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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

December 5, 1986

MEMORANDUM FOR ALLEN WALLIS, State
ALAN WOODS, USTR
LOUIS LAUN, Commerce
✓ DEANE HOFFMANN, CIA
FRANK VARGO, Commerce
JAMES GRIFFIN, Treasury
DOV ZAKHEIM, Defense

SUBJECT: Final Draft of Response to NSSD 2-86 (U)

Attached for your concurrence is the final draft of the study undertaken at the President's direction in National Security Study Directive 2-86 on Recent Soviet Initiatives in International Economic Affairs. (S)

Please communicate agency comments directly to me by COB, Wednesday, December 10. When these have been received, the document will be forwarded to the President. (C)



Alexander H. Platt
Director of International Economic
Affairs

Attachment

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Response to NSSD 2-86

Soviet Initiatives in International Economic Affairs

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Soviet Initiatives in International Economic Affairs
NSSD 2-86

EXECUTIVE SUMMARY

On September 16, 1986, the President signed National Security Study Directive 2-86 (Appendix A) requesting an interagency examination of recent initiatives undertaken by the Soviet Union in the area of international economic affairs. The Departments of State, Defense, Treasury and Commerce, the Central Intelligence Agency and the Office of the United States Trade Representative participated in the preparation of this study. The NSSD called for the collection and review of all evidence relating to recent Soviet interest in international economic issues, a summary of past Soviet participation in international economic institutions and a forecast of potential future Soviet activities in this area. Finally, the NSSD required the preparation of analysis and conclusions drawn from the material collected. (S)

The NSSD review of Soviet activities in international economic affairs identified some increased Soviet interest in the field, most notably a Soviet application for participation in the new trade round and heightened interest in General Agreement on Tariffs and Trade, and expressions of interest in membership in the World Bank and International Monetary Fund. Other areas of some increased activity are the international financial markets and a potentially renewed interest in joint ventures with the West. The Central Intelligence Agency

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forecasts cautious but steady Soviet involvement in Western economic activities. (S)

The study concludes that Soviet participation, while initially aimed at building experience, will also present the Soviets with new opportunities and forums to challenge U.S. policy objectives. It also poses some risk to U.S. security interests by creating increased opportunities for KGB activity and the potential for disrupting financial markets. (S)

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I. Review of Soviet Activities in International Economic Affairs

The interagency NSSD group identified the following developments which suggest increased Soviet interest in greater participation in the international economic system. (S)

A. Reorganization of Soviet Trade Bureaucracy

Several changes have recently been made in the Soviet bureaucracy which suggest a new Soviet approach to international trade. On an operational level, certain ministries and enterprises have been given increased autonomy to engage directly in importing and exporting without the intervention of the Ministry of Foreign Trade (MFT). To coordinate these entities, a new Foreign Economic Commission has been created made up of representatives from MFT and various other economic organizations. Other organizational changes include the establishment of a new Administration for International Economic Relations in the Ministry of Foreign Affairs, headed by Dr. Ivan Ivanov, a reform minded academic; and the establishment of the State Committee for Economic Cooperation (GKES) to oversee joint venture activity. (S)

B. Soviet Interest in the GATT

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The recent overtures by the Soviet Union to play some role in the General Agreement on Tariffs and Trade is the most dramatic example of a new Soviet interest in the western international economic system. (S)

On several occasions since 1979, the Soviets have informally explored participation in GATT affairs; however, their application to the GATT Secretariat to participate in the new round of trade negotiations in mid-August was the most overt expression of interest to date. In support of their application, the USSR indicated to its trading partners that, among other things, the USSR wished to move its economy more into the framework of international economic relations, that closer associations with the GATT would help expand trade with GATT members and that Soviet interest in the GATT is "100 percent economic." With selected countries, the USSR also pointed out that it would serve as a counterweight to the United States in the GATT for smaller contracting parties over whose interests the United States "runs roughshod." (S)

The Soviet application for participation in the Uruguay round was successfully sidetracked at Punta del Este because of strong U.S. and nearly unanimous European opposition. However, future Soviet interest in GATT can be expected either directly or indirectly (through the application to the GATT of client states such as Bulgaria), especially as the GATT comes to terms with the readmission of the People's Republic of China. (S)

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C. Soviet Motives for Encouraging EC-CEMA Talks

Shifts in the Soviet Union's strategy to treat the European Community ("EC") as a political entity and to allow countries that are part of the Council on Mutual Economic Assistance ("CEMA") to have bilateral ties with the EC are key concessions that could lead to significant progress in EC-CEMA talks. (S)

The Soviet objective for enhancing the likelihood of success of these negotiations appears to be to gain greater political and economic access to the Community, possibly, in part, to gain EC support, or at least a softening of the EC position, for Soviet entry into the GATT. In addition, the Soviets stand to gain from direct access to the EC decisionmaking process, obtaining West European technology and enhancement of CEMA's prestige. (S)

D. Soviet Initiatives Towards IMF/IBRD Membership

Although a Soviet official in August said the Soviet Union is taking no steps towards IMF membership, at a conference in the Soviet Union in July, Soviet academics told their U.S. counterparts that the Soviet Union should consider seeking IMF membership. Further conflicting reports of possible Soviet interest in the IMF/IBRD have recently been received. Close attention must be paid to further developments in this area, as Soviet membership would probably result in a significant

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diminution in U.S. influence in these organizations and a likely erosion of U.S. Congressional support. (S)

E. Soviet Interest in International Bond Market

In mid-July the Soviet Union and United Kingdom signed an agreement settling outstanding claims arising before 1939. Part of the agreement provided for the settlement of private claims arising from Tsarist bonds issued before October 1917. In recent days the Soviets have indicated an interest in exploring resolution of outstanding defaulted bond claims in the United States. Taken together, these actions may suggest an interest by the Soviets to create good will in the financial markets as a precursor to active Soviet bond market participation. Except for a small participation in a syndicated bond offering for a Finnish entity (as a lender), there has been no such Soviet activity.

