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FILE

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USSR: Aggressively Pursuing Joint Ventures  
with the United States

Summary

The USSR has stepped up efforts in recent weeks to sign joint venture deals with US firms. General Secretary Gorbachev probably will raise the topic at the upcoming summit meeting. The Soviet leadership has expressed particular interest in joint venture deals with US companies in the energy, agroindustrial, transportation, and consumer goods sectors. Moscow may be pressing the issue, in part, to demonstrate that expanded economic cooperation would benefit both countries, especially if various trade impediments between the two countries were removed. But the sudden explosion of interest in joint ventures with the US, coupled with recent Soviet moves to be more flexible and conciliatory in project negotiations, also suggests that Moscow is more urgently seeking an infusion of Western technology and equipment to aid its industrial modernization program. Moscow's tactics may result in a few deals being more quickly concluded, but Western firms will remain wary until key questions of profitability and profit repatriation are answered. The small number of joint venture deals likely to be concluded in the near term will have only a limited impact on the performance of the Soviet economy during the current (1986-90) five-year plan. Over the longer term, joint ventures could help improve the performance of certain industries, increase the skills of selected personnel, and provide access to some new foreign markets.

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This typescript was prepared by [redacted] Office of Soviet Analysis. Questions and comments are welcome and should be directed to Chief, Economic Performance Division [redacted]

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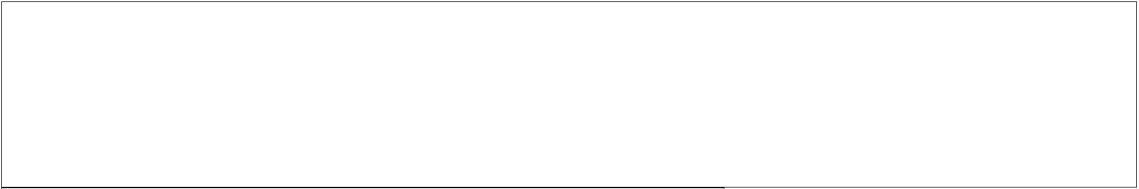
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USSR Aggressively Pursuing Joint Ventures with the US

Soviet officials are seeking to revive flagging economic ties with the United States across the board, and at present are making a particularly strong effort to establish joint ventures with US firms.

-- Earlier this month the USSR concluded its first joint-venture deal with a US company--Combusion Engineering will help produce control instrumentation for use in the Soviet petrochemical and oil-refining industries--and a venture with Pepsico involving restaurants reportedly is imminent. The Soviets also announced that a "letter of intent" has been signed with Occidental Petroleum and Italian and Japanese firms to build a petrochemical complex, which, if the deal is concluded, would be the largest joint venture to date.

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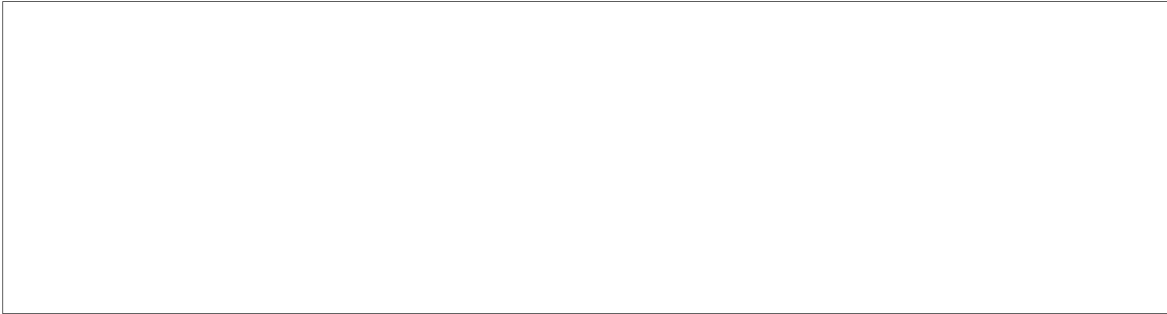
Gorbachev may also

