WESTERN BANKERS IN LENDING TO HUNGARY.

7. IN THIS REGARD, A RANKING BANK OFFICIAL TOLD AN AUSTRALIAN DIPLOMAT THAT THE HUNGARIANS HAVE BEEN ADMONISHING THE POLES THAT UNLESS BANK INTEREST IS PAID AND THE RESCHEDULING PROCESS CONTINUES, THE REST OF EASTERN EUROPE WILL SIFFER. THIS MESSAGE WILL REPORTEDLY BE REPEATED TO THE POLISH FINANCE MINISTER WHEN HE VISITS BUDAPEST NEXT WEEK. (PRESUMABLY THIS MESSAGE IS REALLY INTENDED FOR THE SOVIETS, BUT THE HUNGARIANS ARE NOT SAYING SO OPENLY TO US. HKGARIANS DO MAKE THE POINT THAT THERE ARE SOME IN MOSCOW WHO WOULD BE PLEASED TO SEE HUNGARY RELY LESS ON WESTERN TRADE AND CREDITS).

8. FOR BERN: WE WOULD APPRECIATE INFORMATION EMBASSY BERN MAY HAVE REGARDING SWISS BANK WILLINGNESS TO MAINTAIN CREDIT LINES TO HUNGARY. AS MUCH OF THE NATIONAL BANK'S BORROWINGS HAVE REPORTEDLY BEEN IN SWISS FRANCS, A CUTOFF OF SWISS BANK CREDIT LINES WOULD BE MUCH MORE SERIOUS THAN FROM AUSTRIAN OR SCANDINAVIAN BANKS. WHAT IS UNCLEAR IN THIS REPORT IS WHETHER NON-SWISS BANKS BASED IN ZURICH ARE INCLUDED IN THE REPORTED CUTOFF OF CREDIT LINES. SWITZERLAND'S DCM HERE CONFIRMS THAT SWISS BANKS CUT OFF SHORT-TERM CREDIT LINES (IN LATE DECEMBER OR JANUARY) AND THAT THE NATIONAL BANK HAS RAISED THIS MATTER WITH THE SWISS AMBASSADOR. THE NATIONAL BANK HOPES TO GET THESE CREDIT LINES RESTORED, AFTER FURTHER DISCUSSION IN ZURICH. BUT THE SWISS DCM COULD ADD NOTHING MORE.
KUCHEL
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PAGE Ø1 AMCONSUL KRAKOW Ø1Ø9 DTG: 291356Z JAN 82 PSN: Ø51Ø65
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C O N ~~F~~ I D E N T I A L KRAKOW Ø1Ø9

E. O. 12Ø65: GDS 1/28/88 (BASTIANI, CARL A.) OR-M
TAGS: ECON, ETRD, PL, UR
SUBJECT: PROBLEMS PRODUCING CHEMICALS FOR FARMERS; CHEMICAL SUPPLIES FROM USSR

1. (U) MAJOR CHEMICAL PLANT, "ORGANIKA," AT SARZYNA IN RZESZOW PROVINCE REPORTEDLY IS EXPERIENCING DIFFICULTIES IN OBTAINING INGREDIENTS FOR THE PRODUCTION OF CHEMICALS FOR USE IN AGRICULTURE. SINCE MOST OF THESE MATERIALS HAD BEEN IMPORTED PREVIOUSLY FROM THE WEST AND THERE IS SUCH A SHORTAGE OF FOREIGN EXCHANGE CURRENTLY, PLANT OFFICIALS ARE SEEKING NATIONAL SOURCES AS WELL AS SUBSTITUTES WHICH COULD BE PRODUCED WITHIN THE PLANT.

2. (U) JAN 25 EDITION OF "NOWINY" (RZESZOW, PRZEMYSL, TARNOBRZEG, AND KROSNO), WHICH REPORTED ON PROBLEMS DESCRIBED IN PARA 1, ALSO PROVIDED FIGURES ON RECENT SUPPLIES OF CHEMICALS SHIPPED FROM THE SOVIET UNION. ACCORDING TO THE REPORT, 1,7ØØ TONS OF PHOSPHORUS BROMINE, CYANIDE, ASBESTOS, AND SODIUM SULPHATE HAVE BEEN RECEIVED FROM THE USSR THUS FAR IN JANUARY. THESE SHIPMENTS ARE REPORTEDLY SIGNIFICANTLY HIGHER THAN THOSE FOR DECEMBER 1981. SHIPPED BY RAIL, CHEMICALS ARE TRANSSHIPPED AT MEDYKA IN PRZEMYSL PROVINCE BECAUSE OF THE DIFFERENCES IN GAUGES OF THE RESPECTIVE RAIL SYSTEMS. RECIPIENTS OF THESE SUPPLIES HAVE BEEN CHEMICAL PLANTS AT OSWIECIM (AUSCHWITZ), STARGARD GDANSK, AND SARZYNA.

