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EAST-WEST COMMERCIAL POLICY: A CONGRESSIONAL DIALOGUE WITH THE REAGAN ADMINISTRATION

A STUDY

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

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LETTERS OF TRANSMITTAL

Congress of the United States
JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)
WASHINGTON, D.C. 20510

February 10, 1982

To the Members of the Joint Economic Committee:

I am pleased to transmit to you a study entitled "East-West Commercial Policy--A Congressional Dialogue with the Reagan Administration." In late September of 1981, I posed a number of questions to senior Cabinet officials asking for a clear statement of U.S. policy toward East-West commercial policy. The study consists of the Administration responses to those questions as well as background material provided by the Congressional Research Service. Following the imposition of martial law in Poland, I again wrote to the Cabinet officers involved in formulating East-West commercial policy to see how their views had been affected. The supplementary responses of the Administration appear in the appendix.

The Committee is grateful to the Congressional Research Service of the Library of Congress for its assistance. Dr. John P. Hardt coordinated the contributions of the Congressional Research Service and worked with Dr. Kent H. Hughes of the Joint Economic Committee staff in designing and implementing the study. Dr. George Holliday and Ms. Kate Tomlinson of the Congressional Research Service both helped prepare the background material included in the study.

It should be understood that the views expressed in the background material are not necessarily those of the Joint Economic Committee or the individual Members.

Sincerely,

Henry S. Reuss

Henry S. Reuss
Chairman

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February 5, 1982

Honorable Henry S. Reuss
Chairman
Joint Economic Committee
Congress of the United States
Washington, D.C. 20510

Dear Mr. Chairman:

Transmitted herewith is a study entitled "East-West Commercial Policy: A Congressional Dialogue with the Reagan Administration."

The study consists of questions on East-West commercial relations sent by you to a number of Cabinet officers and their responses to your questions. Background material on various issues raised in the course of the Congressional dialogue with the Administration was provided by the Congressional Research Service.

Dr. John P. Hardt, Associate Director of the Congressional Research Service and the CRS senior specialist in Soviet economics, co-ordinated the efforts of the service. Dr. Kent H. Hughes supervised the study for the Committee.

The views expressed in the background material are not necessarily those of the Joint Economic Committee or the individual Members.

Sincerely,

James K. Galbraith

James K. Galbraith
Executive Director

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

January 6, 1982

Honorable Henry S. Reuss
Chairman
Joint Economic Committee
U.S. Congress
Washington, D.C. 20515

Dear Mr. Chairman:

I am pleased to transmit to you a dialogue on East-West Commercial issues. In August you asked for our assistance in drafting a letter, background statements and commentary.

Letters with questions about U.S. trade policy towards the East were addressed to the Secretaries of State, Defense, Treasury, Commerce, and Agriculture and to the United States Trade Representative in September. A workshop was held by the Congressional Research Service on October 27. Congressman Hamilton, many staff members, representatives of all the responding agencies and the National Security Council, and CRS staff had a fruitful exchange. The questions, some CRS background statements, the agencies' answers and CRS commentaries are included in the enclosed dialogue. We expect this dialogue to be published along with additional analysis by Dr. John P. Hardt, Dr. George Holliday and Ms. Kate S. Tomlinson of CRS at an early date. A subsequent volume of country analyses prepared by Commerce may also be published, as indicated in your letter of request and the response from Commerce.

Dr. John P. Hardt coordinated the effort. Dr. George Holliday and Ms. Kate S. Tomlinson contributed, with Dr. Hardt, the CRS background and commentary statements.

Sincerely,

Gilbert Gude
Director

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Foreword

by

Chairman HENRY S. REUSS

The need for a coherent and consistent East-West commercial policy has never been more dramatically illustrated than in the response to the Polish crisis. The imposition of martial law is only the latest in a series of developments related to the failure of the Polish economy. The possibility of a confrontation between the Polish government and the trade union movement, Solidarity, and of direct or indirect military intervention by the Soviet Union, has been apparent since the wave of strikes that led to the demise of the Gierek regime in the summer of 1980. Yet, martial law seemed to catch the Administration, as well as other foreign governments, by surprise.

What distinguishes the U.S. from West European governments and Japan, however, is the way that our approach to East-West commercial relations changes, stops, goes or revolves with each new crisis. Unfortunately, this Administration seems to be following the practice of previous Administrations, which was to take controversial initiatives, without prior consultations with our allies, and then to complain about the lack of unity in the West.

From a European perspective, United States policy toward East-West trade appears incoherent and self-centered. President Reagan lifted the partial embargo on U.S. grain exports to the Soviet Union which had been imposed in response to the invasion of Afghanistan by President Carter; on the other hand, the Administration went to considerable lengths to block European and Japanese participation in the construction of a pipeline that would bring Siberian gas to Western Europe. The fact that the burden of this combination of policies fell on the shoulders of our friends rather

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than on ourselves was not lost on the European or the Japanese public. And this perception of opportunism was not eased when, after Western Europe committed itself to help build the pipeline, the Administration indicated that U.S. companies and European companies using U.S. technology would be allowed to compete for pipeline business.

Martial law in Poland prompted the U.S. to impose a limited range of sanctions first on Poland and later on the Soviet Union. Once again, failure to coordinate in advance with the Europeans and the Japanese aggravated the impression that U.S. leadership in East-West relations has been ineffective and haphazard. The Administration used the Polish crisis to raise the pipeline issue one final time, after the U.S. had already announced its unilateral measures. The subsequent West German and French decisions to proceed with the pipeline then came to appear to be a defeat for the Administration's diplomacy. Such a perception was unnecessary and avoidable.

The broader questions of East-West commercial policy remain unsettled. One question concerns the repeated U.S. attempts to use trade as an instrument for political purposes. Another question concerns the means for achieving Western unity. The unilateral American response followed by virtually no European or Japanese action points up the need to develop a unified Western policy on East-West commercial ties. Without European and Japanese cooperation, an embargo on most high technology items will have relatively little effect on the Soviet bloc. Even in the area of grain exports, where the United States is the world's leading exporter, unilateral action may not bring the desired results. Canada, Australia and Argentina are potential alternative sources of international grain reserves.

The renewal of trade sanctions along with threats that they will be broadened creates a dilemma and a credibility problem for the Administration. Our allies have a much greater stake in East-West trade than we do. By requesting that they join us in sanctions while we continue selling grain to the Soviet Union, we appear to be inconsistent and to be asking them to make bigger sacrifices than we are willing to make. But, by broadening the sanctions ourselves, or acting unilaterally to declare the Polish loans in default, we risk financial and political consequences of unknown dimensions and increasing Western disunity.

In attempting to build a consensus for a unified Western position on East-West commercial ties, the U.S. will have to weigh carefully the differing perceptions of our economic and military allies. The Siberian pipeline is a good case in point. The Reagan Administration has portrayed the project as a Soviet Trojan horse offered to an unsuspecting Western Europe. In the view of the Administration, the Europeans are in danger of becoming dependent on Soviet gas and Soviet orders for industrial equipment.

There is, however, another perspective on the pipeline.

The Europeans, particularly the West Germans, have stressed the contribution that Soviet gas can make to diversification of their energy supplies, and hence reduced dependence on oil from the Persian Gulf. From this perspective, the pipeline adds rather than detracts from European security. Moreover, the Germans have arranged a system of back-up contracts for gas from Norway and elsewhere so that, in the event of a world political crisis, the energy leverage of the Soviet Union would not be decisive. (The question does remain whether other European nations, such as Italy, can make similar arrangements.)

Finally, the Europeans argue that the relationship created by the pipeline between the West and the East flows both ways. To be sure, the gas will tie Western Europe more closely to the East. On the other hand, the hard currency which the Soviets will earn, and which they will use to purchase Western goods and capital equipment, will tie the Soviet Union to the West. Many Europeans believe that such closer economic relations and greater mutual security will enhance, rather than detract from, the prospects for peace and for a gradual liberalization of Eastern Europe.

In September of last year, I asked a number of Cabinet officers to respond to a series of questions on East-West commercial policy. In an effort to clarify the major issues in East-West commercial relations, I have asked the Congressional Research Service to provide some background and commentary on the responses of the Cabinet officers. Following the imposition of martial law in Poland, I asked the same Cabinet officers if they wished to add anything to their earlier answers. What follows are the Administration's responses to my questions, the CRS background and commentary, and the post-Poland amendations.

SUMMARY

The Congressional dialogue with the Reagan administration covers a wide range of East-West commerical policy issues. Several of the key questions in the ongoing debate are briefly covered in the following sections.

1. Trade with the East

In the 1980s Western exports are likely to follow the trend of the late 1970s: industrial exports largely by West Europe and Japan; grain mainly from the United States and other exporting nations. European industrial countries have become increasingly dependent on Soviet oil and gas. With the construction of the pipeline, the share of Soviet gas in their energy imports will burgeon during the decade. As a result of this pattern of trade, Western technology and credit will remain available to the USSR and the CMEA, but our businessmen will be out of the Eastern market.

2. Credit and Trade Facilatation

Western credit has increasingly become a prerequisite for East European imports. The likelihood of East European balance of payments deficits in the future makes credit even more critical. Overexposure and unsecured loans in Poland appear to have made the Western creditors hostage to their debtors.

3. Trade Normalization and Linkage

The United States has dramatically turned back the process of "normalization" of trade with the Soviet Union and Poland by imposing embargoes and sanctions following the Soviet invasion of Afghanistan and the declaration of martial law in Poland. As these have been substantially unilateral actions that excluded the use of the strongest economic weapons, such as a full across-the-board embargo, the impact on the Soviet Union has been minimal.

4. New Constraints on Strategic Trade

The Reagan administration pushed hard for a new, more restrictive definition of strategic trade based on "critical technologies." Although the West European countries pledged to support the U.S. embargoes and not to undercut them in principle, in practice their trade with the Soviet Union was not seriously affected. Europe will supply $10-15 billion in equipment and pipe to the USSR and import vast quantities of natural gas in the years ahead. U.S. export restrictions on rotors and related equipment for compressors and some pipelayers affect West European contracts worth tens of billions of dollars. It seems likely that even those U.S. exports may be provided by other Western suppliers.

5. Import Restrictions on Eastern Goods

Our companies have expressed legitimate concerns about unfair marketing practices by Eastern exporters. U.S. firms and officials have singled out dumping and countertrade (basically barter-like trade) for special attention. As the Executive respondents indicated, some of our practices in dumping cases are unworkable. Legislation to remedy these deficiencies is now under consideration.

6. Grain Trade and the Long Term Agreement

The embargo on grain and superphosphate exports was lifted, leaving the rest of the Carter sanctions in place. As part of the subsequent response to Polish martial law, the discussions with the Soviets on a Long-Term Grain Agreement were suspended. Since the farm bill would make full parity the support price in the event of selective restrictions on grain exports, the Reagan administration would probably have to embargo all trade with the Soviet Union, if it wished to embargo grain sales, as it hinted it might do if the situation in Poland worsens.

7. US - Soviet Maritime Agreement

The agreement which assured U.S. vessels a share of the bilateral grain trade and regulated port access expired at the end of 1981. Efforts to renegotiate this major agreement were set aside after Poland's declaration of martial law.

8. Trade Potential of Eastern Markets

The Eastern countries -- the USSR, Eastern Europe, the People's Republic of China, and other Communist countries -- have a common need for Western technology, food, and credit. Western Europe, Japan, Canada, Australia, Brazil, and Argentina seem to be more likely to develop these markets than the United States. The China market may be the exception, as our policy of normalizing trade ties with that country is similar to the policies of other Western countries towards the other Eastern markets.

9. Exchanges With Eastern Countries

A pattern of scientific, technological, economic, political, and cultural exchanges has become standard for Western relations with Eastern countries. U.S.-Soviet agreements, including the one on science and technology, that come up for renewal this spring and summer will not be renewed. The U.S. will, however, maintain the pattern of exchanges with China and some other Eastern countries. Whether any other Western nation shares the Reagan administration's view of the dangers of inadvertent technology transfer and its implications for Soviet military power is not clear. Nor is it clear whether any countries will adopt the Administration's restrictions. Absent a unified policy, U.S. controls on technology flows from the exchanges are likely to be ineffective.

The Executive respondents have answered the nine questions posed to them. Some have chosen to add their views on the declaration of martial law in Poland and discuss the actions taken in response to it.

NINE QUESTIONS ABOUT OUR EAST-WEST COMMERCIAL POLICY

General Prospects for East-West Trade

Question 1. What is the outlook for U.S. trade with the East as a whole? With individual countries? How important is our Eastern trade likely to be if it remains a small share of our total trade turnover and a smaller share of our GNP? Is its importance likely to be expressed in terms of the significance of Western transfers of technology to Eastern economies? If U.S. exports are significant to the Eastern economies, are they also important to us for creating new jobs and making production more efficient? Or should the significance of potentially increased trade be judged largely in terms of its political effects within and between the Eastern and Western societies?

CRS Background

Even with the resumption of the grain trade after the removal of the grain embargo in April 1981, U.S. trade with the Soviet Union is less than that of the major industrial nations of Western Europe and Japan. American non-agricultural exports to the Soviet Union represent less than a quarter of the bilateral trade. Likewise, U.S. trade with East Europe is smaller than that of the major Western industrial nations. Only with the People's Republic of China is U.S. trade in both agricultural and industrial exports expanding significantly.

Commercial relations with the West are very important for most of the East European countries in terms of share of GNP and critical nature of imports. For the Soviet Union and the People's Republic of China, shares of GNP and criticality of trade are lower that they are for the East European countries, but imports of some products such as energy equipment, certain types of automotive and other machinery, and feedgrains are especially critical.

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CRS Background (continued)

The Eastern market is important to U.S. agriculture, but not to any other major economic sector in the U.S.A. Sales of equipment, such as gas pipe, on the other hand have become important exports to some Western industrial nations in terms of jobs and production.

East-West commercial relations may be approaching a significant change in level and composition, depending on Soviet energy futures and West European and Japanese policy on technology trade and credit: If Soviet oil output holds up and the dollar value of Soviet oil exports to the West remains stable, a major source of import financing--representing at present about a half of Soviet hard-currency earnings--will be preserved. If the West Siberian gas export pipeline is financed and supplied by Western banks and companies, and gas is provided to pay for the loans, a significant increase in Soviet hard-currency earnings may be forthcoming, perhaps as much as $10 billion after the line is operative in mid-1980s. Leonid Brezhnev stressed the importance of the export gas pipeline during November 1981 at the Party meeting in Moscow and the German-Soviet Summit in Bonn. He ordered the line completed by the end of 1985 "without fail." The balance of payments implications of the pipeline completion alone could mean an increase on the order of 30 percent in the volume of West European and Japanese trade with the Soviet Union, largely in technology.

While the level of West European and Japanese trade may increase significantly, Soviet trade with the United States might be sharply reduced. If Soviet harvests are high enough to permit reduced imports or if the United States is considered a residual grain supplier, the U.S.-Soviet grain trade may fall to low levels. As corn and wheat are the largest components of U.S. exports to the U.S.S.R., the United States might, thereby, be reduced to an insignificant role in Western trade with the U.S.S.R. Trade with the Eastern European countries may

CRS Background (continued)

be held down due to their balance-of-payments and debt-management problems. Only the PRC may be an expanding Eastern market for the United States, but that trade is constrained by problematic Chinese hard-currency earnings, especially from oil exports.

Answers

STATE

It is clear that the prospects for expanded trade with Communist nations have dimmed somewhat in comparison to the high expectations of several years ago. Sharply reduced growth rates, growing debt burdens exacerbated by high energy prices and continued difficulty in generating high volumes of competitive exports for hard currency have forced many Communist governments to scale down ambitious development programs.

The most dramatic growth in our trade with individual countries has been with the People's Republic of China. In 1980, the first full year that our bilateral trade agreement with China was in effect, our trade with China jumped to $4.8 billion. U.S. exports reached $3.7 billion, or approximately half the total of all U.S. sales to Communist countries. Although the Chinese have significantly scaled down some of their most ambitious industrial projects, Chinese determination to modernize the economy, the leadership's pragmatic approach to economic development, the country's enormous growth potential, and our improved bilateral relationship make the prospects good for a continued expansion of U.S.-Chinese economic and trade relations.

In the case of the Soviet Union we are prepared to continue our trade in non-strategic areas on the basis of mutual advantage, provided the Soviets act responsibly and with restraint in the international arena. Although we cannot divorce our policies from overall Soviet behavior, even in the area of non-strategic trade, it is expected that the Soviet need for imported agricultural commodities will continue to offer exceptional export potential for U.S. farmers.

We shall scrutinize carefully proposed exports to the USSR of technology, equipment, and materials which could contribute significantly to Soviet military potential. Our concerns extend particularly to the military impact of transfers to Soviet defense priority industries. The magnitude of U.S. exports to the USSR affected by this policy is not large. Multilateral cooperation is essential to avoid a much larger impact on U.S. exports to Western firms wishing to avoid controlled U.S. components in items which their governments do not control.

We recognize that our economic and trade ties constitute a key component in our relations with the countries of Eastern Europe. In developing our policies in this area we will take into account the distinctive character and internal dynamic of each country. We hope to be able to continue to develop our economic and commercial relations with Poland, Romania and Hungary, all of whom are

STATE (continued)

eligible to receive non-discriminatory (MFN) tariff treatment. Although Czechoslovakia, Bulgaria and the German Democratic Republic do not receive MFN tariff treatment and are not eligible for U.S. government supported credits, our trade relations with these countries have also continued to expand in recent years. The debt situation, which has caused severe economic hardship in Poland and has necessitated the imposition of austerity measures in Romania, will obviously continue to inhibit the ability of these countries to spend hard currency for imported goods. Belt tightening is also taking place to varying degrees in other East European countries. Finally, although we intend to continue to differentiate with respect to the application of trade controls to Eastern European countries, tighter restrictions on exports to the USSR in militarily relevant areas will also have a depressant effect on exports to other Warsaw Pact countries. We will continue to deny the sale to Eastern Europe of technology, equipment and materials which would not be approved for the USSR if there is a substantial risk of diversion either to the USSR or to a significant military use in Eastern Europe. Thus, while we do not expect our overall trade relations with the countries of Eastern Europe to contract, we believe that further dynamic expansion is equally unlikely.

