



**Directorate of
Intelligence**

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The USSR's International Economic Breakout



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An Intelligence Assessment

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January 1987*

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The USSR's International Economic Breakout




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An Intelligence Assessment

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Division, SOVA 

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Economic Breakout** 

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Key Judgments*Information available
as of 19 December 1986
was used in this report.*

The USSR has embarked on a wide-ranging campaign to increase its role in international economic affairs. It has restructured its foreign trade apparatus, proposed new forms of economic cooperation with Western firms, expanded its use of international financial instruments, and applied to participate in the General Agreement on Tariffs and Trade (GATT). These initiatives reflect, in part, a new generation of Soviet leaders who are willing to consider more active tactics in pursuit of their economic and political goals. The sharp drop in hard currency revenues from energy exports has added further impetus to pursuing new trade and financial avenues. 

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The course of future Soviet activity in the world economy will depend, in large part, on decisions regarding the role of Western technology and equipment in Gorbachev's modernization drive. The leadership will probably spend the next year or two gaining experience and expertise in the international financial arena as well as assessing continuing domestic programs before deciding whether or not to abandon its conservative positions regarding reliance on foreign technology, Western participation in the economy, and its willingness to substantially expand indebtedness to the West. 

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Until the Soviets settle on a long-term economic strategy for dealing with the West, we can expect cautious but steady expansion of activity in the international arena. In the interim, we judge that actions by Moscow are unlikely to achieve its stated goals of greatly expanding exports of manufactured goods, raising the quality and technical level of its domestic output to world standards, or attaining recognition as a major economic and trading power:

- While the recent reorganization of the foreign trade apparatus will probably speed up contract negotiations and better serve the needs of the end users, the changes do not remedy the lack of domestic incentives for producers, the distorted price structure, and the inadequate technological base that underlie the poor position of Soviet-manufactured goods in world markets.
- Moscow is likely to take a more flexible approach to its financial activities, but present limitations on hard currency earnings, coupled with some vestiges of traditional Soviet conservatism, are likely to restrict any large-scale speculative approaches to financial management.

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- To date, provisions for joint ventures do not appear to offer sufficient incentives to Western businessmen to invest more than token amounts in the USSR. Even with attractive joint-venture regulations, the level of investment is likely to be too small to have much impact on Soviet exports of manufactured goods.
- Lackluster Soviet trade performance, combined with continued central control over trade activities, will undermine efforts to join GATT and other international economic organizations as well as to advance proposals for international economic security through the United Nations and other international bodies.

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Even gradual expansion of activities in the near term, however, would have important implications for US policy interests:

- Greater interest by Western firms in the success of any joint ventures is likely to improve the assimilation of Western technology at given Soviet enterprises and could increase the flow of controlled technology to the USSR. Moreover, joint ventures established outside the USSR or subsidiaries of joint ventures in third countries could give Soviet technicians greater access to controlled technology.
- Greater involvement in international trade and financial markets would make it easier for Moscow to hide the level of its financial activities through the use of numerous instruments, such as interbank deposits or borrowing from nonbank institutions and banks that do not report to international financial bodies.
- A higher level of activity in the international economy, especially in international forums, will provide Moscow with new opportunities for political activism. In addition, a larger number of Soviet officials in the West increases the potential for KGB activity.

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US interests could be challenged to a greater degree should the regime decide that its piecemeal approach has not worked and that it must rely more heavily on Western technology and equipment for its modernization efforts to succeed. Such a turn to the West might be accompanied by greater domestic economic reforms. Under such circumstances, we would expect to see a much bolder Soviet entry into the international economic

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arena, a major increase in the flow of Western technology to the USSR, and a boost in Soviet activity in world financial markets. Such a policy might make the Soviets more flexible on selected East-West issues, although flexibility is likely to be constrained by an expressed Soviet policy aim of reducing vulnerability to Western economic leverage. 

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Even without a major expansion of economic links to the West, increased Soviet understanding of international financial and commercial markets carries a risk that Moscow may attempt to manipulate these markets to the detriment of US national security interests. The West has been moving rapidly toward globally integrated financial markets, and this has created a potential for Soviet misuse of the system, such as the placement of false data or tampering with the worldwide transmission of data. We believe the probability of such an action would be small as long as the USSR's growing involvement is paying dividends. Indeed, to the extent that its growing activities on international markets tie the USSR closer to the world economic community, the West probably benefits since the Soviets have a greater stake in working to solve problems within the system. Moscow's stake, nonetheless, is not likely to weigh heavily in decisions where political and strategic interests are involved. 

25X1

Secret**Contents**

	<i>Page</i>
Key Judgments	iii
Soviet Motivations	1
Efforts To Improve Trade Effectiveness	1
Reorganizing the Foreign Trade Apparatus	1
Redefining Joint Ventures With the West	2
Developing Financial Sophistication	4
Expanding Ties to Multilateral Economic Institutions	8
Future Soviet Actions	11
Implications for the United States	12

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The USSR's International Economic Breakout [Redacted]

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In a sharp break with tradition, Moscow has recently launched a spate of initiatives that collectively portend a major expansion in the breadth and depth of its participation in international economic and financial activity. Many of its actions have received widespread publicity—the application for participation in the General Agreement on Tariffs and Trade (GATT), the restructuring of the foreign trade apparatus, provisions for joint ventures, and the unexpected settling of outstanding Czarist bonds. At the same time, the Soviets have quietly worked with Western banking and trading institutions to examine ways to expand the range of financial instruments available to finance Soviet hard currency imports. [Redacted]