3. ~~(C)~~ COMMENT: THE FIRST REPORT, STRESSING THAT "WHERE THERE IS A WILL THERE IS A WAY," MUST HOPE THAT READERS WILL NOT NOTICE THE FACT THAT SUBSTITUTES FO THE ESSENTIAL INGREDIENTS HAVE YET TO BE FOUND. IN ADDITION, THE ITEM ON SOVIET SHIPMENTS WAS PLACED STRATEGICALLY BELOW THE OTHER ARTICLE. HOWEVER, THIS PROFFERED EVIDENCE OF JUST WHO ARE POLAND'S TRUE FRIENDS, WHEN READ CAREFULLY, ALSO REVEALS THAT THE BASIC PROBLEM OF PRODUCING CHEMICALS FOR AGRICULTURE REMAINS UNSOLVED. BASTIANI
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168531	CABLE	2	2/2/1982	B1

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168532	REPORT RE POLAND	5	2/5/1982	B1 B3

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Intelligence Appraisal

168532

POLAND: UNCERTAINTY PLAGUES ECONOMIC RECOVERY (U)

PREPARED BY

25x1

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Produced by the Defense Intelligence Agency

Classified by Multiple Sources
Review on 5 Feb 02

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POLAND: UNCERTAINTY PLAGUES ECONOMIC RECOVERY (U)

Summary

(S) The imposition of martial law in Poland last December by the Jaruzelski regime has further aggravated the economic crisis and clouds prospects for an economic recovery. The deteriorating economic conditions — food and consumer goods shortages, low labor productivity, transportation bottlenecks, energy, raw materials, and spare parts shortages, growing inflation, mounting foreign trade deficits, and indebtedness to the West — that led to the crisis in August 1980, continue to worsen, and the economy is virtually backrupt. The economy shows no sign of improvement despite nearly a year and a half of government-Solidarity negotiations to implement effective economic reforms necessary for an eventual turnaround.

(C) Polish authorities claim martial law was necessary to rescue the country from economic disaster as a result of Solidarity-led activity. After nearly 2 months into martial law, Jaruzelski and his Military Council for National Salvation has yet to produce an economic recovery program. In fact, economic reforms specifically designed to begin rebuilding the economy, which were scheduled to be implemented in early January, have been modified and revised to accommodate martial law. Key elements for economic revival are regaining worker trust, obtaining economic assistance from the Soviet Union and CEMA, rescheduling Western debt, and obtaining additional Western aid.

Discussion

(C) Poland's economic crisis has deepened in recent months, and prospects for a turnaround will remain poor until an effective economic recovery program is implemented. The recent imposition of martial law by the Jaruzelski regime further clouds those prospects. Industrial production is likely to continue its decline through the winter, largely due to continued labor strife and shortages of imported and domestic raw materials, semifinished products, industrial spare parts, and energy resources. The 15 percent drop in coal production is of particular concern. As a result, exports of coal — the major hard currency earner — are down 60 percent compared with 1980.

(C/NOFORN) The agricultural situation, however, is a bright spot in an otherwise dismal picture. Although fertilizer and spare parts for farm machinery were scarce, the overall harvest was favorable. The 1981 grain crop is estimated at 20.5 million tons, above average and well above the two consecutive harvest shortfalls of 1979 and 1980, 17.3 million tons and 18.3 million tons, respectively.

(C) Growing and harvesting conditions last year were excellent for potatoes, an important feed for hogs, and sugar beets, the country's main source of sugar. The potato crop is estimated at 45 to 46 million tons, enough to cover domestic requirements. The sugar produced from last year's beet harvest is also expected to meet Poland's needs, but sugar rationing will probably continue, at least through the winter.

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(C) The "good" harvest, however, is yet to have substantial positive impact on the state marketing system where severe shortages of basic foodstuffs continue. These shortages are the result of the poor harvest in 1980, excess demand, hoarding, farmer reluctance to sell crops to the state for zlotys, distribution and storage problems, and other bottlenecks. Although foodstuffs have all but disappeared from state store shelves, more supplies are now handled through the thriving black and private markets.

