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The Dilemma Of East Bloc Debt: Military Solution Or New World Monetary Order—Part II

The last issue of *Executive Intelligence Review* documented how the New York-based investment houses, headed by Lazard Freres, are using the issue of the $50 billion East bloc debt to launch a political offensive to control the economies of the Council on Mutual Economic Assistance (CMEA) countries through credit-issuance blackmail. A thorough analysis of those economies' debt structure proves that within the confines of the dollar system, the socialist states have indeed no other economic choice than either self-imposed austerity or NATO-controlled exploitation to pay back the money they have borrowed.

This is not to say that the East bloc economies are not viable; on the contrary, their rate of development is presently higher than that of the Western nations. Their problem is that they cannot find outlets for the potential exports that they generate with their capital goods investments because of the world economic crisis — a crisis which increasingly contracts their markets in Western Europe.

The only real solution to this dilemma is located within a new world economic monetary order backed by a gold-pegged transferable ruble and based on credit-for-development issuance, opening up new, broad markets for capital-intensive production.

If this transformation is not accomplished, the dollar system, based on debt repayment at the expense of trade and production, offers no economic alternative. The Soviets are well aware of this, and one of their alternatives is not economics; it is a *military* build-up to nuclearly defend their national interests — if provoked. This latter option was expressed in the deliberate choices of their 1976-1980 Five-Year Plan.

Debt Dilemma

According to conservative estimates, the East European debt to the West reached around $46 billion at the end of 1976, and should now be around $50 billion. These figures include neither the $8-10 billion debt of Yugoslavia, nor the $1billion-plus interest-free "swing" credit facility granted by West Germany to East Germany for "intra-German trade." Table 1 shows a country-by-country breakdown, reflecting the increasing growth of the debt of rapidly developing economies which need an ever-increasing amount of funds for industrial equipment.

Table 1

East European Debt To The West (conservative estimates)

(billions of U.S. $)

	end 1970	end 1974	end 1975	end 1976 (estimates)	mid-1977 (NSIPS estimates)
Bulgaria	n.a.	1.7	2.4	2.8	n.a.
Czechoslovakia	n.a.	1.1	1.5	2.1	2.5
DDR	n.a.	3.6	4.9	5.8 (1)	6.5
Hungary	n.a.	2.3	3.2	3.5	4.0
Poland	n.a.	4.9	7.8	10.4	12.0
Rumania	n.a.	2.4	2.8	2.8	n.a.
USSR	2.5	5.9	11.4	14.4	16.0
TOTAL	8.3	21.9	34.0	41.8	n.a.
Comecon Banks	0.0	2.1	2.8	3.5	n.a.
Overall Total	8.3	24.0	36.8	45.3	n.a.

Note: (1) In the case of the DDR, about $1 billion should be added, representing interest-free "swing" facility credits from West Germany for "intra-German" trade

Sources: 1970, 1974, 1975 based on data provided by Chase Manhattan Bank. 1976 based on estimates of Chase Manhattan and Morgan's *World Financial Markets*

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The figures for the real growth of CMEA members' external debt between 1973 and 1976 are the following: 229 percent for Poland; 97 percent for East Germany; 86 percent for Hungary; and a very high 105 percent for the Soviet Union.

In terms of percentages of net year-end debt principal to hard currency annual export levels — the best available numbers to measure debt-burden — the situation of the CMEA countries appears quite gloomy. The high ratios of Hungary, East Germany and especially Poland and Bulgaria, stand out. Bulgaria's 340 percent, Poland's 270 percent and East Germany's 230 percent are comparable — and are compared, notably by New York bankers pushing the debt-scare — to the ratios of the most heavily indebted lesser-developed countries (LDCs), such as Chile's 310 percent, Turkey's 320 percent or Peru's 260 percent.

It is from such figures that Senator Javits, among others, "deduce" that "IMF discipline" should be extended to East bloc countries, and Fund missions sent to Warsaw, Budapest and Sofia to "prescribe stabilization plans" — in other words production and service cuts to pay the debt.

