AMERICAN INTERESTS SPECIAL
"FOLLOW THE MONEY"

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(Videotaped portion.)

NARRATOR: Paris: On Friday the leaders of the free world, seven industrial powers, will gather here for the economic summit. They will discuss interest rates, budget deficits and currency values, about what you'd expect from an economic summit meeting. Missing from the agenda is an item that could very well dwarf all the rest, and issue that the Western alliance seems reluctant to face, loans and financial credits to the Soviet Bloc.

Mikhail Gorbachev is starved for Western capital, hard cash to keep his economic reforms alive. In the next hour, you'll see how Western banks hold the keys to Gorbachev's future, at home and abroad, and you'll see how a super-secret intelligence program was able to track and East Bloc loan through the international banking system to a bloody ending. The high stakes of superpower finance on this special addition of American Interests.

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(End of videotaped portion.)

MR. KONDRAKE: Welcome to this special addition of American Interests. I'm Morton Kondracke. In this program we report on a Soviet initiative that's both new and alarming. It's a story of financial intrigue of how the Soviets and their allies are using the Western banking system to finance activities hostile to Western interests. We call our report "Follow the Money," and the trail begins right here in Washington DC.

NARRATOR: George Bush spent much of the past six months reacting to initiatives from the Kremlin, arms control proposals, economic overtures, news of political reform within the Soviet system. In May, the President flew to Western Europe.

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to try to regain the rhetorical offensive at a series of meetings. In Germany, he proposed withdrawing 30,000 US troops from Europe in exchange for large cuts in Soviet conventional forces. And he convinced West German Chancellor Helmut Kohl to soften his position on the elimination of short-range nuclear weapons.

In June, it was Gorbachev's turn to use West Germany as a megaphone for his peace offensive. He criticized President Bush for moving too slowly on arms control and called on Europeans to join him in the quest for a denuclearized Europe. He also called on Western governments to provide him with financial credits, loans to help the ailing Soviet economy.

On July 14th, President Bush returns to Europe, this time to Paris for an economic summit meeting among the Western powers. In a recent joint resolution passed with bipartisan support, Congress urged the President to add a new item to the summit agenda, coordinating an Alliance-wide response to Gorbachev's campaign for loans from Western banks. The Bush administration refused.

SEN. SPECTER: The United States is still the leader, and we saw that when President Bush was at NATO. We still have the commanding voice, so that we ought to assert very emphatically our concerns that US capital or Western capital is not advanced to the Soviets in a way which will ultimately help their military system.

REP. SCHUMER: We ought to know what we're doing. We ought to know how much we're lending. We ought to know the effects of that lending. And we ought to not be afraid to regard lending as a weapon in our strategic arsenal.

NARRATOR: What Mikhail Gorbachev has been borrowing is referred to by bankers as hard currency -- US dollars, British sterling, West German marks, Japanese yen -- any currency that is accepted around the world in payment for goods and services. The Soviet Union needs hard currency to do business internationally, because the Soviet ruble is itself inconvertible. That is, few international vendors will accept payment in Soviet rubles, which can be readily exchanged only for the currencies of other Soviet-bloc countries.

DAVID WIGG: The Soviet bloc is a soft-currency island in a hard-currency sea. Virtually anything they want to do outside their borders, including the acquisition of embargo technology or the
financing, for example, of a disinformation campaign, they have to finance it in one of two ways. Either they sell an export commodity or they borrow the money from a Western bank.

NARRATOR: As the Soviet Union enters a period of economic crisis, Gorbachev's need for hard currency has become desperate. Evgeni Novokov was on the staff of the Soviet Central Committee until he defected to the West in 1988.

MR. NOVOKOV: The hard currency is a goal of any economic leader in the Soviet Union, because they do understand that hard currency is the ticket to cover all shortcomings in the Soviet economy.
NARRATOR: Senator Bill Bradley advocates more careful lending practices in dealing with the East bloc.

SEN. BRADLEY: If you increase domestic investment in the Soviet Union, which their plan will require, then you can only get that increased domestic investment from the defense sector in the Soviet Union or from trade with the West or from capital from the West. I think that gives us an opportunity. What we want them to do is to get it from the military side of the budget.

NARRATOR: Gorbachev's Soviet Union is a superpower with a split personality. One face is that of a military giant. The view from the Politburo's reviewing balcony reveals why. 40 years of the arms race has created the world's most formidable conventional army and its largest nuclear force. At sea, the Soviet navy has become a global presence, able to project Soviet power to the world's four oceans.

The land mass of the Soviet Union and its contiguous satellite states stretches across two continents. Six East European countries are firmly in the Soviet orbit. Client states like Cuba, Vietnam, Ethiopia and Angola extend Moscow's influence to Latin America, Southeast Asia and Africa. But, as Gorbachev has quickly learned, the costs of empire are heavy.

During the mid-1980s, the Soviet Union spent up to $15 billion a year aiding its allies in Eastern Europe, $7 billion went to support Cuba, Vietnam and Mongolia, and an additional $5 billion went to Afghanistan and other Third World countries, a total of $27 billion in aid, credits and subsidies. That $27 billion represents 1.3 percent of the Soviet GNP. In comparison, the US spent $11 billion supporting allies around the world, representing only 0.3 percent of US GNP. And the costs continue.