- The need to develop a competitive Soviet export sector for manufactured goods has increased the pressure for Soviet representation in international economic organizations. Moscow feels that its current reliance on raw material exports for the bulk of its trade earnings is not consonant with its level of economic development and, moreover, makes it too vulnerable to fluctuations in world commodity prices.
- The recent deterioration in the Soviet hard currency position, the result of reduced earnings from both oil exports and arms sales, has encouraged the Soviets to explore alternative sources for financing imports.¹ [Redacted]

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Soviet Motivations

While many of these initiatives had been considered in the past, it has taken a new generation of Soviet leaders to diverge from a tradition of over 60 years of conservative approaches to trade and diplomacy. Heightened Soviet interest in expanding economic links to the West can be ascribed to several factors:

- Changes in senior economic management have resulted in the ascendancy of action-oriented individuals who realize that new tactics must be used to meet Soviet economic challenges, particularly modernization and accelerated growth. A revamped foreign policy apparatus is also taking a more dynamic approach to Soviet international affairs, including economic issues.
- The reorganization of key domestic economic sectors and the foreign trade apparatus is an effort by Gorbachev to streamline the bureaucracy and to allow it to respond to these challenges. The new trade policy team probably realizes that Soviet goals in the international arena have been frustrated in the past by conservative and ideologically constrained approaches and, in general, by a relative ignorance of the operations of the international financial and commercial markets.

Efforts To Improve Trade Effectiveness

Reorganizing the Foreign Trade Apparatus. In late September 1986 the Soviets announced a major overhaul of the Ministry of Foreign Trade (MFT). More than 20 ministries and 70 large associations and enterprises have been granted authority to conduct trade directly with their foreign partners as of 1 January 1987. To carry out this trade, the ministries and production associations will have foreign trade organizations placed under their jurisdictions, many of which will be transferred from the MFT. [Redacted]

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Breaking the MFT's monopoly over foreign trade is clearly tied to Soviet efforts to expand exports of manufactured goods by strengthening the link between producers and world markets. In addition, it is designed to improve the efficiency of importing Western technology by giving end users more say in contract negotiations. Under the current system, negotiations are drawn out, and purchases often do not meet the requirements of end users, because price considerations of the foreign trade organizations win out over technical specifications [Redacted]

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Table 1
Soviet Ministries With Direct Access to
Foreign Trade Partners, as of 1 January 1987

State committees
Gossnab (State Committee for Material and Technical Supplies)
Gosagroprom (State Agro-Industrial Committee)
GKNT (State Committee for Science and Technology) ^a
Goskomsport (State Sports Committee) ^a
Goskomizdat (State Publishing Committee) ^a
Machine-building ministries
Minenergomash (Ministry for Power Engineering)
Mintyazhmash (Ministry of Heavy Machine-Building Industries)
Minelektrotekhprom (Ministry of Electrical Equipment Industry)
Minavtoprom (Ministry of Automotive Industry)
Minselkhovmash (Ministry of Machine Building for Agriculture)
Minpribor (Ministry for Instrument Making and Automation)
Minstankoprom (Ministry for Machine Tool Building Industries)
Minkhimash (Ministry of Chemical and Petroleum Machine Building)
Other
Minmorflot (Ministry of Merchant Marine) ^a
Minrybkhov (Ministry of Fisheries) ^a
Mingeo (Ministry of Geology)
GUGK (Main Administration of Geodesy and Cartography)
Minkhimprom (Ministry of Chemical Industry)
Minstroimaterialov (Ministry of Building Materials Industry)
Minmedbioprom (Ministry of Medical and Biological Industries)
Tsentrosoyuz (The Central Union of Consumer Cooperatives) ^a

^a Entities previously having some control over their foreign economic relations.

Included in the list of ministries being granted the right to conduct trade directly are the State Agro-Industrial Committee (Gosagroprom), the State Committee for Supplies (Gossnab), the Ministry of Chemical Industry, and several machine-building ministries, although their precise roles have yet to be defined (see table 1). The Soviets have publicly indicated that, at least for the present, the MFT will continue to control trade in raw materials, food, and about 60 percent of machinery imports. [redacted]

[redacted] Gosagroprom will acquire control over all agricultural trade, which would further reduce the MFT's power. It is expected that, in time, additional ministries and enterprises will be granted autonomy over their trade transactions. [redacted]

At present it is uncertain exactly how funds are to be allocated to cover imports, but it appears likely that distribution of funds among the various sectors of the economy will continue to be centrally determined. Six billion rubles reportedly will be allocated to selected ministries and enterprises—presumably to at least some of the ministries and enterprises being granted authority to conduct trade independently—to finance trade transactions for an unspecified time, possibly a year. Failure to meet export targets, however, will result in a reduction in allocated funds. Selected ministries and enterprises will be able to retain up to 90 percent of export earnings—although the US Embassy in Moscow indicates that this will pertain only to above-plan exports—and Vneshtorgbank (VTB—the Bank for Foreign Trade) can extend them credits. [redacted]

As part of the reorganization, the Soviets have created a coordinating commission made up of the heads of the major ministries and departments engaged in trade activities (see table 2). It is supposed to provide strategic guidance to the foreign trade sector; its command over resources, however, appears to be far less than that accorded the state committees formed to oversee agriculture and construction. The commission's clout has been enhanced by the naming of Vladimir Kamentsev, a recently appointed deputy chairman of the Council of Ministers with reportedly strong administrative and negotiating skills. The MFT and the State Committee for Foreign Economic Relations (GKES)—which administers economic and military programs—will continue to monitor foreign trade operations but, at least for the MFT, with reduced power. GKES, on the other hand, is to oversee cooperation projects on Soviet territory in addition to construction projects overseas. VTB appears to have gained a greater role in controlling the distribution of scarce hard currency funds. [redacted]