It is necessary for us to keep the importance of East-West trade to the U.S. economy in perspective. Total trade turnover represents a minuscule proportion of overall GNP and the $7.6 billion in total exports to Communist countries represented only about 3.4% of total U.S. exports in 1980. These percentages are more likely to decline rather than increase over the medium term. This being said, this trade is extremely significant for certain sectors of the U.S. economy. The most spectacular example is, of course, agriculture where our total 1980 sales of approximately $5.05 billion represented 14.4% of our total agricultural exports.

Since Communist countries traditionally have used their hard currency resources to purchase only high priority items not otherwise available, a high percentage of total East-West trade has been in products and processes with sophisticated technologies. Such purchases have been important to Eastern efforts to update such industrial sectors as chemicals, motor vehicles, metallurgy, and machine building as well as to exploit energy reserves. While the export of American technology has made some contribution to the growth and modernization of Eastern economies, U.S. technology exports are only a small percentage of total OECD high technology exports to the East. There are relatively few commercial areas where sophisticated technologies and products are not available from sources outside the U.S.

East-West trade's contribution to job creation in the United States is not insignificant. We would roughly estimate that the $7.5 billion in U.S. exports to the Communist countries in 1980 supported 300,000 American jobs. While the benefits to the U.S. economy are modest in comparison to U.S. trade with Canada or the European Community, they should not be dismissed. The consistent trade surplus that we have attained in our trade with the East ($5.1 billion) makes a significant contribution towards the improvement of our overall balance of payments.

Our economic relations with the East may offer us a limited opportunity to influence Soviet and East European economic and political behavior. In Eastern Europe our economic and trade ties make up a key component of our overall relationship and contribute to our goal of encouraging evolutionary change, the increased assertion of national self-interest and greater governmental respect for the rights of individual citizens.

COMMERCE

United States trade with Eastern Europe, the Soviet Union, and China exceeded $10 billion in 1980. U.S. exports were valued at $7.7 billion; U.S. imports totalled $2.5 billion. Trade with the communist countries amounted to only 4 percent of total U.S. world trade, with exports accounting for approximately 0.3 percent of U.S. GNP. Under any foreseeable scenario, U.S. trade with communist countries will continue to be a very small share of our GNP and global trade over the next several years.

At present, we estimate that high-technology exports have been only a small part of the trade, about 6 percent of total U.S. exports to communist countries, whereas U.S. high-technology products exports are a much larger share (about 19 percent) of U.S. exports to the world. Other Western countries export considerably more high-technology items to the communist countries with a share in total exports that more nearly equals their trade with the rest of the world.

Despite its relative small volume, we believe it is incorrect to conclude that trade with communist countries is unimportant, or that the costs to the United States of not trading are small and easily accepted. Given our current problems of high industrial unemployment, lagging productivity, and sluggish economic growth, U.S. businesses must be encouraged to pursue aggressively profitable trade export opportunities everywhere on the globe. Communist countries now represent markets as comparable in size to the Latin America region and we can no longer afford to surrender these or any other significant markets to our Western European and Japanese competitors.

However, the conceptual liberal trade model which guides U.S. trade policy in free world matters, is not applicable in examining U.S.-communist trade. Trade with communist countries presents special problems relating to U.S. national security and foreign policy that necessitate unique responses.

Economic benefits to the United States from our trade with the communist countries include:

- The United States runs a substantial surplus in trade with the communist countries that helps hold down the large U.S. global deficit. This surplus totalled $5.1 billion in 1980.

- Using the convention that each $1 billion in U.S. exports creates 24,000 job opportunities, U.S. trade with the East was responsible for an estimated 308,000 jobs in 1980.

- Communist countries have become major markets for U.S. agricultural products. Agricultural goods accounted for two-thirds ($5.1 billion) of U.S. exports to the East in 1980.

- Trade contributes to production economies and efficiencies.

- The East can provide diversification in sources of supply of many industrial materials for U.S. manufacturers.

- Export possibilities in East-West trade tend to be relatively unaffected by Western business cycles.

COMMERCE (continued)

Notwithstanding these positive aspects, the Administration's trade policy toward our potential political and military adversaries in the Warsaw Pact cannot be divorced from our broad national security objectives. Specifically, in pursuing the benefits of commerce, we must be vigilant to avoid contributing to the Warsaw Pact's military capabilities either through transfer of technology or via sales of industrial products which can strengthen their military capabilities. As a result, our trade policies towards these countries are more restrictive than our trade policies toward other countries.

AGRICULTURE

The Soviet Union and Eastern Europe are growth markets for U.S. agricultural exports. In 1974, before the Trade Act of that year focused attention on the region, U.S. agricultural exports there amounted to $1.2 billion, or 5 percent of total farm exports. In 1979, the corresponding figures were $4.8 billion and 14 percent. With the partial embargo in 1980, they fell to $3.1 billion and 8 percent.

The Soviet Union and Eastern Europe are important markets especially for certain commodities. In 1979, before the embargo, the region took 29 percent of U.S. exports of feed grains, 21 percent of wheat, 12 percent and 17 percent respectively of soybeans and soybean products, 22 percent of hops, 11 percent of hides, 9 percent of tallow and 9 percent of lemons.

Soviet foreign trade policy during the past five-year period had made record amounts of foreign goods available to consumers. In spite of massive imports of goods for direct consumption, as well as raw materials to be used for the production of food and other consumer goods, serious shortages still persist in food supplies and in the quality and assortment of most consumer goods. The import bill for imported agricultural products amounted to $12.5 billion in 1979 and probably reached $15 to $16 billion in 1980. A further increase is likely in 1981.

Soviet imports have gone up in part because Soviet planners have decided to increase the meat component in the Soviet diet and Soviet incomes have risen substantially, and partly because feed production has been unable to keep pace. Another bad crop is likely this year, and the USSR will probably import as much grain as it is physically capable of doing. Over the longer run, production will continue to vary with the weather and the Soviets will continue to try to diversify their sources of supply through bilateral agreements such as those negotiated with Canada, Argentina, and Brazil. Nevertheless, larger and more reliable supplies make the United States a desirable trading partner.

In Eastern Europe, Poland usually imports about a quarter of its grain requirements, and in the past two years it has imported 30 percent. The United States is the leading supplier. Imports account for 80 percent or more of Polish use of oilseed cake and meal, and the United States is the second supplier behind Brazil. Given the importance of the Polish livestock industry in the present economic crisis there, substantial shipments of U.S. grain and oilmeal seem likely over the next several years. Both Romania and the German Democratic Republic are trying to curtail imports, but both are simultaneously trying to expand their livestock output. It seems likely, therefore that they will continue to import oilseeds, meal and grain from the United States over the next several years.

TREASURY

Current projections for East-West trade in the 1980s suggest only modest growth. Although a precise figure cannot be placed on the rate of growth, most analysts agree that East-West trade will not approach the high rates of growth that were experienced in the 1970s. This is due both to the underlying economic limitations in the East, as well as to the ambivalent character of trade with Communist countries which--because of political and security related interests--place restraints on the growth of trade. U.S. trade with the East currently remains a small share of our total trade and GNP. Total exports to the Communist countries in 1980 reached $7.6 billion which represents only about 3.4% of total U.S. exports in that year.

Despite this relatively modest size, non-strategic trade with the Communist countries is of significant interest to the United States. Commercial benefits from expanding trade and financial operations with the Soviet bloc are essentially no different than the commercial benefits derived from trading with any country. These benefits include increased domestic employment (1980 exports to Eastern Europe, for example, can be estimated to have supported about 300,000 American jobs), reduced import prices, and efficiency of increased specialization. Accordingly, the United States is prepared to permit increased trade with the East in non-strategic areas. However, U.S. export policy toward the USSR is being scrutinized carefully by this Administration, with the intention of restricting sales of high technology products which could contribute to Soviet strategic capabilities.

Like much of the developed West, the Eastern countries face slower economic growth in the immediate future. The declines in growth in the East are due primarily to more costly and limited energy supplies, constraints on economic efficiency caused by cumbersome central planning, sluggish labor productivity and poor investment decisions. Slower growth has hampered the region's export expansion plans and limited Eastern countries' imports from the West.

U. S. TRADE REPRESENTATIVE

We expect that U.S. trade with the Soviet Union and the countries of Eastern Europe will grow only modestly in real terms in the short run. A number of factors contribute to this expectation: the slowdown in real growth of the Eastern countries' economies, their mounting hard currency debt, the rising costs of energy and natural resources, and their continued limited ability to produce the quantity and quality of goods to generate the export earnings required to support a higher volume of trade with the West. Prospects vary, of course, from country to country, with expectations brighter for trade with those countries which have been traditional markets for U.S. agricultural products: the Soviet Union, Bulgaria, the German Democratic Republic, and Poland, although the current economic difficulties there cloud the picture considerably. However, agricultural trade is prone to fluctuations in foreign demand, resulting from variations in domestic production, harvest performance, and the weather.

Given this outlook, U.S. trade with the Soviet Union and the countries of Eastern Europe is unlikely to amount to more than a small share of our total trade turnover in the short term. From the standpoint of the United States, it will continue to be of relatively minor economic importance, except in certain agricultural product sectors. However, trade with the East will continue to be important politically as a means for buttressing existing relations and forging new ties with the countries of the region. From the Eastern perspective, trade with the United States and the other countries of the industrialized Western world will continue to be of major importance. The West will remain as the major source of the technological innovation needed to modernize their economies, and the food necessary to feed their peoples. However, security constraints on the part of the United States and the West, and hard currency constraints on the part of the Eastern countries will combine to limit the potential growth of trade in technologically sophisticated product sectors.

DEFENSE

U.S. trade with the East has declined in recent years. Reduced growth rates and rising debt burdens have sharply limited increased trade with Eastern Europe. The high cost of energy, overly ambitious investment programs and bad management, particularly in Poland, all have contributed to the downturn. Trade with the Soviet Union has been decreased in the aftermath of Afghanistan and would have fallen further were it not for successive bad harvests which have led the Soviets to resume large imports of grain from the U.S.

U.S. grain exports to the Soviet Union have been important to U.S. farmers, but our total exports to Communist countries were less than four percent of U.S. exports in 1980. Our policy of restricting exports to the Soviet Union of technology, equipment and materials, which could contribute significantly, directly or indirectly, to Soviet defense industries, affects only a small volume of U.S. exports but is essential to U.S. security. On the other hand, our bilateral trade with the People's Republic of China has increased in part because of the Chinese effort to modernize their economy and military, and improved relations which have resulted in a considerably more favorable export control policy toward China.

Continued difficulty in earning hard currency will constrain economic development programs in Eastern Europe in order to pay for essential energy imports. Better management will be needed to avoid higher debt burdens and raise productivity. Poland will take many years to restore previous levels of production and may not avoid debt rescheduling even with substantial economic aid. The pace of Western technology transfer to Eastern Europe for economic development will depend heavily on whether and when effective economic reforms are implemented and on Eastern Europe's support for Soviet political and military adventurism. It should now be clear to Eastern Europe states that accumulating debt is not an adequate substitute for more effective economic policies.

The U.S., NATO, Warsaw Pact and global economies have changed greatly since the 1950s and 1960s. The industrial countries are reorganizing their economies to adjust to the technology explosion, particularly the impact of more powerful computers and integrated circuits. Today, we find that some children's toys contain more advanced technology than military equipment on which our security rests. Many systems in the private sector are, today, more sophisticated than the command and control nets that warn us of nuclear attack. Simultaneous improvements in quality and efficiency are reorganizing national and international markets in other industries. During the 1970s, the traditional distinction between our defense mobilization base and the rest of the economy has largely disappeared. This process is expected to continue during the 1980s and 1990s. Therefore, we expect to make recommendations to amend the Export Administration Act and tighten COCOM strategic criteria to recognize technological changes in the economy, to better safeguard our valuable dual-use technology and know-how.

DEFENSE (continued)

Multilateral cooperation is needed to control subsystems that are themselves parts and components of larger systems. These subsystems often incorporate high technology which could make an important contribution to Soviet military potential. The primary issue is they must be controlled. This means we must seek the cooperation and help of our citizens and the citizens of our allies. We must assure both friendly governments and their publics have a better understanding of what is needed and why.

CRS Commentary

The benefits of East-West commercial relations will come from increased jobs, production and sales to the People's Republic of China and agricultural trade with the Soviet Union and East Europe. The hard currency surpluses with Eastern countries of over $5 billion in 1980 helped reduce the United States' global deficit in trade.

Our trade with adversaries such as the Soviet Union poses a dilemma in terms of balancing trade facilitation and restrictions. How this balance should be drawn is not a settled issue in the Reagan administration. Nor is it clear how the licensing policy of the United States should differentiate among the various state-controlled or Communist countries. The policy of "evenhandedness" in licensing exports to the People's Republic of China and the Soviet Union has been rejected, but the Administration is still considering how much it should differentiate between the various East European countries and the Soviet Union. The Administration's response to the imposition to martial law by the Jaruzelski government was to impose sanctions on both Poland and the Soviet Union and to ask other CoCom members to approve tighter controls on exports to Poland as well as to the Soviet Union.

The Executive agencies did not clarify the basis for a common Western policy for dealing with the East. Indeed as European and Japanese trade with the Soviet Union in industrial commodities burgeons and United States trade becomes even more dominated by variable agricultural sales, the de facto difference in East-West commercial relations become more marked and need for Western policy concensus greater.

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Credit and Trade Facilities.

Question 2. What methods of promoting commercial relations, e.g. improved terms of credit, relaxed trade restrictions, and improved business facilities, are likely to be effective? What is the likely future role of the Export-Import Bank in East-West trade? What are the prudent limits that we should place on the use of trade promotion in expanding our trade?

CRS Background

Among the budget cuts proposed by the Reagan administration are reductions in the trade promotion programs of the Export-Import Bank and the Departments of Commerce and Agriculture. Such cuts are consistent with the Administration's avowed policy of reducing the role of government in the economy. At the same time, the reductions raise questions about the ability of the Administration to carry out programs to promote exports of grain and other non-strategic goods to Communist countries.

Official export credits appear to be particularly important in U.S. trade with non-market economy countries. While the Soviet Union and some other Communist countries are denied U.S. Government credits by the law, some Eastern European countries and the People's Republic of China, which may use U.S. export credits, have expressed a strong interest in continued and expanded credit facilities. Credits are essential to such countries as Poland, with severe hard currency debt problems; they are also important to other Communist countries, most of which have chronic shortages of hard currencies with which to pay for needed imports of grain, machinery and equipment and other items from the West.

The availability and terms of official credits also may be an important determinant of the competitiveness of U.S. firms in Eastern markets. Japan and several West European countries have offered large official credits with low interest rates and attractive repayment terms. U.S. exporters frequently maintain that they are at a competitive disadvantage in this respect. International negotiations aimed at harmonizing official export credit programs have been underway for several years and, if successful, could alleviate this problem.

CRS Background (continued)

Four East European countries--Poland, Yugoslavia, Romania and Hungary--have already made extensive use of U.S. official export credits, and China received its first Eximbank loan in October 1981. As a part of its efforts to normalize trade relations between the United States and China, the Carter administration suggested that Eximbank might play a major role in facilitating U.S.-China trade. Cutbacks in Eximbank's direct lending authority, however, may preclude credits on the scale envisioned during the Carter administration.

Answers

STATE

In promoting commercial relations with some Communist countries, bilateral trade agreements, the extension of nondiscriminatory (MFN) tariff treatment, government-supported credits by the Export-Import Bank and Commodity Credit Corporation, and better access and facilities for U.S. businessmen have all played important roles and will continue to be important in the future. While government-supported lending institutions such as Ex-Im and CCC will be operating under tighter budgetary constraints, we nevertheless anticipate that they will continue their lending programs in Poland, Romania, Hungary and China, and play an important role in the future development of our economic relations.

Our trade promotion activities are also likely to be affected by budget cuts. We believe it important, however, to try and continue to participate in major trade fairs in Eastern Europe and China to the best of our ability. In promoting trade with the East, we clearly should exclude those exports we restrict for national security or foreign policy reasons.

COMMERCE

Commercial relations with communist countries are directly affected by legislation governing U.S. international trade policy including most importantly: the Trade Act of 1974, Sections 402 and 406, Trade Act of 1979, Section 773(c) and the Export Administration Act of 1979.

Since the Committee is well versed on the East-West trade provisions of these statutes, a detailed recapitulation of criteria for normalized commercial relations is omitted. Nevertheless, reciprocal extension of MFN and official credits are prerequisites for expanding bilateral trade with all U.S. trade partners. In addition, a continuing stable East-West trade environment can be crucial for U.S. companies to meet the strong competition they face from Western Europe and Japan. Beyond these basic requirements for trade, there are a variety of official and private sector activities which have proven effective in promoting East-West trade.

COMMERCE (continued)

The U.S. Government has established joint governmental commissions with Hungary, Poland, Romania, the U.S.S.R. and China to review issues and initiated appropriate actions on a wide range of bilateral trade activities, including finance, business facilitation, commercial law, visas as well as on ad hoc trade problems.

In addition, several private bilateral organizations also have been established to assist U.S. firms in competing for trade with communist countries. The U.S. Chamber of Commerce sponsors five of these Joint Economic Councils; with Bulgaria, Czechoslovakia, Hungary, Poland, and Romania. Other private sector sponsors have organized the U.S.-GDR Trade and Economic Council, the U.S.-U.S.S.R. Trade and Economic Council, and the National Council for U.S.-China Trade.

In addition to these institutional fora, various Commerce Department trade facilitation activities also exist. Experts of the Commerce Department's Foreign Commercial Service have been assigned to Czechoslovakia, Hungary, Poland, Romania, the U.S.S.R., and China. FCS personnel have a high level of business expertise and provide U.S. firms with market information and trade assistance. In addition, Commerce trade development facilities in Moscow, Warsaw, Budapest and Prague assist U.S. business and provide logistical support for our promotional events in Eastern Europe and the U.S.S.R.

Commerce trade assistance and promotion programs, have proven effective in expanding the U.S. share of East-West trade. Key activities include advising new-to-market companies, arranging in-country contacts for U.S. firms, advising on U.S. export license policy and procedures and providing market research and analysis of trading techniques in the communist countries.

In addition to the aforementioned legislative restraints, U.S. exporters are particularly disadvantaged in trading with the communist countries due to the absence of a long trading tradition with these countries as well as geographic distance. Because of high debt burdens and rising energy costs, the Communist countries are becoming more selective in their imports from the West. Accordingly, U.S. trade promotion efforts will be directed at increasing our share of Western manufactured goods exports to the East to match more closely the share U.S. firms enjoy in other markets. In 1980, for example, the U.S. share of all exports to Communist countries by 17 industrialized Western nations was 14.5 percent. Our share of manufactured goods exports, however, was only 4.5 percent. Meeting this basic trade development goal of increasing our market share will, of course, become increasingly difficult with a reduced commitment of resources.

