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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Economic Relations Between Yugoslavia and the Warsaw Pact Countries

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
January 1969

INTELLIGENCE MEMORANDUM

Economic Relations Between Yugoslavia and the Warsaw Pact Countries

Summary

The economic relations of Yugoslavia with the USSR and the other Warsaw Pact countries have been little affected by the worsening of political relations after the invasion of Czechoslovakia. Indeed, the trade agreements negotiated for 1969 -- the last was signed by the USSR at the end of December 1968 -- envision a substantial increase in Yugoslavia's trade with the Warsaw Pact countries. Yugoslavia's trade with these countries, although less than one-third of its total trade, offers an important market and source of supply for its newer -- and more inefficient -- industries. But the leadership is now less interested in the growth of these industries and more interested in restructuring and modernizing the economy, an effort that depends heavily on expanding trade with the West. Moreover, the leadership remains uneasy about the intentions of the USSR toward a free-wheeling Yugoslavia. As a result, trade with the Warsaw Pact countries probably will fall below the targets of the trade agreements for 1969, as it has in many past years, and these countries' share in Yugoslavia's trade will increase little, if any.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

Yugoslavia has a substantial stake in trade with the Warsaw Six* (the Warsaw Pact countries less Rumania). These countries, which account for about one-fourth of Yugoslavia's total imports and one-third of its exports, furnish outlets for Yugoslav goods that cannot compete in other markets, notably machinery and equipment, iron and steel products, and consumer manufactures. In return, the Warsaw Six are Yugoslavia's most important source for imports of fuels and other material inputs such as raw cotton and semifinished iron and steel products. Moreover, this trade is important to Yugoslavia's efforts to maintain a balance in its relations among the Communist, Western, and less developed countries.

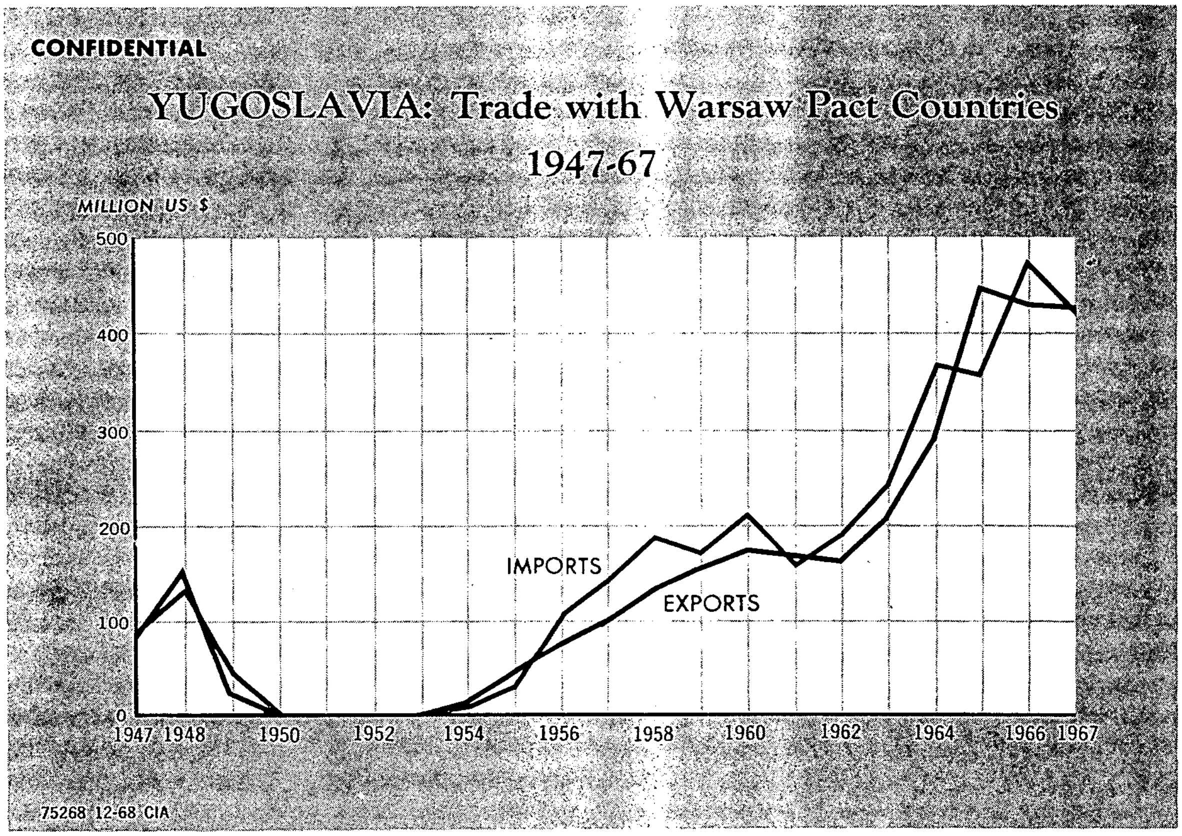
The Yugoslavs are far less dependent on the Warsaw Six now than they were in 1948, when trade was completely disrupted. A trade cutoff would nevertheless result in a recession in output, a rise in unemployment, and a temporary setback to the relaxation of federal economic control that has taken place since 1965. Serious dislocations would be felt by some industries. In 1967, for example, the Warsaw Six took 77 percent of Yugoslav production of railway cars, 44 percent of cables, 38 percent of bauxite, and 30 percent of the output of cargo ships. With added economic assistance from the West, however, Yugoslavia could make a fairly rapid adjustment to the loss of trade.