(S)

F. Soviet Strategies for Coping with Hard Currency Shortages

Soviet oil export earnings, which accounted for roughly half of non-arms related hard currency earnings in 1985, will fall by about \$5-6 billion this year. This is likely to reduce total 1986 hard currency earnings to \$23-26 billion, down from a peak of \$34 billion in 1984. As noted above, the prospect that such export revenues will remain depressed for the rest of the decade

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is undoubtedly one reason for the new Soviet interest in international economic institutions and stimulating manufactured goods exports. In the meantime, however, the Soviets have been forced to take steps to meet the resulting foreign exchange shortfall:

Gold Sales -- Soviet gold sales have increased significantly. Sales through August 1986 were an estimated \$3 billion, \$1 billion more than in all of 1985. The Soviets could earn another \$1 billion from such sales in the last few months of 1986 before disposal of major additional quantities cause a substantial depressive effect on price. The intelligence community estimates the Soviets could sell about 400 tons of gold (220 tons more than in 1985) before the price is significantly affected. (S)

Import Cuts -- Soviet planners have started to implement selected import cuts, although not of a magnitude that reduced earnings may later require. Consumer-related purchases will probably be cut most severely, and machinery and investment goods the least. Given a continued world grain glut, the value of Soviet agricultural imports could fall significantly if the weather is reasonable and agricultural productivity improves. (S)

Expanded Soviet Activity in International Financial Markets

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Gorbachev has expanded Soviet ties to international financial markets to offset declining hard currency earnings, diversify Soviet sources of funds, and gain economic intelligence. According to Western financial statistics, Soviet commercial debt increased by \$6.5 billion in 1985, and over \$3 billion in the first six months of 1986. Although short-term borrowing increased, the Soviets also took advantage of their strong credit rating to raise about \$2.8 billion in medium- and long-term syndicated loans on favorable terms. Moscow also made greater use of supplier credits and in some instances sought deferred payments for Soviet purchases. (S)

The Soviets will probably continue to be more active in international financial markets. This will take the form of increased gold sales (including bilateral gold swaps); increased borrowing (third party borrowings, ECU denominated borrowings, indirect supplier credits, and possible entry into the Eurobond market); and expansion of foreign-based financial entities (e.g., joint Soviet-Arab banks, investment banking relationships). (S)

While the USSR's excellent credit rating might facilitate a modest level of additional borrowing, there is no indication the Soviets will implement a long-term strategy of heavy borrowing as a reaction to lower export earnings. The leadership, recognizing the political dimension of borrowing, is reluctant to place itself in the position of being overly dependent on the West. The Soviets would also not want to jeopardize their ability to

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finance grain imports in a bad harvest year. But even the most liberal estimates of expanded Soviet financial market activity would still result in a relatively small role for the Soviet Union in international financial markets. (S)

G. Soviet Expressions of Interest in Joint Ventures

There is increased Soviet interest in the establishment of joint ventures -- to include Western management and equity participation up to 49% -- between Soviet and Western entities. However, other than indications that the Soviet Union is investigating new regulations to promote such relationships, details on the terms they are prepared to offer are still to be provided. The Soviets appear to be soliciting proposals from Western firms in order to ascertain what types of joint ventures (on what terms) are feasible. Even so, our knowledge of the extent of contact between Western firms and the Soviet Union on joint ventures is still anecdotal and fragmentary. (S)

The advantages to the Soviet Union of increased joint venture contacts are clear: new sources for hard currency, improvement of consumer goods, access to managerial know-how, and an opportunity to increase pressure on Western companies and government to obtain high technology otherwise unavailable to them. Yet the Soviets may be reluctant to concede real management control, or access to the Soviet industrial hinterland to prospective foreign partners, and there will inevitably be

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bureaucratic resistance to new ways. For their part, prospective foreign partners are likely to be interested in the Soviet domestic market, while the Soviets seem to see the program as a means to stimulate manufactured goods exports. (S)

Overall, lack of clear new Soviet regulations and a prognosis for lengthy joint venture negotiations over differing objectives make a marked introduction of Soviet-Western joint venture activity unlikely in the next few years. (S)

H. Soviet "International Economic Security Initiatives"

Soviet Foreign Minister Shevardnadze's September 23 address to the United Nations General Assembly included a strong pitch to establish a new, comprehensive system of international security -- the Soviet theme that ties together all of Gorbachev's disparate disarmament and foreign policy initiatives. Included in the Foreign Minister's speech is a call to establish economic vehicles to channel assistance to Third World countries and to develop a global scientific and technical cooperation program. Both efforts presumably would be carried out under UN auspices. The Soviets have formally introduced a proposal to this effect for consideration at this year's UNGA. Economic security, however, is only one small element in the proposal -- the reference to it is vague and debt is the only area specifically mentioned. (S)

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Soviet interest in pursuing a multilateral approach to global security problems stems from ideas detailed in Secretary General Gorbachev's report to the Party Congress last February. Unfortunately, the Foreign Minister's UNGA statement sheds no additional light on the Soviet proposal beyond what was offered last February. (S)

None of these ideas in the Soviet UNGA proposal are new. For the economic items, the Soviets simply have resurrected outdated north-south themes -- areas where Soviet economic interests are small and the prospects for political visibility are high. By weaving them together in 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" embodied in a series of proposals dating back to early 1986. The Shevardnadze speech is the most recent opportunity for the Soviets to plug their proposed security programs. However, Soviet reforms in this area, self-characterized as ideologically correct, promise greater compatibility with the economies of the West while maintaining the state controlled nature of the Soviet system. (S)

II. Historical Overview of Past Soviet Participation in International Economic Institutions

Soviet participation in international organizations spans six decades, from the time the USSR joined the Universal Postal

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Union (UPU) and the International Telecommunications Union (ITU) in the mid-1920s. The USSR had a brief association in the 1930s with the International Labor Organization (from which it withdrew in 1939 and again rejoined in 1954). The other organizations under review were not established until after World War II. Overall, Soviet participation in international organizations reflects basic Soviet foreign policy interests. The USSR has made good use of highly visible forums to attack its enemies, support its Third World friends, and defend its interests in debate and in staff studies. (S)

Over the years, Moscow has been careful to join those organizations which best serve its interests. For example, the Soviets are keen to join organizations where they can obtain information and studies on economic trends. Among the specialized agencies, the Soviets tend to congregate where they have access to sophisticated Western technology [e.g., the International Atomic Energy Agency (IAEA)]. The Soviets are cooperative with the West in a number of these venues including the World Meteorological Organization (WMO) and the IAEA. The USSR has tended to shy away from those organizations that require sizable funding commitments and or information that it considers sensitive. Thus, until recently, Moscow has avoided the GATT and IMF, where bargaining power and reciprocity count for more than polemics. (S)

