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**A FOREIGN ECONOMIC POLICY
FOR THE 1970'S**

**HEARINGS
BEFORE THE
SUBCOMMITTEE ON
FOREIGN ECONOMIC POLICY
OF THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES
NINETY-FIRST CONGRESS
SECOND SESSION**

PART 6—East-West Economic Relations

DECEMBER 7, 8, AND 9, 1970

Printed for the use of the Joint Economic Committee



U.S. GOVERNMENT PRINTING OFFICE

40-333 O

WASHINGTON : 1971

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A FOREIGN ECONOMIC POLICY FOR THE 1970'S

MONDAY, DECEMBER 7, 1970

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The Subcommittee on Foreign Economic Policy met, pursuant to notice, at 10:05 a.m., in room S-407, the Capitol Building, Hon. Hale Boggs (chairman of the subcommittee) presiding.

Present: Representatives Boggs and Conable.

Also present: John R. Stark, executive director; John R. Karlik, economist; Myer Rashish, consultant; and George D. Krumbhaar and Leslie J. Barr, economists for the minority.

Chairman Boggs. The hearing will come to order.

Today we open 3 days of hearings on the possibility and advisability of expanded trade and investment flows between the U.S. and Socialist economies. Recently American businessmen have complained that restrictions imposed by the U.S. Government prevent them from competing with Western European producers for sales to Eastern Europe and the Soviet Union. An even more novel development is the sale of manufacturing operations by Western firms to Socialist governments. Foreign investment is also being discussed as a possibility, and Yugoslavia appears to be a leader in acquiring investment from abroad. On the other hand, it is necessary to control flows of strategic materials and military technology to Socialist countries. Occasional review of such limitations is desirable to insure that they are serving their objectives without becoming counter-productive.

We hope to touch upon all of these issues in these hearings. The first day, today, is devoted to the political considerations that argue either for or against an expansion of economic relationships between East and West. Tomorrow and Wednesday will focus in detail on the economic feasibility and desirability of additional forms of trade and investment between East and West.

First, in our distinguished panel of witnesses today is Richard V. Allen, vice president of International Resources, Ltd., located in Denver, Colo. Next is John C. Campbell, senior research fellow for the Council on Foreign Relations. Third, we have Francois Duchene, who is director of the Institute for Strategic Studies in London. He has not arrived as yet, but we understand he is on his way.

Our concluding witness will be Uri Ra'anah, professor of international politics at the Fletcher School of Law and Diplomacy.

Mr. Allen, we would be very happy to hear from you first.

STATEMENT OF RICHARD V. ALLEN,¹ VICE PRESIDENT, INTERNATIONAL RESOURCES, LTD., DENVER, COLO.

Mr. ALLEN. Thank you, Mr. Chairman. It is a pleasure to present what I consider my periodic review on the subject of East-West trade, expanding our relations with East-West Europe. Some 10 years ago Congressman Paul Kitchin held a series of hearings which awakened my interest in the subject, and since then it has been a subject of continuing interest to me.

It is possible to think of 10 or even 20 very good economic reasons why we should remove immediately every barrier that seems to impede trade between East and West today. Each of these reasons, as adduced, would be subsumed under the broad heading of the principle that the expansion of trade brings positive benefits to the American economy and ultimately to the people of the United States.

But on the other hand, there are two very good reasons why these will not be removed very quickly. They are the foreign policy objectives as stated by the present administration, and in a sense a continuation of past foreign policy and, on the other hand, national security requirements. Your inquiry is focused primarily on the three areas—the Soviet Union, Eastern Europe, and the possibility of expansion of trade with Communist China—and I will touch briefly on all three of these.

Today, many people feel that the conflict in Indochina has not only awakened the United States to the growing importance of Asia as a whole, but has also caused a major shift in priorities for our foreign policy for the next decade. Some even argue the Pacific basin is a real area of the future, the place where our major interests will develop during the next 2 decades, and the emerging reality will slowly diminish the importance of our traditional interests in Europe.

Therefore, a quite persuasive case can be made for this point of view and one only has to examine the case of Japan to appreciate the logic of it.

My own view is somewhat different. That is, while our main interests may, in fact, change over the long run, the main axis of our foreign policy is going to remain oriented toward the Soviet Union, that the major global questions and the problems which arise in the years ahead are going to be decided by these two super powers. This is so if only because the major pressure points in the world today remain those which threaten to bring the United States and the Soviet Union in some sort of direct confrontation, and the basic policy choices that are going to be made in Washington and Moscow are going to be long-run determinants for overall developments in the so-called continuing conflict, and will also affect the prospects for world peace.

Now, Mr. Chairman, this administration has adopted as its principal foreign policy theme a shift from the "era of confrontation to

¹ Richard V. Allen is vice president of International Resources, Ltd., Denver, Colo. He is also a special consultant to the National Security Council and is a member of the President's Commission on International Trade and Investment Policy. In 1968 he served as director of foreign policy operations for the Republican presidential campaign, and was appointed to the President's staff in December 1968. In which capacity he served until November 1969. Previously, he was a senior staff member of both the Hoover Institution on War, Revolution, and Peace, Stanford University, and the Center for Strategic Studies, Georgetown University. He has published a number of books on East-West affairs and national security, among them "East-West Trade: Its Strategic Implications."

an era of negotiation," and has taken important steps such as the strategic arms limitation talks, negotiations concerning the Middle East, and the sort of negotiations on Vietnam that continue in Paris. Simultaneously, the implementation of the Nixon doctrine has begun, with what I consider to be the sensible and clearcut objective of removing or reducing the chances for direct confrontation with the Communist powers; at the same time, this doctrine provides for the improvement of self-defense capabilities of other nations, those nations having thus far relied almost exclusively on the American guarantee.

It is my view that, for these initiatives and for the conduct of the U.S. foreign policy generally, the President deserves praise and credit.

On the one hand, in implementing this constructive policy of seeking negotiations with a potential adversary, the administration ought properly to be doing everything it possibly can to expand trade with the Socialist bloc. There are those who argue that the time is ripe for us to do it at the moment. On the other hand, the administration looks out on a world which I have characterized as fairly unsettled, and sees these pressure points standing out looming in the foreground.

So the administration has to ask itself as it perceives the national interest and as it interprets the requirements of our national security, whether expanded trade with U.S.S.R. of any magnitude could, in fact, make more difficult the resolution of potential conflict situations between the two by enhancing the overall capability of Soviet Union. In other words, the administration has to ask itself whether the export of any given commodity or technology could, in fact, increase the overall military or strategic capability of the Soviet Union, or could facilitate support for North Vietnam, support for revolutionary militants or so-called national liberation movements.

Now, regarding Eastern Europe, I think we can and must make distinctions among the individual Communist countries and particularly as those countries assert their own independence from the Soviet Union itself. In the last 2 years, the President's visits to Yugoslavia and Rumania have caused, I think, a substantial improvement in our relationships with Eastern Europe, and this development should be encouraged.

At the same time, the Western European countries are in the process of adjusting their historical relationships with Eastern Europe; a meaningful détente has occurred and it has provided the framework for a dialog to occur between East and West.

This is typified today by the visit of Chancellor Willy Brandt of West Germany to Poland in an attempt to normalize relations between those two countries. Historically, those relations have been very tense.

At the same time, it is necessary to remember when considering the possibility of expanding the trade with Eastern Europe, Mr. Chairman, that the Soviet Union does consider Eastern Europe to be one of its privileged spheres of influence and considers it as harmful to the so-called unity and cohesion of the Socialist commonwealth, which could be identified as a euphemism for the national interest of the U.S.S.R., the spread of Western influence.

Now, the administration, in my view, will properly pause before the question of expansion of East-West trade, particularly as it effects the Eastern European countries, as it recalls the sudden, brutal and very effective invasion of Czechoslovakia in August 1968. I have said

that this was quite predictable event, despite the widespread belief in the non-Communist world that an invasion was simply an impossibility. You will recall, I am sure, the coverage of the events in Czechoslovakia in the Western press during the period of January to August 1968. Things were moving so rapidly in Prague at that time that it was generally felt that centrifugal force alone would cause Czechoslovakia to achieve some sort of independent status, free of the Soviet domination.

In late 1970, as we consider this topic, Mr. Chairman, we may have forgotten the invasion of Czechoslovakia, but I am certain that we can ill afford to forget its lessons or its aftermath. The most important aspect of the invasion of Czechoslovakia came later in terms of the so-called Brezhnev doctrine, which asserts the duty of the Soviet Union to intervene in any situation in which it feels its interests threatened, particularly on its periphery. That is to say, any dramatic shift to pull apart the unity of the Socialist Commonwealth would be quickly met by decisive Soviet force as was the case in Czechoslovakia. Therefore, we ought to keep in mind as we discuss the possibility of expanded trade for purposes other than its mere economic benefits, the possibility that the Soviet Union may, in effect, intervene in a similar fashion.

In our commercial relations with the countries of Eastern Europe, we have to remain on our toes and be able to secure the business in so-called borderline or "gray areas." At the same time, we will have to weigh each commercial transaction on its merits and in the process we are going to have to maintain traditional safeguards.

That is to say, we must have complete assurance against the utilization of some marginal product or technology by a third party, in such a manner as to augment its overall capability in conflict or confrontation situations.

Now, with this much said, I think a policy of this sort gives substantial leeway for increased trade in the peaceful sector, and it gives the American businessman a chance to compete because competition, of course, is increasing worldwide and may particularly increase in the Eastern European market. I think at this juncture one could favor an almost unlimited expansion of trade with Eastern European countries in the field of consumer goods because we have a capacity to satisfy the wants and needs of human beings. I think that the consumer goods sector in the area of basic consumer goods that make life easier and more pleasant could, in fact, be expanded for great profit to the United States, perhaps politically as well as economically.

With regard to China, one sees very little possibility of dramatic improvements in our relations, and perhaps this process will take a great deal of time—one, two or more decades. And there appears to be, in my view, no immediate benefit, or economic benefit flowing from trade with China. Therefore, any expansion of trade would be considered essentially symbolic.

I think there are a number of ideological and practical limitations on the question of trade with Mainland China, one of them being the political obstacles that the Chinese themselves impose. They may wear down and erode with time. We will have to wait and see.

One wonders whether an American trade delegation to Peking would seize the opportunity to pay collective obeisance to the thoughts of Mao Tse-tung as a prerequisite to doing business.

Now, one other consideration that you want to include in your deliberations, Mr. Chairman, would be a possible rapprochement between China and the Soviet Union. Some are now viewing this as a rather remote possibility, but I think it would change the picture substantially should the Soviet Union and Mainland China decide to "patch it up" in any significant way. I would not suggest to you that things will ever be the same as they were in pre-1960 years, but I would suggest to you that this could, if it is a meaningful development and a reality, seriously effect our own policy vis-a-vis trade with the Communist countries.

Now, let me come to what I consider to be a most important point. In the beginning I said that the main axis of our foreign policy is going to remain oriented toward the Soviet Union and this will be the case for some time to come. Presently, the United States-Soviet relations may be characterized as correct and businesslike on the surface, but with growing undercurrents of tension below. I do not detect a warming trend, especially in light of Soviet behavior in the Middle East and elsewhere. So it is quite likely that the policy debate in Moscow is continuing today. At the same time it will be rash for us to assume that either outcome of the debate will redound to the benefit of the United States. After all, Soviet leaders are debating the pursuits of their own objectives and not ours.

One more factor in this debate, Mr. Chairman, is the way in which the East-West power balance appears to be changing. Since the Cuban missile crisis of October 1962, the U.S.S.R. has come a long way. Many felt at that time, as a result of having faced the overwhelming strategic superiority of the United States, having stared down the nuclear gun barrel as it were, the Soviets had resigned themselves to a long term and perhaps even a perpetual inferiority vis-a-vis the United States, and that the détente that blossomed between the United States and the Soviet Union after Cuba led to a number of very optimistic, indeed overly optimistic appraisals of future Soviet behavior.

I do not think this optimism was warranted at the time and certainly I do not think events have proved the optimist's case. In fact, not only did the Soviet Union refuse to accept the long range inferiority vis-a-vis the United States, but immediately after the Cuban missile crisis proceeded to marshal its resources so it could achieve the quantum leap ahead of the United States. Simply stated, Soviet leaders began a drive to overtake the United States in terms of strategic power and also to assure there would be no more Cubas with an outcome such as that in 1962.

We are seeing today the first results of this program. The Soviets have continued the policy of putting their consumers in second place and keeping them there, and they have allocated increasingly large amounts of their scarce resources to the military sector. Some argue that their goal is parity with the United States and that once this happens, once they achieve this status, they are going to shut off or slow down their military-industrial complex.

I do not believe that this is the case. My view is that the U.S.S.R. is going to continue to press for overall and clear-cut superiority over the United States.

Now, if you just glance at the available unclassified and declassified data, you should be concerned with this problem. The implication

is that the balance of power may be shifting the wrong way from our point of view and with it may come severe restraints on the U.S. capabilities, and certainly a construction in the field of policy choices, particularly in times of severe friction and possibly unwanted confrontations.

One of the most persuasive cases made in this regard was made by Senator Henry Jackson in a November 8 address at the Hague. Senator Jackson commented: "Looking ahead, as Soviet power grows, the willingness of the Soviet leaders to become involved in new areas—and their inclination not to accept diplomatic defeat, as once in Cuba—is likely to grow accordingly."

Mr. Chairman, I would request Senator Jackson's address be incorporated into these proceedings, because I consider it relevant to the discussion at hand.

Chairman Boggs. Without objection, it may be incorporated.

(The address follows:)

THE STRATEGIC EQUATION AND A BOLDER KREMLIN

(Address by Senator Henry M. Jackson, Before the Military Committee, North Atlantic Assembly, The Hague, the Netherlands, November 1970)

I.

Many people in recent years have believed that the changing strategic relationship between the Soviet Union and the United States has no great significance, and that the worst of NATO's problems with the Soviets are behind us.

As you may know, I do not share this optimistic outlook.

For some time a number of us have been warning that Soviet parity with the U.S. in strategic arms—or Soviet superiority—could result in Soviet leaders undertaking a more extensive and more dangerous range of risks in the international arena. Moscow's deepening penetration of the Middle East—using Egypt as its Trojan horse—is an unpleasantly dramatic confirmation of this forecast. And the hopes of many for a speedy and conclusive round of SALT negotiations have been prejudiced by Soviet violations of the standstill ceasefire in the Middle East.

The somber prospect of a Soviet Union, with rapidly expanding military capabilities, increasingly disposed to throw its weight around in support of its great power interests has implications which should be weighed very seriously by members of the Atlantic Alliance.

II.

Is "parity" in strategic power the goal of the Soviet leadership, or is it only a stage in the pursuit of "strategic superiority" over U.S. nuclear power? Is the Soviet Union seeking to achieve a major shift in the worldwide balance of power hoping thereby to consolidate its own alliances and disintegrate the opposing forces?

If one assumes that "parity" is the Soviet goal, it is difficult to explain the extremely rapid growth in their land-based missile force, particularly their continuing deployment of the SS-9 missile. The Soviets, with a smaller GNP than the U.S. and a serious deficiency of consumer goods have now invested approximately \$9 billion in SS-9's alone—a figure that exceeds our entire strategic offense budget for FY 1971.

When the Soviets succeed in perfecting a MIRV device, each SS-9 launcher, of which the Soviets now have operational or under construction more than 300, would be capable of delivering three 5-megaton warheads at intercontinental ranges. Other potential MIRV options could add to this capability.

Moscow's build-up of land-based offensive missiles has been paralleled by an equally rapid expansion of its Y-class submarine force, and these submarines are being constructed at a rate of 8-10 per year.

Even when the Soviets were in a state of admitted strategic inferiority to U.S. power, they periodically pressed forward policies designed to advance their

political interests and to undercut the security of the West. In these past probings, the strategic inferiority of Russian power has set limits to the extent of the risks that the Soviet policy-makers were willing to run. Now, however, Kremlin leaders can be confident of overall nuclear equality with the United States—even a superiority in some nuclear weapons areas—and they can count on a local superiority of forces in many parts of the world.

Looking ahead, as Soviet power grows, the willingness of Soviet leaders to become involved in new areas—and their inclination not to accept diplomatic defeat, as once in Cuba—is likely to grow accordingly.

As Leonard Schapiro, one of Great Britain's most respected Soviet scholars, puts it:

* * * the Soviet Union derives increasing confidence from the sheer quantity and size of the weapons which it possesses. There has always been an almost pathological Soviet fear of actual, numerical inferiority in weapons vis-a-vis a possible enemy. Conversely, as the numbers and strength of Soviet weapons of all kinds, nuclear and non-nuclear as well, increase, so one should expect them to become bolder in their policy and more prepared to take risks.

And as the able American analyst of Soviet policy, Thomas Wolfe, points out:

In trouble spots * * * where the presence of U.S. and Soviet military power may tend to overlap, even a slight propensity in the Kremlin to press for political gains commensurate with the Soviet Union's stronger military posture could greatly aggravate existing instabilities. Moreover, a Soviet Union advertised as the strategic equal of the United States and possessing an improved capacity to intervene in local situations would probably find itself under new pressures to come to the help of clients abroad, where previously it was excused from becoming engaged because it obviously lacked the means to do so.

The tasks of deterrence and defense stretch on ahead, therefore, as far as any of us can see—not only in the central European region but also for NATO's vital flanks.

In particular, we cannot discount the danger that the course of repression and counteraction in East Europe will produce new crises and disturbances spilling over the frontiers of NATO. Nor can we expect that a Soviet Union which brazenly exploits the tragic conflict between Arabs and Jews on behalf of historic Russian ambitions in that area, will not undertake to test Western resolve and staying power on other fronts.

Furthermore, in our efforts to ameliorate East-West tensions in Central Europe we must take care to assure that tangible benefits flowing Eastward are matched by tangible, and not merely symbolic, benefits flowing to the West. Symbols, after all, can disappear overnight while arrangements that bring forth complex geographic and economic relationships remain.

III.

There is little disagreement in America about the value of the Atlantic Alliance or the importance and firmness of the U.S. commitment to the defense of the NATO area. But I and others in our Congress have had a strenuous time trying to maintain an effective American combat force in Europe.

This problem stems partly from a failure on the part of many Americans to understand why American troops in Europe are so important. The main purpose of the American troop commitment is political: to leave no doubt in the Kremlin that the United States would be involved, deeply involved, from the outset of a Soviet-inspired crisis or a Soviet move against the NATO area. It needs to be perfectly clear to the Russians that their forces would meet enough American forces to make the crisis a Soviet-American crisis, not just a European one. This means, in my judgment, that a token American force is not adequate. It should be an effective American combat force, not just something to be tripped over, but a force capable of putting up a serious fight.

The primary function of NATO's conventional forces, with their vital American component, is to meet an emergency as effectively as they can, posing the continual threat that if the emergency continues and enlarges, the risks of escalation continue and enlarge with it—in particular the risk of nuclear war. This risk of escalation is one which no one should minimize. Short of a direct attack on U.S.

territory, nothing would touch a deeper psychological nerve or lead to a more immediate sense of alarm throughout my country than American and European forces jointly resisting Soviet aggression in the NATO area.

For this reason, a NATO force capable of containing a sizable attack is required. Any smaller force would tempt the Soviet leaders to test the allied will, and might one day lead to a situation in which the allies had only two choices: either to back down, or to resort to threats that would ring hollow given the inadequacy of our conventional preparations.

NATO force requirements are designed, of course, not only to contribute to deterrence and defense but also to fortify the diplomatic bargaining position of the West vis-à-vis the East. A major and as yet unachieved purpose of the Atlantic Alliance is to reach a genuine, stable European settlement with the Soviet Union. Among other things, such a settlement will involve the return of Soviet forces to the Soviet Union. How can the Soviet Government be encouraged to move in this direction? Certainly not by putting in jeopardy the bargaining position we have worked so long and hard to construct. Clearly, we should sustain that position and actively pursue acceptance of gradual and balanced revisions in forces on both sides of the Iron Curtain, recognizing the geographic asymmetries of the Atlantic security area.

If and when the Soviet Government sees an advantage in reciprocal reductions in forces in Europe, this could surely be done so as to advance the legitimate security interests of all nations concerned.

As you well know, American pressures for cuts in our forces in Europe are nourished by the widespread feeling in the United States that too many Europeans are less concerned with the security of their homelands than we are. In talking to the people this fall in many parts of our country, I was repeatedly asked: "If the Europeans on the scene are not worried enough to put up the money and the forces, why should we be concerned?" Thus signs of indifference in Europe provide powerful ammunition to Americans of isolationist inclination.

Most Americans do not expect gratitude for past U.S. help to Europe: but they do expect a fair deal. And they don't think they are getting it. I believe they have some justification for feeling this way. I cannot see that, overall, Western Europe is making a reasonably proportionate contribution to the common defense effort. The problem is bound to be of concern for Americans because of our major expenditures required to maintain a strong and safeguarded U.S. nuclear retaliatory capability and to help defend other areas in the world of importance to all free nations.

Further complicating the problem is the remarkable indifference in most European circles to the difficulties and dangers in the Middle East. From across the Atlantic it seems that too many Europeans have been too slow to come to grips with the threats to the common security that result from Soviet designs on that critical flank of NATO. This sort of unconcern, this kind of insularity if you will, further feeds the isolationist elements in the United States.

There is a lot of talk these days on both sides of the Atlantic about national priorities. All of the NATO nations have urgent homefront tasks which make heavy demands on national budgets and energies. None of us have resources to squander. But let's make no mistake about it. We won't be able to keep building better societies at home if we fail to shoulder essential responsibilities abroad.

This issue of priorities, of course, is not an either/or proposition. We should not delude ourselves with the notion that we must choose to devote resources and energies *either* to domestic needs *or* to national security. Indeed, even the term "domestic" when applied to priorities can be misleading: for nothing is more "domestic" than the survival of the people of the Atlantic nations and their freedom to decide their own destiny free from domination by any outside power.

There is something ludicrous about the notion that one kind of survival is more important than another. We must not only work for just and stable societies at home, but, together, we must maintain peace by deterring adventurism and nuclear war. Success in one of these tasks will not help us survive failure in the other.

You can appreciate that I am encouraged by the evidence that more Europeans now understand that there is a direct relationship between their willingness to draw on their own resources for their own defense, and the willingness of the American people and the American Congress to maintain a substantial American troop presence in Western Europe.

I want to commend the European Defense Ministers who at their meeting in Brussels October 1 worked out a two-pronged approach to "burden-sharing" on the correct assumption that NATO members find themselves in a variety of financial and political positions. Some members are able to strengthen their NATO mobility, and, in some cases, increased numbers of assigned forces. Other members will prefer to contribute more money to the common NATO defense pool to strengthen Alliance support for the American presence in Europe. Some members may adopt both approaches.

I assure you that early, concrete and substantial progress in "burden-sharing" is essential to strengthen the hand of those of us in the U.S. Congress who want to fend off unwise Congressional cuts of our troops in Europe after July 1, 1971.

So I look hopefully to the European members of the Alliance accepting a greater share of the task of protecting the NATO area. For I remain convinced that the future effectiveness of the Alliance depends in very large measure on the scope and quality of European efforts to keep NATO formidable.

Mr. ALLEN. Now, I recognize that we are not here to discuss the strategic equation between East and West, but I do mention it because it has a bearing on the deliberations of this committee of Congress and because it is relevant to the future of the U.S. trade policy toward the Communist countries.

The picture that emerges in the strategic balance is not a very pretty one and it has nothing to do with "hawks" or "doves." It has to do, I think, with facts and subsequently, of course, the interpretation of those facts.

The discussion becomes much more interesting and more intense when one begins to discuss the motives involved. Thus, it may not be particularly revealing or profound to say that the Soviet Union is seeking to augment its power, its influence, and prestige at the expense of the West, and of the United States; and that it will attempt to gain strategic footholds wherever it can without provoking direct Western response; that it believes in the psychological value of preponderant and even overwhelming military strength to be a key ingredient in this process; and that while the Soviets recognize the United States is not going to take all of this lightly and will, in fact, respond in its own way, it nonetheless aims for an eventual reversal of American superiority.

This, in my opinion, represents a fair appraisal of Soviet objectives.

But then you could ask whether it makes any sense to do business with these people if this is the case? And I would answer in the affirmative, provided we pay careful attention to the categories of our commercial transactions, and provided we shed some illusions concerning the political benefits which trade allegedly confers upon the partners in a commercial transaction.

These illusions are what I refer to as the "blue sky" aspects of trade. As long as 10 years ago, in the hearings which Congressman Kitchin held, one saw a whole series of these "blue sky" aspects: trade reduces tensions, trade demonstrates our own peaceful intentions, trade diverts resources from military sectors to the consumer sector, trade makes others dependent on us and therefore they must behave in such-and-such a way, trade divides the Communist camp.

I think each of these illusions should be examined very carefully. Some may have an element of truth, but, on balance, I feel they serve no particularly useful purpose in a discussion of expanding our trade.

It goes without saying that sophisticated technology which has even the remotest bearing on military capability must be prohibited in this trade, and everybody agrees on the need for this.

You will have to examine, of course, the issue of what is strategic versus what is nonstrategic. This is an important question, as some have made the case that even the most innocuous of commodities to be transferred from the United States to the Soviet Union could, in fact, release resources in the Soviet Union—especially if a given item costs more to produce in the Soviet Union and is needed and wanted for the military sector.

Now, we should, in the same instance as that of Eastern Europe, make a direct effort to sell our finished consumer goods. Perhaps the Soviets really do not want them because they consider them to be frivolous and would rather acquire the technology and produce them on their own.

We could continue to reduce the “positive list” items, that list which far exceeds that of the traditional NATO list. We could try to bring our trade practices into line with our allies.

I would propose, Mr. Chairman, although I indicated that I do not hold up much hope for its success, the reactivation of the coordinating committee or COCOM efforts and a real effort to harmonize our trading policies with our NATO allies. If we had a consistent policy among these countries, the major trading countries and perhaps Japan, I think we have a much more desirable situation than the current fragmented approach which leads to the Soviet Union being able to play off one potential supplier against the other.

I should like to make a proposal concerning one trade sector, and I think that this sector holds out some substantial possibilities, given a willingness on both sides to engage in it, and that has to do with the export of technical resources and services of American natural resources companies. I think it is generally acknowledged that in the field of exploration and development of natural resources, the United States has held a significant lead. And as the demand for raw materials increases in the years ahead, these skills could become increasingly important.

In view of the tremendous unexplored and unexploited land mass of the Soviet Union and in some instances that of other Communist countries, and in view of the limited resources which these countries possess to develop their natural raw materials industry as rapidly as might be desired, it would seem to me that American technological superiority could fill a very important vacuum here. That is, by injecting that American technological expertise in the search for and discovery of raw materials, we may indeed have an exportable “commodity.”

The Soviet Union has traditionally been reluctant to enter into any joint ventures within its own boundaries and especially into joint ventures which would involve foreign equity ownership. In this case the service contract approach might be implemented, and this could be significant over the longer run, depending on what could be found. Once a survey would be completed under the service contract, it would not be absolutely necessary for the American contractor to be involved in the developmental stages.

Now, some people are going to argue, Mr. Chairman, that helping the Soviet Union find significant stocks of raw materials is not unlike exporting sophisticated technology, and therefore would contribute to the augmentation of Soviet military capabilities. This is not necessarily so, although everyone can recognize a latent element of risk.

I would put it to you that it is a long step from identifying and proving a natural resource reserve and the actual development of that reserve. The intermediate steps involve money, scarce resources. Therefore, it could be argued equally effectively, I think, that such ventures could, in fact, tend to divert Soviet attention and resources from the military sector, were they to be identified as potential—profitable and developable.

The Soviet Government could perhaps take the capital required to develop these resources from the hard-pressed consumer sector, but that sector is already so hard pressed that one does not envision the Soviet consumer standing still for an unfavorable development of this kind and at his expense. In any case, I would suggest that has been a neglected possibility and we should have another look at the possible export of technological services, particularly in a period in which there seem to be many technicians increasingly available, what with the downdrift of U.S. military spending and subsequent unemployment in certain sophisticated areas.

I would like to conclude, Mr. Chairman, by expressing to you that it is my belief that the majority of the American people believe that it is no longer possible or even wise to refuse to engage in peaceful commerce because of political or ideological preferences. We certainly do not approve of the government of the mainland China, but we have discarded the old concept of total embargo. We do not approve of the one-party Communist regimes in the Soviet Union and Eastern Europe, yet we trade with those countries.

I would suggest that it would be wise for the Congress, although this has no direct bearing on our discussion today, to reexamine the policy of total embargo against Rhodesia, of whose government it is said we do not approve. It strikes me somewhat inconsistent with our trade practices and announced policy of free trade that we should obstruct all trade with this small country. If we really do believe that trade can be made to serve the cause of world peace by reducing tensions, Rhodesia should receive treatment at least equal to that accorded the Communist countries. Even though I am very much aware of, and can understand, the special political pressures in the case of Rhodesia, I consider the policy of total embargo to be completely counterproductive in this case, as I would in any other case.

In conclusion, Mr. Chairman, I believe the time has come for a careful reexamination of our East-West trade policies; that we can safely relax or eliminate specific obstacles to that trade, provided these steps be taken with due regard for foreign policy and national security objectives and provided we have some reason to expect meaningful benefits to flow from it.

Thank you, Mr. Chairman.

Chairman Boggs. Thank you very much.

Mr. Campbell, you may proceed.

STATEMENT OF JOHN C. CAMPBELL, SENIOR RESEARCH FELLOW, COUNCIL ON FOREIGN RELATIONS

MR. CAMPBELL. Mr. Chairman, two important points stand out in any consideration of the policy questions involved in East-West trade and economic relations. The first is that this subject is related to

nearly all the main issues of world politics: the nature and course of the United States-Soviet relationship; the solidarity of the Western community of nations; Germany and European security; and future developments in Soviet and East European societies. Therefore, it is primarily political and not merely economic. The second point limits the first. It is that in the realm of practical policy the American decisions on trade with the East are not and will not be immediate or decisive in their influence on these big issues. A liberal trade policy is no sure step to cooperation and peace as it is often said to be. Nor is a restrictive policy on trade with the U.S.S.R. and Eastern Europe going to have any significant effect on the growth of the Soviet economy or its capacity to make war. We have seen that in the past. The real influence of decisions on East-West trade aside from the psychological effect, is likely to be evident only in the longer term, when it will flow mainly from the developing relations between Western and Eastern Europe.

How we look at the problem requires some assessment of developments in the Soviet Union and in Eastern Europe, and of present and future East-West relations. It is fruitless to spend much time in argument whether the cold war is over or is still with us. In the form which it took in Stalin's day and later when Khrushchev was challenging us in Berlin and in Cuba, it is over. Yet, that cold war has not been replaced by cooperation or even mutual tolerance. The United States and the Soviet Union are in a relationship which includes both confrontation and negotiations, and the negotiations has not yet scored much success. It has been well described as a limited adversary relationship.

The Soviets have seized opportunities, as in the Middle East, to exploit local situations and make gains at our expense. They have shown no urgency in coming to an agreement on limitation of strategic arms. Meanwhile, they have been building up long-range, all-purpose forces, especially naval forces, the better to compete with us as a global power. They have continued to supply North Vietnam. They are trying to gain ground at our expense in the Far East, south Asia, and elsewhere.

On the other hand, the Soviets are not engaging in an aggressive global strategy with a high risk of war. Only in the Middle East have they deepened their involvement to the point of danger, and even there they seek a political way out in agreement with the United States, a way out incidentally which would accord with their own aims. In Asia they are as concerned with China's competition as with ours. Ideology gets heavy play in their public declarations, but the main motivation for their drive to exert influence on such a wide basis is to prove to themselves and to the world that the Soviet Union is a world power fully equal to the United States.

It has been said that the relatively defensive Soviet policy in Europe has the aim of freeing Soviet hands to deal with China and to challenge us in the third world. This may well be so. Neither the Middle East, however, nor Southeast Asia, nor Cuba, productive as they are of crises and headlines, gives us so clear a look at basic Soviet policies, and Soviet dilemmas, as does Europe. Europe is still at the center of East-West relations. There the crucial questions of conflict and coexistence come to the test. There too, the dynamic

forces of economic and social change challenge the institutions and the fabric of society on both sides of the line of division.

Over the years the Soviet Union has alternately pursued policies of aggressive pressure and of détente in Europe. In general, the choice has been a matter of tactics, and both sets of tactics probably have had the same long-term aims: to nail down Soviet domination of Eastern Europe, to prevent reunification of Germany within the Western alliance, to break up NATO, to bring about U.S. withdrawal from Europe, and to divide and neutralize the West European nations leaving the Soviet Union as the preeminent power in all of Europe.

Since about 1963 I think we can say that the emphasis has been on the first two of these aims, hegemony in Eastern Europe and the continued division of Germany. The invasion of Czechoslovakia in 1968, which interrupted the progress of the détente policy, was essentially a defensive move to safeguard the Soviet position in Eastern Europe and to remove a contagion which could reach the Soviet Union itself; it was not an offensive action aimed at the West. Since then the Soviets have continued the policy of détente, trying to make the world forget about what happened in Czechoslovakia and calling for a European security conference, which presumably would sanctify the division of Germany and Soviet hegemony in Eastern Europe.

What has changed the face of European politics has been the intersection of this Soviet policy and the new "east policy" of the Federal Republic of Germany. It has introduced movement and fluidity into a situation which had previously been rigid. The open question is, Who will gain from this new fluidity?

Chancellor Willy Brandt has concluded a general renunciation-of-force treaty with the Soviet Union which confirms the status quo and a treaty with Poland recognizing the Oder-Neisse line, and he is moving toward a relationship with the German Democratic Republic that stops just short of formal recognition. Brandt's critics say that he has given away positions long held and received nothing but words in return. His defenders say that he has given away nothing that Germany really had; that neither alone nor with its Western allies could it gain reunification or change the Oder-Neisse line as long as Soviet power remained where it was in Europe. The hope persists of gaining some concrete reward in the form of guarantees of access to West Berlin and of that city's ties to the Federal Republic—matters now under negotiation by the four powers responsible for Berlin.

What these new developments in Europe will mean is worth some speculation. The Soviets obviously gain by German, and inferentially Western, acceptance of what they call the unchangeable consequences of the Second World War. They will take what benefits they get from that without giving up their own efforts to gain ground in Western Europe. Just because they have such aims, however, does not mean that they will come any closer to achieving them than in the past. If NATO holds firm with adequate strength, and we keep our troops in Europe, and the U.S. strategic deterrent remains, the possibilities of military action in Europe are minimal. The shape of Europe will be determined not by Soviet desires but by the developing political and economic forces in Europe itself.

The fact is that the dynamic forces are on the Western side, not on the Communist side. Western Europe's economies are growing, adapt-

ing to the pace of technological change. The European Common Market can compete as an economic entity with Russia and America. The addition of Great Britain and other new members will make it even more formidable. The close ties with America, governmental and private, will draw the Atlantic nations together in an expanding economic system—unless they are so witless as to engage in trade and financial warfare among themselves.

In contrast, the economies on the Communist side of the line are facing growing tensions and serious difficulties. Some of the scientific, managerial, and political elite see the need of reforms which will loosen the system of command economy and centralized planning, and thus will liberate the initiative of the professional and managerial men and provide incentives for labor. The problem is that efforts to free productive forces may threaten the system of tight control by which Communist Party leaders have kept their monopoly of political power; it may do so by creating new interest groups, by diffusing power beyond the party apparatus, by giving scope to the brains and skills of non-party people, and by allowing a freedom of inquiry which could eventually question the system itself.

All the Communist regimes face this dilemma and have other common problems. But their ways of dealing with them, their positions, attitudes, and policies have not been the same. In our consideration of relations with the Eastern countries, we have to remember that we are dealing with what is a bloc only as a military alliance and as a group over which one big power exercises varying degrees of control over several small ones. It is not a monolith, no matter what they say.

The East European regimes are aware of their inability to defy Moscow on issues the latter regards as vital. Some are subservient, knowing they depend on Moscow for ultimate survival. But they all are motivated in one way or another by the concept of national interest. They all have to make some compromise with their subjects, if only for the elementary reason of making the system work and preventing economic stagnation. As for the peoples, in contrast to the regimes, we know well enough from Hungary in 1956 and Czechoslovakia in 1968 that they do not welcome either Soviet domination or the Communist system.

It is desirable for the United States, therefore, Mr. Chairman, to consider the Soviet Union and the East European states separately. The former is a threat to our security. The latter are not, except insofar as their territory and armed forces can be used against us by the U.S.S.R. They are, indeed, a greater potential threat to Soviet security than to ours.

First, let us look at the U.S.S.R. It has a large economy which enables it to keep up the arms race and a major effort in space while still producing enough for the civilian population to keep discontent within bounds. True, the Soviet Union is in a continuing situation of strain on its resources requiring difficult decisions on priorities. It is not alone among the great powers in that respect. Neither in industry nor in agriculture has the Soviet leadership found satisfactory answers to its pressing problems, and as the country enters the age of electronics and computers the gap between the Soviet Union on one side and America and Western Europe on the other may grow wider.

The central problem for the Russians is economic reform: how to meet the demands of modern postindustrial society, and whether this

can be done without cracking the rigid party control and orthodox ideology on which the entire system rests. There will be changes in leadership in the fairly near future, perhaps at the party congress next year. This is inevitable because of the high average age of the members of the Politburo, but such changes are not likely to make for decisive shifts in policy one way or another. In the longer run, say in the 1980's, there could be radical change, perhaps even by violence, which is in the historic Russian tradition. That would probably come only if the system outlived its time by failing to adapt to new requirements and had to face concurrent crises in the economy, in dealing with non-Russian nationalities in the U.S.S.R., and in foreign affairs, bringing splits in the party and in the top leadership. The safer and better founded estimate for this decade is that the system will weather the strains more or less intact. The party leaders will attempt to combine party dictatorship with a measure of economic flexibility and efficiency, as East Germany seems to be doing, but the key in that case may be that these people are Germans as well as Communists.

Will American policy on trade have an effect on these issues of the Soviet future? Trade between the two countries is quite small—a total of \$116 million in imports plus exports in 1968, the last figures I have. As far as negative influence goes, we have already seen from the past record that export controls, which have helped to keep the volume that low, have not weakened or noticeably delayed the Soviet military effort. We have not really tried to wage full-scale economic warfare in the past, and indeed there is no disposition or possibility to do so now.

Western Europe's trade with Russia is over 20 times ours—\$3.4 billion in 1968—but it is not a weapon that would cripple the Russians even if it could be used, and the fact is that it cannot. This question has caused too much disharmony within the Western alliance over two decades to permit serious consideration of a new effort on our part to get the Western Europeans to do what they do not want to do.

As to positive influence through trade, the prospect is limited there also. More liberal export and import policies might in time double or triple the present volume of United States-Soviet trade, but it would still be small, since we have no great demand for their goods and no reason to give them large credits.

The Soviets are anxious to get advanced American and European technology, no doubt of that. It is one of the chief motives for the policy of détente and the recent reconciliation with West Germany. This may give some room for bargaining to Western Europe in the first place, but also to the United States, as we have the most advanced technology in some fields which they want. I am not speaking of technology with an immediate military application. Providing technological data, equipment, and advice—outside the obvious items of military use—for a quid pro quo, could be advantageous to both sides.

Indeed, if we look at the question from the broad political standpoint, increased scientific and technological exchange and trade which feeds into the Soviet civilian economy could have beneficial effects for the West. Arrangements such as the expansion of the Soviet automobile industry with Western equipment and advice could help in the trend toward the satisfaction of consumer wants by the Soviet Government. If Russia is about to enter the automobile age, with all that that means

in expenditures on highways, gas stations, and future popular pressure on the economy, vested interests will be created. The hand of those primarily interested in the domestic economy may be strengthened in comparison with those attracted to imperial ventures abroad. The more such trade confirms the Soviets in relations with the West which have some basis in economic reality for them, the more the policy of détente may move beyond the status of a tactic or a slogan. New facts may create new attitudes.

I stress that this is a hope, not a prediction. I would not claim too much for the virtues of trade as a means of influencing the Russians in one way or another. The Soviet Union has had a long experience, going back to the 1920's, in making use of Western equipment and expertise while guarding itself against the contamination of Western influence and ideas. I am merely saying that more open doors in the trade field offer greater possibilities in overall East-West relations than the various policies and measures we have now, inherited from an earlier time. Such a change in American policy, Mr. Chairman, is overdue.

The countries of Eastern Europe present a quite different picture, of which our legislation and trade policies have already taken some account, but not enough. Like the U.S.S.R., they need Western technology. More than the U.S.S.R., they need to trade to live. Trading within their own bloc does not satisfy their needs.

They realize how much their progress toward wider trade and more normal relations with the West depends ultimately on Russian consent. Even Rumania, which has parted company with Moscow on many issues of foreign policy, can play the game of independence and cooperation with the West only within certain limits. The West Germans finally came to the conclusion that they could not expect a real expansion of their relations with Eastern Europe, outside of Rumania, without first taking the road to Moscow. Their treaty with the Soviet Union opened the door to Poland, and so will it be, barring a hitch in ratification, with Czechoslovakia, Hungary, and Bulgaria. We in the United States have had little to say in recent years about "liberation" of Eastern Europe in comparison with some years in the past, against Russia's will, because we have taken account of the realities of the nuclear balance. It is notable that President Johnson, in his speech of October 7, 1966, linked the Soviet Union and Eastern Europe together in appealing to them to cooperate with the West for peace.

It is no service to ourselves or to the nations of Eastern Europe, however, to carry this reasoning too far and keep them together with the Soviet Union in all of our thinking. The striking differences between Eastern Europe and Russia are more evident today than when the Soviets helped impose a Communist regime on those peoples 25 or so years ago. Nationalism is flourishing, both in the Communist governments and among the people at large. It is a powerful issue which draws them together whenever a government is bold enough to use it, even though the political system is despised by the people. Rumania is an example. Another factor is the sense of being European, which extends to the new generation brought up under communism. They do not feel natural ties to Russia, which is a different civilization with a different history, sufficient cause for antagonism even without the bitter experience of having been denied full independence from Soviet control.

There are three aspects of change which have appeared in Eastern Europe: greater national autonomy, internal liberalization, and economic reform. The pattern is different in the individual countries. Only Czechoslovakia in 1968 had all three, and we know the results. The existing regimes resist some and encourage others. The issue of economic reform, especially, is going to exert pressure for modification of a system that has stifled economic modernization and expansion, and will create pressure for more links with the West. Even the Communist regimes have been looking for ties to the European Common Market, for Western trade, acceptable forms of investment, and scientific and technical knowledge to insure the progress which they know they cannot expect from their economic relations with Russia. This will be even more evident, I am sure, when more normal relationships are established with West Germany.

The main obstacle to the further growth of East-West trade, of course, is the inability of the East European countries to sell in the West enough to pay for the many things they wish to import from the West. Yet, the existing trade both ways is already substantial and has been steadily rising. Western Europe in 1968 exported \$2.99 billion worth of goods to Eastern Europe, and in return took \$2.7 in imports. The Western countries will not give unlimited credit, but arrangements for greater investment, joint ventures, and the development of new markets on both sides offer prospects for expansion and ways of dealing with the payments problem.

Again, on the American side, the trade is minimal with Eastern Europe, although it is larger than that with Russia—\$297 million was the two-way total in 1968. But here there are more possibilities for expansion and more solid reasons for encouraging it. Particularly in the case of their exports, our denial of most-favored-nation treatment to all except Poland is in the nature of punitive discrimination. Surely the President should be given the authority to grant most-favored-nation treatment in each case as the national interest is served thereby. It seems to me, Mr. Chairman, there is every reason to extend it to Rumania as soon as possible.

Will the Soviets accept a continuing multiplication of ties between the East European countries and the West, especially when they already are aware of the connection between such ties and internal developments in those countries? They have the power to crush heresy, to chastise those who seek their own road to socialism, or a road out of socialism. But they may be faced with some really difficult decisions on the pros and cons of using it. Eastern Europe's leaders, having witnessed the fate of Czechoslovakia, will be careful not to provoke that kind of fraternal assistance. And the Soviet Union will not easily take decisions to intervene here, there, and everywhere to stop unfavorable trends.

The Western nations are not going to foment revolt in Eastern Europe. All concerned know that they cannot provide effective help to peoples facing the overwhelming force at Moscow's disposal. What I am really talking about here, Mr. Chairman, are economic and social and cultural developments, not about the military balance and security. If the Western World holds firmly to NATO and keeps up its strength, the security of Western Europe will be safeguarded. If the Warsaw Pact remains on the other side, we have no reason to chal-

lenge it. The existing balance is the best guarantee of all Europe's security until something better is found to take its place.

Mr. Chairman, I think we can let East-West contacts go forward and particularly those between Eastern and Western Europe. Let them find all the common interest they can. If those trends pose problems and difficult choices for the Soviet Union, we have no need to spare the Soviet leaders such choices. The record has shown that the Soviet Government will take account of conditions and realities which exist, and shape its policies accordingly. What better conditions will there be for more reasonable Soviet policies in Europe than a strong, united, and prosperous Western Europe and an Eastern Europe whose economic and social progress and chances for greater independence are enhanced by a multiplicity of mutually beneficial ties with the West?

Thank you, Mr. Chairman.

Chairman Boggs. Thank you, Mr. Campbell.

And now, Mr. Duchene.

STATEMENT OF FRANCOIS DUCHENE, DIRECTOR, INSTITUTE FOR STRATEGIC STUDIES, LONDON, ENGLAND

Mr. DUCHENE. Mr. Chairman, the disasters of the interwar period taught governments after the war to think in terms of the impact of economics on security. The creation of the International Monetary Fund and GATT, the Marshall plan and point IV, the European Common Market, would all have been impossible without such a sense of interaction. The unprecedented emergence of international institutions to deal with international chains of cause and effect has been the most creative political innovation of the postwar period. The framework provided for national policies of prosperity may well have been as potent for the stabilization of the cold war as the balance of nuclear prudence. At any rate, the mutual reinforcement of unprecedented prosperity and peace during the cold war period makes a striking contrast with the vicious circle of slumps and fascism between the wars. Spectacular, too, is the way in which political expectations were colored immediately after the war by fears or hopes, according to one's allegiance, of slumps in the capitalist world and the sense which now exists in the East itself of a technology gap with the West.

Economic factors may well be equally prominent in the period of international diplomatic movement we are likely to have in the coming years as a result of the relative stabilization of the cold war. One reason for this could be that while we all are, and probably will be, conscious of having to tread carefully in the security field, our greater self-confidence in the economic one may lend us not to tread carefully enough in that arena.

The present situation of increased international fluidity is essentially ambiguous. This is clear in the negotiations between the superpowers—such as SALT or the Middle East—and in the German Ostpolitik. On the one hand, you have the hope that the codification of political competition within the conditions of a nuclear environment may gradually circumscribe the East-West confrontation itself. On the other hand, you could easily have a situation where what is called

“détente” actually means a shift in the balance of power and increased insecurity for all.

This ambiguity is understood very sharply when it comes to security matters. There is a clear sense of the risks that substantial withdrawals of U.S. forces from West Germany, not matched by greater West European self-reliance, either military or political, would tend to undermine the confidence of the Western European States in their security. This could introduce an element of placation in their dealings with the Soviet Union and reduce their sense of freedom to choose their own policies.

