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DIRECTORATE OF
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Intelligence Memorandum

Financing Soviet Imports from the Developed West

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INTELLIGENCE MEMORANDUM

FINANCING SOVIET IMPORTS FROM THE DEVELOPED WEST

INTRODUCTION

1. The Soviet decision to import record quantities of grain in 1972-73 has again focused attention on the USSR's ability to finance these purchases and to continue to increase its imports of advanced Western machinery and equipment, as well as to service its steadily growing debt to the West. This memorandum examines the means available to the USSR to finance its hard currency deficit in trade with the West and includes a discussion on the role of gold and a review of the availability and terms of Western credits.

CONCLUSIONS

2. Massive imports of Western grain and other goods during 1973 are likely to result in a record Soviet hard currency deficit estimated at roughly US $1.8 billion, which will be financed by a combination of Soviet gold sales and Western credits. The USSR will be importing about $1.6 billion in grain – about $1 billion more than in 1972 – and most of the 1973 deliveries will take place in the first half of the year. In addition, large quantities of sugar and a record volume of Western plant and equipment will be imported in 1973. To cover the deficit, the USSR will use at least $400 million in Commodity Credit Corporation (CCC) credits to finance its grain imports and roughly $500 million in Western government-guaranteed credits to help finance imports of machinery and equipment, and it may sell about $400 million in gold. Moscow should

Note: This memorandum was prepared by the Office of Economic Research.

have no difficulty financing the remaining deficit – about $500 million – by other means, chiefly short-and medium-term non-guaranteed credits. Also available to the USSR are some unused credits of the International Bank for Economic Cooperation (IBEC) of the Council for Mutual Economic Assistance (CEMA), which during 1972 borrowed or received commitments for medium-term Eurodollar funds of at least $200 million.

3. The United States has emerged as an important creditor of the USSR, extending loans of more than $800 million in 1972, compared with the less than $10 million in earlier years. The $500 million CCC line of credit will finance some 30% of 1972-73 Soviet grain imports from the West. Moreover, many US banks and finance houses are exploring ways in which they can increase their role and perhaps take the lead in financing Soviet imports from the West, especially in the expected dramatic increase in Soviet imports from the United States itself.

DISCUSSION

4. The USSR attaches special significance to trade with the industrial Western countries because of its needs for Western equipment and technology and other goods that are in short supply. Among the latter, grain has become particularly important. The USSR is again importing large quantities of Western grain to offset harvest shortfalls, as it did in 1963-65.

5. The USSR's failure to generate sufficient hard currency earnings from exports has led to persistent deficits in the Soviet hard currency balance of trade (see Table 1). The deficit apparently rose in 1972 and will increase sharply in 1973 because of the large quantities of Western grain contracted for in 1972. Imports of 28 million tons of grain, worth $1.8 billion, have been contracted for and were scheduled for delivery in 1972-73, with the bulk of the deliveries occurring in 1973. The USSR may contract for additional grain in 1973 and also is expected to import about $150 million in sugar. Soviet imports of machinery and equipment are also expected to rise above the 1972 level. The USSR will thus be faced with a hard currency deficit in 1973 much greater than in any previous year – perhaps $1.8 billion.

6. Until 1966 the USSR relied primarily on gold sales to finance its hard currency deficits. During 1960-65, for example, the USSR sold more than $2 billion worth of gold to finance its trade deficit with the West. Dwindling Soviet gold reserves and the greater availability of Western credit resulted in increased Soviet use of Western government-guaranteed medium-and long-term credits, which replaced gold sales as the chief element

Table 1

Soviet Hard Currency Trade Balance

Million US $

	Exports	*Imports*	*Balance*
1960	739	1,018	-279
1961	866	1,059	-193
1962	912	1,179	-267
1963	969	1,279	-310
1964	1,011	1,544	-533
1965	1,331	1,546	-215
1966	1,479	1,746	-267
1967	1,688	1,604	+84
1968	1,896	2,004	-108
1969	2,109	2,422	-313
1970	2,182	2,698	-516
1971	2,646	2,955	-309
1972[a]	2,900	3,500	-600
1973[b]	3,200	5,000	-1,800

a. Preliminary estimate.
b. Projected.