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Soviet behavior in international economic organizations has varied considerably from a highly propagandistic, obstructionist approach in UNESCO, and a somewhat less antagonistic stance in ILO and UNCTAD, to a businesslike and constructive approach with minimal politicization in WIPO, IAEA, and ICAO. Not surprisingly, the Soviets seem to be most constructive and least polemical when they share with us the goals of the organization and see at least some degree of benefit to themselves. (See further discussion, Appendix B.) (S)

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How Moscow proceeds relative to recent initiatives will depend, in large measure, on future leadership decisions regarding (a) the role of Western technology and equipment in Gorbachev's modernization drive, (b) the extent of Western managerial involvement and corporate ownership, and (c) the acceptable level of hard currency indebtedness, (d) the degree to which Gorbachev is able to implement the "restructuring" of the Soviet economic system. Moreover, it will take some time before these decisions are made:

o The leadership will likely spend the next year or two assessing the sufficiency of ongoing domestic programs-- shifts in investment priorities, management reorganizations, and the discipline campaign--before reconsidering their conservative positions regarding Soviet reliance on foreign technology and equipment and systemic economic reform.

o It will take awhile for Gorbachev's new team of managers to acquire the experience and expertise necessary to confidently move heavily into the international financial and commercial arenas. (C)

Until the Soviets complete the formulation of their long term trade strategy, we can expect cautious but steady movement into the international economic arena. In the area of joint ventures, the first contracts could be signed as early as next year. Although with less fanfare, the Soviets are likely to encourage expansion of coproduction and utilization of Western management services. The Soviets 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 having to offer credits. More remote is the possibility of Soviet multinationals, primarily in cooperation with Western firms. According to [redacted] Soviet provisions for joint ventures will include the right to establish subsidiaries in third countries. (S)

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Progress along these lines is apt to be slow. While some Western firms may be willing to make a relatively small investment to gain entry into the Soviet market, most are likely to take a wait-and-see attitude. 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. The Soviets themselves are apt to approach actual negotiations cautiously.

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Granting the amount of Western control of production decisions that would be required by the Western parties would go against the grain of most Soviet managers. At present, it appears that there is still a considerable amount of uncertainty among mid-level Soviet officials who deal regularly with Western businessmen over what exactly joint ventures will entail. (C)

Even if impediments to successful joint ventures can be overcome, the level of investment is likely to be too small to have much of an impact on expanding Soviet exports of manufactured goods. Nor will the recent changes in the foreign trade apparatus likely 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. (C)

How the Soviets will respond to lackluster export performance is difficult to predict. 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. (C)

As long as Moscow continues its conservative approach towards reliance on Western technology, an increased role for the USSR in the international financial arena is unlikely. The Soviets will probably become more adaptable to new financial instruments and more flexible in the management of their assets. For example, [redacted] reports that Soviet-owned banks are now permitted to hold certain Western bonds in their portfolios. But the present limitations on Moscow's currency earnings, coupled with some vestiges of traditional Soviet conservatism, are likely to restrict sharply any large-scale speculative approaches to financial management. Gold trading and real estate scandals involving Soviet-owned banks and the resulting tightening of central control from Moscow are indicative of Moscow's attitude. (S)

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The Soviets will continue their approaches to a variety of multilateral 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 which they consider will affect their interests. Lackluster trade performance and a trade sector that remains largely under the control of central authorities will, however, undermine Soviet arguments that their system is becoming more compatible with the aims of the GATT. (C)

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 least not at the present time. Disclosure requirements and less control over its economic aid are likely to deter any serious Soviet interest. Nor would the Soviet leadership be willing to accept being labeled as developing country in order to get access to World Bank credits. (C)

The USSR will almost certainly become more active in promoting its own solutions to international economic issues. It may perhaps go as far as proposing 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 will probably 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 the expected lackluster trade and economic performance could weaken Soviet positions. (C)

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Analysis/Conclusions

On the basis of the relevant information identified in the interagency review, the following conclusions can be drawn in response to the questions posed in NSSD 2-86:

1. Increased Soviet interest in participating in international economic affairs is driven by: (a) a desire to establish a role for the Soviet Union in international economic affairs commensurate with its global role in political and security affairs, (b) a means of increasing East-West contacts for the purpose of gaining access to Western high technology, management skills and economic intelligence, (c) a necessary step to offset hard currency earning declines resulting from lower oil prices, (d) as a means of diversifying its source of funds, and (e) in order to develop an export policy that shifts its emphasis from the sale of natural resources to finished products, as a spur to Soviet modernization and global competitiveness. (S)

2. The NSSD process identified the following evidence of increased Soviet interest in international economic affairs:

- a. Application to take part in the new round and increased interest in GATT.
- b. Expressions of interest in the World Bank/IMF.
- c. Reorganization of the Soviet trade bureaucracy.
- d. Some additional activity in the international financial markets.
- e. Encouragement of EC-CEMA talks.

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f. A possible new approach to joint ventures with the West. (S)

3. Future Soviet activity in the international economic arena will probably be cautious, but steady. Possible areas of increased activity:

-- GATT will probably remain a key area of interest to the USSR both for its prestige and the chance to participate in negotiations which they consider will affect their interests. Lackluster trade performance and a trade sector that remains largely under the control of central authorities will, however, undermine Soviet arguments that their system is becoming more compatible with the aims of the GATT. (C)

-- IMF and World Bank membership are not likely to be pursued actively at the present time. Disclosure requirements and the risk of less control over its economic aid are likely to deter any serious Soviet interest. (C)

-- A sharply increased role for the USSR in the international financial arena is unlikely. In particular, large-scale speculative approaches to financial management will be sharply restricted by current limitations on Moscow's currency earnings, coupled with some vestiges of traditional Soviet conservatism. (C)

-- For largely political reasons, the Soviets will continue to press for formal EC-CEMA relations although probably without expectation of anything but minimal economic gain. (C)

In general, the USSR will almost certainly become more active in promoting its own solutions to international economic

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issues. It may perhaps go as far as proposing 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 will probably 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 expected lackluster trade and economic performance could weaken Soviet positions. (C)

4. Increased Soviet participation in the major international economic institutions would generally not be helpful to U.S. objectives. Past history indicates that the quality of Soviet participation in international economic institutions depends largely upon the degree to which they share with the U.S. the goals of the specific organization and recognize some benefit to themselves. The nearly total incompatibility of the Soviet economic system with that of the West, however, would make Soviet membership in certain key institutions, such as the GATT and IMF/IBRD, extremely undesirable. This would be for both technical reasons and because of the risk of politicizing heretofore non-political institutions. (S)

