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# WITHDRAWAL SHEET

## Ronald Reagan Library

**Collection Name** EXECUTIVE SECRETARIAT, NSC: COUNTRY FILE

**Withdrawer**

KDB 8/25/2015

**File Folder** SOVIET BLOC ECONOMIC AND FINANCIAL SITUATION  
UPDATES (4/4/82) (1)

**FOIA**

F03-002/5

**Box Number** 19

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107

ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
168809	MEMO	N. BAILEY TO W. CLARK: SOVIET BLOC ECONOMIC AND FINANCIAL SITUATION UPDATE NO. 18	3	4/14/1982	B1
168810	REPORT	RE SOVIET BLOC FINANCES <b>PAR 10/12/2010 CREST NLR-748-19-20-2-2</b>	17	4/1/1982	B1 B3
168811	CABLE	RE USSR	2	4/6/1982	B1
168812	CABLE	RE USSR	2	4/7/1982	B1
168813	CABLE	091641Z APR 82	1	4/9/1982	B1
168814	CABLE	RE USSR	6	4/8/1982	B1
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168809 MEMO

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168810	REPORT  RE SOVIET BLOC FINANCES	17	4/1/1982	B1 B3

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Bailey

# The Soviet Bloc Financial Problem as a Source of Western Influence (U)

National Intelligence Council  
Memorandum

MORI/CDF per C05056018

DECLASSIFIED IN PART  
NLR OREST  
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NIC M. 82-10004  
April 1982

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# The Soviet Bloc Financial Problem as a Source of Western Influence (U)

## National Intelligence Council Memorandum

*Information available as of 8 April 1982 has been  
used in the preparation of this report.*

This memorandum was coordinated within the National Intelligence Council and the Directorate of Intelligence. Comments are welcome and may be addressed to the author, Maurice Ernst, National Intelligence Officer for Economics,   
(U)

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NIC M 82-10004  
April 1982

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### **The Soviet Bloc Financial Problem as a Source of Western Influence (U)**

#### **Key Judgments**

The USSR and Eastern Europe are encountering serious hard currency problems caused by systemic deficiencies, accumulated hard currency debt, weak Western markets, and the Polish crisis. Private sources of long-term credit to the Bloc have largely dried up. Poland and Romania are unable to meet their hard currency obligations and most of the East European countries will be forced to curtail imports. The USSR still has substantial short-term flexibility but its long-term hard currency earnings' prospects are poor.

These problems give the West an unusual opportunity to influence Soviet Bloc developments, although there exists little direct leverage on these countries' policies. The main instruments of influence are the volume and terms of new government-guaranteed credits and the rescheduling of existing obligations. These actions can affect the Soviet Bloc's ability to finance hard currency imports both directly and through their impact on the willingness of private bankers to lend at their own risk.

Western financial restrictions would further curtail the USSR's ability to pay for hard currency imports in the 1980s and would thereby increase Moscow's difficulty in coping with worsening economic problems, including an already massive and rising defense burden. Hard currency shortages might force Moscow to weigh financial costs more carefully before embarking on foreign assistance programs or adventures. Such restrictions, however, would not force Soviet concessions in important areas of foreign or defense policies, such as Afghanistan. They could influence indirectly the evolution of Soviet policies, although the Soviet reaction might be either aggressive or accommodating.

With respect to Eastern Europe, Western financial instruments—notably the handling of Polish and Romanian rescheduling—can be used as sticks or carrots. A strongly restrictive policy could trigger widespread debt default, which would hurt the East European economies, force the Soviet Bloc economies closer together, increase the burden on Moscow of supporting its empire, and also create risks for the stability of the international banking system. On the other hand, a liberal Western financial policy would allow Hungary, and to a lesser extent Poland, some flexibility in the choice of economic and social policies, and Romania some limited independence in foreign policy. By the same token, Moscow's economic burden would be somewhat relieved.

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The West's ability to use what potential influence its financial instruments provide is substantially restricted, however, by differences between the United States and our West European allies as to the role and importance of trade with the East. The Europeans view this trade as providing jobs at a time of severe unemployment and as creating mutual interdependencies that will tend to limit Soviet adventurism and provide bargaining chips with Eastern Europe. The European governments, like the private bankers, are concerned about excessive financial exposure to Soviet Bloc countries but are not willing to severely restrict trade with these countries.

Nevertheless, the common ground which exists may be sufficient to support an informal agreement now that has the effect of limiting the volume of new government-guaranteed credits and of tightening their terms. Such an agreement would not significantly reduce the USSR's import capacity. It could, however, prevent a possible increase in imports by: (1) giving a negative political signal to private lenders, thereby strengthening their reluctance to make long-term loans to the USSR; and (2) heading off possible attempts by West European governments to compensate for reduced private credits through larger or longer term government-guaranteed lending.

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### The Soviet Bloc Financial Problem as a Source of Western Influence (U)

#### Trends in East-West Economic Relations

Political detente in the 1970s helped to stimulate a massive increase in the volume of East-West trade—more than a threefold increase for the USSR and about a doubling for Eastern Europe. Trade with the West also grew as a share of most Eastern countries' total trade, with the most dramatic increase occurring for the USSR. The importance of trade with the West to the Eastern Bloc economies is greater than its share in their GNP would suggest (3 to 7 percent in Eastern Europe and less than 2 percent in the USSR). These countries all rely on the West for critical imports of food, steel, and high-quality equipment.

The expansion of East-West trade was aided by formal and informal encouragement by Western governments, including a loosening of export controls, and a massive expansion of credit. In the early 1970s, most of the Western credit was in the form of government-guaranteed loans for machinery and equipment sales. As trade surged, however, and contacts multiplied, the USSR and the East European countries entered private Western financial markets on a much larger scale than before. For example, the USSR and several East European countries adjusted to the unexpected drop in foreign exchange earnings during the 1975 recession by borrowing on a large scale in the Eurodollar market. Encouraged by the detente atmosphere, the Communist countries' excellent payments record, the belief that Communist governments had the power to undertake any economic adjustment that financial circumstances might require, and the assumption that the USSR would play the role of lender of last resort for Eastern Europe, Western banks competed with each other for loans to the Eastern Bloc. By the end of 1980 Eastern Bloc hard currency debt exceeded \$80 billion (compared with only \$8 billion in 1971), or nearly \$100 billion if the debt of the CEMA banks is included.

