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As Oil Prices Fall, Moscow's Woes Rise

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As the price of oil declines there are both happy and worried people around the world. Among the latter should be the oligarchs in Moscow. The Soviets' future looks bleak, one with no good options.

The Soviet Union prospered from the great world commodities inflation of the 1970s. The value of its exports of oil, natural gas, gold and diamonds surged. However Soviet leaders long have wanted to escape from being a commodity exporter like Chile or Brazil, and instead to use their raw materials to produce finished goods, such as machinery, for export. But Russia now imports both grain and machinery; the prices of the commodities it sells have lately gone into reverse, and the most important, oil, threatens to plunge. The best information—futures prices—says that the oil price later this year will be about $25 a barrel. However, the best information isn't very good. The Organization of Petroleum Exporting Countries might be able to stabilize the price. But suppose it drops to $20 a barrel, maybe even to $15 in the next several years?

Eighty percent of the value of the U.S.S.R.'s exports to the West and about 40% of its exports to Eastern Europe are in the form of energy. About 3.5 million barrels a day of oil are exported, more than half to the West for hard currency. About two trillion cubic feet of gas goes to Western and Eastern Europe. These exports generated almost $25 billion of last year's total hard-currency earnings of about $30 billion. Some of the remaining hard-currency earnings are energy related: the sale of weapons to oil-rich Arab states.

Every $1-a-barrel decline in the oil price probably would pull down hard-currency earnings by close to $1 billion. (The West Europeans are negotiating lower prices for Soviet gas in parallel with lower oil prices; Moscow goes along because it wants to sell them more gas.) With oil at $15 a barrel, Moscow would see its hard-currency earnings drop to about $20 billion from $30 billion.

A Shift to the West

It is harder to predict what would happen in its trade with Eastern Europe, which takes place largely under bilateral agreements denominated in an accounting currency ("transferable rubles"). During the past decade the East Europeans were subsidized by Moscow under these agreements. But lately the Soviets have been cutting back on the subsidy, reducing oil shipments and raising the price while selling them more gas.

If the world oil price drops sharply, will the Soviets give them the full benefit of lower prices? If not, and the price gap between Soviet and Western oil widens enough, the East Europeans might try to shift to Western sources for oil. The sad shape of their economies gives them a powerful incentive to do this, but they don't have much to sell that the West wants, and Moscow would set sharp limits to such a Westward reorientation of Eastern Europe's trade. But for Moscow to switch from a policy of subsidizing the East Europeans to, in effect, taxing them would further heighten tensions within the Bloc. The result is likely to be continued, but reduced, subsidies by Moscow.

On the import side, Moscow gives highest priority to food imports that recently have averaged about $10 billion to $12 billion a year in hard-currency payments. No significant agricultural reforms are in the offing; something like this level of imports still will be needed in the years ahead.

Most of the remaining earnings go to the importing of critically needed machinery both from Eastern Europe and the West. Recent Soviet statistics show that about 35% of Soviet machinery investment—about half originating in the West and half in Eastern Europe—comes from abroad, a big increase from a decade ago. Much of this imported machinery is concentrated in such sectors as fertilizers and papermaking, and there are many imported components—for instance, electronic controls—used in much Soviet machinery. Moreover, much East European machinery sent to the Soviet Union incorporates Western technology.

A cut in machinery imports from the West by, say, one-half plus perhaps substantial reductions from Eastern Europe, would be a serious setback for the Soviet economy. According to the Central Intelligence Agency, the pace of Soviet economic growth has slowed in the past decade. Over this period, gross national product growth has averaged a little more than 2% annually, about 1% per capita. The loss of a sizable part of its machinery imports, if it persisted for some years, would depress economic growth further.

What could Moscow do? Here are some possibilities:

- *Tighten belts and increase energy exports.* As oil prices began to fall after the early 1980s, Moscow responded by increasing oil exports. Its oil production was still rising then; now it is falling. (Tass reports that 1984 production fell slightly from 1983; this is the first decline since World War II.) It might push harder to substitute still plentiful gas for scarcer oil domestically, supply less oil and more gas to Eastern Europe, and supply more oil to the West for hard currency. All of this would be difficult, would take time and is unlikely to recoup much of a large revenue loss.

Other steps might include trimming military expenditures and reducing consumer-goods production in order to make more machinery for the investment sector. The military would strongly resist and the regime must be frightened of the popular reaction to cuts in consumption. Grain imports could be reduced for a year or two, but this would mean slaughtering livestock and less meat consumption in the future.

As for sales of natural gas to Western Europe, the famous "deal of the century" has turned out to be less than a bonanza for Moscow. The contracted quantities have been smaller than expected, and most buyers are taking only the minimum amounts of gas called for in the contracts. More important, an oil price decline will drag down the gas price further.

With oil at $15 a barrel, natural-gas earnings from the deal of the century would be only $1 billion to $2 billion a year during the next decade after interest and amortization payments to Western banks. However, price declines are removing new supplies of Norwegian gas from the scene, most of which are probably too costly to develop at a price below the equivalent of $25 a barrel for oil. The sale of, say, another one trillion cubic feet of gas a year might earn Moscow an added $2 billion to $2.5 billion annually in gross terms (the net would be less if more Western pipe or pumps had to be bought). This wouldn't go far in recouping large foreign-exchange losses, even assuming the West Europeans would risk becoming still more dependent on Soviet gas.

In short, Siberian gas, which may become a large hard-currency earner in the long run, probably won't yield large extra sums in the next decade.

- *Export other products.* Gold and diamond prices have fallen greatly and Soviet sales have been pushing them down. The market for more weapons sales to oil-rich Arab states is declining as their oil revenues shrink. The Soviets have little else that the rest of the world wants.

Trouble Raises Prices

- *Borrow more money.* By ordinary banking standards, the Soviet Union's gross debt of $20 billion to the West and net debt of $10 billion is modest. Its debt-service ratio is about 20% of 1984 export earnings, but this ratio would climb if foreign-exchange earnings fall. Nonetheless, additional borrowing seems feasible. Although this would be only a stopgap, many economic managers are probably focusing on how to get through the next few years. In any case, statements are once again ema-

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