Redefining Joint Ventures With the West. Moscow is likely to complement increased end user autonomy with the capability to conclude joint ventures with Western firms. The Soviet leadership has passed a decree that will permit up to 49-percent foreign equity and allow for some foreign management and quality control, repatriation of profits, and other prerequisites

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Table 2
Composition of the State Foreign
Economic Commission

Chairman	First Deputy Chairman
V. M. Kamentsev USSR Council of Ministers	A. K. Antonov Council of Ministers and USSR Representative to CEMA
Members	
State Committee for Science and Technology Chairman	Gosplan First Deputy Chairman
Gosagroprom First Deputy Chairman	Ministry of Foreign Trade Minister
Machine-Building Bureau Chairman	Ministry of Finance Minister
Vneshtorgbank (VTB) Chairman	Gossnab First Deputy Chairman
State Committee for Foreign Economic Relations Chairman	Ministry of Foreign Affairs Deputy Minister

to make such ventures attractive to Western firms. The Soviets see several advantages to such a relationship:

- Partnership with a Western firm would provide access to established markets and trademarks that could make it easier to sell Soviet-made goods in the West.
- Quality control by the Western partner would help assure that products meet world market standards.
- A long-term equity relationship with a Western firm could allow for automatic updating of production lines to keep up with changing Western demands and technology.
- Joint ventures would also allow for transfer of technical know-how related to organization and management of production and the use of advanced technology, neither of which is easily transferred through traditional equipment purchases.

- Such arrangements would allow for the transfer of Western technology at little or no hard currency cost to the Soviets until after production begins.

The Soviets have set down some general guidelines for the operation of joint ventures, although most details remain vague. Capital contributions from the West reportedly will take the form of equipment, technology, or financing; and the USSR's share will include spending on "social infrastructure." Management of the joint enterprises will consist of a board with Soviets occupying the positions of both chairman and director-general.

According to the Soviet press, production plans for joint ventures will not be set by central planners, and purchases from and sales to domestic enterprises are to be conducted through foreign trade organizations with prices set at world levels, thus effectively segregating these enterprises from the rest of the domestic economy. At the same time, joint ventures will be required to abide by Soviet law in setting wages, hours of work, and vacation time for Soviet workers.

The Soviets have expressed particular interest in establishing joint ventures in chemical manufacturing, machine building—including equipment for the energy sector—wood processing, electronics, communications, and the light and food industries. Soviet officials say they are currently considering over 100 joint-venture proposals from Western firms, including those from the United States, Japan, Italy, Germany, and Sweden. Negotiations on these proposals are still in the preliminary stages, although a few letters of intent have been signed. Import substitution will play a major role in joint-venture decisions by the Soviets, but they also expect that the venture will generate sufficient exports to at least cover hard currency costs. Soviet trade officials have also proposed to Western businessmen on several occasions that joint ventures in the West be established to market Soviet technology.

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Although such joint ventures have strong appeal to many Soviet officials, there are several other types of arrangements that would provide many of the same advantages. For example, buy-back and coproduction arrangements would allow for access to Western technology but with less direct Western involvement. Indeed, many of the discussions under the rubric of joint ventures appear to be little more than coproduction or buy-back arrangements in the manufacturing sectors. For example, an agreement with a Finnish firm for the construction of a paper-producing factory that has been touted as a joint venture calls for the Finns to provide equipment in return for delivery of 25 percent of the annual production as payment, an arrangement that probably differs little from earlier compensation agreements. [redacted]

The purchase of Western management services could also improve Soviet efficiency in introducing new technological processes and organizing production. Such arrangements should be particularly attractive to the Soviets in key sectors of the economy where they might desire to limit the extent of Western involvement, such as in agriculture and the development of raw materials. Discussions along these lines began late in 1985, but there has apparently been little followup since the drop in oil prices and increased interest in joint ventures. [redacted]

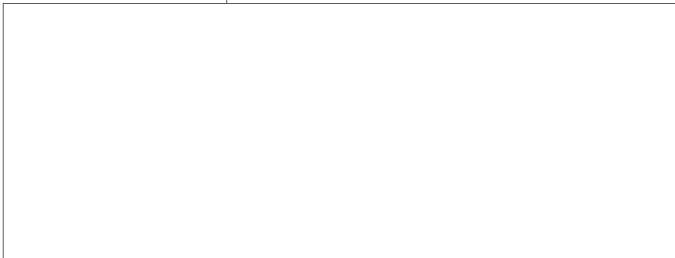
The Soviets are also increasing their efforts to promote the formation of joint enterprises with other members of the Council for Mutual Economic Assistance (CEMA). Some progress seems to be at hand, but most East European countries probably see these efforts as attempts by Moscow to lay heavier claims on their manufactures (see inset on Soviet-East European joint enterprises). [redacted]

Developing Financial Sophistication

Although the degree of actual borrowing has yet to be determined, Gorbachev's financial managers are clearly interested in taking full advantage of the wide range of Western financial markets and instruments to improve the effectiveness of Soviet borrowing activities (see table 3). Past financial managers were extremely conservative in their financial dealings with

the West—relying heavily on Eurocurrency borrowings, promissory-note financing, and government-backed credits—and seemingly obsessed with obtaining the lowest nominal interest rate (to the point of allowing a substantial compensating markup in the cost of imported equipment). As a result, the USSR often paid more for its funds, despite the nominally low interest rate, and received greater adverse publicity in doing so than other borrowers with an equal credit risk. [redacted]