Poland has incurred the largest debt, about \$25 billion. The other East European countries have been more cautious, but Romanian, East German, and

**Table 1**

#### Soviet Bloc Hard Currency Debt and Debt Service Ratio

	Gross Hard Currency Debt (million US \$)		Debt Service Ratio <sup>a</sup>	
	1970	1980	1970	1980
USSR	1,800	18,300	6	9
Poland	1,103	26,000	19	101
East Germany	1,416	14,500	14	55
Romania	1,639	10,700	36	25
Czechoslovakia	564	4,620	9	18
Hungary	601	8,700	16	30
Bulgaria	681	2,975	30	32

<sup>a</sup> Repayments of and interest on medium- and long-term debt as a share of hard currency exports.

This table is Secret.

Hungarian debt ranges between \$8 billion and \$15 billion. The Soviet hard currency debt surged from less than \$2 billion in 1971 to over \$10 billion in the mid-1970s, leveled off in the late 1970s at about \$18 billion as Moscow restricted its hard currency imports, and then began to rise again to over \$19 billion (see table 1).

**The Soviet Bloc Hard Currency Problem.** A fundamental reassessment of the risk of lending to Soviet Bloc countries has curtailed those countries' access to Western private credit and made some of the remaining credit flows vulnerable to new negative developments. The Soviet hard currency position has worsened greatly in recent months and long-term prospects are poor. Most East European countries either cannot meet their hard currency obligations or must make severe economic adjustments to do so.

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The severe deterioration of the Soviet and European hard currency positions has been due to the following factors:

- Increasingly evident systemic deficiencies, resulting in declining growth of productivity and poor export performance.
- The logical implications of the rapid accumulation of hard currency debt in past years—a process which obviously could not continue unless hard currency earnings were also growing rapidly, which they are not.
- In the Soviet case, and to a lesser extent in the East European countries, events outside their control (Western recession, bad crops, lower oil and gold prices, high interest rates).
- The Polish political crisis and economic collapse and its fallout.
- The general worsening of East-West relations, especially in the past year.

These factors led to a fundamental reassessment of the risk of lending to Soviet Bloc countries, which in turn has curtailed those countries' access to Western private credit and made some of the remaining credit flows vulnerable to new negative developments. In the past few months, the possibility that Western governments might restrict or discourage credit to Eastern Europe has created added uncertainty in financial markets and has further discouraged bank lending.

**The Soviet Problem.** The Soviet hard currency position has worsened greatly in the last 12 months because of falling oil prices, bad crops, weak markets for other exports, and aid to Poland, and probably will remain difficult in the foreseeable future. Last year, Moscow drew its hard currency assets to dangerously low levels and has since had to sell large amounts of gold, expand its short-term borrowing, and cut non-food imports. With large gold reserves (worth some \$17 billion at a gold price of \$300 an ounce) and small fixed debt obligations (equal to less than 10 percent of

export earnings), Moscow has substantial flexibility to deal with its foreign exchange problems in the short run. Longer term prospects for increasing hard currency earnings, however, are poor.

The chances are that the volume of Soviet hard currency exports will stagnate or decline during the coming decade. Specifically:

- The volume of Soviet crude oil exports has been declining for three years and, with domestic oil production likely to be at best constant and at worst in steady decline, it will be extremely difficult to prevent a further drop, and eventually perhaps a complete cessation, of oil exports for hard currency.
- Gas exports will continue to increase, but not on a large scale until the Yamal pipeline can be completed—which will probably not be before the latter part of the decade. Even then the increase in gas exports will probably less than offset the decline in oil exports.
- Arms exports for hard currency appear to have leveled off for lack of large new clients. Even current large customers, such as Libya, may have to pare purchases if oil export revenues continue to decline.
- Other Soviet exports (wood, metals, manufactures) are likely to stagnate because of supply limitations and Soviet inability to adapt to Western market needs.

Without the Yamal pipeline a sizable decline in exports would be inevitable, even if Moscow redirected some of the gas to its own and Eastern Europe's use in order to free some oil for export to the West. With the pipeline and some good luck in oil development, the volume of hard currency exports may be held about constant.

Moscow's main hope for sizable increases in hard currency earnings would be another large jump in the prices of oil, gas, and gold—in the case of oil, an event that appears unlikely in the next two or three years, but increasingly likely during the second half of the 1980s.

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If Soviet hard currency earnings are stable or declining in the long term, Moscow will need to greatly increase its new borrowing from the West to avoid a decline—even more to achieve an increase in its hard currency import capacity. But, unless the new credits were on very easy terms, with long maturities, the Soviet debt service ratio would reach dangerous proportions within only a few years. For example, with average maturity of new credits (other than for Yama) of five years, and continuation of recent interest rates, hard currency borrowings sufficient to raise import capacity by 3 percent a year would push up debt service ratios to between 25 and 50 percent by 1985 and over 70 percent or more by 1990.

**The East European Problem.** East European countries' hard currency problem is far more severe than the USSR's. Their gold and foreign exchange assets are minimal and their debt service obligations are enormous. Leaving aside Poland, which is in a class by itself, East Germany has a debt service ratio above 60 percent, and the rest, except Czechoslovakia, are all above 30 percent. These ratios put the East European countries in the same class as Brazil, Mexico, and Chile, countries with far more flexible economies and generally rapidly increasing export earnings.

Although Poland's 1981 private debt rescheduling agreement finally has been signed, Warsaw has next to no chance of generating a large trade surplus or obtaining enough debt relief and credits to cover a 1982 debt service burden of \$10 billion. None of the possible outcomes to Poland's financial mess is likely to improve the prospects for borrowing by other East European countries.

Romania also is in de facto default—a problem which, like Poland's, has hurt other East European countries' ability to borrow. Bucharest's effort to reschedule its debt with banks is off to a smoother start, but several obstacles must be overcome to conclude an agreement. Even with debt relief, Bucharest would face a large financial gap. After sharp import cuts in 1981, there is less scope for adjustment without damage to the already strained domestic economy. Reserves are low and Romania is reluctant

to draw from its gold stock perhaps because some of it has been used as collateral for loans. Large, additional cuts in imports would set in motion an economic decline, such as has occurred in Poland.

East Germany and Hungary have multibillion-dollar borrowing needs this year, and they are virtually shut out of Western capital markets. Banks have been reducing their medium- and long-term exposure for the past year, and, in recent weeks, some West European banks have reduced their short-term lines of credit. Even if the cutbacks are modest, East Germany, Hungary, and Yugoslavia will face serious problems in 1982, but they might be able to get through by recourse to government-guaranteed loans, supplier financing, reserve drawdowns, and sharp import cuts.

Even if existing debt were rolled over, the East European economies would at best limp along with little or no economic growth for the next several years. It is important to keep in mind that Western credits played an important role in financing a large increase in investment in nearly all East European countries during the 1970s, and that this investment was an important factor in sustaining tolerable, if generally slow, growth rates. This important prop for inefficient economies has disappeared.

