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UNITED STATES POLICY TOWARD EAST-WEST ECONOMIC RELATIONS

(Draft Response to NSSM 247/EPBSM 1)

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[redacted]

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NSSM 247/EPBSM 1: U.S. Policy Toward
East-West Economic Relations

Short Replies to Questions Posed

1. US Economic Interests

a. What are US economic interests in Eastern Europe and the Soviet Union? (see pp. 32-45)

The economic benefits the US seeks in trading with the East are the same as those it expects from foreign trade generally. These include foreign markets for US goods, with positive effects on the US balance of trade and on employment, and supplies of needed raw materials and products more efficiently produced abroad. Although US trade with the East is small compared with total US foreign trade, our trade surplus has been large ($4.5 billion in 1971-75), and has helped substantially to offset deficits in US trade with the rest of the world in recent years. Eastern markets are becoming increasingly important to the US agricultural sector, and agricultural exports are essential to a domestic farm policy that promotes full production. US non-agricultural exports to the East remain modest, however, as do US imports of Eastern goods and services. The US economy is not dependent on East-West trade.

b. How important are US economic interests in relation to US national objectives? (see pp. 1-5, 51-52)

The advancement of US economic interests in the East generally supports the achievement of US national objectives. US trade with the East, like other trade, strengthens the US economy, thereby strengthening the country generally. The establishment of good trade and economic relations with the East provides incentives for the Communist countries to move away from their historical emphasis on self-sufficiency, toward a pattern of sustained economic interaction with the United States and the West. This pattern does not of course preclude the possibility of war, but it does make it necessary for Soviet policymakers to consider the potential costs in economic terms of indulging in aggressive or expansionist foreign adventures. US trade with the East is also a response to Eastern initiatives, the rejection of which could have a negative impact on East-West political relations. The development of US trade with Eastern Europe helps to reduce these countries' economic dependence on the USSR.

The positive effects promotion of US economic interests has on advancement of our other national objectives are not sufficient to override national-security concerns expressed in legislation restricting the export to the East of items and technologies which would significantly increase Eastern military capability. In 1969, however, Congress took note of the favorable impact of East-West trade on achievement of US national objectives by eliminating as a control consideration the contribution exports might make /to the economic potential of the Eastern countries.

c. How have US economic interests in the East evolved over the past ten years? (see pp. 33-43)

As US trade with the East has expanded, the US has acquired a greater interest in the establishment of a stable, long-term trading relationship. This is especially true in the agricultural sector, where grain sales to the East have become an important feature in world trade. In non-agricultural trade, a number of US companies have established long-term relationships with Eastern enterprises, but very little US production is specifically geared to the Eastern market. Imports from the East, which have increased more slowly than exports, are less important to the US economy. East-West trade is only a small percentage of world trade, and the US share of non-agricultural trade between East and West is smaller still.

d. What is the projection over the next ten years? (see pp. 43-45)

US agricultural exports to the East are expected to continue at a high level, perhaps increasing over their recent levels if the ability of the USSR to supply grain to Eastern Europe continues to decline. US exports of non-agricultural items are also expected to continue to increase. As Soviet participation in the world economy continues to grow, the US interest in taking Soviet production, consumption, and foreign trade into account in developing global economic policies in such areas as food and energy will rise.

e. Are all opportunities being exploited in pursuit of these interests, and if not, what are the constraints? (see pp. 45, 60-72, 86-110)

The primary constraint on the continued rapid expansion of East-West trade is financial. East-West trade is conducted in convertible currencies (chiefly dollars), which the Eastern countries must acquire through exports of goods and services to the West or through borrowing. (For the USSR, gold sales are also important.) Eastern manufactured goods do not readily find buyers in the West, and Eastern exports of raw materials are limited by production problems and rising domestic demand. Earnings from invisibles, such as tourism and shipping, have not been sufficient to cover the Eastern deficits in merchandise trade. Eastern indebtedness to the West has risen sharply since 1974. Western exporters and financial institutions will not indefinitely extend credit to finance Eastern current-account deficits. For some Eastern countries, the need to service the debt is already a constraint on import capacity, and future borrowing is likely to be more restrained.

