East Bloc Collapse

Soviets face 'scissors crisis'

by Scott Thompson

While members of the "Anglo-Soviet Trust" hope for a full-blown repetition of the 1920s New Economic Policy in the Soviet Union, there is mounting evidence that the Soviets are facing a "scissors crisis" of the sort that led to the partial dismantling of the NEP in 1927. The present "scissors crisis" is being led by the collapse of Eastern European economies that the Soviets have heretofore been successful in looting, combined with a 1920s-style decline in hard currency earnings from raw materials sales.

One result of the present "scissors crisis" has been nearly a doubling of Soviet hard currency debt, through so-called untied loans from major commercial banks of the industrialized Western nations, so that the Soviet Union can continue to fund its empire.

Historically, the main figure that the "Anglo-Soviet Trust" has associated with the NEP (which opened the Soviet economy to foreign concessions) was Nikolai Bukharin, a Western-educated agent of the Odessa grain trading cartels. Bukharin argued for agricultural (over industrial) development of Russia, and he envisioned a Bolshevik conquest of Europe as presaging its forced return to a pastoral economy, as U.S. Treasury Secretary Henry Morgenthau later envisioned the treatment of Germany's postwar economy.

While many of the concessionaires re-tooled Russian raw materials and industrial processes with modern technology, what Leon Trotsky termed a "scissors crisis" arose because of the collapse of export earnings from raw materials and agricultural products. The grain cartels and raw materials concessionaires were bleeding the Soviet economy, so Josef Stalin, first siding with Bukharin against his more powerful rival Trotsky, next turned on Bukharin and ended NEP provisions that permitted ready repatriation of profits from the Soviet Union.

Collapse of hard currency earnings

Replacing the grain and mineral exports of the 1920s as the main source of Soviet hard currency earnings has been energy exports, especially oil and natural gas. The volume of Soviet oil deliveries to the West rose by about a quarter from 1975 to 1980, but because of OPEC pricing the value of its sales tripled. In 1975 the Soviet Union earned 49% of its $8.56 billion hard currency from exports of oil and gas, especially to the OECD countries. In 1985 it earned 74% of its $22.34 billion hard currency from exports from the sale of oil and gas.

This is a minuscule amount of hard currency at Soviet disposal to run an empire, and there has been a decline in Soviet hard currency earning power because of the collapse of energy prices. Every dollar decrease on the price of a barrel of oil means a $500 million loss in annual revenue for the Soviet Union. In the latter part of 1985, Urals crude sold on the spot market at about $27 per barrel; by the middle of 1986 the price had dropped to about $11 per barrel.

Western analysts have placed the Soviet loss of hard currency earnings from 1985 to 1986 in the region of $8 billion, or roughly one-third of the country's exports to the West in 1985.

Economic warfare has assisted this decline in Soviet hard currency exports from energy sources. Starting with the 1979 Soviet invasion of Afghanistan, U.S. sanctions have especially embargoed the sale of advanced oil and gas technology needed by the Soviets to exploit their dwindling reserves. Further, the Reagan administration won support from the International Energy Agency in May 1983, to limit Soviet gas supplies to Western Europe beyond those amounts already contracted by year-end 1982, because it was possible to rely upon new fields opened in Norway.

Even before dwindling Soviet reserves force a drop-off in sales to the West, which is expected to occur by the mid-1990s, these two factors combined to block a Soviet end-run around declining oil and gas prices by increasing production. For the first time since the war, oil output actually fell in 1984 and again in 1985. A recovery in 1986 led by increased investment under Mikhail Gorbachov's policy of perestroika increased output by 4%, merely restoring 1983 levels.

The Soviets have been left with six options for increased hard currency earnings:

1) go more heavily into the international narcotics market (part of Soviet policy since the Khrushchov era), which has been done through such client states as Syria, Afghanistan, Cuba, as well as through proxies in the "Golden Triangle" opium zone;

2) produce world market quality goods, which is the stated goal of perestroika ("restructuring") combined with the policy of joint ventures, but so far this is merely in its start-up phase;

3) sell more gold on European markets, but this risks depressing prices;

4) increase the looting of Eastern European economies, but many of these have already entered a breakdown collapse phase;

5) increase syndicated borrowing from commercial banks; and,

6) issue of Euronotes, bonds, or other securities, which the Soviet Union has just begun to do.