#### **The Potential For Leverage and Influence on the Soviet Bloc**

The Soviet Bloc's hard currency problems coupled with deteriorating economic performance throughout the Bloc present the West with an opportunity to exert a degree of influence over the USSR and its Warsaw Pact allies. Soviet Bloc dependence on Western credits for food, equipment, and technology gives the West the opportunity to use credits as an instrument of influence.

A reduction in the availability of Western credits to the Soviet Bloc would at least temporarily affect the Bloc's capacity to import Western goods. For Moscow, declining hard currency imports would pose serious problems. In the 1980s slower economic

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growth will present the Soviet leadership with increasingly tough and politically painful choices in resource allocation and economic management. Annual increments to national output will be too small to simultaneously meet mounting investment requirements, maintain growth in defense spending at the rates of the past, and raise the standard of living. Simply stated, something will have to give. The Soviet need for Western goods and technology will therefore increase greatly. Imports can relieve some economic problems by raising the technological level of key Soviet industries and by reducing shortages of grain and such important industrial materials as steel. Western equipment and know-how will be particularly important to raising productivity in the critical machine-building and energy industries. The Soviets must continue importing large amounts of agricultural products and will probably expand their purchases of steel and some other industrial materials.

The main Western government policy instruments affecting the flow of capital to Soviet Bloc countries are: the volume and terms of government-guaranteed

credits; interest rate subsidies; rescheduling of past government-guaranteed credits; and pressure on private banks. Moreover, any official financial actions would surely have an indirect effect on the willingness of the private sector to lend at their own risk to the Soviet Bloc. Credits financed or guaranteed by Western governments make up about one-third of the Soviet Bloc's total hard currency debt—with Poland, the USSR, and East Germany having relied the most on such credits (see table 2).

**The Direct Levers.** Western governments have at their option a number of direct measures to influence the flow of capital to the USSR and/or its Warsaw Pact allies.

To illustrate the *direct* impact of some such measures:

- A 3-percent increase in interest rates charged on the new government-guaranteed credits—roughly the recent increase in OECD Consensus rates for the

Table 2

Million US \$

### Soviet Bloc Dependency on Western Government-Backed Credits in 1981

	Soviet Bloc	USSR	Poland	Romania	East Germany	Hungary	Czechoslovakia	Bulgaria
<b>Stocks</b>								
Total hard currency debt	87,775	24,500	26,000	10,700	14,730	8,250	4,620	2,975
Of which:								
Government-backed debt	29,225	8,500	13,500	1,700	3,800	350	900	475
As a percent of total debt	33	41	52	16	26	4	19	16
<b>Flows</b>								
Gross hard currency borrowing	40,324	5,600	10,000	4,274	6,600	4,310	1,930	910
Gross borrowing from government-backed credits	9,715	2,300	5,750	360	700	100	265	140
As a percent of gross borrowing	24	41	58	8	11	2	14	15
As a percent of imports		8	88	5	10	2	6	6
Net change in stock of government-backed debt		+300	+3,100		+300	+50	+50	+35

This table is Secret.

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USSR—provided at the 1981 annual level would gradually increase interest payments for the USSR by about \$60 million a year, assuming a five-year repayment schedule and no grace period in repayments. The cumulative effect of such a policy over a 10-year period, for example, would result in a total increase of interest payments of some \$1.5 billion for the USSR and \$2-2.5 billion for the Soviet Bloc, excluding Poland. It should be noted, however, the aggregate numbers still pale in face of an East Bloc financing requirement of hundreds of billions of dollars for all of the 1980s.

- At the extreme, a moratorium on new government-guaranteed credits to Soviet Bloc countries (excluding credits for the Yamal pipeline) would reduce the net flow of Western capital by amounts equal to 5 to 6 percent of the 1981 level of hard currency imports. The effects would take some three to five years to be fully felt as the government-guaranteed credits under existing commitments were drawn down.
- Western creditors could also declare Poland in default of its obligations as a result of the initiatives of either private banks or Western governments, but formal default would not of itself have much impact on Poland's capacity to import from the West. It would cause substantial but short-lived disruptions of Polish exports, thereby reducing earnings. Polish default could have severe repercussions for other East European countries, and for Western banks. Private bankers' willingness to lend to other East European countries would be even further weakened. Not only Romania, but also Hungary and East Germany could be forced into debt rescheduling or, failing this, into de facto default.

**The Indirect Impact.** The greatest potential effects of Western government credit restrictions are of an *indirect* nature. They would come from the political signal restrictions on government-guaranteed credits would convey to private lenders. It is highly unlikely that Western banks would be willing to resume unguaranteed long- and medium-term lending if Western governments were imposing politically motivated limits on government-guaranteed credits. Short-term lending might also contract, depending partly on

the creditworthiness of the individual countries. To some extent, this effect has already been felt by the Bloc.

As things now stand, no Soviet Bloc country has received any mid- or long-term unguaranteed bank credit for almost a year. Shorter term credit is available (except to Poland and Romania) but on less favorable terms than in the past. To date, credit restrictions have come entirely from the private sector, and not from any specific Western government action. The current discussion over credit restrictions has contributed to an atmosphere of uncertainty for the private banking community, however.

Pressure on the USSR could also be exerted via Eastern Europe. Soviet trade with Eastern Europe helps to knit the Soviet empire together. All the East European countries, except Romania, depend on the USSR for one-third or more of their trade (see table 3), including the bulk of supplies of oil, gas, and other critical commodities. But Moscow pays a high price for this close relationship. By denying East European countries the possibility of developing economies and economic systems that could be reoriented mainly toward the West, Moscow has little choice but to provide some direct and indirect forms of aid. The direct aid is in the form of credits on bilateral account. The indirect aid takes the form of delivery of undervalued Soviet raw materials and foods in return for overvalued East European manufactured goods. Many of the commodities the USSR exports to Eastern Europe are also sold on the world market, generally at higher prices. The most important Soviet export—oil—is sold to Eastern Europe far below world market prices. Most of the East European exports can be sold on world markets only at severe discounts, if at all, but the Soviets pay world market prices for them.

Before the Polish crisis and its negative impact on Soviet Bloc creditworthiness, Moscow had planned to reduce its price subsidies on oil exports to Eastern Europe, thereby forcing painful economic adjustments in those countries. The Bloc hard currency crisis reopens the issue of Soviet support.

