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NATO COUNTRIES' GUARANTEED EXPORT CREDITS TO EUROPEAN COMMUNIST COUNTRIES(1) IN THE LIGHT OF THE CURRENT ECONOMIC SITUATION

Report by the Economic Committee

On 18th March, 1974 the Council invited the Economic Committee(2) to examine in depth the whole range of problems concerning Western trade with Communist countries, with a view to drawing relevant conclusions. This matter has been discussed by the Committee over the last few months in the light of the changed Western economic situation; it has concluded that one focal issue in East/West economic relations continued to be that of guaranteed export credits. The outcome of these discussions is the subject of the present report.

2. For political and commercial reasons, the Allied countries have demonstrated over the years an interest in guaranteed export credits granted to Communist countries. As early as 5th August, 1959 the Council decided to establish a reporting procedure(3) on such credits of a duration of over 180 days.

3. In particular, it was agreed that if any change of policy leading to the extension of government-to-government credits or loans to the Soviet Union were to be contemplated by any member country, the latter should inform the Economic Committee so that the matter be discussed there. In practice, only very few government-to-government credits have been reported to NATO and the amounts involved have been minimal. This paper, unless otherwise stated, is concerned with officially guaranteed private export credits(4) extended to Communist countries.

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(1) USSR, East Germany (including East Berlin), Czechoslovakia, Hungary, Poland, Rumania and Bulgaria.
(2) C-R(74)10
(3) C-M(59)75 approved by C-R(59)30
(4) These are export credits for which governments or national agencies have given official cover, or which have been financed by national governments, or organizations under their control (source: AC/127-D/331).

4. During the preparation of the CSCE, Allied countries considered the political implications of trade and export credit policies towards the East. They agreed, if the question of credits were raised, to point out to Communist countries that they applied a uniform and open policy to all industrialized countries, including Communist countries.

5. The Warsaw Pact countries, which are substantial importers of machinery and equipment from the West, have availed themselves of guaranteed export facilities which usually accompany such deals with these countries. An important consideration, however, has been to ensure that the volume of credits extended by NATO countries remained within the limits of the Warsaw Pact countries' capacity to repay their debts.

6. Western credits, in particular NATO countries' guaranteed export credits to Communist countries, have been an important element in the promotion of East/West trade. However, the share of this trade in NATO countries' total trade has remained small: in 1959 it accounted for 3.04% of NATO countries' total trade. In 1972 it went up to 3.4%(1) and, in 1973 to 3.8%.

7. The Warsaw Pact countries have a long-standing interest in acquiring Western machinery, technology and, occasionally, foodstuffs. Whereas until recently such procurement may have been limited by the low level of hard currency earnings, recently such earnings, at least in the case of the Soviet Union and, to some extent, Poland, have increased substantially since prices of many basic products, in particular energy, have gone up to unprecedented levels.

8. This development has coincided with drastically changed economic conditions in most Allied countries, faced with serious balance of payments and inflation problems(2). Consequently, monetary policies may have to be fine tuned, interest rates are liable to remain relatively high and internal borrowings expensive. In contrast to this rise in domestic credit costs, interest rates charged on guaranteed export credits have remained relatively low. Indeed, in many Western countries, such rates have been traditionally somewhat below domestic ones in order to promote exports, thus involving a form of subsidy financed from public funds. Over the last year or so, however, the discrepancy has grown. This development benefits the foreign borrower while it involves an additional charge for the lending countries. Moreover, the present inflationary situation in the West favours borrowers who incur debts in currencies which may be depreciating fast.

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(1) See C-M(73)131
(2) For example, in 1974 it is expected that prices will have risen by 11.5% in the USA, 14.5% in the UK and 19% in Italy.

9. In view of the foregoing, the main Western trading countries have judged it necessary to re-examine the conditions for granting export credits with a view to increasing their interest rates and shortening their duration. The EEC, the United States and Japan are examining ways to set limits to the conditions according to which they currently grant guaranteed export credits. They are endeavouring to fix the lowest commonly agreed interest rate level and to limit the duration of such credits basing their decisions on objective criteria such as the per capita national product in the borrowing country. These criteria would divide the borrowing countries into three main groups according to the level of the per capita GNP. Within this framework, the European Communist countries would all fall into the same category. It is reasonable to assume that the other Western industrialized countries will accept the agreements which could be reached by the EEC, Japan and the United States.