President Nixon has recognized this risk in proposing that there should be no reductions in American troops in Europe without equivalent reductions in Warsaw Pact forces and armaments. The members of the Atlantic Alliance, despite differences in their individual approaches, have been careful to react together to Eastern proposals for East-West negotiations. They are also aware that their future security insurance calls for collective reappraisal and NATO's “AD 70” exercise has been one sign of this.

There is not, however, the same awareness in economic policies. This may be natural because there is greater flexibility in the economic field. The West is more self-confident in it, less seems to be at stake, and it is necessary to seize opportunities. But there could be concealed risks in this.

In brief, what seems to be happening today is that new approaches to East-West economic relations are beginning to emerge at a time when rising economic nationalism, or regionalism, among the Western industrial powers is threatening to sour their own relations. This raises issues which plainly have strategic parallels. In both economic and security fields, the problem is how to build up possible East-West relations without encouraging both Western and West European disintegration favorable to Soviet hegemony in Europe; not to deny change but control it.

We are now seeing a tendency toward economic division in the West. For a long time after the war, the United States was able by itself to supply the missing component of material and financial resources that was necessary to insure the steady and rapid growth of the market economies. Its “good creditor” policies and support for international mechanisms were decisive.

Now, there are at least three major economic powers in the West, and if you count the West Europeans as not one group but several nations, more than that. This alone makes the coordination of Western policies in the economic field much more difficult. In addition, however, the social pressures producing inflation and other domestic strains in most advanced societies lead governments to express in their international policies the interest of particular lobbies and in general to have far more difficulty in balancing their economic and financial relations with one other. There are also new “transnational” factors such as the international, or “multinational” corporations or the Eurodollar market, which act as transmitters of these imbalances and in effect remove the instruments of control from the hands of individual governments. They could only regain control collectively, but this is difficult because they have no consensus about their common interests as they had for their emergency programs after the war. As a result, economic relations

between the market economy countries are becoming less stable and more difficult to coordinate and more disruptive.

Such forces can plainly affect security. Anxiety for the future of security relations in the Pacific region has already been aroused by the difficult textile talks between Japan and the United States. Similarly, economic harmony or discord between the United States and European communities, particularly an enlarged one including Britain, could displace vital votes in Congress on such issues as withdrawals of American troops from Europe. In a less visible but equally pervasive manner, the political climate in Western Europe toward the United States could be profoundly affected by the evolution of economic relations. Of all the "external" elements which might sway legislatures or governments in debates on the security choices posed by ambiguous situations, economic ones could be the most powerful.

When one turns from intra-Western relations to economic policy toward the East, it is striking that it is primarily the allies of the United States and not the United States itself which are involved in this movement. This is particularly true of the West Europeans. Japan is much more reticent in its dealings with the Soviet Union, partly because of reservations toward the Soviet Union itself and partly because of fear that to enter too deeply into Siberia would alienate Communist China and cut short Japanese long-term hopes for better relations with it. But even Japan has begun to conclude agreements with the U.S.S.R. and if it is to double its GNP to \$400 billion a year by 1975, as Japanese economic planners hope, there will be considerable pressure for more access to the raw materials Siberia possesses in abundance.

As for Western Europe, and barring an unforeseen reversal, the pressure for closer East-West links is likely to grow. The contrast with the United States can be seen, for instance, in the way in which Daimler-Benz and Renault have taken up negotiations on building a major truck plant in the U.S.S.R. after Ford withdrew. The need of the smaller East European countries for trade with the West; the awareness of the Soviet Union itself of the technology gap with the West; and the West Europeans desire to improve political relations and do larger business; will all gradually press in this direction.

There will be limits to this pressure. One is the difficulties the East Europeans encounter in expanding their supply of marketable exports. Another is that investing in Eastern Europe is, on previous experience, not invariably profitable. Politically, too, closer contact need not always lead to harmony. One of the main motives in Eastern Europe for a European security conference seems to be to bring the maximum bargaining pressure on an emerging Common Market and, if possible, to inhibit the emergence of its foreign trade policy. But this would not necessarily create decisive dissensions: at least one European community country has already signed a trade agreement with an East European one which in effect postpones the date when the Common Market foreign trade policy can come into operation.

In short, you could get in the years to come in the economic field a contrast between dissension within the West and new contacts between some Western and Eastern countries which would be significant in political and security terms as well as economic ones. The core of the matter need not be that East-West trade would continue to be small

compared with trade between the Western countries, nor that joint production arrangements between East and West would remain minute in comparison with the massive investments across the Atlantic which are developing both ways now that the Europeans are investing in the United States more than they formerly did. Politically speaking, East-West arrangements in the economic field would seem to be a new frontier relative to the past. It would be possible to imagine there was a substantial potential for future growth. Particularly with the Soviet Union, any agreements reached would be likely to be concentrated in large projects easy to publicize in political terms. If, at the same time, the Western powers were quarreling because of their economic nationalism, the cumulative political effect could be out of all proportion to the relative weights of the economic facts. Such a contrast might serve one of the implicit themes in East-West approaches in Europe, strong in Eastern Europe and not altogether absent even in some Western European countries, of a primarily European system of cooperation. The possible interest of the U.S.S.R. in this is so obvious that West Europeans are bound to be wary. But the confusions of the economic and political process could gradually overlay what are currently clear priorities in terms of the overall balance.

There are, then, hopes and risks in the present state of East-West economic relations to match the uncertainties of the security situation. The Soviet Union's security does seem to require both a damping down of nuclear confrontation with the United States and quiet on the European front as its center of anxiety gradually shifts to Asia. On the other hand, policies to attain these are quite compatible with ambitions for "parity" with the United States, which could mean local political "superiority" in much of the Middle East and potentially in Europe.

On somewhat similar lines, the economic opening to the East is also ambiguous. It could bring new opportunities for cooperation. The interest of the Socialist countries in joint production arrangements with Western firms could create lobbies for more cooperation with the West in their productive and bureaucratic systems. It could encourage the tendency in the smaller East European countries which continues, despite the Czechoslovak disaster, to move toward more market-oriented systems. This, in turn, might, in the long run, encourage the slow march to limited convertibility evident in the recent COMECON decisions to give a backing of 1 billion convertible rubles of account to what seems to be a kind of payments union. All these moves might make it easier to bridge the gaps between Eastern and Western systems. It might gradually become possible to move from "peaceful co-existence" considered as a form of political karate short of nuclear confrontation, to something more nearly resembling normally confident cooperation.

If, on the other hand, economic links between East and West Europe and between the U.S.S.R. and Japan were to develop without United States involvement of a significant kind, a habit would grow among America's allies of seeing their economic and security relations in separate compartments. This could become something more active if, for instance in one major growth area of the "transnational economy, the Western governments quarreled over policies toward international corporations while East-West joint production arrange-

ments proliferated. Insensibly, East-West economic cooperation might itself become an element in a new kind of confrontation. The East Europeans might encourage this tendency by pressing for new multi-lateral institutional arrangements, on grounds of parity, between East and West. Such a development would be relevant to the United States, which might find that to concentrate its East-West policies on security issues such as SALT or the Middle East would isolate it from economic processes of more consistent interest to many other countries, including even the U.S.S.R. It could affect America's allies, particularly the West European nations, because the U.S.S.R. could gradually define the context for bilateral relations and so enhance its European influence. It could also harm the system of world cooperation by weakening Western international economic organizations, which would be under their own strains, and by creating competing regional agreements, possibly even one day called "of association" between East and West in Europe.

In such circumstances, the importance of U.S. economic policy toward the Communist states cannot be measured in terms of the minute proportion of its GNP—less than 1 percent—represented by its trade with them. The problem is one of the role of this policy in a period when the nuclear stalemate, the diffusion of power across the world and the new problems of—especially industrial—society are beginning to change relations between and within the political systems established during the cold war. If the United States were to remain aloof from economic relations with Eastern Europe when these are assuming greater importance for some of her major allies; and was herself in economic conflict with them; one of the present pillars of secure dealings with the Socialist states, and the U.S.S.R. in particular, would be undermined. In present and even more in future circumstances, a static U.S. economic policy toward the Communist countries risks being self-defeating.

The principal argument against freer economic policies toward the Soviet block has been that they potentially enhance the defense potential of the adversary. This is impossible to deny in purely quantitative terms. It is indeed sensible not to transfer, through trade and investments, military items, or advanced technologies which the U.S.S.R. maintains an expensive intelligence system to acquire. However, the existence of the embargo on such sales has not prevented the U.S.S.R. from reaching de facto parity with the United States in nuclear deterrence from the early 1960's onward and from significantly catching up in naval construction during the later 1960's.

This suggests that restrictions even on such central sectors of the defense economy are far from being decisive. Restrictions on comparatively or wholly civilian items are arguably still less meaningful. In fact, a number of developments, quite apart from the achievement of strategic parity by the Soviet Union, has tended to erode the arguments for them. One is that a total embargo has become manifestly impossible since America's major industrial allies are trading and investing in Eastern Europe. The U.S. Export Administration Act of 1969, recognizes this fact when it called for U.S. exports when comparable commodities or data are available abroad.

It has in any case grown increasingly doubtful whether the mere importation of foreign capital or technology can contribute very greatly

to the removal of the "technology gap" of which the East European countries have become so aware. Even between Western Europe and the United States, the "technology gap" was widely agreed after much argument in the early sixties to be rooted primarily in difference of industrial structures and management. This diagnosis seems to apply a fortiori to the Socialist states. Their basic weakness is an administrative system which is far too rigid for increasingly advanced economics and makes it impossible for them to mobilize their resources of skill and capital to the best effect. In such a context, new technologies imported from the West, such as automobiles, either make comparatively little contribution to the general expansion of the economy or else require a profound change in the whole system toward a more consumer-oriented society.

This seems to be a dilemma which the East European economies can no longer avoid. This is particularly visible in the smaller and industrially more advanced states. Either they begin to satisfy the pent-up latent demand for greater efficiency and goods and—with the exception of East Germany—gradually loosen the control of the state; or they maintain centralism and face the prospect of being increasingly outpaced, outsold, and outmoded. Even in the U.S.S.R., the pursuit of "modernization" has been associated with that of a modest degree of decentralization. However reluctantly and slowly, their own internal forces seem to be beginning to push the East European countries in the direction of a distant pluralism. It is impossible to say how far and fast this will go; and the country where change is most remote is the U.S.S.R., incomparably the biggest, the most powerful, and most self-sufficient, which defines the political context for them all. But even there, the best long-term hope for genuine East-West understanding lies in the development of the potentially pluralist forces in society. To reduce the hold of the state and increase these forces should be the major long-term objective of Western policy toward the U.S.S.R.

There may even be an opportunity to improve the long-term prospects for cooperation in the East European, and particularly Soviet, stress on joint production arrangements. In terms of creating continuous personal links, joint production agreements are potentially more committing than trade. Just as one of the main benefits of a continuous Russo-American consultation through SALT might be to create constituencies of interest in the bureaucracies of both countries for further cooperation, so joint production might produce a growing invisible lobby for better East-West relations in the economic field. Against this, one new arrangement may work against investment in the U.S.S.R.: this is essentially the Japanese fear that too close an involvement in Siberia might alienate Communist China.

This argument apart, the case for relaxing some of the restrictions on normal trade, commercial credit, and investment with Eastern Europe which distinguish the United States from its allies, now seems to be stronger than in the past.

In the light of this there seems to be some areas where the United States could usefully redeploy its economic policies toward the Socialist states, and more precisely the Soviet bloc.

The first would be to relax the special impediments placed by the

United States on its East-West economic relations, in terms of trade, credit, and investment. This would not lead to any sudden growth in trade. Nothing is less likely in the medium-term. The major impediments to East-West trade lie in Eastern Europe itself, though it is striking that Poland, the only Warsaw Pact country to which the United States has extended MFN treatment, also has far the biggest trade with the United States. Nor would the principal aim be rapidly to improve the atmosphere of East-West or superpower relations. This might have some significance, but it would not change the basic situation. The main objective would be to close the potentially significant gap which is beginning to open up between the United States and its major allies in their economic relations with the Communist bloc.

The second policy the United States could usefully pursue would be to try to reduce intra-Western economic frictions. These tensions have a strong dynamic of their own and mere exhortation will not remove them. However, there should be enhanced awareness of the possible East-West complications of the rash of protectionism that is spreading over the Western World. In particular, it would be constructive of the United States not to encourage, or at least not to join, directly or indirectly, in East European efforts to discourage the European community from developing a common foreign policy toward them. There is a parallel between economics and security here. The crisis of confidence in NATO's defense prospects can only be lastingly resolved if, in one way or another, the West European nations, either militarily or politically, become more self-reliant within the NATO system. This will probably require a more cohesive West European effort. Analogously, a failure of the European community countries, either with their present, or with an enlarged, membership, to develop common trade policies toward Eastern Europe would raise doubts about their capacity to act coherently in other ways. Doubts about their long-term power to deal with the U.S.S.R. on equal terms would increase.

Third, the major Western Powers should try to improve the mechanisms for the coordination of economic policies among themselves. It is possible that a European Security Conference, or failing that the process of economic negotiations in Europe, will lead to proposals that specific bodies be set up, or revived, to handle the multilateral problems of East-West economic relations. If this happens and there is no coordination between the major market economies, or, worse, there is dissension between them, East-West institutions could begin to compete with established Western international institutions and discriminate in particular against the United States. The aim in increasing dealings with the Socialist bloc should be to extend and if possible reinforce, not dilute, the highly beneficial international economic arrangements already in force. From this point of view, cooperation between the major non-Communist economic powers would be crucial. Chancellor Brandt, taking up an earlier proposal of the Action Committee for a United States of Europe, has suggested there should be a United States-European Community Contact Committee. This would be valuable for East-West economic relations as well as other economic policies, and should include Japan.

Finally, there is a crying need for the Western nations individually to improve their domestic procedures for coordinating security and economic policies.

This is an era of specialization in which one set of institutions and experts tend to follow economic questions, and another, security questions. This leads to a compartmentalization of thinking and planning which treats as different areas of policy which, in practice, crucially interact. There should be an attempt to break down the rift between the two cultures in legislatures, administrations, and think tanks.

There has been a development in the sixties of bureaus for military and political affairs. There are strong arguments for something similar in the realm of economic affairs.

If this were done, the traditions of the golden age of international economic policymaking after the war might be maintained in a period which increasingly requires new initiatives. If not, there is a risk of a dissolution of collective purpose which could produce new insecurities for everyone.

Thank you, Mr. Chairman.

Chairman Boggs. Thank you.

Now, Mr. Ra'anán.

STATEMENT OF URI RA'ANAN,^{1 2} PROFESSOR OF INTERNATIONAL POLITICS, THE FLETCHER SCHOOL OF LAW AND DIPLOMACY

Mr. RA'ANAN. Mr. Chairman, I appreciate the courtesy extended to me by your committee in asking me to appear here. I value this opportunity particularly in view of the outstanding service rendered to the academic community by the committee during past hearings and in its subsequent publications.

I will, if I may, focus my analysis on the Soviet background to our topic. Since Lenin, the Russian leadership has been demonstrating in practice its support for the fundamental primacy of politics over economics. As Khrushchev admitted in an expansive moment, "We value trade least for economic reasons and most for political purposes."

Yet Moscow has not ceased to avow its adherence to a supposedly Marxist creed; consequently, we might reasonably have expected the Soviet decisionmaking process to revolve around "economic factors— which, Marxism insists, are the key to human history. Few of my colleagues in the Sovietological community will quarrel with the contention that it is easier to find instances of Soviet economic moves guided by political or quasi-ideological considerations than of policy measures inspired primarily by economic motivations. In view of this phenomenon, it may be helpful to set the stage for subsequent, more detailed

¹ I wish to express appreciation to my colleague, Prof. Marshall I. Goldman, for his helpful criticism and comments on this statement.

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hearings on the specifics of East-West trade, by discussing the political framework within which the Soviet leadership operates—no less when it is dealing with commercial questions than with diplomatic or military issues. Perhaps this may serve by way of explanation for my presence at this forum, as a noneconomist, in spite of the highly technical nature of our topic.

In considering the Soviet political framework, one should realize that, although the demise of ideology as a relevant factor in Moscow's deliberations has repeatedly been proclaimed by Western analysts, these obituaries may well prove to be premature. To be sure, as we have seen, in practice the current Soviet leadership is far from being Marxist. This does not mean, however, that Moscow necessarily desires—or is able—to renounce entirely certain basic commitments to a doctrine conveniently subsumed under the title of "Leninism"; nor does lipservice alone suffice meet these commitments.

This is not merely due to factors of conditioning, although undoubtedly constant immersion in the turgid waters of ideological jargon does tend to influence thought patterns. For instance, a young colleague, Professor Legvold, questioned Soviet foreign assistance experts in West Africa as to the precise meaning of Moscow's terminology for certain types of Afro-Asian regimes. The Russian economists and technicians at first confessed that they regarded terms like "noncapitalist path of development," "national democracy," etc., as little more than ideological claptrap. Very soon, however, in describing the local situation, they themselves resorted to the same expressions they had so contemptuously dismissed, clearly being unable to pursue their analysis in any other fashion.

Of even greater weight than conditioning is the fact that the very nature of the Soviet political process, particularly the unresolved problem how to institutionalize the transfer of power from one leader to the next, makes it incumbent upon each successive ruler to envelop himself in an aura of legitimacy. In the absence of genuine legitimacy—which normally derives from strict adherence to time-hallowed, revered institutions—Soviet leaders must of necessity invoke the concept of ideological orthodoxy as the touchstone for their right to be in power. History tells of many rulers of particularly dubious antecedents who have been all the more anxious to claim the title "Defender of the True Faith."³

The coup d'état and other abrupt and extra legal power transfers have remained the rule of Soviet political life.⁴ This pattern of force is not fortuitous, but endemic in the system itself. A highly authoritarian regime of this type could theoretically institutionalize the transfer of power in a relatively smooth and peaceful manner by resorting to the ancient custom of "laying on of hands"; that is, each ruler could nominate his own successor. The harsh reality of politics, however, does

³ Stalin, for instance, after being disowned by his dying predecessor Lenin, seized power in a manner resembling a coup d'état. Consequently, he was particularly eager to pass himself off as Lenin's legitimate heir—an image he did his best to foster by ordaining himself the High Priest of a new Leninist cult. Thus, he led the public recital of vows to maintain the tenets of Lenin's creed and then enshrined these tenets in canon law by publishing a catechism in his own name called "The Foundations of Leninism."

⁴ Beria was ambushed and liquidated by his rivals in 1953. Khrushchev suddenly ousted Malenkov in 1955, only to be removed from power himself 2 years later while visiting abroad, but returned after a few days with the aid of the Army to stage a countercoup and purge his prematurely triumphant adversaries; finally, Khrushchev's own proteges removed him from power while he was blissfully vacationing in 1964 and confined him in perpetuity to his dacha.

not permit such easy answers; a leader cannot coexist under totalitarian conditions with his political heir, since the young "rising sun" will inevitably dim the glory of the old "setting sun." Sooner or later, a Soviet ruler apparently must remove his would-be successor or be ousted by him. This is borne out by the sad history of various Soviet "crown princes."⁵

Under these circumstances of succession to power by resort to force, it is understandable that almost no Soviet leader has been able to boast of a clear, unchallenged, and credible title to his position. What rivals threatening his political, or even physical survival, a leader must strengthen his power base by establishing a claim to legitimacy; it is, after all, much harder to challenge a quasi-lawful ruler than an avowed usurper. Under Soviet conditions, such legitimacy can only be derived from a proper ideological posture. A new leader has to try and justify his seizure of power by demonstrating that he, unlike his adversaries, represents the true and orthodox interpretation of "Leninism."

It is significant that both the Tito-Stalin confrontation and the Mao-Khrushchev quarrel were accompanied by violent polemics in which each side accused the other of being schismatics or even heretics. All the parties concerned understood very well that to challenge the opponent's ideological orthodoxy meant questioning the legitimacy of his rule and, consequently, undermining his domestic power base.

Thus, because ideology remains intimately linked to power itself, it is likely to continue playing a significant role in the Soviet system.

The reason for this discourse on the politico-ideological dimension of the Soviet scene may, hopefully, become more apparent when we consider Moscow's posture toward economic and trade issues. In these fields, we can note the persistence of attitudes which make comparatively little economic sense, but become readily understandable once one realizes the needs and compulsions of Soviet leaders to conform to certain minimal ideological obligations.

This appears to be especially true of Soviet agriculture which, in a sense, constitutes the key to the whole Soviet economic puzzle. Considering that the U.S.S.R. is the world's second industrial power and, in area and population, the largest of the developed countries, it devotes an extraordinarily high proportion of its total population to agriculture (the proportion may now be five times as high as in the United States, and in absolute numbers there are perhaps seven times as many farmers in the U.S.S.R. as in the United States). Yet the monetary value of the Soviet Union's farm output is probably no more than roughly equivalent to that of the United States, in spite of self-imposed output restrictions in this country. This is not simply an investment problem, since the Soviet leadership is now actually pumping considerable and steadily increasing sums into the agricultural sector. However, the sad fact remains that output growth per capital invested in Soviet agriculture has apparently declined to less than half its level in the 1950's; that is, returns on investment are steadily diminishing. The indications are, therefore, that Soviet agriculture constitutes a disproportionately wasteful segment of the

⁵Two of Stalin's proclaimed heirs, Kirov and Zhdanov, died under suspicious circumstances, while of Khrushchev's heirs one, Kirichenko, suddenly disappeared into obscurity, another, Kozlov, was ousted after a convenient illness, and the third, Brezhnev, finally showed his gratitude by overthrowing Khrushchev.

economy, both in manpower and in money, and, it seems, is particularly inefficient in terms of productivity. Yet the U.S. experience demonstrates that in a developed country agriculture can both enjoy high labor productivity and largely finance its own investment (although, admittedly, capitalization is very high in U.S. agriculture). Needless to say, the problems of the agricultural sector lead to serious repercussions throughout the whole Soviet economy, with regard to the availability both of manpower and of investment capital. Moreover, there are significant social consequences, since nearly half the Soviet population, living in rural areas, is gravely disadvantaged as far as educational, cultural, sanitary, and communications facilities are concerned.

Closer examination shows that the shortcomings resulting from the Soviet approach to agriculture cannot be dissociated from distortions in Soviet economic perceptions caused by ideological commitments. Moscow has proceeded for decades upon two interlinked assumptions that derive from ideology: (a) The U.S.S.R. and its allies must aim at a measure of autarchy at least in basic food, that is, grain, so as to be minimally dependent on the non-Communist world—for security reasons; and (b) collectivization is essential as the only viable alternative to bourgeois modes of production in the countryside.

Under the uncertain climatic conditions prevailing in the U.S.S.R., the decision to concentrate so heavily on grain production, rather than rely at least in part on trade to provide regular wheat and corn supplies, has had far-reaching implications. Grain cultivation on the Eurasian Plain requires extensive farming with large units that can provide the necessary machinery and abundant manpower. These very requirements, of course, reinforce the case for collectivization. Grain production and collectivization together have led to the current situation, whereby the large Soviet rural population is clustered together in a mere 50,000 huge collective and state farms, while America's much smaller agricultural population is spread across some 3 million individual farming units. The average Soviet farm covers an area at least 100 times larger than its U.S. counterpart, and has to support perhaps 500 times as many persons. (Thus the U.S.S.R. can fairly be said to be suffering from rural overpopulation).

It is this very size and consequent bureaucratization, as well as the depressing effect on personal incentive caused by the stiff state grain procurement quotas, which, most observers agree, is largely responsible for the poor performance of Soviet agriculture. Yet there is nothing wrong with the individual Soviet farmer, provided he is given the proper stimulus, as is strongly indicated by the extraordinary output of the so-called "private plots"; these cover a relatively insignificant area, but manage to supply the cities with an overwhelming proportion of their intake in proteins, fruit, and vegetables. Moreover, they supply the collective and state farmers in question with much of their own food and a large and growing part of their cash income. Since the Soviet farmer can only spend a very limited portion of his time on his "private plot," clearly he works far more efficiently there than for the collective. The Soviet leadership, while forced to tolerate this bourgeois survival temporarily, has repeatedly indicated that it is ideologically unacceptable and destined eventually to be abolished.

Yet by purely utilitarian criteria, the "private plot" or its equivalent should obviously be the wave of the U.S.S.R.'s economic future. If the leadership could forego its ideological obsession with autarchy in grain production and with collectivization (actually bureaucratization) of the countryside, it could permit family units of farmers to concentrate on what they so demonstrably do best: Mixed market farming and gardening—benefiting both their own socioeconomic level and the dietary standards of the urban population (which still consumes far too many carbohydrates as compared to proteins).

This could be achieved without necessarily restoring formal private ownership of the land, as opposed to individual or family control of production. On the basis of such a rationally economic, non-ideological approach, the countryside, with a much smaller and more efficient labor force, could supply the U.S.S.R. with an incomparably better diet of proteins, fruit, and vegetables as well as a limited proportion of grain requirements. The surplus rural population could provide a much needed labor reserve for new industrial projects geared, for the first time, to the demands of the world market. The new industries, devoted mainly to consumer goods including secondary food production, would compete in the export arena,⁶ while the Soviet Union would regularly⁷ import a certain portion of its grain consumption (a more economic proposition than producing it domestically).⁸ Trade turnover would, at last come to represent a significant percentage of the Soviet national income and the U.S.S.R. would become a major and most eligible international trade partner. Needless to say, all this is mere daydreaming since, as we have seen, the current Soviet leadership does not desire—nor can it afford—to abandon its ideological commitments to such an extent.

The present Soviet reality, of course, remains qualitatively different from the picture we have projected. The leadership is prepared to tinker with collectivized agriculture but not to deal with its fundamental shortcomings. Moscow still seems to regard international trade—at least outside the confines of the Soviet bloc—as a mere afterthought to the general economic equation. There apparently continues to be relatively little interest in searching for the least costly source of a commodity, if this means shopping abroad; the U.S.S.R. resorts to foreign trade primarily to the extent that certain items required for the fulfillment of the state plan are unobtainable domestically—and exports other goods, mainly to gain the currency needed for such sporadic imports.

Although much attention has been devoted in the West to Soviet discussions on economic and price reforms, there is no real indication that they can materially affect the present state of affairs. It is perfectly true that, in initiating the 1966–70 5-year plan and at the last (23d) Congress of the Soviet Communist Party in 1966, the Soviet

⁶ Admittedly, Soviet industrial competition on the world market would require a revolutionary increase in Soviet standards of quality; failing such improvement, the U.S.S.R. could still finance grain imports through exports of oil, timber, and mineral ore.

⁷ In crisis years of crop failure due to climatic reasons, the U.S.S.R. is forced to import grain even under present conditions.

⁸ Competent economists have estimated that the Soviet Government devotes roughly twice as much money as the United States to subsidizing agriculture, especially grain production. Importing a constant portion of this grain would save money for the U.S.S.R. not only in this respect, but also because Western governments, as they have demonstrated, are quite eager to subsidize grain exports to the U.S.S.R. and eastern Europe.

leadership did indicate willingness to modify the country's production pattern in order to expand international trade, including commerce with the West. In terms of absolute numbers, an increase has taken place, primarily in trade with West European countries that are eager to absorb raw materials from the East in return for machinery and industrial know-how. However, this pattern negates the very purpose proclaimed by Soviet leaders in 1966; namely, to elevate the U.S.S.R. from the status of a "semicolonial" exporter of raw materials to the position of a modern, industrialized exporter of machinery.⁹

Moreover, in spite of an absolute increase in trade figures, the U.S.S.R. and the other Communist countries have, proportionately speaking, fallen still further behind the rest of the world. In 1968-69, a mere 12 percent of the global trade turnover was contributed by the Communist countries (about 1 percent less than at the beginning of the 1960's), compared with 18 percent contributed by the LDC and 70 percent by the developed countries of the West. International trade turnover per capita was almost 1,000 percent larger in the West and nearly 50 percent larger in the LDC than in the Communist area. Within the Communist world, the U.S.S.R., with foreign trade turnover equaling an insignificant few percent of national income, lagged far behind the East European countries, some of which, especially Hungary, continue to be much more dependent on external commerce. Many observers feel that, because of this factor, intensive Western observers feel that, because of this factor, intensive Western trade with Eastern Europe could contribute substantially to "building bridges," i.e., to drawing these countries closer to Western Europe, thus, hopefully, strengthening their autonomy vis-a-vis the U.S.S.R. While this is probably correct with respect to the atmospheric effect on the general population of Eastern Europe, the argument has its limitations. "Bridge building" can be a self-liquidating process, as the Soviet invasion of Czechoslovakia demonstrated—in other words, if an East European state shows too much divergence from the Soviet path, the U.S.S.R. may intervene with armed force. Thus, it could be argued, "bridge building" can only be justified to the extent that the West is prepared (as it apparently was not in the Czech case) to deter the U.S.S.R., if necessary, from resorting to physical violence against East European and other countries.

Conversely, some would-be Soviet "bridgebuilder" might well tell his colleagues in Moscow that continued extension of Soviet bloc trade

⁹The U.S.S.R. presents two faces to her commercial partners. With regard to Europe, including most of her own East European allies, the Soviet Union is a "semicolonial" exporter of raw materials and importer of machinery and know-how, while, in relation to the LDC, the U.S.S.R. is a traditional "Western" exporter of machinery in return for Afro-Asian agricultural commodities and minerals. Consequently, the Soviet leadership has been caught in some striking contradictions. In negotiations since the early 1960's with her East European CMEA partners, the U.S.S.R. has argued that her raw materials are expensive to produce and that she should, therefore, be paid more than current world market prices for her exports. (In fact, the Soviet Union has constantly charged her East European friends more than Western customers for the same commodities.) At the same time, Moscow has offered the East Europeans lower prices for their manufactures than are charged by West Europeans, on the grounds that East European industrial goods are qualitatively inferior. Ironically, the LDC, in negotiating with Moscow, have repeated almost verbatim Russia's arguments with the East Europeans. The LDC have stressed that Russian manufactures are of lower quality than Western goods and ought to be cheaper; conversely, the LDC have emphasized that their own raw materials are expensive to produce and ought to be priced more highly. Yet, at the first UNCTAD in 1964, the LDC were brusquely told by a Soviet representative that, if they wanted their exports to be more profitable, they should learn to work more efficiently rather than charge higher prices.

with the West, especially Western Europe, could help to widen the gap between the United States and its allies. He might emphasize that such a commercial relationship would probably increase West European reliance on raw materials from the East, as well as creating a deep, vested interest in the Western business community to continue exporting to the East. He might note that, in view of the inherently non-symmetrical East-West relationship—with a highly centralized state monopoly of trade, on the one side, facing a relatively open interplay of market forces, on the other—the U.S.S.R. would find it fairly easy to manipulate trade with Western Europe so as to exert political leverage. For instance, after building up a flourishing commercial partnership with country X, Moscow could hint that an important trade agreement might not be renewed unless the U.S.S.R. met with greater political understanding, leaving it to business interests in country X to pressure their government in the desired direction.

Such arguments, like those of Western advocates of "bridgebuilding," have a certain cogency and validity, but also have their limitations. The fact remains that it is highly questionable—in view of the ideological barriers to a fundamental redeployment of Soviet productive forces, which we discussed earlier—whether the U.S.S.R. really would or could develop foreign trade to the dimensions required to exert irresistible leverage on major Western States. It is, of course, possible and even likely that the Soviet leadership will, from time to time, initiate importation programs of considerable proportions in order to catch up in a particularly significant area. Thus, the U.S.S.R. is seriously behind in the technetronic revolution, possessing, for instance, less than 4 percent of the world's computers¹⁰ and less than 6 percent of all nuclear powerplants. Moscow would obviously be interested in acquiring know-how through trade channels; another approach the Soviet leadership is testing concerns coproduction ventures (although, to date, most of these have really amounted to little more than construction of plants in the U.S.S.R. by Western enterprises). Western governments have displayed eagerness to extend considerable credit facilities to the Soviet Union for such purposes. Nevertheless, various current developments in the area of trade with Moscow seem to have an essentially sporadic character and do not negate the assumption that there are in-built barriers in the Soviet system to the transformation of the U.S.S.R. into a trade-oriented society.

It may, perhaps, be asked whether the increasing modernization of the Soviet Union is not producing "technocratic" elements that would be highly impatient with economic irrationality and would, therefore, apply pressure to bring about desirable changes. To pose the question in this way, however, means failing to comprehend both the nature of the Soviet "technocracy" and its precise place in the U.S.S.R.'s body politic. The Soviet elite consists of three distinguishable elements: (a) the higher party and State bureaucracy, (b) the technical and economic intelligentsia ("technocrats"), and (c) the scientific and cultural intelligentsia ("creative" or "prestige" intelligentsia). The first of these groups tends to be the least educated in the wider sense of the word, having often been limited to high

¹⁰ See "America and Europe" by Prof. Z. Brzezinski, *Foreign Affairs*, October 1970.

school training or less and, in some cases, to Communist Party higher schools and professional institutes. The second and third groups enjoy a far higher educational and cultural level, but, as will be seen, are prevented by the bureaucracy from any real access to political power. Both the technocrats and the creative intelligentsia enjoy the very substantial economic benefits of elite status, but the former are far less "opposition minded" than the latter. The reason is that an electrical engineer in his somewhat esoteric profession is less apt to suffer infuriatingly petty-fogging daily interference from bureaucrats than a novelist, whose work even a semiliterate Soviet censor can read and mutilate. Thus the artist is constantly hampered in his creative efforts, which are the very essence of his profession. It is not surprising therefore that the Soviet liberal opposition numbers many poets, novelists, film directors, ballerinas, and top-ranking scientists of the creative, theoretical level, but very few engineers, factory, and kolkhoz managers or laboratory technicians.

Moreover, even if the technocrats were to become less acquiescent than they now are, the bureaucracy has made fairly certain that they would be kept from the center of power. Technocrats now number almost 25 percent of the Soviet Communist Party's total membership, but were permitted only an insignificant 2 percent of the membership of the party's central committee. The creative intelligentsia, with about 11 percent of the party's total membership, was restricted to 4 percent of central committee members, all of them carefully chosen, "tame" intellectuals. The bureaucracy, on the other hand, with a mere 2 percent of the party's total membership, seized no less than 92 percent (including military functionaries) of the central committee seats. Workers and peasants, the vast bulk of the Soviet population, were awarded a symbolic 1.5 percent of seats on the central committee of a supposedly "Proletarian Party."¹¹

Under these circumstances, it appears highly premature to expect lateral leverage by the technocracy in favor of economic rationality—not to speak of mass "pressure from below" for more and better consumer goods—to have a relatively significant impact on Soviet policy-makers and their basic economic and trade posture. As we mentioned earlier, the leadership seems prepared to tinker, but not to adopt fundamental changes that could be challenged on ideological grounds.

With this general background in mind, one has to conclude that the subject of East-West trade remains what it has always been—a political rather than an economic question. It has no inherent virtues or vices, but depends entirely on the use to which it is put. It cannot be divorced, in fact, from the general context of East-West political relations. To speak of flourishing trade leading to improved relations with the U.S.S.R. is to reverse the logical order. It is true that negotiations on a commercial agreement have sometimes been a harbinger of a new political relationship, as in the case of the Hitler-Stalin Pact, but that has always occurred because the Kremlin concluded that a diplomatic change was required and used the commercial framework to signal this change. Perhaps "signal" is the key word in this connection.

¹¹ The statistics mentioned in this paper are taken from Prof. Boris Meissner's excellent work "Der Funktions- und Strukturwandel der Partei," *Ost-Probleme*, 22/23, November 17, 1967.

To take a frequently mentioned example, the granting of most favored nation status may no longer be a matter of great economic consequence, but it can act as a political barometer. It is easy to imagine, for instance, why such a step might have one interpretation if taken in relation to an East European country striving to maintain its autonomy under Soviet pressure, and a somewhat different significance if granted to the U.S.S.R. under the same circumstances. As in all political matters, it is frequently the perception of the spectators rather than the real motivation of the actors that carries weight. Consequently, timing, sequence of actions and general context are factors of some importance. Presumably this holds true of the question of commercial relations with the U.S.S.R., as of other basically political issues.

This is a matter, therefore, that can hardly be considered in isolation; at any one particular moment, it may have to be evaluated against current Soviet actions in key areas—whether this be Berlin, the Middle East, Cuba, or SALT. To formulate the precise equation is always a matter of considerable delicacy and, to that extent, a certain degree of diplomatic and strategic guidance is probably inevitable.

In concluding, Mr. Chairman, may I again point out that I am not an economist and most certainly not an expert in the highly technical field of international trade; consequently, I can only plead that questions concerning the commercial, economic, and legal specifics of East-West trade be addressed to other colleagues who, unlike myself, are competent to deal with them.

Thank you, Mr. Chairman.

Chairman BOGGS. Thank you very much.

Mr. Conable.

Representative CONABLE. Thank you, Mr. Chairman.

Gentlemen, I say this is generally a very pessimistic view you have given us this morning. I think it has been a very interesting presentation, however.

Mr. RA'ANAN, I was particularly interested in your analysis of Soviet agriculture. You say that we have only about one-seventh of the production personnel involved in food production that the Russians do. What are those figures? I always understood they had somewhere around 50 percent involved in food production, and we have only about 4 or 5 percent.

Mr. RA'ANAN. Well, sir, the definition of "farm population" is quite different in these two instances. In the case of the U.S.S.R., almost 50 percent of the inhabitants are defined as "rural population," but not all of these are active farmers. Many in fact, are bureaucrats.

Representative CONABLE. Some of them are in the services; is that it?

Mr. RA'ANAN. That is correct; many are in service occupations.

Representative CONABLE. What you say about Russia is true to even a greater extent of China, is it not? In China, don't they have close to 80 percent engaged in food production and a greater potential food deficit than the Russians have?

Mr. RA'ANAN. I feel that, in China, the same ideological limitations operate, perhaps even to a greater extent, although this is not necessarily a permanent factor.

Representative CONABLE. And that, of course, is aggravated by China's introspective mood at this point. If Russia is not looking outward in terms of trade, China is doing so even to a lesser extent; is that correct?

Mr. RA'ANAN. I believe that this particular mood in China may well be dissipating, at least in the diplomatic sector. During recent months there have been major indications of resumption contact with the outside world. How far this will affect the commercial sector is not yet entirely clear, but I am inclined to think that these developments will have an impact on China's external trade.

Representative CONABLE. Russia has been recently purchasing some food from the EEC, has it not? For instance, did it not pick up a substantial block of butter surplus from them, generated as a result of their unrealistic subsidy program there?

Mr. RA'ANAN. Yes, sir.

Representative CONABLE. And that has taken some pressure off the EEC.

Mr. RA'ANAN. As my statement indicated, while the U.S.S.R. does not eschew occasional opportunistic moves of this type, by and large it confines major food importation programs, especially in grain, to crisis years, when production has spectacularly failed, very often for climatic reasons. The year 1963 constituted a typical example. Generally, therefore, such moves were made under duress, and were not primarily a result of planning or of economic rationality. It is still not the rule for the Soviet Union to resort to imports just because a commodity may be obtained more cheaply abroad.

Representative CONABLE. Can we expect the pressure for international trade to be greater on China than it is on Russia because of China's smaller degree of self-sufficiency?

Mr. RA'ANAN. I would not preclude such a possibility.

Representative CONABLE. And if that is so, is China likely to be looking outward particularly with respect to the food production regions of Southeast Asia?

Mr. RA'ANAN. I think that is entirely possible.

Representative CONABLE. How is China and how is Russia going to pay for this type of purchase? How have they done it in the past and how are they likely to do it in the future? In other words, what is the quid pro quo for this kind of trade? It seems unlikely to me that China could, except at a considerable loss to herself, undersell Japan with respect to cheap manufactured articles to pay for the things she might be buying.

Mr. RA'ANAN. Well, where the pricing of export items is concerned, the Communist countries have always operated in a peculiar fashion. Their evaluation of what it costs them to manufacture a current export item, would not, I think, be accepted by most Western economists. Very often, what are considered to be standard ingredients of manufacturing costs in the West are not taken into account in the Communist countries which, therefore, tend to set artificially lower prices, that occasionally encourage dumping practices.

In answer to the first portion of your question, the Soviet Union has, of course, from time to time, unloaded part of its gold reserves in order to pay for imports. Russia can continue doing so, although clearly not in an unlimited fashion.

If I may make one particular point in relation to China, since we are speaking of commercial questions in a political context: It has seemed to me for some time that, from the Western point of view, it is, perhaps, advantageous that the global constellation has become essentially triangular, so that there are not only two capitals that count; namely, Washington and Moscow, but three, including Peking.

A triangular relationship of this type tends to disadvantage the Soviet Union. It is the Russian leaders who are caught, both geographically and politically, in a two-front situation, facing potential antagonists on both flanks. Consequently, it is the Soviet Union that benefits when the United States and China are at odds with one another. A somewhat improved Western commercial relationship with China could signal to the Soviet Union—if I may again stress the significance of the concept of signaling—that the West is essentially interested in the preservation of China's independence against potentially itchy trigger fingers in the Kremlin.

Since 1966, there is believed to be a faction in Moscow which is thinking in terms of preemptive measures against China, or rather against the Maoist leadership. It seems to me that, from a Western point of view, such Soviet intervention would be most undesirable since its end result might be the restoration of the Sino-Soviet bloc with a new Peking regime dependent on the Red Army. Any act that would signal to the Kremlin that Soviet intervention against China is not an acceptable proposition as far as the rest of the world is concerned, might help to serve as a deterrent. It would be read in Moscow as indicating that the Soviet Union would not be assured of an automatic, benevolent neutrality on its Western flank, if it were to take violent measures against China.

Consequently, I would tend to place the question of a trade relationship with China in a somewhat different context than the issue of commercial relations with the Soviet Union.

Representative CONABLE. What kind of quid pro quo could the Communist countries give to the United States in return for granting them most-favored-nation treatment? Would it be entirely political? Is there any quid pro quo there that we would find advantageous or would it have to be political?

Mr. RA'ANAN. In the purely commercial sector, I could not say with any assurance what such a quid pro quo might be. I continue to regard the grant of most-favored-nation status as an essentially political matter; thus, I would distinguish between the granting of this status to a country such as Rumania and shall we say, to the Soviet Union. Such a distinction would be obscured if both were given MFN status simultaneously. In the case of countries that have at least made an attempt to stand up to Soviet pressure, it is obviously helpful to signal that the West appreciates their plight and is prepared to help such countries obtain a modicum of economic advantage.

I am not convinced that there is any benefit to be gained just now by extending such treatment to the Soviet Union itself. It is conceivable that, in a different context, greater accommodation by the Soviet Union on some of the vital global issues that I mentioned earlier in my statement might justify a more favorable Western response. I

think there should be some order of priorities, according to which concessions in the commercial field correspond to behavior in the political arena. The order of priority should obviously favor the more accommodating regimes—or at least those, like Mao's China, whose hostility is verbal rather than physical—over those whose current actions threaten vital Western interests.

Chairman BOGGS. Would other members of the panel like to comment on that question?

Mr. CAMPBELL.

Mr. CAMPBELL. Representative Conable, it seems to me that there is something that we can bargain, or should bargain, about in giving most-favored-nation treatment selectively to one East European country or another. I would mention the case of Rumania. It seems to me this is something that would have a definite symbolic significance and show, as the President's visit did, an American interest in their ability to maintain what independence they can of Soviet control.

And at the same time it would give them a better chance to find some market for their goods here, which they find it very difficult to do under the 1930 tariff rates. That move, therefore, would open up somewhat more our economic relations with them.

Now, perhaps there are not any other immediate candidates from a political standpoint to give most-favored-nation treatment to, but it might well be that with further developments, and an increase of, let us say, Polish or Hungarian trade with Western Europe, that it would be a natural thing for us to make the same kind of gesture to them in due course. As for the Soviet Union itself, it does not seem to me desirable now and I do not really foresee in the near future any reason why we should make the same proposal for them.

Representative CONABLE. I wonder if you could help me as to why Rumania is considered the best candidate. It is not just the result of the independence based on their unanimity policy—where China and Russia must agree before they go with the Communist bloc nations on trade—it is also the result of their having resisted the efforts of the Soviets to make their production entirely complementary to Soviet production; is that not right? The Soviets, for instance, started out with the idea Rumania was going to produce oil and farm supplies and that was about it.

And the Rumanians have gone ahead and developed other industries and therefore have surpluses that are potential industrial surpluses that are not part of the Soviet plan for locking all countries together with trade dependence. Is that the reason that Rumania is now the best potential trade partner?

Mr. CAMPBELL. Yes, sir.

I think that contributes to it considerably. Ever since 1962, when Khrushchev tried to build up some kind of an integrated economy in Eastern Europe with the Soviet Union, in which obviously the dominant factor would be Soviet Union economy and political direction, the Rumanians took the initiative to resist that and consequently it never went through in the form the Russians proposed it.

It has remained Soviet policy, I think, to move in that direction and they have done it both in the COMECON organization and in their bilateral relationships with Eastern European countries, includ-

ing Rumania, which signed a trade treaty with the Soviets last summer.

Rumania remains under considerable pressure in that regard. On the other hand, it is not just a matter of economic policy. Rumania has taken important foreign policy positions, for instance, toward the Middle East, where they did not break with Israel, and in Europe, where they themselves renewed relations with Western Germany, a move which the Soviets did not like. In a series of foreign policy decisions taken by the Rumanians they have shown they are, in fact, independent, and I think we have wanted to encourage that.

Representative CONABLE. Is it not true their internal economy does not slavishly follow Soviet design?

Mr. CAMPBELL. That is quite true, even though some of it may not be very good economies. For example, their building up a huge steel complex as they have, but nevertheless they did it as a sign of showing their independence, they were not going to take the line laid down by Moscow.

Representative CONABLE. But the inevitable result is they have to look outward for a market away from the Communist bloc?

Mr. CAMPBELL. They can look toward Western Europe, they can market some of these things in Eastern Europe. For example, oil products, the products of their petrochemical industry, and so on. They can find markets in various other places.

Representative CONABLE. Now, to come back to the agricultural side, is it not true that the green revolution in the developing countries is working against the possibility of increasingly outward view by the Communist bloc nations because of the growing agricultural independence of these developing countries? Is that likely to be a negative factor in terms of possible building up of Communist bloc trade?

Mr. CAMPBELL. Others can answer this, but I will just make one remark. It seems to me the Communist countries of East Europe can export some of their industrial goods, as Yugoslavia has, to third world countries, but the fact of increased agricultural production does not make the great difference there in those countries. On the other hand, there is competition with better quality products from the West, so even there they are under handicaps.

Representative CONABLE. Mr. Allen, you had something to say?

Mr. ALLEN. I would agree with that assessment. It seems to me that for those less developed countries which desire to expand their trade with Eastern Europe and the Soviet Union, it would put them in a fairly good bargaining position if the product of the "green revolution" were something the Eastern European countries wanted and needed. It would give them a greater capacity to barter for finished goods.

There is no guarantee, however, that those finished goods coming from Eastern Europe will in any way match the quality of what is available in the advanced Western countries. One could get into triangular trading relationships and trade-offs, but in any case I would not view the "green revolution" as being an impediment to trades.

Representative CONABLE. One last question, Mr. Chairman.

Chairman BOGGS. Go right ahead.