Competitive financing terms are a key to effective promotion of U.S. exports worldwide; and this is no less true in communist markets. Notwithstanding its budgetary limitations, access to Eximbank programs continues to be an important cornerstone of normalized trade relations for communist countries. The Committee is well aware of the legislative constraints in Eximbank's activities in East-West trade and of difficulties the U.S. Eximbank has experienced in trying to match the often concessionary terms offered by our competitors. The recent progress in achieving a Western consensus to reduce subsidized official export financing is clearly a positive development.

COMMERCE (continued)

Finally, our trade promotion efforts should be consonant with our overall objective to expand U.S. exports and, at the same, to restrict those exports which would enhance the Warsaw Pact's military capabilities.

AGRICULTURE

Market development activities in the Soviet Union were curtailed during the partial trade embargo. Some market development cooperators again have begun to initiate contacts with Soviet organizations. The political environment has remained unfavorable, however, for market development programs and these activities are quite limited at this time.

In Eastern Europe, at least ten cooperators are active through such means as sponsoring trade missions and technical seminars. Those most heavily involved are the American Soybean Association, the U.S. Feed Grains Council and the U.S. Wheat Associates.

We shall take up the questions in order below, but it may be appropriate to state at the outset our concerns in this area.

- We want to develop and expand export markets to sustain farm income. About a quarter of farm sales come from exports, which account for around 60 percent of U.S. wheat production, 40 percent of soybean production and 30 percent of corn production. We foresee moderate growth in the Soviet/Eastern European markets as these countries attempt to build their livestock economies and generally are unable to be self-sufficient in their production of feedstuffs.

- We want to promote stable trading relationships that provide a favorable environment for growth. Hence we want to avoid disruption both in sales to this area and to supplies available for other traditional markets, which could be affected adversely by large-scale purchases of state-trading agencies. We want to be perceived as a reliable supplier, both in the Soviet/Eastern European markets and elsewhere.

- A large part of this Department's business is to provide information about selling prospects against which U.S. farmers can plan. Therefore we seek to develop information sources in this region where governments are traditionally secretive about policy intentions and harvest prospects.

DEFENSE

Improved commercial relations depend heavily on Soviet and East European policies. Improved forms of credit cannot effectively help Eastern European countries when their first problem is to pay back the debts they have. We will continue to deny the sale to Eastern Europe of technology, equipment, materials, services and know-how which we would not approve for the U.S.S.R., where there is a substantial risk of diversion to the U.S.S.R. or to military use in Eastern Europe. As a practical matter, improved business facilities depend more on improved trade, than the opposite. Improved trade must depend on economic reform, particularly in Eastern Europe, and political-military restraint, particularly in the Soviet Union.

TREASURY

For countries like Czechoslavakia and Bulgaria, the reduced prospects for trading with the West are not as significant because of deliberate decisions by these governments to focus their trade within the Eastern bloc. For the rest of Eastern Europe, slower economic growth will result in either a deteriorating balance of payments position or necessitate painful adjustments to their internal economies. Poland, for example, is now encountering extreme difficulties in financing its hard currency debts. Romania has recently experienced some payments arrearages, while others such as Hungary have cut back sharply on imports from the West to avoid large current account imbalances. Attached you will find rough estimates of the hard currency current account balances for the USSR and each of the East European countries (Table 1).

The combined indebtedness of the USSR and Eastern Europe has climbed steadily from $11 billion in the early 1970s to roughly $81 billion by the end of 1980. These countries borrowed to purchase western capital equipment and other goods to modernize and upgrade their manufacturing sectors. As a consequence, East-West trade increased dramatically by nearly 300% from $20.5 billion in 1972 to $83 billion by 1979. Resort to hard currency borrowing has varied considerably among the Eastern countries. As can be seen from Table 2 attached, three countries, Poland, the USSR and the GDR, built up sizable debts by 1980 and now account for about two-thirds of the total outstanding debt of the bloc. Commercial borrowing, principally from West European banks, accounts for most of the increase in debt. In 1971, commercial debt liabilities totaled $4.4 billion (roughly 50% of gross debt), but by the end of 1980 these borrowings had grown to $60 billion (about 75% of gross debt). */ Official and Government guaranteed credits totaled roughly $21 billion by the end of 1980 as opposed to $39 billion in 1971 and, therefore, fell from 45% to 25% of total debt during that period.

With the exception of Poland where debt rescheduling has become a necessity and Romania where arrearages have occurred recently, the East European countries have serviced their outstanding hard currency debt on time. Their ability to continue to service the external debt will depend mainly on their future foreign exchange earnings, as well as their success in avoiding large concentrations of maturing debt and maintaining adequate reserves of foreign exchange. In general, the Eastern European countries have a satisfactory and proven financial record in the international community. They have generally followed conservative financial policies and have been meticulous in meeting payments on time.

We do not expect those Eastern countries which have access to credit from the Commodity Credit Corporation and the Export-Import Bank to increase significantly their borrowing in the near term. As part of the overall budget program of the United States Government, the lending and guarantee authority of the Export-Import Bank may be reduced. Presently, only three countries -- Romania,

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*/ Some of this represents credits that are guaranteed by western governments and are included in the number below for official credits. Data are not readily available to identify the double count.

Hungary and Poland -- have access to U.S. official credits and guarantees. Only Poland has made extensive use of these guarantees, primarily from the Commodity Credit Corporation for the purchase of U.S. agricultural commodities. Other East European countries may eventually have access to U.S. official credits should they meet U.S. legislative requirements under the provisions of the Trade Act. At this time, the Administration does not plan to seek to amend these legislative requirements.

The United States is critical of international practices of subsidizing export credits. Export credits and guarantees are considered by the Western Europeans as important marketing instruments, however, and have been available at subsidized, below market rates of interest. The United States has worked vigorously for changes in the International Arrangement on Export Credits to reduce and eventually eliminate these subsidies to all countries, including the Soviet Union and Eastern Europe. The recently concluded amendment to the International Arrangement has significantly lowered the subsidy element in official export credits.

TREASURY (continued)

TABLE 1
COMMUNIST COUNTRIES: HARD CURRENCY CURRENT ACCOUNT BALANCES.
(Billion U.S. $)

	1979	1980
USSR		
Current Account	4.5	2.5
Trade account	-2.0	-2.5
Non-monetary gold sales	2.2	0.8
Invisibles and transfers	4.3	4.2
BULGARIA		
Current Account	0.5	0.8
Trade account	0.7	1.1
Invisibles and transfers	-0.2	-0.3
CZECHOSLOVAKIA		
Current Account	-0.9	-0.2
Trade account	-0.8	0.0
Invisibles and transfers	-0.1	-0.2
EAST GERMANY		
Current Account	-1.5	-0.9
Trade account	-1.5	-1.0
Invisibles and transfers	0.0	0.1
HUNGARY		
Current Account	-1.1	0.2
Trade account	-.7	0.2
Invisibles and transfers	-.4	-0.1
POLAND		
Current Account	-2.9	-3.0
Trade account	-1.7	-.9
Invisibles and transfers	-1.2	-2.1
ROMANIA		
Current Account	-1.7	-2.3
Trade account	-1.2	-1.6
Invisibles and transfers	-.5	-.7

Table 2

- PRELIMINARY -

Estimated USSR and East European Hard Currency Debt to the West
(in millions of US dollar equivalents)

	Commercial Credits			Government Backed			Gross Debt			Net Debt		
	1978	1979	1980	1978	1979	1980	1978	1979	1980	1978	1979	1980
USSR	9,500	10,500	10,800	7,100	7,900	8,200	16,600	18,300	19,000	10,600	9,100	10,000
Bulgaria	3,800	3,600	3,200	310	250	175	4,200	3,800	3,400	3,600	3,000	2,600
Czecho-slovakia	2,800	3,700	4,200	400	400	500	3,200	4,100	4,700	2,500	3,020	3,500
GDR	8,200	9,100	11,200	350	1,200	1,400	9,000	10,300	12,600	7,800	8,400	10,400
Hungary	7,400	8,200	8,100	60	70	80	7,500	8,300	8,200	6,500	7,100	6,800
Poland	14,000	16,500	14,800	4,200	4,800	20,100	18,200	21,300	25,000	17,300	20,200	24,000
Romania	3,500	4,800	N/A	1,600	1,800	N/A	5,100	6,600	9,260	4,800	6,800	9,000

U.S. TRADE REPRESENTATIVE

While the United States remains interested in developing its commercial relations with the Eastern countries, U.S. economic policy will be more closely attuned and consistent with U.S. political and strategic objectives. Where commercial interests conflict with security concerns the latter will take precedence. The necessity of subordinating commercial relations to broader considerations will inherently limit the latitude available for the promotion of trade and the availability of tools for that purpose.

For example, it is unlikely that the current restrictions on the development of full commercial relations embodied in Title IV of the Trade Act of 1974 will be altered. Within that framework the United States has entered into commercial agreements providing for most favored nation (MFN) treatment with Romania, Hungary, and the People's Republic of China. It would appear unlikely that overall East-West relations would improve in the near future to the point where we would be willing to consider the negotiation of additional commercial agreements. In any case, such agreements would be subject to the restrictions set forth in the Jackson-Vanik Amendment which links trade benefits with emigration policies and performance. To date many of these countries have adamantly refused to recognize this linkage and provide the necessary assurances called for under the section.

Title IV also conditions access to U.S. official credit and loan programs. Of the Eastern countries, only Poland, Yugoslavia, Romania, and Hungary are eligible for Export-Import Bank loans and Commodity Credit Corporation (CCC) programs. In light of the Administration's emphasis on fiscal responsibility and budgetary restraint, and with prevailing interest rates at record highs, it is unlikely that official credit programs will provide an impetus to expanded trade. More likely, Eximbank will be forced to be more discriminating in committing its lending resources, as will the CCC with its programs. Nevertheless, we expect both to continue to be active in support of U.S. exports to the Eastern countries.

Our commercial relations with the Eastern countries need to be consistent with the broad political and security circumstances and objectives which currently characterize Western relations with the Soviet Union and its allies. Within this context, it is difficult to characterize U.S. trade relations with individual Eastern countries as "normal" in the manner one would describe U.S. trade relations with a country in the West such as Canada. United States trade relations will continue to differentiate between the various countries of Eastern Europe and the Soviet Union, but will depend in large part on the state of overall relations. In all cases U.S. policy will be based on reciprocity and mutual benefits.

United States security interests compel us to place limitations on the export of certain high technology and products with military applications. These controls will be strengthened by the clear identification of significant items to be controlled and improved predictability of the administration of export control guidelines. At the same time, the United States will monitor levels and terms of trade with the Eastern countries so as to limit dependence upon markets or resources of the Soviet Union and Eastern Europe and to reduce vulnerability, arising from such dependence, to the exercise of Soviet influence over the West. Where possible, the United States will coordinate its policies with those of its Western allies toward trade and commercial relations with the Eastern countries so that to the extent that governments are involved, they can utilize whatever influence they may have to affect the economies of these countries and, through the reallocation of resources, their political behavior in ways which are favorable to Western interests.

CRS COMMENTARY

The Administration's responses raise questions about the priority assigned to official export promotion efforts in East-West trade. On the one hand, the answers suggest that such programs have been effective in the past and are needed for the development of future trade relations. On the other hand, the respondents acknowledge that future export development efforts will be hampered by the Administration's proposed budget cuts.

The responses provide little information on new strategies or programs for promoting trade with the East. The State and Commerce answers suggest that the Administration is largely satisfied with existing programs, and that it plans no major initiatives in export promotion. The U.S. Trade Representative adds that new trade agreements (which, under the Trade Act of 1974 are prerequisites for the extension of MFN and official credits to Communist countries) are unlikely to be negotiated in the near future.

The responses emphasize the importance of official export credits to the past expansion of East-West trade. Given the increasing indebtedness and payments problems described in the Treasury response, official credits may be even more important to future trade. Nevertheless, the responses do not explain how budgetary constraints on the credit programs of the Export-Import Bank and the Commodity Credit Corporation will affect U.S. exports to Communist countries. The U.S. Trade Representative notes only that it is unlikely that official credit programs will provide an impetus to trade expansion. The Agriculture response does not mention the role of official credits for agricultural exports. None of the responses discusses the possible future needs of China for export credits.

Licensing and Trade Restrictions

Question 3. To what extent should we now view trade relations with the Eastern countries as "normal" commercial relations? With respect to normalization of commercial relations, will U.S. policy continue to be based on differential treatment of the various countries of Eastern Europe, the Soviet Union and the People's Republic of China? Should we also give more attention to controlling imports from Eastern countries? To what extent should our continued adversarial relations dictate limits on our exports, especially of high technology and products of military significance? Can economic bargaining pressure or linkage be effectively utilized to change or moderate those aspects of Eastern societies that run counter to our perceived national interests or minimum standards of conduct?

Question 4. How should we identify critical technologies? What progress has the Administration made in relating critical technologies to our licensing process and to that of CoCom? Does the Reagan administration plan to use "foreign policy" criteria in licensing, expecially in the export of energy technology? If so, how would you differentiate your intended use of "foreign policy" criteria from that of the Carter administration? How much longer will the sanctions imposed by President Carter in response to the Soviet invasion of Afghanistan be retained? What is the rationale for retention or removal of the remaining Afghanistan-related trade restrictions? How do you assess the success of the Carter administration's grain embargo, sanctions, and Olympic boycott? What East-West trade relations are "compatible with our political and security objectives," as noted in the Ottawa communique? How may we define more precisely "trade in strategic goods and related technology with the USSR"? How may this definition be revised and differentiated to deal with other state controlled economies?

CRS Background

To some extent, fundamental differences between market- and nonmarket-economy countries preclude a total normalization of East-West commercial relations. For example, the criteria specified in U.S. laws and regulations controlling dumping and market disruption inevitably differentiate between market- and nonmarket-economy countries because of differences in the way prices are set and foreign trade decisions are made. Given the basic constraint imposed by systemic differences, however, progress toward normalization can be achieved by changes in some U.S. statutory or administrative measures which provide less favorable treatment for Communist countries than non-Communist countries.

<u>CRS Background</u> (continued)

Indeed, since the early 1970s, the U.S. Government has implemented a number of changes which have put U.S. commercial relations with the East on a more normal basis. Among the important changes were the extension of most-favored-nation treatment and U.S. Government credits to Romania, Hungary, and China (Yugoslavia and Poland had already received them) and a substantial relaxation of controls on exports to most Communist countries. Less movement has taken place in U.S. trade policy toward the Soviet Union and several small Communist countries.

The reasons for differential treatment of Communist countries in U.S. trade policy relate primarily to the differences in U.S. military-strategic relations with various countries, as well as perceived differences in their foreign and domestic policies. Thus, national security controls on exports to the Soviet Union are more stringent than for exports to other countries because it is considered to present the primary military threat to the United States. Similarly, the Soviet Union has been denied MFN treatment and eligibility for U.S. official credits because of their restrictive emigration policies. The U.S. Government has also imposed controls on exports to the Soviet Union for foreign policy purposes in response to the Soviet invasion of Afghanistan and the Soviet role in the declaration of martial law in Poland. In the latter case, the Administration also imposed economic sanctions against Poland.

Export controls have been the key issue in the Reagan administration's consideration of East-West trade policy. President Reagan ended the partial grain embargo, established by former President Carter in response to the Afghanistan invasion, but has maintained other Afghanistan-related controls. Statements by Reagan administration spokesmen have suggested that more stringent national security controls will be imposed on exports to the Soviet Union and that a major effort will be made to improve cooperation among U.S. allies on multilateral export controls. The effort was begun in earnest during a high level CoCom meeting on January 19-20, 1982.

CRS Background (continued)

In formulating an export control policy, the Reagan administration is confronted with a number of difficult problems. A fundamental dilemma is how to reconcile the Administration's free market orientation and desire for unfettered exports with its concern about augmenting Soviet military strength. It also is grappling with the question of foreign policy controls. While Administration spokesmen have supported the notion that trade policy should be linked to our overall diplomatic and strategic relations with the Soviet Union, the Administration has been loath to spell out the conditions under which trade restrictions should be applied. The Administration is also trying to identify and apply to the export licensing process a list of "critical technologies." (The critical technologies approach to export licensing was begun in past administrations, and its application was required by the Export Administration Act of 1979.) The coordination of U.S. export control policy with the policies of U.S. NATO allies may prove to be another formidable undertaking. Finally, determining the limits of relaxation of controls on exports to China--a policy initiated during the 1970s and furthered by the Reagan administration--promises to be a controversial element of export control policy.

Answers

STATE

Our economic and trade relations with the Communist world, and particularly with the countries of the Warsaw Pact, have a different dimension from our economic relations elsewhere. Economic relationships with these countries cannot be divorced from our broad political-security objectives. U.S. economic policies must support the overriding foreign policy goal of deterring Soviet adventurism, redressing the military balance between the West and the Warsaw Pact and strengthening the Western Alliance. Given these considerations, it is difficult to envision how our trade relations with the Soviet Union and its Warsaw Pact allies could be completely "normal."

We plan to continue a policy of differentiation in the execution of our trade policies. In June of this year the United States renewed bilateral trade agreements with Romania and Hungary for additional three-year periods and extended MFN for these countries and for China for an additional year. In the case of China export control licensing policy has been modified to permit roughly twice the level of technology we would authorize for export to the Soviet Union. China and Romania are in their own separate country groups for export control purposes, while Poland and Hungary are classified together in a category distinctive from the U.S.S.R. and the remaining East European countries.

STATE (continued)

In the past we have placed limitations on imports from Communist countries for reasons similar to those which occasion controls on imports from non-Communist countries. We will continue to take actions, as necessary, to discourage dumping and export subsidy practices which disrupt U.S. markets and injure U.S. producers. We will also be mindful of the risk of vulnerability arising from an undue dependence on an Eastern source of supply for critical raw materials. We are particularly troubled by the planned West Siberian gas pipeline project which we fear may make many of our European allies excessively dependent upon Soviet natural gas.