The chances that the USSR would break off trade were remote even at the moment of greatest political friction following the invasion of Czechoslovakia. The effect would only have been to push Yugoslavia closer to the West. The USSR and its partners gave assurances to Yugoslavia soon after the invasion that economic relations would be maintained in spite of political disputes. Trade under 1968 agreements and deliveries under Soviet industrial credits were

* *The USSR, Bulgaria, Czechoslovakia, Hungary, East Germany, and Poland. For the purposes of this memorandum, Rumania is excluded from the data and analysis of Yugoslavia's economic relations with the Warsaw Pact countries because Yugoslavia's present political relations with Rumania differ sharply from its relations with the other members.*

continued, and by the end of 1968 agreements calling for increases in trade in 1969 had been negotiated between Yugoslavia and the Warsaw Six. Most of the new pacts envision increases of 10 to 12 percent above the 1968 trade levels. The Soviet-Yugoslav agreement, signed on 27 December 1968 after a lengthy delay by the USSR in opening talks, calls for a two-way exchange of $500 million -- almost 30 percent above the probable level of trade in 1968.

Trade agreements, particularly in recent years, have been poor indicators of actual trade between Yugoslavia and the Warsaw Six. Some increase in trade undoubtedly will take place in 1969 in view of the resurgence of industrial growth in Yugoslavia since the middle of 1968. Yugoslavia, however, still is running a surplus in its clearing accounts with this area, reflecting the greater freedom given to importers in 1967 to exercise their preference for Western goods. Thus the Yugoslav government probably will continue efforts begun last year to restrain exports to the Warsaw Six. Moreover, Yugoslavia has redoubled attempts to expand trade contacts in the West. Italy, West Germany, and the United States have been approached regarding debt rescheduling and new loans; the United States has already responded favorably. Yugoslavia also is continuing to press for more favorable treatment for its exports to the European Economic Community (EEC). Even partial success in these efforts could lead to increased trade with the West at the expense of trade with the Warsaw Six.