Untied loans

Since Mikhail Gorbachov became General Secretary of the Communist Party of the Soviet Union, the Soviets' borrowing has more than doubled. A recent joint study by the Central Intelligence Agency and Defense Intelligence Agency, titled "Gorbachev's Economic Program: Problems Emerge," shows Soviet estimated hard currency debt to the West holding relatively steady from 1980 to 1984 at around $20 billion, when it suddenly jumps to $41.2 billion for 1987. Most of this increase at a rate of $6-8 billion a year, is led by commercial debt to major banks that have syndicated loans to the Soviet

consulting firm, estimates that Soviet gross indebtedness will rise from about $29 billion in 1985 to $53 billion by 1990.

For the East bloc as a whole, total external indebtness exceeded the $100 billion mark by year-end 1986, with the Polish debt then exceeding total Soviet hard currency indebtedness. Soviet borrowing under Western government programs tied to export-import business has declined dramatically in the 1980s as a proportion of the Soviets' overall borrowings. Instead of government-to-government credits tied to the exports of the respective countries, the Soviet Union has been able to obtain untied loans at highly favorable rates of interest. "Untied" loans mean that it is cash-on-the-barrelhead, which the borrower can employ for any purpose he chooses.

Almost 80% of Soviet borrowing is in the form of such untied loans, and over 90% of that loan money is being provided by the commercial banks of Western Europe and Japan. U.S. banks provide slightly less than 10%, but the attitude of one U.S. commercial bank that led a $200 million syndicated loan for the Soviet Union, First Chicago, was to say: "The loans could be used for the military, but we would hope not. I mean, they do so much of that kind of thing anyway, it doesn't matter."

While some of the Soviet borrowing has been directed toward the purchase of high-technology prototypes for breakdown and possible duplication by scientists assigned to the military sector, PlanEcon Inc. estimates that the main purpose of Soviet hard currency borrowing has been to fund their empire. Already, the Soviets have placed between $50-60 billion in strategic loans to Third World countries that they wish to bring within their empire. The total value of this debt might be 50 cents on the dollar, and much of it is low-grade debt that the Soviets have little hope of collecting.

So far, the amount of Soviet borrowing has caused little concern among bankers, because the Soviets have ready assets to cover the debt that they hold. The $200 million First Chicago syndicated loan was offered at merely one-eighth percent over the London Interbank Offer Rate, with an eight-year maturity, six-year grace period. One former assistant to David Rockefeller at Chase Manhattan Bank, however, Roger W. Robinson, Jr., who was the senior director for international economic affairs at the National Security Council until 1984, has tried to get bankers to impose voluntary constraints upon untied loans on the basis that the loans are used by the Soviets for their military, KGB international operations, and for funding their empire.

Robinson's role as a spokesman against untied loans is ironic, because David Rockefeller's bank has been involved in business with the Soviet Union for over 50 years. During the 1920s and 1930s, Chase maintained a $30 million revolving credit for the Soviet Union, which acted instead of the Export-Import Bank for financing trade, and David Rockefeller has himself been a spokesman for untied loans to the Soviet Union through his role as one of the founders (now a director emeritus) of the U.S.-U.S.S.R. Trade and Economic Council.

Well-informed sources have named the following U.S. banks as involved in this sort of business with the Soviet Union: Chase Manhattan Bank, First Chicago, First Boston Corporation, Bank of America, National Bank of Detroit, National Bank of North Carolina, Citibank, Irving Trust, Chemical Bank, Republic National Bank of New York, Bank of New York, Mellon Bank, Marine Midland, First Interstate Bank, Ltd., First National Bank of Chicago, Union Bank, Bankers Trust, Morgan Guaranty Trust Co., Manufacturers Hanover, and Continental Illinois.

Legislation

Preliminary hearings were held in November 1987 on a new bill, H.R. 3095, introduced last August by Rep. Jack Kemp (R-N.Y.) and Rep. Toby Roth (R-Wis.) to stop untied lending by U.S. banks. The bill is known as the International Financial Security Act of 1987. Even if the bill does pass, it is unlikely to curtail the Soviets' ready access to Western European and Japanese sources of untied loans, unless an international agreement is reached to block such loans to the Soviet Union.

Should this happen, the Soviets have another option. In January 1988 the Soviet Union ended a 70-year absence from the international public bond market when a state bank sold a $77.8 million bond issue in Switzerland. PlanEcon Inc. estimates that this bond issue was a trial balloon, and others are likely to follow. It was to be able to launch such bond issues, that the Soviet Union made an effort to settle its czarist debt with the United Kingdom last year, so that it could place bond issues on the London market. So far, no such settlement has been reached in the United States, and the Soviets are barred from issuing bonds on the U.S. market.