Our adversarial relations will dictate limits on our high technology exports. An important Administration goal is to eliminate the transfer of technology and equipment which contributes significantly to Soviet military capabilities. We believe that there is a need to strengthen multilateral controls on the transfer of technology. At the same time we feel that non-strategic trade ties with the Soviets can be a factor in influencing Soviet behavior. On the other hand, it would, of course, be unrealistic to expect that economic pressure or linkage can be effectively used to change those aspects of Eastern societies which Eastern governments perceive to be central to their national interests. Trade ties are a very important element in the development of our overall policy towards Eastern Europe. Although it is the Administration's goal to reduce foreign policy trade controls, we are prepared to continue to use these controls as part of an overall response to future Soviet aggression.

The Department of Defense has played the lead role in the effort to identify critical technologies. Defense produced a preliminary list of these technologies in 1980 and has been working on a further refinement of this list since then. Research in connection with this work has been and will be used as an input in the review of item definitions on both the COCOM list and the U.S. list of controlled items. Changes already in effect include those resulting from the 1978-1980 list review and a few revisions since then (e.g. polycrystalline silicon and fiber optics).

The Administration is currently reviewing all outstanding foreign policy trade controls in an effort to determine what controls will be extended into 1982. Only a limited number of foreign policy trade controls apply to the Soviet Union. The most important of these are the controls pertaining to the sale of oil and gas exploration and production technology and equipment. Other foreign policy controls include those on exports and related payments in support of the 1980 Moscow Summer Olympic Games, (including for diesel engine assembly lines) for the Kama River Truck Plant, and restrictions on the sale of crime control equipment which is controlled for export to all countries other than NATO members, Japan, Australia and New Zealand. Of these controls, only the Olympic embargo is a candidate for elimination because the event has already taken place. Since trucks produced by the Kama River Truck Plant were used in the Soviet invasion of Afghanistan, we believe it appropriate that this control remain in place. Other Afghanistan related foreign policy trade controls were the restrictions on the sales of agricultural commodities and phosphates which were removed at President Reagan's direction in April of this year.

The controls on the sales of oil and gas equipment and technology predate the Soviet invasion of Afghanistan. The Carter Administration imposed these controls in 1978 to indicate U.S. displeasure at the crackdown on Soviet dissidents and the harassment of U.S. businessmen and journalists. There is a broad agreement within the Administration that existing license requirements should remain in place. But the licensing policy for approval or denial of sales in this area is still a matter of intense discussion.

STATE (continued)

We intend to try and cut back on the use of foreign policy trade controls which do not produce movement towards the foreign policy goals which they were intended to promote and end up penalizing American firms to the benefit of foreign competition. This was the case with the Carter Administration's partial grain embargo which, although well intentioned, became increasingly ineffective as the Soviets turned to other sources of supply.

This being said, we will not forswear the use of trade controls as part of an overall response to aggressive actions. When Communist governments take measures which are particularly repugnant to us, it is important that we react, preferably with the cooperation of our allies, in an area which will hurt them. Although economic measures will inevitably have costs, to us as well as to them, failure to take action in response to provocations could have a far higher price tag in the long run.

There are a broad range of East-West trade relations which can be compatible with our political and security objectives. The most obvious example is our agricultural trade ties which, as previously noted, comprise the bulk of U.S. exports to the Communist countries. Sales of consumer goods, medical equipment and food processing equipment would also fall into this category. As part of our effort to control more effectively exchanges in those areas which could adversely have an impact upon our national security interests, we are developing a list of military relevant industries which we believe merit special scrutiny. The issue of trade in these areas will be an item of particular interest at the upcoming COCOM High Level Meeting. We feel that special attention should be paid to the transfer of industrial processes and know-how in these areas. Such transfers may pose a greater threat to the security of the allies than the sales of industrial hardware.

We will have variations in our licensing policy depending on the country of end use. The most obvious example is China where we are prepared to sell items markedly higher in sophistication than we would transfer to the Soviets and their Warsaw Pact allies. Dealing with Eastern Europe presents special difficulties. While the East Europeans by themselves present little in the way of a direct security threat to the U.S., the danger of leakage to the Soviets will continue to be a nagging concern.

COMMERCE

There exists a number of legislative constraints on U.S.-Communist country trade. The legal bases for such constraints were delineated in the previous section. Defining "normal commercial" relations with Communist countries is difficult since trade with these countries is subject to several extraordinary considerations. Minimal conditions would include reciprocal MFN tariff status and eligibility for official credits. However, even where these minimal conditions exist, U.S. trade relations with communist countries are unique in contrast to trade with Western market economies.

This Administration has continued what has been basic U.S. trade policy for almost a decade in differentiating between the U.S.S.R., the countries of Eastern Europe, and China. The Administration has already eased restrictions on the sale of advanced equipment and high technology to China. The Administration is also consulting with Congress to seek appropriate congressional action to end some of the remaining economic legislative discriminations against China. We will also continue to take into account the distinctive character of each country in the East European area, encouraging evolutionary change and increased assertion of national self interest.

COMMERCE (continued)

Perhaps more critical and complex is the issue of U.S. exports to communist countries. U.S. East-West trade policy is affected by the need for controlling exports to the Soviet Union and its allies of products and technologies with strategic importance. The extent of control is determined by the Export Administration Act of 1979. The EAA provides authority for the regulation of exports to the extent necessary to: (1) protect our national security; (2) further our foreign policy goals; and (3) protect against excessive drain of scarce materials.

The Soviet invasion of Afghanistan brought to light the need for drastic redirection of our export controls toward the U.S.S.R. It became clear that in some important areas the Soviets have turned the liberalization of trade with the Western countries to their strategic advantage. Western technology, especially the transfer of dual use technology, financed with export credits, has provided the U.S.S.R. and some of the Warsaw Pact countries some technology and equipment needed to modernize their military-industrial base, placing the Soviet Union in a strategically comparable position.

While the U.S. trade policy towards the non-market economy countries over the past decade has been toward developing mutually beneficial commercial relations and the reduction of East-West tensions, national security interests have remained paramount. For this reason, U.S.-communist country trade policy is affected by the need for controlling exports to the Soviet Union and its allies of products and technologies with strategic importance.

It is the goal of this Administration to stem the flow of high technology and know-how to the Soviet Union, which has in some instances enhanced Soviet military-industrial capabilities. Consequently, in the past few months, we have been reviewing our policy on East-West trade and export controls in the context of overall East-West relations. Based on the findings of the policy review, the Administration is determined to tighten strategic trade controls on technology and goods which can upgrade Soviet production in areas relevant to their military strength. Greater emphasis will be placed on controlling technology and process know-how which the Soviet Union seeks to acquire for expanding their military-industrial capabilities. On the other hand, Commerce over the years has processed a staggering number of licenses, in some cases for products of marginal technological concern. While tightening up on high technology exports, we also intend to restrict controls to only those areas with military and strategic implications.

The Administration is now also examining export control policy toward the East European nations. A number of policy questions will be reviewed, including differentiation in view of the risk of technology diversion and our political relations with Eastern Europe.

President Reagan presented the Administration's concerns about the impact of technology transfers on Western security at the Ottawa Summit in July. He stressed the need for the West to place its system of cooperative controls high on its diplomatic agenda. The United States is now preparing for a high level meeting later next month in Paris to begin the dialogue with our allies on strengthening the multilateral system of strategic trade controls under COCOM.

COMMERCE (continued)

The present informal multilateral system is not working as well as it should and the Administration is committed to improving it. This is one of the most important U.S. initiatives in the export control area in at least 25 years.

Identifying critical technology is the essence of export controls. In the 1950's when the United States had clear technological superiority, export controls focused on specific pieces of hardware. Today, with many more countries entering the high technology market, and the Soviets enhancing their military strength based on easy access to Western technology, the definition and identification of critical technology becomes more germane to Western security.

A Defense Science Board study in 1976 ("Bucy Report") recommended a dramatic redirection of U.S. and allied export controls: controlling technology (technical information and process know-how) and keystone or critical production equipment, not exclusively end products. Among the manifestations of the Bucy report was the Export Administration Act of 1979, which directed the Secretary of Defense to develop a Military Critical Technologies List (MCTL). Under the Act, critical technology was intended to mean technology that is critical to the production of U.S. weapons or which would increase Soviet military capabilities.

The first list was completed in October 1980. The Department of Defense received comments from business on the list. Problems have arisen in defining the technologies in sufficiently narrow terms that allow their integration into the Commodity Control List (CCL) for export licensing purposes. Once the Department of Defense has completed a refined MCTL and transmits it to the Department of Commerce, the Secretary of Commerce is responsible for working out the details of its utilization and incorporating it into the CCL. The list must be refined, including input from business through the technical advisory committees which provide advice to the Department of Commerce in administering the export control program.

In addition to controls on U.S. exports to the East for national security reasons, the U.S. government has also controlled exports for foreign policy objectives. Energy equipment falls into the category of goods currently controlled for foreign policy reasons.

The current policy governing these controls on energy equipment and technology is one which we inherited from the previous Administration. The Reagan Administration is now in the process of examining this legacy. The policy was originally installed in 1978 and has since operated on an ad hoc basis where each new application was examined on its own merit.

At Ottawa the President also discussed the security implications to the Western Alliance of potential dependence by Europe on Soviet energy. We do not believe dependency on Soviet energy supplies to be in Western Europe's interest; nor do we want the Soviets to increase substantially their hard currency earnings.

COMMERCE (continued)

In the process of determining what we can do, the Department of Commerce has two very important, and at times seemingly contradictory charges. First, and most important in our trade relations with the Soviet Union, the export licensing process must guard against transfers of goods and technology which endanger our national security. The second charge is trade promotion. The convergence of these two charges--one to restrict, and the other to promote--are nowhere more evident than in the debate surrounding Soviet energy development and possible construction of a 3,000 mile pipeline from Western Siberia to Western Europe. Many companies have made the point that they are quite willing to "play by the rules" as long as the rules are not subject to constant changes. This Administration understands this. Our goal is a system of controls that gives our companies clear guidance and predictability. Controls must protect our vital national security and foreign policy interests, and at the same time permit U.S. firms the opportunity to compete aggressively in non-controlled areas.

Trade sanctions placed on high technology exports to the U.S.S.R. in response to their invasion of Afghanistan remain in effect. Specifically, there is a "no exception" policy for exports to the U.S.S.R. of technology and/or products which require COCOM approval. Other COCOM-member countries instituted similar restrictions and this policy remains in effect.

The decision to lift the grain embargo does not indicate any change in the opposition of the U.S. to the Soviet invasion of Afghanistan or acceptance of the status quo there. Also, the President has stated repeatedly that the grain embargo was not an effective tool. The U.S. will persevere in its efforts to achieve a potential settlement predicated upon the withdrawal of Soviet forces from Afghanistan.

The President has the authority under the Export Administration Act to control exports for reasons of short supply, foreign policy, and national security. This Administration intends to use foreign policy controls judiciously and on a contingency basis. Controls for contingency purposes are most effective, when coordinated with actions by our allies.

AGRICULTURE

We regard a stable or normal trading relationship as very important to all three of the concerns we noted above. [Answer 2.] In the normal course of events we question whether trade policies are suitable or effective in bringing about a change in political actions. Extreme situations may dictate extreme measures; but in our view, such situations should be dealt with as they arise and not as part of a standing procedure.

SPECIAL TRADE REPRESENTATIVE

The Export Administration Act of 1979 (P.L. 96-72, 92 Stat. 503, September 29, 1979), the statutory authority for the government's control of commercial trade for national security, foreign policy, and short supply purposes, allows the use of policies utilizing export licenses to promote U.S. economic interests, strengthen national security, and advance foreign policy interests. The objective of U.S. regulation of trade is to balance the commercial benefits of trade against the need to safeguard U.S. security interests. In order to protect U.S. national security interests, the United States must maintain its lead in technologies which are critical to the U.S. military posture.

The militarily critical technologies exercise was undertaken to address questions about selected areas of high technology, their effect on U.S. strategic requirements, the array of mechanisms through which they may be transferred, and the effectiveness of export control restrictions. These exercises, which represent a systematic effort to confront the problems of military risk through a comprehensive reappraisal of the Commodity Control List, could potentially shift the weight of present U.S. export-licensing policy from the case method to the "list approach." The critical technology approach is not a panacea, but it does represent the first attempt to develop a comprehensive rethinking of the national security aspects of the export control system. Once the Department of Defense develops its list and transmits it to the Department of Commerce, the Secretary of Commerce is responsible for working out the details of its incorporation into the Commodity Control List. Subsequently, the Administration will confer within the Multilateral Coordinating Committee for Export Controls (CoCom) on the utilization of militarily critical technologies on a multilateral level.

The Carter Administration imposed foreign policy controls in August 1979 on exports of equipment and technology destined for the oil and gas sector of the Soviet economy. These controls were tightened in January 1980 following the Soviet invasion of Afghanistan when the United States imposed a number of sanctions on trade with the Soviet Union. Current policy follows the presumption to deny exports of technology for the manufacture of equipment while continuing the presumption for approval for exports of end-use equipment not subject to the "no exceptions" policy in CoCom. The Administration is currently conducting a review on the range of licensing procedures available on exports to the Soviet Union of equipment and technology for the exploration and production of petroleum and natural gas.

The Administration is committed to reducing export disincentives and regulations that impair efforts by domestic industry to expand exports. An interagency group will shortly begin a review of foreign policy criteria in licensing.

The sanctions on trade with the Soviet Union, imposed by the United States following the Soviet invasion of Afghanistan in December 1979, were intended to demonstrate that Soviet actions which contravene international law would entail economic costs for the Soviet Union that adversely affect other aspects of the U.S.-Soviet relationship. The President lifted the partial agricultural trade embargo, including the ban on exports of phosphate rock and other phosphate-based materials, on April 24, 1981. Restrictions on high technology exports to the Soviet Union, however, remain in place. In lifting the grain embargo, the President emphasized that there had been no change in U.S. opposition to the Soviet invasion of Afghanistan.

DEFENSE

The outlook for U.S. technology trade with the East is linked to Communist political behavior and the perceived military threat to the security interests of the United States, its allies and friends. This necessarily takes into consideration the internal and foreign policies of the Soviet Union, the Eastern European Warsaw Pact countries and China.

This Administration has implemented a vigorous program designed to safeguard U.S. and Western technology from Soviet compromise. Our focus is on controlling critical production equipment, production technology and materials which could contribute directly or indirectly to Soviet military potential.

Among the East European countries, we are inclined to be more forthcoming in approving exports of products and equipment to Poland, Hungary and Romania because of their relatively more independent foreign or domestic policy vis-a-vis the Soviet Union. The harder line states, i.e., Czechoslovakia, East Germany and Bulgaria, are treated only marginally, if at all, better than the Soviet Union. While there is a political-economic rationale for differentiating between Warsaw Pact members, from a security perspective there is little reason for this differentiation. We have to take great care in carrying out this policy because of the danger of diversion.

Our more liberal trade policy with China for technology items tracks with our strategic perception of China's minimal military threat to the U.S. and its allies and friends, as well as its foreign policy distance from the Soviet Union. The U.S. is prepared to assist China in building its manufacturing base through exports of carefully selected equipment and technologies. On the other hand, the Reagan Administration will act to isolate strategic technology areas where we cannot be as forthcoming for security reasons as the overall policy suggests.

Militarily Critical Technologies List (MCTL) items are identified through a number of methodologies using the current COCOM control list for dual-use technologies as a starting point. The Services review the control list to identify those items and their array of production technologies which are "critical" to the military mission. Soviet capabilites are reviewed by the intelligence services and industry advisors identify civil uses and foreign availability. Candidate critical technologies are then distilled from this process.

Until now, there have been no changes in the Commodity Control List (CCL) directly based on the MCTL. However, a number of our 1982 COCOM List Review proposals will draw on information garnered from the MCTL undertaking. At some point soon, the MCTL will be reviewed and compared with the CCL. We hope to make revisions to the CCL to take advantage of the considerable research effort represented by the MCTL.

Restrictions imposed on technology trade with the Soviet Union after the invasion of Afghanistan were selective. Independent of the Afghanistan invasion, they represented growing security concerns over the levels of high technology exported to the Soviet Union. Therefore, these "sanctions" are intended to continue and be selectively strengthened.

The Reagan Administration is working with our allies to sharpen strategic criteria which will more precisely define concerns over "trade in strategic goods and related technology with the U.S.S.R." As stated, we are concerned over exports of technology, equipment and materials which could contribute

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DEFENSE (continued)

directly or indirectly to Soviet military potential. It is expected that the MCTL effort will aid significantly in bringing such items into sharp focus. A revised definition in strategic criteria will be applicable to all Communist countries. Differentiation is anticipated however, on a case-by-case basis depending on the cooperation we receive in return. This would permit a possible three-tier approach to export controls with the Soviet Union at the bottom most restricted level, China and Yugoslavia, at the comparatively least restricted top level, and the East European countries arrayed between, with Poland, Romania and Hungary in a potentially more favorable position depending on performance and protection against diversion.

Equipment and technology specifically for oil and gas exploration and production in the Soviet Union were placed under foreign policy export controls by the Carter Administration. There was a general presumption to deny exports of technology and a general presumption to approve exports of end-use equipment, except when the equipment was subject to other multilateral or national security controls. Thus, manufacturing know-how or sophisticated seismic equipment, for example, would be denied, while end-use items such as pipelaying machinery, could be approved. One factor being considered is the impact of U.S. equipment on projects such as the West Siberia to Western Europe natural gas pipeline. The President has indicated his opposition to this project and we have relayed our concerns recently to our allies on the grounds of the dangers of European dependency on Soviet energy sources and the contribution this project could make to Moscow's political, economic and military posture.

There are very few unilateral national security controls and, where they do exist, generally the material, product or technology is not available elsewhere. There are, however, times where, in order to assert leadership, unilateral controls for national security will be necessary. Such markers are important to our allies and friends so there is firm understanding of our meaning and intent. Of course, the free use of such controls without real purpose only harms American business and encourages others to sell equipment and technology. On the other hand, we cannot and should not allow our export control policy to be driven by the problem of foreign availability to the point we fail to control essential technology. We can do better and we are working to develop a more effective export control policy, one that will have, in large measure, the support of our friends and allies.

CRS Commentary

The lengthy responses suggest that export control policy has received much consideration by the Reagan Administration. They also give the impression that the review of past policy is ongoing: important questions appear to remain unanswered, and there is evidence of significant differences among various actors in the Administration.

The State and Commerce responses provide the present Administration's basic critique of the export control policies of past administrations:

in the area of national security controls, past policies have facilitated the transfer of technologies which have contributed to Soviet military power;

foreign policy controls imposed in the past have been largely ineffective; and U.S. exporters have not been given clear signals about what kinds of exports to Communist countries are allowed.