CONFIDENTIAL
YUGOSLAVIA: Trade with Warsaw Pact Countries
1947-67
MILLION US $
500
400
300
200
100
0
IMPORTS
EXPORTS
1947
1948
1950
1952
1954
1956
1958
1960
1962
1964
1966
1967
75268 12-68 CIA

The Uneven Course of Total Trade

1. Yugoslavia's economic relations with the USSR and Eastern Europe have run an uneven course since World War II. As a result, trade with these countries has not been built into the Yugoslav economy as it has in the other Eastern European economies. In 1948, Yugoslavia's trade turnover with the Warsaw Six totaled $294 million, about half of its total trade. As shown in the chart, the cutoff of economic relations that accompanied Yugoslavia's ouster from the Cominform in that year reduced trade to a trickle in 1949. Yugoslavia did not trade at all with Communist countries during 1950-53 and had to switch to the West for essential imports. The death of Stalin in 1953 led to a thaw in political relations and when the Soviet government finally made its peace with Yugoslavia in 1955, trade expanded rapidly. In 1956, about $494 million in commodity credits were extended to Yugoslavia by the USSR, Czechoslovakia, East Germany, and Poland.

2. After the Soviet government branded Yugoslavia "revisionist" in 1958, economic relations cooled again. The USSR suspended drawings on credits, and East Germany, Poland, and Czechoslovakia followed suit. Up to then, Yugoslavia had taken advantage of only about $109 million of the credit line extended two years earlier. Nevertheless, trade turnover with the Warsaw Six continued to grow slowly until 1960 and then dropped back to an average of $335 million in 1961-62. This level was only 14 percent above that of 1948 and represented 22 percent of total trade. A new period of rapprochement began in 1962, and new credits were granted in 1963. Total trade turnover with the Warsaw Six nearly tripled during 1962-67, reaching $849 million in 1967 -- 29 percent of Yugoslavia's total trade.

3. As a result of successive steps to liberalize the system of foreign trade since 1965, Yugoslavia has accumulated a sizable surplus in its clearing balances with the Warsaw Pact countries. By 1967 this surplus, including both goods and services, had reached about $160 million. Exporters have found it easier to sell to Communist countries,

where quality standards are lower and where prices paid generally exceed those on the world market. Importers, on the other hand, have become increasingly resistant to purchasing Eastern European goods because they are generally of lower quality and carry higher prices than comparable Western goods. Thus in 1967, when a relaxation of trade controls gave importers more freedom of choice, they unleashed a flood of orders for Western products and fell far short of filling the import quotas agreed upon with the USSR and Eastern Europe.

4. In order to reduce clearing surpluses and ease the corresponding strain on hard currency reserves, Yugoslavia has had to restrict opportunities for importing from the West and keep closer track of exports to the Communist world. With longer run solutions in mind, the Yugoslavs have also tried to modify trading arrangements with the Warsaw Pact countries to provide for settlement of outstanding balances in hard currency. Agreements to this effect were reached with Czechoslovakia and Hungary in the summer of 1968, and discussions on this theme have been held with other Warsaw Pact countries.

5. Reflecting these efforts to reduce clearing surpluses with the Warsaw Six, exports to these countries have fallen from 41 percent of total Yugoslav exports in 1965 to 34 percent in 1967 and to only 29 percent during the first nine months of 1968. Imports from the Warsaw Six averaged 27 percent of all Yugoslav imports during 1965-67; the share has dropped from 30 percent in 1966 to about 26 percent currently.

6. The USSR is Yugoslavia's leading trade partner among the Communist countries, taking about 46 percent of Yugoslavia's exports to this area during 1965-67 and supplying one-third of Yugoslav imports from the area. Next in importance are Czechoslovakia and East Germany, followed closely by Poland. The average shares of each of the Warsaw Six in Yugoslav trade with this area during 1965-67 are shown below:

	Percent of Total	
	Exports	Imports
USSR	46	33
Czechoslovakia	14	21
East Germany	16	18
Poland	13	14
Hungary	7	8
Bulgaria	4	6

7. Although Yugoslavia does not supply a significant fraction of the trade of any of the Warsaw Pact countries, the USSR has accounted for about 13 percent of Yugoslavia's total trade turnover since 1964. Czechoslovakia, East Germany, and Poland each have accounted for from 4 to 5 percent, and Hungary and Bulgaria for about 2 percent.