(C) Although no one is going hungry, no early or significant improvement in this situation is projected. Meat, in particular, is in short supply. Poland's livestock industry is still feeling the impact of the poor 1979 and 1980 grain harvests and disastrous output of fodder crops in 1980. Livestock inventories are well below 1980 levels, and recovery is not expected for at least 2 years even under ideal conditions. Despite the much improved production of grain and fodder crops last year, sizable grain imports are still needed to meet Poland's domestic requirements. Even though much of the imported grain will be earmarked for livestock feed, little rebound in herd size is anticipated. As a result, unless meat imports are markedly increased -- and the serious shortage of hard currency will limit imports -- per capita meat consumption will drop to the lowest level since 1973. Moreover, recent US-imposed sanctions on Poland will exacerabate the problems of market supplies.

(C) Poland's economic performance in 1981 was worse than anticipated and even more disastrous than in 1980. Few targets for 1981 were met. National income last year dropped an unprecedented 15 percent below the 1980 figure, the third straight year of decline. Preliminary figures for industrial production also show a decline of about 15 percent. Coal production is estimated at 164 million tons (15 percent below 1980), the lowest level since 1974. Production of meat declined by 25 percent and dairy products by 8 percent. Furthermore, the supply of consumer goods dropped by 10 percent, while aggregate incomes rose 25 percent. As a consequence, the gap between supply and demand has widened significantly, exacerbating the inflationary pressure. In addition, exports dropped 14 percent, double the percentage of decline in imports.

(C/NOFORN) The magnitude of Poland's hard currency debt compounds the dismal internal economic conditions. Warsaw's external financial situation has been deteriorating rapidly for several years and has reached the point where repayments due on its hard currency debt exceed Poland's ability to pay. Total Polish debt to the West is currently \$27 billion, \$16 billion held by commercial (private) creditors and \$11 billion by government (official) creditors. Inability to pay its Western debts is but one aspect of Poland's financial dilemma. In order to launch an effective economic recovery program, Warsaw is dependent on new hard currency credits. Western creditors, however, have refused to extend new credits to Poland until a debt rescheduling agreement is signed by the nearly 500 Western banks and Warsaw.

(C) Western governments have already rescheduled nearly \$3 billion of the \$11 billion Poland owes them. Current negotiations, however, center around rescheduling Poland's 1981 financial obligations to Western commercial institutions. The banks have insisted that Poland pay the \$350 million in overdue interest before they will reschedule the $2.4 billion of principal that came due in 1981. Warsaw did not meet the 14 December 1981 deadline for paying the interest. Instead, Polish authorities made a request for a $350 million bridging loan from Western banks to cover these interest payments. The banks have rejected Poland's request and are continuing to pressure Warsaw to pay the interest as a condition for rescheduling Poland's 1981 financial obligations.

(C) Recent reports indicate Poland has begun making small payments on the interest and may have already reduced the amount of interest outstanding to $200 to $250 million. Furthermore, Warsaw has apparently informed Western banks that all 1981 back due interest will be paid by 15 February, which will satisfy the condition for a debt rescheduling agreement. The money will probably come from the Soviet Union. Despite these encouraging signs, Poland's ability to meet the interest payments remains uncertain.

(C/NOFORN) Gen Jaruzelski's military regime has not been able to implement a comprehensive set of policies to bring about a sustainable recovery in output, to reduce inflationary pressures, and to solve Poland's enormous debt problems. The imposition of martial law has aggravated Poland's economic crisis and makes any chances of recovery more uncertain. 25x1 one of the reasons for martial law was to prevent a total economic collapse brought about by Solidarity-led activity. An examination of Poland's economic activity in the months prior to martial law, however, does not show rapid decline in output. On the contrary, industrial production was showing signs of a modest recovery. Output in November increased by 4.2 percent over October, and coal production made its third consecutive positive showing. Furthermore, Solidarity strike activity had been negligible since March 1981, compared with the first quarter of that year. Moreover, after almost two months into martial law, Warsaw still has not unveiled a comprehensive economic plan to preclude the projected economic disaster used to justify the crackdown.

Outlook

(C/NOFORN) Under the present situation, economic policy options available to the regime are as precarious as they were prior to martial law. Indeed, the crackdown has diminished chances of regaining workers' trust as well as obtaining Western aid. Without these key elements, economic recovery is virtually impossible. Moreover, US economic sanctions against Poland have placed an added strain on its economy and have darkened Poland's ability not only to meet the debt repayments but also to turn the economy around. Lack of imported materials and spare parts -- an endemic problem -- will become even more critical.