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Table 3

Percent

## Soviet Bloc Trade Patterns in 1980

Exports To				
	USSR	Eastern Europe	Developed Countries	Other
USSR		42.3	31.9	25.8
Poland	33.1	22.4	34.2	10.3
East Germany	35.5	24.5	24.3	15.7
Romania	20.7	19.1	34.5	25.7
Czechoslovakia	34.4	26.9	22.2	16.5
Hungary	36.6	26.6	23.7	13.1
Bulgaria	50.0	16.5	16.9	16.6
Imports From				
	USSR	Eastern Europe	Developed Countries	Other
USSR		42.9	35.4	21.7
Poland	34.6	20.4	33.8	11.2
East Germany	35.1	23.6	30.8	10.5
Romania	16.5	15.7	30.8	37.0
Czechoslovakia	36.3	28.9	24.0	10.8
Hungary	35.5	23.9	30.3	10.3
Bulgaria	58.4	17.3	17.7	6.6

This table is Unclassified.

A worsening of the East European hard currency and economic situation is bound to impose additional burdens on the USSR. Moscow simply cannot afford to let the East European countries go begging to the West by themselves, or alternatively to let their economies deteriorate to the point that serious political consequences could follow. Additional Soviet assistance to Eastern Europe may or may not take the form of hard currency, but, even if it did not, there would be indirectly an unfavorable impact on the Soviet hard currency position. By the same token, an improvement in the East European economic situation would make it easier for Moscow to reduce some of its economic burden of empire.

*The Limitations of Leverage and Influence on the USSR.* This is not to say the West could force the Soviet Union to reverse basic policies through the use of credit levers. Although Moscow could make good

use of increased imports from the West to help relieve its serious and growing economic problems and Western aid to Eastern Europe would serve to reduce the Soviets' burden, Western credit policy used either in a negative or positive fashion would provide little direct leverage on the USSR. It would be difficult to find any specific linkages between Western credit policies and Soviet military and foreign policies. The East-West interface is simply not broad enough to permit policy *quid pro quos* which might be feasible given the nature and limited scope of the economic restrictions and at the same time do not engage central issues of national power and prestige. On these central issues there is little chance that Western economic pressure on the USSR would induce Moscow to become more accommodating. For example, the threat of Western credit restrictions, or a promise to lift them once they have been imposed, could not

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induce Moscow to withdraw from Afghanistan, or allow Poland to slip out of the Soviet power orbit, or concede significant military advantages to the West. Moreover, the Soviet economic problems are predominantly homegrown, and cannot be greatly worsened by Western actions.

On the other side, Western economic pressure could provide hardline Soviet leaders with an excuse for economic problems, a justification for continuing dynamic military growth at the expense of the Soviet consumer, and a political rationale for assuming a more aggressive stance in foreign areas to show defiance of Western actions. There also exists a slight possibility that a sharp curtailment of Western credits could provoke Moscow to declare a moratorium on the repayment of the Bloc's \$80 billion worth of debt to the West.

Within these limits, there remains the possibility that sustained Western economic pressure could influence Soviet policy choices. Restrictions on government-guaranteed credits, coupled with the likely negative reaction of private lenders, would increase the cost to the USSR of both civilian and military programs and thereby exacerbate the worsening economic trends. It is reasonable to expect that the negative impact would fall particularly hard on Soviet programs requiring large foreign exchange expenditures, such as foreign aid to or other involvements in Third World countries. Moscow might then give greater weight to cost considerations in their policy decisions concerning such programs. Eventually, growing economic stringencies could lead to major changes in Soviet policies and priorities, although we see no sign that such changes are in the offing.

**Leverage and Influence on Eastern Europe.** Western economic leverage directed toward East European countries is potentially larger than that on the USSR because of their far greater dependence on economic relations with the West (table 4), and their lesser concern with national power and prestige. But Western leverage on Eastern Europe is also severely limited by the present threat of Soviet military control and the self-interest of Communist leadership and elites in protecting the existing political system. Leverage,

**Table 4**

Percent

**Soviet Bloc Imports From the Developed West**

	As a Share of Total Imports		As a Share of GNP	
	1970	1980	1970	1980
USSR	24.0	35.3	0.7	1.7
Poland	26.0	33.7	2.4	3.9
East Germany	28.0	30.8	4.2	4.2
Romania	40.0	33.3	3.6	3.4
Czechoslovakia	24.8	24.0	3.1	3.3
Hungary	27.1	30.3	5.0	7.4
Bulgaria	19.3	17.7	3.7	4.2

This table is Unclassified.

moreover, is a two-way street. For example, West Germany for decades has traded economic concessions to East Germany in return for limited rights of travel and access, and to Poland in return for the repatriation of ethnic Germans.

Potential Western leverage or influence in Eastern Europe varies from country to country. It is small in Czechoslovakia and Bulgaria, both countries with a relatively small hard currency debt, close economic ties with the USSR and hardline political leaderships. Although West German economic leverage has been employed on East Germany, that country's central role in sustaining the USSR's East European empire and military position in central Europe leaves room for little political flexibility in relations with the West. The possibilities for Western leverage and influence are greatest in Poland, Romania, and Hungary. It should be noted, however, that realizing this influence requires use of both carrot and stick, for under present circumstances positive Western government actions will be necessary to avoid a further curtailment of Western trade with these countries.

The potential for Western political influence in Poland has been greatly reduced by the imposition of martial law and the political dynamics that this

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critical step set in motion. The present Polish leadership is unwilling to share power in any meaningful way with the workers' movement, and the Soviets probably would not allow them to do so. This means that Western actions can affect only those aspects of the Polish scene that are considered politically safe by both Warsaw and Moscow. There remains considerable uncertainty, however, as to how Poland can rebuild a workable, if not efficient economy, and a tolerable form of political control. Although the exigencies of martial law give the hardline elements in the Polish party a clear advantage for the present, competing political factions will push for diverse solutions, and there will be considerable uncertainty as to what will work, what is politically safe internally, and what will be acceptable to Moscow.

These uncertainties provide the West not so much with direct leverage on the Polish Government, as with a potential for indirectly influencing in a small way Polish internal policies. So long as formal default, and the consequent legal scramble for Polish assets, can be avoided, reformist elements in Poland can hold out the hope of some new Western assistance in the future. Even more, a rescheduling by Western governments of Poland's 1982 official debt obligations, and/or acceptance of Poland as an IMF member, would provide clear signals of support for Polish policies if these were seen by the West as moving in the right direction. By the same token, formal default would probably foreclose these options and would leave Poland no alternative but to seek even greater Soviet support and economic integration into the Soviet Bloc. Although Moscow might welcome these added restraints on the restive Poles which would come with a formal Polish default, it would be very unhappy at the prospect of adding to what it regards as an already excessive level of economic assistance.

The degree of Western influence on Poland should not be exaggerated. Western actions cannot affect Poland's foreign policies in any significant way, its military position in the Warsaw Pact, or its fundamental political system. Even the politically acceptable scope of economic reform would be far less in Poland at this stage than in Hungary. Hungary was able to undertake a substantial economic decentral-

ization, but only years after Kadar had established a stable political base. By contrast, Poland could expect any substantial decentralization of economic authority to quickly become highly politicized, and to present a major threat to the party's monopoly of political power.