The responses provide only generalizations about the goals of the Administration in redressing these problems.

With respect to national security controls, the Administration states that its goal is to eliminate the transfer of technology and equipment which contributes significantly to Soviet military capabilities. This is presumably the policy followed by the other recent Administrations, since such language has been included in U.S. export control laws since 1969. Thus, the Export Administration Act of 1979 declares that it is U.S. policy to restrict the export of goods and technology which would make a "significant contribution to the military potential" of adversary countries. The Administration's responses provide no details of any violations of this basic guideline. The Commerce Department does, however, assert that the Soviet Union and other Warsaw Pact countries have obtained technologies needed to modernize their military-industrial base, placing the Soviet

CRS Commentary (continued)

Union in a strategically comparable position. This is a controversial statement, which is likely to be disputed by many observers of export control policy.

References in the Commerce Department statement to controlling exports which contribute to modernization or enhancement of Soviet "military-industrial" capabilities raise the question of whether the Administration aims to broaden the basic guideline for national security controls. Prohibiting exports which contribute to enhancement of Soviet "military-industrial" capabilities could suggest a much more restrictive policy than the current guidelines included in the Export Administration Act. A more restrictive policy is also suggested by the Commerce Department statement that there is a need for a "drastic redirection" of U.S. export controls toward the Soviet Union. The State Department response does not refer to Soviet military-industrial potential and does not suggest a need for a drastic change in policy. It suggests, more moderately, a need to strengthen multilateral export controls. Neither response provides specific details on what kinds of technology transfer, heretofore permitted, will be prohibited in the future.

The responses on foreign policy export controls also lack details of impending policy changes. The State Department states that it is the Administration's goal to reduce foreign policy trade controls, but notes that only a limited number of foreign policy controls apply to the Soviet Union. Of those in effect, State asserts that only controls on exports related to the 1980 Moscow Summer Olympic Games might be eliminated. Such a move would have no practical effect since the Games have already taken place. The Reagan administration has already removed the partial grain embargo--one part of the foreign policy controls imposed by the Carter administration in response to the Soviet invasion of Afghanistan. According to the Commerce Department, the Administration took this action because the grain embargo was not an effective tool. No explanation is given for the retention of

CRS Commentary (continued)

other Afghanistan-related export controls.

Aside from the statement that most existing foreign policy controls should remain in place, the responses provide few details on future policy. In particular, they provide few guidelines on the conditions or circumstances under which new foreign policy controls might be imposed. The State Department responds that they might be imposed in response to measures taken by Communist governments which are "particularly repugnant to us." The Commerce Department responds that the Administration intends to use foreign policy controls "judiciously and on a contingency basis." The Agriculture Department questions whether in the normal course of events, trade policies are suitable or effective in bringing about a change in political actions, but adds that "extreme situations may dictate extreme measures." None of the responses explain clearly how the Reagan administration's application of foreign policy controls would differ from past policy.

With respect to the third criticism of past policies--the lack of clear guidelines to U.S. exporters--the Commerce Department states that it is the goal of the Administration to give U.S. companies clear guidance and predictability. The response does not include an elaboration of how this will be achieved.

On two other subjects, the responses emphasize continuity with the policies of past Administrations. The State and Commerce statements reaffirm the past policy of differentiating in U.S. trade policy among the Soviet Union, the countries of Eastern Europe, and China. (The Commerce Department notes some measures already taken to ease restrictions on trade with China.) The Administration is also continuing the effort of identifying critical technologies and, like the previous Administration, appears to be encountering difficulties in integrating a list of clearly defined technologies into the existing Commodity Control List.

Question 5. What are the criteria under which a country is determined to be state controlled for purposes of anti-dumping and market disruption investigations? Are third country comparisons the best method for making determinations on dumping? Does current U.S. law provide U.S. producers sufficient protection against market disruption from goods produced in non-market economy countries? What should our policy on countertrade and compensation agreements be?

CRS Background

Special provisions in U.S. law regulate imports from Communist countries. The market disruption provision of Section 406 of the Trade Act of 1974 protects against increasing imports from Communist countries which are or threaten to be a significant cause of material injury to a U.S. industry. It differs from the escape clause provision (Title II of the Trade Act), which applies to imports from any country, in that it contains a lower standard of injury and certain procedures for expeditious handling.

U.S. anti-dumping law is designed to protect against sales at less than fair value which result in injury to a U.S. industry. Because of the difficulty of determining fair value in a centrally planned economy, special provisions of the law apply to Communist countries.

Various kinds of countertrade or compensation agreements, which are becoming increasingly prevalent in East-West trade, could pose special problems for U.S. domestic industries. Such agreements involve payment in products--often goods produced with imported Western plants, machinery and equipment. When Western firms agree to accept payment in products, they are forced to market them on world markets, often in competition with U.S. domestic producers.

Answer

STATE

The criteria for dealing with state controlled economies for anti-dumping investigations are set forth in Section 773(c) of the Trade Act of 1979. Section 406 of the Trade Act of 1974 is the appropriate statute for market disruption. Section 406 refers to products of Communist countries and defines the term to mean "any country controlled by Communism." Past precedent indicates that this statute would apply to all Warsaw Pact countries, the People's Republic of China, North Korea, Mongolia, Vietnam, Kampuchea, and Cuba.

STATE (continued)

We are not content with the current method of using third country comparisons for making determinations in dumping cases involving centrally planned economies. One serious shortcoming of the present system is that exporters from non-market economies, unlike other exporters, are unable to determine what price they would have to charge in the U.S. to avoid dumping. U.S. import-competing industries also have difficulty estimating "fair value" and the use of constructive costs is administratively burdensome and expensive. This Department, together with other concerned agencies, is actively considering proposals which we believe would address many shortcomings of present procedures.

Existing statutes are sufficient to deal with the problem of market disruption from goods produced in non-market economy countries. Considering the large increase in our trade with these countries over the last decade, instances of market disruption have been relatively infrequent.

Economic strains affecting Communist countries have increased pressures on Western firms to enter into countertrade or compensation arrangements. One government has introduced requirements calling for Western counter purchases of up to 140% of the value of goods it imports. The U.S. and other Western governments are disturbed by this trend. Countertrade has been discussed intensively at the OECD and is the subject of a report recently prepared by that organization. We will be taking up the problems of countertrade at a special meeting of the Economic Commision for Europe's Trade Committee, which will be held in Geneva from November 9-12. We strongly reject Eastern notions that countertrade is a "higher form of trade." Countertrade is economically inefficient, distorts normal trade patterns, and may encourage market disruption. At the same time we realize that in certain instances countertrade arrangements may be profitable for American companies, particularly those that have well established ties with Communist countries. But we would caution U.S. business to be wary of the risks of barter-type transactions.

COMMERCE

The U.S. also maintains controls on imports from the communist country "state-controlled economies". Section 406 (Trade Act of 1974) protects against market disruption caused by surges of imports from Communist countries. The provisions of this law are administered by the International Trade Commission. The final remedy is determined by the President.

The Department of Commerce has responsibility for administering the anti-dumping and the countervailing duty statutes. Both of these provisions deal with unfair trade practices. State-controlled economy country imports are specially provided for in the anti-dumping law. The countervailing duty law is silent on the distinction between market and non-market economy countries and has never been used in a dispute concerning imports from an Eastern country (there is general agreement on the difficulty, if not impossibility, of adequately measuring the degree of subsidization in a non-market ecnonomy).

The provisions of our antidumping law dealing with imports from state-controlled economy exporters require the Department to look to the prices and costs of an unrelated producer in a free-market economy as a surrogate "fair value" for the imported product from the state-controlled economy. This approach means that neither U.S. industry not the state-controlled economy exporters can ever predict

COMMERCE (continued)

accurately what that "fair value" will be, since it depends on an unpredictable selection by the Department of a surrogate producer/country for each new case. By contrast, our dumping law in normal cases assumes that the foreign exporter will know in advance whether it is dumping (since the Department looks to that exporter's own prices or costs, rather than a surrogate), and can control it afterwards.

Our experience in past years with these state-controlled economy dumping cases leads us to believe that the present statute and regulation are overly burdensome, abstract, and complicated. Thus, administration of these cases becomes enormously costly in terms of staff time and quite expensive for both U.S. petitioner and foreign respondent. In light of this, although not agreeing with all the provisions set forth, we welcome the proposal for new legislation to handle this problem, such as the bill introduced in the Senate this year (S.958).

The U.S. anti-dumping law and market disruption provisions of the Trade Act of 1974 (Section 406) are among the most important statutes which govern imports from non-market economies. There are special provisions of our anti-dumping law which deal with non-market (or state-controlled) economies, and our market disruption law applies only to imports from communist countries.

Our antidumping legislation requires the Secretary of Commerce to determine whether "the economy of the country from which the merchandise is exported is state-controlled to an extent that sales or offers of sales of such or similar merchandise...do not permit a determination of foreign market value." The economic criteria upon which such a determination is based differ from case to case.

Two general but key economic factors which figure prominently in such a determination are: (1) the extent to which prices are permitted to fluctuate in response to supply and demand and; (2) the extent to which the exchange rate reflects the appropriate relative value of the country's currency. Many other economic indicators are important in specific cases. The Commerce Department's recent preliminary investigation concerning truck trailer axle and brake assemblies from Hungary is illustrative. In that case, among other indicators, some of the factors involved in determining the state-control issue included: method of controlling wage increase levels, sources of capital financing, method of hard currency allocation and general management structure.

It should be noted that the issue of state-control has no direct bearing on market disruption investigations. Our market disruption law (Section 406 of the Trade Act of 1974) concerns all "communist" countries, defined in the statute as "any country dominated or controlled by communism."

Under our present anti-dumping statute, the fair value for merchandise imported from a state-controlled economy country is determined by using the prices or costs of a non-state-controlled economy country producer of such or similar merchandise. This producer, whenever possible, is selected from a country at a similar level of economic development.

COMMERCE (continued)

There are a number of problems with this approach. It is difficult to find a surrogate country which is not state-controlled and which resembles a state-controlled economy in economic development and structure. Since a perfect match is nearly impossible, considerable time and expense are involved debating the merits of countries which are all "second best" choices.

After choosing a country or group of countries as potential surrogates, the Administration must then persuade a producer in that foreign country (who is not a party to the case in any respect) to give the U.S. Department of Commerce confidential data about its sales and production costs. We then determine a "fair value" for merchandise from a state-controlled economy. This "fair value", in effect, becomes the price at which the state-controlled economy producer can sell to the U.S., even though the state-controlled economy producer has neither knowledge nor control of that "fair value" at any given point. Thus, the third country comparisons called for under the present law have clear flaws.

Market disruption by non-market economies is dealt with by two statutes: Section 201 (escape clause) of the Trade Act of 1979 which protects against imports from all of our trading partners and Section 406 (market disruption) of the Trade Act of 1974, which applies only to increasing imports from communist countries.

A market disruption action is similar to an escape clause action except that the standard of injury (to domestic producers) is lower and provisions for expeditious handling are included. These two provisions, which concern problems created by unfair trading practices, are, of course, supplemented by our anti-dumping legislation, all of which form the network of trade laws governing imports from communist countries. It should be noted that since the enactment of the 1974 Trade Act, protection from market disruption by communist countries, as embodied in Section 406, has been sought in only six cases involving three products.

Countertrade or compensation agreements tie Western exports to the East to Western imports of Eastern products that are valued at the amount or some portion thereof of the Western sales. The decision whether or not to participate in countertrade or compensation arrangements rests with individual firms. The role of the U.S. Government is to provide information to U.S. businessmen on communist country practices and countertrade techniques. At bilateral and multilateral discussions on countertrade it is the policy of the U.S. Government to air both the micro- and macro-economic problems which can arise with countertrade (protracted negotiations, lack of acceptable Eastern products available for countertrade, etc.). We also point out to our Eastern trading partners that most forms of countertrade are inefficient and costly short-term solutions to the long-range problems of improving both their marketing techniques and quality of exportable goods.

U. S. TRADE REPRESENTATIVE

Section 406 of the Trade Act of 1974 governs the conduct of investigations to determine if goods from a nonmarket economy (i.e. state-controlled country) are disrupting U.S. markets. Section 406 applies only to communist countries and section 406 (e) (1) defines a communist country as any country dominated or controlled by communism. For the purpose of dumping investigations under Title VII of the Tariff Act of 1930 as amended, the provisions in section 773 (c) regarding state-controlled economies come into force only if it is determined that the country is state-controlled to the extent that sales in that country or to third countries do not permit a determination of the foreign market value of the goods under investigation in accordance with the normal procedures. There are no separate criteria for determining whether a country is state-controlled other than to consider whether the nature of the country's economy is such that the normal methods for assessing foreign market value cannot be used. When it is not possible to determine foreign market value based on prices in the country of exportation, it is generally preferable to make determinations on the basis of third country comparisons. However, cases may arise where it is less time consuming to use constructed value rather than third country sales.

Current U.S. laws do appear to provide U.S. producers sufficient protection against market disruption from goods produced in nonmarket economy countries. Since the enactment of section 406 of the Trade Act of 1974 only five petitions for relief under section 406 have been filed. Three of the petitions resulted in a determination of no injury by the International Trade Commission (ITC), a fourth resulted in a positive decision which was turned down by the President because market economy countries rather than U.S. producers would benefit from import restrictions on communist countries. The ITC then initiated a proceeding under section 201 of the Trade Act of 1974 and was granted relief that limited imports from all countries, not just nonmarket economy countries. In the fifth case, President Carter first rejected an ITC determination of injury in regards to imports of ammonia from the Soviet Union, but later imposed restrictions under the emergency action provisions of section 406. However, the ITC then found that there was no market disruption.

The U.S. Government recognizes countertrade as a reality in its commercial relations with the nonmarket economy countries. United States firms are not discouraged from entering into countertrade arrangements when it is profitable for them to do so. However, countertrade is essentially a trade distorting phenomenon. Rather than promoting the expansion of trade through the use of more efficient allocation of resources and production according to the principle of comparative advantage, countertrade requirements may require balancing of trade accounts at the level of the individual firm, or even the individual transaction, greatly reducing opportunities for achieving greater economic efficiency.

CRS Commentary

The responses reflect general satisfaction with the market disruption procedures of U.S. law. They have been used infrequently and apparently pose no major administrative problems.

The responses of State and Commerce, however, express serious reservations about the effectiveness and practicality of existing anti-dumping procedures. They seem receptive legislative initiatives to deal with existing problems. Commerce mentions the bill (S. 958) introduced by Senator Heinz, but notes that it does not agree with all of its provisions. Especially relevant is the removal of the third country equivalent criterion, which is acknowledged to be difficult to apply accurately even when "considerable time and expense" are devoted to it. Although they would welcome removal of the uncertainties of the third country equivalent approach, non-market countries would prefer the application of GATT anti-dumping provisions.

All of the responding agencies are critical of countertrade arrangements. Efforts to combat such agreements have been limited largely to advising U.S. companies on the problems involved and discussing the issue in the Organization for Economic Co-operation and Development and the Economic Commission for Europe.

Agricultural Trade

Question 6. Since the grain embargo has been lifted and the US-USSR long-term grain agreement (LTA) has been extended for one year, we seem to have returned to normal grain trade. Why is the grain trade treated differently than other commercial relations? As this is likely to be the third successive poor crop year for the USSR, would this not have been a propitious time for us to renegotiate a better LTA? Will the Soviets be assured that we will not embargo grain sales? Were we to extend our agreement to other agricultual trade and cooperation what commodities or activities should be included? Should we apply the same pattern of agricultural trade to other Eastern countries? How might Poland be a special case for an "Agricultural Strategy" by the U.S.?

CRS Background

The Soviet Union's strategy of raising meat production as an incentive for increased labor productivity, coupled with periodic grain shortfalls, led it to import large quantities of U.S. grain in the mid and late 1960s and early 1970s. Soviet demand for U.S. grain was highly variable, with especially large purchases occuring in 1972 and 1975, but little or none in the other years.

To stabilize grain exports to the Soviet Union the United States concluded a five-year supply agreement in 1975. Starting in October 1976, the agreement commits the Soviet Union to purchase 6 million metric tons (MMT) of corn and wheat in approximately equal amounts each year. Unless American grain supplies fall below 225 MMT, the Soviets have the option of purchasing an additional 2 MMT of grain without consulting the U.S. Government. If the Soviets want to purchase more than 8 MMT in a year, consultations are required. As the agreement covers only wheat and corn, some observers recommend the inclusion of other agricultural commodities such as soybeans in any new agreement with the Soviets.

Under the terms of the agreement the Soviets purchased 6 MMT of wheat and corn during the first agreement year (October 1976-September 1977), 14.6 MMT during the second year, and 15.3 MMT during the third. For the fourth year, the Carter administration authorized Soviet purchases of 25 MMT, but later reduced the amount to 8 MMT--the minimum allowable under the terms of the grain agreement--in response

CRS Background (continued)

to the Soviet invasion of Afghanistan. The Carter administration decided to honor the agreement for what was to be its fifth and final year and again authorized sales of 8 MMT.

The Reagan administration lifted the embargo on agricultural commodities on April 24, 1981. During the first week of August it was announced that the grain agreement, which was due to expire on September 30, would be extended for an additional year. On October 1, the Administration announced that the Soviet Union could purchase up to 23 MMT of grain during the sixth year.

The decisions to lift the embargo, approve large above-agreement sales, and defer negotiations on a new long-term agreement (LTA) have been controversial within the Administration, the Congress, and the general public. Answers from the Departments of State and Agriculture to written questions posed by Congressman Lee H. Hamilton corroborate reports of an inter-agency split on the decision to end the embargo.* The State Department's response asserts that U.S. grain exports reached record levels despite the embargo and that no full-scale assessment of the embargo's impact on domestic grain prices had been made. The letter stated that the embargo had a "significant" impact on Soviet grain imports and noted that meat production began to decline in the summer of 1980. On the reliable/unreliable supplier question, State responded that under current conditions the Soviet Union would have to turn to the U.S. for a portion of its corn import needs and that other potential buyers of U.S. grain would realize that their access to the U.S. market was secure, since the embargo was "an exceptional response to Soviet aggression." In contrast, then Acting Secretary of Agriculture Lyng began by stating that "...the embargo on the USSR had not been effective in terms of its impact upon the USSR, while here at home it represented a serious burden for American farmers." In his view, the embargo's primary impact on the Soviet Union was "disruption" in shipping, handling, and supply lines. He further stated that "...continuation of the embargo would have

* The full texts of the questions and answers may be found in the Congressional Record, May 18, 1981, pps. E 2390-E 2391.