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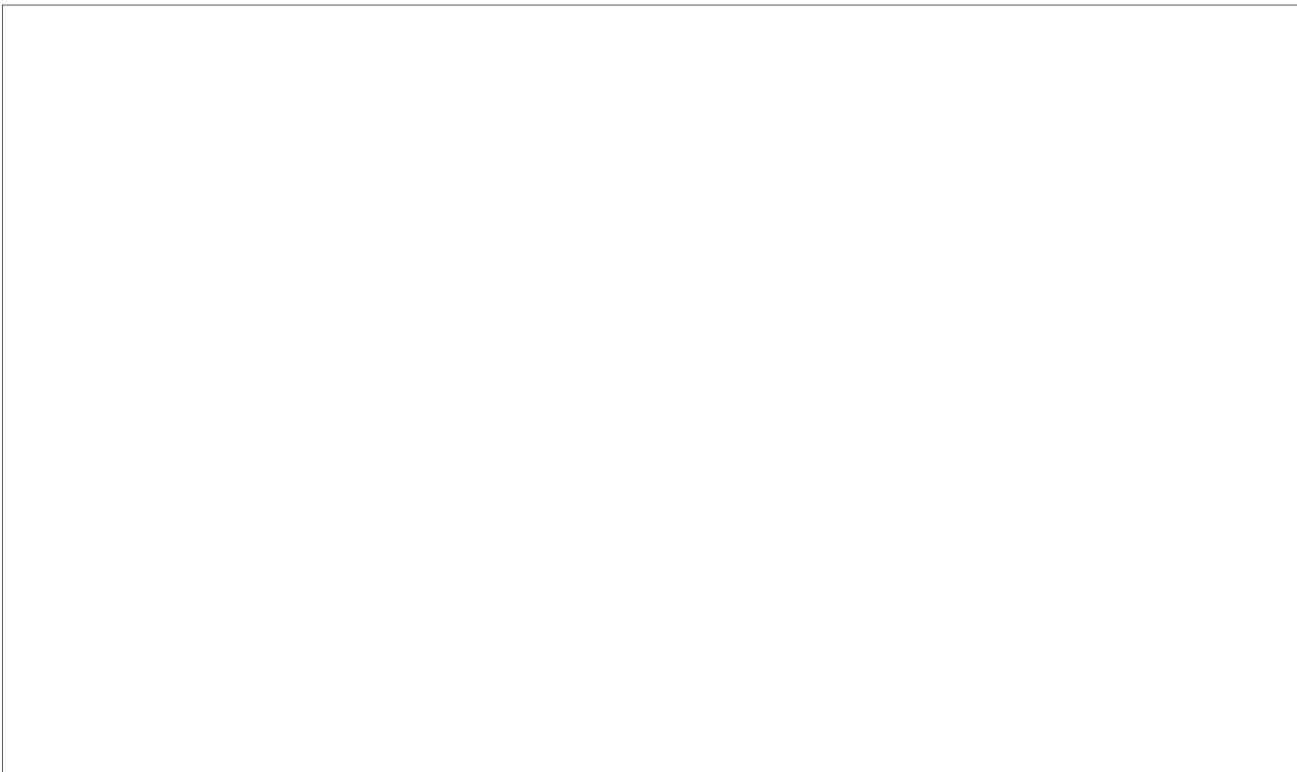
address US businessmen on the issue during his Washington visit as well as at the US-USSR Trade and Economic Council meeting scheduled for early next year in Moscow.



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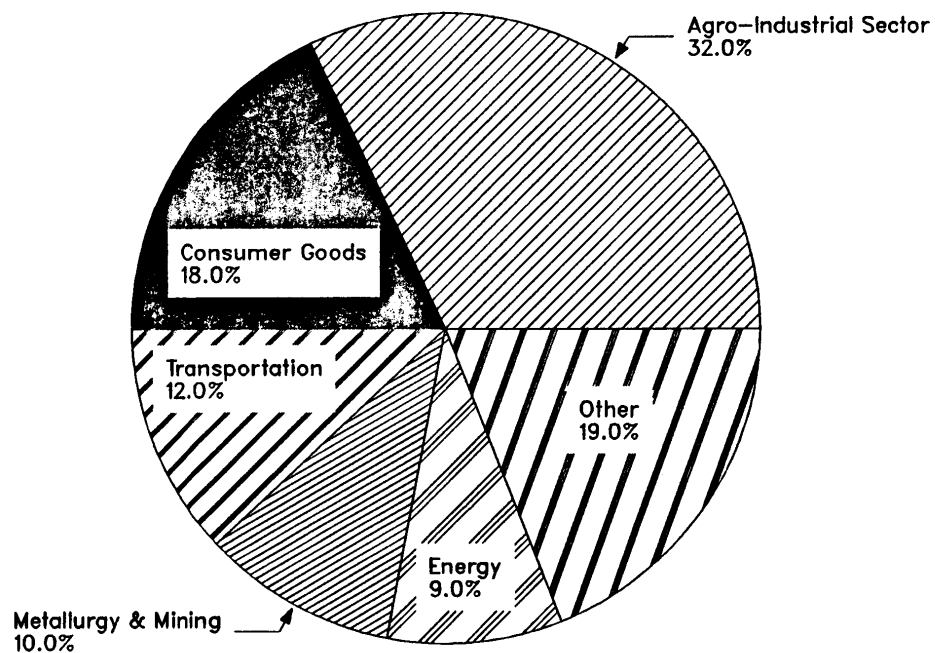
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The recent flurry of activity and high-level Soviet interest in joint ventures with US firms stand in sharp contrast to the sluggish pace of joint venture signings that have occurred over the past year. Moscow has received about 300 proposals from various Western firms, but just 10 contracts, including the one with Combustion Engineering, have been signed since the Soviet