Composition of Trade

8. Yugoslavia's most important exports to the Warsaw Six have been industrial manufactures; its most important imports from them have been raw and semifinished materials. Table 1 provides data on the relative importance of Yugoslavia's trade with the Warsaw Six in 1967 for major categories of products. These countries account for at least half of Yugoslavia's total exports of machinery and transport equipment (particularly ships, railway rolling stock, electrical cable, and agricultural machinery), chemicals, and consumer goods (particularly clothing, footwear, and furniture). The Warsaw Six also take nearly a third of Yugoslavia's exports of iron and steel and nonferrous ores and metals (notably bauxite). Because most of these products, except nonferrous metals and some consumer goods, cannot compete effectively in Western markets, sales to the Warsaw Six have given a welcome boost to Yugoslav output.

9. The Warsaw Six provide over two-fifths of Yugoslavia's total fuel imports, notably coal, and over one-third of its imports of minerals and metals and consumer goods. In physical terms, Yugoslavia obtains a significant share of its imports of raw materials and semifinished products

Table 1

Yugoslavia: The Share of the Warsaw Six in Total Exports and Imports
1967

	Million US $				Warsaw Six as a Percent of Total	
	Exports		Imports			
	Total	Warsaw Six	Total	Warsaw Six	Exports	Imports
Food, beverages, and tobacco	336	45	182	34	13.4	18.7
Machinery and transport equipment	255	143	572	112	56.1	19.6
Metals and minerals	208	68	296	100	32.7	33.8
Fuels and power	22	1	85	37	4.5	43.5
Chemicals	74	37	167	35	50.0	21.0
Other industrial materials and semimanufactures	183	43	335	80	23.5	23.9
Consumer and other light industrial products	174	91	70	23	52.3	32.9
Total	*1,252*	*428*	*1,707*	*421*	34.2	24.7

for the iron and steel, petroleum, chemical, rubber, and textile industries from these countries. It also imports from them some important types of machinery and equipment, especially metalworking equipment, agricultural machinery, and military hardware.

10. Trade in services with the USSR and Eastern Europe is small relative to such trade with the rest of the world. Earnings from services, however, are an important part of Yugoslavia's total trade with several of the Warsaw Pact countries -- for example, such earnings were about 38 percent of exports to Czechoslovakia in 1967. Yugoslavia has earned a clearing surplus in invisibles with Communist countries, amounting in 1966 to about $70 million, or 27 percent of total net earnings from invisibles. Most of this surplus reflects transit charges on goods shipped through Yugoslavia. Earnings from Eastern European tourists are of minor importance. Visitors from the Warsaw Six accounted for only about 14 percent of total Yugoslav receipts from tourism in 1967; West German visitors alone probably accounted for twice that proportion.

Extent of Yugoslav Economic Dependence on the Warsaw Six

11. One way to measure the extent of Yugoslavia's economic involvement with the Warsaw Six is to describe the impact that a loss of this trade would have on the Yugoslav economy. A complete cutoff of trade, or a selective reduction of trade in the more important items exchanged between Yugoslavia and the Warsaw Six, would result in a temporary recession in industry and a drop in employment. The industries most affected would be machine building, metallurgy, shipbuilding, chemicals, and textiles. Output in these industries, which accounted for slightly over half of Yugoslavia's industrial production and employment in 1967, probably would actually decline in the first year following a trade cutoff. The probable impact, industry by industry, is indicated by data in Table 2, which shows exports and imports in physical units as a share of domestic production and apparent consumption, respectively, in 1967.