In Romania, as in Poland, the main Western policy issue is whether or not to reschedule debt service obligations, and on what terms. A successful rescheduling will not eliminate Romania's hard currency problems, which are deep-seated, nor prevent a drastic slowdown in economic growth. But it could give Romania some options other than a substantial redirection of its trade from the West toward the Soviet Bloc. In recent years, some 60 percent of Romania's foreign trade has been with non-Communist countries and less than 20 percent with the USSR. Should Romania be forced to make such a shift, the limited freedom of action Bucharest has been able to exercise in its foreign policy will almost certainly be greatly curtailed. These expressions of Romanian independence from Moscow, although on largely peripheral issues, have been useful to the West. On the other hand, accommodating Romania's economic needs would involve substantial economic costs to the USSR.

Hungary has developed broad economic linkages with the West as well as the CEMA countries and created a unique amalgam of central planning with elements of market economy without in any way threatening the Communist Party's monopoly of political power or the country's attachment to Moscow in foreign policy. There are few indications that Moscow has opposed Budapest's relatively liberal economic policies or would welcome an opportunity to reverse them. Nevertheless, lack of access to Western credits could force a sharp curtailment of Hungarian trade with the West and consequently greater economic dependence on Moscow. Hungary depends little on government-guaranteed credits, but a great deal on medium-term private credits, and these are highly vulnerable to changes in market psychology. Membership in the



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IMF would provide both an important new source of hard currency and a boost to market confidence in Hungary.

#### **West European Perspectives and Interests**

The differences of perspective and interests between the United States and its European allies concerning economic relations with the East make it difficult to find common ground on which to base joint financial restrictions aimed at the East and thus limits our ability to exercise that leverage which exists.

The broadest agreement among the allies is in the private sector. Bankers throughout the West are concerned about their financial exposure to Soviet Bloc countries and would like to reduce it. They consider themselves particularly overexposed in Eastern Europe but also have become increasingly aware of the extent of the USSR's long-term hard currency problem. Moreover, they see the severe worsening of East-West relations in the past two years or so as substantially increasing the political risk involved in any long-term lending to the Bloc.

To some degree the reduction in the East Bloc's creditworthiness in the private sector is reflected in the attitudes of Western governments. As mentioned before, Western governments do not want to be saddled with the heavy budgetary costs that would be entailed in a large-scale bailout of private bank exposure under government guarantees. Moreover, most Western governments probably agree that they have excessively encouraged credit to the Bloc in the past and would prefer to reduce or eliminate the subsidy element in this lending in the future.

This common ground becomes severely limited, however, by the following considerations:

- Trade with the East is still viewed by the Europeans as promoting their economic, political, and strategic interests. West Europeans view this trade as providing jobs at a time of severe unemployment and as creating mutual interdependencies which will tend to limit Soviet adventurism and provide bargaining chips with Eastern Europe.

- They give little weight to the argument that East-West trade buttresses Soviet military power because of its small size in the overall Soviet economy and the long-established priority given to the Soviet military.

- They are even more reluctant to reduce trade with Eastern Europe than with the USSR because of their greater bargaining power with the East European countries, the close bilateral economic, historical and cultural ties with a number of them, and the belief (or rationalization) that Western influence can spread through Eastern Europe and eventually to the USSR.

More precisely, East-West trade plays a small role in the West European economies but is important to certain industries. Even for West Germany, which accounts for about one-fourth of OECD exports to the Soviet Bloc, sales to the East amount to only about 6 percent of total exports and directly provide jobs for about 1 percent of the labor force. The relative importance of trade with the Soviet Bloc increased sharply in the mid-1970s, but has since been declining, and is now nearly back to what it was in 1970 (see table 5).

Nevertheless, the West European countries consider their trade with the East to be important for both economic and political reasons:

- Although a small part of total trade, trade with the Soviet Bloc is one of the most important sources of export earnings from outside the European Community. In the case of West Germany and France, exports to the Bloc about equal those to the United States and are far larger than exports to Japan.
- About one-half of West European exports to the Soviet Bloc and the USSR consist of machinery and steel. The Soviet Bloc, especially the USSR, is an important market for West European steel and for some types of machinery. For example, it accounts for about 15 percent of West German and 12

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Table 5

Percent of Total Exports

## Soviet Bloc Share of Western Exports 1970-80

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
West Germany	5.6	5.6	6.5	7.1	7.7	8.8	7.6	7.1	6.9	6.5	6.3
France	3.6	3.6	3.7	3.7	3.6	5.0	4.9	4.4	3.8	4.1	4.2
United Kingdom	3.1	2.6	2.7	2.5	2.6	2.9	2.6	2.5	2.6	2.3	2.3
Italy	5.3	4.9	4.2	4.4	5.4	6.2	5.3	5.0	4.3	3.7	3.5
Japan	2.3	2.2	2.6	2.2	3.0	3.9	4.2	3.3	3.3	3.2	2.8

This table is Unclassified.

percent of Italian steel exports. Some West European plants are almost exclusively dependent on the Soviet Bloc market.

- During the current Western economic recession, there are few alternative markets for exports to the Soviet Bloc. The United States and Western Europe are giving priority to fighting inflation. Many less developed countries, faced with a massive debt burden and depressed prices for their primary product exports, are forced to curtail imports. Falling oil revenues are greatly slowing growth of the OPEC market. Consequently, any source of increased or sustained demand is important to the West Europeans. Moreover, the steel industry is in secular decline, so that orders from the Soviet Bloc are important in cushioning the needed adjustment in employment and plant capacity.
- Perhaps most important, the Europeans see their political and security interests best served by increasing economic contacts with Eastern Europe and the Soviet Union to promote political and economic stability there and to establish a web of interdependence between East and West. For West Germany, moreover, ties with the East are vitally important in keeping alive the ideal of German reunification and maintaining a high level of personal contacts between West and East Germans.

Although some groups within the West European countries—such as certain conservative political par-

ties and the military establishments—are sympathetic to the view that Western exports to the East Bloc have at least indirectly supported Soviet military efforts, these particular groups generally have had little say in trade and credit matters. European business interests and trade officials have consistently promoted increased trade with the East as has most of the foreign policy establishment.

For all these reasons the West Europeans look favorably on trade with the East and are reluctant to restrict this trade except where its specific contribution to Soviet military strength can be demonstrated. Among our major allies, West Germany and France have the strongest economic and political stake in economic relations with the Soviet Bloc. Italy too has substantial ties with the Bloc. UK interest is substantially less, however, and Japan's is smaller than that of any West European country.