CRS Background (continued)

increasingly endangered the Soviet and other markets for U.S. agricultural products."

In addition to questions about the wisdom of lifting the embargo and the timing of the decision, there have been criticisms that the Administration should have, but did not, extract a quid pro quo from the Soviets. Some applaud what they view as a decision to return the U.S.-Soviet grain trade to its usual basis, while others object that the U.S. should not bail out the Soviet Union, which has had three poor harvests in a row. Still others are concerned that American policies on grain and non-grain exports to the Soviet Union are inconsistent. They note that our more restrictive policy on non-grain exports leads our allies to argue that their policy of normal trade in energy equipment should be viewed as compatible with our policy of normal trade in grain.

Although generally smaller than exports to the U.S.S.R., U.S. grain exports to the other Eastern countries are significant, nonetheless. The People's Republic of China is the only other communist country with which the United States has a long-term supply agreement. It provides for annual Chinese purchases of 6-9 MMT of corn and wheat for the four years beginning on January 1, 1981.

Answers:

STATE

Both Eastern Europe and the Soviet Union are important markets for U.S. agricultural products, chiefly grains. In the Soviet case, this reflects the fact that agricultural production is a particularly weak link in the Soviet economy. Because the potentially large Soviet demand for grains could cause significant market fluctuations, our grain trade has been governed by a long-term framework agreement since 1976.

Terminating the partial grains embargo in April was a step in restoring our grain trade with the USSR. To the extent that the conditions of trade in each commodity reflect the strategic and technical considerations appropriate to the commodity involved, grain trade is not treated differently than other commercial relations. Trade in grains and agricultural products, which are basically items for immediate consumption, is different from trade in many industrial products, which can have an important multiplier effect on increasing industrial production, transfer important technology, and contribute to Soviet development in militarily relevant ways.

STATE (continued)

The U.S.-U.S.S.R Long-Term Agreement (LTA) was recently extended for a period of one year. We have not yet fixed a date for discussion of a further renewal or of a revision of the text, however, we believe that renegotiation of the LTA is largely independent of the crop situation in the USSR for any specific year. By definition, the LTA would cover the longer term. Many factors influence the level of Soviet imports from the U.S., including port capacity limitations, prices, availability from other grain suppliers, and Soviet crop conditions. Thus, we do not see that this--as opposed to some other--time to be especially promising for renegotiation of the LTA.

The issues to be considered in a new LTA will include the question of assurances against embargoes and whether to include other commodities. The Soviets have shown considerable interest in the question of guarantees but no interest in including additional commodities in the LTA thus far. In general, we prefer to let agricultural trade develop in regular, commercial channels. Because these matters will be under negotiation, it would be inappropriate to comment further.

The use of normal commercial channels, to the extent possible, is also our preferred agricultural trading relationship with Eastern Europe. We see no distinct advantage to negotiating bilateral agreements in Eastern Europe.

The primary exception to this rule is Poland, which is indeed a special case. The special situation there has led to a series of U.S. actions designed to ease the serious agricultural situation, including:

a. access to US agricultural export financing programs which has helped to ease significantly the impact of bad harvests over the past four years.

b. qualification for Commodity Credit Corporation (CCC) credits, which have provided direct credits and loan guarantees exceeding $2 billion to buy US farm products in fiscal years 1978-81. (Payments falling due in 1981 have been rescheduled. Rescheduling negotiations for 1982 payments are set to take place during the latter part of this month.)

c. A PL 480 concessional sales (Title I) agreement with Poland in August for $47.6 million of corn.

d. U.S. authorization on April 2 for the sale of 30,000 tons of dried milk and 30,000 tons of butter at concessional prices with payment in Polish currency.

COMMERCE

President Reagan reaffirmed his commitment to the expansion of agricultural exports by lifting the grains embargo to the U.S.S.R. on April 24, 1981. U.S. grain exports to the Soviet Union constitute a substantial portion of total U.S. grain trade and have been subject to special bilateral arrangement since 1972. It is important to ensure that our grain exports to the U.S.S.R. are consistent with overall U.S. policy. An extension of the current grains agreement was favored by the Administration to preserve existing arrangements while evaluating carefully our position on a new long-term grains agreement.

COMMERCE (continued)

The United States also views Eastern Europe as important agricultural customers and the U.S. Department of Agriculture has bilateral cooperation programs with several countries.

AGRICULTURE

The USSR is a very important grains customer. In 1979, it took roughly 15 percent of our wheat exports and 20 percent of our feed grains exports. The Long-Term Agreement has provided an effective means of dealing with this very large single buyer in terms of providing a mechanism for discussing possible purchases with the Soviets, for ensuring that purchases were consistent with our available supplies, and for enhancing U.S. exports. The possible modification of that agreement, such as by extending it to cover other products or commodities, or by modifying current provisions concerning wheat and corn, involves complicated considerations and possible trade-offs. It is rarely advisable to negotiate against a deadline, even if poor Soviet crop prospects seem to put them under special pressure. We expect an agreement to work effectively over several years; hence our negotiating positions need to be thought out very carefully.

We do not believe that Poland presents a suitable special case for an agricultural strategy by the United States. Poland is a big market for U.S. agricultural commodities, but not so big as the Soviet Union. It is a market primarily for U.S. agricultural -- as opposed to industrial -- products, but the predominance is not so great as with the Soviet Union. The Polish economy is in a state of crisis and a number of countries including the United States are working with Poland to deal with that crisis. An agricultural focus to the Polish problem is too limited.

DEFENSE

Grain trade has been treated more often like normal commercial relations with the Soviet Union, in part because Soviet agricultural production often is uncertain and the U.S. is a strong grain producer with a large exportable surplus. However, even grain was partially embargoed after the Soviets entered Afghanistan. Few would doubt that stronger measures to restrict grain exports might have been imposed had the Soviets intervened in Poland's internal affairs with brutal force. They have not. In the meantime, hard currency not spent on grain might have been diverted to import technology. Russia's uncertain weather is keeping the pressure on other sectors of the Five Year Plan, besides agriculture, in the competition for resources.

Poland will continue to need U.S. food aid. Only broad economic reforms and several years of hard work will put Poland's economy on the road to recovery.

U. S. TRADE REPRESENTATIVE

Recent decisions regarding agricultural sales to the Soviet Union are consistent with the overall policy of the Administration towards U.S.-Soviet trade. While the Administration has sought to strengthen controls of exports of goods and technology with potential strategic applications, growth of trade in non-strategic product sectors, such as agriculture, has not been discouraged. The Soviet Union has become an important market for U.S. agricultural products. In 1979, sales to the Soviet Union comprised roughly 15 percent of total U.S. wheat exports and 20 percent of total U.S. exports of feed grains.

The long-term grains agreement concluded in 1976 has provided an effective mechanism to facilitate the development of this trade. Because of uncertainties in overall U.S.-Soviet relations, discussions on a new agreement did not begin until August 1981. The remaining time before the expiration of the existing agreement of September 30, 1981, was not sufficient to permit negotiation of a new agreement. As a result, the agreement was extended for an additional year with the understanding that further discussions on a new agreement would be held in the near future. Given the long history of Soviet difficulties in meeting their grain needs, it is likely that their interest in a new long-term agreement will remain strong regardless of the crop situation in any particular year.

The Administration is still in the process of formulating its position on the various aspects of a new agreement, including the questions of assurances and product coverage. With regard to assurances the Administration has made clear to the Soviet Union that agricultural sales will continue to be considered within the broader context of U.S.-Soviet relations. However, the Administration has taken the position that sales of agricultural products will not be singled out for restriction in the event of future sanctions on trade with the Soviet Union. With regard to product coverage, a number of additional products--for example, poultry, meat, tobacco, soybean meal and oil, wheat flour, and corn gluten--have been suggested for possible inclusion in a new agreement. These possibilities will be considered as preparations for negotiations on a new agreement continue.

Bilateral agreements similar to the U.S.-Soviet Long Term Agreement are not appropriate for most of the countries to which the United States exports agricultural products. Because of the very large amounts of grain shipped to the Soviet Union and the potentially destabilizing effect of their purchases on U.S. and world grain markets, the Soviet Union is an exception. However, the same conditions do not apply to the Eastern European countries. Although Poland is a relatively large market for U.S. agricultural commodities, it is not large enough to merit the negotiation of a long-term agreement to increase U.S. agricultural exports.

CRS Commentary

In their responses the State Department, the Department of Agriculture, and the U. S. Trade Representative note the importance of Soviet and East European grain markets to the U.S. farm sector. Particularly striking are the calculations that sales to the Soviet Union accounted for about 20 percent of U.S. feedgrain exports and about 15 percent of its wheat exports in 1979. One might conclude, therefore, that grain sales to the Soviet Union could make an important contribution to farm income, which is expected to decline for the third consecutive year in 1982.

Both the State Department and the USTR emphasize the consistency of Administration policy on grain and non-grain exports to the Soviet Union. They argue that grain exports are non-strategic and consistent with a policy of promoting non-strategic exports, but restricting those of a strategic nature. Some observers, especially in West Europe, would challenge this argument. In their opinion, grain is a strategic export because large, continuing grain sales make it possible for the Soviet Union to accommodate persistent shortfalls in agricultural production and concentrate on increasing its military and industrial strength. If this counter argument is accepted in government circles, U.S. policies on agricultural and industrial exports could cause friction within CoCom.

The USDA response to this question and to questions 1 through 3 amply reflects its special interest in expanding U.S. agricultural exports and concern about the reliable supplier issue. It emphasizes the importance of maintaining "stable or normal" trade relations with all customers -- both in the Soviet Union and Eastern Europe and in other areas -- so that the U.S. will be perceived as a reliable supplier. Despite the concerns about the United States' image as a reliable supplier that its response hints at, and its prediction that the Soviet Union will continue efforts to diversify its sources of supply, USDA is fairly optimistic

CRS Commentary (continued)

about the outlook for the U.S. exports of grains to the Soviet Union.

The argument that this year was a particularly propitious time to negotiate a new LTA with the Soviet Union did not receive much support from the Administration. The State Department explicitly rejected it, remarking that "...re-negotiation of the LTA is largely independent of the crop situation in the USSR for any specific year." The USTR takes a similar approach. It concludes that the Soviet Union would probably be interested in an LTA regardless of its crop prospects for any given year because of its periodic grain shortfalls. The USDA response implicitly acknowledges the argument, but implies that the United States could have forfeited its bargaining advantage by negotiating "against a deadline."

Holding the Soviet Union directly responsible for the imposition of martial law in Poland and the suppression of Solidarity, President Reagan announced on December 29 that negotiations on a new grain agreement with the Soviets would be suspended. The action did not affect sales of grain during the remainder of the sixth year of the agreement, although the President left open the possibility of further sanctions against the Soviet Union.

It is clear from the Administration's responses that it is not inclined to negotiate long-term grain supply agreements with other Eastern countries. Whenever possible, it prefers to keep trade on a regular commercial basis. The Administration believes that long-term agreements with the East European countries are unwarranted because their purchases are too small to disrupt U.S. or global grain markets.

Merchant Marine Agreement

Question 7. Our bilateral maritime agreement comes up for renewal this year. What considerations should we have in improving the agreement? Are Soviet maritime practices, e.g. in crosstrades, inimical to our interests?

CRS Background

The second U.S.-U.S.S.R.-Maritime Agreement, which was signed in 1975, expired on December 31, 1981. Negotiations on a new agreement were held in mid-November and early December, but apparently ended in deadlock. On December 29 President Reagan announced that the United States would suspend further negotiations with the Soviets as part of its response to the imposition of martial law in Poland.

The Agreement stipulated that both countries' flag vessels were to share equally in the carriage of bilateral cargoes, with the proviso that each country's vessels should be offered no less than one-third of dry, bulk cargoes (i.e. grain). The Agreement also provided for access to 40 ports in each country on 4 days' notice and annual renegotiation of cargo rates. To enable higher-cost U.S. vessels to participate in the grain trade, the Government provided special subsidies. Since 1979, U.S. tankers, which are used to transport grain as well as oil, have not participated in this trade. Because no funds for the special subsidy program were used in FY 1981, it was not funded in the budget for FY 1982. Many analysts believe that tankers will become available for this trade, as demand for their services in transporting Alaskan oil declines. Thus, guaranteed access to business at profitable rates would offer attractive benefits for U.S. shippers and maritime unions.

In recent years concern about the growing share of the Soviet merchant fleet in the U.S. crosstrades, i.e. shipments between the United States and a non-Soviet port, has been mounting. For example, the Soviet Union earned about $256 million from the U.S. crosstrades in 1978, while the U.S. share of the Soviet crosstrades was virtually nil. The crosstrade issue was not addressed in the Agreement, but in 1978 Congress passed the Ocean Shipping Act, which gives the Federal Maritime Com-

CRS Background (continued)

mission authority to reject rates filed by state-controlled shipping companies if it decides that their rates are unfair. Marine insurance of bilateral cargoes was an additional irritant. Since the U.S.S.R. required that virtually all bilateral cargoes be insured by its state insurance company, U.S. underwriters were effectively precluded from insuring cargoes. In addition, the rates charged by the Soviet agency for insuring grain shipments were higher than those U.S. companies would have charged. In the fall of 1978 the U.S. and the U.S.S.R. signed a memorandum of understanding, which set a formula for sharing the insurance of bilateral cargoes. Another outstanding issue besides those of equal benefits in bilateral and crosstrades is port access. The Defense Department believes that security considerations make it inadvisable to allow Soviet access to some of the ports on the list on 4 days' notice.

Answers

STATE

The operation of Soviet liner vessels in our cross trades has been a significant problem, although present Soviet shipping activity in the U.S. trades is negligible as a result of a longshoremen's boycott of Soviet ships instituted in January 1980. The seriousness of this problem was recognized when Congress passed the Ocean Shipping Act of 1978 (also known as the "Controlled Carrier Act"). This law gives the Federal Maritime Commission authority to reject rates filed by the shipping lines of the USSR and other state controlled steamship companies for crosstrade voyages if such rates are not considered just and reasonable. In addition to the Controlled Carrier Act, we are taking account of the cross trade problem in planning for a possible new US-USSR maritime agreement, which would also reflect our continuing desire to assure US-flag participation in the US-USSR bilateral trade at remunerative rates.

COMMERCE

The U.S.-U.S.S.R. Maritime Agreement comes up for renewal this year. We expect talks to begin in November. Specific dates are now being discussed. The U.S. plans to maintain the opportunity for U.S. carriers to participate in the movement of bilateral trade and to obtain a more equitable balance of economic benefits in crosstrades.

AGRICULTURE

We believe that the United States has benefited from the agreement and, although the agreement might be modified in certain particulars, there should continue to be an agreement and that it should not jeopardize existing agricultural trade.

U.S. TRADE REPRESENTATIVE

The U.S.-U.S.S.R. Maritime Agreement was signed in 1972 and renegotiated with minor changes in 1975; the current agreement expires on December 31, 1981. There were two broad objectives which the United States sought to achieve when the agreement was first negotiated: First, to ensure U.S. merchant marine participation in the trade between the two nations; second, to facilitate the movement of trade by increasing port access.

While the U.S.-U.S.S.R. Maritime Agreement has accomplished the two major goals for which it was designed, there is an imbalance of benefits accruing to the two nations because of Soviet participation in the U.S. crosstrades. In a new agreement, the United States intends to seek a more equitable arrangement on crosstrades either by obtaining greater Soviet adherence to operating practices in the U.S. crosstrades and/or by securing cargoes for U.S. flag vessels in Soviet crosstrades.

With regard to the inimicality of Soviet participation in U.S. crosstrades, the presence of the Soviet fleet in our trades is not harmful per se, so long as they are not operating on U.S. bilateral or crosstrades in a predatory or noncompetitive manner. Experience has shown, in some instances, that state-controlled carriers take advantage of their economic and cost structures by charging extremely low rates. The long-term effect of such practices may be a reduction in competition or a lessening of the role our merchant marine plays in foreign trade. The Reagan administration is committed to ensuring that competition continues to exist over the long run and that the consumer of shipping services continues to benefit from such competition.

DEFENSE

The Department of Defense has proposed several changes in the list of U.S. ports open to Soviet vessels on 4-days' notice under the U.S.-Soviet Maritime Agreement, which expires December 31, 1981. This will not necessarily close the ports affected; instead, it will require 14 days' advanced request for entry. The Soviets accepted the U.S. deletions during the first round of talks (November 18-19). Soviet maritime practices, particularly crosstrade and grain-rate issues, are being reviewed and have been clarified but not resolved. Negotiations will be renewed in Moscow beginning December 7.

CRS Commentary

From the agencies' responses it appears that the Administration considered a new maritime agreement desirable, if not critical, provided that the crosstrade issue could be resolved. With the expiration of the old agreement, Soviet vessels will continue to have access to U.S. ports, but will have to apply for permission 14 days in advance.

Country Forecasts

Question 8. The Eastern countries all are experiencing domestic and foreign economic difficulties. Please provide detailed assessments of the economic prospects of each of these countries to 1985: the Soviet Union, the GDR, Poland, Czechoslovakia, Hungary, Romania, Yugoslavia, the PRC, North Korea, Mongolia, Vietnam, and Cuba. We are especially interested in their economies as potential markets and as countries with a propensity for debt buildup.

CRS Background

Each of the European members of CMEA (the Council for Mutual Economic Assistance) grew at a comparatively satisfactory rate in the 1970s. The Soviet Union and the smaller nations of East Europe benefited from abundant and cheap energy, Western credit at below market rates, and increased trade with the West. Yugoslavia followed the same pattern during the decade.

The People's Republic of China launched a program of modernization and normalization of commercial relations with the West. After Deng's ascendance to power, the PRC moved toward rapidly expanded and significant levels of economic interdependence with the West.

As client states with very limited ties to the West, North Korea, Mongolia, Vietnam, and Cuba remained dependent on the Soviet Union.

For the small countries of East Europe the Eighties will be a decade of slower growth in national product and Western trade. Growth will be limited by energy constraints, reduced credit availability and a restricted Western market. The Soviet Union, in contrast, may benefit from continued gas and oil exports and significantly expanded Western trade.