Nicaragua now costs the Soviets more than $1 billion annually, including $515 million in aid for Central America's largest and best equipped army. Vietnam, with an economy in virtual collapse, receives $2 billion a year and Cuba, a close ally since Fidel Castro came to power in 1959, receives $5 billion.

According to a former Cuban economic official, Moscow's investment in Cuba extends the reach of the Soviet empire, but, financially, the Soviets will never get their money back.

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GUSTAVO PÉREZ-COTÍ: There is a joke among the bureaucrats and technocrats in the finance world in Cuba. If you have an opportunity of buying something in another country or buying it in the USSR, they say buy it in the USSR, even if it is a little bit of lower quality or a little bit higher price, but buy it there, because the account, the bill, you write it on ice. That's a Spanish expression. It means that the ice will melt and the debt will also melt with it.
NARRATOR: Most of the Soviet subsidies to client states like Cuba are paid in rubles, but part of the subsidy must be delivered in hard currency to buy goods from the West.

GUSTAVO PEREZ-COTT: The Soviet Union has been giving hard currency grants and loans to Cuba for many, many years.

NARRATOR: Until recently, the Kremlin has willingly paid the cost of empire and superpower status, but this is the other face of the Soviet Union: Long lines for food at the grocery store; shops emptied of consumer goods; liquor and sugar rationed, even in the capital city; and, in the shadows, a burgeoning black market, the only place to find many consumer goods. According to Soviet exile Vladimir Bukovsky, the Soviets' problems go far beyond economics.

VLADIMIR BUKOVSKY (Soviet defector): We are talking a big nation. There is big percent of this — large proportion of this nation has just degenerated. We’re having; I don’t know, recent figures — there are something like 40 million medically-certified alcoholics in the country. These people are not going to be productive or democratic; they’re going to be alcoholics, whatever you do. The infant rate morality is increasing. The life expectancy is around 60 now — it dropped. The number of mentally and physically handicapped children is incredible. Yes, it’s a degeneration as well. So we are talking about a big proportion of this nation which probably is good for nothing anyway.

NARRATOR: Economist Jan Vonous, longtime observer of the Soviet Union.

JAN VONOUS: It’s a crazy system where in a sense those who sell in the stores may distribute goods depending on what sort of bribe you pay to them, so in fact they reap some of the benefits. And in terms of, say, capital goods and materials that are distributed to enterprises, it’s favor for favor. It doesn’t depend that you have the rubles, because if somebody doesn’t like you, you may not be able to get the goods anyway.

NARRATOR: A few statistics on the Soviet economy help tell the story. The gross national product of the Soviet Union is roughly half that of the United States. In other words, 280 million Soviet citizens produce only half as much as 240 million Americans. According to US intelligence estimates, the Soviet budget deficit has increased from 3 percent of GNP to 9 percent in 1987. And Moscow’s own National Institute of the Economy estimates the current Soviet deficit at 11 percent of GNP.

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almost $200 billion. By comparison, the US budget deficit, which is
the source of much hand-wringing in the West, amounts to 4 percent
of US GNP. Another striking difference between the super powers is
that more than half of the Soviet GNP is controlled directly by the
government, while only a quarter of US GNP passes through governmen
t hands. And while Gorbachev has won praise for his public statements
on arms reduction, US intelligence estimates that Soviet military
spending has remained constant at between 17 and 25 percent of GNP.
In fact, defense spending actually increased in absolute terms by 3
percent in 1988. US military spending, by contrast, is about 6
percent of GNP, and headed lower.

SEN. BRADLEY: The Soviet Union is a first-rate military power
and a fourth-rate economic power. And ultimately, the poor economy
will have an impact on the military, and I think that's what
Gorbachev recognizes.

NARRATOR: Gorbachev has responded to the Soviet deficit by
printing money, rubles, flooding the domestic market with paper
currency. In a market economy like the United States, increasing
the money supply without a corresponding increase in production
leads to inflation, and inflation leads to higher prices for
consumers. Inflation has a quite different effect in the Soviet
Union.

JUDY SHELTON: We think of inflation as being synonymous with
the idea of increasing prices, because we allow the prices to rise
to accommodate the extra money in the system. But under a fixed
price regime, under Socialism in the Soviet Union, those prices
aren't allowed to rise. So instead, the inflation is manifested,
not as prices going up, but in longer lines. And it's because the
Soviet workers can now afford to buy things at the old fixed price,
many more of those workers can afford it, and so the goods sell out
immediately at the old price.

NARRATOR: The Soviet government could relax the arbitrary
system of price controls, but that would create other problems for
the regime.

JAN VANOUS: They can only look around at a country like
Yugoslavia, which an inflation of 250, 300 percent; Poland, 100, 120
percent; Hungary, in the 20's; and they are scared that if they do
the same thing, that Soviet workers will start marching in the
streets.

NARRATOR: With few goods available for purchase, much of what
Soviet workers earn goes directly into savings. In 1987 alone, 24
billion rubles were deposited in Soviet savings accounts. Today,
300 billion rubles, about $480 billion, sit in Soviet state banks.
In order to unlock these savings and motivate workers, Gorbachev
must put more goods on the shelves, goods that consumers really want, goods from the West. How can the Soviets pay for these goods with Western exporters unwilling to accept the soft rubles piling up in Soviet banks? International trade offers the Soviets one avenue, for if the Soviets can sell more of what they produce to the West, they'll be able to buy more in return. But the Soviets have a long way to go.

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