12. A cutoff of exports could be highly disruptive for several industries. Railroad car producers, for example, exported about 77 percent of their output in 1967 to the Warsaw Six; shipbuilders, 30 percent; and cable manufacturers, 44 percent. The loss

Table 2

Yugoslavia: Indications of the Impact of Economic Pressure on the Production and Consumption of Selected Products
1967

Thousand Metric Tons a/

			Exports to Warsaw Six		Imports from Warsaw Six	
	Production	Apparent Consumption b/	Volume	Percent of Production	Volume	Percent of Apparent Consumption
Principal exports						
Bauxite	2,131	325	804	37.7	0	0
Refined lead	94	48	14	14.9	4	8.3
Rolled copper c/	60	49	9	15.0	Negl.	Negl.
Railway stock	52	16	40	76.9	Negl.	Negl.
Tankers and cargo ships (number) d/	23	20	7	30.4	0	0
Lead cables	59	27	26	44.1	e/	1.1
Artificial fertilizers	1,740	2,328	260	14.9	280	12.0
Principal imports						
Hard coal	909	2,186	0	0	832	38.1
Crude oil	2,374	4,495	0	0	675	15.0
Pig iron	1,177	1,243	0	0	141	11.3
Rolled steel f/	1,298	1,864	94	7.2	348	18.7
Unwrought aluminum	45	64	Negl.	Negl.	15	23.4

Table 2

Yugoslavia: Indications of the Impact of Economic Pressure on the Production and Consumption of Selected Products
1967
(Continued)

Thousand Metric Tons

	Production	Apparent Consumption	Exports to Warsaw Six: Volume	Exports to Warsaw Six: Percent of Production	Imports from Warsaw Six: Volume	Imports from Warsaw Six: Percent of Apparent Consumption
Principal imports (Continued)						
Cement	3,313	4,131	Negl.	Negl.	459	11.1
Metalworking machinery	8	24	1	12.5	7	29.2
Agricultural machinery g/	41	50	5	12.2	11	22.0
Raw cotton	10	101	0	0	23	22.8
Synthetic and reclaimed rubber	6	42	0	0	14	33.3

a. Unless otherwise indicated.
b. Apparent consumption is production plus imports less exports, no account being taken of inventory levels. Actual reported consumption figures were used for crude oil.
c. Including products of copper alloys.
d. Seagoing ships only.
e. 306 tons.
f. Excluding blooms, slabs, and billets.
g. Including tractors.

of such a large part of the export market for machinery and equipment and the consequent cutback in output would, in turn, reduce domestic demand for steel and nonferrous metals. In addition, the steel industry would have lost a foreign market for about 7 percent of its rolled steel production, and the nonferrous metals industry would have lost such markets for 38 percent of its bauxite production and 15 percent of both its lead and its rolled copper output. An export cutoff also would hurt the production of chemical products including fertilizer, plastics, and many chemical compounds and of consumer goods, especially clothing, footwear, and furniture.

13. A loss of imports also would have adverse effects. As shown by the data for 1967, some of the most important imports from the Warsaw Six as a share of apparent Yugoslav consumption are hard coal (38 percent), aluminum ingots (23 percent), crude rubber (about 33 percent), petroleum (15 percent), and metalworking and agricultural machinery (29 and 22 percent, respectively). Thus, until replacement purchases could be made, iron and steel production would be hurt by the loss of coking coal supplies, nonferrous metallurgy by the loss of imports of aluminum ingots, and the rubber industry by the cutoff of much of its supply of synthetic rubber. Shortages of oil for households and industrial purposes probably also would occur. In addition, a termination of imports of equipment under Soviet industrial credits would disrupt progress in building thermoelectric powerplants at Lukavac, Kostolac, Kosovo, Tuzla, Obrenovac, and Sisak and would delay work on the Djerdap Hydroelectric Power Station and the Danube Locks -- both of which are part of the joint Rumanian-Yugoslav Iron Gates project. Soviet credits also are aiding the reconstruction of Skoplje and the modernization and expansion of steel plants at Zenica, Smederovo, Ilijas, and Niksic. Food supplies would not be noticeably affected by an import cutoff, nor would supplies of coal for heating, for transport, and for electric power production. In addition, Yugoslavia could get along without most, if not all, of the consumer manufactures now imported from the Warsaw Six.