As part of its decision to broaden its financial dealings, Moscow is moving aggressively to build the requisite expertise. [redacted]



[redacted] The US Embassy in Moscow reports that Yuriy Ponomarev, considered by Western bankers to be quite knowledgeable as well as a risk taker, has been promoted to a key banking position. This appointment is another sign that Moscow may become more innovative in international finance. [redacted]

VTB and Soviet-owned banks in the West are already adopting a more sophisticated approach:

- They are participating in swaps involving exchanges of obligations in various currencies as well as substitution of fixed for variable interest rates—a method of diversifying the debt portfolio.
- Moscow Narodny Bank, the Soviet-owned bank based in London, recently put together a \$100 million note issuance facility (NIF), a new instrument incorporating an option to issue notes as well as raise cash through bank advances. VTB has also recently accepted a French proposal to organize its own NIF.

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Soviet-East European Joint Enterprises

To promote intensive economic development, Moscow highlighted increased cooperation between Soviet and East European enterprises at the CEMA summit in June 1984 and later as part of CEMA's heralded Long-Term Economic, Science, and Technology Program. During the signing of the program in December 1985, the USSR and five other CEMA members announced the formation of a multilateral production association, Interrobot, to develop and produce robotics. The Soviets have also signed agreements for bilateral enterprises such as "Robot" with Czechoslovakia and two machine tool production associations with Bulgaria. Despite the fanfare accorded the announcements, these associations represented only a modest move toward direct enterprise links envisioned by Moscow and probably varied little from longstanding specialization arrangements within CEMA. [redacted]

A more recent decree, however, outlines Moscow's strategy for removing obstacles and creating incentives to accelerate the formation of enterprise-to-enterprise ties among socialist countries:

- Selected Soviet associations and enterprises will be given the right to formulate projects and seek partners in other CEMA countries.*
- Organizations will be free to negotiate and sign contracts for volumes and prices of goods and services under joint projects.*

- Firms will be financially independent, with revenue remaining under the control of the enterprises—except for small deductions going to sector ministries.*
- Profits made by enterprises will be distributed in proportion to participants' contributions. [redacted]*

In addition the Soviets signed bilateral agreements with most East European countries at the annual CEMA premiers' meeting in early November 1986 that are designed to promote direct ties. These signings, coupled with the recent decree, would appear to go far in opening the way for increased Soviet-East European cooperation. Other critical issues hamper direct links—as evidenced by criticism at the premiers' meeting on the slow progress in implementing cooperative agreements—and must still be resolved. Artificial prices and exchange rates complicate the valuation of labor and capital between countries and may lead to disputes over profit sharing. Input demand by joint firms that are ostensibly free to set their own output levels may be at odds with centrally decreed plans. [redacted]

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Table 3
Soviet Financial Options

Type	Advantages	Disadvantages	Use by the Soviets
Assets			
Cash, demand deposits, time deposits	Readily available pool of funds, boosts credit rating, requires no special expertise to administer.	Low to no interest earnings.	Large percentage of assets in these types of accounts.
Bonds	Higher interest rates, longer terms, low risk. Requires little management.	Risk of capital loss if bonds sold before maturity.	VTB invested \$3.2 million in Finnish bond in August for first time. Soviet-owned banks in the West permitted to hold some Western bonds.
Hard currency loans	Best rates available.	Few creditworthy borrowers, less liquid than other asset types.	Largely lending to client states, with little participation by Soviet-owned banks in international syndicates.
Other—such as real estate, commodities, futures, options	Possible large capital gains, portfolio diversification.	High risk, illiquid; requires expertise and management skills.	Relatively inactive except for a few unsuccessful real estate ventures and gold speculation by Soviet-owned banks, with large losses. Activity now mostly confined to dealings in foreign exchange and gold options.
Liabilities			
Interbank credit	Attractive commercial rates. Some potential for obscuring sources and uses of funds.	Deposits must be rolled over and interest paid in short intervals. Bankers expect offsetting deposits.	Active users of interbank market, but evidence that deposits and credits balance out.
Bank lines of credit	Competitive interest rates, no publicity, flexible. Usually not tied to trade.	Reported in BIS statistics.	USSR taps this market heavily and has ties to West German, Austrian, and Japanese banks.
Government-backed credits	Subsidized, below market; at fixed rates with terms of up to 12 years.	Requires cash downpayment. Inflexible, tied to imports. USSR categorized as rich country—higher rates.	Before 1975, all loans had government backing. Since then, over 50 percent of USSR's net debt has had government backing.
Syndicated loans	Attractive interest rates, repayment terms, and loan amounts.	Reported in BIS statistics; up-front commissions and fees.	Heavy use in mid-1970s to finance large projects. Cut back in early 1980s but reentered in 1984 with heavy use in 1985.
Promissory-note financing	Readily available export financing, some of which may be eligible for government guarantees. Notes held privately are not reported in BIS statistics.	Inflexible since they are tied to import purchases. Usually requires cash downpayment. Often no control over creditors since paper may be traded.	Heavily used in the mid-1970s and again more recently. Some of the paper is sold at a discount in the <i>a forfait</i> market. The Soviets try to control the amount of paper by purchasing as much as possible.