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## SOVIET-US JOINT-VENTURE NEGOTIATIONS: AREAS OF INTEREST<sup>a</sup>



law permitting joint ventures took effect on 1 January. Gorbachev may believe that discussion of joint ventures at the highest levels while he is in Washington will provide the endorsement needed to spur additional signings. [redacted]

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Soviet Motivations

The Soviets' sudden rush to joint ventures may, in part, reflect a desire to have something concrete to present at the summit regarding the economic agenda. With a number of impediments on both sides still stifling US-Soviet trade in general, joint ventures appear to be one area where some progress might be made. Gorbachev may believe that by having a few joint venture agreements with US firms either in hand, or nearly so, he can demonstrate the enthusiasm that exists on both sides for expanded economic links and thus press for easing US impediments to expanded bilateral trade. [redacted]

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The joint venture push, however, undoubtedly extends beyond a desire to improve the US-Soviet economic climate; it signals a real Soviet need for US and other Western technology and equipment to fuel Gorbachev's modernization effort. The Soviet leadership is not satisfied with the current pace of its industrial modernization program and probably believes that indigenous efforts alone will not achieve the desired results. Moscow probably views joint ventures as a better vehicle than current trade and economic relationships for acquiring and assimilating Western technology, managerial expertise, and

marketing skills. In the long run, joint ventures are aimed primarily at improving the quality of Soviet manufactured goods for export and reducing Soviet reliance on exports of oil and other raw materials. But Moscow probably views the short-run benefits from a quick infusion of Western capital and technology as more urgent. Indeed, the up-front contributions of machinery and equipment by the Western partners reduces the initial hard currency outlays by the Soviets, an important financial concern at the moment given the Soviets' hard currency constraints.

[redacted]

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Outlook for US Firms

The Soviet leadership is showing more flexibility in the formation and operation of joint ventures which will help make such projects more attractive to US and other Western firms. For example, Moscow published a decree in early October that gives the Western partner more control over sales in the Soviet market, simplifies the procedure for joint-venture approval, and clarifies provisions for a tax holiday. According to the US Embassy in Moscow, twelve new instructions covering a host of problems such as taxes, currency regulations, and customs have already been written but need additional work before they will be released.

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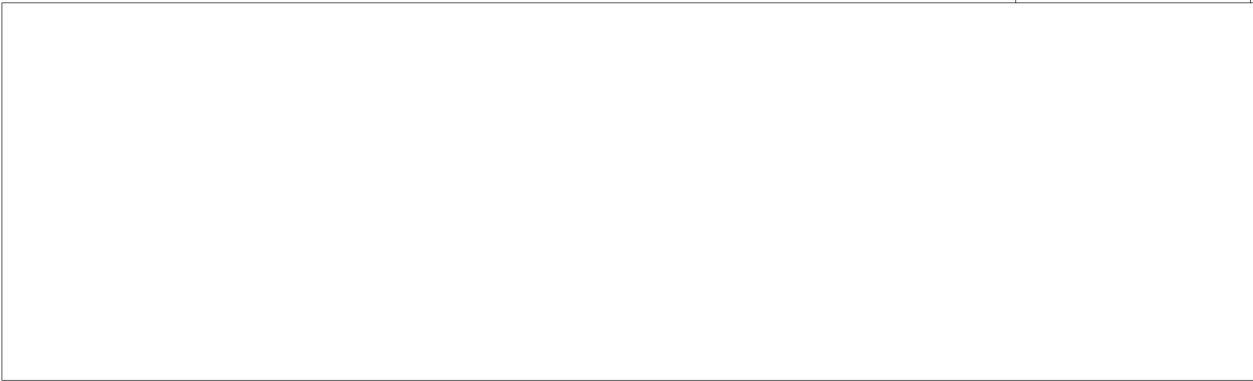
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In addition, the Soviets are pushing barter and other arrangements to enable Western firms to earn hard currency for profit repatriation without having to export the joint venture's output, as mandated by the current legislation. For example, Combustion Engineering will recoup its investment by receiving Soviet petrochemical products to sell in the West. [redacted]

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Given the high visibility of the issue and the Soviet leadership's willingness to compromise, we believe that some additional joint ventures will be formed with US companies in the near future. US firms are likely to move cautiously, however, as many questions remain about the profitability of such endeavors (see inset). Additionally, West European and Japanese firms appear to have the upper hand for the bulk of deals that are likely to be struck in the near future. US firms will probably remain at a disadvantage in negotiating with the Soviets because of their perceived vulnerability to government-imposed trade sanctions. Moreover, non-US firms usually can, in most instances, offer the Soviets comparable equipment and technology with the added advantage of having access to government-backed insurance and credits. [redacted]