Although debt maturity terms are very difficult to know due to the lack of public information, it is widely understood that the CMEA's total payments deficit reached $12 billion in 1975 and $10 billion in 1976. But the figures are again moving up in 1977, and one source indicates that "this year, the East bloc has to find $12.8 billion to repay its foreign debts," of which the Soviet Union is said to owe $5-6 billion. About one-fourth of the sector's total debt is therefore to be repaid in 1977.

Such an unfavorable debt-maturity structure is aggravated by the fact that in the next two to three years, relatively old, 8-10 years official export credits to Eastern Europe will come due at the same time as shorter-term Eurocurrency credits incurred a few year later by the same countries. The convergence of the two currents will over-inflate the debt burden, and require further indebtedness to pay back the old debt — an operation otherwise known as "roll over" by bankers dealing with Third World countries. But some East Bloc countries, such as Poland, are already running into problems to get new additional medium-term credits. They are therefore compelled, as shown by figures made available by U.S. and Western European banks, to rely more and more heavily on short-term bank credit, which in turn further aggravates the debt maturity question and triggers a vicious circle.

The CMEA members are perfectly aware of the nature of their debt dilemma, but still hope against hope that a few rectifications will help them to keep things together.

Debt Gimmicks

Their first tactical effort is to pull together all their resources to avoid the disrupting case-by-case approach that Chase Manhattan and the New York investment houses have attempted to use to isolate Poland, widely known to be the weakest link of the chain both economically and politically.

This common strategy is first reflected on the Eurocurrency markets (see Table 3), where Poland has limited its indebtedness to near zero in January-July 1977 (contrary to the preceding years), while the other, relatively less vulnerable CMEA countries have increased their indebtedness proportionally to Poland's decrease.

At the other end of their debt structure, the East bloc countries are trying to diversify their sources of finance, mainly by establishing direct links with oil-exporting nations, according to the July 22, 1977 *Journal of Commerce*.

It is in relation with these two developments that the CMEA countries are expanding the use of the transferable ruble. First, they have decided to progressively work out all exchange operations within the CMEA itself in transferable ruble accounts instead of remaining at

Table 2

Eastern Europe —
% Ratio Of Net Year-End Debt Principal To Hard Currency Annual Export Levels

	1974	1975	1976*
Bulgaria	210	320	340
Czechoslovakia	40	70	100
DDR	140	200	230
Hungary	130	180	200
Poland	140	210	270
Rumania	100	130	120
USSR	30	110	n.a.
TOTAL	90	150	n.a.

* preliminary estimate

Note: This is still a rough measure of Eastern Europe's debt ratios due to the lack of published information, but it permits at least certain appropriate comparisons.
Source: Chase Manhattan Bank, *East-West Markets*

Table 3

Eurocurrency Bank Credits To Eastern Europe (registered)
(millions of U.S. $)

	Total CMEA	Poland	USSR	Other Countries
1974	1238	509	100	629
1975	2597	475	650	1472
1976	2503	525	283	1696
1/76—7/76	1849	416	250	1183
1/77—7/77	1685	19	234	1432

Source: Morgan Guaranty, *World Financial Markets*, July 1977

the gross level of bilateral arrangements. Second, they have opened transferable ruble accounts to third parties, mainly leading Third World countries and oil-producing states. Algeria, Mexico and Kuwait are known to be part of these arrangements. It is also widely understood in the Swiss banking community that "conservative" Arab states are discreetly "purchasing" T-rubles through relevant Zürich-based intermediaries in preparation for a mammoth expansion of OPEC-East bloc trade.

But all these operations, whatever their positive aspects, are still "diplomatically" launched within the framework of the dollar-denominated system. As such, they, at best, help the East bloc to gain some precious time, but they are economically doomed to fail if they are not publicly linked to a political offer to OPEC countries and such European countries as France and West Germany to join a gold-based monetary system backed up by a gold-pegged T-ruble. Soviet "realpolitiking" in this area can only lead toward self-imposed austerity. This is already happening now, notably in Poland.

Self-imposed Austerity

The burden of the debt has already induced austerity measures in the East bloc, but the New York banks should not be too happy about it. If, on one side, the Soviets are committed to pay and to avoid immediate open tensions, then, on the other hand, they are orienting all their economic forces toward the development of their military capability to be in the best position to confront their enemies in a future stage of *absolute tension.* More precisely, the only reason why they are "irrationally" accepting an economic setback is because of a "rational" — in military terms — strategy, a short-term war winning build-up.

