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Need of Czechoslovakia for Western Economic Support

The new leadership in Czechoslovakia probably will seek large-scale economic support from the West. The USSR may furnish a sizeable hard-currency loan, which would provide adequate operating reserves. Czechoslovakia probably must turn to the West, however, for long-term help in overhauling the economy. The government will proceed cautiously. The new leadership is anxious to avoid difficulties with the USSR over foreign policy. It also distrusts Western political intentions. In all probability, Czechoslovakia will first look for offers from Western business firms and international organizations. To support this effort, the government doubtless will seek improved relations with Western countries, including West Germany and the US. At present, however, it would be politically risky for Czechoslovakia to seek large-scale aid from the West German government. And Czechoslovakia cannot expect help from the US so long as the war in Vietnam is going on.

Possible Soviet Economic Pressure

Soviet deliveries of materials to Czechoslovakia apparently have continued on schedule during the recent political turmoil. Unlike Rumania, Czechoslovakia is utterly dependent on these deliveries, as pointed out by a Czech radio commentator last week:

Let us not forget that among other differences between Czechoslovakia and Rumania, our cars run on Soviet gas; two out of three rolls are baked from Soviet flour, and our gigantic metallurgical combines would come to a standstill within a few days after Soviet ore supplies stopped. Nothing of the sort is happening here, as is common knowledge: cars are running, rolls are baked, and so forth.

The commentator went on to quote the minister of Foreign Trade, Frantisek Hamousz, who said that Soviet crude oil (practically the entire supply of Czechoslovakia) had been coming in on time, that hard winter weather and a shortage of trucks had somewhat delayed iron ore shipments (two-thirds of Czech consumption), and that the USSR had offered an additional 5,000 tons of cotton to make up for shortfalls in Egyptian deliveries.

In all likelihood, the USSR will fulfill this year's commitments to Czechoslovakia and will agree to further increases in deliveries next year. It is clear that it would not be in Soviet interest to exert economic pressure that would weaken the new government and lead

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to popular uprising. It must be noted that the USSR has no acceptable candidate to sponsor in place of Dubcek.

The Need for Short-Term Credit

Even if Soviet deliveries continue as expected, Czechoslovakia may still want immediate help with the balance of payments. The USSR, which has provided such help in the past, may well come through once again -- if it has not already done so.

Czechoslovakia's net reserves of gold and hard currency are very small relative to the size of its hard currency trade, which ran at some \$800 million in 1967. Estimates of the balance of payments back to 1948 indicate that Czechoslovakia has not added significantly to its reserves over the period. This conclusion is borne out by evidence that the USSR has on several occasions extended short-term credit to Czechoslovakia to relieve balance of payments pressure.

The hard currency position of Czechoslovakia improved in 1967, slightly easing the Czech short-term payments position. Nevertheless, the new leadership probably will ask the USSR for a substantial line of new credit, so that Czechoslovakia can stop trading on a hand-to-mouth basis. There has been a rumor that Czechoslovakia asked for and was promised a large hard currency loan from the USSR and East Germany at the Dresden Conference. Short-term difficulties have weakened the bargaining position of Czech foreign trade representatives, contributing to the unfavorable price and credit terms that Czechoslovakia has had to accept.

Western European banks may perhaps be willing to help. A group of eight West German banks recently provided a line of short-term credit to the state bank of Hungary, to help underwrite the liberalization of foreign trade that Hungary is undertaking under its "new economic mechanism."

Czechoslovakia also could get a substantial line of credit by reactivating its membership in the International Monetary Fund, as the government may intend to do. Czechoslovakia belonged to the IMF until the end of 1954, when it was suspended for failing to supply the required fiscal information to the IMF. But the economic steps required to meet minimum IMF requirements will take time, to which must be added the time for passing on Czech qualifications. Thus rejoining the IMF is not an answer to the immediate foreign exchange problems facing Czechoslovakia.

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The Need for Long-Term Loans and Foreign Investment

In twenty years of Communist rule the economic growth rate of Czechoslovakia has fallen far behind that of the Western European economies. In 1948, Czechoslovakia was better off than West Germany and Austria; now it is backward in comparison with either country. The Czech economy has grown under Communist management, but less rapidly than the West German or Austrian and at higher cost. Moreover, the output of goods and services is inferior by Western standards. It does not meet the demands of domestic consumers and foreign buyers.