Representative CONABLE. I would like to ask Mr. Ra'anán if he had any reason to believe that there would be any sympathetic view, on the

part of the Soviet Union to the development of a consumer goods trade with them? It would make it unnecessary for them to develop apparently something of a diversion from their basic requirements but, on the other hand, a consumer goods industry does contribute rather vigorously to the revolution of rising expectations in the Communist countries and apparently tends to make the people their dissatisfied with their lot once they see that the consumer goods are a possibility for them.

It would be pretty much a political decision, would it not, to permit any substantial consumer goods trade and, therefore, it is unlikely they would be permitted there?

Mr. RA'ANAN. I think that in terms of Soviet priorities, sir, the likelihood of really large-scale consumer goods trade is not terribly great. What does exist is willingness on the part of the planners and the political leaders to proceed and obtain from the West those items which the Soviet Union most sorely lacks in terms of its own planning requirements; however, consumer goods do not normally fall within this category.

The Kremlin is anxious to catch up in the technetronic revolution, by importing know-how, if necessary, by obtaining Western patents, licensing arrangements, and so forth; for such goals, the Soviet Union will have to pay a fair amount, which it will be able to raise with some difficulty.

To go beyond these aims to any real extent, into what are secondary consumer objectives for which there are not enough internal pressures for the reasons I tried to outline, is a very unlikely Soviet move at this stage; namely, during the next 4 or 5 years. Beyond this period, who can tell? I do not believe that, in the near future, there is a high probability of a major, sustained Soviet consumer goods importation program, other than sporadic moves in the automobile sector. I do not anticipate a calculated Soviet decision to compensate by imports for the lack of a really first-class, quality-conscious Soviet consumer goods industry.

Representative CONABLE. Thank you, Mr. Chairman.

Chairman BOGGS. Thank you, Mr. Conable.

Mr. DUCHENE, do any of the Eastern European countries subscribe to GATT?

Mr. DUCHENE. Czechoslovakia was a founder member, but its membership has mostly been rather formal. Poland, however, has reached agreements with GATT countries which give it a special position in the organization.

Chairman BOGGS. Would the extension of membership in GATT promote further East-West trade?

Mr. DUCHENE. It is remarkable that Poland, which alone of the Warsaw Pact countries receives MFN treatment on GATT terms from the United States, has much the largest trade with the United States of any East European country. In the question of MFN and economic relations with East European countries, there is a difference between the balance sheet and process approaches.

If you take the balance sheet approach, seeking immediate political advantage, you might, for instance, deal first with Rumania. This, can make the East-West relationship more difficult because it sounds as if one is striving to divide the East European countries and brings

out what you might call the Czechoslovakian complex in the Soviet Union.

If, however, one takes a more general approach to East-West economic relations, aimed at encouraging the process of development and change in East European countries—including according MFN treatment or GATT association to those who seek them—you then get differentiated policies among these countries as a result not of your discrimination but of their own development. I think the Hungarians might be able to do a great deal more, for instance, than, say, the Soviet Union, simply because they have a far greater need for exports. However, you can hardly invite people into GATT who have not asked to come into it, and not all the Warsaw Pact countries have asked.

Chairman Boggs. Would any other members of the panel like to comment?

Mr. CAMPBELL. I would like to say, Yugoslavia is a full member of GATT; they did apply and were accepted. The basic question, of course, with all of these countries is where a state-trading country fits into the GATT, and that is a very complex question, which I will not go into now but just mention it, one which has to be overcome through some rather complex negotiations. But the Yugoslav economy, which is now a mixed one, has made it possible for them to have full membership and be accepted as such.

Chairman Boggs. In view of the fact that Western Europe trades extensively with Eastern European countries and to some extent the Soviet Union, is American policy having any impact? If you can buy in Western Europe goods and articles that you cannot buy in the United States, how effective is the U.S. policy? Does any of you care to answer?

Mr. ALLEN. Well, I suspect that the U.S. policy, on the evidence, has not been all that effective in terms of denial. I interpret your question to be that of denial.

Chairman Boggs. Right.

Mr. ALLEN. I think there are certain key areas which do have a bearing on strategic posture, if you will, military capability, in which the United States is substantially far advanced, particularly in the field of computers. There are those who argue that if we continue to deny to the Soviet Union or Eastern Europe sophisticated computer technology, they can certainly get it from Europe and, therefore, we have just lost the business by our own intransigence.

I do not think that is the case because the Soviet Union does not want to buy built-in obsolescence and therefore wants to stay with the state of the art of technology. We have such a lead, and an increasing one, that they obviously want and need the best money can buy. In this case, denial, strategic denial, is effective. It does prevent them from acquiring this technology which would in turn allow them to divert it to whatever purposes they may see fit or, on the other hand, to release resources that could be inimical to the long-term interests of the United States, such as increased support of Egypt or the Arab countries, more militant countries.

Chairman Boggs. Any other member like to comment on that question?

Mr. CAMPBELL. Mr. Chairman, it is certainly true that those items which are on our strategic lists, but which are not on the agreed list, they can get from Western Europe. It does not seem to me there is a strong reason for our continuing to exercise controls over those particular items.

In the field where our technology may be much further advanced, that is a different question and it seems to me there is a case in that instance for continuing to deny and control.

On the other hand, the rapidity of technological change is such that very soon the lead on individual items tends to be lost. So that on items which are being replaced by more advanced items in our own country, those obsolescent items might well be available for export even to the Soviet Union.

Chairman BOGGS. Are the reasons for the Soviet penetration of the Middle East political as well as economic, or both?

Mr. ALLEN. I think it is quite clear that the primary reason is a political-strategic reason. The secondary reason would be certainly an economic one in terms of providing energy resources over the long term.

The potential opening of the Suez Canal and eventual free passage for the Soviet Union to the Indian Ocean would be a long-term strategic goal as well.

Chairman BOGGS. The objective to provide crude mineral resources for the Soviet Union or to deny them to Western Europe.

Mr. ALLEN. Perhaps both.

Mr. RA'ANAN. Mr. Chairman, I would say that although there is an economic aspect it is, perhaps, an afterthought. I think the primary objective of the Soviet Union in the Middle East is politico-psychological, so to speak. Since the mid-1950's the U.S.S.R. has pursued a policy whereby it agrees to a temporary standstill, a temporary partition of the globe, in the Northern Hemisphere, but continues an offensive in various ways, both direct and indirect, overt and covert, in the Southern Hemisphere, in the so-called Third World. The Middle East has to be viewed within that context.

As the Russians see it, power consists of two ingredients: The first is physical power; the second ingredient is the perceived willingness to use that power. It is very important, in terms of the impact on the Third World for the Kremlin to be clearly perceived to be using its power to score unilateral advantages.

The peoples of the Third World understandably, in view of their past history, have come to be obsessed with one thought: never to be caught on the losing side. Consequently, it is very important for the Soviet Union to be perceived throughout the Third World to be the winning side, the side that is scoring gains. To be sure, these may be limited gains, that need not necessarily paint the map red; what is important in sheer power terms, is that Moscow should be clearly seen to be gaining and should be scoring its gains openly defying the West.

To refer to a particular instance, the rather blatant Soviet violation of the cease-fire standstill in the Suez Canal area played a significant role as far as perception in the Third World is concerned—since it impressed onlookers with the fact that the Soviet Union could do this and get away with it. Observers felt that the Soviet Union is able

to enforce unilateral changes and to reap the benefits of such changes as a result of Soviet willingness and determination to use power.

I believe that these types of quasi-psychological power concepts and considerations are very, very important. The Middle East is a most "visible" part of the Third World; therefore it is particularly important for the Soviet Union to demonstrate the effectiveness of its policy in the Middle East. I would imagine that this aspect has first priority in Soviet considerations and that economic factors occupy a much lower spot on the agenda.

Chairman Boggs. Just one final question. What do the members of the panel envisage in the future in the way of trade between Japan and mainland China?

Mr. ALLEN. I would like to comment on that, Mr. Chairman. I think that the Japanese recognize a vast potential market, but at least in terms of the ruling liberal Democratic Party in Japan today, there are not too many illusions about the immediate short-term benefit of that trade.

As was quite correctly pointed out here today, I believe by Mr. Duchene, the Japanese have been extremely cautious in their dealings with both the Chinese and the Soviets. The rigors and the agonies of trying to do business with the Chinese have been experienced on numerous occasions by the Japanese trade delegations, and while they recognize it is necessary and consistent with their expanding role in the Far East to continue to cultivate this market to some extent, they harbor no illusions.

But, again, they do recognize that market, they feel it may have some longer term importance, and the concept of keeping the foot in the door economically is fairly important to the balanced Japanese policy.

Chairman Boggs. Any other member of the panel like to comment on that?

Mr. ALLEN. I would like to take advantage of your presence for just 30 seconds. I would like to add something that may seem somewhat irrelevant, but could, in fact, bear on the question at hand.

That concerns the present trade bill before the Congress. I would like to add my voice to that of the several thousand economists and numerous others in urging that this particular bill not be passed by the Congress of the United States, and it has its relevance in this area of discussion right now.

I believe this bill is harmful to our interests worldwide. Beyond that, to adopt a protectionist attitude and to fail to assess the long-term consequences of what I consider to be this counterproductive bill could, in fact, trigger trade with the Soviet Union in areas that are not now being covered by existing trade and could unleash, I think, a substantial wave of opposition to U.S. trade policies and/or leadership in the future.

Chairman Boggs. Thank you very much.

I thank all of you gentlemen for coming. It has been very helpful to the committee.

We will adjourn until 10 o'clock tomorrow morning.

(Wherennon. at 12:15 p.m., the subcommittee adjourned, to reconvene at 10 a.m. on Tuesday, December 8, 1970.)

A FOREIGN ECONOMIC POLICY FOR THE 1970'S

TUESDAY, DECEMBER 8, 1970

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The Subcommittee on Foreign Economic Policy met, pursuant to notice, at 10 a.m., in room S-407, the Capitol Building, Hon. Hale Boggs (chairman of the subcommittee) presiding.

Present: Representatives Boggs and Reuss; and Senator Javits.

Also present: John R. Stark, executive director; John R. Karlik, economist; Myer Rashish, consultant; and George D. Krumbhaar and Leslie J. Barr, economists for the minority.

Chairman Boggs. The subcommittee will come to order.

Today our review of the possibilities for expanded East-West trade and investment shifts in its emphasis to detailed economic considerations. Yesterday we discussed the political gains and risks that might arise from an intensification of economic relationships. Today and tomorrow, by contrast, the economic rather than the political feasibility and desirability of additional trade and investment between East and West will be the focus of our attention. Of course, the political dimension of such considerations can never be forgotten and some safeguards will always be necessary as long as the potential for military conflict exists.

A highly distinguished panel of witnesses has assembled today. First, we will hear Mr. J. Irwin Miller, chairman of the Cummins Engine Co. of Columbus, Ind. Mr. Miller was also Chairman of a group appointed by President Johnson to consider East-West economic relations.

Next is Mr. Samuel Pizar, a practicing attorney in Paris and author of a recently published book on today's subject.

Third, we have Mr. Ota Sik, who is currently professor of economics at the University of St. Gallen in Switzerland and was formerly Deputy Premier of the Czechoslovak Socialist Republic and member of the Czechoslovak Party Central Committee.

Fourth, we will hear from Mr. Otto Wolf von Amerongen president of the German National Chamber of Commerce and Industry, and also president of Otto Wolf A.G., a firm producing steel, and with interest in mining and other fields. He is also a member of a group to advise the German Government on trade policy with Eastern European countries.

Mr. Miller, we will be very happy to hear from you.

**STATEMENT OF J. IRWIN MILLER, CHAIRMAN OF THE BOARD,
CUMMINS ENGINE CO., INC., COLUMBUS, IND.**

Mr. MILLER. Thank you, Mr. Chairman.

It is an honor to be with you.

In beginning my comments, I should call attention to the fact that our Special Committee on East-West Trade met and concluded its deliberations in 1965. So it is from such a perspective that I tend to view the problem. I believe, however, that in many ways it is still a useful perspective.

Chairman Boggs. Would you like to make it a part of the record?

Mr. MILLER. Yes.

Chairman Boggs. Without objection, it will be made a part of the record.

(The document referred to follows:)

REPORT TO THE PRESIDENT
OF THE
SPECIAL COMMITTEE ON U.S. TRADE
RELATIONS WITH EAST EUROPEAN
COUNTRIES AND THE SOVIET UNION

The White House
April 29, 1965

The Special Committee on U.S. Trade Relations with East European Countries and the Soviet Union was created by the President on February 16, 1965. Its task was to explore all aspects of expanding peaceful trade in support of the President's policy of widening constructive relations with the countries of Eastern Europe and the U.S.S.R. That policy was reaffirmed by the President in his State of the Union message when he said, "Your government, assisted by leaders of labor and business, is now exploring ways to increase peaceful trade with the countries of Eastern Europe and the Soviet Union."

The members of the Committee are :

J. IRWIN MILLER (Chairman)

Chairman of the Board, Cummins Engine Co., Inc.; Member, Executive Committee, World Council of Churches

EUGENE R. BLACK

Chairman, Brookings Institution; Past President, International Bank for Reconstruction and Development

WILLIAM BLACKIE

President, Caterpillar Tractor Co.; Director and Chairman of the Foreign Commerce Committee, U.S. Chamber of Commerce

GEORGE R. BROWN

Chairman of the Board, Brown & Root, Inc.; Chairman, Board of Trustees, Rice University

CHARLES W. ENGELHARD, JR.

Chairman, Engelhard Industries; Director, Foreign Policy Association

JAMES B. FISK

President, Bell Telephone Laboratories; Past Member, President's Science Advisory Committee

NATHANIEL GOLDFINGER

Director of Research, AFL-OIO; Trustee, Joint Council on Economic Education

CRAWFORD H. GREENEWALT

Chairman of the Board, E. I. du Pont de Nemours and Co.; Chairman, Radio Free Europe Fund

WILLIAM A. HEWITT

Chairman of the Board, Deere and Co.; Trustee, U.S. Council of the International Chamber of Commerce

MAX F. MILLIKAN

Professor of Economics and Director, Center for International Studies, Massachusetts Institute of Technology; President, World Peace Foundation

CHARLES G. MORTIMER

Chairman, General Foods Corp.; Trustee, Stevens Institute of Technology

HERMAN B WELLS

Chancellor, Indiana University; Former U.S. Delegate to the United Nations General Assembly

EDWARD R. FRIED served as Executive Secretary to the Committee and **JAMES A. HENDERSON** as Deputy Executive Secretary.

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THE WHITE HOUSE,
Washington, D.C., April 29, 1965.

THE PRESIDENT

OF THE UNITED STATES

DEAR MR. PRESIDENT: You have asked us "to explore all aspects of the question of expanding peaceful trade" in support of your policy of "widening our relations" with the countries of Eastern Europe and the Soviet Union.¹

Any useful consideration of the desirable degree and pattern of peaceful trade relations between ourselves and these countries must begin with the Soviet Union itself.

The Government of the Soviet Union has steadily, over many years, by words and deeds, declared its hostility to our own country. The U.S. Government and the American people support the most powerful defense system the world has ever seen in recognition of this fact.

Without this preponderant military power, it would be idle and even dangerous to explore the possibilities of expanding peaceful trade, or for that matter, of any peaceful relations with the Soviet Union. For the same reason, we rule out from these considerations any kind of strategic trade that could significantly enhance Soviet military capabilities and weaken our own position of comparative military strength.

With a secure defense, on the other hand, we can prudently seek practical means of reducing areas of conflict between ourselves and the U.S.S.R. Indeed, we assume the United States has an obligation in today's nuclear world to pursue such possibilities as part of its long-term commitment to strengthen the prospects for peace in the world.

While the Communist threat remains, its nature constantly changes, because the conditions of men and nations everywhere are changing. Thus, our Government must be forever reexamining its policies, programs, and methods to make certain that they are appropriate to the times and to the national purpose.

It is now clear that the ties between the East European nations and the Soviet Union are neither quite so numerous nor so strong as they have been in the past; the forces of nationalism are growing. Between the Soviet Union and Communist China, sharp differences have arisen. There is also a ferment in all of the European Communist countries

¹ It is understood that policies with respect to trade with Communist China, North Korea, North Vietnam, and Cuba are outside the terms of reference of this Committee. Our findings and recommendations do not apply to trade with these countries. The terms "Communist countries" and "European Communist countries" as used in this report refer to the nations of Eastern Europe and the U.S.S.R.

as they try to cope with the awakening demands of their people for a better life within the confines of a system geared more for military power than for human welfare.

It is an essential part of U.S. strategy to resist Communist efforts to expand through aggression. At the same time, we know that the danger of aggression will never be overcome until the Communists change their view of the world and the goals they ought to seek. Through our attitudes and actions, therefore, we must aim to influence these countries toward decisions that stress the attainment of prosperity through peaceful means. To appear hostile toward all of their objectives deprives us of the opportunity to influence the choices they make as to kinds of objectives or as to means of achieving them.

The possibilities of "peaceful coexistence" and mutually advantageous trade do not sound convincing coming from those who speak of "burying us." We know very well that coexistence means something different to Soviet leaders from what it means to us. Within the framework of a policy so labeled, they believe they can still pursue hostile actions against the free world so long as major war does not result. But they have found it necessary to change their view of coexistence over the past decade and the conditions of the modern world will cause it to change further over the next decade. Much the same may be said of Soviet motivation and desire, and that of most of the East European nations, for increased trade with the United States. This Committee, therefore, has come to believe that in a longer time perspective the possibilities of "peaceful coexistence"—in the genuine meaning of that expression—can be made to grow. We conclude this in spite of Soviet professions and not because of them.

We are aware that the Communists have their conviction as to how the forces of history will operate and that they profess to be convinced that time is on their side. We also have our own conviction. We believe that men and nations function best in an open society. There are signs that pressures for greater openness within Soviet society are mounting. The reasons may be pragmatic rather than ideological, but they are nonetheless real. The Soviets want a modern and technically advanced society. Their own experience shows that the building of such a society can be severely handicapped by a closed and tyrannical political order and a rigid, centrally directed economic system.

We desire to encourage the growth of forces in the European Communist countries that will improve the prospects for peace. Within these countries we seek to encourage independence from Soviet domination and a rebuilding of historical ties with the West. In each of these countries, including the U.S.S.R., we seek an opening up of the society and a continuing decentralization of power. It is in our

interest to promote a concern with internal standards of living rather than with external adventure.

We must look at our trade policies toward European Communist countries in that broad context. Trade is a tactical tool to be used with other policy instruments for pursuing our national objectives.

Trade cannot settle the major outstanding issues between ourselves and the Communists, nor can it, by itself, accomplish a basic change in the Communist system. Over time, however, trade negotiations and trade relations can provide us with useful opportunities to influence attitudes in these countries in directions favorable to our national interest. Trade involves contact of peoples and exchange of ideas and customs as well as of goods and services. It requires the building of mutual trust, and good faith, and confidence. An expansion of trade would require from the Communists a growing commitment to international rules and adherence to international standards for responsible behavior; it cannot be based on Soviet-imposed conditions or usual Communist trading practices.

Trade and government-to-government negotiations which set the framework for trade can be means of reducing animosities between ourselves and individual Communist countries and can provide a basis for working out mutually acceptable solutions to common problems. A constructive attitude toward trade can serve as a counterpart to our national determination to convince these countries through our deterrent military power that they cannot gain their objectives through aggression. Properly conceived and wisely administered, a growing trade with East European nations and the Soviet Union could become a significant and useful device in the pursuit of our national security and welfare and of world peace.

In sum, trade with the European Communist countries is politics in the broadest sense—holding open the possibility of careful negotiation, firm bargaining, and constructive competition. In this intimate engagement men and nations will in time be altered by the engagement itself. We do not fear this. We welcome it. We believe we are more nearly right than they about how to achieve the welfare of nations in this century. If we do our part, time and change will work for us and not against us.

These are the general propositions which underlie the specific findings and recommendations which we now submit. They are based on excellent briefings and supporting papers prepared by government agencies in answer to questions the Committee raised, on materials submitted to the Committee by interested private organizations, and on a careful review of some of the most pertinent published material on this subject. The members of the Committee have found that

exposure to this source material and thorough discussion of the issues brought new perspectives and fresh judgments. We would emphasize, on the basis of our experience, that public understanding of how trade can best fit into our national strategy is essential to the effective use of trade as an instrument of national policy.

FINDINGS

Review of Our Position

1. The United States has a long tradition that trade is a normal element of relations between countries. We have departed from that principle rarely and only for compelling reasons. Indeed, we began the period following the close of World War II by treating trade with the U.S.S.R. no differently from trade with other countries. We did not impose security controls on this trade until 1948 and then did so purposefully in response to aggressive Soviet expansion in Eastern and Central Europe. In the atmosphere of the Berlin blockade and the Korean war, we expanded these controls and gained the cooperation of other principal trading nations in an international embargo of strategic commodities.

2. When we first applied these controls we were the predominant source of capital, of advanced industrial technology, and of exportable resources in the West. The U.S.S.R. while pursuing an aggressive external policy, operated internally from a relatively weak and backward industrial base. At that time, we had both strong cooperation from other Western nations and a considerable unilateral capacity to insure that Western resources would not contribute to the growth of Soviet military power.

3. The underlying situation changed rapidly, particularly over the past decade, and the process continues today. The ability of the Western Europeans to trade, in terms of exportable resources and technology, grew rapidly in the wake of their dramatic economic recovery. Moreover, they saw the death of Stalin and the end of the Korean war as marking sufficient change in the political climate to justify resumption of their historic trade with Communist Europe.

The capacity of Communist countries to trade across the Iron Curtain also increased, following a marked growth in the strength of their economies. They saw in this trade a means of hastening economic growth and meeting planning goals. The interest of the East European countries in this trade was further heightened by the failure of Soviet attempts to impose a system of integration on their economies.

4. These developments created pressure on the part of our allies to ease the internationally agreed Western restrictions on exports to the East. As a result, the International Embargo List was gradually reduced. The West European nations reduced their controls accordingly; the United States did not do so to the same degree. A growing disparity arose between the United States and its major industrial allies in regard to respective attitudes toward the trade, controls on the trade, and participation in the trade. This disparity exists today and poses basic questions about our trade policy. The United States has three alternatives. It can leave things as they are. It can eliminate this disparity through action across the board that would bring U.S. trading practices into line with those of our allies. Or it can modify its practices selectively and on a country-by-country basis. Only the third alternative could offer new negotiating leverage with individual Communist countries.

5. The mere existence of these differences in trade restrictions is sometimes cited as sufficient cause for changing U.S. export licensing controls to conform to those of Western Europe and Japan. In the Committee's view, this reasoning misses the essential point. The effectiveness of the U.S. denial of machinery and equipment to Communist countries is, of course, diminished by the availability of comparable advance technology from Western Europe and Japan. It is also true that our business firms are at a disadvantage in Communist markets in competing with West European firms. Commercial considerations, however, have not been the determining factor in framing U.S. policy on this subject and should not be now. It is not the amount of trade that is important but the politics of offering trade or of withholding trade.

6. The United States initiated its controls for political reasons and should be ready to revise them when it is in the national interest to do so. This requires careful judgments on the significance of events, trends, and opportunities in individual European Communist countries and on how our relations with such countries fit into our overall strategy. It is on these grounds that we must be concerned to keep our policies under constant review—and not simply because we and our European allies may at a given moment be somewhat out of step.

7. As East European countries have shown signs of moving toward more independent positions, the United States has made greater use of trade inducement and less use of trade denial as an instrument of national policy. We have differentiated our trade policies toward individual Communist countries in accordance with the political opportunities they present. We responded promptly and effectively in 1948 when Yugoslavia adopted a more independent position toward

the Soviet Union. We took action in the trade field when Poland, in 1956-57, gave signs of moving toward somewhat greater autonomy in Eastern Europe. And we took a modest step through trade talks in 1964 toward more promising relations with Rumania in response to an initiative from the Government of that country.

8. In these terms, the circumstances under which we would be willing to expand peaceful trade and the process of negotiating such trade take on considerable significance. Our Government should be properly equipped and oriented to negotiate aggressively and confidently with European Communist countries in the trade field as in all other fields whenever favorable opportunities and circumstances present themselves or can be created.

The Character of the Trade

9. Trade between the European Communist countries and free world industrial countries was close to \$3.5 billion each way in 1964. It grew at an average rate of nearly 10 percent a year over the past decade, or somewhat more than the rate of growth in the overall trade of Western industrial countries. The U.S. share in this trade was small—about one-tenth of total Western exports to these countries in 1964—and even this figure is abnormally high because it includes large wheat sales which are not likely to be a normal feature of this trade. For Western Europe, trade with Eastern Europe has ranged between 3 and 4 percent of total trade. For the United States, the proportion, even in 1964, was barely 1 percent.

10. The aggregate economic significance of this trade is small for all the countries concerned. For example, total imports from the West are for the Soviet Union only one-half of 1 percent of its gross national product and for East European countries 2 percent of their combined national product. For Western Europe, the aggregate significance of this trade is even less, and for the United States, it is negligible. U.S. exports to all European Communist countries this year probably will not reach \$200 million, or less than we sell to Switzerland.

11. The trade is of somewhat greater significance for particular industries in the European Communist countries. The U.S.S.R. and the East European countries are interested primarily in buying advanced or specialized types of machinery, industrial plants, and industrial processes and technology from the West to meet specific economic planning goals or to become self-sufficient in certain industrial sectors. They also buy metal manufactures and small quantities of consumer goods. To finance their purchases they sell to the West mainly industrial raw materials, minerals including gold, foodstuffs, steel products,

and particularly oil. They also sell relatively small quantities of manufactured goods.

The trading methods of the European Communist countries reflect the rigidities of their State-controlled systems. Decisions regarding the level and composition of both imports and exports are made in accordance with a national plan and are carried out by State trading organizations. Bilateral agreements are negotiated on a country-by-country basis. These agreements specify the categories of goods to be exchanged and set targets for the volume of that exchange. They provide for a balance between imports and exports in order to conserve foreign exchange. Deficits are met by the sale of gold or credits.

12. There is little doubt that the European Communist countries are interested in purchasing more from the United States than they do now—principally machinery, equipment, complete plants, and technical data. This advanced technology could provide the United States with some of its most effective bargaining leverage for trade negotiations with Communist countries.

13. If we relaxed some of our restrictions, purchases of European Communist countries from the United States would probably rise in the short term. But their lack of foreign exchange would soon limit this trade. In this sense, foreign exchange, rather than present U.S. export controls, is the major limitation on the potential for this trade.

If the European Communist countries are to develop a growing trade with the United States, they will either have to sell more to the United States or earn more convertible foreign exchange through favorable trade balances with Western Europe. It would be more difficult for these countries to expand exports to the United States than for them to increase sales to Western Europe, since the United States is not a good market for their primary materials and, in particular, would not in the foreseeable future be a buyer of oil—the largest single Soviet export.

The U.S.S.R. is likely over the future to seek to expand its sales of oil in Western Europe and elsewhere as one means of earning more foreign exchange. Its success will depend on its ability to produce increasing quantities of oil above its domestic needs and on the willingness of importing countries to buy more Soviet oil. In the case of Western Europe, increased purchases of Soviet oil would probably be tied to increased Soviet purchases of West European products. Whether through the sale of oil or other commodities, it is not likely that the U.S.S.R. and the East European countries will be able to develop and rely on a large excess of exports over imports in their trade with Western Europe to help finance purchases in the United States.

For this reason, long-term growth in the trade of the European Communist countries with the United States is more up to them than up to us. They would have to be prepared to invest in new export industries, to learn new marketing methods, to build dealer and service organizations abroad, and to develop relations of confidence with U.S. business firms. Such positive actions move a country to participate in the world economy and to abide by generally accepted international practices. They are intimately related to a nation's world outlook and are evolutionary in nature. If made, they would move these countries in directions favorable to our national security and welfare.

14. The Committee has seen various estimates of our possible exports to the U.S.S.R. and Eastern Europe over the next decade; none suggest that this trade would constitute a significant part of our total trade. There is no convincing case for any specific figure, but it is clear that our commercial stake in this trade is very small. It could grow modestly over time, but only as our overall relations with these countries change. In any event, it is dwarfed by political considerations.

The Two Sides of the Argument

15. With these facts in mind, it is useful to lay out the main arguments on either side of the issue of national policy toward expanding peaceful trade with these countries. Reasonable and thoughtful people can differ on this question. We have tried to probe carefully all sides.

16. *The case against expanding peaceful trade* with the European Communist countries comes down to the proposition that these countries are hostile toward us and we should not strengthen them through trade. By selling to them goods and services of any nature, whether wheat or our technologically advanced machinery and equipment, it is argued that we help them to solve some of their pressing internal problems and make it easier for them to use their limited resources for building up their military power and strengthening their potential for subversion abroad. Moreover, this argument states that by expanding trade with these countries we bestow upon them a kind of respectability and prestige which will enhance their position in the developing countries of the world and which they will use to our ultimate disadvantage. In sum, this argument holds that the risks of expanding trade are significant and the gains negligible.

17. *The case for expanding peaceful trade* comes down to the proposition that we can use trade to influence the internal evolution and external behavior of Communist countries. Trade provides us with a policy instrument to encourage the movement toward greater national independence in Eastern Europe and the trend toward greater concern for consumer needs in all the European Communist countries. By refusing to trade we put ourselves in a posture of hostility that

could be at odds with these developments as well as with other elements of our overall strategy toward these countries. Our refusal to trade cannot importantly limit Soviet military power but it can help to reinforce their doctrinal belief in the need for self-sufficiency. A willingness to trade, on the other hand, would be concrete evidence of our belief in constructive and peaceful relations. The benefit done our relations with the underdeveloped world by evidence that we genuinely believe in the efficacy and ultimate triumph of open societies far outweighs the disadvantages of any enhancement of Soviet legitimacy. In sum, this argument holds that the gains are significant and the risks are negligible.

18. There are persuasive elements in each of these cases. No one policy is wholly right or wholly wrong, and any course chosen has its risks. Taking into account both gains and risks, the Committee feels that the national interest clearly lies on the side of a more active use of trade as an instrument of foreign policy.

Trade as an Instrument of Policy

19. Before the United States can consider using trade with Communist countries to advance our political ends, however, we must be sure it will not weaken our military security. Expert opinion on this subject shows the following:

First, exports of commodities that are closely or directly related to military use or could significantly enhance Communist military capabilities are strictly controlled. The Committee believes these controls should continue.

Second, gains from nonmilitary trade with the United States are unlikely to release additional resources for Soviet military expenditures. The U.S.S.R. accords overriding priority to military expenditures. Any change in total resource availability in the U.S.S.R. through trade would, under present policies, affect its civilian economy, not its military budget.

Third, the U.S.S.R. has an advanced weapons technology and a military production capability that is virtually independent of its external economic relations.

In sum, total Western nonstrategic trade, let alone U.S. trade, could not be expected to alter the fundamental relationship between East-West military capabilities.

20. It is easy to exaggerate many aspects of the trade question: On the one hand, the possible military and economic gains to Communist countries, and the risk of irremediable security losses; and on the other hand, the economic gains for U.S. business from such trade and, in some respects, the political consequences. Trade is not a one-way grant of benefits to either party. It involves costs as well as

gains, and it is an exchange from which both parties must benefit or it will not take place. The unmatched industrial power of the United States puts it in a position to use this area of relations with Communist countries with authority and confidence.

In turn, the Soviet leaders have their own special prejudices regarding this trade. They tend to exaggerate its importance to the United States and the interest it holds for U.S. business. They have long believed we would be forced to seek markets in Communist countries to cope with depressions. And this belief is related to their standard assumption that "orders from Wall Street" must bring U.S. policy around. The fact is that peaceful trade cannot grow without an improvement in the underlying conditions that form the foundation for trade.

21. In the Committee's view, the time is ripe to make more active use of trade arrangements as political instruments in relations with Communist countries. Trade should be brought into the policy arena. It should be offered or withheld, purposefully and systematically, as opportunities and circumstances warrant. This requires that the President be in a position to remove trade restrictions on a selective and discretionary basis or to reimpose them, as justified by our relations with individual Communist countries.

Trade moves should be adapted to circumstances in individual Communist countries and used to gain improvements in, and to build a better foundation for our relations with these countries. As opportunities arise, the United States should enter into Government-to-Government negotiations with individual Communist countries on this front, bargaining as "Yankee traders" for reciprocal advantages.

22. Specifically, if individual Communist countries are interested in expanding peaceful trade with us, the United States should be prepared and able to negotiate the terms under which such trade could grow. These negotiations would set the framework for trade and should be designed to strengthen the U.S. political and commercial position. The trade itself would be carried out by private U.S. firms dealing directly with Communist State trading agencies.

To deal with problems arising from differences in our economic systems, the United States should use its leverage to obtain, among other things, these concessions in matters related to trade: Satisfactory assurances regarding the arbitration of commercial disputes in third countries; appropriate arrangements for the protection of patents and other industrial property; agreement on procedures to avoid dumping and other forms of market disruption; and the settlement of financial claims. In the case of the U.S.S.R., such financial claims negotiations would have to include an arrangement for a satisfactory

settlement of lend-lease obligations. The United States should also seek: The establishment or expansion of trade and tourist promotion offices; the facilitation of entry, travel, and accommodation of commercial representatives; the improvement of consular relations; and agreement on copyrights.

Whenever possible, we should use such negotiations to gain agreement or understandings on such matters as library and informational facilities, embassy quarters, the establishment of consulates, the jamming of broadcasts, the distribution of Government and other publications, and the initiation or expansion of cultural and technical exchanges.

In these ways, we could use trade negotiations to open up new avenues of peaceful engagement with Communist countries and create new opportunities to influence their development. This would not be a once and for all proposition—but a regular process in which we could make trade an asset that could be used over and over again.

23. As its part of the negotiating bargain, the United States must be prepared to remove trade restrictions on a selective basis. Within security limitations, the U.S. Government should adopt a flexible export licensing policy. It should use its discretionary authority in the field of commercial credits, and it should be in a position to offer individual Communist countries the opportunity to sell on normal competitive terms in the U.S. market.

24. In its trade negotiations with Communist countries, the United States should strive to free the trade itself as much as possible from rigidities and Government intervention and make it increasingly responsive to market forces. The United States should insist that payments be made in convertible currencies and should oppose any governmental linkage of exports and imports. Termination and cancellation provisions in our trade agreements would give us adequate leverage to police the trade.

Trade with the United States should put pressure on Communist countries to move away from the rigid bilateralism that characterizes their usual trade arrangements. It should encourage them to become more heavily engaged in the network of world trade and committed to the Western practices that govern most of this trade.

25. U.S. aims in these negotiations must be political; we seek to encourage moves toward the external independence and internal liberalization of individual Communist nations. We are not interested in fostering animosities among European Communist nations. Our long-term purpose in our dealings with these countries must be to create an atmosphere in which they will inevitably find that their interests are more and more linked to peaceful relations with the Free

World. We must hold to these kinds of purposes in our trade negotiations with European Communist countries. They are not only necessary to make the effort worthwhile, but they form the only base on which our trade can, in fact, grow.

26. The major specific issues involve our policies on export licenses, on the sale of technology, on credits, and on the granting of most-favored-nation tariff treatment. Before discussing them, the Committee would emphasize that these issues are part of an interrelated whole and that U.S. policies on each should be formulated and applied with this in mind. For example, the United States cannot expect political advantages from the isolated use of export licensing controls on a case-by-case basis. Trying to negotiate in this way would be a waste of U.S. bargaining power. On the other hand, the coordinated use of all the potential assets—export licensing, MFN and guarantees of commercial credit—in periodic Government-to-Government trade negotiations with individual Communist countries would put the United States in the best possible position to get the most advantageous results from such negotiations.

Export Licensing

27. Issues in export licensing arise mainly in regard to commodities and technology which the United States restricts for export to Communist countries but which are not included in the International Embargo List. Many of these products and industrial plants are freely exported from Western Europe and Japan. They are not closely related to military production or use and therefore are in the area of peaceful trade. As a group, they are of interest to the European Communist countries and would make a contribution to their economies insofar as they could be purchased only from the United States, or purchased from the United States in more advanced design, better quality, or lower cost than from other Western countries.

28. The United States should adopt a flexible and selective policy in respect to licensing the export of commodities and technology. We should be prepared to relax our controls, country by country in support of negotiations to obtain concessions and achieve better relations. Conversely, we should tighten our controls, should relations deteriorate.

29. The language of the Export Control Act and the declaration of policy expressed by the Congress in that Act is consistent with this approach. As stated in the Act, "it is the policy of the United States to use its economic resources and advantages in trade with Communist-dominated nations to further the national security and foreign policy objectives of the United States." The Act gives the President full discretion to apply controls on trade with Communist nations to

carry out this policy. The criteria for applying controls were rephrased in a 1962 amendment, but the effect of this amendment is by no means clear. Given this ambiguity, there has been a tendency among those charged with the administration of trade controls to give more emphasis to the restrictive rather than to the discretionary provisions of the statute.

30. The Committee believes this is unwise and not required by the law. The Act comes up for renewal this year. It should be renewed with emphasis placed on the possibilities for using trade and export licensing for constructive as well as for restrictive purposes. In light of the new and changing political circumstances in Eastern Europe and the U.S.S.R., more regard should be given to the use of this tool to influence our future relations with these countries.

The Question of Technology

31. Communist countries are mainly interested in buying our best machinery, our advanced industrial plants, and our latest technical data.

It can be argued that sales or licenses in these categories should not be permitted because they would permit the Soviet bloc nations to allocate more of their scarce research and development talent to the military, and would thus harm the relative position of the United States.

Insofar as a reasonable equivalent can be obtained from other Western nations or Japan, this argument has little force. In the smaller number of cases, where a nonstrategic technical advantage is obtainable only from the United States, the possible effect on Soviet military capabilities, as pointed out above, is negligible. On the other hand, the power to release for trade items of nonstrategic but advanced technology can be used by the President as an effective trade tool for accomplishing foreign policy objectives.

For reasons which follow, however, we doubt that the Communist countries will be successful in buying a large amount of advanced technology from the United States. This may lead to some irritation and disillusionment on their part. But in the end, bargaining in this field may force the Communist nations to face up to meeting the conditions that a genuine trade in technology requires.

32. The Committee does not believe that many U.S. firms would be interested in selling their most advanced technology to European Communist countries. In the normal course of trade, business firms protect their most advanced technology and bargain hard for satisfactory terms for such technology as they are willing to sell. These practices would hold all the more for trade with Communist countries.

Some U.S. industries and firms that support heavy research and development programs refuse to sell their industrial processes or to build complete plants for sale to others. Money alone will not buy their know-how. They are willing to exchange their processes for what they consider equivalent technology from other firms. Such an exchange of technology between a U.S. firm and a Soviet State organization would be feasible in only a very few instances. Or such firms are sometimes willing to build their own plants abroad embodying their technology. The possibility of a private U.S. firm's establishing a subsidiary or entering into a joint venture in the U.S.S.R. is beyond our present vision; it may not be so farfetched in some East European countries.

Many U.S. firms are prepared to license their technology in Western Europe and elsewhere in the free world. Most are reluctant to do so in the U.S.S.R. since they do not have confidence in the licensing arrangement or in the protection of their technology afforded by Soviet law. As in the case of the trade in goods, the flow of technology will inevitably depend on development of common ground rules and of relationships of trust. The recent Soviet expression of interest in joining the International Patent Convention is of significance in this connection.

In some cases Western managerial methods and organization are integral to Western technology. It would not be enough for the Communists to import the plant itself; they probably would need Western technicians to install the equipment and supervise initial operation. They might even have to adapt their operating methods to its design to use it efficiently.

In other cases the use of Western plants or processes is limited for lack of a wide range of supporting industries to supply components and a serious shortage of managerial and technical talent. Modern plants cannot easily be operated or maintained, let alone duplicated, outside the industrial milieu for which they were designed.

Where U.S. firms are willing to sell technology, it is frequently their second best or in the process of becoming so. For the importing country, gearing up for a new type of production takes time. In a fast-moving field where technology is perishable, this method of operation can become a way of importing obsolescence.

In essence, the importation of technology involves much the same calculation as the decision to import anything else. Whether technology seems worth purchasing depends on the price. Whether it turns out to be advantageous depends on the efficiency with which it is injected into the system. In today's world no country can continue

to rely heavily on the pirating of importation of technology to improve its relative industrial position. To do so may appear to be cheap in the short run, but could turn out to be a sure way of perpetuating second-class industrial status.

33. In view of all these considerations, the Committee believes the United States should treat the trade in nonstrategic technology in the same way as other trade. The President should use his authority to permit the sale of nonstrategic technology in support of U.S. trade negotiations with individual Communist countries. The decision to *permit* the sale is a Government decision to be made on foreign policy grounds. The decision to *sell* and the terms of sale of such machinery and equipment should be left to the individual U.S. business firm.

Credits

34. Credits can become an issue if U.S. trade with Communist countries expands. Most U.S. firms would not extend credits to Communist countries without Government guarantees. As matters stand now, the President can authorize the Export-Import Bank to guarantee commercial credits to a Communist country when he determines that guarantees to such a country are in the national interest. The terms of such credits must be within the range of common-commercial practices, but in any event, it is U.S. Government policy to limit such credits to 5 years. This limit is also consistent with the Berne Union—a long-standing, though informal agreement, reached by leading insuring and guaranteeing institutions in the field of international credit. The Committee believes we should hold to this position. It is recommended further that the President make appropriate use of his powers in this area to secure recognition of the validity of any financial claims outstanding and to obtain reasonable settlements of such claims.² These claims are considerable in amount and consist largely of expropriated American properties and defaulted bond issues, and in the case of the U.S.S.R., of course, of lend-lease obligations.

35. It is sometimes argued, particularly in Western European countries, that credits in excess of 5 years should be extended to the East for industrial plants that are normally amortized over a lengthy period. Some of these countries are guaranteeing such credits. As further justification for this position, the point is made that Communist governments have proven to be excellent credit risks and thereby are justified in asking for long-credit terms.

36. The Committee sees considerable danger in this line of reasoning. Among other things, it could easily lead to a credit race among

²Mr. Black believes that reasonable settlements of these claims should be obtained prior to extension of any Government-guaranteed commercial credit.

Western suppliers and already shows some signs of doing so. There is no necessary relationship between the decision of Communist countries to purchase capital equipment and their future ability to earn foreign exchange to pay for such purchases. Medium- and short-term credits can be justified to meet temporary payment imbalances. But permitting these countries to pileup long-term debt could enable them to put their creditors under substantial pressure to accept unwanted commodities in lieu of defaults and could amount to a subsidy for their economies.

Apart from the commercial risks, it is important to recognize that long-term credits could run counter to the central purpose of this trade and reduce its potential political benefits. If Communist countries are strongly interested in purchasing United States or any other Western capital equipment on a scale substantially beyond their near-term capacity to finance, they should be obliged to face up to the implications of that position. The appropriate course for them to follow would be to divert resources to their export industries and to devote greater effort to design and marketing activities for sales in the West. Long-term credits enable these countries to postpone such decisions and transfer the burden of adjustment to Western capital markets, rather than to accept the responsibilities of growing interdependence with the free world.

We should not be concerned if a more restricted policy on credit would put U.S. firms at a competitive disadvantage relative to those of some other Western countries in negotiating with Communist authorities. The United States should set an example; it should not be party to a practice that enables the Communists to play off one Western country against another.

Most-Favored-Nation Tariff Treatment

37. Most-favored-nation tariff treatment is normally granted by the United States to all countries. Exports from countries not granted MFN tariff treatment are subject to the high duties of the United States Tariff Act of 1930. Present legislation prohibits granting MFN tariff treatment to all Communist countries except Yugoslavia and Poland. This prohibition places a serious barrier in the way of expanding peaceful trade with the other European Communist countries because it denies them normal competitive terms in their attempts to sell to us.

38. The prohibition against granting MFN deprives the President of a valuable bargaining tool. Vesting discretionary authority in the President to grant as well as withdraw such tariff treatment would be the single most important step in permitting the Government to use trade more effectively as an instrument for shaping our relations with

these countries. Without this tool any initial moves we might make in this direction would soon come to a halt. With it we could hope to maintain the momentum of change in a direction favorable to our interests.

39. The principal arguments *against* affording MFN treatment to these countries are: (a) We would get no tariff concessions in return. Tariff rates in Communist countries have only nominal significance since foreign trade is dependent on the decisions of State trading authorities and not on market forces; (b) Communist countries should not receive MFN since they are not prepared to open their markets to world competition on the basis of established trading rules; (c) MFN would make it easier for them to dump their products in our markets; and (d) MFN is not so important to them because they export mainly primary products and the tariff discrimination they face for these products is not nearly so great as it is for industrial products.

40. These arguments in the Committee's view are outweighed by the advantages we would gain from a discretionary policy on this issue. The concessions the United States would seek for MFN would not be simply in tariff rates but in the overall conditions we could negotiate for expanded trade. The problem of Communist dumping is the kind of problem that can be handled in the course of Government-to-Government trade negotiations. If these countries are to make a serious effort to market their products in the United States, they will have to be assured of being able to compete on normal terms in the U.S. market.

41. MFN should not be granted to Communist countries automatically, or as a matter of right, or for an indefinite period. In these respects there should be a basic distinction between the MFN we grant by statute to free world countries and the MFN we would grant to Communist countries as part of specific trade understandings. It would be granted only for the duration of such agreements and subject to periodic review. As a bargaining asset, it is uniquely well adapted to U.S. policy objectives. Discretionary authority to grant MFN would allow the President to go much farther in differentiating among Communist countries. It would also symbolize our interest in encouraging these countries to move toward more open trading systems on an evolutionary basis. And it would demonstrate to these countries the advantages of better relations with the United States and the disadvantages of a deterioration in this relationship.

Trade and Strategy

42. Our trade policies are but a small part of our overall strategy toward European Communist countries. One aspect of this strategy, as we mentioned earlier, is to make clear that we will oppose and frustrate any actions that menace the peace of the world. Another aspect

is to demonstrate that both sides can benefit from peaceful exchange, and in so doing, to influence and encourage those Communist leaders who are moving away from the view that military confrontation is inevitable. At the very time we must pursue the first aspect of our strategy even to the point of crisis, such as in Vietnam, we should also be willing to pursue the second as concrete evidence of the United States dedication to the cause of peace.

Trade relations and trade negotiations can be a highly effective means of communicating this point. The United States can use trade to convey its true image and intentions: That it favors mutually beneficial relations; and that it is willing to go as far as Communist nations are willing to go in establishing a set of intergovernmental relations that conform to international standards. But the United States is justified in insisting on evidence as it moves step by step along this road. Along with such activities as cooperation in water desalinization, the exchange of visits of Heads of State, and technical and cultural exchanges, trade negotiations can give us a way of testing Communist intentions and can give them a way of testing U.S. intentions.

RECOMMENDATIONS

1. The Committee believes that peaceful trade in nonstrategic items can be an important instrument of national policy in our country's relations with individual Communist nations of Europe. Political, not commercial or economic considerations, should determine the formulation and execution of our trade policies.

2. The United States should in no case drop its controls on strategic items that could significantly enhance Communist military capabilities.

3. In respect to nonstrategic trade, the United States should use trade negotiations with individual Communist countries more actively, aggressively, and confidently in the pursuit of our national welfare and world peace.