(C/NOFORN) Nevertheless, since declaring martial law, the Polish authorities have made continued commitment to economic reform one of their central themes. Two weeks before the crackdown, a provisional economic reform was decreed by the Council of Ministers. The plan gave workers a greater role in their places of work, decreased central control of the economy, and reduced the role for branch industrial ministries. However, even this limited economic reform effort, which was intended to be implemented this year, has been significantly weakened. This scaledown includes curtailing workers' self-management, increasing the proportion of the economy centrally controlled under the provisional reform, and restoring a role for the branch industrial ministries in directing enterprises under the provisional reform. Although these measures are supposed to be temporary, they will, nevertheless, impede and diminish prospects for long-term economic reform and recovery.

(C/NOFORN) Shortly after the crackdown, the martial law regime announced tough new measures, including a reduction in the January meat ration and large-scale retail price increases. Jaruzelski has also taken the opportunity to introduce on 1 February enormous (200 to 400 percent) price hikes for a broad range of fuel and food commodities. Such hikes had originally been scheduled for January but were postponed due to the uncertainty of public reaction. The hikes were necessary in an effort to begin an overhaul of the domestic economy. Public reaction to them, however, while martial law is in place is uncertain.

(S/NOFORN) Poland's financial problems will remain a serious obstacle to economic recovery. Until Poland becomes current on its 1981 interest payments, Western creditors will not conclude a debt rescheduling agreement. Although the possibility of this hapening is improving, Poland faces a $10 billion borrowing requirement this year. The Polish economy will have to continue to adjust, and the increasing disequilibrium in the balance of payments will be carried over to coming years. Western creditors are insisting that before Poland's foreign credit is restored, certain measures for economic recovery must be implemented. These include:

— Introduction of a substantial price reform and of a policy restoring real prices.

— Incentives to coal production and redistribution of exports in order to reach the 1979 level of export revenue in convertible currencies as soon as possible.

— Further reduction of agricultural imports through the encouragement of greater production and distribution by the private sector.

— Reduction of the budget deficit.

— Strict control of money supply.

— Allocation of foreign exchange to the sectors of the economy where export potential is the highest.

(S/NOFORN) Although Moscow will probably provide the necessary funds to keep Poland going, its ability to do so indefinitely is questionable, since the Soviet Union itself faces severe economic difficulties. Therefore, Poland's potential for recovery is critically dependent on Western aid. This aid may be contingent on the regime's handling of martial law. ((Classified by multiple sources; review on 5 Feb 02)

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168534	REPORT RE USSR-POLAND	1	2/5/1982	B1

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Excerpt from National Intelligence Daily of February 5, 1982

USSR–POLAND: Soviet Banking Tactics

Moscow in late December reportedly instructed Soviet-owned banks chartered abroad to create contingency reserve accounts to guard against a possible Polish default. The Poles owed these banks more than $300 million by midyear, but the Foreign Trade Bank of the USSR apparently assumed more than $200 million of this debt during the fall. [redacted] 25X1

Comment: While the reported instruction may simply reflect concern over Western regulatory requirements, it also suggests Soviet pessimism about Poland's ability to resolve its financial problems. The Foreign Trade Bank's apparent assumption of most of the Polish debt owed to these Soviet-owned banks puts them in a stronger position to weather a possible Polish default. [redacted] 25X1
[redacted] 25X1

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168535	REPORT RE USSR (PP. III-IV, 33-34 ONLY)	4	1/1/1982	B1

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168535

Soviet Economic Dependence on the West (U)

Key Judgments

The dramatic surge in Soviet trade with the West during the 1970s resulted largely from a growing dependence by the USSR on foreign machinery, technology, and farm products. Hard currency imports grew ninefold, from less than 25 percent of total imports to nearly 40 percent. By 1980, imports from the West were equivalent to 15 percent of Soviet grain utilization and 10 percent of steel consumption.

During the 1970s Soviet exports to hard currency countries also climbed, led by energy and other raw materials. By 1980, 40 percent of all Soviet exports of fuels were paid for in hard currency. Western trade dependence on the USSR, however, was much less than Soviet dependence on the West. Imports from the USSR in 1980, for example, represented only 2 percent of imports by OECD countries. Because foreign demand for Soviet exports did not match Moscow's increased appetite for Western goods, a payments gap developed that was financed by large Western credits, both commercial and government backed.

Given Soviet reluctance to make systemic changes, the USSR's economic prospects for the 1980s indicate a continued—and perhaps even greater—need for Western goods and credits. Indeed, Western imports are particularly well suited to help alleviate the very problems that confront the Soviets during this decade—declining productivity and resource shortages:

- Likely imports are concentrated in sectors crucial to raising technological levels and productivity.
- Imported oil and gas equipment could help find and work reserves needed to offset depletion in existing fields.
- Food imports are crucial to maintaining living standards, essential for worker morale and productivity.