All the ongoing five-year plans of the CMEA countries reflect in one way or another acceptance of certain economic restrictions imposed on the population. The current Soviet Five-Year Plan (1976-1980) is not based on "creative," long-term investment, as were the preceding ones, but on short or medium-term "payback" investments in equipment of already existing capacities.

"The investment policy of the Soviets...is now based on more modest investments, but capable of bearing fruit in a shorter period of time," comments the authoritative official French publication, *Courrier des Pays de l'Est,* which characterizes the new Soviet choices as "Malthusian if compared to the past." The planned rate of growth of the Soviet economy for the 1976-1980 period is a mere 26 percent, as against 40 percent planned in the 1971-1975 period. Leonid Brezhnev, in his key opening speech to the Supreme Soviet reported in *Izvestiya*, Oct. 26, 1976 urged primary investment in the reorganization of already existing firms — "where productive capacities can be developed without creating new constructions and investment costs can be reduced."

Worse, moves to conserve energy have been promulgated throughout the Soviet Union. The campaign "resembles jawboning," according to Chase Manhattan's *East-West Markets* (March 7, 1977), with large poster displays and exhortations to turn off unneeded lights and idle equipment in factories. "But a new layer of energy-use guidelines for various industries will set ceilings on the number of kilowatt-hours or equivalent used in different types of production, and energy consumption will have greater weight in calculating plant efficiency," comments the Chase publication.

This campaign is, of course, used by Chase and Lazard forces for psychological warfare purposes, similarly to the CIA report which predicts that the Soviet oil production will not reach the officially planned 640 million tons, but will stagnate at around 550 million tons. There is nonetheless a key element of truth in it, which is a relative vulnerability of the Soviet bloc in terms of present energy production.

Firstly, without major Western credits, the Soviets would not be able to meet their energy goals. The relatively reliable Petroleum Industry Research Foundation estimates that the Soviets will achieve an approximate production capacity of only about 600 million tons.

Secondly, even if they reach their goal of 640 million tons, the Soviets will have hard currency problems within a dollar system. They currently produce about 520 million tons; about 140 million tons is exported — half to the CMEA, half to the dollar zone. Those oil exports to the West represent $6.5 billion, and cover 45 percent of the total Soviet imports. With 640 million tons produced in 1980, their developing economy will need about 500 million tons and only 140 million tons will be available for exports, the same amount as today! To maintain the 45 percent coverage of Western imports, not only will the Soviets have to export less to the CMEA and more to the West, but they will have to reduce the rate of growth of their total imports. In turn, the CMEA countries will have to import more dollar-denominated oil to replace the quantities withdrawn by the Soviets, which will mean cuts on their part in other imports.

This explains in part why the CMEA, despite its advanced nuclear program, had to launch an energy-saving drive. In brutal terms, the Soviets are faced with the following dilemma within the dollar system: triage the CMEA energy supplies, or triage their own imports. Their current plan is a stop-gap, to do a little of each.

Furthermore, all the East bloc nations are engaged in official export drive and import-cut plans to pay their debts. For example, Poland's plan projects an 80 percent increase in total export volume from 1975 to 1980, with no increase in imports! At the beginning of the year, Polish officials announced an all-out offensive to rationalize and restrict imports. But everybody "suspects the realism" (as put by *Foreign Affairs*) of such a plan. It can only

Table 4

Banks' Claims on Eastern Europe

(billions of U.S. $)

	Total Eastern Europe	USSR
All Banks	29.20	10.35
U.S. Banks	4.29	1.51
Non-U.S. Banks*	24.91	8.84

* over 90% West European
Source: Morgan Guaranty, *World Financial Markets*, July 1977

succeed within the framework of an unprecedented commodity boom. Several of Poland's main manufacturing exports to the West are "import sensitive" (clothing, furniture), and expansion of other manufactured exports cannot amount to much in the medium term, so the prospects to 1980 depend heavily on coal, copper and sulphur. Domestic coal rationing was introduced in November 1976, but only a very large increase in the price of copper would offer any hope that Poland might be able to meet its dollar-debt repayment schedule at the end of the present decade.