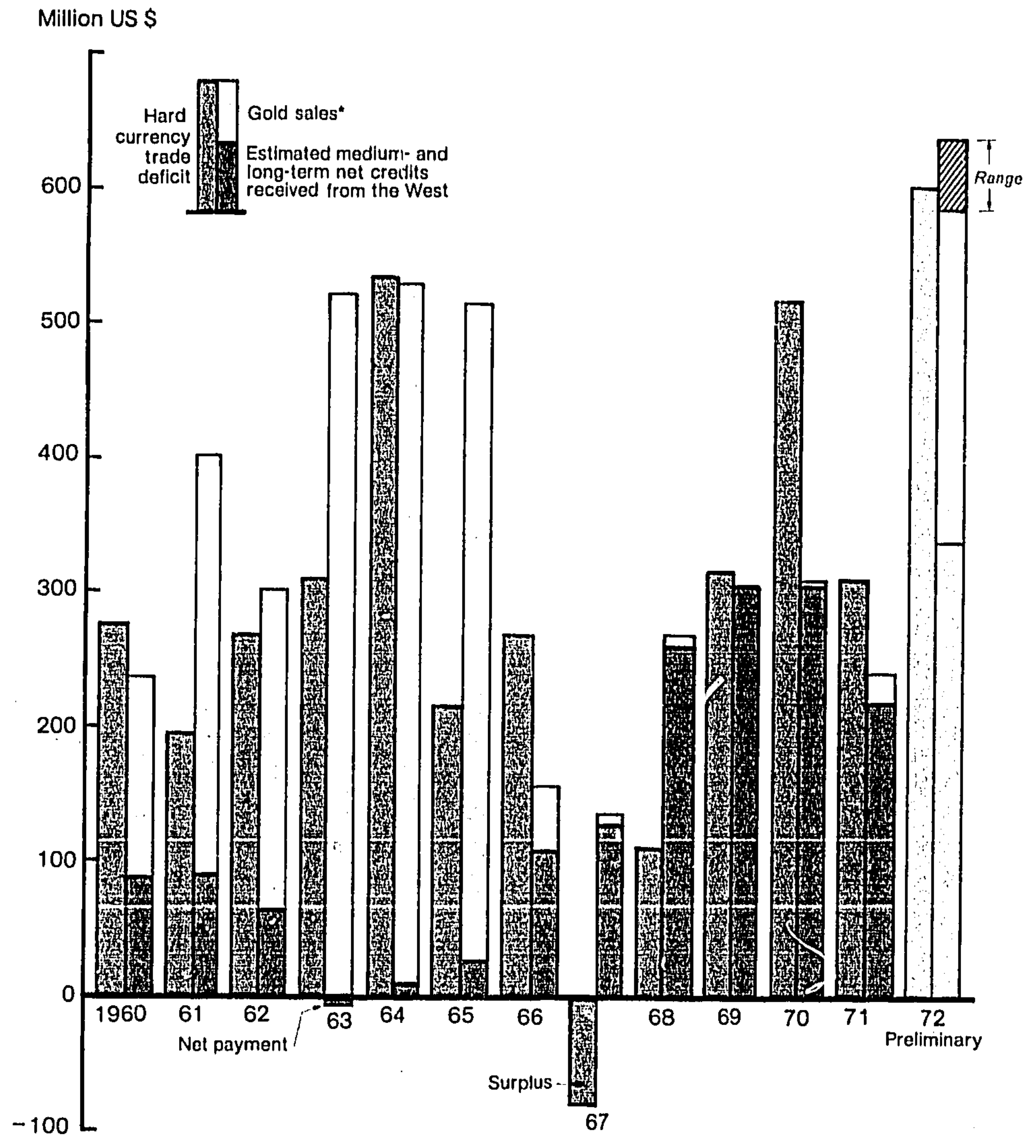
in financing the Soviet deficit with the West (see the chart). During 1966-71 the USSR drew down about $3.1 billion in such credits, most with an average maturity of about eight years. As a result, Soviet medium-and long-term indebtedness increased from less than $400 million at the end of 1965 to more than $2 billion by the end of 1971. Most of the drawings have been in support of imports of plant and equipment. The USSR also has increasingly used short-term credit facilities available in Western money markets.

7. Beginning in 1972 the USSR resumed large-scale gold sales – estimated at $250 million to $300 million – to help finance a deficit that is estimated to have reached at least $600 million. Government-guaranteed credits also were an important means of financing the deficit – as they were in earlier years – and amounted to more than $300 million (net). In addition, the USSR was active in Eurocurrency markets, especially seeking medium-term non-guaranteed credits.