10. When examining guaranteed export credits to the European Communist countries, it seems appropriate to consider separately first the Soviet Union and then the East European countries.

The case of the Soviet Union

11. Among Communist countries, the USSR is the largest beneficiary of NATO countries' guaranteed export credits(1). At the end of 1973, outstanding guaranteed export credits totalled $4.9 billion, of which about 75% had a duration exceeding five years(2). The service payments on the aggregate debt amounted only to 14% of Soviet export earnings.

12. Despite a considerable strengthening of its financial position, the USSR is demonstrating a continuing interest in export credits, in particular to finance growing purchases, in the West and in Japan, of machinery and equipment. In NATO countries, such orders jumped from $644 million in 1971 to $2.2 billion in 1973(3) and, in 1974, they would seem to have moved up even higher. The Soviet Union's readiness to increase its borrowings in the West, however, does not inhibit it from

(1) No information is available to the International Secretariat on non-NATO countries' credits. One major lender is Japan and Japanese outstanding private credits to the USSR are estimated at $400 million.
(2) At the end of 1972, guaranteed export credits outstanding to the USSR from NATO countries alone amounted to $2.7 billion, while suppliers' credits outstanding to 86 less developed countries amounted to $12 billion. This figure, however, does not include private credits extended to LDCs through banks and other sources which at the end of 1972 totalled $18 billion (World Bank Annual Report 1974).
(3) See AC/127-WP/387, dated 21st March, 1974

attempting to obtain the most advantageous, and even preferential, credit terms. A greater harmonization of these terms would, no doubt, enhance the negotiating position of each Allied government and frustrate Soviet endeavours at playing off one exporting country against another.

13. With the onset of large scale industrial co-operation deals, the USSR would normally receive long-term, self-liquidating, export credits. These in turn would enable the Soviets to exploit more rapidly and fully their vast natural resources. This type of development would ensure outlets throughout the Western world for these resources and further improve Moscow's ability to boost its hard currency earnings - an important component of its credit worthiness.

The case of Eastern Europe

14. Over the last few years, East European countries' trade with the West has been growing faster than their trade with COMECON. The extension of Western guaranteed export credits has no doubt been instrumental in this development. For instance, credits outstanding from NATO countries to East European countries amounted to $3.8 billion (of which $41.5 million were government-to-government credits), at the end of 1973; 54% of these credits had a duration of over five years. Poland and Rumania, which have a large proportion of their trade with the West, also have the largest volume of credits outstanding, $1.4 and $1.1 billion respectively.

15. East European countries, furthermore, have been drawing on the Eurodollar market for additional resources. For instance, in 1973 Bulgaria took $115 million, Poland $420 million, Hungary $90 million; in the first three-quarters of 1974, the borrowings were $85 million, $272 million and $150 million respectively(1). These East European countries, in contrast to the Soviet Union, which borrowed only $50 million in 1973 on the Eurodollar market, are prepared to pay the full market price to obtain financial facilities which, at the end of 1974, may have been some 3 to 4 percentage points above the interest rates generally charged on guaranteed export credits.

16. In the past, East European countries have shown caution in taking up Western export credits. More recently, however, some of them have been increasing their borrowings and would now seem to be approaching the limits of their debt servicing capacity. For instance, in 1973 Rumania's reimbursements of its debts to Allied countries equalled about one-half of its earnings from its exports to them; consequently, Rumania had to obtain a rescheduling of some of its debts. This development suggests that some East European countries might now represent a greater risk for the lenders.

(1) IMF Survey, dated 25th November, 1974

17. The lending nations, basing their export credit programmes mainly on commercial considerations, may prove reluctant in the future to encourage a further increase in the indebtedness of some East European countries, lest this jeopardise their debt servicing capacity. Consequently, this would lead to a further reduction of these countries' purchasing power in world markets, already diminished by global inflation and rising commodity prices. In addition, the slowdown in the growth of Western economies would also tend to reduce their hard currency export earnings.