The major West European countries have used government-guaranteed credits as an important means of increasing exports to the Soviet Bloc. These credits are particularly important in financing exports to the USSR because a large proportion of those exports are for major projects, such as gas pipelines and chemical plants, which require long-term credit financing. About 30 percent of exports to the USSR, including the bulk of exports of machinery and steel from the major West European countries have been financed

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by government-guaranteed credits. At least for the next few years, the Western governments will face a dilemma. They are loath to increase an already large budgetary exposure to bank credits which are seen as increasingly risky for both economic and political reasons. On the other hand, they are under pressure at least to maintain exports to the Bloc by providing increased credits under government guarantees to offset the decline in Soviet Bloc access to the private credit market.

For all these reasons it is highly unlikely that our European allies will accept any restrictions on government credits to the USSR or to Eastern Europe which would have the effect of forcing sizable reductions of East-West trade. They may be willing to accept some sort of de facto ceiling on credits or on debt exposure and some further reduction in interest subsidies, but any such agreement is likely to be informal and flexibly applied.

The European governments are extremely concerned with preventing a spread of the Polish financial crisis to the rest of Eastern Europe. They would very much like to see Poland's and Romania's 1982 debt service obligations rescheduled and generally would like both Hungary and Poland to join the IMF. In addition, the West Germans want to avoid any public discussion of East Germany's precarious financial position, for fear that they will have to confront much more openly and dramatically the inconsistencies between economic actions designed to maximize contacts with East Germany and West Germany's key role in the Western alliance and the European Community.

The strong West European views on protecting their economic ties with Eastern Europe give the United States some potential leverage with its allies, since these may be willing to trade off some moderate restrictions on credits to the USSR in return for some US cooperation on Polish and Romanian rescheduling and Polish and Hungarian IMF membership.



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divesting themselves of subsidiaries that have not come up to scratch, eg, the sale in 1981 of Winchester (guns) by Olin Corporation and of Harley Davidson (motor cycles) by AMF Corporation.

The confusion is greatest in the financial sector. A depressed economy, technological advance, the invasion of foreign competitors, knockout interest rates and a crisis in the thrifts are combining to force the biggest change in the structure of America's depository and financial institutions since the New Deal. Scarcely a day goes by without large savings and

loan associations or big money centre banks getting calls from federal regulators begging them to rescue their distressed brethren.

The McFadden and Glass-Steagall Acts and other legislation applying geographical limits or who-does-what rules to deposit takers and moneylenders are being amended by crises in the markets rather than by congress. Here again the difference between what the law says and what the Reagan administration's regulators and enforcers would prefer it to say is large and widening.

## London stock market

### And Malvinas to you too

As the British navy advanced this week, the London stock market retreated. At first, the market did not know what to make of the troubles in the distant Falkland Islands. It remained nervously unmoved. But with Monday's resignation of the foreign secretary, Lord Carrington, stockbrokers were back on the comprehensible, solid ground of an old-fashioned "Suez-like" political crisis. On Monday, April 5th, the market suffered its biggest one-day fall this year.

Government securities bore the brunt of it, as sterling weakened. The gilts' index recorded its worst one-day drop since mid-1979. Equities did nearly as badly. The Financial Times ordinary share index fell 16.4 points at one stage, recovering lamely to close the day 11.1 points down at 559.9. Companies with interests in Argentina were among the worse hit. Lloyds Bank, with 38 branches there through its international division, had 5% knocked off its share price.

The market remained nervy on Tuesday as the pound hit a 4½-year low against the dollar. However, afternoon sobriety was more evident, if no more explicable, than on Monday. The index regained most of the morning's 17-point fall but still closed 6.9 points down on the day at 553.0. Brokers said that on both days jittery private clients were the main sellers, some because they wanted to move their money overseas in case the Conservative government fell and its successor reinvented exchange controls. By Wednesday morning, the City showed signs of regaining its nerve.

A company thrust right into the floodlights was Coalite, the Derbyshire-based builders' merchant to smokeless fuel maker. Its small subsidiary, the Falkland Islands Company, ran the islands' economy rather like a medieval fiefdom. It owns almost half the land—an area equivalent to a third the size of Wales. It also owns 267,000 of the islands' 650,000

sheep and employs 266 islanders, the largest chunk of the working population. It has had a virtual monopoly over the local stores, shipping services and wool industry. It also acts as a surrogate bank—a sort of East India Company in miniature in the south Atlantic.

Coalite says the company contributes about 1½% of the group's business. This gives it an annual turnover of about £5m and profits of £330,000. Coalite is especially reticent about the Falkland Islands Company's activities outside the islands. It has a ships' provisioning and a vending machine rental business in England.

The company was acquired in 1977 along with the rest of its then parent, Charringtons, which had picked it up from the ailing Slater, Walker group four years earlier. Slater, Walker acquired it in 1971, attracted by its portfolio of investments and a large cash pile. Before that the company had enjoyed 120 independent and profitable years.



The City knows bulls and bears, not sheep

## Russian gas pipeline

### Bankers tighten the taps

The natural-gas pipeline to deliver, eventually, about 40 billion cubic metres of gas a year from Siberia's remote Urengoi fields and Yamal peninsula to western Europe is catching Polish flak. West German banks are most at risk in Poland and experience there has made them leery about increasing lending to other communist countries, including Russia.

In consequence, when representatives of 20 banks met in Frankfurt this week to sign an agreement to reschedule Poland's debt, it very quickly became apparent in informal discussions that West German banks are most unhappy about Russia's recent request for an extra DM75m (about \$30m) of unguaranteed loans for the trans-Siberian pipeline that is now under construction.

This sum will not make or break a project costing at least \$15 billion. West German lenders have already extended DM2.5 billion in credits and are poised soon to announce agreement on a further DM300m the Russians asked for in December. Even so, the West German hesitation is significant because it reflects a general dampening of enthusiasm that may delay completion of the pipeline.

The DM2.5 billion loan was extended by a consortium of 16 West German banks and largely guaranteed by the state export credit insurance agency, Hermes. It was founded on a promise by the Russians to make a 15% down payment from their own resources. In December, the Russians said they could not keep their promise, and asked for another DM300m.

Members of the banking consortium were divided over what some of them saw as a dangerous breach of principle. Bankers say the credit is likely to go ahead once niggling over interest rates is over; but some banks, led by Bayerische Landesbank, may opt out.

These banks were particularly annoyed by Russia's request for the extra DM75m early this year. Even the big banks, Deutsche, Dresdner and Commerzbank, are not keen to lend a lot more money unguaranteed. There have been three main reasons for the shift from the go-go fervour of a year ago, when there was talk of DM10 billion in German financing alone.