14. The impact of a trade cutoff on production would be spread fairly evenly among the regions of

the country. The share of the industries that would be most affected in the total industrial product of the republics ranges from 46 percent for Macedonia to 58 percent for Kosovo-Metohija -- the backward autonomous region of Serbia. The shares in the other republics hover around the average share of 53 percent for the country as a whole. The brunt of a trade cutoff would fall on the steel industries of the lesser developed republics -- particularly of Bosnia and Herzegovina and Montenegro; on the lead industry of Kosovo-Metohija; on the machine building and textile industries of the more developed republics -- Slovenia, Croatia, and Serbia; on the shipbuilding industry of Croatia; and on the chemical industries of the more advanced republics and Macedonia.

15. A trade cutoff also would stifle other forms of economic cooperation between Yugoslavia and the Warsaw Six. Joint production deals between enterprises have been concluded in nearly every branch of industry, and an East German firm -- Lacke and Farben of Berlin -- was the second, after Fiat of Italy, to invest directly in a Yugoslav enterprise following the passage of Yugoslavia's Joint Investment Law in 1967.

16. In the short run, enterprises and the government could do little to reverse the effects of a sudden cessation of trade with the Warsaw Six. To soften the impact, the government would have to take rather stringent measures. Import controls would need to be strengthened to prevent a drain on hard currency reserves from a switch to the West for imports. Price controls would have to be extended to prevent inflation and protect the remaining export markets. Subsidies probably would be needed by some exporters, particularly those that had been selling both to hard currency markets and to the Warsaw Six and had incurred increased per unit costs because of the loss of the latter market. Steps also would need to be taken to cushion the effects of added unemployment on domestic demand, perhaps by raising unemployment compensation rates. The government might even have to resort to rationing until emergency purchases could be made of fuels, cotton, rubber, and other necessary raw materials. These products would have to be obtained for hard

cash on the open market because it would be difficult to arrange emergency imports under clearing arrangements.

17. The government's leverage in dealing quickly with the effects of a trade cutoff would be constrained by its present hard currency position. Unfortunately, Yugoslavia already has a large deficit in hard currency trade; in 1967 it amounted to $436 million -- a whopping 64 percent of hard currency exports. The offset of net earnings from invisibles, estimated at roughly $235 million, still left about a $200 million deficit on current account. Although a slight improvement occurred in 1968, the Yugoslavs reportedly are having trouble securing enough financial credit to cover the imbalance and may have to draw down hard currency reserves, which stood at about $122 million in July 1968. Moreover, import controls would have little effect in the short run because many of the more significant imports, such as machinery, are arranged for well in advance. For these reasons, a trade cutoff would inevitably prompt requests for emergency financial assistance from the West.

18. In time the Yugoslavs could -- and would -- take steps to cure the dislocations resulting from a loss of trade. The structure of imports with hard currency countries could be changed to substitute necessary raw materials for less essential imports. Yugoslavia would also attempt to increase trade with its remaining bilateral partners, although little success could be expected in replacing the large Warsaw Pact market for Yugoslav steel and machinery exports. The government could take steps to encourage domestic investment and initiate new projects, such as roads and other public works, to try to absorb part of the added unemployment. Western countries would probably be asked for assistance in the form of rescheduling Yugoslav debt repayments and providing new long-term credits to aid in the modernization and restructuring of Yugoslav industry. The government also might relax some of the restrictions in its new Foreign Investment Law, which thus far has not attracted much Western capital.

19. Also, with time, some domestic enterprises could try to expand and diversify output so as to fill the gaps left by a cutoff of imports from the Warsaw Six. This approach might be reasonably successful for cement, some consumer manufactures, and perhaps a few kinds of machinery. In most cases, however, this method of adjustment would be severely restricted by the nonsubstitutability of products and the small domestic market for many products imported from the Warsaw Six.

20. The need to revert to controls in the short run would mean a setback to the government's current economic programs. Added import controls would counteract efforts to expose enterprises to foreign competition; new price controls would weaken the attempt to achieve a more realistic structure of relative prices through market forces; and greater government involvement in investment programs and in economic decision-making in general would reverse the flow of power from the government to enterprises and banks that has taken place since 1965. With good luck and good management, however, the added price and import controls could be relaxed gradually, once the effects of a cutoff had worked their way through the economy and new patterns of industrial production and demand for imports had been established. Favorable trends in exports and Western financial assistance would increase the chances of an early return to the partial degree of freedom that currently exists.