This coheres with the $350 million loan that Chase Manhattan is pulling together for the Polish copper industry. The Chase scenario is to enforce Poland's debt payment with a coming copper-boom hoax, having the development of the Polish copper production under top-down control. Hence the fact that Chase's top East bloc expert publicly declared that "our basis for going ahead with the loan has been total control on outflows and inflows of funds: year by year, on-site control on expenditure of the loan and guaranteed repayments tied to copper exports to the West."

Such a miserable submission to Wall Street terms, a direct offense to the national sovereignty of their nation, has been accepted by the Poles not without afterthoughts. But in the meantime, they are not taking the appropriate measures to solve their dilemma. They are as a result very badly hit and vulnerable to political destabilization.

The country has not recovered from the 1974-76 crop failures and slaughter of livestock herds. Thus, Communist Party General Secretary Gierek had to reorient the ongoing five-year plan toward production of consumption goods and food supplies traded off against industrial investments, upon which zero growth has been imposed until 1980! This de facto incorporates Poland within the dollar system.

Hungary is somewhat engaged in a similar turn, and projects a 60 percent rise in the volume of exports to non-socialist countries and only a 40 percent rise in imports from them over this five-year plan. The Hungarians imposed zero growth on their imports from the non-ruble area in 1976, and are engaged in a "selective credit policy" which discards long-term infrastructural investments and pushes investments in equipment and existing installations "which will increase productivity and expand export potential."

Soviet imports from Western countries are already declining: they only reached $3.38 billion for the second quarter of 1977 as against $4.08 billion for the second quarter of 1976.

It is easy to figure out that these policies are not economically viable. Simple arithmetic shows that at current rates of East bloc gold sales and invisible earnings (allowing for the rising interest burden of the debt) the continuing rapid growth of CMEA debt could be avoided only an inachievable turnaround in East European trade balances. Richard Portes correctly states in *Foreign Affairs* that "If the flows of 1976 remained unchanged through 1980, the debt would be approaching $90 billion by the end of that year. Alternatively, if imports and invisibles stayed constant at 1976 levels, then merely in order for the debt to level off by end-1980, the USSR would have to increase its hard currency exports by over

Table 5

Official Export Credits To Eastern Europe

(end 1975 percentage distribution by lending country)

	BULGARIA	CZECHOSLOVAKIA	DDR	HUNGARY	POLAND	RUMANANIA	USSR
U.S.	0	0	0	0	2.0	4.2	4.6
FRANCE	41.8	17.2	19.7	16.6	20.7	16.3	32.7
W. GERMANY	15.3	26.7	46.3	20.7	9.9	26.9	29.7
ITALY	9.8	6.6	1.8	16.6	5.1	11.0	11.0
BRITAIN	7.1	7.8	3.8	29.0	28.1	16.6	6.9
JAPAN	10.5	6.1	2.9	0.4	6.6	12.7	8.4
AUSTRIA	2.8	21.1	14.7	2.9	11.6	2.8	3.0
OTHER	12.7	14.5	10.8	13.8	16.0	9.5	3.7
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0
EEC SHARE	74.0	58.3	71.6	82.9	63.8	70.8	80.3

Note: Export credits are government-guaranteed commitments on signed contracts, negotiated by such institutions as COFACE, ECGD and Hermes.

Source: *East Europe's Debt To The West: Interdependence Is A Two-Way Street*, by Richard Portes, in the July 1977 issue of *Foreign Affairs*.

10 percent per annum, Poland by over 20 percent per annum, and the rest of Eastern Europe by about 8 percent per annum; the resulting stable debt levels would be about $27 billion, $20 billion, and $23 billion respectively. Since it seems certain that Eastern Europe's net hard currency imports of raw materials and fuel will have to rise, any stabilization in the medium term would require both sharply reduced imports of Western capital goods and sharply increased exports of manufactures to the West." In other words, this "stabilization" would require both economic suicide—cuts in much needed supplies—and increased exports to *collapsing* Western economies.

East bloc officials are no idiots, and know this situation very well. In private conversations or in their economic reports, they either implicitly or explicitly say that any "realistic" projected accumulation of the debt could not be financed without "excessively straining the present monetary system." Dr. Janos Fekete, deputy chairman of Hungary's National Bank, bluntly told various Western sources that he sees the West entering another recession.