The early flush of Chinese trade expansion has been followed by reappraisal and retrenchment. Economic relations with Japan, the United States and other Western countries are likely to expand, but at a more measured pace.

Without significant prospects of increasing their economic relations with the West, the client states are likely to be an increasing burden on the U.S.S.R.

Answers:

STATE

Our assessment of prospects for the economies of individual Communist countries through 1985 is as follows:

USSR. The Soviet economy will continue to grow over the next few years but at markedly lower rates compared with the 1960s and early 1970s. Targets for the 1981-85 Five-Year Plan are among the lowest ever set and reflect growing constraints in the supply of energy and other resources. Annual increments to the labor force are declining and the Soviets have not met plans for increased productivity. General mismanagement in an overly centralized economy--where there still are no signs of any meaningful reform that would produce results in the next few years--casts doubts over whether even the lower industrial growth targets will be met in their entirety. Recurring and persistent problems in agriculture add to the economic dilemma facing the Soviet leadership over the next few years on matters of investment, consumer welfare, and defense spending.

Against such a backdrop, Soviet demand for Western machinery, equipment, and materials will continue to grow--especially for high technology goods that could spur productivity and for materials needed to overcome domestic supply bottlenecks. The USSR livestock sector will be particularly dependent upon Western grain over the next few years in view of its three consecutive poor grain harvests (1979-81). As always, financial constraints will limit the amount that Moscow can purchase from the West. The Soviets are conservative bankers, however, and their present debt is manageable--facts that argue for continued lending from private sources. In addition, as a major gold producer, Moscow can augment its foreign exchange holdings by selling gold.

Eastern Europe. The Eastern European economies will experience slower, and in some cases almost zero, growth through 1985, marked by constraints imposed by inadequate energy supplies, lagging agricultural performance, and the need to limit increases in hard currency debt. The impact of all these factors has brought economic problems to the fore in Poland--where a major debt rescheduling is underway--and in Romania and Yugoslavia. All three will require strong stabilization measures through at least the next two years, if not longer. Tighter hard currency situations throughout Eastern Europe will restrain the drive to modernize plant and equipment. The region's leading industrial powers--the GDR and Czechoslovakia--will see their efforts to renew their aging industry bases compromised by tightening hard currency constraints. Hungary and Bulgaria have achieved balance-of-payments stability, but have seen slowing growth as a partial result. Albania remains a significant exporter of chrome, but offers little sign of ending its isolation.

Soviet oil and gas supplies do not fully meet the region's rising demand, and the goals for nuclear energy appear unrealistic. The persistent failures to boost grain production underlie a continuing need for substantial grain imports--primarily from the US--to maintain livestock production and meet consumer expectations. Economic reform is imperative for economic progress, but it languishes in every country save Poland--where economic collapse remains a possibility--and Hungary. The latter's innovative approach has brought a more open economic system, and given the country a sound balance of payments. Access to Western credits--to alleviate debt burdens and permit vital imports, both technological and agricultural--and effective policy responses to the needs for energy and reform will be key to Eastern European economic performance through 1985.

STATE (continued)

China. The Chinese have not yet released an official Five-Year Plan for 1981-85. However, economic policies most likely will stress developing infrastructure, promoting economic efficiency, and raising consumers' living standards, rather than attaining a high rate of economic growth. Priority areas for investment will be agriculture, light industry, transport and energy. In heavy industry, the current readjustment program's calls for cutting capital construction will be constrained by bureaucratic resistance, unfamiliarity with "market socialism", declines in energy production, shortages of managers and workers with needed skills.

China will continue to import technology from the West to meet its needs especially in energy production. In addition, China will remain a major market for U.S. agricultural commodities, raw materials and intermediate goods. Protectionist barriers against Chinese textiles and light manufactures could become a major constraint on US-China trade. The Chinese have retained a very conservative borrowing strategy. They have drawn very little of the almost $30 billion in credits available to them from foreign banks and governments. Most likely, they will continue to seek multilateral and bilateral loans at concessional rates to avoid incurring higher-cost debt.

Vietnam, North Korea, and Mongolia. The US has no diplomatic relations with these countries and almost non-existent trade. While both Vietnam and North Korea would welcome greater trade with and investment from the West, political and economic factors make them unattractive markets. Vietnam's economy has deteriorated since 1978 and now depends on Soviet and East European aid to meet its food and fuel requirements and technical assistance. North Korea's poor repayment record on its $1.4 billion debt and inefficient trade corporations have discouraged Western firms from considering new agreements with Pyongyang. Mongolia's economy, based on agriculture and animal husbandry, has a close complementary relationship with that of the USSR, its main source of technical and developmental assistance.

Cuba. The Cuban economy depends on the Soviet Union for about 25% of its GNP, and economic prospects are poor. The World Bank describes the Cuban economy as having an average negative growth rate since 1960, the only such case in the Communist world. Occasional ups and downs are attributable to the lack of Soviet subsidies, as the domestic Cuban economy continues to be highly inefficient. Opportunities for the sale of Western industrialized products will continue to exist, but the availability of hard currency will act as a constraint. Foreign exchange earnings are largely dependent on how much sugar Cuba can sell on the volatile international sugar market, after meeting obligations to the USSR. Cuba's current level of debt to the West is high relative to its ability to earn hard currency and expected to remain so. Havana will continue to seek limited Western credit.

COMMERCE

Attached in Appendix I are Commerce Department reports* on the overall outlook for East-West trade through 1985 and on the trade and economic prospects for each communist country (U.S.S.R., Poland, Romania, GDR, Czechoslovakia, Hungary, Bulgaria, China, Albania, Cuba, Vietnam, Mongolia, and North Korea). Several of the articles are reprinted from an October 1981 issue of the Commerce Department's periodical, Business America. Yugoslavia is omitted from discussion of communist country trade and economic prospects. The Commerce Department treats Yugoslavia as a Western country for trade development purposes.

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* To be released in a subsequent volume.

CRS Commentary

In spite of slow growth and limited hard-currency earnings, the Eastern countries will have increasing needs for Western technology, grain and credit. Limitations on energy and labor supplies and systemic deficiencies account for the slow-to-no-growth prospects in the East. Energy exports may be the key to improve the import capability of both the Soviet Union and China. All members of CMEA and Yugoslavia will find their domestic economies and imports from the West constrained by their energy trade with the USSR. Low-growth prospects will be exacerbated by a restricted Soviet energy export policy.

Bilateral Exchanges

Question 9. We have developed a pattern of bilateral governmental, professional, academic, and private exchanges with the USSR and other Eastern countries. Please enumerate and assess the future prospects of these exchanges as they relate to our commercial relations. If we view the transfer of expertise and know-how as significant to our security relations, how should this security concern affect further exchanges? How may we, should we, assess the net benefit from these exchanges?

CRS Background

The U.S. Government sponsors a number of scientific-technical, commercial, and cultural exchanges with most of the East European countries, the People's Republic of China, and the Soviet Union. In recent years, the exchanges with the Soviet Union have received the most attention due to their curtailment in January 1980 as part of the U.S. response to the Soviet invasion of Afghanistan and to concern on the part of some that they may not be in the best interest of the United States.

Between 1972 and 1974 the United States and the Soviet Union signed 11 agreements on cooperation in the following scientific and technical fields: environmental protection, medicine and public health, space, science and technology, agriculture, oceanography, energy, transportation, atomic energy, artificial heart research, and housing and other construction. Some Americans believe that these exchanges benefit the Soviet Union more than the United States due to their perception that the Soviets fail to cooperate wholeheartedly and/or that Soviet science lags behind American science. Others reply that the Soviet Union leads the United States in certain scientific areas and that the exchanges provide the United States with access to Soviet science that it would otherwise not obtain. In the Bucy Report the Defense Science Board singled out scientific exchanges as an especially important form of technology transfer.

CRS Background (continued)

Beginning in late 1981, the Reagan administration had to decide whether to renew a number of the agreements that were due to expire in December 1981 or during the first half of 1982. (Some of the agreements provide for automatic renewal unless either party gives 6 months' notice of intent to terminate, while others contain an expiration date.) Because action was required and because it was concerned about the possibility of unwise technology transfers, the Reagan administration gave the exchanges special scrutiny. Before the end of December the Administration decided on renewal of the agreements on health, oceanography, artificial heart research, and environmental protection. But in response to the imposition of martial law in Poland, the Administration decided not to renew the agreements on energy, space, and science and technology.

The agreement on cooperation in science and technology, the basic agreement that set the pattern for the others, also provided for similar cooperative agreements between private American firms and the State Committee on Science and Technology of the U.S.S.R. Since then, a number of American firms have concluded such agreements, but little is publicly known about the amount of cooperation actually undertaken. American professional organizations like the National Academy of Sciences and the American Society of Civil Engineers also sponsor exchanges with Soviet organizations. Other privately run exchanges include the academic exchanges of the International Research Exchange Board (IREX) and a few American universities. Some Members of Congress have expressed the belief that these exchanges may benefit the Soviet Union more than the United States and that they may represent an unwise form of technology transfer since Soviet exchange students generally do research on advanced science and technology, while the Americans students generally do research in the humanities and social sciences.

CRS Background (continued)

Following the Soviet invasion of Afghanistan in December 1979, the Carter administration sharply curtailed U.S. participation in official exchanges with the Soviet Union. Cooperation under the 11 science and technology agreements was drastically reduced; a meeting of the Joint U.S.-U.S.S.R. Commercial Commission, a Cabinet-level group that meets periodically to direct bilateral trade, was postponed; American trade exhibits in the U.S.S.R. were cancelled; and negotiations for renewal of the General Agreement on Contracts, Exchanges and Cooperation were suspended. The Administration's decision did not apply to the privately sponsored exchanges, whose participants were free to make their own decisions on participation. The Administration continued its support for those academic exchanges that receive funds from USIA.

Answers

STATE

At present, the U.S. and U.S.S.R. have 11 governmental agreements in specialized areas (agriculture, artificial heart, atomic energy, energy, environment, health, housing, science and technology, space, transportation, and world oceans). Activities under these agreements are currently running at about 25 percent of the pre-Afghanistan level. They are conducted on the basis of strict reciprocity.

Academic exchanges continue at slightly reduced levels compared to the situation before Afghanistan. These programs are not conducted under any formal intergovernmental agreement but are funded by ICA. As with the activities under the official agreements, these programs are conducted on a reciprocal basis.

Concerning technology transfer and security, currently all proposed Soviet exchange programs are thoroughly evaluated by an interagency panel of technical consultants, and those programs judged to involve an unacceptable loss of U.S. technology are disapproved and visas are not issued. By insisting on a mutuality of benefit and through our interagency evaluation, we are satisfied that our technical transfer and security concerns are addressed in an acceptable fashion.

STATE (continued)

While none of these exchange activities relate directly to commercial relations, it is difficult to assess what benefits the Soviets have derived from the scientific and technical agreements over the last several years. It is believed, however, that activities under these agreements, which are closely monitored by specialists from the U.S. side and which involve, of course, only unclassified matters not subject to export restriction, have brought no major scientific or technical benefits to Moscow. Similarly, we have no way of accurately judging whether the Soviets have applied the unclassified, non-military data they may have acquired under the exchanges to military uses. The likelihood, however, is that this has not been the case to any significant degree.

It should be pointed out here that, given our open society, the Soviets have access to published U.S. scientific and technological material and to open scientific meetings. With respect to the latter, Soviet scientists are invited to participate in scientific meetings by their U.S. counterparts and do so on a regular and frequent basis. Much of the information that the Soviets derive from the official exchanges is therefore available to them outside the exchanges framework. (This, of course, is not true with respect to U.S. access to Soviet scientific developments.) To a great extent the exchanges provide us with access to Soviet science, which we would not have in the absence of the exchange agreements.

COMMERCE

Fundamental research in the natural, applied and social sciences and in the humanities conducted under the bilateral governmental, professional, academic and private exchanges with the U.S.S.R. and the East European countries has no direct commercial content.

In cases where there is potential for transfer of sensitive technology, these exchanges come under the purview of the Export Administration Act of 1979 and are an area of concern for this Administration. Decision on the requests for these meetings and exchanges are reviewed carefully on a case-by-case basis to determine the national security risks involved.

U. S. TRADE REPRESENTATIVE

Bilateral governmental exchanges with the Soviet Union, the People's Republic of China, and the countries of Eastern Europe have been useful in promoting bilateral trade and commercial relations with these countries. The bilateral government joint commissions, including the U.S.-China Joint Economic Committee, the Joint American-Polish Trade Commission, the Joint U.S.-Romanian Economic Commission, and the U.S.-Hungarian Joint Economic and Commercial Committee have been valuable in solidifying the expanding bilateral commercial ties. These fora have provided a useful mechanism for the discussion of broad economic and trade issues and are an integral component of U.S. relations with these countries.

DEFENSE

Scientific exchanges with the U.S.S.R. which could serve as conduits of sensitive technology to the Soviet Union are being looked at carefully by this Administration. These exchanges must be carefully monitored and reviewed, lest they be used to assist Soviet development of new military systems.

Various measures are being taken to improve our monitoring of exchanges. Increased support is being given to developing the organization and resources necessary to properly evaluate the impact of exchanges and to monitor the Soviets and their agents entering this country. These measures are in addition to the regular review procedures governing bilateral exchanges. Most of the bilaterals will be reviewed within the next year. Some of these exchanges involved sensitive technology, while others are in less controversial areas. We recognize it is imperative these be conducted in a framework that does not bring harm to our national security.

CRS Commentary

The Administration's responses stress that it carefully scrutinizes proposed exchanges to determine their potential for technology transfer or risks to national security and rejects those that would cause, as the State Department's answer puts it, "an unacceptable loss of U.S. technology." Reciprocity is stressed as a determining factor. The Defense Department's reply also mentions preparations for further evaluations of the exchanges and monitoring of Soviet activities in the United States that are outside of and supplementary to the normal review process. These responses will be welcome to those who have been concerned about the exchanges as a vehicle for technology transfer.

The Administration's assessment of the distribution of benefits is also of interest. The State Department argues that the Soviet Union does not get any "major" scientific or technical benefits from the exchanges. It also argues that the Soviet Union could get most of the information it gets from the official exchanges from private exchanges and unclassified publications if there were no official exchanges, but that these exchanges provide the United States with information about Soviet science that it would not otherwise obtain. The Defense Department's answer reveals comparatively greater concern that the Soviets could get militarily useful information from the exchanges.

ADDENDA

RESPONSES FROM DEPARTMENTS OF STATE, COMMERCE, DEFENSE, AND AGRICULTURE AFTER POLAND DECLARED MARTIAL LAW IN DECEMBER 1981

RECEIVED FEB - 1 1982

DEPARTMENT OF STATE

Washington, D.C. 20520

JANUARY 22 1982

Dear Mr. Chairman:

Thank you for your letter of January 6 inviting our supplementary comments on the Administration's East-West trade policy and the prospects for East-West economic relations in light of the recent developments in Poland. The imposition of martial law and the Soviet Union's involvement in the Polish crackdown have darkened the prospects for expanded U.S. trade links with the U.S.S.R. and Poland. As noted in our letter of October 23, we cannot divorce our economic policies towards the Soviet Union from overall Soviet behavior, even in the area of non-strategic trade. In response to the events in Poland we have taken a number of measures in the economic sphere vis a vis the U.S.S.R. These include the expansion of export controls on oil and gas equipment to cover transmission and refining equipment and technology. Previously controls had applied only to equipment and technology for oil and gas exploration and production. A decision has been made to suspend action on all applications for validated licenses for export to the Soviet Union. Other measures include the termination of Aeroflot landing rights, the closure of the Kama Purchasing Commission, the postponement of discussions on a new U.S.-U.S.S.R. Grain Agreement and a decision not to renew the U.S.-Soviet Maritime Agreement. Measures taken with respect to Poland are the termination of landing rights for the Polish national airline, the cessation of fishing privileges for Polish vessels in U.S. waters, and the adoption of a policy of "no exceptions" regarding licenses for high technology exports.

We are watching developments in Poland closely. Future Soviet policy with respect to Poland will have an important impact on the future of our economic and trade relations with the U.S.S.R.

The Honorable
Henry S. Reuss,
Chairman,
Joint Economic Committee.

In our view the imposition of martial law has significantly worsened Poland's already poor economic prospects. Assisting Poland will place additional strains on the economies and resources of the Soviet Union and other members of CMEA. This alone will have negative consequences for the further development of East-West economic relations.

Sincerely,

Richard Fairbanks

Richard Fairbanks
Assistant Secretary for
Congressional Relations

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

JAN 8 1982

RECEIVED

Honorable Henry S. Reuss
Chairman, Joint Economic Committee
House of Representatives
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter concerning recent changes in the Administration's East-West Trade Policy.

President Reagan, responding to the events in Poland on December 29, 1981, imposed a number of economic sanctions on the U.S.S.R. and Poland. As a result of this action, we are updating replies to five of the questions on East-West commercial relations raised by the Joint Economic Committee. Please find enclosed an addendum to the October 23, 1981, Department of Commerce response to questions posed by your committee.

If I can provide additional material, please let me know.

Sincerely,

Mac Baldrige

Secretary of Commerce

Addendum to the October 23 Commerce Department Responses to Questions Relating to East-West Commercial Relations Posed by the Joint Economic Committee

President Reagan, citing heavy and direct Soviet responsibility for repression in Poland, on December 29, 1981 imposed a number of economic sanctions on the U.S.S.R. and Poland. In light of the President's actions, the Commerce Department would like to add the following to our October 23 responses to the Joint Economic Committee:

Question 1: The President stated on December 29, "We intend to maintain a high-level dialogue. But we are prepared to proceed in whatever direction the Soviet Union decides upon--towards greater mutual restraint and cooperation, or further down a harsh and less rewarding path. We will watch events in Poland closely in coming days and weeks. Further steps may be necessary and I will be prepared to take them. American decisions will be determined by Soviet actions."

Question 4: The U.S. has suspended the issuance or renewal of validated licenses for electronic equipment, computers and other "high technology" materials, and has expanded the list of oil and gas equipment requiring validated export licenses and suspended the issuance of such licenses.

Question 7: The U.S. has suspended negotiations on a new Soviet-Maritime Agreement.

Question 8: As a direct result of the December 29, 1981 sanctions, U.S. exports to the Soviet Union in 1982 will probably be about $200 million less than previously projected, i.e., they will reach perhaps $3.5 billion.

Question 9: The U.S. has announced a policy of non-renewal of some exchange agreements on energy and technology and a review of all other exchange agreements.