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Table 3
Soviet Financial Options (continued)

Type	Advantages	Disadvantages	Use by the Soviets
Acceptance financing	Competitive interest rates with borrower not limited to draw-down at specific times. Purchases may be made from any supplier for eligible goods.	Medium-term funds only with restrictions on purchases.	VTB's first bankers' acceptance in August 1985 was with US and Canadian banks, followed by August 1986 acceptance with British banks.
Bonds	Lower rates than syndicated loans with wide range of options: fixed or floating rates, range of repayment terms, and public or private offerings. Nonbank-held bonds not reported to BIS.	If public offering, widespread publicity may affect credit rating.	Moscow Narodny Bank launched floating rate, private placement bond in May 1986. Rumor that VTB will soon offer long-term fixed-rate bond.
Multiple-option facilities (note issuance facilities—NIFs)	Incorporates several types of loan facilities at option of borrower: notes issuance, cash advance, or revolving credit. Borrower may request banks to bid competitively or may take predetermined rate of interest. Several currencies usually available—no need for interest, debt, or currency swaps.	Lenders have option to cancel facility after some preagreed time period. Borrower cannot lock in low rates for long terms. Fees payable to arrangers quarterly, irrespective of utilization. Also, utilization fees assessed.	VTB has not yet borrowed in this manner. Moscow Narodny Bank issued its first NIF through its Cayman office on 15 August 1986.

- Last year the Soviets agreed to an acceptance facility—a financing technique in which the bank guarantees payment to exporters for trade documents—with US and Canadian bankers for grain purchases. In August 1986, VTB arranged a 100-million-pound-sterling bankers' acceptance led by a British bank, the first time the Bank of England has permitted the Soviets to borrow in this manner.

The Soviets are also making unprecedented moves in world bond markets. In August 1986, VTB agreed to invest \$3.2 million in a yen-denominated bond issue, marking the first entry of the USSR into the international bond market. Most financial analysts believe that this venture is an indicator of Moscow's interest in marketing its own bond issues, a cheaper source of long-term funds than syndicated borrowing. Recent settlement with the British on Czarist bonds in default since 1917 removes a longstanding impediment to the issuance of Soviet bonds.

The Soviets appear to have recognized that more sophisticated financial dealings entail expanding their presence in the international financial arena. Soviet banking authorities have renewed efforts to establish a branch of VTB in Tokyo and have been negotiating with Kuwait to establish joint banking operations to fund projects in the USSR and in third world countries. Moscow Narodny Bank has reportedly opened a subsidiary in the Cayman Islands to take advantage of the tax break offered in the issuance of new financial instruments. Moscow is also seeking financing from nonbank institutions: MNB has requested direct loans from Japanese insurance companies to VTB to finance Japanese exports to the USSR.

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Expanding Ties to Multilateral Economic Institutions

The Soviets are exploring the possibilities of expanding ties to a number of international economic institutions. To some extent, increased participation in these bodies goes hand in hand with Moscow's efforts to enhance its ability to boost exports. Such membership also provides Moscow with an opportunity to both expand its knowledge in this area and to gain new forums to promote its political interests. Soviet actions to date on this front, however, do not appear to be as well thought out or as carefully planned as other recent trade moves. In particular, years of neglect probably have left Moscow without a clear understanding of the costs and benefits of association with some of these international institutions. For example, Ivan Ivanov, a high-ranking official on the newly created State Foreign Economic Commission, told US Embassy officers that there were only three or four Soviet experts on GATT. [redacted]

Despite recent rebuffs, the Soviets' interest in GATT remains keen. The Soviets apparently believe that membership in GATT will expand their general knowledge of world economic conditions and trade opportunities. In their view, it will also help to integrate the USSR into the international economy by making Soviet exports eligible for reduced tariffs and numerous other trade benefits that accompany GATT membership. Further, the coming round includes negotiations on services that could affect Soviet activities in international shipping. They may also believe that GATT membership would make them less vulnerable to economic sanctions. [redacted]

Meeting GATT membership criteria would prove difficult, however, despite arguments by the Soviets that their recent reorganization of the foreign trade sector makes the Soviet economy more compatible with the aim of GATT. Although the reorganization could help improve the efficiency of Soviet foreign trade, crucial trade decisions remain centrally controlled. Thus, the Soviets have still not accepted the concept of free trade, which forms the basis of GATT. It is also unclear whether Moscow would be willing to provide the detailed statistics and trade policy descriptions required by GATT. Moreover, with no meaningful tariffs or quota systems, the Soviets have

few direct concessions that they can offer for accession to GATT. Such Soviet concessions would have to incorporate commitments to increase imports from GATT signatories, which other centrally planned countries who have joined GATT have acceded to, such as Poland and Romania. The Soviets would have difficulty meeting such commitments, however, given current hard currency problems and only a limited potential for expanding exports. [redacted]

While the Soviets would probably view their initial participation within GATT as an economic learning experience, in time Moscow might bring a strong political element to the organization. The meetings could be used to criticize US actions or upset the GATT decisionmaking process—which relies on consensus rather than votes—in favor of developing countries. Such activity has been common Soviet practice in some international forums and would complicate procedures in an organization that has been unusually successful in avoiding politicization (see inset on Soviet activities in other international bodies). [redacted]