The US faces legislative constraints as well, including the Jackson-Vanik amendment (prohibiting the extension of MFN treatment or government-backed credits to non-market countries that deny their citizens the right or opportunity to emigrate) and the Stevenson amendment (prohibiting the extension of more than $300 million in Eximbank direct or guaranteed credit to the USSR without Congressional approval).

National-security constraints are reflected in the restrictions of the Export Administration Act on the export to Communist countries of goods or technology which would make a significant contribution to their military potential.

US business must aggressively pursue Eastern markets if the US share of East-West trade is to expand. If the attitudes of the US Government or public toward East-West trade are seen by businessmen as hostile or mercurial, US companies will be less likely to commit themselves to long-term relationships with Eastern enterprises.

f. What problems with Eastern countries could arise in pursuing these opportunities? (see pp. 3-5, 48, 73, 86-89, 94-104)

Chronic Eastern hard-currency trade deficits have resulted in a large accumulation of external debt. Western countries should be cautious in their lending policies (and Eastern countries can be expected to show restraint in borrowing) so that the growth of the Communist-country debt (although it is not now unmanageable) does not in the future jeopardize the market's willingness to make credit available for the expansion of East-West trade. A precipitous drop in East-West trade could threaten disruption of the plans for economic growth in some Eastern European countries, and that in turn could contribute to political instability in the area.

g. What problems could arise with our Allies in pursuing these opportunities? (see pp. 5-12, 50-51, 75-77)

US efforts to increase its share of the market would raise normal problems of commercial competition. Cooperation in the embargo of strategic commodities would decline further if the pattern of U.S. exports were seen as evidence that the U.S. was using the embargo for commercial advantage. However, the U.S. has been and no doubt will continue to be more scrupulous than other COCOM members in adhering to agreed controls.

2. Eastern Economic Interests

a. What are the economic interests of the Soviet Union and Eastern Europe in the US and the West? (see pp. 16-21, 132, 135)

In trading with the West, the East is interested in the usual benefits of foreign trade and in expediting industrialization and modernization. The Eastern countries seek especially to acquire advanced Western technology and equipment. The Soviet Union, Poland, and the German Democratic Republic also import large amounts of grain from the West, largely in response to consumer demand for improved diets. Soviet imports of technological products and of grain contribute to Soviet economic growth and well-being, but are small compared to domestic production. In Eastern Europe, trade with the West has become an integral part of the strategy for national economic development in all countries except perhaps Bulgaria.

b. How important are these interests to the national objectives of these countries? (see pp. 46-49)

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The advancement of Soviet economic interests in/the West trade with is an important element in furthering the objective of economic growth, and of eventually attaining technological and economic equality with the United States. The Soviets can be expected to continue to pursue opportunities to acquire Western goods and technology, unless East-West political relations deteriorate to the point at which the West effectively terminates economic relations. Nevertheless, the Soviets will manage their economy, and particularly their military sector, so as to avoid dependence on unassimilated Western technology or on continued supplies of Western equipment, parts, or materials. In addition, the Soviets have demonstrated their willingness to forego opportunities to improve trade with the West in order to advance or protect other national objectives, including: among others:

-- a free hand in emigration policy;

-- nonrecognition of the supranational character of the EC;

-- territorial claims to the islands north of Japan;

-- protection of economic information; and

-- stable Communist control in the countries of Eastern Europe.

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East-West trade is more important to the Eastern European countries than to the USSR. Major cutbacks in imports from the West could have serious negative effects on the ability of these countries to satisfy the rising expectations of their populations, with possibly serious consequences for stability in the area. The objective of maintaining good relations with the USSR, however, is more important to these countries than is the promotion of their trade with the West, and to an important extent the degree of interaction between Eastern European economies and the Western world is determined in Moscow.

c. What problems or constraints with their allies do they have in pursuing their economic interests? (see pp. 49, 111-113)

The USSR provides resources saleable in the West, such as oil, to Eastern Europe at terms less favorable to itself than those prevailing on world markets. Such sales reduce Soviet capacity to export to hard-currency customers. The Eastern European countries generally support Soviet positions on certain East-West trade issues, such as the Jackson-Vanik amendment, or EC-CEMA relations, whether or not it is in their economic interest to do so.

d. What problems or constraints with the West do they have in pursuing their economic interests? (see pp. 5-7, 105-110, 114-120)

Low and unpredictable Western demand for Eastern manufactured products, and supply constraints on the export of Eastern raw materials, have kept Eastern foreign-exchange earnings below the level needed to finance desired imports from the West. Consequently, Eastern hard-currency debt, especially in certain countries, has risen sharply.