Is it not, therefore, ridiculous to think that the official strategy of Fekete's hungary and other Eastern economies is based on debt repayment through an export drive? Moreover, the East bloc nations intend to cut their imports from nations to whom they want to export more. How is the West German economy going to absorb more East bloc products if its exports toward the East bloc have fallen by about 12 percent in volume (8.6 percent in deutschemarks) between January-June 1977 and the equivalent period of 1976?

The developments in the East, therefore, only make sense as part of a military-political operation.

Actual Soviet Policy

The actual Soviet policy is not based on an economic analysis, but on a military strategy. What is, in fact, happening is that all the economies of the East bloc are being aligned in support of the Soviet military build-up, independently or even opposed to their short-term or medium-term self-interests. Two key developments underscore that fact:

*The Soviet turn toward "profitable" investments is of a different nature from that of other East bloc countries. While Hungary or Poland have "reoriented" their plans toward exports and consumption goods, the 1976-1980 Soviet plan is committed to the short-term expansion of existing industrial resources and development of agricultural self-sufficiency. Besides, two related sectors are strongly pushed: nuclear energy and general research and development (the latter with new emphasis on short-term or medium-term applications). For the first time since the end of World War II, less emphasis is put on "fundamental research," a clear sign of a decision to use all the available technology ("consolidation of the economy instead of quality of life or long-term investment," says the *Courrier des Pays de l'Est* in its own way) in a near future date to confront the enemy.

*The economically incomprehensible moves toward import-restrictions and energy conservation can only be understood as a preparation for a new period of relative bloc autarchy—i.e., war preparation. Behind the much touted export drive is Soviet import-cutting, not to repay the debt—as silly New York bankers would still believe—but to prepare the military defense of their self-interests threatened by those same New York bankers!

The only sane alternative for the Soviets is a full *war-avoidance* strategy: the immediate pull-out of the doomed dollar system and construction of a pro-development bloc involving Eastern and Western Europe together with the Arab World and leading Third World nations. A positive element in that urgently required development is the fact that most of the Soviet debt is held by West European bankers (Table 4) or government agencies (Table 5). Arrangements should be therefore immediately made on a multilateral basis "from the Atlantic to the Urals," following the lines defined by U.S. Labor Party chairman Lyndon H. LaRouche's International Development Bank proposal. There is no other way out than nuclear war.

— Louis Carriègue

Chase: Move For Control Of Polish Funds

The following interview with a senior Chase Manhattan official was made available to EIR.

Q: Is the London *Financial Times* report on Chase Manhattan's $350 million loan to the Polish copper industry correct?

A: Yes, they have been talking to our people in Europe. What is significant in our new loan is that it involves a consortium of big banks. There are some precedents, I mean project loans with similar conditionality to East bloc countries. But up to now it only involved a single bank and small project loans. *Now, we have obtained total control over inflows and outflows of funds linked to a $1 billion project.* Our basis for going ahead with the loan has been precisely this: year-by-year, on-site control on expenditure of the loan and guaranteed repayments through all income generated by copper exports to the West.

Q: What is your opinion of Poland's foreign debt?

A: Poland is a special case; the prospects are not bad after 1982, but there is a big problem before that, a gap to be filled. There is a problem of "bridging," it is like a LDC country.

Q: Do you think that the International Monetary Fund should step in, as suggested by Senator Javits in his Aug. 29 speech before the Senate Banking Committee's subcommittee on international finance?

A: There is no immediate possibility of imposing an IMF intervention, it is not a practical answer. If some people push for it, it could be useful in the process of negotiation. But it is just not feasible at this point. It is otherwise pretty clear that there will be a financial problem next year. We expect some type of informal rescheduling. We expect the Soviet Union to step in and help the Poles.

Q: Do you mean help them to pay you?
A: Yes, I mean to pay their creditors. Besides, the two billion deutschemark credit from the West German Dresdner Bank to Poland allows some indirect rescheduling. Sure, it is tied to machinery exports, but arrangements are being made. Poland's privately-held debt will be backed up by West German credit.