4. We should not, however, remove our present restrictions on this trade either automatically or across the board. Communist countries are changing, in varying degrees and in different ways. We should adapt our trade policies to the political circumstances and opportunities that present themselves from time to time in the individual countries. At present significantly greater trade opportunities exist in certain East European countries than in the Soviet Union.

5. Negotiations with each of these countries should involve hard bargaining, from which the U.S. Government should expect to receive satisfactory assurances regarding the removal of commercial obstacles

arising from differences in our economic systems. We should bargain for agreements on matters related to trade, such as reasonable settlements of outstanding financial claims and procedures to avoid dumping, and, as appropriate, understandings on a variety of cultural, informational, and other matters at issue between us.

6. Provision should be made in trade agreements with Communist countries for frequent review at specific intervals. This would provide the opportunity to negotiate for new gains and to settle additional matters of disagreement.

7. An aim of American policy in trade negotiations with Communist countries should be to bring their trade practices into line with normal world trade practices.

8. To accomplish these purposes, we must be able to use our trade policies flexibly and purposefully in support of such negotiations. The President should have the authority to remove or, if necessary, impose trade restrictions as required for the achievement of our foreign policy objectives.

9. In administering export controls, the determination of what is strategic should be made primarily by the Department of Defense. The power to withhold or release nonstrategic goods or advanced technology for trade should be exercised by the President as an instrument for accomplishing foreign policy objectives.

10. The President should be given discretionary authority to grant or withdraw most-favored-nation tariff treatment to and from individual Communist countries when he determines it to be in the national interest. There should be a distinction between this MFN tariff treatment and the MFN tariff treatment we grant by statute to free world countries. It should be granted to Communist countries only for the duration of the trade agreement of which it is a part, and it should be subject to periodic review.

11. The President should continue to exercise his authority to allow Government-guaranteed commercial credits up to 5 years duration, if such terms are normal to the trade and if they are considered to further the national interest.

12. Trade with Communist countries should not be subsidized, nor should it receive artificial encouragement. The U.S. Government should decide the permitted scope of the trade in terms of security considerations. Within these limits, the amount of trade that takes place should be left to U.S. business and the U.S. consumer to decide. In terms of foreign policy considerations, however, it should be recognized that trade with European Communist nations can be as much in the national interest as any other trade.

13. In view of the changes now taking place and of changes that will continue to take place in the Communist societies, the United

States should, at regular intervals, review its total trade policies toward the whole Communist world to ensure that they remain consistent with, and effective in support of, foreign policy objectives.

14. If trade with Communist countries is to be used for these objectives, the U.S. public, the Congress and the executive branch must have a thorough understanding of the problem, the opportunities that trade affords, and U.S. national objectives in this field. The U.S. Government should take every opportunity to make explicit what it intends to do and what it seeks to accomplish. It should act to remove any stigma from trade with Communist countries where such trade is determined to be in the national interest. The foreign policy advantages of such trade to the United States are not widely enough appreciated. With greater public awareness of both facts and objectives, the United States will be in a stronger position to use this trade as it must be used—for national purposes and to support national policy.

* * * * *

In conclusion, we emphasize that these findings and recommendations constitute a long-term strategy.

The intimate engagement of trade, over a considerable period of time, when taken with the process of change already underway, can influence the internal development and the external policies of European Communist societies along paths favorable to our purpose and to world peace. Trade is one of the few channels available to us for constructive contacts with nations with whom we find frequent hostility. In the long run, selected trade, intelligently negotiated and wisely administered, may turn out to have been one of our most powerful tools of national policy.

The members of your Committee have found this assignment difficult, challenging, and important. We hope this report will be useful to you and to the Nation.

Respectfully submitted,

(signed)

J. IRWIN MILLER, *Chairman*

EUGENE R. BLACK

WILLIAM BLACKIE

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CHARLES G. MORTIMER

HERMAN B WELLS

Statement of Comment by Mr. Goldfinger

I have reservations about several issues in the Report and respectfully submit the following comments.

At the outset I wish to make it clear that I am not opposed to the expansion of economic and financial relations with the Soviet bloc under all conditions. However, I am concerned about the conditions.

Trade relations with the Soviet Union and its European satellites should be viewed as a tool of our Nation's foreign policy. Therefore, the Report should have placed greater emphasis on the political aspect of this issue.

There is also inadequate caution in the Report about the risk of exporting American technology—particularly advanced technology—to those countries. In centrally planned, totalitarian states, military and economic factors are closely related. There is no reason to believe that the export of American machinery and equipment to those countries will necessarily redound to the benefit of their peoples.

³ See statement of comment on next page.

Moreover, in our readiness to engage in bilateral trade negotiations with individual countries of the Soviet bloc, we should have no illusions about the ability of trade, in itself, to alter Communist attitudes and policies. Neither is trade, as such, a sure force for peace, as indicated by the two World Wars between trading nations.

Recognition of these realities should result in greater emphasis on the principle of quid pro quo concessions than is contained in the Report. In my opinion, there should be no expansion of trade, extension of Government-guaranteed credit or most-favored-nation tariff treatment without political quid pro quo concessions from them.

The Report's discussion of most-favored-nation tariff treatment omits or only briefly deals with several thorny problems concerning potential imports from those countries—such as goods produced by slave labor, dumping, market disruption, international fair labor standards and the need for an adequate trade adjustment assistance mechanism at home.

In conclusion, I believe that considerations of national security and international policy objectives should have top priority in evaluating trade relations with the Soviet bloc—over any temporary or marginal commercial advantages that may exist.

Mr. MILLER. The task assigned to my committee was to explore all aspects of expanding peaceful trade with the countries of Eastern Europe and the Soviet Union and to make appropriate recommendations. The People's Republic of China was expected from this. I reviewed this report again, and I am impressed with two points that are pertinent.

First, our findings in the main still seem to be applicable today and, second, it is still true that 5 years later the United States is paralyzed in this policy area by restrictive laws and regulations. I am, therefore, personally delighted that this committee has decided to take a fresh look at the problem.

I would like to begin by reviewing some of the general conclusions of the analysis furnished 5 years ago.

First, we determined that the U.S. commercial stake in this trade would be very small. In my opinion, this is still true. We saw no reason then, nor do I see any now, to believe that this trade will within the next two decades constitute a significant portion of our total foreign trade and certainly not of this country total economic activity.

Second, this trade cannot settle major outstanding issues between ourselves and Communist nations, nor can it, by itself, accomplish a basic change in any nation's internal systems.

But we thought very strongly, and I continue to feel that trade and government-to-government regulations that set the framework for trade can be a genuine means of relieving animosities between ourselves and individual Communist countries and can provide an environment for working out mutually acceptable solutions to common problems.

We felt that properly conceived and wisely administered, a growing trade with East European countries and the Soviet Union could become a significant and useful device in the pursuit of our national security and welfare and of world peace; and that in sum, trade with these countries is politics in the broadest sense—holding open the possibility of careful negotiations, firm bargaining, and constructive competition. All of these areas in which Americans have many skills.

So, in these terms, there is no basis for exaggerated views of either the risks or the gains of such a policy for either side. The issues can be most sensibly approached if we view this trade for what it is—an effective and almost unique form of peaceful engagement characterized by mutual benefits and slowmoving, but positive, political side effects.

If we engage in this trade, the United States will be in the posture of acting positively and confidently and not negatively and fearfully as we now appear to the rest of the world in this area.

What does the East-West trade picture look like 5 years later? World trade has continued to grow since 1965 at a rate of approximately 11 percent annually, while East-West trade has grown by somewhat less—roughly 8 percent a year. Trade of all countries with the Soviet Union and Eastern Europe and Communist China grew from about \$7 billion each way in 1965 to \$9.5 billion in 1969—still barely 4 percent of total world trade—a small figure.

U.S. participation in this trade remains as marginal as ever, although it has been growing at approximately the rate of the total volume. U.S. trade with the Soviet Union and Eastern Europe was \$150 million each way in 1965—less than our total trade with Switzerland—

and by 1969 had risen to somewhat under \$250 million each way. It accounts for barely one-half of 1 percent of total U.S. trade and only 3 percent of what Western Europe and Japan export to these countries.

If these figures on U.S. trade reflect such modest change, what is the reason? Several reasons that existed in 1965 exist no longer. In 1965, there were heavily critical public attitudes. There was lack of interest by American businessmen and there was strong congressional opposition. Each of these has diminished to a very considerable degree in the past 5 years.

Public acceptance of the desirability of increased trade and contact with Communist countries has grown. There has been almost no criticism and considerable applause of this administration's decision to begin removing some of the longstanding limitations on Communist China, a subject which our committee ruled out of serious consideration in 1965. More generally, there seems to be now a wide public appreciation of the need to explore all avenues of peaceful contact with those with whom we have serious differences.

So far as the business community is concerned, we all read in the papers of a steady succession of visits to Eastern European countries by American businessmen and there was strong congressional opposition. Encouragement stemmed as well from the special attention President Nixon devoted to building our relations with Rumania and enlarging commercial and economic interchanges with that country in particular.

Congressional attitudes also seem to have changed in the past year or so—certainly as they are reflected in the Export Administration Act of 1969. This act replaces the Export Control Act of 1949, and the change in name suggests a new approach to the problem.

I have three features of this new act specifically in mind. First, the act of 1969 contains specific congressional endorsement of a policy favoring peaceful trade with the U.S.S.R. and other Eastern European countries.

Second, it ties security consideration solely to whether exports contribute significantly to military potential, and cuts the link with the broader and ambiguous reference to economic potential in the previous act. And, third, it establishes requirements for reviewing and reducing the control lists as rapidly as possible.

These changes make this act administratively much more effective and provide a clearer direction to policy.

We should ask why, then, is the trade record so unimpressive? I think the major reason is clear. The hands of President Nixon are tied in these matters today just about as securely as were those of President Johnson. The single most important legal restriction that was identified in 1965 as preventing the flexible use of trade as a policy agreement was the ban on extending most-favored-nation tariff treatment to Communist countries.

In addition, the discretion which President Johnson was able to exercise permitting Government-guaranteed commercial credits for trade with Eastern Europe was taken away by the Fino amendment of 1968 to the Export-Import Bank Act. I fully understand the concerns underlying this amendment, but in my view a reduction in Presidential authority in these matters does not help and is more

likely to hurt. In this respect, the situation today has deteriorated somewhat from the legislative framework portrayed in 1965.

On the other hand, export control legislation is better and the number of commodities under control considerably reduced. Nevertheless, the licensing requirement for Eastern Europe still remains an obstacle for hundreds of goods whose strategic significance is impossible to assert in today's world. There are still over 900 items requiring Commerce Department licenses for Eastern Europe. Whatever their significance may be in the eyes of the U.S. officials, they are simply not controlled at all by any other country in the world.

I do not wish to be unfair. I believe it is true that the Department of Commerce has a genuine interest in expanding U.S. exports to Eastern Europe as Secretary Stans and Deputy Assistant Secretary Scott have made very clear indeed.

I believe further that Commerce has held to a minimum the cases which are denied. Yet, for a businessman, uncertainty over the rules clouds this trade and the fact remains that much more could be done in the area of U.S. export regulations to place American exporters on an equal footing with companies operating under the laws of other major industrial countries.

But more than controls is involved. The principal problem in expanding U.S. trade with the Soviet Union and Eastern Europe is the inability of Eastern European countries to pay for greatly increased purchases in this country. It is true that they could elect to make more substantial purchases in the United States with convertible currency they earn in sales to other Western countries, and to some extent they do so. In general, however, Communist countries have tended to keep the level of their purchases in particular Western countries in some reasonable proportion to their sales in that country's market.

In my view, the most essential change is that which we recommended in 1965; namely, the restoration to the President of discretionary authority to negotiate commercial agreements with individual Communist countries in which equal tariff treatment might be extended in return for appropriate benefits, and, as we recommended at that time, withdrawn under certain situations, also. I say this for several reasons.

First, only in this way will it be possible for Communist countries to see the prospects of earning dollar balances to increase purchases in our market, or to repay dollar credits. For them, this is a prerequisite to building serious trade relations and planning on such relations for the long pull. I am convinced that until the Eastern European countries see the realistic prospect of obtaining equal tariff treatment in the U.S. market, they are unlikely to undertake the market research and production decisions that would be necessary for a substantial increase in their trade with the United States.

Second, Presidential authority to extend most-favored-nation tariff treatment is very closely related to expanding the membership of East European countries in the General Agreement on Tariffs and Trade—the important international organization which sets worldwide rules and standards for international trade.

Yugoslavia, Poland, and Czechoslovakia are members; Rumania and Hungary are negotiating for membership. I should think we

would want to encourage and welcome membership in that organization by all the Communist countries willing to accept its obligations. And yet, without the authority to extend MFN treatment, the United States must say that it will not grant to such potential new GATT members the tariff treatment it is committed to accord to all members of this organization.

It would indeed be embarrassing for the United States to enter reservations to discriminate against Rumania under GATT because of the requirements of the U.S. law, in face of the special efforts which President Nixon has made to enlarge and improve the economic relations between the United States and Rumania.

The third reason why most-favored-nation authority is of crucial importance is that denial of such equal treatment is resented by Communist nations as a form of discrimination applied solely by the United States. Removing this long-standing symbol of the cold war is probably an essential precondition for trade relations that can lead to an improved political climate. It would be consistent with moving toward President Nixon's goal of replacing the era of confrontation with an era of negotiations. Because of its significance, it should represent a bargaining point of some substantial importance.

Certain the trend of events within the Eastern European countries continues to call for imagination, sophistication, and initiative in U.S. foreign economic policy.

In 1965, an essential element in the findings of our committee was that Communist countries were changing in varying degrees and in different ways. We believed that U.S. trade policies should be adapted to the circumstances and opportunities that may present themselves from time to time in the individual countries.

A new spirit of experimentation seems to characterize the scene in Eastern Europe today. Yugoslavia has reached the point where it welcomes Western investments and has established the conditions for economic cooperation. American firms are actively exploring the possibility of participating in these new forms of joint investment. Rumania has continued to follow a policy of considerable independence in its external relations and of expanding economic relations with the West.

It, too, has been exploring prospects for its own version of joint enterprise with Western firms. Events, however, do not always move in the same direction in different countries. The tragic events in Czechoslovakia in 1968 dramatized the close relationship between reforms in economics and tolerance in politics. The Soviet invasion of Czechoslovakia has understandably led to increased caution on the part of those elements in Eastern Europe who are interested in the greater use of market incentives to guide production, simply on grounds of efficiency.

In the U.S.S.R., itself, economic reform, while still on a limited scale, has reached the point where most production enterprises are now subject to some kind of market influence. This has been changed since 1965. Certainly, the economic picture in the Soviet Union has only emphasized the necessity for some new approach to the problems of raising productivity, if a consumer economy is to be developed there on any reasonable scale in the foreseeable future.

The Soviet GNP grew at the modest rate of 3 percent or less in 1969 and the rate of growth probably has not improved in 1970. They are concerned about this. Soviet agriculture continues to be a drag on growth and a declining element in the total economic picture. By its own admission, the Soviet economy must call on Western technology to make significant progress in the consumer goods area. It is an Italian company that is building an automobile plant in the Soviet Union. It is Ford, Daimler-Benz, IBM, and other Western firms that are wooed by the Soviet planners in order to bring the Soviet Union into the 1960's, let alone the 1970's, in terms of consumer products.

East-West politics are themselves becoming a more active area of change. Chancellor Brandt's Ost-Politik is a new element in the picture and a precursor of new relations with the East. The Federal Republic's acceptance of Poland's western frontier has in itself set in motion a chain of events that will inevitably lead to widening and broadening relations. At the least, the slogans must change. At the most, no one can know.

Both economics and politics, therefore, emphasize the possibilities for evolutionary change in Eastern Europe. Without revising our laws and regulations, the United States will be gravely handicapped in trying to associate itself through trade with these promising developments, and by that association, to influence them toward the direction of greater cooperation.

It has been said that American firms will be able to participate through their Western subsidiaries indirectly in trade with the Soviet Union and Eastern Europe, and that is true. But it is still not an entirely satisfactory state of affairs. It seems clear to me that the ability to engage in major transactions directly in the United States would be considerably more advantageous to the American economy.

But in all of this discussion, I must emphasize once more that economic considerations are minor and the amount of the trade is not expected to be significant for a generation. Instead, the political advantage of having American firms directly involved in contacts and projects in Eastern Europe is great, but it depends primarily on direct participation and not on participation through European subsidiaries. Without being directly involved, the United States may not be involved at all in terms of influencing economic relations with the East.

This seems to me, therefore, to be a propitious time for our country to become more active. The present attitudes in the U.S.S.R. and the other countries of Eastern Europe toward trade with the outside world are attitudes that we should welcome and encourage.

Soviet involvement in international trade has been increasing steadily since the post-Stalin decision to take a more active part in international commerce. During 1969, total Soviet foreign trade turnover reached \$22 billion—a growth rate of close to 10 percent. Over \$1 billion of the increase represented an expansion in trade with the free world, which reached 35 percent of total Soviet trade.

A major motivating factor for this increase in Eastern European trade with the outside world is the desire to draw in Western production know-how in order to increase consumer goods production and manufacturing efficiency. Since this inevitably involves the acquisition

of major plants and capital equipment, it highlights the financing problem. There are only three possibilities: increased exports to hard currency areas, increased medium or long-term credits, or some form of foreign investments—usually through joint enterprises.

It will not be easy for these countries to increase exports rapidly, and certainly not in their early stages of their expanding economic relations with the West. There is also a limit on the amount of credit which a prudent Communist government can afford to carry, and which Western countries will grant to them. Hence, the fascination on the part of Eastern European countries with joint enterprises.

Whether Western companies can make themselves sufficiently multinational to include State trading regimes and whether the latter can find a way to accept foreign equity, profitsharing and the like, will be discovered in the 1970's. One answer is being found in Yugoslavia. Another seems close in Rumania, and I believe we may see these activities widened generally by the end of this decade.

It would be unfortunate if American companies are restricted to operating, in this respect, only through other Western countries.

I would like to conclude by simply noting that in this area the United States is under no compulsion to act. We can continue to neglect this area of relations, we can continue to make no use of this major policy instrument, and we will suffer little from the omission in the near future. What we will lose is an opportunity.

I return to what our committee said about our relations in 1965.

In this intimate engagement, men and nations will in time be altered by the engagement itself. We do not fear this. We welcome it. We believe we are more nearly right than they are about how to achieve the welfare of nations in this century. If we do our part, time and change will work for us and not against us.

Ideological baggage gets stripped away when the protagonists are serious professionals bent on serious business. Arms control seems to be one area where this can be true. Trade is another. We should make use of every opportunity to enable such professionals to deal with each other to solve problems, uninhibited by slogans and motivated by the prospect of mutual gains.

The economic advantages of this trade are small. The foreign policy potential is very great indeed. Trade is one of the few channels available to us for constructive contacts with nations with whom we find frequent hostility.

In the long run, selected trade, intelligently negotiated, widely administered, may turn out to have been one of our most powerful tools of national policy.

Thank you, Mr. Chairman.

I would be happy to answer any questions.

Senator JAVITS. Mr. Chairman, may I have just 1 minute?

Chairman BOGGS. Surely.

Senator JAVITS. Mr. Chairman, I am under considerable pressure today with a railroad strike, as I am the ranking member of the Senate Labor Committee. I came this morning to pay my respects to the outstanding distinctions of Mr. Miller, Mr. Pisar, Mr. Sik, and Mr. Wolf.

If I may, I would like to have the Chair's permission to submit to the witnesses some questions in writing, if they would be kind enough to answer these for the record during the questioning period.

I wish to express, with the Chair's leave, my deep appreciation for the help which they will give our country by the elucidation of this subject. It has, for so long, been frustrated by security and other considerations, which, if anything, are going the other way, rather than toward inhibiting the possibilities of more open channels of communication through trade between East and West.

While I have the opportunity, I would like to state how much indebted the country is to the chairman for the enterprise and the resourcefulness which has brought about this review, which I think will have its effect upon our policy.

Chairman Boggs. Thank you, Senator.

Mr. Pisar, we will hear from you.

**STATEMENT OF SAMUEL PISAR, INTERNATIONAL ATTORNEY,
PARIS, FRANCE**

Mr. PISAR. Thank you, Mr. Chairman.

I entitled my statement "Coexistence and Commerce." I subtitled it "Practicing the American Ethic."

All of this implies a pro East-West trade statement.

Presumably, you have invited me to appear before you because of the recent publication of my book "Coexistence and Commerce," in this country and in Europe. Yet what I have to say derives primarily not from academic research, but from my practical experience as a counselor to multinational corporations and banks in the United States and in the European Common Market.

Mr. Miller has given us an excellent overview of the current status of East-West trade and its prospects for the future. I will not stop on specific figures, but I would like, if you permit, to take a look at the economic situation inside the Eastern bloc, at what the East is doing about it, how the outside world is reacting, what is the role of the United States in this total picture. I will then try to suggest some new policy guidelines and make some specific proposals.

By now it has become amply clear that the Soviet Union's effort to build a self-sufficient Communist Commonwealth has failed. It has failed because the political interests of an industrialized Russian giant and the national aspirations of the smaller Eastern European countries cannot be reconciled.

It has failed, Mr. Chairman, in a larger sense because the economic system of state socialism has proven too rigid to meet the needs of the masses and the demands of the new technological age. It has not only failed in its own orbit, but it has discredited socialism in the West as well. The British Labor Party and similarly inclined political groups in Europe have abandoned the platform of nationalization of the means of production, in part because the Soviet model has resisted both efficiency and democratization.

Can there be a clearer admission of the failure of Marxist-Leninist economics than to invite Fiat, Ford, and IBM to Russia, after half a century of Communist power, to show how modern automobile and computer industries should be built?

The more enlightened Communist leaders know that they are facing a painful choice. If they do not allow the warm winds of Western know-how to blow Eastward, they will end up with stagnating econ-

omies. On the other hand, if they loosen up their system, they may unleash changes that will sweep away their monopoly of authoritarian power.

It is my view that the social and economic pressures within communism's own bosom are sufficiently strong to tip the balance in favor of those willing to relax the iron grip, in return for the material benefits their people want so much and need so badly.

There are many conservative Stalinists in the Communist bloc and they have dangerous aspirations. They continue to be wedded to the dogma that capitalism is doomed to oblivion. Fearing any external contacts and influences, ill at ease with an emboldened class of intellectuals, they would confine the most spirited and original minds to a mental institution.

Now that, Mr. Chairman, has direct impact on economic life. If the great Soviet writer, Solzhenitsyn, cannot publish a book of literature, if the young Soviet historian, Amalric, cannot show how he thinks the Soviet society will look in 1984, if the great cellist, Rostropovitch, cannot play with a clear conscience, then the entire society becomes stagnant. Inventors cannot invent, scientists cannot experiment, and plant managers cannot innovate. There is not that fermentation of ideas that you must have in a society which aims for technological progress and economic growth.

This Communist blindness to the inevitable link between industrial progress and human freedom has proven costly to the East. In an era of galloping technological invention, there can be no sustained economic advance unless minds are free. The cost was succinctly tabulated by an elite member of the Soviet Establishment, the atomic scientist Andrei Sakharov. He said in a letter to the Russian trio, Mr. Brezhnev, Mr. Kosygin, and Mr. Podgorny, and I would like to quote him:

Comparing our economy to that of the United States, we find that we are behind not only on the quantitative plain, but also—and this is much sadder—on the qualitative plain. The gulf is all the greater in the newest and most revolutionary sectors of the economy. We are ahead of America in coal extraction, but behind in oil, gas and electric energy; we are ten years behind in chemicals and infinitely behind in computer technology. * * * We simply live in another era.

Eastern economic planners have lately come to value Western goods, services, and methods. And by "methods," I mean methods of management, incentives, bonuses, and to some extent even profits. The Soviet Union has gradually become engaged in international commercial operations on a larger scale, in terms of volume, variety, and geography, than at any time since the Bolshevik Revolution.

It has given official endorsement to the law of comparative advantage by which each nation trades what it can produce more efficiently for what it needs most urgently. The smaller Eastern European countries, which Russia tried to incorporate into its own closed trade circuits, have moved even more daringly in the direction of industrial and commercial involvement with the outside world.

In the last decade, Eastern trade with the West has spiraled upward at a hefty annual rate of 10 percent, with the less developed countries at a spectacular rate of 20 percent. Moreover—and this is a most important straw in the wind for future evolution—the growth extends beyond the conventional exchange of physical goods to the new dimension of scientific, technological, and industrial cooperation and joint business ventures of various types.

Particularly significant is the emergence of the transideological corporation through which Communist and capitalist firms pursue profit-making objectives in partnership.

In my practice as a lawyer, Mr. Chairman, I have seen and I have helped to form companies where the equity is equally divided between a Communist firm and a capitalist firm, where the board of directors is chosen on a 50-50 basis, Communist and capitalist, and where management is jointly elected and controlled.

Here is another word for your vocabulary. You have inquired into multinational corporations in your hearings some months ago. I offer you the budding concept of the transideological corporation for scrutiny as well.

I am stressing these developments because I have the impression that we are witnessing a breakdown of ideology. Economically, the Communist countries today are like a ripe young woman. They want to deal and have commercial intercourse with the West. But this is not easy, because Lenin said no, Mother said no. Yet her natural hormones tell her otherwise.

The new opportunities offered by this development are now being seized elsewhere in the world. Our allies are in the forefront of a quest to roll back the ramparts of the cold war and to grasp whatever business comes their way. For sometime, and more so in the wake of the new Russian-German Nonaggression Treaty, their business communities have been enjoying something of a feast in the Eastern markets.

American firms, deprived of the equal right to compete, are left only with the crumbs.

East-West commerce still accounts for a small fraction of the total \$300 billion value of world trade. It will therefore be a major new frontier of the international economy. Yet America, the leading repository of man's technological know-how, with a gross national product of \$1 trillion and a stake of over 25 percent in the total merchandise going to the world market, represents less than 1 percent of East-West commerce, hardly one-tenth of the share commanded by the European economic community. And its position is constantly declining. In the process, the United States is becoming steadily less relevant to the political dynamics of the East-West situation and less influential in Europe, as the continent is going its own separate way.

I submit that in the present context of international relations, this constitutes both bad business and bad diplomacy.

If there are strategic considerations which prevent Ford from building trucks in Russia, why are Daimler-Benz of Germany, Renault of France, and Leyland of England—all protected by six costly American divisions, not to mention the Sixth Fleet and our nuclear umbrella—free to bid for the same project, with the most eager support of their governments? The United States seems to be holding back trade without being able to accomplish its professed aims. The goods which we think the Communists should not have get there anyway, to the detriment of American business, American labor, and the American balance of payments.

In short, our policy has become outdated, incoherent, and dangerously out of step with the rest of the alliance. Western Europe and Japan, traumatized by a surge of protectionist sentiment in this country, are pushing ever more aggressively to open alternative markets

in the East. Were such protectionist sentiment to become law, it would lead to an economic fragmentation of the free world and a weakening of the common front against communism.

Efforts to expand our economic dealings with the East are unavoidably controversial, for in the background lie potent and legitimate concerns. The Soviets will probably continue to raise threats, as they have been doing, over Berlin, at the Suez Canal and in the SALT negotiations of Helsinki. But the mutual interest in survival and prosperity requires that we continue the arduous process of building bridges across the underlying gulf of hostility.

The long-neglected Eastern masses are yearning for a consumer society. The same society we seem to be tearing apart. What a strange paradox? It is in our self-interest, Mr. Chairman, to help them build such a society, not only because there is profit in it, but also because this offers us a chance to take the fuses out of communism's hostile ideology and to enable the Eastern social and economic systems to evolve toward ours.

There is one area, and one alone, in which the Russians have become self-sufficient: In their war machine. While it would be foolhardy and immoral to sell them strategic goods, it is naive to think that by not trading with the East we can make it militarily weaker; our embargoes have not significantly diminished Communist strength.

Realistically, all we can hope for is to render the Communist world less willing to go to war. At a time of thermonuclear standoff, this hope can best be furthered by selling it the peaceful goods and technology needed to build a consumer society. Whatever risks might be entailed in such a course have now become small and are worth taking.

As the Communist societies falter beneath the burden of excessive regimentation, and the free enterprise societies brace themselves for the onslaught of internal disorder, the two are creeping closer together. Each has more to gain from closer intercourse with the other.

Ironically, the newly found bond is common desperation: The urban problems, problems of poverty, problems of pollution, problems of disoriented youth, plague all industrial nations. In this context, the promise of East-West trade becomes more than economic. It is a venture on a scale to reawaken the idealism of an alienated generation of young people who feel that not all in the West is good and not all in the East is evil. It is enough to refire the enthusiasm of our besieged industrial society. For it offers a chance to extend the frontiers of individual initiative, material progress and human freedom not only to Eastern Europe and Soviet Russia, but eventually to China as well.

I am proceeding from the assumption that both communism and free enterprise will continue in this world for a long time to come. Neither side will voluntarily dismantle its own social structure or try to overwhelm the other with armed force. This stalemate holds out the relatively cheerful prospects of coexistence and, with luck, constructive cooperation and competition. But to turn these prospects into reality, the United States must shift the focus from military to economic diplomacy.

The main thrust of my argument is this, stated, I am afraid, in somewhat colorful terms: In the present phase of the historic contests with communism it is not our costly and far-flung military arsenal,

but our superior capacity for economic progress that constitutes our most effective—and most neglected—weapon. In a figurative sense, we can only conquer the East with the peaceful sword of commerce and industry, and the human freedoms that goes with it. This sword is best wielded by the imaginative American businessman. I call it a “tender conquest” because deeply within the psyche it is welcomed by the victim.

In this spirit, Mr. Chairman, and in order to give concrete shape to my ideas, I have attempted, over a period of years, originally at the suggestion of Senator Javits, to draft a model charter for East-West economic relations, a charter designed to remove the bureaucratic racks and screws by which trade is still tortured in this country and the East, and to help establish a permanent framework for commerce between State enterprise and free enterprise systems.

My guidelines, set forth at the end of my book, which address themselves, not too pretentiously, I hope, to policymakers, legislators, administrators, adjudicators, and, above all those engaged in day-to-day business transactions may, perhaps, offer a point of departure for a new policy approach.

In conclusion, Mr. Chairman, permit me to formulate what I see as the double challenge of East-West trade, one for businessmen and the other for statesmen.

Since time immemorial, merchants venturing into remote markets have somehow managed to build friendly and lasting relationships, and to overcome the obstacles of religion, racism, nationalism, and witchcraft.

What they are presently facing in the East is no more than the hesitant resistance of a faltering ideology, one that is in awe of their accomplishments, willing to employ their techniques, but unable to embrace certain of their objectives. The pragmatic American businessman must be unshackled to play his part in the long process of competition and reconciliation that lies ahead, and to make an honest profit, too. This, I submit, is at the very heart of the American ethic. the American tradition.

For the great trading nations of the West which are at the center of world commerce, the United States above all, the challenge is how to assimilate the Communist state monopolies into an orderly pattern of international economic cooperation, and thus enable East-West exchange to realize its full potential for prosperity and peace.

Thank you, Mr. Chairman.

Chairman Boggs. Thank you very much, Mr. Pissar.

Now, Mr. Sik, we will be happy to hear from you.

STATEMENT OF OTA SIK, PROFESSOR OF ECONOMICS, UNIVERSITY OF ST. GALLEN, SWITZERLAND, FORMER DEPUTY PREMIER, CZECHOSLOVAK SOCIALIST REPUBLIC, AND FORMER MEMBER, CZECHOSLOVAK PARTY CENTRAL COMMITTEE

Mr. SIK. Mr. Chairman, ladies and gentlemen.

I want to thank you for this invitation, first of all I am rather grateful to have this opportunity to speak here of my problems of the East-West consideration. Please excuse me for my rather poor English. In the discussion, I will have to use an interpreter. Thank you for your understanding.

I realize that it is my views solely as those of one who knows the economy of Eastern Europe that you expect to hear, and I am entirely willing both to say what my views are and to justify them. Although every scientist should be objective when treating of matters that lie within his sphere of knowledge, it can be very difficult for him completely to exclude his own political attitude when dealing with questions concerned with social, political and economic relations between men and nations that lie very near to his heart.

An economist in whose field of research such economic relations lie will, therefore; of necessity always be more or less influenced in his examination and treatment of these problems by those political interests and aims which he himself regards as his own and which he methodically promotes.

Therefore, I cannot claim to speak as a completely impartial and disinterested expert. Always and everywhere I feel myself today to be the representative of a people which in the year 1968—as so often before in its history—tried to realize its own ideas of development and its own vision of what life should and could be and was prevented from doing so by a brutal and violent intervention from outside.

After years of painful experience, the absolute majority of my countrymen were striving with unparalleled enthusiasm and united resolve to create a modern, democratic and humane socialist society. As these aims did not conform either to the dogmatic way of thinking or to the power-preoccupations of the ruling groups in the other Communist countries, these progressive aims and their supporters were crushed by the invaders. Henceforth, like the majority of my countrymen, I can only regard political and economic problems of the future from the point of view of how far future possibilities of development are compatible or incompatible with the accomplishment of our liberal aims and intentions.

It can be objected that such an approach to the problems of East-West economic relations is too narrow and does not admit of a scientific objectivity. To that, I can only reply that there can be no absolute objectivity in one's approach to social questions in a world in which the interests of multifarious states, nations, classes and other social groups are divided, conflicting, mutually contradictory and directed toward the most varied developmental aims.

In such a world, the economic scientist should try to detect all possible changes in development in national and international economic relationships which coincide with the progressive and humane interests of the majority of all the working people in the world and which would promote the preservation of world peace, the freedom of all nations, the abolition of all economic and political oppression of working people by small groups of powerful men and lead to an increasingly greater fulfillment of their needs and the fastest possible evolution of their cultural and humane development.

I am firmly convinced that my search for such economic changes in development and new economic relationships is fully in accordance with my people's political fight for liberty and that, therefore, my approach to economic problems is not vitiated by lack of a broader and more objective criterion.

Today we are living in a time in which essential changes in whole economic systems, not only in developing countries but also in many industrialized countries in the West as well as in the East are growing

to maturity and will be accomplished sooner or later by the rising generations. Alongside many potential changes in the West, I regard fundamental changes which are now underway in the economic as well as in the political systems of the Eastern European states as a precondition for a freer and more successful development not only of the nations living there but of humanity as a whole.

As I see it, one can only judge the role of economic relations between East and West from the aspect of an acceleration of these internal progressive changes in the East. Therefore I regard it as a prime necessity to say something about the internal economic development problems of the Eastern Europeans in order to be able to draw conclusions about their external relations.

The Communist system, with its traditional, highly centralized, monopolistic and bureaucratic characteristics could perhaps have insured a quick transition from the half-feudal, backward Russian economy to that of a great industrial power. This system, however, at a relatively advanced stage of industrial development, becomes an ever greater hindrance to a potentially much more effective economic development, to a faster rise in the standard of living of the people, to a technically and structurally more flexible production, and, above all, to a more humane alignment of sociopolitical developments within the state apparatus. Such a system inevitably becomes even more of an impediment to development in industrially highly developed states such as Czechoslovakia.

Once there was perhaps in the Soviet Union some sense in having such a highly centralized system. In a context where all important means of production, all management of accumulated resources, all mineral wealth and sources of energy, and all investment finance were concentrated in the hands of the state, it was possibly quicker to build up a strong industry than it would have been if one had had to wait for the slow concentration and exploitation of private capital. Neither could this industrialization, with its concomitant phenomenon of a colossal armaments industry, be halted by a policy of embargo on the part of the Western European states. On the contrary, this embargo policy only contributed to Soviet efforts to render autonomous various militarily important sectors of production—quite apart from the fact that a large country rich in natural resources always finds means to procure all important products and supplies from outside even in the face of the strictest embargo policy.

Ever-increasing internal economic difficulties contribute much more to holding back the growth of Soviet power than all attempts to halt this growth from outside by means of embargoes and similar economic measures. The more broad and complicated industrial production becomes, the more factories, kinds of products, special technological processes and interfactory tieups there are, the more impossible it becomes to manage all these operations effectively from one center without real economic initiative from the factories. With the help of a computer, one can, it is true, plan a few hundred production aggregates from one center. The state can also define, facilitate, and directly supervise the carrying out of a small number of favored, highly concentrated production tasks, usually of an important military nature. But the manufacture of the millions of different kinds of products needed by a modern industrial state—even in the comparatively small

country of Czechoslovakia, we reckoned with the existence of one and a half million different kinds of products—cannot be planned and supervised by means of central state control. This huge material production, which must continually develop technically and qualitatively, can only be sustained with the help of a multitude of highly qualified executives and management personnel who possess, and are encouraged to act upon, their own initiative. The role of planned, purposeful and indirect state influence on economic development is without doubt becoming more and more important, but a modern economy cannot develop effectively without independent activity and initiative on the part of executive personnel and factory management.

However, it is exactly this kind of independence and initiative on the part of factory management that the Soviet economic system does not permit. It is made impossible not only by a mass of central, bureaucratic rules and regulations but also robbed of all indispensable economic criteria, guidelines and incentives by a deliberate setting aside, on ideological grounds, of important market functions. The result of such a system is an entirely one-sidedly simplified production which expands only as regards overall quantities and whose real growth becomes more and more fictitious. On the one hand fewer and fewer of the most varied and necessary types of product find their place within the volume of production demanded by the plan; on the other hand masses of unnecessary products are manufactured. At the same time there is an inflation such as is normally found only in wartime; as a result, the consumer receives relatively fewer and fewer really necessary goods and services for his apparently increasing income. Alongside the increase in a purchasing power which there are not enough goods to satisfy, the consumer is indirectly forced to accept goods which he would not buy in normal market conditions. Not only have the factories no economic interest in the quick development of a qualitative and structurally flexible production, but a bureaucratic system of planning directly forces them to avoid as far as possible all real qualitative and technical innovations because these would serve to prevent them from fulfilling the production quotas which are raised every year. The technical basis of production improves only very slowly, much more slowly than that of production in the West. Technical progress in new factories cannot compensate for the much faster obsolescence of machinery and equipment in already existing factories.

Even when the official Eastern European statistics show a fast annual increase in the productivity of labor, this increase is more and more unreal. The factories achieve this apparent increase not so much by means of technical progress as by microstructural shifts in production in the direction of those products which, thanks to their attractive prices—relatively high cost of materials and profits—in proportion to the number of workers, enable them to reach the planned productivity level more easily. Naturally this procedure is carried out more and more at the expense of the consumer, whose requirements are met increasingly inadequately to the accompaniment of an unnecessary waste of materials.

One must not allow technical successes in militarily important spheres of production to conceal the fact that technical development in general lags far behind that of the West. A massive government

preference for these spheres of armament production, whereby they have the best working conditions, the most able personnel, the highest salaries and objectively checked results, is one which does not assist production in other industries and can only continue to operate at their expense.

The general retardation in technical and qualitative development also has the result that capital expenditure in industry becomes relatively less and less effective. In order to achieve planned fast growth in industrial production, the amount of capital expenditure must grow even faster, whereby its share of the national product becomes larger. Industrial capital expenditure—above all in heavy industry—increases at the expense of all other sectors of production and reduces the quantity of consumer goods available to the population. Naturally, as far as labor is concerned, the currents run predominantly in the same direction. Comparative studies prove that growth in the tertiary sphere is proceeding much more slowly and that the share of consumer goods in the national product is much smaller in Eastern European countries than in the West.

However, it would be completely erroneous to regard this development as an absolute retrogression in the economy which would have to lead to an automatic collapse. It remains a form of growth; however, it is one which, owing to the one-sided and exaggerated preference for the heavy industrial sectors and to the ineffective, qualitatively, and structurally more and more retarded production, is bringing about a yet graver development in the people's standard of living. First, consumption of goods by the population is growing much more slowly than in developed countries in the West—even in such industrially highly developed countries as Czechoslovakia. Second, the structure and the quality of the production of consumer goods and services conforms less and less to the developing structure of human needs.

Massive state propaganda—on a scale unthinkable in the West attempts to emphasize the growth of industrial production completely one-sidedly by suppressing all comparative studies, especially those which would make apparent the relative retardation of the standard of living. Only propagandist comparisons where the growth of a few preferred sectors and groups of products is exaggerated, are widely and insistently publicized. In spite of this, a consciousness of the ineffectiveness of their own economy is spreading among working people, especially with regard to the slow increase in goods available for consumption in comparison with the gigantic resources which are pumped into production. More and more people—above all members of the technical, scientific, and cultural intelligentsia—are beginning to compare the economic reality of their own country, first, with development in the West and, second, with home-produced propaganda; thus a critical attitude to their own system is developing.

Every year, increasing economic problems, in spite of all contrary state propaganda, are bringing about a profound differentiation within the inhabitants of the Eastern European states—even though this differentiation is scarcely visible on the surface. On the one hand, discontent and a skeptical attitude to official propaganda is growing among working people.

Accumulating experiences of the contradiction between propaganda and reality and the increasing knowledge which is gradually finding its way from the intelligentsia to the ordinary folk are leading to a spread of the realization that the socialist system is in need of radical

changes and reforms if it is to serve the worker and his needs more adequately.

Under the growing pressure of this discontent and of the economic reality, a section of the party officials are being forced to look for new, more liberal, partly even reformist solutions. The appearance of such politicians as, for example, Khrushchev, who are tempted to develop reformist experiments, is not accidental and such manifestations will be more frequent and widespread in the future.

On the other hand, the increasing economic deficiencies and the concomitant oppositional and liberalist manifestations prompt conservative and reactionary reflexes. The majority of political functionaries of the party and state apparatus, as well as old members of the Communist Party are—thanks both to their dogmatic habits of mind and to self-interest—stubborn opponents of any kind of reform. They regard reformist and liberal views as betrayal of “socialist interests,” by which, of course, they always mean their own interests.

As these conservative and reactionary strata are incapable of changing economic development and significantly improving the lot of the working people by means of the existing system, they are increasingly forced to distract the mass of the people from their real problems by means of political demagogy and the artificial fomentation of hate and the baser emotions. As history shows us, the people’s attention can be temporarily distracted from the actual reasons and from those who are really responsible if the latter is successful in showing them other enemies and in stirring up feelings against them.

Therefore, counterrevolutionaries, revisionists, antisocialists, liberal opportunists, capitalist agents, and so forth, against whom the people’s hate can be kindled, must constantly be found. This hate propaganda appeals to men’s lowest instincts and foments every kind of nationalism, racialism, lust for power and delusions of grandeur.

All criticism of the existing system is pilloried as capitalist subversive activity and every reformist manifestation is suppressed as counterrevolutionary activity. Hate for the Western “Imperialists” is always being artificially fomented and they are blamed for all the nation’s problems and for the necessity of the arms race.

Every area of international tension, every local war and every armed conflict between other nations are welcome to these conservative and reactionary elements: They secretly provoke such phenomena and exploit them to strengthen their own extremist position.

Even though today there are no longer mass executions as there were in Stalin’s time, the old threat is skillfully kept in being by these conservative forces. Suppression of all liberal tendencies and widespread dissemination of fear, envy and hate, suppression of all undesired information, ideological stupefaction of the masses, systematic corruption of officials—these are the weapons by means of which incompetent men can maintain their positions of power in a system which is developing in a way that is against the real interests of the majority of the population.

Nothing is more welcome to these politicians and power-bureaucrats and nothing is of more assistance to them than warlike tendencies among other nations, deterioration in the international situation, the revival of “cold war” policies and similar phenomena.

However, no one except the workers and the oppressed nations in the Soviet power complex itself can break the power of these reactionary cliques and force through progressive and democratic reforms.

In spite of all political repression and what I have already referred to as ideological stupefaction, discontent and concealed opposition is growing within ever broadening social strata owing to experience and knowledge and among the non-Russian nations whose own interests are being stifled by the Soviet central power.

All notions that one can, by means of military power, force alien systems and regimes on other small nations that inwardly reject them are short-sighted and mistaken. As long as the centralized, monopolistic, and bureaucratic Soviet system does not change its nature, as long as it does not give the smaller nations the possibility of finding their own ways, it will develop in opposition to the interests of these small nations and the majority of working people, and will, therefore, of necessity, rouse more and more wide-ranging opposition and political resistance.

It is my deep awareness of this necessity that shapes my approach to East-West economic relations. Most conservative forces in the West are tempted to restrict these relations because, as I see it, they are preoccupied with preserving the status quo with regard to power.

I, on the other hand, am an advocate of broadening and intensifying East-West relations to the greatest possible extent. As I believe in an overcoming of the existing Communist system and its transformation into a democratic and humane socialist society, I am forced to seek out and to stress all those factors and processes which can really promote and support such a development.

In the atomic age in which we live, notions that neither the Soviet or the opposed American system could be overcome and changed by means of a great war from without are unrealistic and either quixotic or hypocritical. But the danger that extremist, power-preoccupied, warmongering forces within both systems could, at a certain opportune moment, create a political situation which could get out of their control and lead to a world catastrophe is one which can hardly be set aside. All the more, therefore, must one promote all processes and relations that weaken these reactionary forces and strengthen humane and democratic ones.

No hindrances to and limitations of East-West relations, such as embargoes and similar measures, can prevent the growth of Soviet military power. Such measures only help the reactionary, Stalinist forces. In the long run, however, every widening of these economic relations constitutes a support of a liberal and reformist development.

Economic relations involve, above all, contacts between men: They lead to the overcoming of mistrust, they assist technical comparisons and self-critical evaluations, and promote new needs and economic incentives. From time immemorial, active economic contacts have led to progressive changes in and approximations between systems while autarkic aspirations have only served the purposes of nationalistic warmongers.

It would naturally be erroneous to believe that trade, increasing deliveries of Western goods to the East, and similar activities, could by themselves automatically lead to a change in the Eastern systems. Such a change is a lengthy and very indirect process which will be set

in motion primarily by the internal economic contradictions and brought to friction by means of the struggle of progressive forces against conservative ones. However, relaxation of external tensions and the development of economic relations take the wind out of the sails of the reactionaries and strengthen the positions and arguments of the liberal forces.

The economic problems of a centralized, bureaucratic system cannot be eliminated solely by means of a developing of foreign trade. Every Eastern European state must compensate for the inferior technical, qualitative, and structural development of its products by means of relatively low prices—very often prices involving a loss—when exporting, in order to be able to sell at all on exacting markets.

So, owing to annually deteriorating terms of trade, the Eastern European states steadily lose more than they gain by importing qualitatively better products from the West. Their internal economic problems, created by an ineffective and bureaucratic system, cannot, therefore, be eliminated by more intense trading with the West. On the contrary, economic analyses in depth show that the losses from foreign trade on exacting Western markets, are so enormous that they can never be compensated for by gains in productivity achieved with the aid of modern techniques imported from the West.

The people and institutions who, through their direct responsibility, are interested in the import of Western goods are either not identical with those who export or, owing to the uneconomic price and money system, they cannot judge the effectiveness of this foreign trade. Only an economy completely dominated by a bureaucracy which ignores criteria of effectiveness and covers all losses by means of a system of anonymous protection and subsidy can maintain itself at all in the long run in the face of such growing losses.

However, Western trade and production organizations can always have an interest in trade with Eastern Europe. Enormous markets for Western exports indubitably exist there. A greater problem is the Eastern ability to pay, which is limited by the nonexistence of convertible currencies and, therefore, always dependent on reserves of Western currency obtained from export transactions.