Although there has been some reported interest in joining the *International Monetary Fund* (IMF), Soviet officials have denied any intention of seeking membership. The USSR rejected IMF membership as too restrictive after participating in the organizational meetings at Bretton Woods, New Hampshire, in 1944. In particular, the USSR was unwilling to give up autonomy in setting its own trade and exchange rate practices, did not agree with the gold subscription requirements, and refused to release sensitive economic data such as gold reserve and balance-of-payments information. These factors are likely to continue to contribute to the Soviet lack of interest in the organization. In addition, as a large industrial nation, the USSR would be required to pay a sizable subscription upon joining. Since it is unlikely to draw heavily on IMF funds, it would be a net creditor, which would be a major departure from its policy of extending economic aid on a bilateral basis. [redacted]

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***Soviet Behavior in International
Economic Organizations***

The USSR has been an active participant in a number of international specialized organizations since the mid-1920s, when it joined the Universal Postal Union (UPU) and the International Telecommunications Union (ITU). Moscow has tended to gravitate toward those organizations that can provide technical and economic information as well as coordinate international services. On the other hand, it has shied away from organizations such as the IMF and GATT, which require sizable funding commitments and/or information that it considers sensitive. Its level of participation in aid and humanitarian organizations—such as the UN High Commission for Refugees, the International Fund for Agricultural Development (IFAD), and the United Nations Children's Fund (UNICEF)—is also low, probably to avoid funding commitments.

Soviet behavior in these organizations ranges from constructive and businesslike to highly propagandistic and obstructionist. To a large extent, Soviet behavior is determined by the level of specialization of the organization:

- *Soviet conduct in the highly specialized organizations such as the World Intellectual Property Organization (WIPO) and the International Civil Aviation Organization (ICAO) is businesslike and*

constructive. The USSR uses these organizations to collect technical information and to advance and support proposals that serve its national interests.

- *At the other extreme, the Soviets use the United Nations Educational, Scientific, and Cultural Organization (UNESCO) as a political forum to attack Western interests and spout disarmament propaganda. This behavior is calculated to win the favor of Third World countries, to protect the USSR from unwelcome initiatives, and to further Soviet political agendas.*
- *There are also a number of international economic organizations—those most similar to the GATT in function—in which the Soviets are mostly cooperative but occasionally advance political aims. For example, in the Economic Commission for Europe (ECE), the Soviets cooperate reasonably well on the technical level but sometimes use the forum for propaganda purposes. Other organizations in which Soviet conduct is mixed include the International Labor Organization (ILO) and the United Nations Committee on Trade and Development (UNCTAD).*

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Although we expect the USSR's interest in the IMF to continue to be weak, some factors could eventually cause it to reconsider membership:

- The size of the Soviet economy, from which voting shares are determined, makes it likely that the USSR would receive a voting share large enough to gain a seat on the Executive Board and put it in the position to influence important Fund decisions such as the structure of the Fund, changes in quotas, and allocation of Special Drawing Rights (SDRs).
- The Soviets also could use their position to influence decisions on lending to Soviet Third World clients. In particular, Moscow may believe its image could be enhanced as a lender within the IMF. [redacted]

Joining the IMF would also give Moscow the option of subscribing to membership in the *World Bank*. The costs and benefits of joining the World Bank would be much the same as those for the IMF, and, thus, World Bank membership is also not likely to be immediately attractive to the Soviets, unless their involvement in international trade and finance increases considerably. [redacted]

Since the CEMA summit in June 1984, the Soviets have been actively pursuing their longstanding interest in establishing formal *European Community (EC)-CEMA* ties. Economic and trade issues probably motivated Soviet interest in earlier years, but the present effort has a more pronounced political flavor. Moscow clearly wants some form of official EC recognition to enhance the status of the organization within the international community. In addition, the Soviets probably hope to establish a forum to discuss the entire range of East-West issues with the West Europeans without the presence of the United States. Another longstanding Soviet goal has been to keep relations with the EC on a multilateral basis to block EC arrangements with individual East European countries. However, in a major concession last year to break the deadlock, the Gorbachev regime gave the green light for Eastern Europe to conclude bilateral arrangements with the EC. Moscow is still likely to monitor closely the East Europeans' dealings with the EC. [redacted]

Soviet approaches to other world institutions, such as the *United Nations*, have also had a decidedly political bent. The Soviets first broached their ideas about an economic security initiative in general terms at the UN last year. Soviet Foreign Minister Shevardnadze's 23 September 1986 address to the United Nations General Assembly included a strong pitch for a new, comprehensive system of international security—a Soviet theme that ties together all of Gorbachev's disparate disarmament and foreign policy initiatives. The economic component of Gorbachev's proposal calls for the establishment of a system of equal economic security, removal of economic blockages and sanctions, and creation of vehicles to handle the international debt problem. Included in this proposal is an effort to draw up principles to govern the use of part of the funds released from proposed military budget reductions to provide the lesser developed countries (LDCs) with some economic relief. [redacted]

None of these ideas are new. The Soviets have simply restructured outdated North-South themes—areas where Soviet economic interests are small and the prospects for political visibility are high. By weaving them together with other proposals on security and political issues into one overall framework, however, the Soviets are trying to create an illusion of newness and to lend concreteness to what Gorbachev calls new political thinking. Some of these ideas were embodied in a series of proposals put forth in mid-1986. Soviet initiatives have not met with much enthusiasm from the LDCs; in fact, Soviet and LDC interests on international economic issues have been diverging over the last decade. However, with a new set of policymakers in place and Gorbachev's call for new ideas, it is possible that in time the leadership will propose some fresh ideas, particularly if it is interested in taking a global approach to addressing international economic problems that affect the USSR's trade and financial position. [redacted]