Q: What, then, are your problems?
A: Look, we have two main problems. First, there are two tiers of banks. On one side, very large banks, with very knowledgeable people, oriented toward project lending. But on the other side, we have a second tier of small banks which entered the market in 1974 to issue short-term credit because of high returns. These people are not knowledgeable, they are easily frightened. They have no long-term commitment. I am referring to California, Texan, Pittsburgh and Chicago banks. They are very volatile. Up to now they have followed the lead of larger banks. But if one breaks — I mean one of these small banks — the whole second tier can follow. And as a whole, these banks are important. If they stop issuing credit to Eastern Europe, we would have a bad situation.

On top of this, we have our second problem. Project loans are guaranteed by related exports, but if there is no recovery in Western Europe, the CMEA members will not be able to increase their exports. Everybody could be squeezed.

Q: Don't you believe the Soviets are thinking of solving these problems within the confines of a new monetary system? I am referring to transferable ruble proposals.
A: The Hungarians understand quite well all the advantages of such an operation, but the Soviets are overcautious. There will be more convertibility within the CMEA itself. On that issue, the Soviets will reconsider their position and support CMEA transferability, because they are now aware of the advantages of surpluses in their current accounts with other Eastern nations. But they won't move on an broader scale. With such countries as Algeria, Mexico, Venezuela or Kuwait, they prefer to move on a bilateral basis. Besdies, there is competition within Eastern European countries vis-à-vis the Third World and OPEC markets. Sure, they will strongly reorient their exports toward OPEC, export their technical expertise. They have been very disappointed with Western European markets.

But the Soviets are not able to see all the advantages of a multilateral approach. They probably think it is too risky. They do not understand all the potential advantages of a multilateral approach based on a transferable ruble. The Soviets have no strong leadership now, they have no more builders. Therefore they follow their short-term interest, and will not go further.

France, BRD Act To Save European Industry

West German Chancellor Helmut Schmidt and French President Valéry Giscard d'Estaing have greatly increased cooperation between their two countries on nuclear power, an issue of prime importance for the fate of Europe's industry. France is publicly aligning with Schmidt's policies of rapid development of nuclear energy sources, and is backing Schmidt's resistance to Carter administration dictates on reflation and energy conservation that would kill European industry. These agreements have also opened new vistas in the aerospace sector.

The improvement in Franco-German relations occurred after a telephone conversation between Schmidt and Giscard last week. The French president has since sent a special emissary to Bonn "to deepen the discussion." Both countries have big plans for the future nuclear industry in Spain. During Spanish Prime Minister Suarez's recent visit to France, Giscard recommended that Spain stop buying nuclear power plants from the United States, and instead cooperate with both France and West Germany. Spain has already shown much willingness to comply with such a policy, especially in the context of its prospective membership in the European Economic Community (EEC).

France's backing of Schmidt on the inflation question could not have come at a more opportune time. Schmidt will meet this week with British Prime Minister James Callaghan, and the latter is expected to repeat his recent call for West Germany to prop up the U.S. dollar by implementing reflationary monetary and fiscal policies. The French newspapers *Le Monde* and *Les Echos* have praised Schmidt's "policy of no global boost" and have called the programs of President Carter, Callaghan and West German Atlanticist Willy Brandt "delusions."

Contrary to the broad hints being circulated in the American press, Schmidt has made no signs of significantly altering his policies, and in a recent television interview said that his country "is not in bad shape because of its strict anti-inflationary policy, which we will stick to."

Arab Aerospace Industry?

Last week, a huge $1.5 billion deal was signed between France, West Germany and a number of Arab states, according to the financial daily *Les Echos.* The arrangements will rapidly coalesce a full-scale Arab armaments and aerospace industry, and vastly develop the Middle East's industrial infrastructure. The deal was arranged in the course of a recent visit by French Defense Minister Bourges to West Germany and a French visit by Egyptian President Sadat; it will include the sale of 26 French Mirage jets to Saudi Arabia (to be handed over to Egypt) and cooperation on the assembly of 200 Twin Alpha jets, which are a joint French-West German product.

West Germany is prohibited by constitutional law from delivering armaments to any designated "crisis area," but in the case of this deal it is expected to get around the regulation by only delivering components to France or elsewhere. Moreover, since such an Arab aerospace