Gold Sales

8. Last year's large Soviet gold sales are reminiscent of those in 1963-65, when the USSR also had to import massive quantities of grain

Financing the Soviet Deficit in Trade



*Sales for 1960-68 are based on a value of $35 per troy ounce; for 1969-72, sales are based on the prevailing market rates.

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from the West. During those three years, Soviet gold sales averaged $511 million per year and Soviet gold reserves fell sharply (see Table 2).

Table 2

Impact of Deficit Financing on Soviet Gold Reserves

	Hard Currency Trade Deficit (Million US $)	Gold Sales		Gold Reserves (Metric Tons)
		Million US $	Metric Tons[a]	
1960	279	149	132	2,200
1961	193	310	275	2,020
1962	267	239	212	1,905
1963	310	523	465	1,550
1964	533	520	462	1,205
1965	215	490	435	895
1966	267	45	40	990
1967	....[b]	10	9	1,125
1968	108	10	9	1,265
1969	313	....	....	1,420
1970	516	4	3	1,585
1971	309	22	19	1,750
1972[c]	600	250-300	150	1,830

a. Calculated at the rate of $35 per troy ounce for sales in 1960-68 and at prevailing market rates during 1969-72.
b. The USSR had a trade surplus of $84 million in 1967.
c. Preliminary estimate.

Then during 1966-71, Soviet gold sales averaged $15 million per year. By relying mainly on credit to finance its deficits with the West, the USSR was able to double the size of its gold reserves from its 1966 level to about 1,750 tons at the end of 1971, and now produces gold (net of domestic consumption) at the rate of about 200 tons per year. In 1972, however, the USSR may have sold as much as 150 tons of gold, and possibly more. The USSR first entered the market in March 1972 in a manner calculated to avoid depressing the price; sales averaged only about 1 ton per day through May. Sales resumed in July at roughly the same rate so that by the end of September about 140 tons were sold. Reduced supplies of South African gold and careful selling practices enabled the USSR to dispose of its gold at high free market prices, averaging about $52-$62 per troy ounce, which yielded about $250 million to $300 million in revenue.

Western Credit Facilities

> It can be said with some certainty that East-West trade has not been hindered for the want of adequate finance. It therefore stands to the credit of those people, on both sides, who so ably organized the appropriate machinery to provide the necessary finance. As you know, a great part of the business is financed in convertible currency; and here, I would like to pay a special tribute to Western money markets, which have shown considerable flexibility in adapting to the situation.
>
> *Vladimir A. Drovossenkov*
> Director, Moscow Narodny Bank
> From an address given to the
> American Management Association
> in New York on 11 March 1969

Government-Guaranteed Credits

9. Since the mid-1960s, Western medium- and long-term government-guaranteed credits have been the chief element in financing the Soviet deficit with the West, and they are likely to remain so in spite of the recent large-scale gold sales by the USSR. There is no indication that the recent grain crisis has had any impact on Soviet policy toward long-term borrowing. In the early 1960s, Western credit facilities were limited to the short term and medium term and served generally to augment earnings from gold sales. Now, however, earnings from gold sales are used to augment Western credit facilities. Most of the present financing comes from the large commercial banks in Western Europe, which in turn generally obtain political and economic risk insurance from their respective governmental export credit and insurance institutions.[1] For example, banks in France, Italy, West Germany, and the United Kingdom together are estimated to finance about three-fourths of the USSR's total hard currency indebtedness. In recent years, Japan also has emerged as an important supplier of credit and, together with the United States, is likely to become an increasingly important source of credit to the USSR. The United States played a very

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minor role in financing Soviet imports until 1972, when Export-Import Bank and CCC facilities were made available to the USSR.