Western countries maintain a variety of discriminatory protective devices to prevent increased imports from the East from causing injury to domestic industries or disruption in domestic markets.

The COCOM embargo restricts Eastern access to Western goods and technology with military applications.

3. <u>Relations between market and nonmarket economies</u>

a. What are the major impediments to more normal economic relations between market and nonmarket economies? (see pp. 507, 50-53, 106-108, 114-122)

Political and security considerations and systemic economic differences severely complicate East-West trade relations.

Eastern economies are centrally planned, and foreign trade operates through state-controlled monopolies. The domestic price structures of the Eastern countries are isolated, to varying degrees, from the influence of world-market prices. Eastern tariffs, because they do not affect domestic prices, are generally ineffective as regulators of trade, and non-tariff measures can be carried forward in secrecy. The negotiation of reciprocal trade concessions between East and West is therefore extremely difficult. Because the prices of the factors of production in the East need not reflect market forces, Western countries find it awkward to administer trade laws based on market concepts, such as those on dumping or subsidization, with regard to Eastern goods. Some Western countries have found it necessary to resort to discriminatory protective devices.

In addition, Eastern industries, because they face no competition at home, are generally ill-equipped to compete on international markets. Eastern exporters are deficient in marketing skills. Because of Eastern state-trading monopolies, the lack of public economic information, and the difficulty of dealing directly with end-users, Western firms must develop new marketing techniques if they wish to export to the East.

The political division of Europe has severely inhibited the growth of East-West economic relations. Political and security considerations have especially influenced US trade and economic relations with the East, but they have also influenced the East-West trade policies of other Western countries. Security concerns have produced a Western embargo, in which NATO countries (except Iceland) and Japan participate, on the export of strategic goods and technologies to the Communist countries.

b. What constitutes effective economic reciprocity in East-West economic relations? (see pp. 84, 86-113)

Prices in individual East-West trade transactions measure economic reciprocity from the standpoint of the traders, just as they do in trade between market-economy countries. In the long run, roughly balanced trade between East and West (though not between individual countries) is necessary for effective economic reciprocity, because there are no substantial offsets to Eastern trade deficits except credit, which the West will of course not permit to rise indefinitely.

c. What measures should the US take with other industrialized democracies, in multilateral fora, and bilaterally with nonmarket economies, to help ensure effective reciprocity and to deal with the problem of disruption or unfair trade practices resulting from trade with nonmarket-economy countries? (see pp. 114-120)

To help ensure effective reciprocity, the West should avoid extending credit on especially liberal terms, particularly to those Eastern countries with chronic major trade deficits with hard-currency areas.

With regard to unfair and disruptive trade practices, the US should pursue negotiations in the MTN. Following conclusion of the MTN, attention should be given to possibilities for revising US procedures for applying antidumping and countervailing-duty legislation to imports from nonmarket-economy countries. With the nonmarket countries, bilateral consultations on these issues in general should continue, and specific trade problems should be handled under such bilateral and multilateral mechanisms as exist, such as the market-disruption mechanism of the US-Romanian trade agreement, the arrangements for consultations within the intergovernmental commercial commissions the US has established with Poland, Romania, and the USSR, and the provisions for consultations under the GATT multi-fiber arrangement.

