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Soviet Borrowing from the West

Background

Prior to 1964 the USSR was unable to get anything better than medium-term credits (1-5 years) from the West, but in 1964 the United Kingdom broke with the Berne Union guidelines, which called for a five-year ceiling on export credits to Communist countries, and provided the USSR with a \$280 million line of credit with a repayment period of up to 15 years. Competition soon forced all other West European nations and Japan to also drop the Berne Union accord, and long-term credits (averaging 8 years) soon became the rule (see Table 1).

The Soviets were quick to use their good credit rating and their ability to channel large contracts to desired suppliers to foster credit competition among potential suppliers. As a result the French, Italians, and Japanese have all provided especially preferential credits in support of Soviet purchases. The United Kingdom extended large credit lines to the USSR at normally competitive rates, but the West German government has yet to subsidize export credits in support of Soviet purchases.

The US played a very minor role in financing Soviet trade until 1972, and reported claims of US banks and other businesses

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against the USSR prior to 1972 were \$10 million or less annually, all on a short-term basis. Soviet purchases of US equipment and technology from US-based firms were limited, as a result, to those items not obtainable elsewhere. However, US subsidiaries in Europe and Japan which are able to utilize government subsidized credits did a substantial amount of Soviet business. In some instances, the USSR was able to secure foreign government-backed credits which covered purchases of US-produced goods required for larger projects being undertaken by the USSR and its European partners. In 1967, for example, the Soviets prevailed upon the Italians to provide a \$25-30 million loan to cover Soviet purchases of certain equipment and technology from US-based firms in support of the Soviet-Italian construction of the FIAT plant at Tolyattigrad.

The Emergence of the US

With the beginning of detente, however, the US quickly became a major supplier of credit to the USSR. In 1972-1973, US commercial banks acting without Eximbank participation provided \$108 million in long-term loans (see Table 2) to cover Soviet purchases of tractors and pipelaying equipment. Since the opening of the US Eximbank window in the fall of 1972, Eximbank has approved \$290 million in long-term credits in

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Table 1

Selected Credit Lines Granted to the USSR 1966 - 1972

Financial Terms for Selected Soviet Purchases						
		Contract Value (Million US \$)	Interest (Percent)	Down- Payment (percent)	Length of Credit (years)	Description
Italy	1966	320	5.6	N.A.	11	Government line of credit extended to finance Soviet purchases for Fiat plant at Togliattigrad.
Japan	1970	80	6.0	12	7	Credit extended to cover Soviet imports of Japanese technology and equipment for the development of Vrangal' Port.
France	1970-1975	1240	5.97-6.25	N.A.	7-8½	Government line of credit to cover Soviet purchases of machinery and equipment for period of 1970-1974 Soviet-French trade agreement. Original credit of \$930 million was completely utilized by the end of 1973 and an additional \$310 million was granted to cover Soviet purchases during 1974.
West Germany	1972	40	6.0	N.A.	8	Salzgitter Industriebau (part of the Salzgitter Steel owned by the West German government) contracted to deliver a plant to produce low-density polyethylene. It is not clear who is financing the deal, but it may be Salzgitter itself, in which case the low interest rate is probably offset by a higher sale price.
United Kingdom	1972	500	6.0	N.A.	5½-8½	General credit line extended by British merchant banks to promote UK exports to Kama; under government guarantee.
Italy	1973	550	6.-6.25	N.A.	8-10	Government line of credit to cover various Soviet machinery and equipment purchases. Credit will be extended in three annual tranches during 1973-1975.

Self-Liquidating Credit Arrangements with the USSR

Venture	Country	Year	Contract Value (Million US \$)	Interest (percent)	Repayment Schedule (Years)	Description
Siberian timber development	Japan	1968	133	5.8	5	Financed through suppliers' credit guaranteed by government and supplied by a combination of funds from the Japanese Export-Import Bank and private banks. Repayment to be from a separate contract for Soviet deliveries of wood products, 1969-73.
Pipe (natural gas)	Italy	1969	196	Somewhat more than 5.6	Possibly 8-10	Financed by the Italian government through Istituto Mobiliare Italiano (IMI). Repayment tied to separate contract for Soviet delivery of natural gas, 1973-92
Pipe (natural gas)	West Germany	1970	328	6.25	10	Financed by a consortium of 13 West German private banks with 50% of financing guaranteed by West German government. Repayment tied to separate contract for Soviet delivery of natural gas, 1973-92

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support of \$743 million in Soviet imports. In addition, Eximbank has given preliminary commitments of \$198 million in support of an additional \$440 million in potential US exports. Soviet requests for further Eximbank credits, e.g., \$49 million for exploration of natural gas reserves at Yakutsk, are currently under consideration. The USSR also drew down \$500 million in three-year CCC credits during 1972 and 1973 to cover a portion of the \$1.8 billion in Soviet grain purchases from the US during this period.