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Boxed Inset

Obstacles Abound

Besides concerns about profit repatriation, Western firms are troubled by a number of other provisions in the joint-venture regulations that could affect the operation of the enterprise, including:

- o Management control. Although responsible for quality control of production, the Western partner will not be given the flexibility to manage the labor force. At present, this power is likely to reside with the general manager who, according to regulations, must be a Soviet citizen.
- o Material supply. The joint enterprise will be dependent on the state planning process for allocation of material inputs, thereby depriving Western firms of the freedom and flexibility under which most of them work.
- o Valuation of capital contribution. The value of the contributions to joint ventures, which will determine profit distribution, may be difficult to evaluate. The process will be further complicated if the Soviets insist on using their inflated official exchange rate which would undervalue Western contributions.
- o Accounting. Joint-venture regulations require that the accounting method used by the joint enterprise must be the same method employed by all Soviet enterprises--a system that would most likely result in lower tax deductions than if Western practices were used.

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End Boxed Inset



Limited Impact on the Soviet Economy

The Soviets will likely have only a limited number of joint ventures with firms from the US and other Western countries in operation during the next few years. Indeed, Moscow plans to conclude agreements for only 20 to 30 projects during the first year or two and then impose a temporary moratorium on signings, according to [redacted] the US Embassy in Moscow. The Soviet leadership hopes to use the breathing space to ensure the success of those projects already under way and to review and change the regulations as needed. We believe that these ventures will not have much of an impact on Soviet hard currency earnings or the quality of domestic production during the current (1986-90) five-year plan. Most of the deals concluded so far appear to be relatively small endeavors, involving simple production processes, low-level technology, and little foreign capital (see table). Even if a few larger deals--such as the petrochemical complex with Occidental Petroleum--are struck in the near term, actual construction will take several years years to complete. [redacted]

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Over the longer term, Moscow stands to reap some benefits from even a small number of joint ventures. The close interaction between Western managers and laborers and their Soviet counterparts afforded by joint ventures will familiarize more Soviets with Western production practices and marketing techniques. These improved skills and work habits will

**Joint Venture Projects Signed in 1987**

<u>Western Firm</u>	<u>Soviet Partner</u>	<u>Project</u>
Combustion Engineering (United States)	Ministry of the Petroleum Refining and Petrochemical Industry	Production of instrumentation for petroleum refineries and petrochemical plants
Finnair (Finland)	Intourist (State Committee for Foreign Tourism)	Refurbishment of Hotel Berlin in Moscow
FATA (Italy)	Ministry of Machine Build- ing for Light and Food Industry and Household Appliances	Production of commercial and industrial refrigerators
Heinemann Machine and Installations Con- struction (West Germany)	Sergo Ordzhonikidze Machine Tool Building Plant	Production of lathes and flexible production modules
India's Tourist Corporation	Moscow City Council of People's Deputies	Indian-cuisine restaurant in Moscow
Liebhern (West Germany)	January Uprising Production Association	Production of self- propelled cranes
Mineraloel und Rohstoff Handel (West Germany)	Nizhnekamskneftekhim Production Amalgamation	Production of ethylene glycol
Suomen Kati-Myynti Osakeyhtioe (Finland)	Tallin Sewn Goods Production Association <u>imeni V. Klement</u>	Production of women's clothing

Western Firm

Soviet Partner

Project

Sadolin (Finnish subsidiary of Danish Sadolin)

Estonian Republic Association Estkolkhozstroy

Production of paints, varnishes, and wood preservatives

Tairiku Boeki (Japan)<sup>a</sup>

All-Union Association Irkutsklesprom

Process high-quality Siberian broadleaved trees into furniture paneling



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be diffused to other Soviet industries in time, as Soviet personnel move on from their joint-venture assignments. How far and how fast this occurs, however, will hinge largely on the progress Moscow makes with its ambitious domestic economic reform package, not on the number of joint ventures in hand. Joint-venture arrangements with reputable Western firms will also probably provide the Soviets access to new foreign markets, albeit on a smaller scale than currently envisioned by Moscow. Finally, the production from some joint ventures could eventually improve the performance of certain industries. For example, the process-control systems from Combustion Engineering's joint venture could potentially maximize output of gasoline and other light petroleum products at Soviet refining facilities. 25X1

We believe that the transfer of COCOM-controlled technology will probably not be a problem for the West in the near term, but it could become one further down the road, especially if the first few joint ventures are successful. If competition develops among Western firms to form joint ventures, Moscow would be in a position to exert more pressure on them to ante up high technology to secure a place in the Soviet market. Moreover, a growing number of joint ventures--even those not requiring high technology--expands the opportunities for the recruitment of Westerners with access to such technology. 25X1

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