10. Until 1964 the USSR was unable to get anything better than medium-term credits (i.e., up to five years) from the West. The breakthrough came in 1964 when the United Kingdom breached the Berne Union guidelines calling 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. (In practice, however, most long-term credits extended to the USSR mature within eight years.) France and Italy quickly met the British challenge and provided credit facilities with similar provisions. Not only did competition for Soviet business lead to the general abandonment of the old Berne Union guidelines, but it also brought on a series of agreements providing interest rates below the market rate, usually subsidized by the Western governments. Table 3 shows the extent to which interest rates are subsidized in France, Italy, and the United Kingdom.[2]

Table 3

Selected International Interest Rates

Percent

	Commercial Rate as of 15 Nov 72	*Rate Applicable to the USSR*
France	7.10 - 7.70	6.25[a]
Italy	7.00 - 7.75	6.00 - 6.50[b]
Japan	4.50 - 7.00	5.50 - 6.00[c]
United Kingdom	8.00 - 11.00	6.00[d]
United States	5.75 - 6.75	6.00[e]
West Germany	8.75 - 9.25	6.00[f]

a. For projects more than $63 million, an interest rate of 6.05% is applicable to the USSR. On 15 September 1972, France reduced its general rates for sellers' credits with seven or more years duration from 6.67% to 6.35%, and for buyers' credits with seven years or more duration from 6.83% to 6.5%. The buyers' credit rates made available to the USSR in 1970 and reaffirmed in June 1972 – 6.05%-6.25% – are still more favorable.

b. Applicable rate for the $129 million line of credit for purchases for the Kama truck plant.

c. Applicable rates for $29 million in credits extended to cover presslines for Kama.

d. Export Credit Guarantee Department rate for government-guaranteed credits.

e. Export-Import Bank rate.

f. Involving an "interest subsidy device," the subsidy paid by the manufacturer rather than by the government. See paragraph 24.

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11. Western nations have varied their methods of subsidizing credits to the USSR as well as to other Communist countries. The governments of Italy and France accomplish this by direct subsidization of the interest rate and by rediscounting at low rates the commercial loans advanced by the private sector. The United Kingdom indirectly subsidizes interest rates by allowing private banks to include some of their guaranteed export paper as a certain percentage of their statutory reserves. Since these funds ordinarily are sterile – i.e., cannot earn any interest – the private banks are able to offer lower than market rates for a certain percentage of their government-guaranteed loans. The West German government plays no role in financing credits, but it can affect the ability of the commercial banks to rediscount their loans on the commercial market because rediscounting at favorable rates requires a government guarantee on the credit. Nevertheless, many German banks and businesses have extended and continue to extend short-term and sometimes medium-term unguaranteed credits to the USSR. Japan dces not subsidize export credits through rediscounting of commercial bank financing but, like the United States, uses low-interest Export-Import Bank financing for a portion of export credits.

12. The USSR has made extensive use since 1965 of Western government-guaranteed credits to finance its imports of capital equipment from the West. For example, during 1960-65, drawings on Western credits averaged roughly 13% of the USSR's imports from hard currency countries. During 1966-72, however, the average increased to about 24%. The level of indebtedness also has risen substantially, reaching more than $2.4 billion at the end of 1972 (see Table 4).

13. Except for the recent three-year CCC credits in support of US grain sales to the USSR, Soviet drawings on Western government-guaranteed medium- and long-term credits generally are linked to deliveries of capital goods. The continuing increase in Soviet orders for Western machinery and equipment is a clear indication that Western credit facilities will be used. Soviet orders for Western plant and equipment placed in 1972, for example, totaled about $1.7 billion, compared with $841 million in 1971 and $514 million in 1970.

Self-Liquidating Credits

14. The debt service has grown (see Table 5) as a result of the increased use of Western credits. Because the USSR has found it difficult to expand exports to pay for increasing imports from the West, it has pressed for and concluded several contracts calling for repayment of Western credits (usually government-guaranteed) with the products of the installation built with these credits. Such contracts now number a half-dozen, with several

Table 4

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

Million US $

	Estimated Drawings	*Scheduled Repayments*	*Interest*	*Net Credits*	*Outstanding Debt at the End of the Year*
1959	60	12	0	48	48
1960	125	37	2	86	136
1961	165	70	6	89	231
1962	180	106	10	64	305
1963	140	130	14	-4	315
1964	170	147	15	8	338
1965	190	149	17	24	379
1966	275	149	20	106	505
1967	305	152	29	124	658
1968	510	215	38	257	953
1969	630	270	57	303	1,313
1970	700	319	79	302	1,694
1971	700	387	96	217	2,007
1972[a]	900	457	106	337	2,450

a. Preliminary estimate.