We are attaching a copy of an article from the U.S. Department of Commerce publication Business America (pp. 3-4) describing the sanctions and giving a preliminary assessment of their impact on U.S. economic relations with the Soviet Union as well as the President's statement on the sanctions (inside cover of the attached Business America).

Attachment

Poland—The Soviet Responsibility and the American Response

Presidential Statement Issued Dec. 29, 1981

The Soviet Union bears a heavy and direct responsibility for the repression in Poland. For many months the Soviets publicly and privately demanded such a crackdown. They brought major pressures to bear through now-public letters to the Polish leadership, military maneuvers, and other forms of intimidation. They now openly endorse the suppression which has ensued.

Last week I announced that I had sent a letter to President Brezhnev urging him to permit the restoration of basic human rights in Poland as provided for in the Helsinki Final Act. I also informed him that, if the repression continued, the United States would have no choice but to take further concrete political and economic measures affecting our relationship.

The repression in Poland continues, and President Brezhnev has responded in a manner which makes it clear the Soviet Union does not understand the seriousness of our concern, and its obligations under both the Helsinki Final Act and the U.N. Charter. I have, therefore, decided to take the following immediate measures with regard to the Soviet Union:

- All Aeroflot service to the United States will be suspended.
- The Soviet Purchasing Commission is being closed.
- The issuance or renewal of licenses for the export to the U.S.S.R. of electronic equipment, computers and other high-technology materials is being suspended.
- Negotiations on a new long-term grains agreement are being postponed.
- Negotiations on a new U.S.-Soviet maritime agreement are being suspended, and a new regime of port access controls will be put into effect for all Soviet ships when the current agreement expires on Dec. 31.
- Licenses will be required for export to the Soviet Union for an expanded list of oil and gas equipment. Issuance of such licenses will be suspended. This includes pipelayers.
- U.S.-Soviet exchange agreements coming up for renewal in the near future, including the agreements on energy and science and technology, will not be renewed. There will be a complete review of all other U.S.-Soviet exchange agreements.

The United States wants a constructive and mutually beneficial relationship with the Soviet Union. We intend to maintain a high-level dialogue. But we are prepared to proceed in whatever direction the Soviet Union decides upon—towards greater mutual restraint and cooperation, or further down a harsh and less rewarding path. We will watch events in Poland closely in coming days and weeks. Further steps may be necessary and I will be prepared to take them. American decisions will be determined by Soviet actions.

Secretary Haig has been in communication with our friends and Allies about the measures we are taking and explained why we believe such steps are essential at this time.

Once again I call upon the Soviet Union to recognize the clear desire of the overwhelming majority of the Polish people for a process of national reconciliation, renewal and reform.

President Imposes Economic Sanctions On The U.S.S.R. And Poland

President Reagan, citing heavy and direct Soviet responsibility for the repression in Poland, on Dec. 29 imposed a number of sanctions affecting U.S.-Soviet economic relations (the President's statement is printed on the inside front cover). This action followed suspension on Dec. 23 of major elements of the United States economic relationship with the Polish Government to underscore opposition to the imposition of martial law in Poland and the ensuing suppression of human rights. The sanctions on U.S.-Soviet economic relations consist of the following steps:

- Suspension of Aeroflot service to the United States;
- Closing of the Soviet Purchasing Commission;
- Postponement of negotiations on a new U.S.-Soviet long-term Grains Agreement (LTA);
- Suspension of negotiations on a new U.S.-Soviet Maritime Agreement;
- Suspension of issuance or renewal of validated export licenses to the U.S.S.R. for electronic equipment, computers and other "high-technology materials;"
- Expansion of the list of oil and gas equipment requiring validated export licenses and suspension of the issuance of such licenses; and
- Non-renewal of some exchange agreements on energy and technology.

Underlining U.S. desire for a constructive and mutually beneficial relationship with the Soviet Union, the President stressed that: "We are prepared to proceed in whatever direction the Soviet Union decides upon—towards greater mutual restraint and cooperation, or further down a harsh and less rewarding path."

As a direct result of the Dec. 29 sanctions, U.S. exports to the Soviet Union in 1982 will probably be about $200 million less than previously projected. Exports will reach perhaps $3.5 billion, including $2.5 billion in agricultural commodities and $1 billion in non-agricultural goods. Imports may total as much as $800 million, partly contingent on projected increases in U.S. purchases of ammonia.

The projected totals compare with U.S. exports to the U.S.S.R. of about $2.5 billion and imports of $350 million in 1981.

Following is a brief description of the sanctions imposed on the U.S.S.R.:

1. Aeroflot Service Suspension. The Department of State, in cooperation with other federal agencies concerned, is taking the steps necessary to suspend Aeroflot service to this country after Jan. 3, until further notice. Under the U.S.-Soviet Civil Air Agreement of 1967, which remains in effect, the United States is no longer obligated to permit any specific number of flights by the Soviet airline because the U.S. carrier, Pan American, ceased its service between the United States and the Soviet Union in October 1978. Since early 1980, Aeroflot had operated two weekly flights from Moscow to Washington. In 1980 it carried approximately 6,000 round-trip passengers.

2. Termination of the Soviet Purchasing Commission (SPC). The Soviet Purchasing Commission has been notified that it will have to close by Jan. 13, 1982. The SPC (formerly Kama Purchasing Commission) has operated in New York since 1973 as an arm of the U.S.S.R. Ministry of Foreign Trade, placing orders for U.S. products, originally for the Kama River Truck Plant. Permission for establishment of the Commission was extended in 1972 by the Secretary of Commerce simultaneously with an undertaking by the Soviet Foreign Trade Ministry to accredit offices of U.S. companies in Moscow, of which there are now 28. U.S. operating authority for the Purchasing Commission in the United States was renewed periodically, most recently until April 1982. The Purchasing Commission was responsible for about $1.5 billion in exports of U.S. equipment and services for various Soviet projects, including an industrial tractor plant, an ammonia production complex, and the Moscow World Trade Center. These purchases represented about one-third of Soviet orders for U.S. non-agricultural goods. Purchasing activity by the Commission has been at a low level since imposition of U.S. trade sanctions in response to the Soviet invasion of Afghanistan. Other Soviet commercial organizations in the United States are not affected by this measure.

3. Suspension of Issuance of Validated Export Licenses. The Commerce Department has published formal regulations that suspend processing of applications for validated licenses to export to the U.S.S.R., effective Dec. 30, 1981. Under the Export Administration Act, the Department maintains lists of specific items—products, technical data, and services—which require validated licenses before being exported to the Soviet Union. As a result of the current steps, no new licenses will be issued for export or reexport of high technology or of oil and gas equipment subject to export controls (see point 6). About 240 license applications worth about $130 million were pending to the U.S.S.R. Western sales of high technology have excluded equipment that would contribute significantly to Soviet military potential. Sales of other kinds of "high technology" have continued and include items such as machine tools, pumps, centrifuges, certain measuring and control instruments, and various types of electrical machinery.

Industrialized Western countries exported about $2.3 billion of "high technology" products to the U.S.S.R. in 1980. The United States exported about $85 million of these products, or about 4 percent of the Western total.

4. Postponement of Negotiations on a New Long-term Grains Agreement. U.S.-Soviet grain trade is currently being conducted under the terms of a one-year extension of the 1975 U.S.-Soviet Grains Agreement, valid until Sept. 30, 1982. Under the existing agreement, the Soviet Union is committed to buy 6 million metric tons of wheat and corn annually, and the United States is obligated to permit shipments to the Soviet Union of up to 8 million tons. In October the United States had informed the Soviet side that it may buy up to 15 million tons in addition to the 8 million tons during the 12-month period ending Sept. 30, 1982. Up to now the U.S.S.R. has purchased about 11 million tons. Postponement of negotiations on a new long-term agreement will not affect current U.S.-Soviet arrangements on sales or shipments of grains nor should it have any immediate effect on this trade.

5. Suspension of Negotiations on a new U.S.-Soviet Maritime Agreement. The United States has been engaged in negotiations toward a new Maritime Agreement, with the most recent meeting ending inconclusively in early December. These negotiations are now being suspended. Under the 1975 Long-term Maritime Agreement, merchant vessels of the Soviet Union had access to 40 U.S. ports on the basis of four days' advance notice. That agreement expired on Dec. 31, 1981. The Soviets now will be required to request permission for one of their ships to call at a U.S. port at least 14 days in advance. Decisions on Soviet requests will be made on a case-by-case basis. The United States will take a restrictive approach toward requests for ships engaged in traffic, including passenger service, between the United States and third countries. In the first 11 months of 1981 there were 337 port calls by Soviet ships, compared with 406 in 1980 and 1,383 in 1979. These figures reflect the decline in U.S.-Soviet trade in 1980 following the post-Afghanistan sanctions and the International Longshoreman Association's boycott affecting most non-grain shipments from east coast and Gulf ports from January 1980 to June 1981.

6. Oil and Gas Equipment Controls Broadened. The Commerce Department is expanding controls governing the export of oil and gas technology to the Soviet Union. Under new regulations effective Dec. 30, 1981, a variety of products, equipment and technical data for the transmission or refining of petroleum or natural gas will require validated export licenses. (Examples of equipment affected by this expansion of controls are air and gas compressors, gas turbine engines for compressors, sensors, meters and mixing equipment, and pipeline cleaning equipment.) Equipment and technology in the petroleum exploration and production areas have required validated licenses for export to the U.S.S.R. since 1978. Until 1981 applications for export of equipment covered by the 1978 controls were generally approved. The Department is now suspending action on all applications for export of oil and gas equipment and technology. Oil and gas equipment has been a major non-agricultural U.S. export to the U.S.S.R. during the last ten years. In 1980 direct exports of such equipment to the Soviets totaled about $50 million; in 1979, $141 million was exported.

7. Non-renewal of U.S.-Soviet Exchange Agreements. The United States does not intend to renew the U.S.-Soviet Agreements on Space, Energy, and on Science and Technology which come up for renewal in May, June and July, 1982, respectively. Eleven bilateral exchange and cooperation agreements are currently in effect with the Soviet Union, including agreements covering agriculture, environmental protection, housing, health and transportation. The agreements provide for visits in both directions and cooperative research projects in designated fields by U.S. and Soviet scientists. Following the Soviet invasion of Afghanistan the United States severely curtailed activities under these programs, continuing only low-level exchanges. There will be a complete review of all these agreements.

The sanctions imposed on Poland on Dec. 23 are:

- Suspension of Polish civil aviation privileges in the United States;
- A halt in the renewal of the Export-Import Bank's line of credit insurance to the Polish Government;
- Suspension of the right of Poland's fishing fleet to operate in American waters; and
- Proposal to our Allies for the further restriction of high-technology exports to Poland.

Under the sanctions,

1. LOT, the Polish airline, will no longer have landing privileges in the United States for its regular or chartered flights. A bilateral agreement governing civil aviation in the two countries will be allowed to expire on March 31, 1982. No U.S. airline currently services Poland.

2. The U.S. Export-Import Bank will not renew a $25 million line of credit insurance to support short-term (180 day) loans to Poland for suppliers and banks to pay for imports from the United States. Without such insurance, private lending to Poland to finance imports is unlikely because of Poland's financial condition. The line of credit expired Nov. 30, 1981.

3. Poland will not be granted a portion of surplus U.S. fishery resources in the 200-mile fishing conservation zone in 1982. Poland's allocation for 1981 was 231,326 metric tons. The U.S. decision will have a substantial impact on Poland's overall fisheries, namely, a decline in the availability of fish in Poland and a hard-currency loss to the Polish Government from lost sales to traditional purchasers, among them, the United States.

4. We will discuss with our Allies and Japan tightening the way controls are applied to the export to Poland of advanced technology with strategic implications.

Polish-U.S. trade totaled $942.2 million through the first three-quarters of 1981; U.S. exports of agricultural commodities represented about two-thirds of this figure.

THE SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

JAN 18 1982

JAN 20 1982

HENRY S. REUSS

Honorable Henry S. Reuss
Chairman, Joint Economic Committee
Congress of the United States
Washington, D. C. 20510

Dear Chairman:

This is in response to your letter of January 6, 1982, inviting additional thoughts on the nature of East-West Trade Policy.

I agree that events in Poland and elsewhere have laid the basis for further policy consideration and development. My comments on specific questions are enclosed.

Sincerely,

Cap Weinberger

Enclosure

Department of Defense Response to the Chairman, Joint Economic Committee, on Certain Questions Related to East-West Commercial Relations: Additional Comments

This provides additional Defense views on a number of questions related to East-West commercial relations, in the light of events in Poland and elsewhere, since the comments provided to the Chairman, Joint Economic Committee on December 11, 1981. Subsequent events in Poland and elsewhere have laid the basis for further policy consideration and development.

Specifically, the imposition of martial law in Poland, at Soviet behest and with indirect but decisive Soviet support, required and has resulted in a firm U.S. response to oppose those who would use force to suppress human rights in Poland. Specific U.S. sanctions are intended to assign responsibility for repression to both the military government in Poland and the present Soviet regime which stage-managed the repression. These sanctions are also to penalize Poland's military government by denying economic support until it lifts current martial law restrictions and releases prisoners. Economic sanctions are also to inconvenience the Soviets and strengthen U.S. security, by denying U.S. equipment and technology and curtailing economic cooperation.

Measures taken by U.S. allies in opposition to armed repression of human rights in Poland assign the primary responsibility to the Soviets, where it belongs. We hope for and intend that the situation be resolved through removing repressive measures over the coming weeks and months. However, we are prepared to implement additional sanctions, should armed repression be increased or sustained by either Poland's military government or the Soviets.

Additional comments on specific questions identified by the Chairman, Joint Economic Committee, and keyed to our response of December 11, 1981, are given below.

1. Outlook for U.S. trade with the East. Efforts by Polish workers to reform Poland's economy, by eliminating graft and incompetent management, have been set back by internal military suppression of economic, political and human rights, at the behest of the Soviets. It should now be clear that suppression of human rights is not an adequate substitute for more effective economic and political policies. The problem is the rigidity of the communist system itself which weakens economic and political incentives, and substistutes repression for participation and negotiation. U.S. trade sanctions against the Polish military regime in response

to their imposition of martial law, and against the Soviets in response to their pressure on Poland, are in reply to Soviet political policy. We hope that repressive measures will be lifted. We are prepared to implement additional sanctions should armed repression be increased or continued.

2. Actions to improve commercial relations that are likely to be effective. Soviet pressure on Poland to reassert the predominance of the communist state through military force has resulted in economic sanctions by the U.S. against both with the support of our allies. Improved trade must depend both on economic reform, particularly in Eastern Europe, and political-military restraint, particularly by the Soviets. These conditions have proved to be sadly lacking in the events in Poland.

3. Outlook for U.S. technology trade with the East. The vigorous Administration program, designed to safeguard U.S. and Western technology from Soviet compromise, is independent of Soviet-inspired events in Poland. Our purpose is to improve U.S. and COCOM export controls on critical production equipment, production technology and unique materials which could contribute directly or indirectly to Soviet military-related activities. We have worked hard to plan an effective High Level COCOM conference, to meet in Paris on January 19-20, 1982, to strengthen our technology export control system.

Among East European countries, we were inclined to be more forthcoming in approving exports of products and equipment to Poland, along with Hungary and Romania, until the imposition of martial law in Poland. Poland is now grouped with harder line states under the domination of the Soviet Union, and like the Soviet Union is subject to U.S. economic sanctions.

4. Militarily Critical Technologies List (MCTL). Restrictions imposed on technology trade with the Soviet Union after the invasion of Afghanistan were selective, but have been considerably broadened following the Soviet supported repression in Poland. Independent of the Afghanistan invasion or events in Poland, they represent growing security concerns over the levels of high technology exported to the Soviet Union. Therefore, these "sanctions" are largely intended to continue and be selectively strengthened.

Equipment and technology specifically for oil and gas exploration and production in the Soviet Union were already under limited foreign policy export controls. These controls have been broadened by the President in response to Soviet supported repression in Poland. U.S. economic sanctions against the Soviet Union now prohibit all exports of oil and gas production, exploration, transportation and refining equipment and technology.

The military repression in Poland is one of those times when, in order to assert leadership and strengthen security, unilateral initiatives to implement sanctions became necessary. Of course, we welcome the support of our allies. However, we cannot fail to take an appropriate political stand in opposition to Soviet aggression and political adventurism.

5. Grain Exports. Existing contracts and agreements for exports of grain and food to Poland and the Soviet Union are being honored. However, negotiations with Poland for 1982 food aid are in abeyance. Negotiations for a new U.S./ Soviet Long-Term Grain Agreement also are in abeyance. This is in part symbolic since expiration of the current agreement is nearly a year away. Humanitarian aid is encouraged, provided it reaches those for whom it is intended. If repressive measures are not lifted, future trade and aid negotiations might be further delayed.

6. No Defense comment.

7. The U.S.-Soviet Maritime Agreement expired December 31, 1981. Talks on renegotiation of the agreement have been suspended. Currently, access to all U.S. ports by Soviet vessels is subject to request 14 days in advance. The U.S. has adopted a restrictive stance on entry of commercial vessels. Generally, liner and passenger vessels are not admitted. Bulk carriers engaged in U.S./Soviet bilateral trade (grain, fertilizers, etc.) are permitted to call at U.S. ports, subject to 14 days advance request.

8. No further comment.

9. Following events in Poland, new efforts are being made to strengthen controls on information disclosure involving sensitive military-related and dual-use technology, particularly to the Soviet Union. Scientific exchanges are being carefully monitored and reviewed.

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

February 2 1982

Honorable Henry S. Reuss
Chairman
Joint Economic Committee
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter of January 6, 1982, in which you invite us to add, in the light of recent events, to our response to your earlier inquiry concerning East-West trade policy.

Our response emphasized the importance of exports in sustaining U.S. farm income, the desirability of stable trading relationships as a favorable environment for exports, and the usefulness of developing market information to help farmers plan. These objectives are fundamental; and while martial law in Poland has to some extent created an unfavorable climate for pursuing them now, our goal remains the same.

With respect to some of the particulars in our response, we might note that negotiations on a new long-term grains agreement have been postponed. The present agreement, however, has about eight months to go and in that period we hope that the situation will improve to the point where a new agreement can be negotiated. The Maritime Agreement with the Soviet Union has expired and negotiations toward a new agreement have been suspended, but we hope that administrative procedures with respect to port access will be adequate to protect our agricultural trade interest.

Sincerely,

John R. Block
Secretary