First, the collapse in Comecon creditworthiness has chilled enthusiasts. The rescheduling of Poland's and Rumania's debts has made bankers fretful about the size of the Soviet Union's pipeline bor-



rowing. Repayment of the loans (from gas sales) is still supposed to be assured, but delays in construction could mean expensive delays in repayment.

Second, America's opposition to the project found more effective expression in President Reagan's post-Poland trade sanctions. The American export ban blockaded one of the pipeline's vital turbine parts, to have been manufactured in the United States. This slowed the pipeline more than any amount of political jawboning.

Three European firms—AEG Telefunken, Nuovo Pignone and John Brown Engineering—that had signed contracts last autumn to supply 125 turbines based on the American General Electric's rotary parts are hunting for ways round the ban—and so are the Russians. According to the Swedish consulting firm PetroStudies, the Russians have brought forward their pipelaying schedule; and have accelerated programmes designed to give them the capacity to manufacture near-substitutes for the American-designed turbines. Reliance on Soviet manufacture, however, would set completion of the project back far beyond the 1984 target date.

Third, as oil prices have dropped and gas supplies increased, European consumers are no longer in quite such a hurry to sign long-term contracts for Soviet gas. Two other new gas pipelines are on the way: Algeria's to Italy via Tunisia (now completed) and Norway's from the North Sea (to be ready by the mid-1980s).

Only West Germany and France have signed firm supply agreements with the Russians. Italy's state-owned utility, Eni, put together an agreement in principle last year, but has yet to get government approval. Holland, Belgium, Switzerland and Austria are still talking. Russia was expected to receive between \$8 billion and \$10 billion a year from sales of 40 billion cubic metres a year. Firm contracts to date guarantee Russia less than half as much income than that.

## Japanese *sarakin*

### Finding foreign friends

TOKYO

Foreign banks, hard pressed to win new business in Japan, have taken a shine to the *sarakin*, the Japanese consumer finance outfits that are about as well respected locally as a low-cut kimono. American and some European banks are said to be supplying 30-50% of the deposits of Japan's biggest *sarakin*. British banks snootily claim to find the business

## Key indicators: World bourses

	Stock price indices				Percentage change on			
		Apr 5	1981-82 high	low	one week	one month	one year	record high
The Falkland Islands	London	559.9	579.8	518.1	-0.4	-0.2	+6.5	-6.3
dispute stops	New York	835.3	882.5	795.5	+1.3	+3.5	-15.9	-20.6
London closing								
Wall Street's	Canada	1580.7	1956.3	1537.6	-0.9	+1.3	-32.7	-34.2
faltering rally. Gold	Australia	461.2	595.5	455.6	-0.5	-0.5	-36.9	-38.2
fever boosts	Japan	539.6	583.3	520.7	+1.8	+0.1	+0.2	-10.6
Johannesburg.	Hongkong	1196.3*	1445.3	1129.8	+2.5	+5.9	-13.4	-33.9
Milan falls on fears	Belgium	102.4	102.4	86.4	+2.8	+9.4	+24.1	-28.0
of an early election.	France	100.0	104.6	88.6	-0.4	+0.8	-7.3	-16.9
Stockholm is	Germany	729.8	729.8	666.7	+1.5	+3.1	+3.6	-29.3
depressed by	Holland	73.9	73.9	63.2	+1.8	+7.1	+8.0	-47.4
opposition party	Italy	198.2	212.7	181.5	-4.3	-3.1	-19.5	-32.1
hints of post-	Singapore	737.2	810.8	687.5	+2.0	+7.2	-11.4	-24.3
election	South Africa	591.3	711.7	563.3	+4.4	-1.1	-5.0	-17.3
nationalisation.	Sweden	577.0	656.5	577.0	-3.5	-4.8	+21.2	-12.6
	Switzerland	262.1	263.1	242.3	+2.8	+6.7	-13.0	-44.2

\*April 2

\*April 2

distasteful, but at least one American bank was cautioned by Japan's finance ministry last year for over-exuberant lending to these consumer finance companies.

The name *sarakin* is a contraction of



"salaryman" (the Japanese tag for company employees) and *kinyu* (or finance). There are now thousands of *sarakin* in Japan. After the bad publicity they attracted in the late 1970s, the finance ministry frowned on domestic banks lending to them. That thrust them into the expensive embrace of foreign banks.

For a take-away loan without security a *sarakin* asks few questions, even about the identity of the borrower. In return for convenience and discretion, the borrower pays loan-shark interest rates that can go above 100% a year.

Japanese consumers are not deterred. Personal loans are estimated to have grown at an average of 36% a year between 1973 and 1979—faster than any other kind of credit, though admittedly from a very low base. For many, the local

*sarakin* is the only source of consumer credit.

The average customer is under 40; in the middle-to-low income brackets and unlikely to get a loan from choosy Japanese banks that prefer to lend to big corporations, and still think of consumer credit as a back-street business.

Four *sarakin* have got a jump on competitors by holding interest rates down to around 40% and by opening up branch offices—usually on upper floors so customers can avoid the shame of being seen to borrow. Lake, ACOM, Takefuji and Promise made new loans of around Y358 billion (\$1.6 billion) in 1981.

The big four are working hard to erase the bad image the industry has got from reports of strong-arm tactics in collecting debts, and of clients driven to suicide and crime. They are advertising, automating and trying to be a businesslike business.

The Japanese parliament may pass a bill this year to regulate the *sarakin*. Best hope: a registration system for new companies, which could set them basking in new-found respectability. That could leave the foreign banks out in the cold as the *sarakin* turn to more traditional (and cheaper) sources of money.

## British investment trusts

### Metamorphosis

Britain's big pension funds and insurance companies have lost patience with the country's flabby £8.5 billion investment trust industry. They want to see it slimmer and fitter. And now that the financial institutions hold three quarters of the shares of investment trusts, it is they (not the small investors the trusts were designed to serve) who have the power to make trust managers look lively.