Table 5

Debt Burden of the USSR

	Hard Currency Exports (Million US $)	*Debt Service[a] (Million US $)*	*Debt Service as a Percent of Hard Currency Exports*
1960	739	39	5
1961	866	76	9
1962	912	116	13
1963	969	144	15
1964	1,011	162	16
1965	1,331	166	12
1966	1,479	169	11
1967	1,688	181	11
1968	1,896	253	13
1969	2,109	327	16
1970	2,182	398	18
1971	2,646	483	18
1972[b]	2,900	563	19

a. Payments of principal and interest.

b. Preliminary estimate.

more under discussion.[3] The gas-for-pipe deals with West Germany, Austria, and Italy are examples of this type of financing.

15. The proposed US-Soviet liquefied natural gas project and the Japanese-Soviet projects for developing natural gas and oil resources in Siberia and the Soviet Far East exemplify the potential size and scope of such projects, the financing of which will run into the billions of dollars. West Germany, for example, just concluded in principle another self-liquidating credit arrangement with the USSR that may allow for the exchange of as much as $625 million worth of machinery and equipment for an iron and steel complex in exchange for eventual Soviet deliveries of iron pellets. A consortium of West German banks reportedly will provide the long-term financing required for this project. From the Soviet point of view, the chief attractiveness of this type of arrangement is that repayment is assured by deliveries. Moreover, significant foreign exchange earnings will accrue from exports of the commodity continuing beyond the amortization period. Also, self-liquidating credits find favor with the Soviet planners because they eliminate so much of the uncertainty associated with attracting finance and searching for and developing export markets. There also is the possibility that the USSR may eventually receive self-liquidating credits with longer term financing (e.g., up to 20 years) that it has pressed for in connection with its projects for natural resource development. Such longer-term financing would allow the USSR to enlarge significantly its credit purchases from the West – and hence its debt – without aggravating its short-run payments position. In 1969, Soviet drawings on self-liquidating credits accounted for 13% of total Soviet drawings on Western credits, and in 1970-71 they accounted for about one-third.

Short-Term and Medium-Term Credits

16. Aside from government-guaranteed loans, the USSR has been making greater use of short- and medium-term non-guaranteed credits to meet its financing requirements. The USSR is estimated to have rolled over $300 million to $500 million in such credits in the past year and is likely to tap the short-term and particularly the medium-term non-guaranteed market for about $500 million in 1973 to help finance its projected record deficit. The availability of the CCC line of credit makes it unnecessary for the USSR to seek such credits beyond this amount. The Soviet banks in Western Europe, especially the Moscow Narodny Bank (MNB) in London, have been particularly active in attracting such funds for the USSR. Over the last few years, for example, the Soviet-owned banks have been instrumental in arranging medium-term and even long-term Eurodollar and Eurocurrency credits for the USSR through their correspondent banks,

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which include just about every major bank in Europe, the United States, and Japan. Some of them, who are recognized leaders in financing East-West trade, include the Dresdener Bank and the Deutsche Bank in West Germany; Credit Lyonnais and Societe Generale in France; Banca Commerciale Italiana in Italy; and Union Bank of Switzerland and Swiss Credit Bank in Switzerland. In the United States, ranking correspondent banks, which are becoming increasingly active in financing East-West trade, include the Bank of America and Chase Manhattan (both of which have set up branches in Vienna to promote their own efforts in East-West trade) and the First National City Bank of New York. Among their correspondent banks in Japan are Mitsui Bank, Mitsubishi Bank, and Nippon Kangyo Bank. The Soviet-owned banks also finance directly some Soviet imports from the West, although the USSR is usually a net creditor to its banks in the West. (For a discussion of the Soviet-owned banks in the West, see paragraphs 18-19.)

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17. The USSR also is able to attract short- and medium-term funds through its own correspondent relations with Western banks. In 1972, for example, the Foreign Trade Bank of the USSR (Vneshtorgbank) was able to attract unusually long time deposits from a number of Western banks. [redacted]

The Soviet-Owned Banks in the West

18. The USSR owns banks in four major European financial centers: MNB in London; Banque Commerciale pour l'Europe du Nord (BCEN) in Paris; Wozchod Handelsbank in Zurich; and Ost-West Handelsbank in Frankfurt. The combined assets of these banks exceed $2 billion, about 95% of which is concentrated in the Paris and London banks. The London bank also has branches in Beirut and Singapore. These banks are an important factor in financing Soviet as well as East European trade with the West. They are a major source of funds for the USSR, although the

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[redacted]

USSR often is a net creditor to the banks. They have established excellent reputations in Western currency markets, which enable them to attract Eurocurrency deposits at prime rates and tap other outside sources of funds.