21. In the long run, a cutoff of trade with the Warsaw Six might even be a blessing in disguise, because much of the consequent drop in output would be in the least efficient Yugoslav industries -- steel and machine building, for example. The government would have to resist demands, however, for hastily conceived investment programs that would utilize excess capacities in such industries, including proposals to start up production of goods previously obtained from the Warsaw Six. Emergency projects of this sort, carried out under the protection of import controls, would mean a longer run retreat from the objectives of the economic reform and would drain off funds that could be used to modernize industries with greater export potential such as nonferrous metallurgy, textiles, and wood products.

Outlook for Economic Relations

22. Yugoslavia's trade with the Warsaw Six has not been noticeably affected by the strain in political relations since the invasion of Czechoslovakia. Soon after the invasion the USSR and its allies reportedly pledged that normal economic relations would be maintained. Thus far, trade under current agreements and deliveries under Soviet credits have continued. There had been warning signs in the fall of 1968; the USSR canceled a conference to discuss Yugoslav ship exports after 1971 and delayed the opening of talks on the 1969 trade agreement. A new date had not been set for the shipbuilding talks as of the beginning of 1969. However, new agreements recently concluded for 1969 call for a substantial increase in Yugoslav-Warsaw Six trade, from a probable level of roughly $900 million in 1968 to about $1.1 billion in 1969. The key agreement, finally signed with the USSR on 27 December 1968, envisions a two-way goods exchange of $500 million -- almost 30 percent above the expected 1968 trade level. This agreement suggests that the USSR, at least for the time being, will not apply economic pressure in an attempt to subdue Yugoslav critics of Soviet policy. Such a step, as the USSR is aware, would only push Yugoslavia into closer involvement with the West.

23. The prospects for Yugoslav-Warsaw Six trade are not so bright as the new trade agreements would suggest. An increase in trade undoubtedly will take place in 1969, if only because of the strong upswing now under way in the Yugoslav economy. The Yugoslavs, however, still carry a large surplus in their clearing accounts with the Warsaw Six, and the government probably will continue efforts to hold exports to these countries to the amounts that importers can be induced to accept in return. Moreover, this trade still is chiefly important as a market and source of supply for the more inefficient Yugoslav industries. Trade with the Warsaw Six conflicts with the current Yugoslav policy of playing down growth in these industries and, instead, of restructuring and modernizing production with the help of expanded trade with the West. As long as this policy is effective, and Yugoslav importers continue to be given some scope to exercise their preference for Western goods, trade with the Warsaw Six probably will remain around its present 30-percent share of Yugoslavia's total trade.

24. The share of the Warsaw Six could even drop further. Still distrustful of Soviet intentions, the Yugoslavs probably will continue to discreetly step up contacts with the West as a hedge against any future rupture in relations with the Warsaw Six. Already, Yugoslavia's aluminum producers have indicated a desire to reduce dependence on the USSR for aluminum ingots by increasing such imports from the United States. Yugoslavia also is engaged in a new round of discussions with the EEC to try to lower barriers to Yugoslav exports -- particularly of agricultural products. Kiro Gligorov, the Vice President of the Yugoslav Federal Executive Council, visited the United States at the end of September to explore prospects for rescheduling debt repayments, increasing Yugoslav exports, and obtaining further credits from the Export-Import Bank and the World Bank. Thus far, the United States has agreed to reschedule PL 480 debts, giving a total relief of $15.9 million. Yugoslavia also has approached the United Kingdom, Italy, and West Germany for financial assistance. A $24 million credit has been obtained from the United Kingdom, and a West German credit of $75 million is under discussion. If such efforts continue to bear fruit, trade with the West will increase considerably in the next few years, possibly at the expense of trade with the Warsaw Six.