Robert Fleming and Touche Remnant, the two biggest trust management



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SOVIET BLOC ECONOMIC AND FINANCIAL SITUATION  
UPDATES (4/4/82) (1)

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<i>ID</i>	<i>Document Type</i> <i>Document Description</i>	<i>No of</i> <i>pages</i>	<i>Doc Date</i>	<i>Restric-</i> <i>tions</i>
168814	CABLE  RE USSR	6	4/8/1982	B1

### Freedom of Information Act - [5 U.S.C. 552(b)]

- B-1 National security classified information [(b)(1) of the FOIA]
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168815	CABLE  RE USSR	2	4/8/1982	B1

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168816 CABLE		2	4/9/1982	B1
	RE USSR			

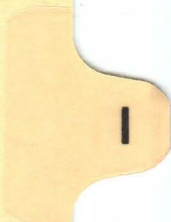
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168817	CABLE	1	4/9/1982	B1
	092147Z APR 82			

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BY KOT NARA DATE 8/25/05

~~CONFIDENTIAL~~ STATE 097146

E.O. 12065: RDS-3 4/5/2002 (STOESSEL, W.J.)  
TAGS: EEWT, ETRD, EFIN, GE  
SUBJECT: - VISIT BY BODO LIEBE, CHAIRMAN OF THE  
EXECUTIVE COMMITTEE OF KLOECKNER-HUMBOLDT-DEUTZ, AG,  
APRIL 5, 1982

1. CONFIDENTIAL - ENTIRE TEXT.

2. SUMMARY: BODO LIEBE, CHAIRMAN OF THE EXECUTIVE COMMITTEE OF KLOECKNER-HUMBOLDT-DEUTZ AG, DISCUSSED GERMAN-AMERICAN RELATIONS, EAST-WEST RELATIONS AND THE SIBERIAN PIPELINE WITH DEPUTY SECRETARY STOESSEL. END SUMMARY.

3. FRG POLITICS--LIEBE NOTED THAT DOMESTICALLY THE SCHMIDT GOVERNMENT WAS UNDER INCREASING PRESSURE FROM THE OPPOSITION WITHIN THE SPD. HE NOTED THE VIEWS OF SPD PARTY VICE CHAIRMAN WISCHNEWSKI, A CODETERMINATION ADVISORY BOARD MEMBER FOR KLOECKNER-HUMBOLDT-DEUTZ, WHO TOLD LIEBE THAT SCHMIDT DOES NOT HAVE THE PARTY UNDER CONTROL. VOICES WITHIN THE SPD WHICH WANT TO GO TO THE OPPOSITION RATHER THAN TO CONTINUE OPERATING IN THE GOVERNMENT ARE GROWING STRONGER. THIS HAS MANIFESTED

ITSELF IN OPPOSITION TO THE NATO DUAL TRACK DECISION ON INTERMEDIATE NUCLEAR FORCES. LIEBE, NEVERTHELESS, BELIEVED THAT THE SPD WOULD OVERCOME OPPOSITION BY THE LEFT WING IN THIS PARTICULAR DEBATE. HE UNDERScoreD THE CONTINUED SUPPORT BY THE GERMAN PUBLIC FOR CLOSE TIES WITH THE UNITED STATES.

4. DEMONSTRATIONS IN BONN--COMMENTING IN RESPONSE TO DEPUTY SECRETARY STOESSEL'S QUESTION, LIEBE EXPRESSED HIS CONCERN THAT THERE WILL BE ANTI-AMERICAN DEMONSTRATIONS DURING THE NATO SUMMIT. HE DISCOUNTED THE POLITICAL IMPORTANCE OF THESE DEMONSTRATIONS, NOTING THAT THERE HAVE BEEN A RASH OF DEMONSTRATIONS IN THE

FEDERAL REPUBLIC INCLUDING DEMONSTRATIONS AGAINST EXPANSIONS OF KLOECKNER PLANTS. HE BELIEVED THAT THE DEMONSTRATORS ARE OPPOSED TO THE FREE MARKET SYSTEM AND CONTINUED GROWTH, THE BASIS FOR GERMAN PROSPERITY.

5. EAST-WEST TRADE--LIEBE NOTED THAT THE SOVIET UNION IS ACTIVELY TRYING TO OBTAIN NEW CREDITS AND EXTEND THE TERMS OF EXISTING CREDITS. A RECENT REQUEST TO THE DRESDNER BANK FOR SUCH CREDITS WAS REFUSED BY THE BOARD. (NOTE: LIEBE IS A MEMBER OF THE SUPERVISORY BOARD OF THE DRESDNER BANK). LIEBE WAS SURPRISED AT THE RESPONSE DRESDNER BANK RECEIVED WHEN IT ASKED THE BONN GOVERNMENT ABOUT ITS ATTITUDE ABOUT SUCH CREDIT REQUESTS BY THE SOVIETS. LIEBE SAID THE GOVERNMENT TOLD THE BANK TO FILL EXISTING CONTRACTS BUT NOT TO EXTEND NEW CREDITS OR CHANGE ANY TERMS OF EXISTING CONTRACTS. STOESSEL REPLIED THAT WE BELIEVE CREDIT RESTRICTIONS TOWARD THE SOVIET UNION ARE PRUDENT AT THIS TIME AND THAT, ALTHOUGH WE ARE NOT TRYING TO STOP ALL TRADE TO THE EAST, THE SOVIET UNION SHOULD NOT BE TREATED AS JUST ANOTHER COUNTRY. LIEBE AGREED AND SAID THAT KLOECKNER-HUMBOLDT-DEUTZ HAD DECIDED NOT TO BECOME TOO DEPENDENT ON TRADE WITH THE EAST AND IN FACT TRADE WITH EASTERN EUROPE AND THE SOVIET UNION COUNTS FOR ONLY APPROXIMATELY FIVE PERCENT OF THEIR TURNOVER.

6. SIBERIAN PIPELINE--LIEBE NOTED THAT KLOECKNER-HUMBOLDT-DEUTZ WAS NOT A MAJOR PARTICIPANT IN THE SOVIET PIPELINE AND IN FACT WAS SUPPLYING ONLY SOME PARTS FROM ITS TURBINE DIVISION. HE STATED THAT HE DISAGREED WITH THE PROJECT BUT RECOGNIZED THAT IT WAS IMPORTANT TO FOLLOW THROUGH WITH SIGNED CONTRACTS. HE ALSO EXPLAINED THAT ALTHOUGH NOT IMPORTANT FOR KLOECKNER, THE PROJECT WAS EXTREMELY IMPORTANT FOR MANNESMANN AND AEG/KANIS. HE WAS ALSO PESSIMISTIC ABOUT AEG/KANIS, SAYING THAT THEIR PROSPECTS FOR

SURVIVAL WERE VERY LIMITED. HE BASED THIS ON HIS CONTACTS FROM THE DRESDNER BANK WHICH WOULD BE INVOLVED IN ANY REORGANIZATION OF A BANKRUPT AEG. AS AN ASIDE HE NOTED THAT THE FINANCIAL CONDITION OF THESE TWO COMPANIES WAS NOT UNLIKE MOST OF BANKS IN GERMANY WHICH WOULD SUFFER LOSSES IN 1982. STOESSEL  
BT

*Update*

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168818 CABLE

1 4/13/1982 B1

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168819	CABLE	1	4/14/1982	B1
	141425Z APR 82			

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