Although Western imports from the East will always be slowed up by the inferior quality and structural inflexibility of Eastern production, this can often be counterbalanced by the relatively low prices at which the bureaucratic Eastern commercial organizations are willing to sell their goods.

The fact that this eventually works to the disadvantage of the Eastern national income and the consumption of goods by the native population will, of course, be of less interest to Western trading partners, for it is a typical result of the ineffectiveness of this administrative system.

Even if, therefore, East-West economic relations cannot by themselves serve to eliminate the defects and losses inherent in the bureaucratic economic system of the Eastern European countries, they can, on the other hand, provide reformist forces there with important proofs and arguments and contribute greatly to an acceleration in the critical consciousness of the mass of the people.

More and more people in those lands are beginning to understand that their own system is not catching up—technically, qualitatively,

and economically—with that of the West, although official propaganda is continually assuring them that it is, but that in reality it is falling further and further behind. Information and knowledge which the regime has withheld from them for years is, owing partly to more intensive economic relations, reaching the people to an ever greater extent and expediting their growing awareness of the necessity for reform.

In this way, therefore, East-West relations can sustain a political development in the Eastern states which is leading to an acceleration in progressive and democratic changes. This development will also proceed in the U.S.S.R. itself, even if it takes a relatively long time to do so.

The pressure from below in favor of democratic and liberal changes will grow stronger and will, under certain conditions, force such changes on those at the center of political power. Even though the reactionary forces are not to be underestimated, the future definitely belongs to the progressive forces, for they will be supported by economic necessity and the interests of the undogmatic, forward-struggling younger generations.

Forces in the West that are really interested in this liberating, democratic development in the East and that want to contribute to a humane and peaceful world development must, therefore, also be interested in an intensification of the economic relations between West and East.

I hope that this development will also one time bring again the liberty for the people of my own country of Czechoslovakia.

Thank you.

Chairman Boggs. Thank you, Mr. Sik.

Mr. Wolff, if we could please hear from you.

**STATEMENT OF OTTO WOLFF VON AMERONGEN, PRESIDENT,
GERMAN NATIONAL CHAMBER OF COMMERCE AND INDUSTRY,
AND PRESIDENT, OTTO WOLFF A.G.**

Mr. WOLFF. Mr. Chairman, I wish to thank you and all the members of the Subcommittee on Foreign Economic Policy for inviting me to testify here before you.

As my English is not so fluent and as I have noticed that I cannot compete with the rest of you, I have decided to read my statement.

With your permission, I will address myself immediately to the subject under consideration in order to give you an idea of how a German businessman views this complex subject. I would also like to mention, in the limited time available, some of the factors conditioning this trade and my judgment regarding its future development.

Since World War II, "Commercial Relations between East and West" have repeatedly been the subject of vehement public discussion. For various reasons, but especially domestic political ones, we are again in such a period of hefty public interest. To a considerable extent, this public debate has been intensified by the signature August 12, 1970, of the yet to be ratified German-Soviet Agreement, by the German-Polish Agreement, by the Long-Term Agreements on Trade and Cooperation in the Economic and Technical Fields with Hungary, Rumania, Poland, U.S.S.R., and Bulgaria.

I do not wish to address myself to the problems of German foreign policy, but I should like to call your attention to the fact that these agreements and the negotiations leading to them are linked with difficult political problems, charged with fierce emotion, and many of these problems will only be solved in time. This applies as much to the Eastern bloc countries as to ourselves.

We in West Germany have found our role in Western Europe and in the Western Hemisphere. We are members of NATO and of the EEC, we cooperate in GATT and in the OECD, and so forth. But, our relations with the East are still not regularized. These are facts—political facts—which I must take into consideration in representing to you the German point of view on East-West trade.

In your country the term "East trade" is probably understood to mean trade between the countries in the Communist sphere of influence and those of the rest of the world. This is correct. But for the Federal Republic of Germany, the situation is somewhat more complex.

Our concept of East-West trade does not include trade with Yugoslavia and certainly not trade with the German Democratic Republic. We do not consider the German Democratic Republic a foreign country. Our commercial relations with the GDR are treated both politically and commercially as "inner German" trade. The conditions for the conduct of our trade with the German Democratic Republic are laid down in a special agreement which is closely connected with the free access of goods to and from Berlin and which also subjects payment transactions to a special procedure.

Our partners in the Common Market, too, consider our commercial relations with the German Democratic Republic as being "inner-German" trade. Consequently, when speaking of East-West trade, I exclude our relations with the German Democratic Republic and with Yugoslavia.

It is well known that, in comparison to most industrial countries, the Federal Republic of Germany—due to her economic structure—is heavily dependent on foreign trade. In contrast to your country, England, or, perhaps, the Netherlands, our economy has relatively little direct investment abroad.

Our foreign trade dependence becomes more clear if one compares—and I know that from an economist's point of view this is not quite valid—our foreign trade volume to our gross national product.

This shows that our imports and exports constitute approximately 25 percent of our gross national product, whereas in the U.S.A. imports and exports amount only to approximately 4 percent of the gross national product. It is against this background that we must view the Federal Republic of Germany's interest in foreign trade and in the progressive liberalization of world trade. It is in this same context that we think of our trade with the Eastern countries.

Last year the Federal Republic of Germany exported goods valued at about 113 billion marks; her imports amounted to about 98 billions. If you examine these figures closely, you will find that the Federal Republic of Germany conducted about 40 percent of her foreign trade with countries belonging to the Common Market, 20 percent with the EFTA, 10 percent with the United States, 26 percent with other industrial and developing countries, but only slightly more than 4 percent with state-trading countries.

I am of the opinion that from the point of view of a proper geographical distribution of commercial risks and a diversification of our foreign trade, the volume of my country's East trade is too small. But this is not the only reason why I, for many years, have supported an intensification of our East trade.

If you look at Germany on a map of Europe, it becomes obvious that German trade activity tends to develop not only to the West, but also to the East. If you consider that before World War II Germany conducted up to 18 percent of her foreign trade with countries which today are Communist States, including the People's Republic of China, then it is clear that our present trade volume with these nations is very modest.

The efforts of German industry to achieve an intensification of trade relations have been variously successful during the past 20 years. In 1950, we started on a relatively small scale. East trade then constituted about 2 percent of the entire imports and exports of the Federal Republic of Germany. Since 1960, these percentages have fluctuated between 3.6 and 5 percent.

Now, the question is whether these 4 and 5 percent can be increased in the short run. This question can only be answered if one looks at some basic facts. First, it is known that the state-trading countries carry out long-term planning, not only of their domestic economies, but also of their foreign trade. This is the practical expression of the need of Communist ideologies to plan everything.

On the average, these countries reserve only approximately 30 percent of their entire foreign trade for the OECD countries, for the developing countries, and for others of the so-called third world. This fact alone shows that the possibilities for a marked increase in trade are rather slight.

The different state-trading countries—but especially the members of the COMECON—are tied nearly exclusively to a bilateral trading policy, not only in their trade relations with other countries, but also amongst themselves. They strive to keep their imports and exports as balanced as possible because their own currencies—and even the dominant currency of the Eastern bloc—the rubel—are not convertible. With exports into Western countries, they procure the necessary foreign exchange to pay for their imports. Simply because of this fact a perceptible increase in trade with the West is not possible without a fundamental change in the planning and currency systems of the East.

A further program is that the Eastern bloc countries have difficulties in adjusting themselves to the rules of free competition in our markets. In order to acquire a market position in our countries we must maintain sales organizations and use advertising. It is, of course, much easier to operate within the framework of a known and more or less inflexible 5-year plan and to adjust one's production accordingly on a long-term basis.

Once such a plan is approved, there is no longer any difficulty in selling goods. Therefore, it is my judgment that as long as the salesmen of the Eastern bloc and the state-trading enterprises do not adjust themselves to the competitive forces which prevail in the Western World, there will not be a striking increase in trade between the East and the West.

Six or 7 years ago, on the initiative of Poland, the Communist States of East and Southeast Europe began to interest themselves in what we call "technical-commercial cooperation." The two main reasons for Poland's initiative were as follows:

1. Poland had a relatively high unemployment rate of skilled workers and some factories were operating below full utilization of their capacity. By means of jobbing contracts with German firms such as Volkswagen, Siemens or Bosch, they wanted to achieve optimum plant utilization.

2. Poland intended to use the revenue of foreign exchange derived from these contracts for purchases on Western markets, in order to surmount—as far as permissible—the 30 percent limit in foreign trade stipulated by her system.

Countries like the U.S.S.R., Hungary, and Rumania adopted the Polish idea, probably for the same or similar reasons. In addition to these immediate goals these countries, through technical-economic cooperation with Western companies, hope to close their technological gaps, the existence of which they openly admit.

From our discussions, which have been carried on over a number of years, quite a few possibilities have emerged for cooperation, the latest being company cooperation in third markets. Here, I mean, for instance, the turnkey erection of a factory in a third country by companies from both sides. The country with the greatest reservations about any form of cooperation is the Soviet Union.

Let me mention only two reasons:

1. The Soviet Union has a fairly self-contained and balanced internal market and is, therefore, relatively little dependent on foreign trade. The Soviet Union, up to now, has not felt it necessary to participate in the world economy on the basis of comparative advantage.

2. The bureaucracy of the Soviet Union is even more rigid than that of smaller Communist countries.

Now, gentlemen, I would like to discuss, for a moment, this question of the relatively small volume of East-West trade from still another and very important angle. Consumer goods play an important part in the trade of your country, in trade among the countries of the Common Market, and in the trade of the countries of EFTA.

But this is not the case as far as the Communist countries are concerned. They import relatively few consumer goods from Western countries because of their shortage of foreign exchange. They must confine themselves to the so-called essentials and by that I do not mean French perfume.

On the other hand, the quality of their own consumer goods is not good enough to compete on the very sophisticated European market. Here, however, I must make allowance for countries like the U.S.S.R. and Hungary who make enormous efforts to sell consumer goods of increasingly good quality to Western countries. Traditionally, these two countries are more closely tied to the Central European market.

But if we discount consumer goods, which constitute more than 50 percent of the FRG's trade with other Western countries, we could no longer talk about an intensive trading relationship. Hence, it follows that we can only expect more rapid development of East-West trade if a striking structural change is effected in the Eastern countries.

After the German-Soviet Agreement of August 12, 1970, had been signed, I was often asked whether it was the prelude to a new commercial era. As a businessman, I am, perhaps, cautious by nature. In any case, I have never had any extreme hopes in this direction and, by the way, trade relations between Germany and the Soviet Union are mentioned only very casually in the preamble of the agreement.

The possibility that Germany might receive the contract for the project of a truck factory on the banks of the Kama River gave rise to speculation that we were about to experience an explosive increase in trade with the Soviet Union.

Bearing in mind this example, I can only state that neither the Federal Republic of Germany nor, certainly, any single entrepreneur could handle a project of this size, not to mention the technical risks and possible requests for financing. Projects of this size should be solved on the basis of international cooperation as it is the case in other countries. The Fiat business in Togliattigrad has amply proved this point.

The Italian industry was not in a position to supply all of the machinery necessary for this project. In this connection I can refer you to my friend, Giovanni Agnelli, who could tell you of his experience with Togliattigrad. I know that Mr. Agnelli is known to many of you.

When speaking of the individual countries of the Eastern bloc, I must treat mainland China as a special case. During the last 10 years this country has moved perceptibly away from the other state-trading countries, not only politically but also in its trade policy. This is demonstrated by the fact that trade with China is not bound by the usual bilateral way of thinking, even though it is subject to fluctuation.

China owns various sources of foreign exchange—some of which are fruitful—which allow her far more freedom in her commercial transactions. Even imports on a larger scale, like, for instance, grain imports, have been settled and paid for without any difficulty. A 1-year trade agreement once existed between the Federal Republic of Germany and China which I negotiated on behalf of German industry. This agreement expired at the end of 1958, and has, unfortunately, not been renewed.

In the meantime, the foreign trade policy of the People's Republic of China has completely changed. In 1957, when I spent 6 weeks in Peking negotiating the agreement, more than 56 percent of the foreign trade of the People's Republic of China was with countries of the Soviet bloc. Today, the proportion is the other way around. More than 70 percent of China's foreign trade is conducted with the countries of Southeast Asia, Western Europe, and with the African and South American countries. Scarcely 30 percent of her imports and exports are with the COMECON countries.

Finally, I would like to say that, fundamentally, trade possibilities with the state-trading countries are not only limited by their commercial policies and by their bureaucratic and legal obstacles, but most importantly by the weakness of their domestic markets. This, after all, is due to the system.

I am saying this in spite of the fact that it is quite obvious to me that especially the Soviet Union, because of the vastness of her territory, because of her great mineral wealth, and her large population, could in time become one of the most important world markets.

I would like to believe that the Soviet politicians want more prosperity for their people. If, however, they want to achieve more than they have now, they will have to participate more intensively in the world economy on the basis of comparative advantage. This means, however, that the Soviets have to recognize the fact that their domestic market is weak in comparison with that of the United States, Canada, and the Western European countries and that, consequently, a fundamental change is imperative if they are really interested in prosperity for their population.

In conclusion, I want to apologize for having restricted myself to generalities. This is not only because a more exhaustive discussion would have required many hours, but also because it is my opinion that we have reached a point where our relations with the East—and I do not mean only in a commercial sense—must be reconsidered. In such situations it may be better to stick to essentials than to drown in details.

I am ready to entertain your questions.

Thank you, Mr. Chairman and gentlemen, for your attention.

Chairman BOGGS. Thank you very much, Mr. Wolff.

Mr. RASHISH, consultant to the committee, has some questions of his own, as well as the questions Senator Javits want to ask.

Mr. RASHISH. Before he left, Senator Javits indicated he had some questions to put to the members of the panel. Let me read these questions and address them to the members to whom Senator Javits wished them addressed, and invite their comments.

The first question is addressed to Mr. Miller.

Senator Javits asked: Do you believe that any quid pro quo for our granting MFN tariff treatment for Eastern Europe should be required and, if so, what is the nature of the quid pro quo that we should ask?

Mr. MILLER. To the question, I would answer yes. I think that the advantages that can be negotiated short term are not major. No one is going to be able to negotiate the tearing down of the Berlin Wall and freeing European nations because the value of trade with us is not all that important, short term, to either of the two parties.

But no one knows what can come about through active negotiation across the table. It is possible to gain limited advantages year after year as these contracts are renewed. My feeling is that the President should have the power to negotiate and he should have all of the tools in his hand, because only in this way can he gain the maximum advantages from any situation.

The kinds of advantages that we can negotiate relate mostly to opening up our two countries to each other and to bringing the Communist nations into the ordinary patterns of regular world trade. It is my feeling that the forces of economics are very much stronger than any force that any individual country can bring to bear. If we can bring the eastern nations and the Soviet Union into the normal relations of world economics, these will work more effectively to change these societies than anything we can do individually.

Mr. RASHISH. Your answer, then, is that the kind of counterconcessions that the United States might seek in negotiating for the removal of the discriminatorily high tariffs being applied to trade with Eastern Europe, aside from that Poland and Yugoslavia, that the counterconcessions in all likelihood will practically be limited to counterconcessions in the commercial and economic area?

Mr. MILLER. And in the cultural and intellectual area. I would not exclude those.

Mr. RASHISH. Does any member of the panel, following on Senator Javits' question, feel that, given the special value that the Eastern European countries derive from trade and technological exchanges with the West, they might be willing to offer political concessions in exchange for commercial or economic concessions?

Is that at all realistic?

Mr. WOLFF. In my opinion, this idea is not very realistic.

As you know, our former Foreign Minister, Herr von Brentano, once had the idea that by paying 10 billion Deutsche Marks to Molotov, the Soviets would return the DDR to us.

And now let me draw your attention to the last few weeks which showed quite clearly—and this in different spheres—that economic concessions, or at least connections, will not necessarily lead to satisfactory political results. Here, let me remind you, for example, of the two meetings between Chancellor Brandt and Herr Stoph; so far none of them lead to any visible and lasting results.

Mr. RASHISH. Does anyone else wish to comment?

Mr. SIK.

Mr. SIK. I want to stress to your point of the question, clearly. I also agree that it is impossible to expect immediate political changes as well as economic relations which would correspond to relations among countries with a normal market economy. I emphasize that it is a long-term process to achieve such changes. But the present intensifying of economic relations will support the development of higher industrial and technical development, higher economic development in the East.

And, step by step with this economic development are growing up, also new social forces. It is an increasing of the progressive social strata, of the technostructure, economists, scientists, and also new thinking workers, that begin to compare Western development with their own development.

What in Czechoslovakia mostly supported the development of new political views and forces in the last years of the Novotny regime were the more intensive economic, cultural, and touristic contacts with the West, beginning from 1963-64. From this time the connections were more intensive than before and they brought new information to the people, new knowledge about the real development in the West, and called for comparisons more than before.

This is very important for the Soviet Union, too. Only through the development of the progressive forces against the conduct of the reactionary forces, against the bureaucrats, the conservative politicians, only through this development can we expect in the future some changes. But this development of different political forces will be so hidden, that from the outside it will not be observed for a long time.

Chairman BOGGS. Let me ask a question at this point. Czechoslovakia had negotiated a great deal of commerce with the West when the 1968 invasion occurred. Had these agreements been entered into?

Mr. SIK. I have to say nearly nothing of what we expected, nothing of our great spring perspectives. Czechoslovakia is going back as far as were the conditions of the last years of the Novotny regime, even to a lower level. In this movement, they are without an economical conception. It is the old system outlawing the new system. Really, they are developing in the old way.

There are fixed plans for the enterprises from the center, and the enterprises are compelled to fulfill the overstrained plans of the increasing of production and productivity of labor. Enterprises are going in the old way, in the old manner, as before.

There is not really chance for cooperation with Western firms because of the invasion.

Chairman Boggs. What I am trying to find out—I asked this question to the panel generally, any one of you can handle it—what evidence is there to sustain the view that if trade is increased between the satellite nations and the West, that the Soviets will permit this if they conclude it is to their disadvantage?

Mr. PISAR.

Mr. PISAR. Mr. Chairman, after the 1968 Russian invasion of Czechoslovakia, many agreements that were being negotiated were suspended. I was involved, myself, in a number of negotiations for major projects with Rumania, Hungary, and Czechoslovakia. The others went forward but the Czechoslovakian negotiations had to be suspended.

The reason for it was not that the Soviets vetoed it, the Soviets did not interfere at all. The reason was that the Czechoslovakian economy became so disorganized, people became so depressed, confused, and demoralized, that things simply stopped functioning.

Now, my view is that any increase in trade between the smaller Eastern European countries and the West would not be stopped by the Russians, because the Russians have become fairly practical in these things. Mr. Kosygin knows how to use a yellow pad and a pencil. He has added up the numbers and he knows that unless he allows an economy like the Czechoslovakia's to trade with the West, he will have to support it.

Before the war—Mr. Sik knows this much better than I—Czechoslovakia was a very skillful little economy. It was highly competitive in the world market. It was selling excellent glass manufactures, shoes, steel products, very good motorcars from the Skoda Works. But when the Soviets put them to work for the Russian market, they disqualified themselves from world competition.

The Russian market is a very easy one to satisfy as to quality. You can sell almost anything there. The result was the Czechoslovakians could no longer compete in the West.

Now, the Russians are not interested in subsidizing Czechoslovakia, Cuba, and Egypt. Their economy is huge, to be sure, but there are limits to everything. So in response to your question, I think that the national reflex of the smaller Eastern European countries to buy Western technology, to trade with the West, will not be vetoed by the Russians, unless they try to go too fast and a political situation develops and the Russian generals get scared and start interfering with what economic planners really want to do.

Chairman Boggs. Any other comment from that?

Mr. Wolff.

Mr. WOLFF. Well, as long as they can exercise a certain political control, they are willing to support, to some extent, an increase in trade agreements between the smaller Eastern European countries and Western trading partners. As I mentioned in my statement, the Federal Republic of Germany concluded several long-term trade

agreements with Eastern countries after the Soviet Union's interference in Czechoslovakia. These activities were never objected to by the Russians.

Chairman BOGGS. What about your trade with East Germany? What difficulties do you have there?

Mr. WOLFF. We do not consider the German Democratic Republic as a foreign country; the commercial connections are considered as a trade "sui generis." The main difficulty in this trade lies in the limited capacity of the DDR's economy.

As you know, the DDR's industry is mainly orientated towards the Russian requirements and, therefore, a very limited capacity is available for the sophisticated West German market.

This is one of the reasons for the enormous deficit they had to bear last year in the inner-German trade. This year there seems to be a slight improvement because, amongst other things, they can deliver more soft coal and textiles to balance the accounts, but, nevertheless, they still face difficulties in meeting their obligations.

Chairman BOGGS. What is the balance between the East and the West in the trade?

Mr. WOLFF. You mean the two parts of Germany?

Chairman BOGGS. Yes; the two Germanies.

Mr. WOLFF. Well, last year it amounted to something about—please let me consult my notes—3,650,000,000 deutsche marks in total, that means imports and exports together. This is almost exactly 1 billion U.S. dollars.

Chairman BOGGS. And it was balanced?

Mr. WOLFF. No; it was not. In fact there was a deficit of about 400 million deutsche marks.

Chairman BOGGS. On one side?

Mr. WOLFF. Yes, of course, but on the other side.

Chairman BOGGS. Mr. Rashish.

Mr. RASHISH. Senator Javits' second question is addressed to Mr. Pisar.

You described the consumer markets of the East as being fertile and untapped outlets for Western businessmen. But, given the emphasis of the U.S.S.R. and the other Eastern European countries on trade which will enhance industrial production, how do we break through this barrier to reach through to the consumers of the East with the feature comforts they desire?

Mr. PISAR. My point was that we have to help the East build consumer products. This does not mean that we will be able, in the near future, to sell them consumer products. We will be able, however, to sell the peaceful equipment and technology with which the East could manufacture its own consumer goods.

Now, as to how to reach that market, this is a very difficult science. You have two types of consumers, the private consumer and, as I have said, we will not be able to reach him in quantity for a long time, even though it is amazing how much the Russians have occasionally been purchasing at Western Europe in the way of shoes, apparel, and other items in shortage.

But in macroeconomic terms, it does not add up to much.

As to the industrial consumer, it is very difficult to reach him too, because the bureaucratic economy is so closed that it interposes monop-

olies through which you must go if you wish to sell. For many years, you could not reach the actual user of the equipment you wished to sell, except through that centralized bureaucratic monopoly that stood between the world market and anyone who wanted to buy in the Soviet Union. The same obstacle was in the way if you wanted to buy from the Soviet Union.

And when the monopoly was buying, the instructions it was getting from the remote industrial users were vague and, in any event, the users did not have much impact on getting the best, the latest equipment. The decisions of the monopolies of the center were based more to the Soviet balance of the payment—how much hard currency they could afford to spend, rather than in terms of technological needs of the particular enterprise that wanted the equipment.

This way of doing business, the Russians have admitted today, is inefficient and wrong, and they are reforming it. Now, when you negotiate with them to sell machine tools or whatever, they bring into the negotiations the industries that are going to use the equipment. And this approach to reform is continuing right along the line. They even have special foreign exchange allocations. If a factory in Novosibirsk wants to buy a piece of American or German equipment, it can get from the Government a special foreign exchange allocation, assuming the equipment will be used further to expand exports to the world market.

In other words, if they earn the exchange they can get special dispensation to use part of that exchange to pay for the equipment they are buying in the West. This evolution has, of course, gone even further in the smaller Eastern countries than in the Soviet Union itself, Hungary, for example.

Mr. RASHISH. Mr. Sik.

Mr. SIK. I think we have to think of the development of these relations in the conditions which are given by the systems in the East. As long as the Eastern countries will exist at all centralistic, their planning systems will also determine the structure of production in these countries. A most important sign of this development is strong preferences in the heavy industry.

This is the greatest problem in general of these countries. All of these countries have to suffer from insufficient consumer goods and all are producing more and more of the heavy industry. I cannot explain it now in detail. It is connected, first of all, with military goals, power goals, of these countries.

Second, with the simplified system of planning, and third, with the great influence of the representatives of heavy industry in the political organization. These are the reasons why these countries have always further and further preferred their heavy industry.

In these conditions exist a large inflation and people cannot get enough consumer goods and services, what they need. But as long as this system will exist, will also the increasing economic relations between East and West develop only in this direction, in direction given by this structural development. It means, that they will for the earned Western currency, first of all, try to buy investment goods and only in a little part consumer goods.

Only in the last month was Czechoslovakia an exception because of the very difficult political situation there. This compelled the Gov-

ernment to make a certain increase of the import of consumer goods, but only for a short time, to satisfy the people.

But this is an exception. Normally, they will need more and more investments, too. In the old system the foreign currency will be always distributed for the imports in accordance with the obligatory production plans and the production structure directed by them.

Mr. RASHISH. On this very point, I notice a rather sharp difference of opinion between Mr. Pissar and Mr. Wolff. Mr. Pissar said that Soviet Union has given official endorsement to the law of comparative advantage. Mr. Wolff, I think, mentioned at the end of his statement, as I recall, that until the Soviet Union gives some endorsement or recognition to the law of comparative advantage, the possibility for expanding trade with the West will continue to be very limited.

Would each of you comment on that? Perhaps we will start with Mr. Pissar.

Mr. Pissar. Well, I am basing my statement on the 23d Communist Party Congress in Moscow in 1966. Mr. Kosygin was reporting to the Congress on the condition of the Soviet economy and its role in the world market.

If you happen to have a copy of my book, I can show you the exact quotation. He said, that it is unacceptable that the great Soviet industrial establishment, should find it impossible to sell its fine inventions—and some of these inventions really are significant—that it is unacceptable that many of the tools, the equipment, and the processes that the Soviets had brought into existence, as he called it, “the fruit of the labor of our wonderful engineers,” could not be sold in the world market.

Then he went to the other side of the equation and said that it is wrong to try to re-invent everything. There is so much, he said, that we can buy in the West and we could save in this way millions of rubles.

This is an official statement before the Communist Party. He endorsed in open language what we would consider the doctrine of comparative advantage. So much for official policy.

Now let us look for a minute at what is happening in practice. The Soviet Union has indeed gone into the world market. It has established a special institution to sell Soviet patents and licenses. It has been bidding on industrial projects in a number of countries. You will remember the Soviets tried to bid for the Coulee Dam generators in the State of Washington, a couple of years ago. Everybody was in agreement that theirs were the best generators, they had a special capacity to develop these generators, they developed them at the hydroelectric projects, such as the great dams at Dnepropetrovsk.

In the end, President Johnson vetoed the purchase of these generators, for security reasons. I remember seeing a statement by a member of the Department of the Interior, that in reality they were refused because they would not look good in the State of Washington with a hammer and cycle painted on them.

The Russians are negotiating with the French today for the building of foundries at the Port of Marseilles. The Russians have been selling diamond bits and drilling equipment to the oil industry. They have a superior steel smelting process that they have sold all over the world, including the United States.

I am saying this to show that they have thrown themselves into the world market with some determination. They are taking advantage of that which they are good at, and the reason for it is that they want to buy Western technology and, in order to buy it, they have to earn the exchange. Once you go in this direction, you are committing yourself to practice the doctrine of comparative advantage.

Mr. WOLFF. Here, I would like to quote from my statement: "If, however, they want to achieve more than they have now, they will have to participate more intensively in the world economy on the basis of comparative advantage."

Of course, what I understand under the term of "comparative advantage" is that they have to open their markets a little bit wider, as Mr. Pissar pointed out. He explained to us the system of the state-trading companies and the difficulties experienced by foreign companies to establish contact with their actual clients. For a long time, in their trade with the West, the Russians have been demanding the so-called most favored nation clause. But it is quite difficult to grant it because they are not able to offer any compensation for tariff concessions, for instance. One has to try whether instead of tariff concessions other advantages could be obtained; that is, direct contact with the client, excluding the influence of the state-trading companies.

I shall never forget when Mr. Nesterow, the president of the All-union Chamber of Commerce in Moscow, paid his first official visit to the International Chamber of Commerce in Paris. During this meeting I proposed to discuss the "most favored nation clause" in order to clarify the extent of the possibilities.

I remember that during their negotiations with France, for instance, the Russians demanded to be treated exactly like the five partners of France within the Common Market. This would have meant better conditions than, for example, those granted to the United States.

With these few examples, I just wanted to show how difficult it is to explain precisely the term "comparative advantage"—especially to the Soviets.

Mr. RASHISH. Senator Javits' third question is addressed to Mr. Sik.

In your statement, you say, "No hindrances to and limitations of East-West relations, such as embargoes and similar measures, can prevent the growth of Soviet military power."

Would you offer the observation that in your opinion the U.S. export control program has not in any way impeded the warmaking capability of the Soviet Union? Do you have a judgment on that?

Mr. SIK. Yes. I think that there is not a real obstacle for growing up a military power in the Soviet Union. I think that, in contrary, this condition of embargo forces the Soviets to seek other ways to secure their military developments, even with higher costs and in a longer time. I say, that they will reach what they have to reach in accordance with their military goals.

But if I could stress in this connection, even for its uselessness, should not the embargo become the main hindrance of intensification of East-West relationship. Thus exist great enough economic hindrance.

I suppose, the Western intention will be to increase the exports to the Eastern countries, and I assume the Eastern countries will be

interested in buying more from the Western. So both sides would have the intention to accelerate their mutual sales and purchases.

Then I see as the largest obstacle of this in the difficulties of selling Soviet goods on the Western market. It is clear that the Soviets will be able to buy from the Western countries only in that sum, which they will get for their own goods in the conditions of a very hard competition on the Western market. And it must be clear that this is the main break for increasing the trade.

I want to emphasize from my own experience, they have the possibility to sell also a certain amount of backward goods and goods with lower technical quality, by selling them for lower prices. This is a way for itself to come on the Eastern market. But from the losses that here arises, will come an economic pressure on the enterprises in the East. They will be compelled to export more and more goods, to get a certain amount of techniques from the West. The losses in prices means losses in national income. From this has to arise the need of reforms in the production.

This I see as a precondition for a battle for independence of enterprises of the state, for overcoming the administrative methods of planning, and so on.

Mr. RASHISH. Mr. Miller.

Mr. MILLER. I would like to comment on that question. In the deliberations of our committee 5 years ago, I think we gave it more attention than any other item. Several things emerged. The first thing is that the United States no longer has any real monopoly on world technology. Anything a nation wants from the United States, it can get a reasonable equivalent from some other industrial country.

The second thing that emerged is that if the Soviet Union wishes to concentrate its resources, it can do any one thing about as well as any other nation. We could not find that the policy of the U.S. Government had in any discoverable way hampered the development of a military machine which was fully satisfactory to the Soviet Union.

On the other hand, like all of us, the Soviet Union cannot do everything at the same time. They have to make choices and that choice has been to starve the consumer section.

Now, the first question of the Senator was, what political gains could we extract, and I said very few short term. I should have added, possibly, very substantial ones long term, because for a thousand years the Soviet Union has been a closed society and fearful of the West, not just since 1917. They have expressed this fear through a desire for self-sufficiency.

Now, the Soviet Union comes up against a dilemma: A rising desire for an improved material way of life for the individual Soviet citizen on the one hand, and the desire for self-sufficiency on the other. The latter can only be achieved at the expense of a lower standard of living. Anything that we can do to encourage the confrontation of these two desires and their resolution in the direction of a richer life for the consumer, means that the choice of the Soviet Union will be made in the direction of turning resources toward consumer welfare rather than toward the military machine. The Soviet Union cannot do both.

Chairman Boggs. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman. I wanted to congratulate you for assembling this exciting panel.

I particularly want to welcome Mr. Sik, who has suffered in the last few years, to thank him for his hospitality to me in Prague some years ago, and to express the hope that he will one day very soon be able to go home again, where he is needed.

I would ask you, Mr. Sik, in your statement you talk about the tendency in countries of the East nowadays—and here I am quoting from your remarks—“for conservative and reactionary strata which are incapable of changing economic development and significantly improving the lot of the working people * * * to distract the mass of the people from the real problems by means of political demagoguery, suppression of all liberty, the widespread dissemination of envy and hate, suppression of all undesired information.”

And then you go on to say that nothing is more welcome to these politicians, and nothing is of more assistance to them than warlike tendencies among other nations, the revival of cold-war policies, and so on.

Actually, this process, I suppose, works on both sides of the so-called Iron Curtain, does it not, and one feeds on the other?

Mr. SIK. Yes. I think that at both sides exist some forces that are interested in having some tensions in the world.

I think that in the East it is, first of all, the majority of the bureaucracy of the party, and also of the state. But I think that in the Western countries also are such forces that have similar goals and slogans, ideas, and propaganda. I think that this action of both opposite forces in the world is helping one another.

Always if it is starting a tension in the world, this is for the benefit of a certain amount of people on both sides, who can strengthen their power, their political positions.

I see also on both sides in opposition to this the democratic forces and their fight against war-mongering and power interests. But, in the East, it is not so superficial as in the West. In the East, there is more hidden development. But I think it is strong enough. Of course, more in the little socialist countries at this moment, among the nations that are oppressed by the Soviet imperialistic policy. But also inside of the Soviet people, I think there exists growing opposition.

First of all, among the more intelligentsia, of course.

Representative REUSS. Thank you, Mr. Sik.

I have one question of Mr. Wolff.

As a German businessman, you testify that you see the prospects of some increase in East-West trade in the months and years to come. As a German businessman, which you are, would it be correct to say that to the extent that the United States keeps its businessmen from making trades and arrangements and selling and buying from Eastern Europe, that are open to German businessmen, this is the greatest thing ever invented for the edification of the German businessman, is it not?

And I do not begrudge it to you at all.

Mr. WOLFF. Well, Mr. Reuss, we have often discussed this point. You know, about 10 years ago, my rather liberal ideas regarding the East-West trade made me quite unpopular, especially in Washington and Bonn. But lately, I think, the climate changed a bit. In my country, as

well as in yours, there seems to be a group of serious businessmen and responsible politicians who are considering an intensification of the East-West trade. We are not afraid if American companies do compete with us in those markets; however, I think it would be preferable if we could act more in the sense of partners.

You know that at former occasions here in Washington I expressed my doubts regarding the two-way U.S. embargo policy which, in the meantime, has been modified or dropped. Here, I refer to the general U.S. embargo policy and the stricter one concerning the People's Republic of China. Doubts already existed against the so-called normal embargo, especially in cases where the Eastern side had already delivered the same products to other Western countries. My comment as far as the China embargo is concerned was simply: it never worked.

But let me revert to the matter under discussion. I would like to repeat what I have said on former occasions. The businessmen of the United States should be able to trade on equal terms with the Europeans in the East-West business. There is a very simple reason for this. On one hand, this would stop the criticism in your country against the East-West trade of the Europeans and, on the other hand, the substantial criticism of your businessmen against your Government.

Once there were plans to establish a sort of "code of common behavior" concerning the East-West trade. This never worked because, especially, the U.S. imports were rather limited, notably as far as agricultural products were involved.

This now leads me to the main problem: East-West trade is limited, on one side, by the small export possibilities of the Communist countries and, on the other side, by the actual small chance of selling their products on Western markets. In this respect may I refer to my statement. As far as your country is concerned, these difficulties seem to me even greater than in the case of the European countries.

Looking at this matter from another angle, I would recommend that U.S. companies should, in the future, participate more directly in the East-West trade and not leave it entirely up to their European subsidiaries as it has been the case so far.

Representative REUSS. Thank you.

Chairman BOGGS. Well, gentlemen, you have been very helpful to the committee. We are indebted to all of you for coming. We will adjourn until 10 o'clock tomorrow morning.

(Whereupon, at 12:30 p.m., the subcommittee adjourned, to reconvene at 10 a.m. on Wednesday, December 9, 1970.)

A FOREIGN ECONOMIC POLICY FOR THE 1970'S

WEDNESDAY, DECEMBER 9, 1970

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The Subcommittee on Foreign Economic Policy met, pursuant to recess, at 10:05 a.m., in room S-407, the Capitol Building, Hon. Hale Boggs (chairman of the subcommittee) presiding.

Present: Representative Boggs.

Also present: John R. Stark, executive director; John R. Karlik, economist; Myer Rashish, consultant; and George D. Krumbhaar and Leslie J. Barr, economists for the minority.

Chairman Boggs. The subcommittee will come to order.

Today we continue our consideration of the economic pros and cons of expanded trade and investment between East and West. This session will conclude our inquiry on economic relations between capitalist and socialist economies. I am very pleased to know that we have a very fine panel this morning.

First is Prof. Alan A. Brown of the University of Southern California; second, Prof. Alexander Eckstein of the University of Michigan. Third will be Prof. John M. Montias of Yale University. Our concluding witness is Prof. Peter Wiles of London University.

Mr. Brown, we will be pleased to hear from you, sir.

STATEMENT OF ALAN A. BROWN, PROFESSOR OF ECONOMICS, UNIVERSITY OF SOUTHERN CALIFORNIA

Mr. BROWN. Thank you, Mr. Chairman.

The broad political and economic issues of East-West trade have been explored in great depth by various congressional committees during the past decade. The purpose of this presentation is not to review past arguments, but to explore how our East-West trade policy is, or may be, affected by systematic changes and certain other recent economic developments in Eastern Europe.

Although these comments specifically refer to Western trade policy with the smaller countries of Eastern Europe, my remarks may also have some relevance to the Soviet Union. As for Asian Communist countries and Cuba, they are outside the scope of this statement.

This presentation, based on the prepared statement that I have jointly prepared with Dr. Paul Marer, will touch upon four questions. First, I will refer to certain connections between recent institutional changes in East Europe—the economic reforms—and East-West trade. In this context, I will briefly reexamine some old arguments against

liberalizing East-West trade to see whether they still have validity if applied to countries now moving toward a market system.

Second and third, I will also consider invisible trade and call attention to some important new developments: specifically, a rapid rise of trade in entrepreneurship and a no less dynamic growth of tourist trade in Eastern Europe. International tourism may be the real sleeper in our long-term East-West trade policy.

Fourth, I will say a few words about commodity trade flows. The statistical analysis is based on a computerized East European foreign trade data bank now nearing completion at the International Development Research Center, Indiana University. For his pioneering work in assembling the most comprehensive set of data in this field, Professor Marer deserves the gratitude of everyone who has need to use East European trade statistics.

IMPLICATIONS OF THE REFORMS

The economic reform movement in East Europe has generated considerable interest in the West. We have been wondering whether these reforms represent basic changes in the economic system or whether they are merely attempts to patch up a centrally planned economy. As is true with other East-West trade issues, the implications of economic reform must be differentiated with respect to their relevance for various East-European countries. Certainly the Soviet Union, where foreign trade is of less importance than in smaller countries of Eastern Europe, falls into a classification by itself.

We should further distinguish between partial reforms and implemented comprehensive reforms. Partial reforms do not alter the essential institutions of centrally planned economic systems, while a comprehensive reform does. It does so by making the economy lean heavily on the competitive forces of market mechanism.

A genuine new economic mechanism has so far been implemented, apart from Yugoslavia, only in Hungary and only since 1968.

Let me now consider three recurrent arguments against East-West trade. It is often argued that private traders are seriously handicapped in dealing with East European economies because they are faced with a highly centralized monopolistic foreign trade structure. Though operations are delegated to a number of specialized foreign trade enterprises, each having exclusive jurisdiction over specific groups of commodities, the rigid central control of the state is never relaxed.

Does this problem continue to face western firms if they trade with a country that has adopted a new economic mechanism? Under the new system in Hungary, there is no longer a detailed annual plan containing compulsory targets. This is very striking, indeed. The detailed central plan has been replaced, to a considerable extent, by the market mechanism.

Now, as a rule, export-import decisions are made by producing and distributing enterprises with a view to their profitability. It is most significant for the western trader that the former emphasis on central direction of foreign trade, a chief "commanding height," in Lenin's phrase, has given way to a new emphasis on the "rules of the game." Western traders, previously handicapped by administered trade, may now feel reassured by this shift in emphasis.

The second point, also frequently argued, is that the Western trader must operate in the dark when he deals with a centrally planned system. He is not allowed direct access to his customers and suppliers, either actual or potential. To negotiate a trade deal is a slow and cumbersome bureaucratic process. Under the new system, foreign trade enterprises are agents of producing enterprises. Rather than serving as an unscalable wall between foreign and domestic firms, foreign trade enterprises under the new system act as connecting links between foreign and domestic markets.

The third issue, frequently raised by opponents of trade liberalization, is that eastern foreign trade enterprises tend to be capricious and from time to time may disrupt world markets. The main reason why a centrally planned economy might engage in price discrimination is that East European trading enterprises, trying to fulfill their foreign exchange quotas, are motivated to undercut western competitors regardless of cost. This tendency of foreign trade enterprises is reinforced by strong pressure from central authorities to secure urgently needed foreign exchange.

Eastern export pricing has contributed to U.S. reluctance to grant most-favored-nation treatment to eastern countries. One argument is that we should not serve as a dumping ground. Another argument is that East European countries cannot meaningfully reciprocate tariff concessions. Although tariff schedules have been introduced in some East European countries nominally conforming to similar schedules in the West, it has been maintained, with justification, that tariffs influence neither domestic prices nor trade flows in a centrally planned economy. Under the new system, the incentives are designed, not to motivate the fulfillment of a centrally determined foreign exchange quota, but to maximize profits. This eliminates the pressure on enterprises to undercut western competitors, regardless of cost, so as to maximize foreign exchange earnings. Furthermore, the newly instituted market mechanism requires meaningful prices. In fact, price and foreign exchange reforms were simultaneously introduced in Hungary on January 1, 1968. The purpose of these reform measures was to assess domestic costs realistically and to link domestic with foreign markets meaningfully. For East-West trade it is important that enterprises, having reliable cost information and motivation to maximize profits, are likely to have a lower propensity to dump; for West-East trade, that tariffs can play a meaningful role in domestic price formation.

In sum, economic reforms in Eastern Europe may invalidate three old arguments against liberalizing trade. On this basis, I can only agree with the following statement by Alec Nove: "Perhaps the removal of restrictions," he said, "should apply first to countries which liberalize their trading procedures. This could be seen not as a politically motivated reward for straying from Moscow's fold, but rather as a recognition that the new institutional arrangements are a better 'fit' with what is regarded as normal in the West."

INVISIBLE TRADE: ENTREPRENEURSHIP

Now I turn to invisible, or noncommodity, trade, which is still a largely ignored area of our East-West trade policy.

For some time we have been aware of Eastern interest in our managerial and entrepreneurial know-how, but we have to some extent misinterpreted the interest of these countries in so-called advanced technology, emphasizing only their desire to buy prototype machines, patents, licenses, and copyrights. In reality, reform-minded East European countries are very much interested in importing entrepreneurship and managerial know-how, which means not merely technical skills, but also certain attitudes, a spirit of innovation, for example, and a willingness to take risks. These assets can be acquired after years of learning and doing, and, generally, only in an open society.

The lack of entrepreneurial and managerial talent in East European foreign trade is probably this region's greatest comparative disadvantage; the centralized economic system does not nurture these qualities. The crucial lack of entrepreneurship was stressed several years ago by Professor Haberler, who noted at the Conference on International Trade and Central Planning that, "There is no room in centralized Socialist economies for the innovating entrepreneur." He also added, "The exigencies of foreign trade may yet become the wedge for far-reaching changes in the economic regime."

Indeed, nearly all of the smaller East European countries have become increasingly receptive to the idea of East-West multinational corporations. For example, a recent official Hungarian policy statement enthusiastically endorsed "joint ventures with capitalist enterprises," which "represent a new category of trade."

The multinational corporation is a form of international cooperation that has already become crucially important in the West. In East-West trade, however, it is a new, revolutionary idea. The policy statement just mentioned stresses that the multinational corporation is not only the selling of goods, services, and licenses, but is also a vehicle for the western trader "to export his experience with scientific management as well as his marketing know-how." The statement concludes, "We should more and more link foreign and Hungarian markets."

INVISIBLE TRADE: INTERNATIONAL TOURISM

We have frequently questioned the ability of East European countries to pay for their imports from the West, and we have ignored the long-term potential of international tourism. Tourist trade has been one of the most rapidly growing export industries in western countries. In OECD countries, it is more important than trade in vehicles or chemicals. Spain, for example, derived more foreign exchange from tourism in 1965, than from all commodity exports combined. In East Europe, tourism is a more recent but no less dynamic phenomenon.

Let us compare, for example, the experience of Hungary with that of Yugoslavia. Yugoslavia may be considered a western country from the standpoint of international trade. During the 1950's, the number of tourists in Yugoslavia increased more than 20 times and approached 1 million by 1960. Hungary, on the other hand, the number of foreign tourists in 1960, was only one-quarter of a million. By the end of the 1960's, the number of tourists increased to nearly 3.7 million in Yugoslavia and to over 3 million in Hungary. Thus, while in 1960, four times as many tourists visited Yugoslavia as Hungary, toward the end of the decade, Yugoslavia's lead was reduced to not much more than 20 percent. It should be added that in no OECD country did inter-

national tourism grow as fast as in Yugoslavia, either during the 1950's or during the 1960's.

In terms of tourist receipts, both Hungary and Yugoslavia are still very much below their potential. Currently, Hungary and Yugoslavia earn \$50 and \$150 million, respectively. According to my projection, if the international climate remains favorable, Hungary's foreign exchange earnings from tourist trade may rise to \$1 billion by 1980. Even with this phenomenal increase, the relative importance of tourism would be much behind such western countries as Spain, Greece, Italy, or Austria.

Developing tourist trade may be the most profitable area for U.S. participation in East-West trade. The construction and operation of hotels in Budapest and Bucharest speak clearer than policy declarations. In these cooperative ventures, so far, U.S. firms have been primarily involved, in contrast with the growing number of joint enterprises in manufacturing, where the field is dominated by West European enterprises.

What would be the possible advantages and risks of our supporting this development by extending not only short-term but also long-term credits to build up tourist trade and related projects? Directly, our assistance in arranging such loans would hardly liberate funds for military projects in East Europe. To be sure, tourist facilities will provide additional hard currency to reform-minded East European countries, which will, of course, help them increase their imports from the West. But, far more than commodity exports and imports, tourism implies direct contact among individuals on a massive scale, and the mutual benefits clearly extend beyond economic considerations.

COMMODITY TRADE

The data in the attached prepared statement show a remarkable long-term rise of East-West commodity trade, as well as an increase of the proportion of western trade in the total trade of some countries in East Europe, particularly Bulgaria and Rumania. But the relative importance of East-West trade is even greater than official statistics show, since trade flows among CEMA countries are relatively overvalued.

Here I will only refer to a few important new developments in Hungary's commodity trade. The question is, Can we discern any effect of the new economic mechanism on Hungary's commodity trade with the West? Although the period is too short for a final evaluation, the record shows that Hungary has achieved impressive gains since the new economic mechanism has been introduced. In 1969, for the first time in a decade, the country realized a trade surplus with the West. This surplus was not the result of a decline in imports, which increased by 18 percent from Western Europe and 10 percent from all Western countries, but of an even faster increase of exports, 30 percent to Western Europe and over 32 percent to all Western countries. This happened in a single year. The very rapid trade expansion is still continuing. During the first half of 1970, exports to the West increased at an annual rate of 33 percent, imports by 58 percent.

Particularly striking is that imported consumer goods from Western countries increased in 1969 by 40 percent, and during the first half

of 1970 by 150 percent. This increase in imported consumer goods alone represents over \$40 million on an annual basis.