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Future Soviet Actions

How Moscow proceeds relative to recent initiatives will depend, in large measure, on future decisions regarding the role of Western technology and equipment in Gorbachev's modernization drive, the extent of Western managerial involvement and corporate ownership, and the acceptable level of hard currency indebtedness. Moreover, it will take some time before these decisions are made. Gorbachev's new team of managers will need time to acquire the experience and expertise necessary to confidently move heavily into the international financial and commercial arenas. And the leadership will probably spend the next year or two assessing the results of ongoing domestic programs—shifts in investment priorities, management reorganizations, and the discipline campaign—before considering bolder moves, especially systemic economic reform. [redacted]

In the meantime, we can expect cautious but steady movement into the international economic arena. The next significant Soviet action is likely to be in the area of joint ventures; the first contracts could be signed within the next few months. Although with less fanfare, the Soviets will probably encourage expansion of coproduction and use of Western management services. They are also likely to look for more opportunities to participate in joint projects in the Third World with Western firms. While the Soviets have used Western equipment to enhance the competitiveness of their bids on projects in the Third World in the past, they have rarely formed direct partnerships with Western firms when bidding on these projects. Arrangements like the one they are negotiating with Kuwait could provide the necessary funding without Moscow's having to offer credits. More remote is the possibility of Soviet multinational companies, primarily in cooperation with Western firms. The Soviets have indicated, however, that the provisions for joint ventures will include the right to establish subsidiaries in third countries. [redacted]

Progress along these lines is apt to be slow. Some Western firms may be willing to make a relatively small investment to gain entry into the Soviet market, but most are likely to approach negotiations cautiously. Years of dealing with cumbersome Soviet bureaucracies, shoddy Soviet manufactures, and unimpressive results from joint ventures with other socialist

countries will make most businessmen wary. Even Western enthusiasm for joint ventures in China—the socialist country with the most liberal regulations—has recently waned. In addition, Western firms are likely to encounter numerous difficulties before arriving at satisfactory contractual terms. [redacted]

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[redacted] specific problems cited by Western businessmen include an appropriate definition of profit and the accounting and pricing procedures to be used for raw material inputs. [redacted]

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The Soviets themselves are also apt to approach actual negotiations cautiously. Granting the amount of control over production decisions required by Western partners would go against the grain of most Soviet managers. At present, it appears that there is still a considerable amount of uncertainty among midlevel Soviet officials who deal regularly with Western businessmen over exactly what form joint ventures would take. Given this uncertainty, Moscow will probably settle on only a few of those proposals currently under discussion to serve as pilot projects. [redacted]

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Even if impediments to successful joint ventures can be overcome, the level of Western investment is likely to be too small to have much of an impact on expanding Soviet exports of manufactured goods. And the recent changes in the foreign trade apparatus will probably not have much success in expanding exports. Although they will probably improve the operation of trade by removing the MFT as a cumbersome middleman for some trade actors, the changes do not remedy the lack of domestic incentives for producers, the irrational price structure, and the inadequate technological base that underlie the poor position of Soviet manufactured goods in world markets. In addition, depressed earnings from traditional exports will severely constrain purchases of foreign equipment that could compensate for some of these shortfalls. [redacted]

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How the Soviets will respond to lackluster export performance is difficult to predict. In the short term, they are most likely to introduce piecemeal adjustments to deal with some of the specific problems that develop. They might try isolating the export-oriented producers and joint ventures from the inefficiencies of the economy, much as the defense industries are protected. However, the benefits of trade—especially in areas of technology assimilation and diffusion—would be similarly isolated.

As long as Moscow continues its conservative approach toward reliance on Western technology, a large increase in the role that the USSR plays in the international financial arena is unlikely. However, the Soviets will probably become more adaptable to new financial instruments and more flexible in the management of their assets. But the present limitations on Moscow's hard currency earnings, coupled with traditionally conservative banking personnel, are likely to restrict sharply any large-scale speculative approaches to financial management. Soviet reaction to gold trading and real estate scandals involving Soviet-owned banks in the past resulted in a tightening of central control from Moscow and is indicative of Moscow's attitude.

The Soviets will continue their approaches to a variety of international economic organizations for both political and economic reasons. GATT will probably remain a key area of interest to the USSR both for the prestige factor and the chance to participate in negotiations that the Soviets consider will affect their interests. Lackluster trade performance and a trade sector that remains largely under the control of central authorities will, however, undermine arguments by the Soviets that their system is becoming more compatible with the aims of GATT.

For largely political reasons, the Soviets will continue to press for formal EC-CEMA relations although probably without expectations of anything but minimal economic gains. IMF and World Bank membership are not likely to be pursued actively at the present time. Membership in these bodies remains secondary to Moscow's interest in GATT, and the leadership would probably like to weigh the costs and benefits of several years in GATT before pursuing membership in the other two international bodies.

The USSR will almost certainly become more active in promoting its own solutions to international economic issues. It may perhaps go so far as to propose new international forums for dealing with such issues, especially if it feels strongly enough that it is being unjustly discriminated against by existing institutions. What forms the new Soviet proposals are likely to take are difficult to predict. We may see a repackaging of old proposals with slightly different nuances rather than bold new proposals. To the extent that the content of Soviet initiatives remains similar to past proposals, international response is likely to be lukewarm at best. In addition, the small Soviet share of world trade coupled with only modest improvements in trade and economic performance could weaken Soviet positions.