An additional risk would be the increased numbers of Soviet officials in the West necessitated by expanded membership in

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international fora, which would provide opportunities for increased KGB activity. (S)

5. There are several implications for the international economic system presented by increased Soviet interest and activity in economic affairs. To the extent that Soviet activities on international markets bring it closer to the international economic community, the West probably benefits since it gives the Soviets a greater stake in working to solve problems within the system. Such a stake, however, is not likely to weigh heavily in Soviet decisions where political and strategic interests are involved. (S)

Increased cooperation with Western firms is likely to improve Soviet assimilation of Western technology in 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 use. 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

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controlled-technology without it being transferred onto Soviet territory. (S)

Greater Soviet 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, borrowing from non-bank institutions or banks outside the BIS reporting area. In the past, Soviet reliance on government-backed credits and a select grouping of major commercial banks in the U.S. and Western Europe provided Western governments with the ability to effectively monitor, and, to some extent, control the level and terms of Soviet borrowing. (S)

Increased trade with the LDCs could recoup some of the lost Soviet prestige and influence in the area. The Soviets would likely be willing to lend to debt-ridden LDCs at attractive rates 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, higher quality Soviet exports combined with LDC debt problems would make trade with the USSR more attractive than in the past. (S)

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 U.S. policy interests. Under such circumstances, we could expect a major increase in the flow of

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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 make the USSR an attractive market for Western direct investment. (S)

Western governments would have to contend with a growing interest group of manufactured goods exporters seeking more favorable trading conditions -- low-interest credits, reduced export controls, better bilateral relations in general. The pressures from the business community would be even greater if the Soviets 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 U.S. policy. A similar policy could be adopted with the Japanese. (S)

6. Soviet membership in the most important international economic institutions and an increased Soviet presence in international economic affairs will pose serious challenges to U.S. policy objectives. The West has been moving towards globally integrated financial and commodity markets at a rapid pace, and increased Soviet understanding of how these markets operate carries a risk that Moscow may attempt to manipulate

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these markets to the detriment of U.S. national security interests.* It is conceivable that the Soviet Union could precipitate a crisis without its role being known, for example, by the judicious placement of false data into the system. We believe such actions would be unlikely as long as the USSR's growing role is paying off in economic and even political dividends. If Moscow perceives few economic benefits and remains a minor player in these markets, however, then the economic loss it would suffer would pale compared with the potential for significant damage to Western economic stability. (S)

The USSR could conceivably employ disruptive 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 -- say in Eastern Europe or the Middle East -- which would otherwise result in a united response from the alliance.

-- If the Soviets come to the conclusion that they cannot effectively compete with the West technologically and economically and that failure in this regard carries substantial risks to their long-term ability to maintain strategic parity, they might attempt to precipitate a more severe economic crisis in the West, seeking to create a snowball effect that could not be controlled by Western governments. They could, for example,

* The Department of Treasury dissents from the view that the Soviets are capable of causing the disruption of the international financial markets noted in the text.

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seek to exacerbate a situation of possible future strains, such as those caused by a severe recession, in hopes of causing major and sustained economic damage to the West. (S)

7. In any case, U.S. policy towards the economic initiatives of the Soviet Union should be to monitor closely activities in those areas where there has been a moderate increase in Soviet interest, while firmly opposing Soviet membership in international economic institutions of primary functional importance to the United States. (S)

In the areas of international financial markets and joint ventures, there is insufficient evidence of increased Soviet activity to raise alarm. In the short run, Soviet presence in the international financial markets is likely to be small as a result of basic Soviet conservatism, lack of financial expertise and a desire not to appear to depend on the West for financing. Similarly, the poor performance of joint ventures with East European countries, the lack of clarity in Soviet regulation and the protracted time required for negotiation make it unlikely that many U.S.-Soviet joint ventures will be formed in the near term. These areas require further close monitoring with a view towards detecting a disruptive Soviet presence in the international financial markets, and carefully reviewing joint venture activities in civilian areas. Some joint ventures could pose serious problems from the export administration perspective, possibly serious enough to require changes in U.S. laws and regulations. We need to explore these problems, and any

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solutions must be consistent with U.S. and other Western national security needs and our COCOM obligations. (S)

Of more immediate concern is the recent Soviet application to take part in the new round and interest in the GATT and possible interest in the IMF/IBRD. Past history suggests that Soviet participation in international economic institutions may not be entirely negative for U.S. interests. Depending on the organization and the extent to which the Soviets and the U.S. share similar objectives, the U.S. can tolerate Soviet participation in some organizations, despite the USSR's use of such membership to gain access to Western technology, economic intelligence and as a basis for KGB activity. However, the United States must respond firmly to Soviet attempts to join the most important functional Western economic institutions, the GATT and IMF/IBRD. The fundamental importance of these institutions to the United States and the functional inability of the Soviet Union to play a constructive role in their work makes it imperative for the U.S. to block Soviet membership. (S)

-- The Soviet's desire to take part in the new round was derailed through active U.S. objection on the basis of sound substantive (i.e. non-political) reasons: the incompatibility of the USSR's huge non-market economy with the functions and objectives of the market-oriented GATT. The U.S. must strongly maintain this position. Strong European support (at least up until now), the consensus nature of GATT business and the unlikelihood that the Soviet Union will make the fundamental

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policy changes to make this system GATT compatible makes their essential admission to the GATT unlikely. (S)

-- Soviet interest in the IMF/IBRD is still academic, but U.S. policy should be to block such an application if it occurs. Although the Soviets, who in the past have been hostile to these institutions, are unlikely to be willing to participate in the exchange of information that is an essential part of membership, the U.S. should be alert to further Soviet actions in this area, and be prepared to take such measures to deny Soviet membership.

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September 16, 1986

NATIONAL SECURITY STUDY
DIRECTIVE NO. 2-86SOVIET INITIATIVES IN INTERNATIONAL ECONOMIC AFFAIRS (S)Introduction

This National Security Study Directive establishes the Terms of Reference for completing a review of recent initiatives undertaken by the Soviet Union in the area of international economic affairs. The Study will be coordinated by the National Security Council Staff. (S)

Objective of the Review

To assess the significance of greater Soviet interest in global economic institutions and affairs; to develop U.S. policy on appropriate response to new Soviet initiatives in international economic affairs; and to begin preparation of U.S. positions on economic issues for the next meeting between President Reagan and General Secretary Gorbachev. (S)

Scope

The review will address the following topics: (S)

First Stage: To be completed by October 1, 1986.