As for Hungary's trade with Socialist countries, it also increased, but at a slower rate.

CONCLUSION

All East European countries have been more and more concerned with the rising opportunity cost of keeping a large proportion of their trade in the sheltered markets of the Eastern trading area. As these countries become cost-, profit-, and productivity-conscious, they will aggressively seek gains from trade. Gains from Eastern trade are held below their full potential despite the large volume and share of this trade in each East European country's total trade, owing to rigid trading and financial arrangements and lack of entrepreneurial initiative. Therefore, what I have called elsewhere "the trade reorientation dilemma" is now emerging in Eastern Europe as a chief policy issue for the 1970's. The dilemma is essentially a choice between continued dependence on Eastern markets and a gradual diversion of trade to the West.

Trade reorientation is a broad concept. It encompasses commodity as well as noncommodity trade. It includes, as a new high-priority objective in some East European countries, the importation of Western managerial know-how, entrepreneurial skill, and market expertise through joint enterprises and other cooperative arrangements. It also includes international tourist trade, which may soon become a major source of foreign exchange. It seems that East Europe is following in the footsteps of West Europe, where postwar development has been promoted by tourism and, more recently, also by multinational corporations.

Turning to commodity trade, rapidly growing imports of East European countries from Western Europe were matched until the mid-1960's by exports. More recently, credits have become important. In the absence of large, long-term credits, we must conclude that East Europe's ability to import from the West will remain closely linked with their commodity export potential unless—let me stress this again—foreign exchange earnings from invisibles continue to increase at a very rapid rate.

As shown clearly by the statistics presented in the attached prepared statement, the less-developed countries in East Europe have been able to push their exports to the West faster than the more developed countries. They have succeeded in this because they possessed more easily marketable products. They, and they alone, were able to redirect their trade from East to West. In so doing, they have increased the pressures on their more developed trading partners to undertake economic reforms.

Ironically, Western trade liberalization toward Rumania might have contributed to economic reforms, not in Rumania, but in the more developed East European countries.

Since pressures to buy Western goods and services are expected to continue during the 1970's, East European policy to reorient trade to the West will also continue. Both institutional and statistical analyses suggest that the comprehensive reforms, so far isolated, will become more widespread. This takes us back to the conclusion stated earlier:

A selective elimination of our trade and credit restrictions seems very desirable.

Thank you, Mr. Chairman.

Chairman Boggs. Thank you very much, Mr. Brown.

(The prepared statement of Mr. Brown follows:)

PREPARED STATEMENT OF ALAN A. BROWN

"EAST-WEST TRADE: OLD ISSUES AND NEW PROSPECTS"

(By Alan A. Brown,* Department of Economics, University of Southern California, and Paul Marer,* Department of Economics, H. Lehman College, City University of New York)

INTRODUCTION

The purpose of this presentation is to explore the implications for U.S. trade policy of (a) recent systemic changes in East Europe and (b) the economic pressures in East Europe for increased trade with the West. These comments are addressed to our trade policy with the smaller countries of Eastern Europe, but they may apply also to the Soviet Union. Asian Communist countries and Cuba remain outside the scope of this paper.

This statement has two parts. Part I deals with the institutional nexus between economic reforms and East-West trade. In this context some old arguments against liberalizing East-West trade are re-examined to see whether they still have validity if applied to countries now moving to a market system.

Part II analyzes noncommodity and commodity trade flows. In discussing invisible trade, we call attention to some important new developments: the rapid rise of trade in entrepreneurship and managerial know-how, and the no less dynamic growth of tourist trade in Eastern Europe. International tourism may be the real sleeper in our long-term East-West trade policy.

In analyzing commodity trade flows by countries and by major commodity groups, we focus on the past ability and future potential of individual East European countries to reorient their trade from East to West. The statistical analysis is based on a computerized Foreign Trade Data Bank nearing completion at the International Development Research Center at Indiana University.

I. ECONOMIC REFORMS AND EAST-WEST TRADE

There has been considerable interest in the West about economic reform movements in East Europe. We have been wondering whether these reforms represent basic changes in the economic systems there, or whether they are simply attempts to patch up centrally planned economies.

As is true with other East-West trade issues, the implications of economic reforms for the various East European countries must be differentiated. Certainly, the Soviet Union, where foreign trade is of less importance than in Eastern Europe, falls into a classification by itself. In the smaller countries of East Europe, we should further distinguish between partial reforms and implemented comprehensive reforms. Partial reforms do not alter the essential institutions of centrally planned economic systems; a comprehensive reform does. Comprehensive reforms lean heavily on the competitive forces of the market mechanism, and this has important implications for East-West trade policy.

Every East European country, even the Soviet Union, has been experimenting with economic reforms, but a genuine New Economic Mechanism has so far been implemented, apart from Yugoslavia, only in Hungary, and only since 1968. Since it is generally recognized by most, if not all, East European countries that the centrally planned command economy has outlived its usefulness, there is a good chance that Hungary's comprehensive reforms could become a model for the rest of Eastern Europe. The strong pressures to buy western goods and services, felt by all East European countries (see Part II) also point in this direction. Thus, if we are genuinely concerned with the relevance of our trade policy, Hungary presents an interesting case in itself, putting into sharp relief the new issues emerging in East-West trade.

*Both authors are also visiting scholars at the International Development Research Center, Indiana University.

A. Three old arguments re-examined

These comprehensive reforms suggest that we should re-examine three economic arguments frequently used against free, nondiscriminatory trade with centrally planned economies.

1. From central plan to abolition of compulsory targets

It is argued that private traders are seriously handicapped when faced with the highly centralized, monopolistic foreign trade structure of East European economies. While operations are delegated to a number of specialized foreign trade enterprises (FTEs), each having exclusive jurisdiction over specific groups of commodities, the rigid central control of the state is maintained.

Partial reforms diffuse and relax the centralized monopoly by giving fewer specific commands so as to avoid a self-defeating rigidity. There is some room to search out profitable trading opportunities. For a western trader, however, there is still little opportunity to initiate and maintain long-term business contacts. Central authorities continue to plan exports and imports and to intervene at will in particular trade deals.

Do these problems confront western firms in trade with a country that has adopted a New Economic Mechanism?

Under the new system in Hungary, there is no longer a detailed annual plan containing compulsory targets.¹ The plan has been replaced by the market mechanism. Now, as a rule, export-import decisions are made by producing and distributing enterprises with a view to profitability. It is most significant for the western trader that the old emphasis on the centralized direction of foreign trade (a chief "commanding height," in Lenin's phrase) has given way to a new emphasis on the "rules of the game." Western traders, previously handicapped by administered trade, may feel reassured by this shift in emphasis. We may add that, in contrast with earlier profit rules under partial reforms, there have been no complaints of administrative tampering with the new rules during Hungary's three-years' experience with comprehensive reforms.

2. From administrative isolation to direct contact

The second point, also frequently argued, is that the western trader operates in the dark when he deals with a centrally planned system. He is not allowed direct access to his customers and suppliers, either actual or potential. To negotiate a trade deal is a slow, cumbersome bureaucratic process.

Partial reforms help to ease some of these problems by providing direct trading rights to selected East European producers and by allowing more operational flexibility. But coordination problems under such "halfway house" solutions tend to intensify, and capricious intervention by central authorities continues. Western traders still face the visible hand of the planner rather than the invisible hand of a competitive market.

Does the same situation prevail under the New Economic Mechanism?

Under the new system, FTEs are agents of the producing enterprises.² Rather than serving as an unscalable wall between foreign and domestic firms, FTEs act as connecting links between domestic and foreign markets.

Producing enterprises are now encouraged to enter into contracts of their own choosing not only with domestic FTEs but also with western firms. In 1969 alone, 42 cooperative agreements were signed in Hungary. Similar East-West cooperative undertakings are appearing with increasing frequency in the other East European countries.

3. From arbitrary prices to workable markets

The third issue, also a common source of complaint by opponents of trade liberalization, is that eastern traders tend to be capricious and occasionally disrupt world markets by their pricing policies. To be sure, it is generally recognized that price undercutting by eastern exporters is to some extent due to western discrimination.³ (Furthermore, price discrimination in some cases is

¹ Specific plan targets in certain sectors have been retained in the form of quarterly and annual plans for fear of domestic bottlenecks and to safeguard long-term bilateral contracts.

² In 1968, for example, less than 10 percent of the volume of Hungary's trade was conducted by FTEs trading for their own account.

³ We may distinguish two main sources. First, as Alec Nove stresses, when the markets of important western countries become inaccessible, the pressure becomes strong to make price concessions on the remaining markets. Second, a point emphasized by Franklyn Holzman, East European exporters may have to absorb discriminatory tariffs and other costs which the importer would have to pay.

more apparent than real. Goods of inferior quality may be sold at lower prices, and these quality discounts may appear to be the result of price discrimination. Also, prices on CEMA markets are higher than world market prices for similar products; therefore, when prices of individual commodities sold on CEMA markets are compared with those sold to the West, an apparent "discrimination" emerges.)

There are, however, western concerns that are more justified. Domestic and foreign trade prices cannot be meaningfully compared in centrally planned economies because of the irrationality of domestic prices, the arbitrariness of foreign exchange rates, and the inconvertibility of currencies. Consequently, the "dumping" of East-European goods on western markets, in the sense of selling below the domestic price, has remained an unresolved question. The main reason, however, why a centrally planned economy might engage in price discrimination is that East European trading enterprises, trying to fulfill their foreign exchange quotas, are motivated to undercut western competitors regardless of cost. (We may realistically assume that demand on world markets is elastic.) This tendency of the FTEs is reinforced by strong pressures from central authorities to secure urgently needed foreign exchange.

Partial reforms have attempted to deal with some of these problems by reducing the arbitrariness of domestic prices, by calculating more realistic "shadow" exchange rates, and by supplementing central directives with profitability norms. The operational significance of these reforms, however, remains rather limited.⁴

These issues of eastern export pricing have contributed to U.S. reluctance to grant most-favored-nation (MFN) treatment to East European countries. One argument is that we should not serve as a dumping ground.⁵ Another is that East European countries cannot meaningfully reciprocate tariff concessions. Even though tariff schedules nominally conforming to similar schedules in the West have been introduced in some East European countries under partial reforms, it has been argued, with justification, that tariffs do not influence either domestic prices or trade flows in a centrally planned economy.

Have any of these complaints been affected by the New Economic Mechanism?

Under the new system, the incentives are no longer linked to the fulfillment of the foreign exchange quota but to the maximization of profits. This eliminates the pressures on enterprises to undercut western competitors so as to take care of the foreign exchange requirements of the state. The new market mechanism also requires meaningful prices. Price and foreign exchange reforms were, in fact, simultaneously introduced in Hungary on January 1, 1968; their stated purpose was to assess domestic costs realistically and to link domestic and foreign markets meaningfully.⁶

The relevance of these reform measures for East-West trade is that enterprises with reliable cost information and a motive to maximize profits are likely to have a lower propensity to dump. As for West-East trade, tariffs in Hungary now play a meaningful role in domestic price formation, since an increasing number of prices are flexible. A new, three-column tariff schedule, put into effect in 1968, was designed to support Hungary's application for GATT membership. To be sure, large import taxes and export subsidies were also introduced under the New Economic Mechanism, but the main purpose of these fiscal measures was to raise the effective exchange rate, which had been set below the equilibrium level. We may note that John Maynard Keynes after World War I had argued in favor of a similar tariff-cumsubsidy scheme to correct for Britain's overvalued exchange rate in the 1920s. The question of import duties plus tariff subsidies has been also vigorously discussed more recently in the western literature.⁷

⁴ For a discussion, see A. A. Brown and P. Marer, "Foreign Trade in the East European Reform," paper presented at the Research Conference on Economic Reform in Eastern Europe, The University of Michigan (November 1970).

⁵ We may note, however, that lack of discriminatory import restrictions in Canada has not resulted in a great surge of East European exports.

⁶ To be sure, there is still a substantial gap between reform aspirations and achievements. We feel, however, that it is important not to bury the main issues under a mountain of qualifications.

⁷ See, for example, Gottfried Haberler, "Import Taxes and Export Subsidies as a Substitute for the Realignment of Exchange Rates," *Kyklos*, XX, fasc. 1 (1967), pp. 17-23; also by G. Haberler, "Taxes on Imports and Subsidies on Exports as a Tool of Adjustment," in R. A. Mundell and A. K. Swoboda, *Monetary Problems of the International Economy*, pp. 173-179; or Roy Blough, "The Adjustment Process and the International Role of the Dollar," *Journal of Finance*, XXIV (May 1969).

B. Summary and conclusion

In sum, economic reforms in Eastern Europe may invalidate the following three arguments against liberalizing trade: First, that detailed commands and arbitrary intervention by central authorities put the western trader at a disadvantage. Second, that because the western trader is administratively isolated from his customers and supplies, his opportunities remains limited. Third, that in the absence of a workable market mechanism, East European trade practices are (or appear to be) discriminatory. We have attempted to demonstrate above that under a genuine New Economic Mechanism these complaints lose their substance. We have stressed that comprehensive reforms embodied in a New Economic Mechanism should be distinguished from the various partial reforms, or intentions, often called "new economic mechanism."

The policy implication of these conclusions is that a very sensible compromise may be reached between those who oppose and those who support free, non-discriminatory trade with East European countries. Let the United States practice selective relaxation of trade restrictions, selective both as to countries and as to areas and instruments. As far as countries are concerned, we can register our agreement with the following statement in a recent book edited by Paul Samuelson: "Perhaps the removal of restrictions should apply first to countries which liberalize their trading procedures. This could be seen not as a politically motivated reward for straying from Moscow's fold, but rather as a recognition that the new institutional arrangements are a better 'fit' with what is regarded as normal in the West."⁸

As far as the lifting of certain kinds of trade and credit restrictions is concerned, some suggestion of how the United States' interest may be promoted are made in Part II, below.

II. THE BROAD CONCEPT OF TRADE REORIENTATION

In this second part of our presentation—the more "practical" issues of East-West trade—our focus is on the "trade reorientation dilemma" that faces all East European countries as the main issue in their trade policy during the 1970s. The trade reorientation dilemma arises from the recognition by the system's directors that, in spite of gains achieved through CEMA cooperation, the opportunity costs of being tied too closely to CEMA markets and trading arrangements are becoming very large indeed. Implications for U.S. policy will be discussed briefly.

In the eastern trading area's sheltered market, many outdated producer goods and inferior consumer goods are exchanged. Whatever advantage a sheltered market may provide during the take-off period of industrialization, it eventually becomes a liability. Absence of competition, lack of entrepreneurial initiative, parallel industrial structures, and slow technical progress—all interact to create "dependency traps." The trade reorientation dilemma poses the question of how to get out of these traps.

Trade reorientation also encompasses receptivity to new trading, producing, and marketing arrangements with the West. It involves seeking out new types of goods and services that can be gainfully exported or imported. These new aspects of trade reorientation are likely to be no less dramatic in their consequences than an immediate and large change in market shares.

In the discussion that follows, we describe trade reorientation in noncommodity trade (invisibles) that is already taking place in Eastern Europe. Then, we discuss trends and projections in commodity trade.

A. Noncommodity trade

1. Trade in entrepreneurial and managerial know-how

Trade in invisibles is still a largely ignored area of our East-West trade policy. We in the West have misinterpreted to some extent these countries' interest in "advanced technology" by emphasizing only their desire to buy prototype machines, patents, licenses, and copyrights. In reality, reform-minded East European countries seem at least as much interested in importing entrepreneurship and managerial know-how. They want management skills as well as entre-

⁸ Alec Nove, "East-West Trade," in P. A. Samuelson, *International Economic Relations* (London: Macmillan, 1969), p. 117.

preneurial attitudes—assets that can be acquired only after years of learning and doing, and, generally, only in an open society.⁹

The lack of entrepreneurial and managerial talent in East European foreign trade is probably this region's greatest comparative disadvantage; the centralized economic system does not nurture these qualities. The crucial lack of entrepreneurship in international trade was noted several years ago by the doyen of western trade theorists, Professor Gottfried Haberler, who used this issue as the theme of a paper on centrally planned foreign trade: "There is no room in centralized socialist economies for the innovating entrepreneur, and entrepreneurial activity is vitally important for international trade—in fact, perhaps, more than for internal growth and development."¹⁰ Having noted the absence of independent entrepreneurs, Professor Haberler anticipated that East European countries would be "more receptive to proposals of reform of their trading system. . . . The exigencies of foreign trade may yet become the wedge for far-reaching changes in the economic regime."¹¹

Indeed, economic reforms in Eastern Europe in general, and recent official statements in particular, confirm Professor Haberler's prophesy. Nearly all of the smaller East European countries have become increasingly receptive to the idea of East-West multinational corporations. A recent Hungarian policy statement enthusiastically endorsed "joint ventures with capitalist enterprises" and called these "a new category of trade."¹²

The multinational corporation is a form of international cooperation already crucially important in the West. In East-West trade, however, it is a new and revolutionary idea. What is particularly important from our point of view—as the policy statement referred to above stresses—is that the multinational corporation not only serves as a vehicle for the sale of goods, services, and licenses, but also permits the western partner "to export his experience with *scientific management* as well as his *marketing know-how*." The statement concludes: "We should more and more link foreign and Hungarian markets."¹³

Surely, we are sophisticated enough to recognize the portent of this statement for coexistence and the opportunities it presents for furthering American interests. United States firms and their subsidiaries have been trying to compete in this area with West European firms, but, unlike other western firms, without much governmental support.

International tourist trade.—Tourist receipts represent a very substantial source of foreign exchange in West Europe. OECD countries derived from tourism \$11 billion in 1967 (excluding international transport), more than their export receipts from the sale of motor vehicles or chemicals. Tourism has been growing much faster than national income, and also faster than commodity exports. Between 1956 and 1965, the income elasticity of international tourism was 2½ to 3 in West European countries; that is, for each 1 percent rise in national income, tourism increased by 2½ to 3 percent.¹⁴ Total world export of goods increased during the 1960s at an annual rate of less than 9 percent, tourism at more than 12 percent; OECD tourist receipts grew even faster, at 13 percent per annum.¹⁵

Information on tourism in East Europe, as on other invisible balance-of-payments items, is scarce. On the basis of recently released Hungarian data, we can make certain tentative comparisons of tourism in Yugoslavia and in some western countries.

In Yugoslavia, tourism is a rapidly growing industry; its growth rate is greater than in any OECD country. Between 1950 and 1959, the number of foreign tourists in Yugoslavia increased more than twentyfold, in Greece about tenfold, and in Austria, Spain, and Portugal more than threefold. In the 1960s, tourist trade in Yugoslavia continued to grow faster than in OECD member countries, and the number of tourist arrivals increased from about 1 million in 1960 to nearly 3.7 million in 1967. As for CEMA countries in East Europe, tourism is a more recent but no less dynamic phenomenon. For example, the number of foreign tourists has surpassed the 3 million mark both in Czechoslovakia (in 1964) and in Hungary (in 1969). This represented a twelvefold increase in Hungary in less than a decade, from a quarter of a million in 1960 to over 3 million in

⁹ We have commented elsewhere on the extreme risk-aversion in a centrally planned economy. (See in A. A. Brown and E. Neuberger, *International Trade and Central Planning* Berkeley: University of California Press, 1968), e.g., p. 62, n. 12.)

¹⁰ Gottfried Haberler, "Theoretical Reflections on the Trade of Socialist Economies, *Trade and Planning*, p. 39.

¹¹ *Ibid.*, p. 43.

¹² *Külkereskedelem* (Budapest), September 1970, p. 259. Emphasis in original.

¹³ *Ibid.* Our emphasis.

¹⁴ *Tourism in OECD Member Countries* (Paris: OECD, 1967), p. 20.

¹⁵ *Ibid.* (1968), p. 23.

1969—an impressive number in a country whose total population is only slightly over 10 million.

Before we move from the number of tourists to an examination of tourist revenues, we ought to consider the composition of tourists by nationalities. This shows an important contrast between Yugoslavia and Hungary. Though the total number of tourists has been increasing dramatically in both countries, most of the foreign tourists in Yugoslavia have come from the West, but in Hungary only a small proportion. Tourists coming from any given geopolitical area have spent about the same amount in both countries, but since western tourists spend about four times as much as eastern tourists, Yugoslavia was able to earn three times as much foreign exchange as Hungary (\$150 million vs. \$50 million) from about 20 percent more tourists.

Compared with tourist earnings of OECD member countries, both Yugoslavian and Hungarian earnings are still very low. In 1966, average revenue per tourist was more than \$200 in Spain, \$130 in Greece, \$120 in Italy, and \$90 in Austria. In Yugoslavia and Hungary, however, average tourist earnings were only \$40 and \$17, respectively. It would seem, as a reasonable hypothesis, that tourists are attracted by lower prices, and, since prices of services are positively correlated with per-capita income in any given country, tourists tend to go to countries where the level of income is relatively low. If, in addition, the price elasticity of tourist expenditures is high, tourist expenditures will be greater in poorer countries. Indeed, there is a very high inverse correlation between per-capita income in the host country and per-capita receipts from foreign tourists. According to this criterion, per-capita tourist receipts should increase 3 to 4 times in Yugoslavia, and 6 to 8 times in Hungary.

The untapped potential of East European tourism appears to be even greater if tourist earnings are compared with commodity export receipts. For example, both Austria and Greece derived more than one-third as much foreign exchange from tourism as from the sale of all commodity exports, and Spain actually earned more from tourist trade than from all exported goods. In Yugoslavia, the corresponding ratio was only about 7 percent, and in Hungary less than 3 percent. We should add, however, that the relative importance of tourist trade has been growing very rapidly in both of these countries. In Hungary, for example, tourist receipts as a proportion of commodity export revenue increased from 0.6 percent in 1960 to 2.7 percent in 1969 (or to 3.5 percent in terms of western tourism and trade).

Barring unforeseen political developments, the relative importance of tourism is likely to rise very rapidly in Hungary during the 1970s. According to our projections, if the international climate remains favorable, Hungary's foreign exchange revenue from tourism may reach \$1 billion by 1980. Even with this phenomenal increase, the relative proportion of tourism to commodity trade would remain much behind that of such western countries as Spain, Greece, or Austria.

This development of tourist trade requires extensive western assistance. The West has been giving increasing aid to Yugoslavia to promote international tourism within the overall development plan of the country. For example, the Adriatic Coast Road and the Central Highway have been financed by the I.B.R.D.¹⁰ In Yugoslavia, every major tourist policy is carefully planned in consultation with western countries; this includes the collection and exchange of detailed statistics, as well as technical assistance on a bilateral and multilateral basis.

The desirability of further tourist development has been actively discussed in Hungarian periodicals. There is also some direct evidence that other East European countries favor western cooperation to promote long-term tourist development. Some large-scale joint East-West undertakings, specifically the construction and operation of luxury hotels in Budapest and Bucharest, speak louder than policy declarations. It is noteworthy that U.S. firms have been primarily involved in these cooperative undertakings, in contrast with the growing number of cooperative ventures in manufacturing, where the field is dominated by West European enterprises.

This seems to be an area where U.S. governmental support could provide many advantages without encountering the usual objections to East-West trade. Tourist-related projects require both short- and long-term credits. Some of these could be arranged through international lending agencies, where U.S. governmental support may play a crucial role. But, beyond this, there should be little

¹⁰ For a discussion of the role of foreign participation in tourism development in Yugoslavia, with a comparison in other countries, see, for example, *Tourism Development and Economic Growth* (Paris: OECD, 1967).

hesitation to provide loan guarantees through the Export-Import Bank. The old arguments against trade in strategic goods have little relevance to tourist trade. There is no reason to believe, for example, that our support in developing tourist facilities would liberate funds directly for military establishments. Does any East European country, or any country in the West for that matter, ever consider the opportunity cost between military and tourist facilities? To be sure, tourist facilities will provide additional hard currency to reform-minded East European countries, which will, of course, help them increase their imports from the West. But, far more than commodity exports and imports, tourism implies direct contact among individuals on a massive scale. The mutual benefits clearly extend beyond economic considerations.

B. Commodity trade: Trends and projections

1. Trade potential: Exports and imports

The data supplied by tables and charts in the Appendix show a remarkable long-term rise of East-West commodity trade, as well as an increase in the relative importance of western trade in the total trade of some East European countries. In 1968, this region's total exports (without adjustment for price-level differences on eastern and western markets) were about \$25 billion, total imports about \$24 billion. Of these totals, one-third (about \$8 billion) represents trade with developed and developing western countries. Here we focus on the trade flows between East Europe and West Europe, which represent approximately 60 percent of this region's trade with the West. A breakdown of individual East European countries' trade with Western Europe for the years 1952-1969 appears in Appendix Table A. These figures are also depicted in a set of charts in the Appendix, each chart showing the rate of growth of total exports or imports for each country for the entire period as well as for four subperiods. The charts present graphically the diversity of trade performance of different countries in this region.

Table 1 summarizes the Appendix material. It compares growth rates of exports and imports of individual East European countries trading with West Europe. We are interested in these figures because they show the ability of the individual countries to pay for western imports. Until the mid-1960s, the expansion of imports seemed to have been highly correlated with the growth of exports to the West. Over the entire period, the diversity among these countries is illustrated by the fact that both exports and imports have been expanding in Bulgaria and Rumania more than twice as fast as in East Germany, Czechoslovakia, and Poland. The average annual rate of growth of CEMA trade with West Europe for the period as a whole was 10 to 11 percent per annum.

TABLE 1.—RATES OF GROWTH OF CEMA COUNTRIES' TRADE WITH WESTERN EUROPE, 1952-69 AND SUBPERIODS
(Percent per annum)

Country	1952-68	1952-55	1955-60	1960-65	1965-68	1968-69
Exports:						
Bulgaria.....	17.6	9.3	21.6	17.9	7.8	-3.2
Rumania.....	15.7	50.4	5.5	13.4	14.5	8.5
Hungary.....	13.0	20.1	7.9	14.8	7.0	29.8
U.S.S.R.....	11.2	12.1	13.2	7.8	6.7	6.8
East Germany.....	8.0	15.2	4.4	9.8	6.7	10.8
Czechoslovakia.....	7.7	6.6	4.6	7.6	6.9	21.2
Poland.....	7.5	-8	6.4	8.8	4.2	9.5
CEMA.....	10.3	10.4	9.2	9.4	7.0	10.8
Imports:						
Bulgaria.....	22.7	19.7	33.8	22.8	-9.0	-11.1
Rumania.....	18.8	15.7	15.9	15.7	28.3	.6
Hungary.....	9.9	9.9	4.8	9.4	9.8	17.9
U.S.S.R.....	11.2	17.4	13.1	2.4	20.8	16.5
East Germany.....	8.3	21.7	4.9	7.6	-1.4	32.3
Czechoslovakia.....	8.5	8.6	13.2	4.3	8.2	13.9
Poland.....	7.8	.3	6.5	7.5	14.4	12.5
CEMA.....	10.7	7.9	11.1	7.3	16.2	14.3

¹ Average annual rates of growth are calculated by fitting exponential curves to the data, using the method of least squares.

Sources: 1952-69, IDRC, Foreign Trade Data Bank; 1968-69, Rudolph Nötel, "Future Development of East-West Trade," unpublished manuscript (based on United Nations and official national statistics).

Looking at subperiods, we find that the rate of growth of exports has declined; this is not true for imports. The sudden increase of imports during the second half of the 1960s for some countries was made possible by large western credits. In spite of credits, however, we see a dramatic decline of imports in Bulgaria and Rumania after 1968.

2. Paradox of export composition

For a better understanding of these trends, we must look at the composition of trade by commodity. The bulk of CEMA imports from West Europe consists of manufactures, 85 percent in 1968, up from about 70 percent in 1952. On the export side, manufactures traditionally represent a much smaller proportion. However, the share of manufactures in CEMA exports to West Europe increased from about 20 percent in 1952 to 36 percent by 1968.

Table 2 shows the rates of growth of East European countries' exports of manufactures and primary products to Western Europe. We find some striking paradoxes. On the average, in the period 1952-1968, Rumania was able to increase its exports of semimanufactured and manufactured goods (SITC sections 5-8) by 43 percent per annum (1), while primary-product exports (SITC 0-4) went up by 14 percent. In the early period, one may argue, the rapid rate of growth of manufactures was due to a low starting point. But, in fact, we find that in every subperiod the rate of growth of manufactures exports was two to five times as rapid as that of primary products.

TABLE 2.—RATES OF GROWTH OF CEMA COUNTRIES' EXPORTS TO WESTERN EUROPE BY COMMODITY CATEGORIES, 1952-68 AND SUBPERIODS¹

Country	[Percent per annum]				
	1952-68	1952-55	1955-60	1960-65	1965-68
Semimanufactured and manufactured products:²					
Rumania.....	43.2	285.8	27.5	21.8	42.1
Bulgaria.....	23.4	62.0	11.5	43.2	9.2
Poland.....	19.3	59.1	22.3	13.1	11.0
Hungary.....	14.9	17.6	11.1	22.8	8.8
U.S.S.R.....	14.9	64.1	6.7	16.0	8.6
Czechoslovakia.....	9.1	26.1	4.0	8.1	6.9
East Germany.....	7.4	19.5	3.6	10.5	4.2
CEMA.....	12.4	33.9	7.3	13.9	9.3
Primary products:³					
Rumania.....	14.1	48.7	4.3	12.7	8.8
Bulgaria.....	17.1	2.4	27.0	14.0	6.3
Poland.....	5.9	-4.8	4.2	8.3	2.1
Hungary.....	13.7	24.5	10.0	13.4	5.5
U.S.S.R.....	10.5	4.4	15.4	6.0	6.1
Czechoslovakia.....	7.9	-11.7	10.5	10.0	5.7
East Germany.....	12.1	-10.5	16.1	14.3	14.7
CEMA.....	9.8	2.9	11.3	8.2	5.8

¹ Average annual rates of growth are calculated by fitting exponential curves to the data, using the method of least squares.

² SITC secs. 5-8.

³ SITC secs. 0-4.

Source: IDRC, Foreign Trade Data Bank.

No less paradoxical are the East German figures. Primary exports, rather than manufacturers exports, were increasing much faster in every subperiod after 1955. Thus from 1960 to 1968, East German exports of primary products to West Europe increased by 163 percent, manufacturers exports by only 79 percent. In Rumania, primary exports during the same period increased by 132 percent, while manufacturers exports jumped by 643 percent. (Between 1960 and 1968, East German manufactures exports increased from \$122 to \$219 million, whereas in Rumania the increase during the same period was from \$14 to \$104 million.)

3. Trade reorientation of commodity flows

Hungary presents a particularly interesting case. Can we discern any effect of the New Economic Mechanism on Hungary's commodity trade with the West? Although the period is too short for a final evaluation, the record shows that Hungary has achieved impressive gains since the introduction of the New Economic Mechanism. In 1969, for the first time in a decade, the country realized a trade surplus with the West. This surplus was not due to a decline in imports (which increased close to 10 percent from all western countries and by 18 per-

cent from Western Europe), but to a phenomenal increase in exports (by more than 32 percent to the West and by 30 percent to Western Europe). This happened in a single year.

This rapid trade expansion is still continuing. During the first half of 1970, exports to the West increased at an annual rate of 33 percent, and imports by 58 percent. Most striking is the rate of growth of consumer-goods imports from western countries, which increased in 1969 by 40 percent. During the first half of 1970, the annual rate of increase was 150 percent. (This increase in consumer goods alone represents over \$40 million on an annual basis.)

As for Hungary's total trade with socialist countries, it also increased, but at a slower rate.

It appears that the economic pressure to redirect trade has been released, at least in the short run, by Hungary's New Economic Mechanism. In all other East European countries, as discussed above, there are also strong pressures to reorient trade in order to reduce the cost of dependence on eastern markets. How dependent were these countries on the sheltered eastern markets in the late 1960s? At one extreme we find Rumania with not much more than half of its trade with the East; at the other extreme are Bulgaria and East Germany, each conducting more than three-fourths of its trade with the eastern trading area (see Appendix Table B).

It should be noted, however, that because the substantial price level differences between western and eastern markets are not taken into account, these official statistics are misleading. If appropriate adjustments are made, the share of East European countries' trade with the eastern trading area is substantially reduced, and that of the West correspondingly increased. For example, Hungary's trade proportion with the West, according to official statistics, has been around 30 percent in recent years; according to more realistic "Adjusted Dollar Prices" (ADPs), this proportion is much closer to 40 percent.¹⁷

Even so, we can use official statistics to estimate the success of trade reorientation in different countries, provided that the rate of distortion remains approximately the same over time. On the basis of these statistics, we find that only the less-developed countries (i.e., net exporters of primary products) have succeeded in reorienting their trade during the 1960s. Trade has been redirected to the West, not only by Rumania, but also by the U.S.S.R., Bulgaria, and (earlier) Poland. No such shift can be observed in Czechoslovakia or East Germany—or, for that matter, in Hungary, until its New Economic Mechanism.

C. Summary and conclusions

All East European countries have been more and more concerned with the rising opportunity cost of maintaining a large proportion of their trade in the protected markets of the eastern trading area. As these countries become cost-, profit-, and productivity-conscious, gains from trade are aggressively sought. Gains from CEMA trade are held below their full potential, despite the large volume and share of this trade in each members' total trade, owing to rigid trading and financial arrangements and lack of entrepreneurial initiative. Therefore, what may be called a "trade reorientation dilemma" is emerging as a major policy issue in Eastern Europe during the 1970s.¹⁸

Trade reorientation is a broad concept, it encompasses commodity as well as noncommodity trade. It includes, as a high-priority objective in some East European countries, the importation of western managerial know-how, entrepreneurial skill, and marketing expertise through joint enterprises or other cooperative arrangements. At the same time, tourism is becoming a major source of foreign exchange. It seems that East Europe is following in the footsteps of West Europe where postwar development was promoted by tourism and, more recently, by multinational corporations. It appears to be very much in the interest of the United States to participate in, and to further, these developments in Eastern Europe.

Turning to commodity trade, we note that the rapidly growing imports of East European countries from West Europe were closely matched until the mid-1960s by exports. More recently, credits have become important. In the absence of large, long-term credits, East Europe's ability to import from the West will remain closely linked with the region's export potential, unless foreign exchange earnings from invisibles continue to increase rapidly.

¹⁷ Paul Marer, "An Empirical Estimate of Foreign Trade Price Levels and Ratios of CEMA Countries," IDRC Working Paper (Bloomington: Indiana University, 1970).

¹⁸ See the discussion of the "Trade Reorientation Dilemma" in "Towards a Theory of Centrally Planned Foreign Trade," *Trade and Planning*, esp., pp. 81-84, also pp. 87-88.

As shown by the statistics presented, the less-developed countries in CEMA have been able to push their exports to the West faster than other CEMA members because the former possessed more easily marketable products. They, and they alone, were able to redirect their trade from East to West without instituting comprehensive reforms. In so doing, they have increased the pressure on their more developed trade partners to undertake economic reforms.

Since the incentives to buy western goods and services are expected to continue in all countries during the 1970s, East European attempts to reorient trade to the West will also continue. But there is a limit to how long the reorientation of commodity trade can proceed, even by the relatively less-developed East European countries, without basic reforms in the economic system. Economic logic suggests, therefore, that comprehensive reforms, so far isolated, should eventually become more widespread.

We have come to two conclusions that together suggest a feedback mechanism between reforms and trade in East Europe. Here, in Part II, we have reached the conclusion that the East European need to trade tends to beget reforms. Earlier, in Part I, we concluded that reforms would beget trade. Both of these conclusions urge a more flexible U.S. trade policy, a selective relaxation of our trade restrictions. It would be folly, indeed, to ignore this feedback mechanism (what might be called a beneficent circle) and to continue thwarting our own commercial interests.

APPENDIX TABLE A.—CEMA COUNTRIES' EXPORTS AND IMPORTS WITH WESTERN EUROPE,¹ 1952-69[In millions of U.S. dollars]²

Year	CEMA		U.S.S.R.		Bulgaria		Czechoslovakia	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
1952	988.0	746.4	383.2	249.2	15.4	11.6	155.5	109.5
1953	912.3	831.8	332.6	306.7	24.9	23.7	141.4	82.8
1954	1,027.6	946.0	413.2	386.3	26.4	18.0	140.1	110.5
1955	1,319.2	1,059.7	521.4	379.1	20.3	20.7	192.7	128.1
1956	1,519.5	1,244.0	595.8	491.8	29.8	29.1	234.2	166.5
1957	1,656.0	1,418.4	769.5	570.4	33.4	39.0	247.8	212.2
1958	1,621.5	1,373.3	707.0	526.0	40.7	37.4	219.7	208.3
1959	1,871.9	1,580.6	880.1	600.0	43.3	99.9	241.7	217.2
1960	2,166.2	1,925.8	1,000.2	807.6	61.3	76.6	265.8	260.4
1961	2,332.0	2,092.2	1,067.7	839.9	73.6	72.2	293.3	313.5
1962	2,491.2	2,339.9	1,138.7	1,028.5	85.2	81.0	297.7	299.0
1963	2,792.9	2,315.6	1,260.6	920.8	104.1	100.9	319.8	261.6
1964	2,974.3	2,490.5	1,277.6	890.2	105.1	146.6	352.1	293.5
1965	3,424.0	2,856.2	1,488.9	944.6	159.9	201.2	393.3	373.6
1966	3,789.5	3,223.7	1,639.0	923.6	180.3	321.9	417.4	476.2
1967	4,032.4	3,824.8	1,758.0	1,281.0	180.0	302.1	436.9	424.0
1968	4,203.4	4,450.6	1,802.5	1,591.0	193.6	273.7	484.3	504.7
1969	4,657.4	5,087.0	1,925.1	1,853.5	187.4	243.3	587.0	574.9

Year	East Germany ³		Hungary		Poland		Rumania	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
1952	89.2	77.8	61.3	66.6	257.2	171.9	26.2	44.9
1953	84.3	92.7	45.5	67.8	234.9	153.6	48.7	55.8
1954	113.0	141.4	63.4	94.0	200.8	164.8	70.7	44.1
1955	129.8	128.3	101.0	151.2	263.8	197.6	90.2	52.5
1956	136.7	130.5	116.0	113.5	319.4	255.4	87.6	51.8
1957	137.3	135.9	92.4	122.2	292.2	269.0	83.4	66.9
1958	138.5	138.7	110.4	109.6	314.1	288.6	91.1	65.7
1959	148.4	137.7	133.3	145.3	344.9	279.0	80.2	65.9
1960	166.5	173.3	152.7	184.4	383.4	286.4	136.3	127.9
1961	168.3	182.5	149.4	186.0	401.2	320.7	178.5	192.7
1962	166.0	167.2	175.2	197.6	443.7	338.0	194.7	221.2
1963	181.6	174.6	235.8	250.9	459.4	365.4	231.6	223.5
1964	229.9	192.5	248.6	263.2	525.4	360.8	235.6	-58.6
1965	260.9	277.4	278.0	268.0	585.5	436.2	266.6	297.6
1966	281.6	335.0	327.8	308.2	630.1	525.2	313.2	354.6
1967	300.6	313.8	341.2	355.8	632.5	610.3	382.2	580.9
1968	316.6	270.7	343.2	349.1	671.4	649.0	391.8	578.3
1969	350.8	358.1	445.5	411.6	735.2	730.1	425.1	581.8

¹ Western Europe does not include Yugoslavia.² Exports c.i.f., imports f.o.b. (trade partner statistics have been used).³ Trade between the Federal Republic of Germany and East Germany is excluded.

Sources: 1952-68, IDRC, Foreign Trade Data Bank; 1969, calculated from rates of growth in Rudolph Notel, "Future Development of East-West Trade," manuscript (based on United Nations and official national statistics).

APPENDIX TABLE B.—SHARE OF EAST EUROPEAN COUNTRIES' TRADE WITH WEST AND CEMA, 1950-69

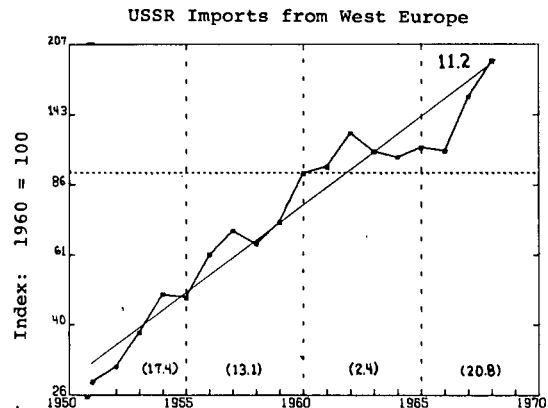
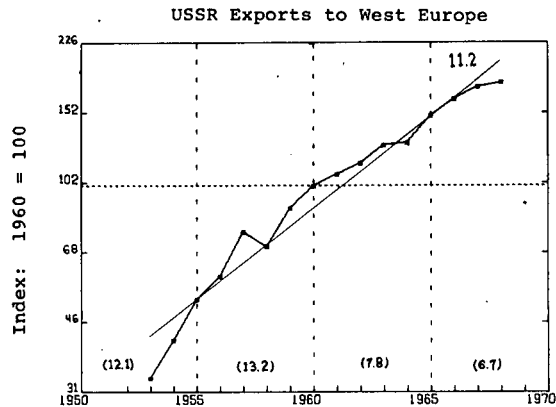
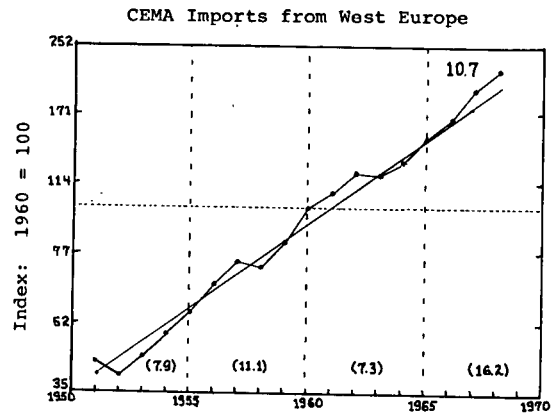
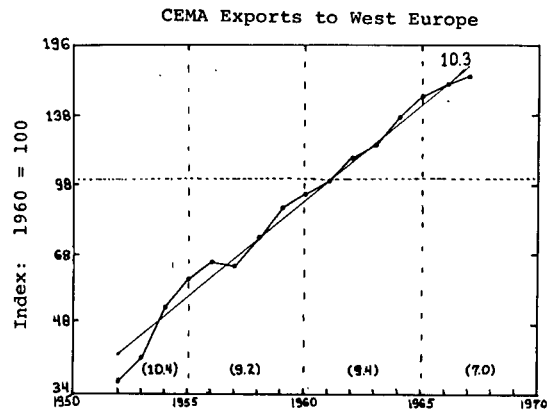
Year	U.S.S.R.		Bulgaria		Czechoslovakia		East Germany		Hungary		Poland		Rumania		Yugoslavia	
	West	CEMA	West	CEMA	West	CEMA	West	CEMA	West	CEMA	West	CEMA	West	CEMA	West	CEMA
1950	19.2	57.1	11.1	88.7	44.4	54.3	27.7	72.3	38.7	60.5	41.0	58.1	16.4	178.1	98.5	0
1951	19.0	57.4	(2)	(2)	(2)	(2)	23.8	76.2	32.7	60.8	42.5	54.3	(2)	(2)	99.4	0
1952	19.1	58.8	(2)	(2)	(2)	(2)	24.9	75.1	27.0	65.8	33.7	62.5	(2)	(2)	99.3	0
1953	16.9	58.8	(2)	(2)	21.5	71.5	22.4	77.6	23.9	68.0	29.9	66.1	(2)	(2)	99.8	0
1954	20.5	54.6	(2)	(2)	25.1	67.4	23.9	76.1	29.0	63.7	29.9	66.1	(2)	(2)	98.0	1.7
1955	20.7	53.0	10.5	86.7	29.7	63.5	27.1	72.1	39.1	53.2	36.1	59.1	18.2	181.8	89.2	10.6
1956	24.3	49.2	15.6	81.3	34.2	58.5	26.9	73.1	37.5	53.5	37.4	56.4	(2)	(2)	75.3	22.4
1957	26.4	52.9	15.6	80.9	32.4	59.8	26.7	73.3	29.8	61.1	39.3	54.5	(2)	(2)	74.2	23.4
1958	26.3	51.7	14.2	81.3	29.5	60.7	26.0	74.0	28.4	59.6	41.6	50.2	22.3	71.5	70.1	28.0
1959	24.7	51.3	17.2	78.9	27.8	63.4	24.0	76.0	29.0	61.8	37.7	55.6	20.2	72.4	70.3	27.8
1960	26.8	52.5	16.0	80.2	28.2	63.4	25.4	74.6	29.1	62.3	36.9	56.3	27.0	66.7	70.5	28.8
1961	28.4	54.5	15.8	80.3	30.3	64.2	25.0	75.0	28.9	65.3	37.5	56.7	31.3	64.0	74.2	24.7
1962	29.8	56.0	17.4	78.4	25.8	69.4	21.0	79.0	27.4	68.4	35.5	59.5	32.1	65.0	76.6	22.7
1963	29.6	58.0	17.4	79.3	25.5	68.8	21.5	78.5	30.3	65.4	34.8	60.5	31.1	64.3	74.4	24.7
1964	30.3	58.0	22.3	74.4	26.8	67.7	23.6	76.4	31.1	65.1	36.3	59.1	31.6	64.6	68.5	30.9
1965	31.2	56.8	23.2	72.8	26.8	67.5	26.1	73.9	31.5	64.8	35.3	60.0	35.1	60.3	64.3	34.7
1966	33.6	54.7	27.0	68.2	29.7	63.5	26.9	73.1	33.4	62.5	37.0	57.7	40.4	54.1	65.2	33.6
1967	32.2	55.9	24.0	72.1	28.2	66.2	25.9	74.1	32.4	64.1	35.3	60.7	47.6	47.2	68.4	30.2
1968	32.6	56.5	22.3	73.6	28.5	65.5	23.9	76.1	29.8	66.5	34.9	61.0	44.8	48.8	68.4	30.7
1969	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	32.2	64.0	(2)	(2)	(2)	(2)	(2)

1 Trade with all Eastern countries.

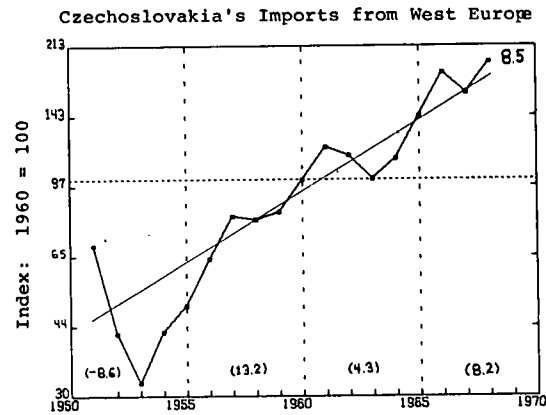
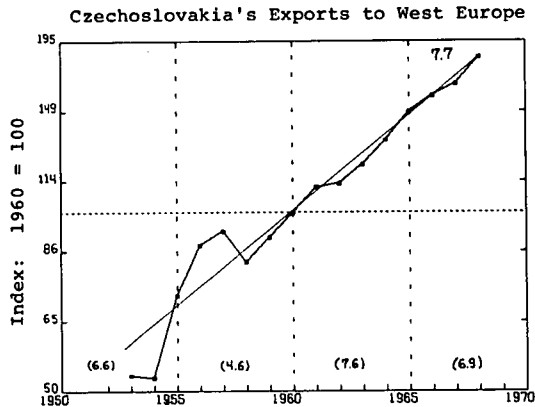
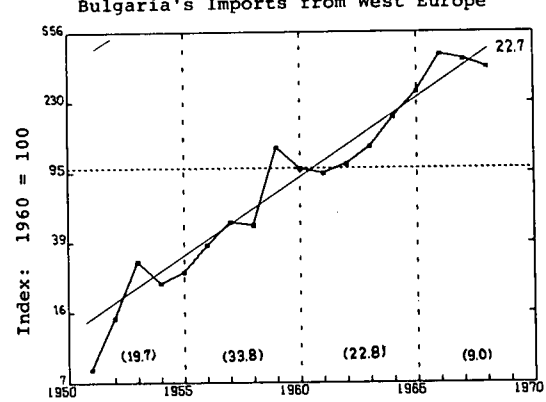
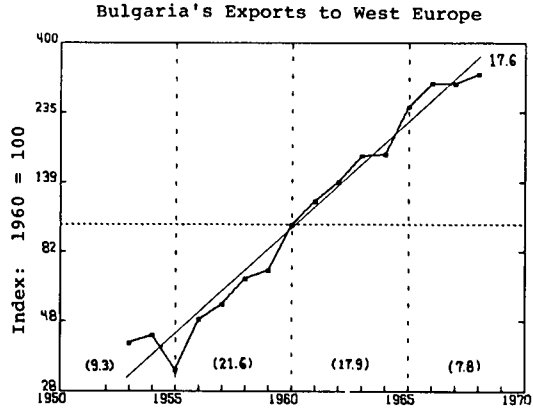
2 Not available.