19. The financing of Soviet imports by these banks is similar to that offered by any large Western bank handling international payments. Quite often they participate with other Western banks in financing Soviet imports or, among themselves, will jointly finance Soviet imports. [redacted] 25X1

[redacted] 25X1

20. Because of their limited resources, the Soviet-owned banks generally restrict themselves to short-term financing. MNB, for example, handles a large volume of documentary credits for the USSR, perhaps on the order of $100 million a year. [redacted] 25X1

[redacted] 25X1

The Emerging Role of the United States

21. Until 1972 the United States played a very minor role in financing Soviet trade. Prior to 1972, US financing of Soviet imports – reflected in reported claims of US banks and other businesses against the USSR – was $10 million or less, all on a short-term basis. In sharp contrast, during 1972, more than $800 million in US short-, medium-, and long-term credit facilities were made available to the USSR.

22. CCC credits, committed in mid-1972 in support of US grain sales to the USSR, account for more than half of the US credit facilities made available to the USSR in 1972. The $500 million CCC line of credit is a medium-term facility which may be drawn upon for a five-year period but which calls for repayment of principle in three equal annual installments plus accrued interest of 6.125% per year. This compares favorably with the 7% interest being charged by MNB and BCEN for their financing of Soviet wheat purchases from Australia.

23. In October 1972 the President authorized the Export- Import Bank of the United States to participate in the financing of Soviet imports of US plant and equipment. Shortly thereafter, it was announced that the Export-Import Bank made a preliminary commitment to provide long-term credits worth some $200 million in support of US exports for the Kama truck plant and a plant to manufacture tableware. In addition to the US Government guarantee that the Export-Import Bank provides – which in itself is valuable because it allows the banks to rediscount their notes at more favorable rates – the Export-Import Bank also participates directly in the financing. For example, the Export-Import Bank will finance up to 45% of value of the US export at a fixed rate of 6%. This is important for US banks because, in spite of the generally higher market rates that they must charge for their end of the financing, the resulting effective composite rate (about 5.75% to 6.25% under current market conditions) makes their credit offers fully competitive with offers by other developed Western nations. Moreover, the Export-Import Bank holds in its own portfolio notes which mature toward the end of the financing period, thus allowing the private banks to be repaid first.

24. Having whetted their appetites for increased sales to the USSR, US businesses and banks have gone ahead and provided long-term export credits to the USSR without Export-Import Bank participation. To ensure a reasonable rate of return, they have resorted to the time-honored West European device of a "variable interest subsidy" paid by the equipment supplier to the bank financing the deal. [redacted] 25X1

[redacted] 25X1

Problems and Prospects

26. The USSR faces a record hard currency deficit in 1973 as a result of the grain purchases and an expected increase in imports of Western machinery and equipment. To finance this expected deficit, the USSR will use a combination of gold sales and Western credit facilities. Even though South African gold sales will increase, the USSR should be able to sell up to an estimated 200 tons of gold in 1973 at prices near $60 an ounce. Such sales would earn the USSR roughly $400 million. Because South African gold sales are not expected to increase substantially until the second half of 1973, the USSR should be in a better position to market its gold – perhaps at higher prices – during the first half of the year, when payment for most of the grain shipments will fall due. But, if grain deliveries are delayed because of US and Soviet transportation bottlenecks, the Soviet payments may be stretched out over a longer period of time. The USSR also has available some $400 million in CCC credits that it can use in 1973 (about $100 million of the $500 million provided had already been used in 1972). The USSR probably will seek to finance some of its grain purchases by refinancing short-term letters of credit through bank loans (i.e., roll over the short-term credits), by borrowing for the medium or long term in the Eurocurrency market, and possibly by drawing on IBEC's facilities.

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29. Despite the current need for short-term and medium-term finance, the USSR is exploring other avenues more basic to its long-term financial needs. The USSR reportedly is interested in the possibility of floating bond issues. At present, however, US investors are precluded from investing in Soviet bond issues by provisions of the Johnson Act. Some West European investors also appear to be wary of getting involved, for fear of setting an unfavorable precedent because of the unsettled Tsarist-government debts.

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