-- Soviet Interest in International Economic Affairs: Full review of information relating to recent Soviet interest in international economic issues, including but not limited to assessments of the significance of: (S)

o The reorganization of the Soviet Ministry of Foreign Affairs ("MFA") to include a new Administration for International Economic Relations. (S)

o The application of the Soviet Union to participate in the new round of multilateral trade negotiations under the General Agreement on Tariffs and Trade. (S)

o Suggestions that the Soviet Union is interested in joining the IMF/IBRD. (S)

o In the financial sector, settlement with the UK on defaulted Czarist bonds and first time Soviet participation in a Eurobond syndication. (S)

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o Increased volume and sophistication in Soviet international financial market transactions. (S)

o Soviet "International Economic Security Initiative", which will presumably be tabled at the UNGA. (S)

o Soviet motives for encouraging EC-CEMA talks. (S)

o Soviet expressions of interest in joint ventures, possibly involving western firms management and significant western on-site participation. (S)

-- Past History: The following will be helpful in preparing for discussions with the Soviets on their participation in international economic institutions: (S)

o Summary review of Soviet official comment on existing international institutions (GATT, IMF/IBRD, etc.) to which they have applied or may apply for admission. Review should focus on Soviet comments at time of creation of those institutions and in the past ten years. (S)

o Summary reports of past Soviet participation in specialized international institutions, e.g., UNCTAD, UNESCO, ILO, WHO, PAO, ICAO. Which have they "politicized"? To which have they made a positive contribution? What have been their substantive positions on economic issues in these fora? (S)

-- Forecast: An assessment of what future initiatives in the international economic field the USSR might undertake and what other international and financial institutions to which they might apply. (S)

Second Stage

-- Analysis: An assessment of the potential significance to the international economic system of the recent Soviet interest in participating in major international economic institutions: (S)

- (1) What has driven the new Soviet interest? (S)
- (2) What changes have taken place in Soviet domestic and international economic policy? (S)
- (3) What changes are under consideration? (S)
- (4) How compatible is Soviet participation to the

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functioning of the major international economic institutions? (S)

- (5) What are the general implications for the international economic system of Soviet participation? (S)
- (6) What are the specific implications for United States' national security? (S)
- (7) What are the pros and cons of possible U.S. policy responses to these expressions of Soviet interest? (S)

A paper covering these topics should be prepared under the direction of the National Security Council, and completed no later than October 15, 1986. (S)

Ronald Reagan

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I. HISTORICAL OVERVIEW OF SOVIET POLICY TOWARD AND PARTICIPATION IN INTERNATIONAL ECONOMIC INSTITUTIONS

Soviet participation in international organizations spans six decades, from the time the USSR joined the Universal Postal Union (UPU) and the International Telecommunications Union (ITU) in the mid-1920s. The USSR had a brief association in the 1930s with the International Labor Organization (from which it withdrew in 1939 and again rejoined in 1954). The other organizations under review were not established until after World War II. Overall, Soviet participation in international organizations reflects basic Soviet foreign policy interests. The USSR has made good use of highly visible forums to attack its enemies, support its Third World friends, and defend its interests in debate and in staff studies.

Over the years, Moscow has been careful to join those Organizations which best serve its interests. For example, the Soviets are keen to join organizations where they can obtain specialized agencies, the Soviets tend to congregate where they have access to sophisticated western technology [e.g. the International Atomic Energy Agency (IAEA)]. The Soviets are cooperative with the West in a number of these venues including the World Meteorological Organization (WMO) and the IAEA. The USSR has tended to shy away from those organizations that require sizable funding commitments and or information that it considers sensitive. Thus, until recently, Moscow has avoided the GATT and IMF, where bargaining power and reciprocity count for more than polemics.

Multilateral Trade & Finance Institutions

IMF/IBRD The Soviet Union took an active part in the Bretton Woods negotiations leading to the establishment of the International Monetary Fund (IMF) and the World Bank (IBRD). Soviet negotiators made numerous specific proposals, some of which were accepted and even today are part of the IMF's Articles of agreement. At the end of the Bretton Woods conference the Soviet delegate approved the final agreement, but subsequently the Soviet Union did not ratify the Articles Of Agreement (and thus did not become a member of the IMF/IBRD). Soviet representatives were still present, however, as observers at the first meeting of the IMF in Savannah, Georgia, in March 1946.

Numerous reasons have been offered to explain why the Soviet Union did not join the IMF and World Bank. The most convincing of these relates to the Soviets' voting share and the requirement to provide economic information, including the amount of gold and foreign exchange holdings. When the IMF was established, 20 percent of members' votes were required to exercise a veto. The United States alone had a 31-percent share of the total vote, while the USSR, Czechoslovakia, Poland, and Yugoslavia combined would have had only 17 percent of the vote.

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Since the birth of the IMF/IBRD, Soviet rhetoric has portrayed these institutions in a most unfavorable light. Soviet polemics and propaganda directed at the IMF in recent years have centered on IMF adjustment programs and their negative impact on Third World countries. Soviet harsh attitudes toward the World Bank may be influenced by the fact the USSR would not be eligible to borrow from the Bank--its per capita income exceeds the IBRD maximum for loan eligibility--and would be required to contribute a substantial subscription to capital. Moreover, the World Bank in recent years has placed increased emphasis on private sector initiatives, which conflict with Soviet ideology.

On several occasions Soviet officials and academics have flirted with the possibility that the USSR might seek to participate in the IMF. In June 1973, M. Alkhimov, then vice minister of foreign trade, declared in an interview with Business Week that participation of the USSR in the IMF was not totally excluded, although there were strong objections to such a move, including objections to the aforementioned weighted voting system and the obligation to furnish economic information. Most recently, in July 1986, Soviet academics told a delegation of US economists that the Soviet Union is studying the potential benefits of IMF membership. However, the head of the Ministry of Foreign Affairs' new International Economic Relations Department--a leading force behind the efforts to participate in international economic fora--is quoted as saying the Soviets "are taking no steps toward participation in the Fund (IMF) or gaining access to its credits."