Note: This table is based on official statistics aggregating trade with East and West regardless of price level differences on the 2 markets (see discussion in the text). For a more detailed discussion see Paul Marer, "An Empirical Estimate of Foreign Trade Price Levels and Ratios of CEMA Countries," IDRC Working Paper (Bloomington, Indiana University, 1970).

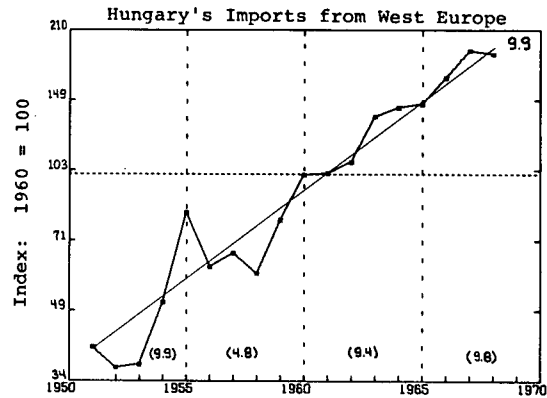
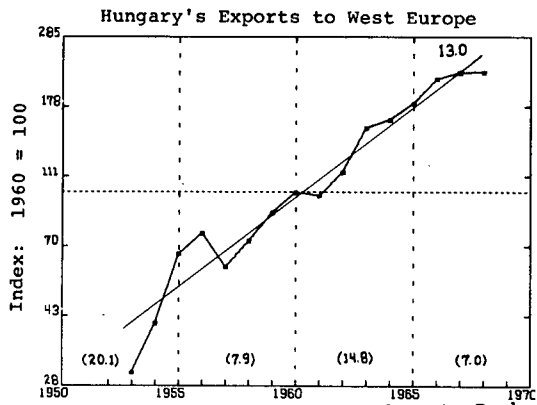
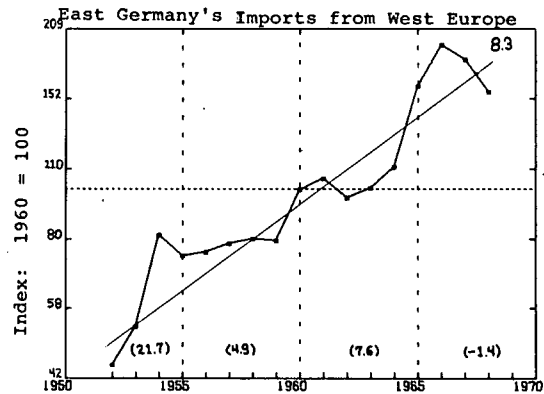
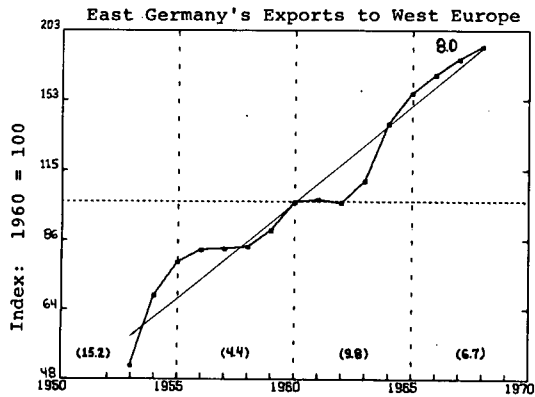
Source: IRDC, Foreign Trade Data Bank.



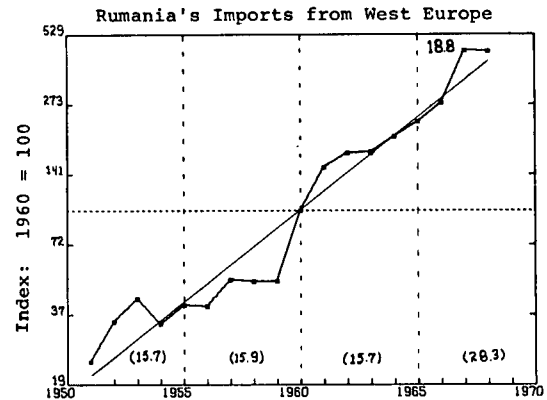
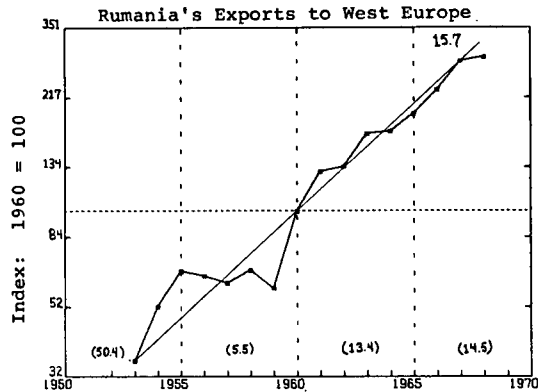
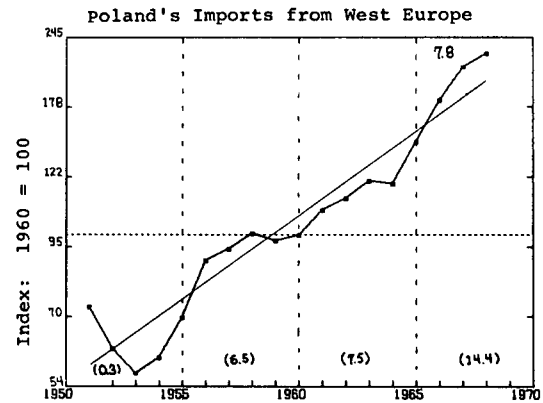
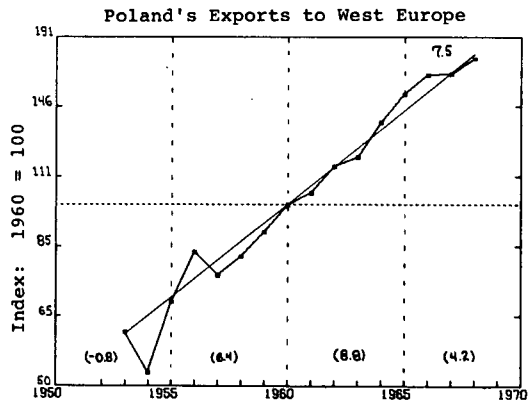
Source: IDRC, Foreign Trade Data Bank, See explanatory note following the charts.



Source: IDRC, Foreign Trade Data Bank



Source: IDRC, Foreign Trade Data Bank



Source: IDRC, Foreign Trade Data Bank

Note: The charts above show index numbers of official data (1960=100, semi-logarithmic scale). Within each chart, the numbers refer to average annual percentage rates of growth for all years and for subperiods. Rates of growth are calculated by fitting exponential curves to all data points, using the method of least squares.

Chairman Boggs. Mr. Eckstein, we will be pleased to hear from you, sir.

STATEMENT OF ALEXANDER ECKSTEIN, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. ECKSTEIN. Thank you, Mr. Chairman. May I express my appreciation for your invitation to participate in these important hearings. I suppose I will represent a marked shift in venue, since I will be jumping from Eastern Europe to China, which is a considerable geographic jump, and although I gather these hearings are primarily dealing with Eastern Europe, my assignment, as I understood it, was to deal with China.

MAINLAND CHINA'S ECONOMIC DEVELOPMENT AND FOREIGN TRADE

With your permission, I would like first to outline a few of the basic facts. As one surveys the last 2 decades of economic development and change in Mainland China, two basic facts stand out: (1) The marked contrast between economic performance and progress in the first as compared to the second decade, and (2) the sharply and almost violently fluctuating pattern of development. The rate and character of progress during the first decade—1949–59—differed so markedly from the second—1959–69—that if one approached the evidence so to speak blindfolded one could not help but wonder whether the economic trends observed relate to the same country. Under the impact of these divergent trends, the Chinese mainland economy was growing at an average annual rate of 7 to 9 percent during the 1950's. The industrial sector was expanding at a substantially faster rate, while agriculture was barely keeping pace with an approximately 2 percent a year rate of population growth.

These markedly divergent growth paths for agriculture and industry contributed to sharp disproportionalities, acute strains and serious supply bottlenecks throughout the economy. With an advancing pace of economic growth amidst agricultural stagnation, it became increasingly clear in the course of the 1950's that sooner or later slow progress in agriculture would also slow down if not arrest the overall advance in the other sectors, including industry.

This was the background against which the regime evolved a new development strategy designed to proceed on the path of industrial advance unabated while greatly accelerating the pace of agricultural progress. The latter was to be achieved by mass mobilization of labor, with such labor to be engaged on irrigation, flood control and reclamation projects. As portions of these projects would be completed, agricultural output would be raised.

This strategy was incorporated into the great leap forward—1958–60—which in a real sense represented the great watershed in Communist China's economic development up to now. It marked the culmination of progress during the first decade and the beginnings of

collapse and stagnation during the second. The failure of the great leap can in considerable part be ascribed to far-reaching planning, management, and technical errors, although a series of unfavorable weather years undoubtedly played their part.

As a result, the Chinese economy went into a deep crisis—1960–62—from which it gradually recovered by 1964 and by 1966 it exceeded previous peak levels of economic activity. However, barely had it embarked on a new path of advance, it received another sharp setback under the impact of the cultural revolution—1966–68. As a result, economic activity may be expected to attain or exceed pre-cultural revolution levels only during the current year—1970.

Due to this fluctuating pattern of economic activity, net growth in the economy was very modest indeed in the second decade, perhaps only a total of 10 to 15 percent between 1959 and 1970. Therefore, for the two decades combined, the average annual rate of growth was around 4 percent and on a per capita basis around 2 percent.

This represents an eminently respectable performance by the historical growth standards of presently developed countries such as the United States, Sweden, or Japan. It is, however, a mediocre performance gauged by the post-World War II standards of the more rapidly growing countries, East or West, developed or underdeveloped. Still, it must be remembered that if China continues to grow even at this relatively modest rate of 4 percent a year, its GNP will multiply 60-fold over a century.

Foreign trade constitutes a relatively small sector of the Chinese mainland economy. Thus, the export or import share of GNP has ranged between 3 and 4 percent and in recent years possibly less than that. Nevertheless, foreign trade has been very important to the Chinese economy. In the 1950's, foreign trade constituted a crucial and most important component of capital formation; the import component of investment was 20 to 40 percent. In the 1960's imports played a most significant role in preventing famine, stabilizing the food supply and thus contributing to political stability.

Thus changes in levels of economic activity and foreign trade were intimately linked. As a result, as the economy expanded in the 1950's, foreign trade grew even more rapidly. While GNP rose by 70 percent between 1952 and 1959, total foreign trade turnover more than doubled. Moreover, China's trade increased more rapidly than total world trade.

As a result, in terms of total exports, China ranked 11th in the world by 1959. However, under the impact of the unfavorable economic developments in the early 1960's, China trade was sharply contracted and as of 1969 had not yet recovered to its former 1959 peak level. Therefore, the country's world trading rank has slipped from about 11th to perhaps 25th.

In terms of direction, too, there was a marked shift between the first and the second debate. Up to 1959 about 70 percent of China's trade was with other Communist countries, approximately 50 percent with the Soviet Union and the other 20 percent with Eastern Europe and the Communist countries in Asia. In marked contrast, this situation has been totally reversed in recent years. Now, only about 20 to 25 percent of China's commerce is carried on with other Communist countries and about 75 to 80 percent is with the non-Communist world.

All of China's 10 leading trading partners in 1969 were non-Communist countries, with the Soviet Union having dropped to 11th place. These include, in their order of importance, Japan, Hong Kong, West Germany, the United Kingdom, Singapore, Australia, Canada, Italy, France, and Ceylon.

With six of these countries China had no diplomatic relations until this year; with Canada and Italy having now recognized the People's Republic, as of now at least four of these countries still have no official relations with Peking. Thus, it is very important to note that absence of formal relations has not been a barrier to extensive commercial exchanges between non-Communist countries and China.

Mainland China's total trade turnover has moved up and down around a \$4 billion level, with a small export surplus for most years. The principal import commodities are iron and steel, wheat, machinery and equipment, chemical fertilizers, non-ferrous metals, rubber, and textile raw material and textile semimanufactures. Leading export items were textiles, clothing, livestock products, fruits and vegetables, rice, soybeans, minerals and miscellaneous light manufactures for consumer use.

THE U.S. TRADE EMBARGO

The United States has not participated in this trade in any way since 1950, with some very minor exceptions such as importation of newspapers, periodicals and books primarily for scholarly use in our universities. With the outbreak of the Korean War, we took the first steps to embargo all exports to and imports from China. This embargo was gradually tightened so that 6 months later; that is, by December 1950, the trade ban was complete.

Since that time sales to China are banned under the export control regulations administered by the Department of Commerce, while an import ban has been enforced through foreign assets controls administered by the Treasury. The latter have until recently reached beyond the boundaries of the United States since all foreign subsidiaries or branches of American firms and all U.S. residents abroad were prohibited from engaging in any commercial or financial transactions with China. These prohibitions also applied to foreign firms with a substantial U.S. interest in them.

Needless to say, the outreach of these foreign asset control regulations beyond our borders has been a continuous source of friction and irritation between ourselves and our allies. As a result, this particular feature of our foreign asset control regulations was rescinded just about a year ago.

No other country followed our lead in imposing a total embargo on trade with the Soviet Union and other Communist countries, including November 1949 administered an international system of controls on trade with the Soviet Union and other Communist countries, including China. These controls, administered through COCOM, have in time been considerably liberalized. Following the outbreak of the Korean war, the U.S. applied a great deal of pressure on its COCOM partners to tighten controls on China trade considerably and to extend their scope beyond the levels applied to other Communist countries. In this way a new committee was formed in Paris in September 1952, the so-called CHINCOM which also included Japan, charged with

the responsibility of administering the so-called China differential.

This, of course, was completely in line with U.S. policy and philosophy, that is, of treating Communist China differently from the Soviet Union. However, following the end of the Korean war, our allies were less and less prepared to abide by this "China differential" so that these particular controls were gradually undermined. Therefore, CHINCOM and the China differential was officially abandoned in May 1957 and China trade was once more placed more or less on the same footing as that with other Communist states and was thus once more administered by COCOM. The United States, of course, continued to maintain its total embargo.

In marked contrast, the People's Republic up to the present time has no corresponding laws or regulations banning trade with the United States or with other "capitalist" countries. It is perfectly true that in operational terms this does not mean very much since in a state-trading system such as prevails in China, the Ministry of Foreign Trade controls all commercial flows through direct administrative means. Nevertheless, it is significant that the Chinese have never erected a formal embargo structure, not even as a retaliatory or symbolic gesture.

This fact acquires added significance if we bear in mind that during the 1950's, at a time when the People's Republic pursued a foreign policy based on the Bandung spirit, the Chinese showed a definite interest in opening trade relations with the United States. They agitated against the embargo and indicated in many different ways that they wanted to do business with American firms.

We tend to forget that there was a time when the Chinese were interested in reciprocal contacts with the United States in a number of fields, most particularly involving journalists and businessmen. They were prepared to enter into these arrangements even without diplomatic recognition and the resolution of the broader issues separating the United States and the People's Republic, such as the problem of Taiwan.

However, at that time we were not interested in this. We were the ones who insisted that the resolution of the basic political issues was an absolute precondition for engaging in any forms of reciprocal exchanges. Now, of course, the tables are turned. In recent years we have assumed China's posture of the 1950's and they have adopted ours.

In recent years, and particularly since the Nixon administration took over, we have expressed a strong interest in normalizing relations with the People's Republic through a series of specific and small steps. This policy is based on the assumption that if unofficial contacts in various forms can be taken then a more favorable atmosphere may be created for the resolution of the more fundamental and more difficult questions. Peking, however, wants to deal now with the latter issues first, before negotiating the small steps and specific exchanges.

We naturally find this posture most irritating and disconcerting. We blame the Chinese for being unreasonable, hostile, irrational, stubborn, and impossible to deal with, forgetting that we must have appeared in this light to the Chinese in the 1950's and perhaps even now, given our erratic and offensive behavior in Vietnam.

APPRAISAL OF THE EMBARGO AND POLICY RECOMMENDATIONS

The U.S. embargo on all trade with China was clearly an act of economic warfare instituted at the time of the Korean war and fully justified as long as we were engaged in combat with the People's Liberation Army. In a war context it was designed to weaken the enemy, to deny him export earnings and most particularly dollar earnings. More importantly, it was to deprive him of access to raw materials, machinery and other products which might continue to his economic strength and through economic strength to his military strength.

As the Korean war has receded into the background the moral, political and economic justification for the embargo has become more and more dubious. Seventeen years after the end of the Korean war it is about time to lift the embargo pure and simple. It is an anachronism, a monument to bureaucratic rigidity and a symbol of a bankrupt China policy we have been pursuing for the last 20 years.

Leaving political considerations aside for a moment, what has been the economic impact of the embargo? At the risk of sounding dogmatic, one could say virtually nil. For all practical purposes, it has been ineffective for some years now.

This was much less the case at the time of the Korean war. In 1950, all of Europe—East and West—was still in the throes of postwar recovery so that undoubtedly there were at least a limited range of goods which the Chinese could obtain only with difficulty outside the United States. However, this became less and less true as the Soviet Union fully recovered, and as the "China differential" was eliminated in 1957 by fully recovered Japan and Western Europe. Thus, at least since 1957, China was able to cover all of her nonstrategic, nonmilitary, import needs through normal commercial channels and without any significant impediments or difficulties.

The U.S. embargo does not seem to deprive China of any market or of any access to nonstrategic items. The only exceptions might be some products with unusually advanced technology components which could not be readily obtained in the Soviet Union or in Western Europe. More likely than not these would be included in the COCOM list anyway, in which case the embargo in and of itself would again have no particular effect.

The only practical effect of the continuing embargo is to deprive our farmers and businessmen of access to the China market. The United States could export to China wheat, chemical fertilizer, farm equipment and other types of machinery. None of these would contribute to China's military prowess. There is no doubt that even under most favorable conditions, total Sino-American trade is bound to be confined to modest levels for some time to come. However, to particular industries and producers it could be of more than negligible importance.

In 1969, the People's Republic imported 4.5 million tons of wheat valued at close to \$300 million, and 6 million tons of chemical fertilizer valued at \$180 million. In fact, one of our major corporations approached our Government authorities some months ago inquiring whether if it sought to export fertilizer to China, would it be granted a license. The response was a flat rejection.

The question may be raised, what could the Chinese sell in our market and how could they pay for our exports? The Chinese might find modest outlets in the American market for their arts and crafts, silks, human hair for wigs, certain minerals, and a miscellany of specialty products. However, there is no need for bilateral trade balancing. The Chinese maintain a large trade deficit with Canada and Australia. These are paid for by foreign exchange earnings accumulated through export surpluses occurring in China's trade with Hong Kong, Southeast Asia, and some other countries as well.

Given these economic realities, the perpetuation of the embargo can be explained only in political terms. Having been committed for years to isolating China, the United States finds it very difficult to overcome the legacy of the past. The Nixon administration is to be commended for committing our Government for the first time since 1950 to normalizing our relations with the People's Republic.

However, the actual steps taken thus far are woefully inadequate. We have lifted the restrictions on American tourist, library, and museum purchases of goods from Communist China. We have also, as noted earlier, removed the outreach of our foreign asset control regulations beyond our boundaries. As a result, an Italian firm was recently able to sell trucks to China powered by GM motors.

Yet the embargo as it now stands still sharply discriminates against China as compared with the Soviet Union. It is a paradoxical fact that while the Soviet Union keeps challenging us in Berlin, in the Middle East, and in a number of other areas, we are permitting non-strategic trade with the Soviets. They are also extending large-scale economic and military aid to North Vietnam. Yet China, which is not challenging us anywhere except verbally and propagandawise, and is extending much more modest aid to Hanoi, is subject to a total embargo.

In the light of these realities it makes no sense to maintain the embargo structure. We should treat China and the Soviet Union the same way. We should proceed on this path regardless whether the Chinese reciprocate or not. As long as we are engaged in Vietnam and moreover keep bombing the north, we can hardly expect reciprocity. However, complete lifting of the embargo, particularly is coupled with a change of our policy in Vietnam, could be a significant political act. It would symbolize and dramatize the fact that the United States is no longer determined to isolate China, to keep it out of the world community, and push it out of the normal channels of international intercourse. This unquestionably would be one of the most important steps we could take here and now in opening the doors toward normalization of relations with the People's Republic.

Thank you, Mr. Chairman.

Chairman Boggs. Thank you very much, Mr. Eckstein.

Now, Mr. Montias, we will be happy to hear from you.

**STATEMENT OF JOHN M. MONTIAS, PROFESSOR OF ECONOMICS,
YALE UNIVERSITY**

MR. MONTIAS. Mr. Chairman, I also welcome the opportunity of coming here to talk about problems of East-West trade. I hope I will be pardoned for concentrating on general economic aspects of this

trade in view of the facts you have heard about the political aspects of this question in the last 2 days.

Hardly any of the trade between the world's nations today follows precisely the patterns that we should expect to find if comparative costs alone dictated the volume or the composition of exchanges. The trade of Western Europe with the Soviet Union and Eastern Europe is undoubtedly greatly inferior to what it would be in the absence of impediments to trade. Its composition is also seriously distorted from this vantage point. But even a casual glance at the statistics of U.S. trade with the Communist countries will reveal that our exchanges are far more abnormal, quantitatively and structurally, than those of our European allies. In the main part of my presentation I shall focus on these apparent abnormalities and suggest some explanations for their occurrence.

If we are to improve on casual observation, we need to devise some sort of a standard by which to gage what should have been a normal pattern of trade. This is not easy if we consider that the trade of the Soviet Union and of Eastern Europe has been wrenched from its traditional multilateral pattern at least since World War II, owing in part to the autarchic policies of the Soviet bloc and in part to Western embargoes and restraints on trade. Already in the 1930's, clearing agreements and other instruments of discrimination in the commercial policy of the East European states had begun to dig out the bilateral channels along which trade was to be conducted in the next 40 years.

We have to go back to the late 1920's, when output and trade had largely recovered from the destruction due to the First World War and to the redrawing of state boundaries in the ensuing political settlement, to get some notion of a pattern of exchanges hampered exclusively by tariffs on imports which, by and large, did not discriminate according to the provenance of the goods exported and hence, while they reduced the volume of trade below its potential level, did not necessarily distort its direction. We then have to guess what the general direction of trade might have been like 40 years later in the absence of bilateral constraints and other discrimination, given the economic development that has taken place in the meantime. This is, of necessity, a highly speculative exercise, and one yielding mainly impressionistic results, but I think it is sufficiently revealing to deserve a summary on this occasion.¹

In the late 1920's, Eastern Europe was involved in a multilateral network of trade and credits. Germany, Austria, and Czechoslovakia were the main suppliers of manufactured goods to the less developed parts of the area. Some of these goods, and particularly machinery products, were sold on credit. A large part was paid for with foreign exchange earned in France, the Low Countries, and the United Kingdom with sales of primary products. The Eastern market was especially important to Germany and Austria, which marketed a little less than

¹The greater part of the statistical calculations underlying this analysis were made by Mr. Mark Allen, a graduate student at Yale University. The data were collected from "Foreign Commerce and Navigation of the United States, 1928," published by the U.S. Department of Commerce, Washington, 1929; "Tableau Générale du Commerce de la France, 1928," published by Imprimerie Nationale, Paris, 1929; "Annual Statement of the Trade of the United Kingdom, 1928," published by H.M.S.O., London, 1929; "Wirtschaft und Statistik, 1929," published by Statistisches Reichsamts, Berlin, 1929; "Organization for Economic Cooperation and Development; Trade by Commodities: Market Summaries," series C, vol. I, January-December 1969; "League of Nations, The Network of World Trade," Geneva, 1942, annex III.

a fifth and a little more than two-fifths of their total exports in the area respectively.

In 1928 the United States, France, and Great Britain all directed 2 to 2.5 percent of their total exports to the U.S.S.R. and to the East European countries that are now members of the Council for Mutual Economic Assistance, excluding East Germany.² We may observe in passing that American exports of machinery products and means of transportation, which made up 35 percent of total U.S. exports to the area, represented 3.5 percent of all this country's exports of such goods. That is significant in view of the unusually small role played by this category of products in our exports in recent years, a point to which we shall presently return.

The U.S.S.R. and Eastern Europe acquired over half of their imports from Western Europe and the United States in 1928. The effect of the depression of the 1930's was to depress the overall volume of exchanges to much lower levels. In general, however, the proportion of East European trade conducted with countries that maintained convertibility such as the United States, Great Britain, and France rose appreciably in the 1930's at the expense of clearing countries. These three Western nations now directed about 4 to 5 percent of their exports to Eastern Europe, approximately doubling the proportion of 1928. These high shares cannot be considered "normal" for the prewar period, since they resulted from the conscious efforts of the governments of East European primary producers to divert trade away from their traditional Central and East European partners, which had imposed currency controls and insisted on clearing agreements, toward Western clients willing to pay in hard currencies. (This motivation for increasing trade with the West, incidentally, is still operative today, as witness the efforts of Rumania and Bulgaria to market an increasing proportion of their primary exports in hard-currency countries in the 1960's to escape from the confining effects of bilateral trade with their CMEA partners.) It was only in the late 1930's—after the Anschluss with Austria—that Germany, using a combination of political and economic pressures, recovered and then surpassed the share of the East European market that it had lost in the depth of the depression.

Since World War II the trade of the Soviet Union and of Eastern Europe has been shaped by the extent and character of the economic development of the area under Communist leadership and by the strong inclination of these governments to trade with each other in preference to trading with the West. In all the countries of the area, irrespective of initial levels of development, similar policies of accelerated industrialization were pursued with a special accent on the metallurgical, heavy engineering, and chemical branches of industry. The Soviet Union supplied the bulk of the metalliferous ores, the oil, the cotton, and the other raw materials that had to be imported by the Eastern European states to feed their rapidly growing industries. While the Soviets exported the equipment for a number of plants and mills which they built throughout Eastern Europe—but especially in the less developed states of the area—their chief role in trade in manufactures was to import a surplus of manufactured goods from Eastern Europe. They thus provided these countries with a most important outlet for the products of their industrialization policies

² In all calculations for 1928 and 1938, Estonia, Latvia, and Lithuania have been included in the Soviet-East European area.

and for a convenient means of financing their raw material purchases on a bilateral basis. (Most of the manufactured products sold to the Soviet Union would have been of insufficient quality to penetrate Western markets in such large quantities, at least at the prices paid for them by the Soviet Ministry of Foreign Trade.) As a consequence of high investment policies and of the dogged determination of the East European regimes to rely on domestic production to supply the basic consumption needs of their populations, imports of consumer goods on the part of these countries fell to very low levels in comparison with 1938 and, still more strikingly, with the late 1920's.

Imports of machinery and equipment in the postwar period conquered the dominant place that had once been occupied by imports of consumer goods in the total imports of most of these states. Czechoslovakia and East Germany played a key role in supplying capital goods throughout the Soviet bloc. Thanks in part to the efforts of the Council for Mutual Economic Assistance in sponsoring specialization agreements among its members in the production of machines and means of transportation, trade in these goods eventually reached remarkably high levels. Machinery and equipment even played a predominant role in the exchanges of Czechoslovakia and East Germany, the most highly industrialized countries of the area. Although the more common types of machines, pumps, and motors are now in quite abundant supply in the bloc, to the degree that they may be said to belong to the category of "soft goods" for which there is a buyers' market in the area, the COMECON market still suffers from a persistent deficit in high-quality, technically advanced equipment. Most "hard goods," however, consist of raw materials and foodstuffs, which are in short supply in the area for two reasons: because they can be sold to the West for convertible currencies and because they are relatively underpriced, compared to manufactures, in COMECON trade.

In the absence of any restrictive policies by the West on trade with the East, what consequences should we expect these trends in output and trade to have had for East-West exchanges? First and most evidently, we should have expected that the share of the West in the total trade of the region would decline and that trade in consumer goods would suffer more than trade in raw materials or in machine products. This banal inference can easily be verified in international trade statistics. On average less than a quarter of the imports of COMECON nations now originates in Western Europe and the United States. One might also have predicted that the share in East-West trade of Western states most capable of exporting technologically advanced machinery and other producer goods would have risen at the expense of traditional exporters of consumer goods. Other things equal, the United States should at least have maintained its relative position as an exporter to the area, considering that it has traditionally been a supplier of capital goods and means of transportation to Russia and Eastern Europe and that it has maintained if not increased its technological lead among industrialized nations since the war.

In the case of the United States, this prediction does not hold up at all; American trade with Eastern Europe turns out to be abnormally low in volume and different in structure from that which we might have expected in view of the prewar record or of the recent performance of our Western allies in trade with the area. None of the

long-term trends in output and trade that have been cited here would lead one to expect that, while France and Great Britain in 1969 were conducting roughly the same fraction of their trade with the U.S.S.R. and Eastern Europe in 1969 as in 1928, the U.S. fraction should have fallen from 2.2 percent of exports in 1928 to 0.6 percent in 1969, and from 1.5 percent of imports to 0.5 percent. Admittedly, the share directed to the area in German and Austrian exports has also declined drastically—from 13 to 4 percent for the former and from 43 to 10 percent for the latter—but we have some fairly persuasive reasons why. In the case of Germany, a large share of the former German market in Eastern Europe has been taken over by East Germany, whose optical and precision engineering products are close substitutes for West German products; in the case of Austria, it may be argued that Austrian exports to the area were traditionally concentrated on consumer manufactures, which were especially affected by the import-substitution policies of the developing Communist countries and, furthermore, that the unusually high export ratios of the late 1920's, which still reflected the trade linkages forged in the days of the Austro-Hungarian Empire, could not but diminish in importance as old political and economic ties with former parts of the empire were loosened in the course of time.

The relative deterioration of the United States in trade with the Soviet Union and Eastern Europe is also apparent from an examination of the foreign-trade statistics of the countries of the area. We should note in this connection that the drop in the share of the United States in Soviet imports from 1928 to the mid-1960's was much greater than in Rumanian or Czechoslovak imports. For all three of these present members of CMEA, the shares of the market occupied by France, Germany, and Great Britain fell less from 1928 to the present than the share of the United States.³

The anomalous position of the United States merges most clearly from a comparison of machinery exports to the U.S.S.R. and Eastern Europe by the major Western suppliers of this category of goods. In 1969, the United States exported \$64 million worth of machinery and transportation to the COMECON countries, exclusive of East Germany (compared to \$38 million in 1928, worth at least \$100 million today). Exports of machinery made up 30 percent of our total exports to the area in this recent year, appreciably less than the proportion—45 percent—represented by these goods in our total exports. By contrast, we may note that over half of French exports to the area were made up of machinery products, at a time when this category represented less than a third of total French exports. For the United Kingdom and Germany the shares of machinery products in exports to the area were about the same as in exports to the entire world (40 to 50 percent).

There were two broad categories of U.S. exports in 1969 for which exports to the area were relatively much greater than exports to the

³ In 1928, the United States made up nearly 20 percent of Soviet imports, compared to 1 percent for the United Kingdom, 5 percent for Germany, and 3.5 percent for France. In 1966, the U.S. share was 0.8 percent, while the shares of the United Kingdom, Germany, and France were all approximately 2 percent. The share of the United States in Rumanian imports fell from 11 percent in 1928 to 1.2 percent in 1968. The corresponding shares for the United Kingdom were 31 and 6 percent, for Germany, 13 and 11 percent, and for France, 9 and 5 percent. American imports into Czechoslovakia dropped from 6 percent in 1928 to 0.5 percent in 1968. The corresponding shares for the United Kingdom were 4.3 and 2.6 percent, for Germany, 30 and 3.3 percent, and for France, 4.2 and 1.4 percent.

rest of the world. These were inedible animal products (10.5 to the area versus 1.4 percent to the world at large) and chemicals (16 versus 9 percent respectively). In the case of exports of chemicals by our major allies the disparity between exports to the area and to the world was in the same direction but appreciably smaller.

We may extend these observations to the entire structure of trade with the U.S.S.R. and Eastern European, which was far more typical of the structure of trade with the rest of the world for Great Britain, Germany, and France than it was for the United States.

What are we to conclude from this failure of the United States to occupy the role in Western trade with the Communist nations of Europe to which it should be entitled by reasons of its technological leadership in the sectors in which these nations are the most keenly interested? Should the anomaly be attributed to the reluctance of the Communist nations to trade with the United States, to the obstacles placed by the U.S. Government on trading with them, or to both?

The relatively high purchases in some categories of products—agricultural products and chemicals in particular—suggest that there is no Eastern boycott on American goods as such. I shall turn presently to the matter of difficulties in financing these purchases from hard-currency earnings. Leaving this general point aside, it may still be argued that East European officials responsible for importing machinery and equipment, other things equal, prefer to place their orders in countries willing to buy some machinery and equipment in return from the state-owned firms they represent. This is partly a matter of prestige and partly of economic interest, at least as they see it. But here the United States is at a marked disadvantage since it imports only a minuscule volume of machinery and equipment from the U.S.S.R. or from Eastern Europe—a mere \$7 million in 1969—whereas West Germany, for example, imported \$44 million worth of these goods in the same year, representing a little over 1 percent of its total imports in this category. Another related important reason for the relatively low U.S. purchases of capital goods in Eastern Europe, compared to France or West Germany, is that the American Government does not engage in bilateral trade with the area on the basis of quotas as these countries do.

It may also be argued with some justification that the Soviets and their East European allies buy mainly goods in this country that they cannot get elsewhere on anything like the same terms or the same quality stipulations, while most desirable machinery, equipment, and means of transport that are available here can also be bought from competing firms in Western Europe, particularly from affiliates of American corporations abroad.

All these factors do restrict the demand for our exports, but they can hardly account for the bulk of the wide discrepancy between the expected and actual levels of American exports of machinery and equipment items to the area.

My hunch is that the discrepancy stems mainly from impediments to trade on the supply side of these potential exchanges. First and foremost are the absolute prohibitions on the exportation of a large number of machinery and equipment items, many of which can actually be purchased from Western Europe (owing to the fact that

COCOM regulations are significantly less restrictive than those imposed by the U.S. Government).

The other impediments may be thought of as setup costs that make trade prohibitively expensive for the relatively small orders for a wide variety of items that East European buyers would like to place in the United States. First, the licensing procedure, which is time consuming and uncertain in its outcome, may, in and of itself, raise the costs of American equipment above competitive levels abroad even in cases where the expectation of favorable action on an application is high. Finally, trade in complex, technologically advanced capital goods requires frequent and often intimate contacts between sellers and buyers.⁴ These contacts are far more easily initiated and kept up at close proximity than across an ocean. Many European firms have a large enough volume of sales in Eastern Europe to justify frequent visits of sales engineers who can help officials in the Ministry of Foreign Trade or in semiautonomous associations and trusts to figure out what items are really needed for what purposes. Most U.S. corporations are at a competitive disadvantage in this regard. Similarly, it is a much more costly expedition for the officials of East European foreign-trade enterprises or associations to travel to the United States than to Germany or France. These additional travel costs have to be justified by immediate and tangible gains if they are to be approved by the myopic bureaucrats who take care of such matters in the ministries of the East European States.

In my opinion, the security of the United States would in no way be impaired if the following measures were taken to promote American exports in general and machinery and equipment in particular. The idea underlying these proposals is that any profitable trade with the Soviet Union and Eastern Europe that does not demonstrably hurt U.S. strategic interests is not just a necessary evil but a positive contribution to the welfare of this country. Like any other goal that deserves to be pursued, it may warrant the expenditures of some public funds to achieve it.

1. All restrictions including licensing for goods that can be bought by East European States on comparable terms of quality and performance from our competitors in Western Europe, Japan, or anywhere outside the Sino-Soviet area ought to be abolished. This implies, for example, that we should strive to eliminate the "COCOM differential" that forbids the sale by U.S. firms of many items that can be sold by Western Europeans to the East.

2. A review should be made of the entire COCOM list of goods that may not be exported from OECD countries to determine whether any items can be removed from the list in view of the technical progress that has taken place in the Soviet Union and Eastern Europe in recent years or of our own objective reappraisal of the military advantage the Communist States might gain from such a liberalization. Thought should be given to the proposal made a few years ago by Mr. William Benton to the effect that the case for removing items from the prohibited list should be presented by an *advocatus diaboli*, before an appropriate board of the Commerce Department, together with the

⁴ One reason why the United States does relatively better in its exports of chemicals to the area than in machinery and equipment is that less specific information has to be transferred between suppliers and their clients to catalyze the sale of most chemicals than in the case of technologically advanced types of equipment.

views of Government agencies wishing to maintain such items on the list.

3. The U.S. Government should facilitate in all possible ways contacts between suppliers of U.S. machinery and equipment and potential buyers in the U.S.S.R. and Eastern Europe. This means among other things that visas to commercial representatives from these countries should be issued promptly and that they should be assisted rather than hindered in making their contacts and in traveling about the states.

4. An attempt should be made by Government agencies to promote U.S. purchases of Soviet and East European machinery and equipment to bring them above present negligible levels. This might be done, for example, by diffusing information to U.S. importers about the availability of items of potential interest, which would presumably include products that have proved to be of sufficiently high quality to penetrate West European markets in recent years.

These measures should go some way toward re-establishing the prewar position of the United States in trade with Eastern Europe. Suffice it to say that if this country could direct the same fraction of its machinery and equipment exports to the area as it did in 1928 these exports would rise from the present \$64 million to \$606 million. In view of the French and British record, such an objective does not seem totally unrealistic. We should keep in mind that as trade in these goods expands, the setup costs—whether these costs are incurred by American exporters or by East European importers—of gathering information and establishing contacts will be spread over a larger volume of exchanges. This will increase the profitability of transacting business and facilitate further expansion of exchanges.

We now return to the demand side of our problem of explicating the low level of American trade with Eastern Europe. Is it possible that the bottleneck in the expansion of this trade resides in the insufficient level of dollar earnings by East European exporters in this country, which prevents them from buying the things they would desire to buy here? This is surely one of the factors adversely affecting trade, but it should not be exaggerated. First it should be stressed that the United States has traditionally exported far more to the U.S.S.R. and Eastern Europe than it has imported from these countries. In both 1928 and 1938, for example, the ratio of U.S. exports to imports in trade with the area was nearly two to one. The difference was made up partly by short- and long-term credits to area countries and partly by the use of East European export receipts in third countries to import from the United States. In 1969, by contrast, U.S. imports from the Soviet Union and Eastern Europe, including East Germany, amounted to 80 percent of exports to this area. Curiously enough, we still run a large export surplus in trade with the Soviet Union, as we did 40 years ago, but we now import nearly twice as much from Poland as we export to that country, a deficit which is sufficient by itself to offset our export surplus with the U.S.S.R. It is interesting that Poland, which is the only state in the area to enjoy most-favored-nation treatment, is also unique in having reversed its prewar deficit with the United States.⁵ Nonetheless, U.S. exports to Poland are on a

⁵ U.S. imports from Czechoslovakia were larger than exports to that country both in 1928 and 1969.

relatively high level, as compared with countries such as Czechoslovakia, which have not been given MFN status. My guess is that, unless exports of machinery and equipment are liberalized, the extension of MFN to East European countries will tend to raise our imports from the area more than our exports and thus diminish our surplus in trade with these countries.

The greater degree of balance between U.S. imports and exports from and to the area in recent years may testify either to the inability of our East European partners to transfer sterling and other Western-currency earnings to their U.S. accounts or to their unwillingness to do so for one reason or another. To the extent that convertibility problems do impede multilaterality, trade with the East European States may depend critically on the capacity of these States to export to the United States (rather than to industrialized Western countries in general). The fact that the United States is not a large importer of the types of foodstuffs the Soviets and the East Europeans have to sell, while the Western Europeans are, may then be a significant factor in explaining the relatively small level of American trade with the area. The financial aspects of the multilaterality problem would have to be studied in depth before this explanation can be generally accepted.

My presentation concludes with a few observations on the long-term prospects for East-West trade.

It is a well known fact that Western Europe exports mainly manufactured goods to the U.S.S.R. and Eastern Europe and imports mainly primary products from this area. In the period 1964-66, for example, manufactures on average made up 78 percent of total West European exports to the area but only 37 percent of imports therefrom.⁶ (The commodity structure of U.S. trade with the area was somewhat more balanced due to our heavy exports of unprocessed agricultural commodities.) Within the manufactured group, finished goods made up an appreciably larger percentage in West European exports to the East than in East European exports to the West. Two-thirds of the value of manufactured products sold by the CMEA countries to Western Europe consisted of semifinished goods in the 1964-66 period, as against slightly less than half in the reverse direction.⁷ This structure of exchanges, it seems to me, is very much what we should expect as a consequence of the persisting disparity in levels of industrial development between Western and Eastern Europe on the one hand and of the particular strategy of growth adopted by the Communist countries on the other. More developed countries generally tend to run a surplus in trade in manufactures with their less developed partners. But this tendency has been accentuated by the priority accorded in the East to producer goods industries, often to the detriment of consumer-goods manufactures with a long tradition in export, and by the failure to invest sufficiently in science-intensive industries with an export potential, including both consumer and capital goods.

We have already seen that many types of capital goods were in relative surplus on the CMEA market but could not find an outlet at reasonable prices in the West. As the industrialization of the area proceeds, and all the more if it continues to be of the extensive type

⁶ Economic Commission for Europe, "Economic Survey of Europe in 1987: The European Economy in 1967," New York, 1968, ch. II, p. 71.

⁷ *Ibid.*, p. 73.

making heavy demands on material inputs, exportable supplies of primary products are likely to shrink. Food consumption, in all likelihood, will keep on rising throughout the area but more rapidly than elsewhere in Rumania and Bulgaria, food-exporting countries that have a long way to go before catching up with the consumption standards in the more developed regions of Eastern Europe. If so, surpluses for export in this category will also decline, except in the improbable event of a marked acceleration in the growth of agricultural output.⁸

If the surpluses of raw materials and foodstuffs that can be exported to the West do diminish, or even fail to expand at a satisfactory rate, how will the members of CMEA finance their rising imports of technologically advanced capital goods, not to speak of their growing needs for primary products unavailable in sufficient quantities on the COMECON market? As I see it, there are three possibilities, which are not mutually exclusive: (1) Through the institution of economic reforms and the adoption of more intensive development strategies, the more advanced of these countries, including Hungary, may improve the competitiveness of their finished manufactures on Western markets, (2) by intensifying cooperation within COMECON, the area may become more self-sufficient in science-based products, possibly at the expense of its long-run development, and (3) the area may become a major exporter of semifinished products to the West including pig iron, steel products, cement and heavy chemicals, and of cheap, mass-produced consumer goods, including shoes and cotton textiles.

The third option makes a good deal of sense economically. Nations that invest heavily (and successfully)⁹ in R. & D. like the United States and, to a lesser extent, Great Britain and some of the smaller West European states have by now generated a marked comparative advantage in many lines of science-intensive goods. At the same time, they may have lost their erstwhile advantage in various types of capital-intensive products.

The question now is whether these Western countries will allow the importation of semifabricates and bargain-basement consumer goods from Eastern Europe on a large scale, in case these goods can actually be bought more cheaply abroad.

A trade policy for the United States that would have the effect of stimulating both exports of science-intensive goods and imports of capital-intensive goods would, in my opinion, be beneficial at this time.

It would provide employment opportunities for our skilled workers, engineers, and scientists and, to the extent that imports of capital-intensive goods would choke off excessive investments in competing American industries, it would reduce the present scarcity of capital, which we require more urgently to build new housing and keep our economy growing with a minimum rate of inflation. To be sure, the contribution that expanded trade with Eastern Europe could make

⁸ For a detailed analysis, see: U.S. Department of Agriculture, Economic Research Service, "Eastern Europe's Agricultural Development and Trade: Patterns and Perspectives, Washington, D.C., July 1970.

⁹ Relative to their per capita national income levels, the East European nations spend more on R. & D. than Western Europe. The yield on these investments, however, appears to be rather low, at least in civilian industries. (Cf. Frederic L. Pryor, "Research and Development Expenditures in Eastern Europe," "East-West Trade and the Technology Gap: a Political and Economic Appraisal," S. Wassowski, ed., New York, Washington, and London, 1970.

to these objectives would be small. But this is not the time to neglect any opportunity to increase the working efficiency of our economy.

Thank you, Mr. Chairman.

Chairman Boggs. Thank you very much, Mr. Montias.

Mr. Wiles, we will be pleased to hear from you.

STATEMENT OF PETER WILES, PROFESSOR OF RUSSIAN SOCIAL AND ECONOMIC STUDIES, LONDON UNIVERSITY

Mr. WILES. It is a particular privilege for me, Mr. Chairman, as a foreigner, to be permitted to address a U.S. organ of Government on matters of its own foreign policy. I am perfectly certain that no American has addressed any organ of the British Government in this manner and I am very appreciative.

Now, you have asked me in your last letter whether an increase of East-West trade is, first, economically feasible; to which I would reply, of course it is feasible, just let the trader go and try. This is a capitalist country and laissez faire on the whole prevails. Let them. If these traders do not like such trade, why, then, it would turn out not to have been feasible. I do not understand, myself, why any organ of Government should really be bothering its head with these questions of technical feasibility.

The fact that there are innumerable Communist obstacles to international trade, as set out by my colleague, Alan Brown, seems to me to be absolutely no argument why we should either impose or relax such political obstacles as we ourselves have chosen. I do not agree with Professor Nove, who was quoted on this, suggesting that the embargo should be relaxed in order to reward institutional change on the Communist side of such character as to reduce the technical obstacles that they put in the way of feasibility of trade. I would say just the contrary: this is a matter of very little concern to ourselves. The COCOM, after all, is a political and not an economic body. It is better to relax our own obstacles to trade in return for a political quid pro quo.