Table 2

Financial Terms for Selected US Credits to the USSR 1972 - 1974

<u>Product</u>	<u>Contract Value (Million US \$)</u>	<u>Interest</u>	<u>Length of Credit (years)</u>	<u>Deferment</u>	<u>Description</u>
Tractors, Pipelayers	\$68	6.0%	7.5	None	Bank of America led a consortium of 13 banks to finance 1972 sale. Loan was made prior to opening of Eximbank window to the USSR and involves an interest subsidy device whereby Caterpillar will reimburse the banks in the event that prevailing market rates for interest exceed 6%.
Machinery and Equipment for Kama Truck Plant	\$342	See description	12	Payments begin in October 1977	The USSR was initially granted a \$192 million credit line in March 1973. Eximbank financed 45% of this amount at 6%, with the commercial portion provided by Chase Manhattan Bank. The line of credit was subsequently extended in March 1974 to \$342 million, with Eximbank's portion in this case financed at 7%. The commercial portion of the additional \$150 million was financed by a Chase Manhattan-led consortium.
Pipelayers	\$40	5/8% above prime	8.5	None	Finance provided by a consortium headed by Wells Fargo Bank. The interest rate throughout the life of the loan is to have a maximum average value of 7.5%. No Eximbank participation involved.
Submersible electric pumping units	\$26	6% Eximbank 7% Commercial	7	None	
Knitting machines	\$5.6	Eximbank portion at 6%	7	Payments begin in February 1975	
All other Eximbank supported loans	\$268.	6% Eximbank			Includes direct authorizations only; pending applications and preliminary commitments cover an additional \$170 million in potential US exports.

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Debt Composition

The Soviet debt structure has continued to lengthen during recent years. During the late 1960's the length of credits extended to the USSR averaged 8 years, but longer credits are now being offered with increasing frequency. The increased credit lengths are due, in part, to the type of goods the USSR is seeking to import as well as to the increased competition among Western nations to provide credits to the USSR. The USSR has requested credits of over ten years with payments deferred for several years to support imports of plant and equipment for the large scale development projects -- Tyumen oil, Chulman coal, Yakutsk natural gas -- currently being discussed with Western firms. The US has proven to be particularly accommodating to Soviet requests, as evidenced by \$154 million in Eximbank-direct credits granted to support Soviet purchases for the Kama river truck plant. In this case the USSR secured a 12 year credit, with payments of principal deferred until 1977. Recent British and French credit lines, in contrast, have a maximum repayment period of roughly 10 years.

Other Sources of Funds

The USSR has also made increasing use of the Eurodollar market in financing its trade with the West. Operating through

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its European banks, the USSR has been able to attract Euro-currency deposits at prime rates. The USSR made particularly good use of this source in 1972 -- tapping the Eurodollar market for several hundred million dollars in both medium-term and short-term credit to finance imports of machinery and grain. The burden of these loans was considerably lightened by subsequent dollar devaluations and the ability of the USSR to sell large amounts of high-priced gold in 1973.

Soviet Debt and Debt Service

The increased use of medium-term and long-term Western credits has led to a rapid increase in the USSR's debt to the West, which reached an estimated \$3.6 billion by the end of 1973 (see Table 3). The actual burden of the debt is a function of debt service, the percentage of total hard currency exports committed to the annual repayment of interest and principal on outstanding credits. The Soviet position in this respect has also worsened, however, rising from 11% in 1967 to roughly 25% in 1973. The debt service ratio would have been even larger had the USSR not been able to obtain Western credits at such favorable terms.

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Table 3

Estimated Soviet Drawings and Scheduled Repayments
on Western Government-Guaranteed Medium-Term and Long-Term Credits

Year	Drawings	Scheduled Repayments Principal and Interest	Net Credits	Million US \$
				Outstanding Debt at the End of the Year
1966	275	170	105	505
1967	305	181	124	658
1968	510	255	255	951
1969	630	322	309	1,316
1970	700	379	321	1,717
1971	700	463	237	2,057
1972 ^{a/}	1,030	562	468	2,649
1973 ^{a/} b/	1,690	895	795	3,612

a. Includes drawings on 3-year CCC credits.
b. Preliminary.

Prospects

Soviet orders for Western plant and equipment have risen sharply in recent years, reaching more than \$2½ billion in 1973, up from about \$800 million two years earlier. Long-term Soviet debt should rise substantially as these orders are filled and as other purchases are made. If the Soviets are successful in concluding some of the developmental projects currently under discussion, long-term debt could approach \$10 billion by the end of the decade.

The ability of the USSR to manage this larger debt, however, will be significantly enhanced by the record increases in Soviet export earnings which are expected during the next

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two or three years. Major price increases for traditional Soviet raw material exports -- oil, coal, timber, diamonds, chemicals -- along with expanded deliveries of natural gas could push total Soviet exports to the developed West to perhaps \$6 billion in 1974 and \$7 billion in 1975, giving the USSR substantial export surpluses. In contrast, Soviet hard currency export earnings were about \$2.7 billion in 1972. As a result, by 1975 debt service -- depending on prices -- would be no greater than in 1973, and perhaps even less. In the longer term the outlook is less favorable, largely because of an expected leveling off and eventual decline in the volume of crude oil exported to the West during 1977-1980.

A rapid increase in export earnings may affect Soviet debt management practices. As a demonstration of the anticipated strong Soviet financial condition, the USSR recently concluded a major deal with West German firms calling for a cash payment of roughly \$800 million in plant and equipment for a pelletization plant and steel mill at Kursk. The Soviet decision to pay cash was partly motivated by the refusal of the West Germans to provide low interest credits, but it is unlikely that the USSR would have had such an alternative even a year ago. The improved Soviet financial position will

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clearly enhance the USSR's bargaining position vis-a-vis Western suppliers, and thereby increase its ability to play off potential suppliers against one another.