Implications for the United States

These new Soviet initiatives—even if constrained and slow to develop—will have important repercussions for US policy interests. Increased cooperation with Western firms would be likely to improve Soviet assimilation of Western technology at given enterprises, although diffusion throughout the economy is likely to continue to be difficult. Soviet ability to make effective use of Western equipment and technology has been constrained in the past, partly by the inability of Soviet managers and engineers to work hand in hand over an extended period with their Western counterparts. A vested interest by Western business in the effective use of Western equipment and technology, backed by a sustained on-site presence, could substantially improve their impact. Moreover, Western firms involved in joint ventures with the USSR are likely to want to incorporate state-of-the-art technology into these projects and could press their governments to relax COCOM controls. Furthermore, joint ventures established outside the USSR or subsidiaries of joint ventures in third countries could give Soviet technicians greater access to controlled technologies.

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Greater Soviet involvement in international trade and financial markets would make it easier for Moscow to hide the level of its financial activities. This could be achieved through the use of numerous instruments such as interbank deposits or by borrowing from nonbank institutions or banks that do not report to international financial bodies. In the past, Soviet reliance on government-backed credits and on a select grouping of major commercial banks in the United States and Western Europe provided Western governments with the ability to effectively monitor and, to a limited extent, control the level and terms of Soviet borrowing. [redacted]

The Soviets may attempt to use increased trade with the LDCs to strengthen Soviet prestige and influence in the Third World. The Soviets would probably be willing to offer loans at attractive rates to debt-ridden LDCs to obtain contracts for projects, particularly those that would generate repayments in raw materials needed for the domestic economy. While this would not represent a shift from current Soviet policy toward the Third World, success in generating higher quality Soviet exports combined with LDC debt problems would make trade with the USSR more attractive than in the past. [redacted]

Greater Soviet activity in the international economy, especially in international organizations, would increase the number of Soviet officials in the West and, thus, the opportunities for KGB activity. [redacted]

[redacted] Such opportunities to promote additional active-measures campaigns would increase, and this would be particularly acute with respect to IMF decisions regarding financial support to various Third World members. [redacted]

If the regime decides in several years that it must rely more heavily on Western technology and equipment for its modernization efforts to succeed, we would expect to see a much bolder Soviet entry into the international economic arena and an even greater

impact on US policy interests. Under such circumstances, we could expect an increase in the flow of Western technology to the USSR with a commensurate rise in Soviet hard currency borrowing. Moscow's low indebtedness, substantial reserves of near-monies such as gold and energy, centralized control over resources, and large unexploited internal markets would—in theory—make the USSR an attractive market for Western direct investment. [redacted]

Western governments would have to contend with their own growing group of exporters seeking more favorable trading conditions—low-interest credits, reduced export controls, and better bilateral relations in general. The pressures to do business with the Soviets would be even greater if they implement internal reforms that result in internationally competitive joint-venture and equity arrangements. In fact, the Soviets could dangle lucrative trade deals in front of the Europeans and reiterate the theme of Pan-Europeanism to encourage them to adopt trade policies vis-a-vis the USSR that are at variance with US policy. Similar efforts could be directed toward the Japanese. [redacted]

A sharply increased desire for Western technology and the accompanying credits might also provide the West with opportunities to advance its interests. In particular, Moscow might become somewhat more flexible on selected East-West issues to create a climate more conducive to expanding Western involvement in the Soviet economy. But actual flexibility would be strongly constrained by an expressed Soviet policy aim of reducing vulnerability to Western economic leverage. Moreover, a Soviet policy that would allow for a greatly expanded economic role for the West might only be pursued after significant changes to the domestic economy had been successfully undertaken. Such conditions—while possibly creating short-term openings for the West—could also diminish the potential for Western leverage over the longer term. [redacted]

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Even without a major expansion in economic and financial ties to the West, increased Soviet understanding of how international financial and commercial markets operate carries a commensurate risk that Moscow may attempt to manipulate these markets to the detriment of US national security interests. The West has been moving toward globally integrated financial and commodity markets at a tremendous pace. The ability to engage in financial, equity, and commodity transactions has outstripped international regulatory agreements. In addition, the rapid rise in transaction volume and the relative inexperience of many of the players have, in the minds of many experts, created the clear potential for an international crisis precipitated by one or more shocks to the system. [redacted]

Such extreme actions, however, would have to be weighed against the probable lack of Soviet control over the events following the initial crisis, especially those in the political sphere. Moreover, we believe such actions would be unlikely as long as the USSR's growing international role was paying economic or political dividends. If, on the other hand, Moscow perceived few benefits and remained a minor player in these markets, then the economic loss it would suffer by creating mischief in the marketplace would pale compared with the potential for significant damage to Western economic stability. [redacted]

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Should Moscow gain the requisite expertise and market access, it is not inconceivable that it could effectively precipitate such a crisis without being detected—at least not until after the fact. For example, the judicious placement of false data into the system or otherwise tampering with the worldwide transmission of financial or commercial information could delay or distort global financial data links, possibly causing a temporary shutdown of international markets and clearing systems. [redacted]

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The USSR could conceivably employ such tactics for a variety of reasons. Financial or commercial market disruption could be initiated to preoccupy the interests of Western governments at a time when the Soviets were engaged in activities—for example, in Eastern Europe or the Middle East—that would otherwise result in a united response from the Western Alliance. In such cases Moscow would be seeking to disrupt rather than to irreparably damage Western trade and financial practices. If the Soviets come to the conclusion that they could not effectively compete with the West technologically and economically and that such failure carried substantial risks to their long-term ability to maintain strategic parity, they could potentially attempt to precipitate a more prolonged economic crisis in the West. [redacted]

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