On the desirability question, however, I have rather different views. Whether feasible or not, an expansion of trade is at least desirable. This evidence defends a COCOM embargo list of somewhat its present severity: and asks that North Korea, Cuba, and China be similarly treated.

Most embargoes and blockades fail in their aims. The League of Nations' "Sanctions" against Italy did not prevent Italy from beating Abyssinia in 1935. British sanctions against Rhodesia—1966 to date—have not brought that country to cancel U.D.I. The Arab embargo of Israel did not win the wars of 1956 and 1968. The Grimby fisherman, who refused Iceland the right to land fish (1952-6), had nevertheless to recognize in the end her unilateral extension of her territorial waters. Soviet sanctions against Yugoslavia (1948-55) drove her into the arms of NATO. Soviet sanctions against Australia (1954-9) made U.S.S.R. a laughing stock. Soviet sanctions against Albania since 1961 have established a Chinese foothold in the Mediterranean. Pakistani sanctions against Afghanistan, 1961-63, demonstrated how good the Soviet railroads were for Western trade with Afghanistan. British sanctions against Persian oil (1951-53) did not restore the Anglo-

Iranian Oil Company to its possessions.¹ The author's refusal, now these 20 years, to buy South African sherry has had no noticeable effect on Apartheid.

It is evident that countries grossly overestimate the power of sanctions and the ease of their enforcement. Economic sanctions are usually a pinprick: they irritate the enemy without hurting him, consolidate his morale and drive him to make other arrangements. These are nearly always possible, since, almost no country has a monopoly of anything. They cause, above all, only minor economic damage, while conferring a huge moral superiority on the embargoed party. They tend, therefore, to consolidate the embargoed people behind their government, for the degree of discomfort suffered is hardly ever enough to offset their loyalties; but meanwhile they induce moral unease among the people and government imposing the embargo, and exacerbate relations between that government and its business sector (especially if capitalist).

In this madhouse the COCOM embargo shines like a rational, though not very friendly, deed. Of all the embargoes in the modern world, this is the most favorable exemplar. Its main virtue is that it is Bismarckian: it has limited and feasible means and objectives.² These are, of course, the refusal of sophisticated military goods, and sophisticated tools for making them, to a potential enemy. The means are limited (export licensing of goods) and experience shows them to be, all things considered, feasible. The objective is similarly limited—or at least has come to be so: delay in the growth of Communist military potential, the preservation of a gap. It is also feasible, since nearly all non-Communist military technology is in fact in the hands of the COCOM monopoly.³ Moreover there is another ground for this feasibility. The COCOM starts with a moral advantage no less strong in the mind of the author than in the opinion of both governors and governed at large: the countries that belong to it are to that extent the less "Merchants of Death"—a reference I am sure I need not explain in this room. They can be presented as, and on the whole are, performing a minimally hostile act in order to preserve the peace.

Can so favorable a view be right? The main counter-argument is that the Communist powers would not have done so much R. & D. if they had not been deprived of the fruits of ours, and would therefore not have developed so quickly. But the Communist striving for economic growth, and willingness to make sacrifices for it, are rightly legendary, and far exceed our own. In particular they have at all times spent vast sums for R. & D. both foreign and domestic. This is no less true of the period 1921–47, when there was a stable regime in full control of U.S.S.R. and no COCOM. It is therefore evident that there would have been more growth at less expense, especially in the military field, without the embargo.

¹ These incidents are all discussed in my "Communist International Economics," New York and Oxford 1968, ch. 17.

² Another—possibly the only other—successful embargo was similarly Bismarckian: that of Finland by U.S.S.R. in 1958. This seems to have had and to have achieved only the limited aim of changing the composition of the Finnish Cabinet (Wiles, loc. cit.).

³ The two great exceptions are Switzerland and Sweden, COCOM substantially hinders their capacity to re-export, even by means of incorporating its components in local assemblages. Both countries have also their own arms export restrictions. However, these do not extend to strategic materials, nor is it illegal at all to sell arms to Communist countries at peace. Quite the contrary, Switzerland extracts pledges from the United States not to use Swiss arms in Vietnam. Communist countries seem seldom to buy capitalist arms, so Switzerland and Sweden mainly constitute a leak of home-produced strategic materials.

The fact that there have been tremendous successes in atomic weapons, aerospace and warships does not alter this judgment. For the whole emphasis has been placed precisely on these fields, to the detriment of all other R. & D. and, no doubt of ordinary investment. Nothing that we could have done would have stopped that shift of emphasis, and it is on the new and rather startling admissions of general technical backwardness that the case for COCOM must rest. The last few years have seen many such admissions in the Soviet press, and the figures for overall Soviet growth seem to bear them out.⁴ These statements and figures have forced me to believe, much against my will as an admirer of the Soviet industrial system, that there is something very seriously wrong with Soviet R. & D. Many causes suggest themselves: the spiritual alienation of the scientific community, the prevention of foreign contacts, the overcentralization, the divorce of development from productive enterprises, the difficulty of putting innovations into the enterprise's plan without jeopardizing bonuses. To pretend to quantify these influences would be sheer quackery. But I cannot think that the concentration on things military is the least of them, and it in turn is caused by COCOM. Nor can I believe that military R. & D. themselves are as successful as they would have been without an embargo.

Moreover this does not apply to the U.S.S.R. alone. East Germany is strongly cultivating her trade with the Federal Republic (which is under a special "inner-German" tariff regime in the latter country), and is often said to be the seventh member of the Common Market. This is for no other reason than the superior technical levels in the West. To be "au Weltniveau" (up to world standards) is one of the principal aims of the Neues Oekonomisches System. These preoccupations would be less pronounced if the East Germans were in fact auf Weltniveau, or if they thought they could become so by trade within the CMEA. It follows that strong pressure must be put on West Germany to enforce strictly the ordinary COCOM rules, as at all times taking precedence over the rules for Inter-Zonen Handel. The Federal Republic's own short-term interest is, in any case, to retain COCOM in all its strictness as a bargaining counter.

A more remarkable case, and one bearing directly on the COCOM, is the fate of Czechoslovakia. When COCOM began, Stalin forced this country to switch from her traditional westward exports of consumer goods to being the CMEA's second machinery supplier. The

⁴ Cf. ed. Stanislaw Wasowski. "East-West Trade and the Technology Gap," New York, 1970; Gertrude Schroeder in "Problems of Communism," Washington, September-October 1970. Official Soviet acknowledgments are two a penny, but here is a particularly remarkable unofficial one, from Zhores Medvedev ("The Medvedev Papers," Macmillan, 1971): This story is given as an example to show that Soviet policies of copying Western technological advances, condemns the U.S.S.R. to permanent backwardness. But accidentally it confirms the enormous effectiveness of the COCOM embargo. The machine in question is an analytical centrifuge, useful for many types of scientific research, including some defense-oriented areas. It was originally developed in Sweden before the war, and perfected in the U.S.A. in 1946-47. It was included in the Truman embargo for sale to socialist states. The U.S.S.R. obtained one via a neutral country, actually a German model which was less sophisticated and therefore easier to copy. About 1947 the instrument industry was ordered to master production of the centrifuge. This led to the creation of a special "construction bureau" and production was eventually entrusted to a factory in Frunze. In 1960 it finally came on the market—by which time no one was interested in it. It was too out of date to perform any of the tasks currently of interest to Soviet researchers, and the current U.S. machines were infinitely superior. Moreover, the embargo had been lifted from them, so they had been bought instead. However, the factory in Frunze continued to produce them according to plan, and built special warehouses to store them. Finally when it was decided to begin construction of a newer model they were given away.

strain of producing complicated goods in vast variety and small lots was very great. Czechoslovakia's terms and balance of trade deteriorated, culminating in the balance-of-payments crisis of 1962-63.⁵ Which led to the celebrated plan for zero growth in 1963, which led to the crisis of confidence in the economic leadership, which led to the crisis of the system as a whole, which led to the fall of Novotný * * *. On any cold view the history of Czechoslovakia since 1962 has been immensely beneficial to the West, with whatever regret it must be said. But this history is directly and principally traceable to COCOM. I am far from saying that COCOM had or should have had such large ambitions. I only say that these events show it is effective.

Now COCOM is the result, indeed, of U.S. initiative and firmness, but it has had to respond to the combined wisdom and folly of many governments. No doubt the United States should relax here and there its interpretations of this joint wisdom, and no doubt others should tighten theirs. But the system is now purged of its early excesses, and substantially what it ought to be. The same cannot be said of the extra severities imposed on Cuba, China, and North Korea by the United States alone. I hold this virtually total embargo to be emotional and counterproductive, and I recommend you to repeal it, putting these countries on the same level as the rest. My reasons are:

(i) The measures have unlimited, if unstated, aims, like total political overthrow or at least total economic stagnation. These aims are unconnected with such trivial matters as the trade in arms, and are incompatible with international morality, so far as that exists. They are, therefore, increasingly incompatible with the feelings of the U.S. electorate.

(ii) The means are grossly disproportionate to these large if questionable ends. They cannot, have not, and will not achieve them. Thus:

(iii) North Korea is a flourishing country with a fine record of economic performance. This alone makes the virtually total embargo a folly.

(iv) China is far too large, and trades far too small a proportion of her national income, to worry about a U.S. embargo—except of course in sophisticated weapons, which COCOM would deny her. Other machinery she gets from all over the world; the United States monopolizes nothing she wants, and is powerless to stop her progress. What has stopped her progress, of course, is the great leap forward and the cultural revolution—mistakes of her own making that owe nothing, as do the Czechoslovakia mistakes, to any U.S. action.

(v) Cuba at least has been made to suffer most severely. Economic as opposed to educational and medical, stagnation has been virtually complete. A huge burden of sugar subsidy has been lifted from the United States and placed upon the U.S.S.R. And while very much of this disaster is due to domestic errors, such as the incontinent switches out of and back into sugar cane, we cannot deny the catastrophic effect of having no American spare parts. I must, therefore, admit that some of the wider aims of the U.S. embargo have been achieved. But is it good for the United States that the Cuban economy should stagnate? Precisely what U.S. interest is served? Cuban stagnation can

⁵ Cf. my op. cit. 1968, pp. 112-122. This passage, however, much underestimates the role of CoCom.

surely take no credit for preventing communism in the Caribbean, for innumerable other causes and far stronger U.S. measures have worked to that end. Above all the total embargo is untenable if Latin America does not collaborate. For it is an OAS embargo, and that is its moral basis. But the Latin will to embargo Cuba is crumbling with the Peruvian coup and now Allende's victory. So the OAS patronage of the embargo will be withdrawn, leaving the United States to go it alone. This will be economically useless, for you cannot help but grow out of the need for American spare parts in a decade, and Cuba is a small country that could be in large part supplied by Latin America, as she is now by Western Europe. The United States should, therefore, consult here dignity and interest now, before she is outflanked. But a COCOM type embargo would be tenable.

Now two of the three countries mentioned are very aggressive to their neighbors: North Korea still, and Cuba until very recently. Does not actual aggression justify more total embargoes: Something more severe than the mere delay in modernization we impose on the potential enemy?

The answer is according to the principle of relative gain: Which party of two belligerents gains more from the trade? It seems to be absolutely forgotten in the case of these severer embargoes that the United States also gains from the international division of labor and could also put greater wealth to good use. The question is, would North Korea or Cuba gain more than the United States? And the answer is not obvious, once the COCOM list has stricken sophisticated military and paramilitary goods. For there is, to repeat, little else that the United States monopolizes from their point of view. It is a genuine question, to be answered only ad hoc: more colthes for a Pyong Yang policeman versus more import duties to be spent on slum schools in Detroit, etc.

A narrow rather than a broad definition of strategic goods is in order since all goods are strategic, and the argument for not exporting steel is hardly stronger than that for not exporting lipstick. If our opponent has all the steel he can afford to make, and if a substantial part of the world market is already available to him, he has already spent as much of his scarce resources on steel, by home production and by exporting in order to import, as he feels he can afford. The opportunity of buying our steel is no great thing for him, since under those circumstances marginal steel (that is, our steel) is not a "technology-laden product." It is therefore no different from lipstick." For he has already decided also how many scarce resources to spend on lipstick; and is as likely to refuse our offer of the one as of the other. At the margin, then, all goods are strategic, or all goods are nonstrategic as you please. High technology differs simply because it is not marginal: its benefits to the buyer have potentially no limit.

The relative size of the two countries is, however, very relevant. For a foreign trade transaction involves equal sums on both sides, and therefore the absolute gains on both sides are of the same order of magnitude.⁶ But the national income of North Korea is about 0.6

⁶ Usually greater in the smaller country, since she is more likely to suffer, if autarkic, from prices that deviate from world average. Having greater changes in production to make, she benefits more. The principle of relative gain is discussed in my op. cit. 1968, pages 465-466.

percent of that of the United States, so her percentage growth will be far greater from this same absolute gain. It must therefore be admitted that it does pay for a large country to embargo a small one, and no doubt at all Cuba illustrates this point very well. But the principle does not of course tell us about the diplomatic and moral position, or whether the economic stagnation of the small power is a genuine interest of the larger one.

China is a still stronger case for "promotion to COCOM status" than either Cuba or North Korea. China is by strict objective criteria (what we economists call "revealed preference") a comparatively peaceful power. There are not many Communist countries of which it can be said that they have committed no or only very disputable acts of aggression since their foundation.⁷ Were a man from the moon to be presented with a brief history of China and U.S.S.R. since 1949, and asked to say which U.S. embargo list was applied to which country, he would surely fit the COCOM list to China. Moreover China is an extremely large country, so unlikely to benefit very greatly anyway. The principle of relative gain might well counsel the United States to trade, for China's national income is enormous: 11 percent of her own. In given bargains, therefore, her gain might even be a smaller proportion of income than for the United States.

However, there is also here a special point. A "technology-bearing import" is not the same good in all cases, but many more imports "bear technology" into an underdeveloped country like China than into, say, U.S.S.R. Indeed some goods might in the former case be so sophisticated as to be useless, and bear no technology at all. It is therefore, logical to embargo more goods in China's case, though it may not be desirable on other grounds. Perhaps the most diplomatic solution would be to be slightly more liberal than the Soviet list for China—for U.S.S.R. has of course such lists for all countries. The list can presumably be inferred by experts from the annual Soviet trade statistics.

In no case, plainly, should such relaxations be made without a quid pro quo. I am saying only that this quid pro quo should now be actively sought, that the U.S. position is morally and diplomatically weak and getting weaker, that it has never economically effective at all in China and Korea, that it has no further potential in the Cuban case, and that limited aims are better.

It has been proposed, with much conviction, that since the quid is economic so should also be the quo. I cannot understand this at all, and am quite sure that what appears to be logic in this proposal is merely deceptive tidy-mindedness, nay a willfully blinkered professionalism. First and last, our embargoes are a political act, having nothing at all to do with unfair or inefficient Communist trading practices, and everything to do with the domestic politics of communism, and with its consequential foreign policy. Above all there are not many worthwhile economic concessions that the Communists can make to us, for that is where we are the stronger players. I am

⁷ Remember that Tibet (occupied, 1950) is widely considered an integral part of China, and India was widely considered to be at fault in 1962 (cf. Neville Maxwell, "India's China War," London 1970, for a pro-Chinese but not absurd view of this affair). This leaves only the intervention in Korea in 1950, which was by the invitation of the Northern government. Only Rumania, Mongolia, Albania, and Czechoslovakia (!) have such a clean record.

not against extracting such concessions, I only think them less important to us than the status of Berlin, or the admission of Western newspapers and scholars; it is for this sort of thing that we should bargain. Above all it would be folly to bargain for changes, however rational, in the institutional system of Communist foreign trade, or to discriminate in favor of Hungary (and China!) because they have already made them. For such matters in here altogether in any nation's sovereignty, and demands for change through diplomatic channels would very obviously violate that sovereignty. Moreover such concessions are as easily withdrawn as any others—witness Czechoslovakia and Bulgaria recently.⁸ And finally it is more than probable that our traders will obtain them without diplomatic pressure, simply because they are in the logic of things and on the whole to Communist advantage. Why then waste our bargaining power on hastening the inevitable?

For even the silliest embargo it can be argued that it lets off steam. Men are aggressive by nature and/or tradition; minimally hostile acts, whether rational in themselves or no, have a purgative function, and so prevent the commission of maximally hostile acts. In much the same way it is probably a very good thing to shoot rockets at the moon, for otherwise they would have been shot at nearer targets. In periods of national anger therefore, I would be chary of making these present recommendations. But there is little real anger today against the three countries named, only an inertia, a congelation of past anger.

For these total embargoes were born of emotion, unrestrained by reason. It is possible, I think, to specify these emotions. On the export side there is simple technological chauvinism: so they don't like us! right, we'll deny them our products, which are the best in the world, that'll show them, they can't get along without us! There is, too, on the import side a curious kind of "commodity racism": do you mean this ping pong ball was made in Bratislava (crab was caught in the Crimea)? take the filthy thing away, we won't have it in our community. Such feelings run deep and strong, but they are neither intellectually nor morally defensible.

Indeed, in Professor Brown's brilliant phrase, certain goods and services are anti-strategic, and furthermore it is not we who suffer from importing theirs but they who suffer from importing ours. The reference is to our tourists, our culture generally, and our management skills—which we must include here even though such skills improve Communist economic performance. For Western management, with its international professionalism and its demand for autonomy, is a very foreign body indeed in an isolationist command economy. Ours is a free society, however imperfect, and theirs is not—nor is it less imperfect in other respects. With expanded trade, we infiltrate them while they deliver to us—ping pong balls.

We hear much, probably too much, about PPBS. These total embargoes are an ideal subject for it. Let the responsible departments state their cost in administration, in export income foregone, and in cheap imports excluded; and explain precisely what objectives are being aimed at, and whether they are being achieved. All systems acquire inertia, and this could best be broken by asking the inert bodies

⁸ For the less well-known Bulgarian case cf. L. A. D. Dellin in *Problems of Communism*, Washington, September–October 1970.

to justify themselves publicly. The present Battle Act reports bear no resemblance at all to PPBS.

Besides, an embargo confined to sophisticated and dangerous objects has impressive natural advantages; it springs from the very nature of rapid technical progress and it reinforces what is spontaneous business policy. For, first, the patent system is notoriously breaking down, since it does not matter in many fields if our enemies or competitors understand what we have already produced. "If it works it's obsolete"—and will be a lot more obsolete by the time they've stripped it, copied it and made it work themselves. Our true advantage is that he who has made the last thing is usually in a far better position to invent the next thing. Having gotten ahead is what keeps you ahead; the legal monopoly of the patent might not be worth the fees. The COCOM type embargo merely superposes further delay on to the natural delay, it works with the grain.

Again the large multinational corporation is coming to dominate increasingly the capitalist world. These monsters like a reasonable and quiet life. They have long memories for industrial espionage and unfair trade. In their chosen fields they outproduce medium-sized countries. It is to their disadvantage to allow their very latest models to be copied, so they automatically embargo them. It is not all that painful for them to be made simply to extend such an embargo. So here again this type of embargo, alone perhaps of the many attempts to impose economic costs on an actual or potential enemy, works with the grain.

Thank you, Mr. Chairman.

Chairman Boggs. Thank you very much, Mr. Wiles.

Mr. Rashish will inquire.

Mr. RASHISH. Mr. Brown, you concentrated a great deal in your exposition on the economic reform measures in Hungary.

Mr. BROWN. Yes.

Mr. RASHISH. Two questions in that connection: One, do you think that, in fact, the Hungarian experience is a model for the rest of Eastern Europe, let alone the Soviet Union; and second, how has Hungary been able to get away with such substantial economic reform measures where Czechoslovakia failed so dramatically in 1968, owing to Soviet intervention?

Incidentally, I would invite other members of the panel to comment on these questions as well.

Mr. BROWN. If I understand correctly, your questions are whether the Hungarian experience may be a model for other countries in Eastern Europe, including the Soviet Union; and second, how the Hungarians have, so far, been able to get away with a very daring, comprehensive reform that did not succeed in Czechoslovakia.

I would like to answer the second question first because I believe it will help us answer the first one.

I think we have to distinguish between the economic reforms in Czechoslovakia and Hungary, on the one hand, and the political statements made in these two countries, on the other. In Czechoslovakia, the political statements were—well, let us say, irritating to the Soviet Union. The Hungarians have been careful. They have not made any statements about trying to get away from the Soviet Union. They want to reform their system because it has become an economic liability. I think this is an important distinction.

But still, the question remains, why does the Soviet Union tolerate rather far-reaching economic reforms in Hungary? I think this goes back to the first question. It is because the Soviet leaders would like to see what the future direction should be.

We can make two statements with a certain measure of certainty. One, the command economy has outlived its usefulness, if it was ever useful. We can find statements like this in East European newspapers. Second, East Europeans are not anxious to adopt capitalism.

This raises the question of what they should do. None of them seems to have an answer, but they can all observe the success of the Hungarians. Hungarian economists have developed models, and Hungarian policymakers have accepted these models. I believe that this experiment in Hungary is of interest to all other CEMA countries, including the Soviet Union, because—whether they are concerned with the growth rate of the Hungarian GNP, or not—the new economic mechanism might offer suggestions even in the Soviet Union for a future course of action.

May I use this opportunity to respond also to two points raised by Professor Wiles. Both of these points may be linked to the reforms.

The first point is Professor Wiles' disagreement with the statement I quoted from Professor Nove. He—that is, Professor Wiles—did not agree, I believe, that a liberalization of trade should be based on political considerations. But my argument was not based on political considerations, and I do not believe either that this was what Professor Nove meant. The meaning of the quoted statement, as far as I can see, is that trade liberalization should not be only a political question, but rather that it is easier, economically, for private traders to engage in deals with market-oriented, reformed economies.

I suggested at the end of my statement, after looking at commodity and particularly noncommodity trade, that there should be selective relaxation of trade restrictions. I did not only mean selective as to countries—that may be one aspect. What I meant, more particularly, was selectivity as to methods. Let me give an illustration.

I am in favor of credits, including long-term credits, to develop tourist trade. For example, we might help to build small airports in tourist resorts, not airports for military transport. Hotels, not barracks. This leads directly to my second point of disagreement with Professor Wiles.

We have studied East-West trade for a long time and have often argued that all goods are strategic. Not so. I believe, we have ignored some dynamic implications of noncommodity trade.

First of all, I do not believe that domestically there is much substitutability between tourist facilities and military potential. Of course, we must recognize that the tourist facilities we help build will provide foreign exchange, which in turn will buy imported goods, and these goods may serve military purposes. Against this possibility, however, we must weigh the peace-promoting potential of tourist trade—specifically, belligerent countries do not attract tourists. Thus, countries heavily dependent on tourist trade are unlikely to be very belligerent. My proposition is that some trade might really be called "antistrategic." The question is not simply strategic versus non-strategic; trade can also be antistrategic, that is, peace-promoting. Such trade must not be ignored. Although I do understand that in one

sense all goods might be considered strategic, I want to stress the dynamic repercussions of certain kinds of trade: Some goods are likely to reduce the military threat by increasing the vulnerability of being belligerent.

Mr. RASHISH. You have overresponded to my question.

Mr. BROWN. I am sorry if I have been carried away.

Mr. RASHISH. I mean in this sense, that I was going to raise separately these two questions of what we should set for in return for the application of MFN, which was Alec Nove's comment which you have cited; and second, the general question of what constitutes strategic goods. I would like to come back to the initial question. That is how the Soviet Union views the development of reform measures in Hungary.

As I understood your response, it was that the Soviet Union takes a rather benign view of it, in fact regards them as something of an experimental model which might provide some instruction to the Soviet Union itself, as well as to the other Eastern European countries, to be followed in the future as part of a, I take it, conscious program for improving economic efficiency in Eastern Europe.

Do the other members of the panel share Mr. Brown's view on that question? Or do they have a different perspective on what the Soviet Union thinks?

Mr. ECKSTEIN. I would like Mr. Montias to speak first and then I will respond. He is the greater expert on this.

Mr. RASHISH. Incidentally, did I misstate your point of view, Mr. Brown? That is a correct statement of your point of view, is it not?

Mr. BROWN. That is correct.

Mr. MONTIAS. I generally agree with Mr. Brown, but I would like to point out that there are some problems for the Soviet Union inherent in Hungary's course toward a market-type economy. The application of market criteria in foreign trade might cause Hungary to direct an appreciably larger part of its trade with the West. I think that the Soviets have received assurances that the percentage of trade carried on with COMECON would not be greatly reduced from present levels. This would put a distinct limitation on the extent to which free decisions can be made by enterprises in Hungary with respect to the direction of their trade, unless appropriate measures are taken by the Hungarian Government. It may, for example, set differential exchange rates that would penalize Hungarian firms for trading with the West more than is absolutely necessary from this political point of view.

I also think that we perhaps ought to consider whether all Soviet leaders are equally benign in their attitude toward the reforms. I suspect that there is a division here and that a change in the power situation in the Soviet Union might bring a different attitude.

Mr. RASHISH. The thought occurs to me that the Hungarians may be proceeding, I think, as Mr. Brown mentioned, a good deal more prudently in terms of rhetoric, at least, than the Czechs, recognizing that the Hungarians had experienced their "Czechoslovakia" 12 years earlier in 1956.

Mr. Eckstein.

Mr. ECKSTEIN. That is it precisely; it seems to me that the 1956 events are very crucial in explaining Soviet attitudes toward Hungary. That is, at least as I understand it and others here will know more

about it, after the 1956 events, the Soviet Union had decided to pursue a policy in Hungary of permitting considerable internal autonomy, including economic affairs, provided that they had absolutely iron-clad guarantees from the Hungarian regime that it is going to hew to a Soviet foreign policy line. Given this general basis, the economic reforms become tolerable to the Soviets as long as the Hungarians proceeded prudently as you suggest, as long as they maintain a certain ratio of trade with Communist countries so that they do not get too pulled away toward the West economically. While in the Czech case, they made a tremendous amount of noise about it; they were partly forced to make noise about it for internal reasons, because in the internal power struggle between Dubcek and Novotný, Dubcek was more and more maneuvered into a position where he was trying to get popular support. In order to mobilize support, he had to use certain kinds of rhetoric and certain kinds of appeals which became more and more threatening and more and more offensive to the Soviet Union. I think this was true both in the political realm and also in the economic realm. So I think there is a significant difference here.

Also, on your first question, I do not believe Mr. Brown really answered it. I do not believe Mr. Brown would really hold that Hungary is typical of all of Eastern Europe, since Hungarian reform has gone much further, except for Yugoslavia, than any of the other countries. It is far from clear that the Hungarian pattern will necessarily prevail in the other East European countries, at least for a long time to come. In each there is in many ways a different internal situation. It is, for instance, far from clear that Rumania, let us say, will in years to come go precisely the way that Hungary did. But again, Mr. Montias is the specialist on this.

Stages of development enter here. The economic reforms are tailored to particular stages of development. To what extent a command economy is viable depends, in part, on the stage of economic development. Hungary is much more developed than Rumania and Bulgaria. Therefore, perhaps, the command economy is slightly less inefficient in the Rumanian and Bulgarian case than it may be in the Hungarian case. Therefore, the pressures for economic reform internally in Rumania and Bulgaria may be less in Hungary.

Another important thing is that the economic reform may, under certain conditions, undermine the power structure of a regime. It reshuffles the power cards. But since in the Hungarian case, Kadar and his group were the carriers of the reform, they had no political motivation for resisting it. In East Germany, on the other hand, if there were a far-reaching economic reform, more far reaching than has existed, it could seriously undermine the present power structure. So, I think, there are these elements that need to be considered. I am sure there are many more.

Mr. RASHISH. Do you want to comment, Mr. Wiles?

Mr. WILES. Yes; I would only want to say that East-West trade is and it should be a political affair. I approve very strongly of thinking politically about it.

However, if we try to influence the trading methods and institutions of Communist countries other than Hungary in a Hungarian direction, you must not be fooled by pure economists who tell you that that is an economic policy of the United States. It is not economics; it

is politics. It is an attempt to alter the way in which they understand the word "socialism." It is a very deeply political idea.

But it is also, it seems to me, a very trivial aim. I do not think it is a matter of very great importance to us whether foreign trade enterprises interpose themselves between the ultimate customer and the western trader, as in most countries, or whether, as in Hungary and even, to some extent, in Poland, they do not. These things are, after all, if I may put it this way, matters of the sovereignty of the powers concerned and it is an interference in their internal affairs to say, we will trade with you because we think you are efficient, or we will not trade with you because we do not like the organization of your Ministry of Foreign Trade.

This is not something upon which to spend one's diplomatic shot. There are larger matters in this world. There are matters of armaments and diplomatic concessions.

Mr. RASHISH. Let's get to a specific problem that divides you and Mr. Brown, which he mentioned in his response to my first question. He quoted Alec Nove in Paul Samuelson's book on the subject of what the United States should ask in return for granting most-favored-nation treatment to the Eastern European countries other than Poland and Yugoslavia, who already have it. If you were managing U.S. policy, Mr. Wiles, recognizing that most-favored-nation treatment is probably the most substantial chips we have to play with in dealing with the East, how would you use your chips?

Mr. WILES. Well, I would use them for some purely political advantage. I do not think that there is a very great deal of economic advantage to the United States to be got out of all this trade. It is there, it is nice, small gains will be made by particular traders and particular consumers and producers. I think it is all rather small beer for the richest country in the world, with such an enormous national income. I would make a straightforward political bargain out of it.

Mr. RASHISH. One is told all the time that the Soviet Union, certainly, and the East European countries, perhaps to a lesser extent would resist any effort to negotiate political concessions in exchange for trade concessions. That it was *infra dig* as just not realistic at all.

Mr. WILES. Well, there are some things you could dress up, are there not? There are fishing rights and, no doubt, legal complications about shipping in foreign ports. In other words, if you gave me a list of all the things you might want, I am very sure I could pick out a number of substantial items which look sufficiently economic to be perfectly usable as chips in this matter. I really do not think that interference in their own internal affairs, which is what here is recommended, the demand that they reorganize their ministries of foreign trade, is a substantial U.S. interest.

Mr. ECKSTEIN. I am a little confused by Mr. Wiles' position. On the one hand, he has just now argued that we should trade, that here we have sort of a tremendous economic gift to give to the East Europeans for which we can command a great deal of political *guid pro quo*; on the other hand, he has earlier argued that really, the economic bargaining power inherent in embargo or trade restrictions is actually quite limited I would submit that there is a sort of slight contradiction here in position.

Leaving that aside, however, on the latter point, I do not see the problem that way at all. It would seem to me to be in the U.S. interest to have an Eastern Europe and even a Soviet Union that is much more open, not only commercially but in every sense, that has more options. If we have many types of relationships, the East Europeans have some choice so that they are not solely and totally dependent on the Soviet Union economically and, therefore, are not solely and totally dependent on the Soviet Union politically. Therefore, I would say that it is to the U.S. political advantage to have more trade with Eastern Europe.

I would say it so happens it is also to our economic advantage. We are not going to gain an awful lot, but as Mr. Montias has pointed out—for instance, in the case of machinery—theoretically, at least, one could increase these exports from \$60 million to \$600-million. That is not an insignificant gain from a balance of payment point of view. So this is a case where I would submit economic and political advantages happily; coincide rather than diverge.

Mr. WILES. I do not think I have been contradicted by Mr. Eckstein in any way.

Mr. ECKSTEIN. I am glad to hear that.

Mr. MONTIAS. My own feeling on the subject is that we should not try to gain small and perhaps temporary political advantages by manipulating our trade policy by making changes in MFN or in other regulations. For one thing, enormous bureaucratic inertia has to be overcome in our organs of government before any such measures can be undertaken. By the time they are taken, the chances are that the political advantage will have vanished.

Let me recall in this connection our position vis-a-vis Poland in the late 1950's, particularly in 1957. When Gomulka came to power in late 1956, many of us were enthusiastic about the reforms that we thought he was preparing to make in the Polish economy, and, in part for this reason, our Government rushed to give Poland most-favored-nation treatment. This was a politically motivated measure and, in light of subsequent developments in Poland, not a very well-advised one. Poland, since that time, has tightened up its political and economic system and is now one of the more centralized states in Eastern Europe, one of those least engaged in economic or political reforms. But once MFN has been granted, it cannot really be taken back.

It seems to me we would be better off to play this game as if we could not predict the political repercussions of our economic policies. We should take these decisions, in other words, in the light of our economic advantage. If, subsequently, we find that the decisions we have taken have unfavorable political developments, then we ought to consider whether we ought to change our economic policy. But we should not try to second guess what the political effects might be, since these are very uncertain and would require a great deal of information that is not at our disposal. For this reason, I prefer to deal with economic matters such as trade regulations from an economic and not from a political point of view.

Mr. BROWN. This has been a set of important questions, and I would like to respond to some of them. Mr. Montias has said, I believe, that the percentage share of East European countries' trade with the West would not change greatly. I would agree, if Mr. Montias meant—

Mr. MONTIAS. You meant in the case of Hungary.

Mr. BROWN. In the case of Hungary?

Mr. MONTIAS. I was talking specifically about assurances with respect to reform in Hungary, nowhere else.

Mr. BROWN. In Hungary—well, Professor Montias may very well be right, but perhaps not. It depends on the success of the economic reforms. Permit me to elaborate.

All East European countries, including Hungary, have been trying to increase their trade with the West for economic reasons. Not many countries, however, have been able to reorient their trade without comprehensive reforms. Let me refer to a table in the prepared statement I have submitted for the record—this is appendix table B. The figures clearly show the process of trade reorientation by two of the least-developed countries in East Europe. In 1955, only 18 percent of Rumania's trade was with the West. In 1959, this proportion is still only 20 percent; but, then, it begins to rise: 27 percent in 1960, and 45 percent by 1968. These are dramatic changes.

Also in Bulgaria, the reorientation of trade to the West has been considerable, achieved without openly debating the question of political independence. There, too, the share of Western trade grew rapidly: it was 10 percent in 1955, 17 percent in 1959, 22 percent in 1964. A peak was reached in 1966, 27 percent; but then it declined to 22 percent. Why?

To explain these shifts, we ought to consider separately Bulgaria's Western exports and imports. These are depicted in the charts at the end of the study. Until the mid-1960's, Bulgarian trade with the West increased very rapidly. Exports grew at an annual rate of 32 percent between 1955 and 1960, and at 18 percent between 1960 and 1965. Imports during these 5-year periods increased at an annual rate of 34 percent and 23 percent, respectively. Then, in the second half of the 1960's, Bulgarian exports began to stagnate and Western imports declined. This does not seem to be a political phenomenon but an economic one. The decline of imports was caused by the slowdown of Western exports. This causal relationship was stressed in a recent study by Dr. Rudolf Nötel of the Economic Commission for Europe: Western demand for primary product exports from East European countries is not growing fast enough, and this makes it increasingly difficult for East Europeans to pay for imports from the West.

Generalizing this conclusion takes us to the interrelationship between trading ratios and economic reforms. Hungary is no exceptional case. Only the less-developed countries of East Europe have found it relatively easy, for awhile, to reorient their trade to Western markets—their desire to do so can be explained on economic grounds—but as these economies are becoming more developed, their continued trade reorientation also becomes more difficult, unless drastic reforms are instituted.

All roads lead to economic reforms. To be sure, some roads have stubborn roadblocks; the traveler must sometimes even take a detour.

In the long run, all East European countries will have to develop new sources of hard-currency foreign exchange to satisfy their steadily rising demand for Western imports. To produce and sell such commodity exports as machinery, for which Western demand is rapidly growing, requires fundamental reforms. Noncommodity trade offers another alternative. This is a vast, underutilized potential: But, again,

to take advantage of this potential requires reforms, not fragmented reform measures but a sophisticated new economic mechanism. Given this foundation, we can reasonably expect a continuation of mutually advantageous trade reorientation to the West.

There is one more point that I ought to stress in considering the relative importance of East-West trade, past, present, and future. If we rely only on official statistics to calculate trading ratios, we may be misled; these statistics generally understate the proportion of East-West trade in any given East European country's total trade. This is due to differences in price levels. Goods are generally exchanged at higher prices in intra-CEMA trade than in East-West trade; therefore, trade flows in intra-CEMA trade are relatively overvalued.

It was for this reason that the Hungarian reformers established dual exchange rates, two different "foreign trade coefficients": 60 forints to the dollar, and 40 forints to the ruble. These two exchange rates would imply a cross exchange rate of 1.50 rubles to the dollar. Although the official, nonconvertible foreign exchange ruble rate (0.90 ruble to the dollar) has not been changed, the effective devaluation of the Hungarian forint—from the official exchange rate of 11.74 forints to the new operational exchange rate of 60 forints to the dollar, and the simultaneous devaluation from 13.04 to 40 forints to the ruble—is a tacit confirmation that the foreign exchange ruble, at least in Hungarian-CEMA trade, has been overvalued. (Or, what amounts to the same thing, trade flows in ruble trade have been overvalued.) This is a remarkable by-product of the Hungarian reform: an indirect devaluation of the foreign exchange ruble. It would be difficult to find a historical parallel.

I should add that these price level differences are not peculiar to Hungary's trade. According to recently published evidence, all intra-CEMA trade is conducted at higher prices than East-West trade. Western economists have long suspected that this was the case; now we have authoritative confirmation from East European sources, based on extensive CEMA price data. Professor Marer has done invaluable work scrutinizing this new information. On the basis of his estimates, for example, the share of Hungary's trade with the West is not somewhat below one-third of total trade, as shown in the official statistics, but may be as high as 40 percent. Similarly, the share of every other East European country's trade with the West should be revised upward.

I should finally like to return to the question whether the Soviet Union takes a benign attitude toward the reforms. My earlier reaction was affirmative; but a more complete answer should be, yes and no. The Soviet leaders are ambivalent, of course. On economic grounds, they would not want to keep on supplying Hungary with raw materials; on political grounds, they have found it necessary.

What are the implications for our foreign trade policy? Let me answer this question only implicitly by stating the three alternatives confronting the smaller countries of Eastern Europe.

First, they may try to increase their trade with other smaller CEMA countries. In the short run, this is an unlikely prospect, judging by past performance, continuing complaints, interrelated institutional barriers. CEMA operating procedures, as well as mem-

ber countries' domestic economic systems, will have to change radically to permit mutually satisfactory large-scale trade expansion. Although they are moving ahead more than before—we may expect important announcements in the near future—I doubt that sufficiently thoroughgoing changes can occur, say, in a year or two. Clearly, this could only be a long-term solution.

The second alternative is to increase the economic dependence of smaller CEMA countries on the U.S.S.R. This would mean not simply maintaining the present dependence but increasing it.

The third alternative is to establish more mutually beneficial economic ties with Western countries. This would accelerate a movement that has been going on vigorously, pretty much without the blessing of either the United States or the U.S.S.R. In this regard, if I may add, I find it easier to understand Soviet ambivalence than that of my own Government.

Mr. Montias is probably right, I am afraid, in stressing that certain elements may emerge in the Soviet Union who will not share the attitude of the present Soviet leaders toward the Hungarian reforms. I do not want to push economic reasoning too far, but political science is not my field; furthermore, important decisions in East Europe are made by people whose minds I cannot read.

Chairman Boggs. In that connection, may I ask the panel to project ahead 5 or 10 years and tell us what you think might happen in these countries.

Mr. WILES. In the question of centralization?

Chairman Boggs. No; the whole question of trade and political perspectives.

Would you care to do that, Mr. Brown?

Mr. Brown. It is very dangerous and yet very challenging to speculate on questions like this. I would start with a disclaimer. I never expected that developments would take the course that they took in Hungary. As a matter of fact, even after they instituted the reform and some data were published, I refused to believe it. I had to take a trip there to see what the conditions were, to talk to economists at length, to talk to people I have known for 10 years, 20 years, longer, to convince myself that there really was a change. I am afraid that my mind was too strongly set.

Now, I do not want to fall into the opposite trap and say, well, this is the way they must all soon go. But, I think, one may say this much: The Hungarians have set a powerful example by showing that theoretical models of economists can be empirically implemented—that an entire economic system can be changed on the basis of blueprints, without bloody revolutions. Willy-nilly, other East European countries must be listening to the central economic point of the Hungarian reformers: that the old system cannot be changed piecemeal, that successful reforms must be interrelated, encompassing all areas of the economy. Reforms must include foreign trade; competition from abroad; links between foreign and domestic markets.

Not all reformers have fully grasped this idea. In all East European countries they talk of certain reform measures; but there is little talk of the need to harmonize reforms, the need to move on many fronts more or less simultaneously.

I believe that, in the long run, the futility of trying to patch up the old system by means of piecemeal reforms will be accepted in all East European countries, by word and deed. They must eventually accept the fact that choices in life are difficult, their basic options are whether to introduce comprehensive reforms, like the Hungarians, or try holding on to a centralized, politically "stable" system, regardless of economic consequences.

What conclusions can they draw if they look at the long-term performance of their own economies? In all East European countries, there have been recurrent expressions—even by top Soviet leaders—of concern with the growth rate of output, productivity, and living standards. Official statements have acknowledged that the old development strategy must be changed. Under the so-called extensive development, they have been using up more and more factor inputs, especially capital, per unit of output. After a point, even massive infusions of capital tend to yield little additional output, capital has now become more and more difficult to substitute for other factors of production. This has been shown to be the case in the U.S.S.R., and I have found that in Hungary the marginal productivity of capital approached zero in the early 1960's. The elasticity of substitution between factors is very low, resources are grossly underutilized, and there are all sorts of incredible imbalances in the economy; they complain of shortages in some areas, as well as of hoarding in other areas.

No one denies that the Soviet-type, centrally planned economy has had great technical accomplishments, but satisfaction of consumer demand is another matter. Both labor and capital have become difficult to mobilize. Foreign trade has always been of crucial importance in the smaller Eastern European countries, and now we hear stated over and over that under the old system of administration and management the gains from trade would remain limited.

But let me end with a word of caution. Long-run economic logic may be repeatedly frustrated by short-run political considerations. Political centralization remains; and it is hazardous to guess what may be done by the political elite at any given moment.

Chairman Boggs. Do any of the rest of you care to become prophets?

Mr. ECKSTEIN. I think prophecy and crystal gazing is always a very difficult enterprise. I am sure you, Chairman Boggs, know better than I. I shall not attempt to prophesy, but I will try to point to a few factors that might be operative in the next 5 or 10 years, without attempting necessarily to forecast the outcome.

I think one very key dilemma that is emerging clearly in Eastern Europe and to some extent in the Soviet Union, which may be aggravated in the future, is, really, two sets of dilemmas. One, how far can you go in the process of industrialization and economic development in the context of what we have come to call the command economy; or to put it another way, one can pose the question which is virtually impossible to answer in any precise manner: To what extent is the continuing process of industrialization and economic development compatible with a command economy and how much economic reform do you need to still maintain sufficient efficiency in your economy to maintain a continuing process of economic growth? I think this is one of the central dilemmas that the Soviet Union and Eastern Europe has faced and will continue to face much more sharply in

the next 5 or 10 years, and therefore, the pressures toward economic reform, I suspect, will continue to be quite strong.

This, then, sets up a second set of dilemmas, in a certain sense, counterpressures, you might say. To what extent is economic reform compatible with the maintenance of the monopoly of the Communist Party and the central power of the regime? And what pressures does the economic regime generate toward some measure of political decentralization and how far can this be tolerated?

The third set of dilemmas, which Mr. Montias has emphasized several times, I think rightly so, revolves around the following question: If you do not check the internal economic consequences of reforms, how far will it go toward leading to some kind of closer relations between Eastern and Western Europe which might gradually tend to pull Eastern Europe away from the Soviet Union, which I think would be intolerable from a Soviet point of view.

Now, it seems to me that these three sets of dilemmas will play themselves out quite differently in the different East European countries; I think in that sense there is a considerable variety rather than uniformity; partly because of their histories, partly because of the characteristics of the different Communist regimes, partly because of their geographic situation. For instance, in the case of Czechoslovakia, the country's immediate proximity to West Germany was undoubtedly a very crucial factor that differentiates it from Hungary. I think these will continue to be an important factor in the future.

What happens in the Soviet Union itself, of course, how far does the Soviet Union itself go down this road will affect very much the fate of Eastern Europe.

Chairman Boggs. Anybody else? We have just a minute or two.

Mr. WILES. I think we must bear in mind, Mr. Chairman, the disadvantages as well as the advantages of the Hungarian system. As has been pointed out often enough by Communist financial administrators, a free Communist market is inherently inflationary. This has also been illustrated by the Yugoslavs with a slightly different model. I understand it is now being illustrated by the Hungarians, too. Of course, that leads us to balance-of-payments crises which, in a market system, are the result of inflation. So it is not obvious that, on its own merits, this system is going to prove to be permanently of greater advantage than much more moderate reforms such as, notably, the East German.

Furthermore, I must repeat that unless political changes result from the Hungarian economic reforms, whether in that country or in other countries more powerful that also adopt it, it is not obvious to me why the U.S. Congress should be interested in the matter. Presumably, we are sitting here worrying away because of the political tensions produced by communism and capitalism in the world.

Now, as to the more moderate model, what the East Germans have to show and what I think on the whole they are showing up to this moment is that the two principal difficulties of Communist economy, which are agriculture and science, can be solved without going Hungarian. I am very ignorant of East German agriculture. I have a vague impression that it is working better than it used to. And certainly, I have the impression of what with one thing and another, East German science is working a lot better than it used to. It seems to me these are the areas we have to watch.

Mr. MONTIAS. I will conclude very briefly, virtually all the points I would have liked to make have been made. I particularly agree with Mr. Eckstein's last comments.

I should like to revert one moment to a point that Mr. Brown made concerning the evolution of certain of the countries that have surpluses of primary goods and can sell them to the West. It seems to me that whether or not they expand their trade with the West will depend in part on the availability of these surpluses in the future; that is, on their own food consumption and on their own raw material consumption if they continue, as they probably will, their industrialization process, but also on the political relations of these states with the Soviet Union. And I believe, in this latter connection, that one cannot put Rumania and Bulgaria quite in the same category. Rumania has achieved a very important degree of political autonomy with respect to the Soviet Union. This, I think, cannot be said of Bulgaria.

The recent turnabout in Bulgarian trade, which Mr. Brown mentioned, is in part caused by supply difficulties; that is, by the inability of the Bulgarians to increase their exportable supplies as much as they would have liked. But it may also be due to the fact that when Bulgarian indebtedness to Western Europe for the heavy purchases of manufactured goods, including especially machinery and means of transportation, it had made in the 1960's increased to a critical level, the Soviet Union found itself compelled to contribute some of its own gold and foreign currency to help Bulgaria in paying these debts. It is said that the Soviet Union demanded from the Bulgarians in return that they should be more prudent in the future and that an even larger part of Bulgarian trade should be carried on with the Soviet Union. In these and similar situations, I suspect that the nature of the political relations of the individual East European states with the Soviet Union will play a critical role in their economic evolution.

Chairman BOGGS. Thank you very much. I thank all the members of the panel. You have been very helpful to the committee.

We will adjourn now, subject to the call of the Chair.

(Whereupon, at 12:35 p.m., the hearing was adjourned, subject to the call of the Chair.)