GATT. Until its recent heightened interest in the organization, the USSR always publicly opposed the General Agreement of Tariffs and Trade (GATT) and the never realized International Trade Organization (ITO). The Soviet Union was repeatedly offered invitations to participate in the formation of GATT (which took place in October 1947) but it refused. As an alternative to the formation of the GATT, the Soviet Union pushed strongly for improving the world trade system through the United Nations. Even after the GATT was formed, the USSR attempted unsuccessfully to arrange trade cooperation agreements through UN agencies like the Economic Commission for Europe (ECE) and the Economic and Social Council (ECOSOC).

From the time of establishment of the GATT up until the recent Soviet request for participation in the new round, the USSR has denounced the organization, particularly for being unable to stop the alleged wave of protectism in the West in the 1970-80s. At times the Soviet Union has flirted with the idea of changing its policy toward international trade. During the Kosygin economic reform period of the mid-1960s, Soviet officials made strong declarations about the importance of more international trade contacts, without specifically referring to the GATT.

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The possibility of the Soviets approaching the GATT began in earnest in 1975 with studies on the subject, according to Soviet trade officials. By 1979, this initiative had gained significant support in the ministry of foreign trade. The subsequent deterioration in relations with the West as well as the general complacency of the Brezhnev government at its end put a stop to the approach to GATT.

Specialized International Institutions

Soviet interest in specialized organizations has continued through the postwar years with the USSR joining many organizations within the UN System. Along with providing key international services in such fields as communications and transportation, organizations of this type have given the Soviet Union access to a wide range of economic, technical, and regional information.

The Soviet Union initially adopted a low profile and defensive posture in these bodies. However, as the West began to lose its working majority in the UN with the arrival of newly independent Third World countries, Soviet involvement in economic and social organizations began to increase substantially. The change in Soviet response to these organizations was calculated to win the favor of Third World countries, to protect the USSR from unwelcome UN initiatives, and to further the Soviet agenda.

Among the specialized agencies, the Soviets tend to congregate where they have access to sophisticated Western technology. For example, 69 Soviets were among the 1,500 staff members of the International Atomic Energy Agency (IAEA) in 1984--which is technically not a specialized agency but an independent intergovernmental organization under the aegis of the United Nations. The IAEA is responsible for drawing up and implementing the safeguards agreements provided for in the Nuclear Non-Proliferation Treaty as well as for developing siting, safety and reliability standards for nuclear power stations. IAEA staff has access to sensitive nuclear-related information from 110 members. Not only is the Soviet IAEA contingent large, representing 14 percent of all Soviets employed by the Secretariat, but it is also high level.

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The Soviets have had a keen interest in joining organizations that exchange information and conduct studies on economic trends. This is reflected in their active involvement in UN-related economic conferences, commissions, and research organizations such as the United Nations Conference on Trade and Development (UNCTAD) and the Economic Commission for Europe (ECE), as well as various organizations and commissions that deal with commodities and resources. Membership in such groups not only provides a source of potentially useful information but also a forum for portraying Communist economic philosophy in its most favorable light and pointing out any perceived inequity in the Western economic system.

Despite their interest in cultivating Third World support, the Soviets have been selective in their participation in multilateral aid organizations and have provided only minimal contributions to UN aid organizations. The principal Soviet rationale put forward for not participating in aid-giving organizations is that Third World poverty is the result of Western colonialism and is perpetuated by neocolonialism. The Soviets argue that the USSR is not a colonial power and is therefore not responsible for Third World poverty or obligated to provide aid.

The USSR's low interest in the aid and humanitarian organizations is a factor in Soviet staffing patterns. No Soviets work for the UN High Commissioner for Refugees, the Food and Agricultural Organization (FAO) in which the USSR is not a member, or the International Fund for Agricultural Development (IFAD). Only four Soviets work for the United Nations Children's Fund (UNICEF) and four for the UN Development Program, the two key UN aid agencies.

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II. ASSESSMENT OF PAST SOVIET BEHAVIOR IN INTERNATIONAL ECONOMIC ORGANIZATIONS

INTRODUCTION AND SUMMARY

Soviet behavior in international economic organizations has varied considerably, from a highly propagandistic, obstructionist approach in UNESCO, and a somewhat less antagonistic stance in ILO and UNCTAD, to a businesslike and constructive approach with minimal politicization in WIPO, IAEA, and ICAO. Not surprisingly, the Soviets seem to be most constructive and least polemical when they share with us the goals of the organization and see at least some degree of benefit to themselves.

Organizations

WIPO--World Intellectual Property Organization

Businesslike and Constructive; The Soviets have acted in a constructive manner in this organization, and have not generally obstructed its work or U.S. initiatives. As any nation, they have periodically formed coalitions with others to advance reasonable positions that benefit them economically.

IAEA--International Atomic Energy Agency

Businesslike and constructive; The Soviets share with us a significant interest in safeguards and non-proliferation. Their participation is constructive with minimal polemics.

ICAO--International Civil Aviation Organization

Businesslike; The Soviets do not make a major contribution to the ICAO, although per U.S. rep they maintain a high standard of professionalism and are contributing in a positive manner to the current Assembly. They accelerated their financial contributions to help ICAO cope with late U.S. payments. USSR rep commented off-the-record that KAL shutdown focussed more attention to ICAO within Soviet government, and the Soviets have been more active since.

ILO--International Labor Organization

Mixed; The Soviets are trying to modify the structure of the ILO to increase the power of governments and reduce that of labor and employers, thereby making it more responsive to their own goals. In addition, they sometimes pursue propaganda lines linking economic development to disarmament.

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ECE--Economic Commission for Europe

Mixed, with some propaganda and polemics; At the technical level, the Soviets cooperate reasonably well, for example on the High Level Meeting on Environment. On the other hand, we have blocked the proposed HLM on energy, which they appear to want to use for propaganda. The Soviets occasionally use the ECE for propaganda, and have placed Soviets in the ECE Secretariat who collect intelligence and slant the organization's work toward Soviet aims.

UNCTAD--United Nations Committee on Trade and Development

Mixed, with moderate propaganda and polemics; although the Soviets are generally businesslike, they usually don't pass up opportunities to present propaganda. For example, they often try to persuade Third World nations of the validity of the Socialist approach to international trade issues. However factors that reduce the opportunities for Soviet influence in UNCTAD are their very low level of development assistance and the structure of UNCTAD, which helps to contain Soviet efforts by placing them in a separate division for non-market economies.

UNESCO--United Nations Educational, Scientific, and Cultural Organization

Highly politicized; The Soviets have politicized all aspects of UNESCO and use it as a political forum from which to attack Western interests and spout disarmament propaganda. In it, they support all types of extremist positions of the NIEO.