Conclusions

18. In the present circumstances, it may appear opportune to consider reducing, as far as possible, the prevailing discrepancy between the interest rates charged on guaranteed export credits and the higher ones obtaining in the domestic financial markets. Under present balance of payments conditions, Western lenders may themselves be growing more dependent on foreign loans with high interest rates; hence the need for closer alignment between interest rates received and those paid.

19. Current efforts by the EEC, the United States and Japan to agree on uniform limits to conditions for export credits are to be encouraged particularly since each national authority remains free to determine the volume of such credits. Agreement among these countries would enable the Alliance members to reduce, as far as possible, discrepancies in the conditions of guaranteed export credits extended to Communist countries.

20. Certain European Communist countries have been insisting on getting export credits on concessionary terms, the latter being asked in some instances, as a quid pro quo for political concessions on their part. On the other hand, it should be noted that the Soviet Union enjoys much improved terms of trade and an enhanced financial position, which enables it to purchase goods in the Allied countries either for cash, or on credit on the same conditions applicable to non-Communist industrialized countries. Poland may be able to do the same in the longer run, as it disposes of exportable energy resources and some raw materials, in particular copper ore, for which there are attractive outlets in the West.

21. Some of the small East European countries, however, far from benefiting from recent changes in commodity prices, have seen their terms of trade deteriorate and their dependence increase on the Soviet Union as a supplier of essential commodities. Their ability to procure certain types of equipment in the West has been put into jeopardy by escalating prices.

The question therefore arises whether it might not be politically desirable to promote Allied countries trade with these nations by maintaining and, possibly extending, the flow of guaranteed export credits to them, although their credit worthiness might have to be reassessed in the future.

22. When considering this question, it should be remembered that export credits are commercial transactions and that commercial considerations therefore play a key rôle. Agreed criteria when extending guarantees for export credits should be related to objective economic factors in order to avoid distortion of competition, and international harmonization of credit conditions should aim ideally at eliminating divergences in interest rates prevailing among the lenders. However, the margin of action in the credit policy field towards the East European countries hinges primarily on three possibilities: determination of overall volume credits to be extended, maximum extension of duration and minimum interest rates, within the framework of agreed limitations. Furthermore, encouragement could be given to credit institutions such as the IMF and the World Bank.

23. Studies carried out during the last few years have come to the conclusion that the development of East/West trade was a contributory factor to the improvement of relations with the Communist countries and that a sound expansion of this trade would favour Western economies(1). Export credits have been instrumental to a large degree in the expansion of this trade. Although it has not been possible to weigh the respective advantages accruing to the Western lending and Eastern borrowing countries, on balance it has generally been thought that both sides stood to benefit from such credits. This matter, however, deserves particular attention in the present period of generalized inflation, credit shortages and recessionary fears in the West and at a time when the Soviet Union is enjoying an improved financial position, favourable terms of trade and a relatively steady rate of economic growth. Consequently, she could try to extract from Western countries vying for her trade additional credit concessions.

24. The Economic Committee:

(a) considers that in view of the current economic situation and the changes which are occurring in international trade relations, the reporting procedure established within NATO on guaranteed export credits to Communist countries remains a most useful source of information for the Alliance countries. It gives them an opportunity to exchange views on the level of European Communist countries indebtedness and on the terms of guaranteed export credits to that area;

(1) C-M(58)93, C-M(68)21 Part I, C-M(72)68

(b) believes that various questions merit examination, regarding the nature of the consultations among member countries, introduced by the Council decision of August 1959:

(i) If prior consultations are to be maintained, should this procedure be applied not only to government-to-government credits extended to the USSR, but also to those credits extended to the East European countries?

(ii) If, on the contrary, consultation is to be replaced by a procedure of information *a posteriori*, would this still engender useful discussion within the Economic Committee?

(iii) Should the Economic Committee also be informed of arrangements for rescheduling of outstanding debts?

25. The Council is invited to give the Economic Committee such directives as it deems necessary in connection with the questions mentioned above.

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