4. Western Economic Leverage

a. How, and to what degree, could economic relations between the industrialized Western nations and Eastern nations be used to pursue non-economic policy interests in the short and long-term future, and at what costs to our own economic interests? (see pp. 123-150)

Economic relations could be used either as positive or negative leverage to pursue non-economic policy interests. Positive leverage could take the form of permitting transactions we had previously denied, if our non-economic conditions were met. This would result in benefits rather than costs to our economic interests. Positive leverage in the form of removal of political conditions, such as the link between emigration and MFN and credits, would not entail economic costs to the U.S. and could result in economic benefits. Positive leverage in the form of liberalizing economic conditions, such as availability of Government-backed credits, could reduce the immediate balance-of-payments benefit to us of the affected trade, but this cost might be reduced or eliminated if the liberalization stimulated an increase in trade resulting in the employment of idle resources.

Negative leverage could take the form of partial or total denial of trade. The cost of trade denial would be loss of export earnings and of related jobs in the West. There would also be the risk that the East would retaliate by denying Western access to such Eastern items as oil and

and gas, chrome and platinum, by defaulting on financial obligations, or by taking steps adverse to our interests outside the economic sphere. Another cost of a partial trade denial would be the inequity of placing the burden of economic leverage on only some sectors(s) of the Western economy. Short-term measures would be constrained by existing legislation; long-term measures could be more sweeping.

b. What would be the principal instruments of economic leverage? (see pp. 128-150)

The principal instruments of economic leverage are those economic goods and benefits the East seeks and the West can make available or withhold: technology and advanced industrial goods, grain, credits, and access to Western markets for Eastern exporters. Domestic laws and international agreements and understandings limit the discretionary authority of Western Governments to extend or withhold these benefits. In addition, the power of decision in most of these areas lies more with the private sector than with the Government, although private-sector decisions can be influenced by public policy and attitudes.

c. To what degree and under what circumstances might they be most effective and which non-economic interests are appropriate and susceptible to such economic leverage? (see pp. 80-81, 124-130, 136, 143-144)

Evidence on the effectiveness of past efforts to use economic leverage is largely inconclusive. The intended non-economic effects of politicized economic decisions have often not been clearly stated. In those cases where non-economic conditions have been clearly stated, other factors have also had an effect on the targeted non-economic issue. The clearest case of attempted leverage is U.S. conditioning of most-favored-nation tariff treatment and government-backed credits on freer emigration from the East. The increase in Jewish emigration from the USSR in 1973 appears to have been partly the result of U.S. diplomatic approaches along these lines in 1972-73. The later decline in emigration appears to have been largely the result of Soviet refusal to appear to be bowing to pressure from the U.S., which made the trade-emigration link a matter of law in January, 1975. A 1975 embargo on grain shipments to the Soviet Union, which was primarily economically motivated, was short-lived because of vigorous US farm-community opposition. A 1968 Public Law denying ExIm credits to countries trading with North Vietnam was not followed by any Communist country cutting off such trade. This history suggests that quiet diplomacy is more effective than public confrontation, that selection of an economic lever considered vital to an influential segment of the U.S. population is not viable, and that economic leverage is more likely to be effective if the non-economic objective is appropriate to the amount of leverage available.

d. How, and to what degree, could the U.S. exert effective leverage in the absence of a common approach by the major industrialized democracies, and at what costs to our economic and other interests? (see pp. 5-12, 50-51, 68-70, 136-137, 141)

Our allies have made it clear that they do not wish to participate in a common approach to use East-West trade in non-strategic items for political purposes. Positive leverage and, within the area of negative leverage, the threat of denial of items uniquely available in the U.S., would be reasonable U.S. options in the absence of a multilateral Western approach. These options would be less effective than the threat of denial of a wider range of Western goods and technologies, although the USSR is to some extent dependent upon the US as a source for feed grains in years of poor Soviet harvests and the USSR recognizes the US as the leading nation in many technologies. Existing legislation and international agreements constrain the use of this negative leverage, however.

The most fruitful approach for unilateral US leverage would probably be removal of existing unfavorable discrimination and permitting previously denied transactions. Our economic interests would be disproportionately sacrificed if we exerted other forms of leverage unilaterally. Positive leverage in the form of favorable discrimination would expose primarily the U.S. to pressure from others for comparable favors. Denying items uniquely available in the U.S. would affect precisely those areas where the U.S. has a competitive advantage and would turn Eastern customers to other Western sources for related (and perhaps unrelated) non-unique items previously procured from the U.S. but procurable outside the U.S. with a longer lead time. There would also be an adverse impact on Western cooperation generally in non-economic as well as economic aspects of East-West relations.