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Background Papers

Soviet Foreign Trade Sector Reorganization

Reorganization of the foreign trade sector is both a prerequisite for and consequence of the Soviet attempt to carve out a greater role in world trade and thereby eventually establish for the Soviet Union a role in international economic affairs commensurate with its status as a political and military superpower. Fundamental reform, however, either is not being contemplated by Moscow leadership or currently is beyond its reach. Instead, in classical Soviet fashion, institutional and personnel changes are the primary focus of the reorganization at this point. Several entirely new entities are being created to oversee the reform effort - at the expense of entrenched institutions - and a younger generation of less experienced bureaucrats is replacing much of the "old guard" in the foreign trade sector.

The sectorial reorganization is prompted by Gorbachev's desire to improve Moscow's export profile and terms of trade. Much like an LDC, the USSR has a high proportion of raw material exports to machinery and equipment exports, with the reverse true for imports. By allowing increased Western contacts for people directly involved in the production process, the Soviets intend to improve access to Western high technology -- a prime objective of and prerequisite for Gorbachev's ambitious plans for improving the domestic economy through rapid advances in the machine-building sector. A more immediate objective of the restructuring may well be to recoup hard currency earnings lost as a result of weak export commodity prices, especially oil.

With this reorganization in the foreign trade sector, the Soviets seem to believe their trade structure will become more compatible formally with the international trade system, on which they are depending in part to bolster their multilateral political and economic objectives. Among the latter are their recent bid to participate in the GATT's new round of trade talks and their attempt to become direct participants in shaping international trade in the next decade.

The thrust of the reorganization is consistent with Gorbachev's domestic priorities in restructuring the Soviet economy -- a combination of improved central control with greater autonomy at the lower level. Also, the Soviets have gone to some length to characterize the changes as ideologically correct, claiming they maintain the state's monopoly on trade while making their system more compatible with the international trade system.

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Operational Changes. The heart of the reorganization is increased autonomy for certain ministries and enterprises. In late September Moscow announced the establishment of guidelines for direct trading links between selected ministries and enterprises and Western firms. Effective January 1987, the new rules will permit some 20 ministries and 70 enterprises, as yet unidentified, to engage directly in importing and exporting without the intervention of the Ministry of Foreign Trade (MFT) or other economic organizations in Moscow. Additional enterprises may be added as they develop sufficient foreign exchange earnings. However, with respect to the larger Soviet economy, the changes planned thus far are limited. The bulk of Soviet economic entities are unaffected by the new guidelines. Planning and party authorities will retain their tight control over the Soviet economy.

The affected ministries and enterprises will be allowed to establish their own self-financing (khozraschet) foreign trade firms, authorized to seek foreign exchange credits from the foreign trade bank (Vneshtorgbank). The new guidelines will permit the affected organizations to use some portion of their hard currency export earnings to purchase imports from the West. These new rules also afford the selected enterprises more individual leeway to define their relationships, such as joint ventures, with Western firms. However, requiring these enterprises to produce for both the domestic and foreign markets poses problems with respect to self-financing, production levels and prices, which could delay actual operations under the new rules.

Organizational Changes. A new Foreign Economic Commission, chaired by a Deputy Chairman of the Council of Ministers, is being created to oversee the reorganization. Composed of the Ministry of Foreign Affairs (MFA), MFT and various economic organizations, it will serve to coordinate the activities of the entities involved in foreign trade. Although it is supposed to facilitate trade, the new Commission appears to be one more bureaucratic layer between foreign suppliers and domestic producers.

A new Administration for International Economic Relations, with responsibility for handling broad international economic issues, has been created in the MFA. Dr. Ivan D. Ivanov, well-known in the West as a reform-minded academic, has been appointed head of the new administration. In addition, the MFT is being reorganized from top to bottom as part of the effort to improve the efficiency of the foreign trade apparatus and to weed out corruption.

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Despite the guidelines' statement that the MFT and the State Committee on Foreign Economic Relations, in that order, will continue to exert a "control" responsibility over foreign trade, the MFA appears to be establishing a substantial role for itself. The MFT's own ineffectiveness has prompted at least some of the changes and it seems clear that it will lose several functions to the two new entities. Viewed together with the creation of the new MFA administration and Ivanov's appointment, it looks like that the MFA, not the MFT, will have the major policy-making role in Soviet international economic relations.

Personnel Changes. Personnel changes which tend to confirm MFA's ascendancy are in the works as well. For some time there have been strong hints that Foreign Trade Minister B. I. Aristov, a fading apparatchik - not a 'new ideas' man, will soon depart; the front-runner to replace him is MFA First Deputy A. G. Kovalev. Ivanov is a likely candidate for a deputy position in the new Foreign Economic Commission, and that its new chairman is V. M. Kamentsev, recently appointed Deputy Chairman of the Council of Ministers.

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SECRETSoviet Interest in GATT Membership

Historical Background. The General Agreement on Tariffs and Trade was drawn up in Geneva in October 1947. The Soviet Union did not participate in the work of the International Trade Organization Preparatory Committee, nor in the rounds of tariff reductions negotiated in the 1940s and 1950s or in the Kennedy Round which was concluded in 1967. Participation in these negotiations was limited to GATT Contracting Parties (CPs) and those countries negotiating accession to the GATT. Although the Tokyo round of Multilateral Trade Negotiations (1973-79) was open to all interested countries, the Soviets chose not to take part. Since 1979, and prior to the most recent overtures, Soviet officials have made periodic informal contacts with U.S. and other GATT CPs to explore receptivity to Soviet participation in GATT affairs. In each case, the Soviets were met with a distinct lack of enthusiasm, and interest abated.

Recent Overtures. The most recent overtures began in April and May of this year. At that time, Soviet officials in a number of CP capitals raised the issue of possible Soviet observership in the GATT. The Soviet Commercial Minister in Washington called at USTR and the Departments of State and Commerce to renew expressions of Soviet interest in GATT observership. A short time later, in Moscow, the Soviet Foreign Trade Ministry called in a number of the USSR's trading partners to make a presentation on why the USSR should be more active in the GATT. The following points were made at these presentations:

- the USSR has a great interest in observing the New Round negotiations in order to gain experience with GATT procedures;
- the USSR wants to move its economy more into the framework of international economic relations and would use GATT observership to "review what changes need to be made in the Soviet economic structure to qualify for full membership;"
- the USSR has an important stake in the international economy and should have observer status in the GATT to monitor world trade developments which affect Soviet interests;
- the USSR believes closer association with the GATT would help expand trade with GATT members;
- Soviet interest in the GATT is "100 percent economic"; and,
- (with selected countries) the presence of the USSR in the GATT would protect the interests of smaller GATT CPs from the United States, which "runs roughshod" over their interests.