Without access to Western goods and technology, the Soviets would be forced to go it alone or rely more on CEMA sources. This would entail major losses in quality, reliability, and productivity. Moreover, valuable time would be lost because the Soviet economy's scarce stock of resources could not be stretched to accommodate a sudden demand for import substitutes. The Soviets probably would see time as the greatest loss because they believe that their economic problems will be toughest in the short and medium term and that the 1990s will bring some relief.

In any event, the USSR will face some difficult choices in attempting to maintain trade links with the West. As a result of an expected decline in oil exports, Moscow will be losing its major foreign exchange earner in the 1980s and will not have the cash to buy Western goods and equipment in the volume it has in the recent past. A hard currency bind surfaced in 1981 that already is beginning to force Moscow to trim import plans. The USSR can maintain import levels in the face of declining foreign exchange receipts only by dramatically stepping up its Western borrowing. But to do so would also raise the Soviet debt burden. In the absence of Western loans, Moscow would have no choice but to cut imports back drastically.

Any reduction in trade with the West would put pressure on Eastern Europe to help fill the gap. Although the trading patterns of Eastern Europe and the West with the USSR are similar—exports of machinery and manufactures in return for imports of raw materials—Eastern Europe would not be a viable substitute. The technological level of its goods, although higher than the USSR's, is still far below that of the West. Moreover, the East Europeans are experiencing economic problems of their own and do not have the industrial capacity to cope with increased Soviet demand. Nor are they in a position to provide any significant relief on the agricultural front. Indeed, many of the East European countries compete with the Soviets for world grain supplies.

[redacted] 25X

[redacted] 25X

USSR:
Heightened Gold Sales Activity [redacted] 25

Moscow has increased its presence in the international gold market in recent months and will be under pressure to make substantial sales this year.

[redacted]

Between mid-November and the end of 1981 Soviet gold sales totaled an estimated 50 tons, bringing marketings for the year to 200 tons (compared with 90 tons in 1980). Gold sales earned the USSR more than $2.5 billion last year. These earnings were enough to cover about 40 percent of the USSR's $6 billion hard currency deficit. The remainder was covered by drawing down foreign exchange deposits and increasing trade credits. [redacted]

If imports are not curbed, the Soviet Union will need an estimated $10 billion in hard currency this year to finance Western imports and service its debt. Moscow has already arranged an estimated $4 billion in Western credits. To finance the remainder, the Soviets will have to raise additional Western credits and/or sell gold. For every $1 billion that the Soviets do not finance through credit, they would have to sell 80 tons of gold at today's price. [redacted]

Soviet Production

The Soviet Union accounts for about 25 percent of annual world gold production and currently has more than 1,800 tons in inventory. With gold production and consumption in 1982 estimated at 325 and 50 tons, respectively, Moscow would have about 275 tons available for sale in the West before having to draw down stocks. Soviet gold production will continue to rise steadily, approaching 400 tons by 1990 and perhaps 500 tons by the turn of the century. [redacted] 25X

USSR: Gold Sales and Stocks *Tons*

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	Production	Sales	Stocks
1970	218	3	1,631
1971	224	19	1,797
1972	243	158	1,842
1973	250	304	1,747
1974	262	131	1,836
1975	258	147	1,900
1976	276	328	1,797
1977	286	332	1,702
1978	297	401	1,549
1979	307	220	1,581
1980	315	90	1,756
1981	320	200	1,825

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[redacted] 25

Soviet Sales

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Soviet sales are usually managed to limit the downward impact on prices. The Zurich-based Wozchod Handelsbank—the Soviet-owned trading bank—handles the bulk of Russian gold sales and usually sells to the major Swiss banks. In late 1981, however, the Soviets made some direct shipments to London, Tokyo, and Kuwait. [redacted] 25X

[redacted] 25X

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The USSR, however, will need cash. The Soviets face the same problems that caused the payments position to sour last year—a large agricultural import bill, sluggish oil export prices, and aid to Poland. In addition, last year's heavy drawdowns have brought hard currency reserves to less than two months worth of imports. The growing wariness of international banks toward lending to Communist countries will increase the cost to Moscow of obtaining additional credits. [redacted] 25

Large Soviet gold sales would tend to further dampen gold prices and thus compound Moscow's financing difficulties. Demand for gold has already weakened sharply over the last few months, primarily a result of the higher real return on other investments and the market uncertainty over the amount of gold being sold by the Soviets. Gold prices also could weaken if the rich oil producers do not match last year's large volume of purchases. [redacted] 25

[redacted] 25

[redacted] 25

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