5. Eastern Economic Leverage

a. How, and to what degree, could the Eastern Europeans and the Soviet Union collectively or separately use economic relations with the industrialized nations to achieve economic or non-economic objectives inimical to the interests of the U.S. and the West?
(see pp. 150-156)

The East could similarly use either positive or negative economic leverage to pursue non-economic objectives. For instance, the USSR might offer oil, gas, or other goods at concessional prices or the USSR might withhold such items as petroleum, chrome, and rare metals (incurring economic costs in either case). They might, also at some cost, shift their purchases from one country to another. Their possibilities are limited, because Eastern economic relations with the West (excluding Finland) have at most only a marginal effect on the functioning and well-being of Western economies. It is unlikely that any Western country would make a significant concession to the East on a non-economic matter of vital interest as a reaction to Eastern economic leverage. It is virtually inconceivable that the U.S. would.

b. What actions might we take unilaterally or in cooperation with the other industrial democracies to inhibit the use of such economic leverage? (see pp. 1-3, 151-153, 156-158)

The West should avoid becoming dependent on Eastern sources for materials and products in order to inhibit such leverage. The West can also act to link the Soviet Union and Eastern Europe more closely to the world economy, raising the costs to the Communist world of applying negative leverage. The East has historically been even less inclined than the West to attempt such leverage, given the costs involved and the probability of failure.

6. <u>Diversity among Eastern Countries</u>

a. In formulating our economic policies, to what extent is it desirable to distinguish among the countries of Eastern Europe and the Soviet Union? (see pp. 3-5, 22-27, 43-45)

Since these countries are united in the Warsaw Pact military alliance, it is not desirable to distinguish among them to any major extent in Western controls on the export of strategic items. On trade in non-strategic items, our economic policies should reflect the significant political and economic differences among these countries in order to encourage the weakening of Eastern European ties to Moscow. Eastern European nations are much more receptive to US proposals that treat them as individual countries, not as appendages of the USSR.

b. What measures could be taken by the U.S. and the industrialized democracies as a whole, to use to our advantage the diversity of interests and needs among Eastern countries? (see pp. 3-5, 43-44, 114-122, 157-167)

Western countries can, through their trade and economic policies, encourage each Eastern European country to increase its economic interaction with the West. This encouragement of diversity can reduce Soviet influence in the area. Western economic policies could be differentiated vis-a-vis the various Eastern countries in such areas as credits, tariffs and quotas, and relationships to multilateral bodies dealing with economic affairs.

7. Eastern Assistance to the Third World

a. What are the costs and benefits of attempting to bring the Soviet Union and Eastern European countries into the process of assisting development in the Third World or more active involvement in other economic issues? (see pp. 157-167)

Eastern assistance to the Third World has historically been largely motivated by Soviet desires for greater political influence. When there are competing factions for government, Soviet aid usually is in support of the faction most vigorously opposed to close ties with the West. On the other hand, constructive Eastern assistance to the Third World could reduce the burden on the West for such assistance.

The Soviet Union is a major producer and consumer, and an important trader, of oil and gas, but it does not participate in either consumer-country cooperation on energy matters or in the producer-consumer dialogue. Bringing the USSR into these talks would add a political East-West element to the already difficult North-South issues, and the risks appear to outweigh the possible benefits.

The Soviets are active in the International Wheat Council, the main forum for international efforts to coordinate grain policies. Although the Soviets have not supported the US position in the IWC, their approach has not been confrontational. We should continue to encourage their participation in these discussions, which are unlikely to complicate North-South relations.

b. What policy measures could or should be taken to encourage this type of Eastern involvement in the global economy? (see pp. 161-162)

U.S. encouragement of increased Soviet and Eastern European contributions to multilaterally administered aid programs for the Third World in which they are already involved might result in useful burden-sharing without unduly increasing opportunities for counterproductive Soviet activity. Even if unsuccessful in increasing Eastern contributions, US efforts in this area could serve to draw attention to Communist deficiencies and win support from the less-developed countries.