These deficiencies are widely recognized in Czechoslovakia. Economists generally agree that the deficiencies can be corrected only by basic changes in institutions, practices, and policies, and with a massive infusion of Western technology and know-how. The economists have so recommended to the new leadership.

What the new leadership will do remains to be seen. Such sweeping changes obviously cannot be made overnight. But Czechoslovakia presumably will investigate the possibilities of getting large-scale Western help. Ota Sik, the leading reformer, recently stated that Czechoslovakia already was looking for a large foreign loan -- he would not say in what quarter or for how large an amount. According to clandestine reports, the government already has turned down one loan -- source and amount unspecified -- because of the political strings attached.

Very likely Czechoslovakia will for some time avoid seeking loans from Western governments. As various Czech officials have indicated, the new leadership recognizes that the USSR is extremely sensitive on the matter of solidarity within the Warsaw Pact. The internal reforms in Czechoslovakia are in themselves unpalatable enough to the Warsaw Pact allies, and it is obviously prudent for the Czech leadership to go slowly in foreign affairs. In particular, the USSR, East Germany, and Poland have been concerned over any approach that would move Czechoslovakia closer to diplomatic relations with West German, although they probably can only delay and cannot prevent such a move.

Czechoslovakia probably will begin by seeking loans from international organizations and by exploring the possibility of accommodating foreign investment and making more use of "joint ventures" with Western businessmen. Among international organizations, the best bet would seem to be the IMF. As a former member, Czechoslovakia could perhaps get special consideration for re-admission. If re-admitted, it would be eligible to acquire drawing rights from the IMF and to apply to the

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World Bank for long-term credit. A recent report suggests that Prague may be planning to approach the World Bank.

Possible US Action

The immediate possibilities for US action are limited, as the government of Czechoslovakia realizes. Not only is Czechoslovakia a Communist country, it is also heavily involved in supplying arms to North Vietnam and is both North Vietnam's and Cuba's third largest trading partner.* The US government, therefore, is prohibited by law from taking most of the steps that could help Czechoslovakia economically -- granting Most Favored Nation (MFN) status, making or guaranteeing loans through the Export-Import Bank, or offering PL-480 assistance. Czechoslovakia undoubtedly would welcome the granting of MFN status by the US as a step in "normalizing" relations, although the Czech economy would gain little in the short run. Only 4 percent of Czechoslovakia's trade with developed Western countries is with the US. The Czechs probably would be even more grateful to receive guaranteed credits and PL-480 aid if US help should become available.

Czechoslovakia has long demanded that the US release \$20.2 million in gold seized from Czechoslovakia by the Germans in World War II. This gold, recovered by the Western allies at the end of World War II, was awarded to Czechoslovakia by the Tripartite Commission for the Restitution of Monetary Gold. France and the UK, the other two members besides the US, have agreed to the release of the Nazi-looted gold to Czechoslovakia. France had no significant claims against Czechoslovakia, and the UK early reached an agreement on its claims. The US, however, has substantial claims outstanding -- chiefly for property of US citizens nationalized by the Communists -- which it has insisted on settling as part of any over-all agreement on claims. The two issues have long been considered by the US to be inseparable.

To complicate the matter, US representatives in 1961 negotiated and initialed ad referendum a draft agreement extremely favorable to Czechoslovakia. After review, this draft was rejected by the State Department. Negotiations were resumed in 1967, and in November the US submitted a new proposal, on far less favorable terms. Although the proposed settlement would release to the Czechs the \$20 million in gold and give them a net \$3 million on other accounts, the remainder of US claims and debt payments to be paid in the following seven years would run just over \$30 million. The Czechs have not responded to the US proposal officially. Individual Czech officials have reacted with indignation.

* The USSR is the largest trading partner, Communist China second.

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The new leadership in Prague probably is quite satisfied for the time being to leave these issues in statu quo. The US welcomes the present liberalization trend in Czechoslovakia but believes that any highly visible approach to the Czechs at this time would embarrass them and perhaps prejudice their case.

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