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Participation in the Uruguay Round. In mid-August 1986, the USSR sent a note to the GATT Secretariat announcing a desire to participate in the New Round talks. They stated that such participation would help them gain experience leading towards a decision on accession in light of the ongoing re-organization of the Soviet economy which provides for increased autonomy and responsibility of enterprises in their business relations. This request was also conveyed bilaterally to our Embassy in Moscow in early September.

The Ministerial Declaration approved by GATT CPs at Punta del Este provides for terms of participation that, in essence, limit participation in the negotiations to current CPs, countries already in the process of negotiating accession, and LDCs that initiate accession negotiations by April 1987. These criteria exclude Soviet participation in the Uruguay Round.

GATT CP Reaction to Recent Soviet Overtures. A majority of developed GATT CPs oppose Soviet involvement in the GATT, either as observer/applicants or in the Uruguay Round negotiations. Australia would not oppose Soviet participation in the new round. Switzerland has taken no position. GATT non-market economy (NME) CPs are on record as supporting Soviet involvement. India favors Soviet participation, and some LDCs are ambivalent or mildly supportive. There are also reports that the EC would exchange support for USSR GATT participation for diplomatic or trade concessions.

NMEs and the GATT. The participants in the original GATT negotiations drafted the contractual obligations of the GATT from the perspective of market economy countries whose trade responds to changes in prices that are determined by supply and demand. This orientation towards a free enterprise economy is inherent in the GATT's basic provisions. State trading was seen as an exceptional situation; GATT Article XVII requires that state-trading enterprises not discriminate in their foreign trade.

Nevertheless, several NMEs are members or observers in GATT. Czechoslovakia and Cuba were members before they became Communist states; Poland, Hungary and Romania joined more recently. Bulgaria is an observer. China, an observer now, has formally applied to resume the seat vacated by Taiwan in 1950. The United States ceased to apply the GATT to Czechoslovakia in 1951. The trade embargo with Cuba renders most GATT obligations between the U.S. and Cuba. The U.S. denied most favored nation treatment to Poland in 1981 and, under the terms of the Trade Act of 1974, grants it on a year-to-year basis to Hungary, Romania and China. In carrying out its trade policy, the U.S. considers Yugoslavia a market economy.

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SECRETEC-CEMA Relations

Overview. On-and-off negotiations since 1973 between the European Community (EC) and the Council on Mutual Economic Assistance (CEMA), as well as between the EC and individual CEMA members, may be entering a decisive stage. Soviet leader Gorbachev's willingness to treat the EC as a political entity and to allow CEMA countries to have bilateral ties with the EC are key concessions that could lead to significant progress in EC-CEMA talks.

The earnestness with which CEMA (read the USSR) has pushed the process along this past year suggests that Gorbachev was not simply interested in form over content. It seems to represent a willingness to give up a longstanding ideological position in return for greater political and economic access to the Community. This complements Soviet moves in other areas (especially finance) to become, or appear to become, more pragmatic, "responsible" players on the international commerce and finance scene. Recent Soviet efforts to get involved in the GATT also fit into this picture. The Soviets may hope to gain EC support, or at least a softening of the EC position, for Soviet entry into the GATT.

The Soviets are interested in having direct access to the EC decision-making process, participating in a forum which excludes the United States, obtaining West European technology, and CEMA's prestige. East European countries worry that the Soviets could use an EC-CEMA accord to crimp their ties with Western Europe. Some would like their own bilateral channels with the EC, linking EC economic concessions to diplomatic ties. The USSR and several of its bloc allies hold that EC-CEMA relations should precede links between the EC and CEMA member countries; Hungary and Romania in contrast clearly prefer direct dealings with the EC before multilateral ties with CEMA are realized.

Moscow's decision to allow individual CEMA countries to sign bilateral agreements with the EC represented a significant concession. It removed, at least partially, what had been a source of anxiety for bloc allies (especially those such as Romania and Hungary, particularly interested in commercial deals with the EC), namely that an EC-CEMA accord would allow the Soviets to control the dialogue between East and West Europeans more effectively.

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In the EC, the Commission is especially interested in an EC-CEMA agreement, which would enable it to insert itself into East-West politics, traditionally the preserve of the EC-12. The Federal Republic of Germany, Italy, and the smaller EC states support the broader agreement, while the United Kingdom and France are less keen. Both the EC Commission and member states profess to be well aware of such pitfalls as Moscow's desire to use EC-CEMA relations to monitor West European ties with Eastern Europe. A major inducement for the EC member states to agree to an EC-CEMA accord would be the credibility gained by the Commission if it could demonstrate that at least two East European countries--Romania and Hungary are currently the most serious candidates--would establish diplomatic relations with the EC "within hours" of EC signature of a joint declaration with CEMA.

Underlying the complexity of organization-to-organization ties is the disparity between the EC and CEMA as institutions. The EC is a cohesive, independent entity with sweeping powers in the trade field. CEMA, in contrast, represents a hodgepodge of bilateral agreements; it is dominated by the economic, and political, might of the Soviet Union and falls far short of an effective multilateral economic organization.

The sequence of bilateral and multilateral recognition among the parties may prove critical to the outcome of the process. To be credible, the Commission's dual-track approach (bilateral ties with the East Europeans along with EC-CEMA ties) must show achievement with at least two East European countries before EC-CEMA mutual recognition. The USSR argues for EC-CEMA ties first. To varying degrees, this position is supported by the German Democratic Republic, Poland, and Bulgaria. The East Europeans have never seen it in their interest to have the USSR use an EC-CEMA accord to increase its control over relations between East European countries and Western Europe. Hence some of the East European countries may try to negotiate and even sign a bilateral accord with the EC before an EC-CEMA one narrows their room for maneuver.

Current Status

The EC Commission participated in an initial experts' meeting with CEMA in Geneva September 22-24 to discuss a proposed umbrella declaration which would establish relations between the two organizations. The CEMA team was headed by Deputy Secretary General Kurowski, while the EC team was led by a deputy office director. Commission negotiators had a mandate to agree on nothing -- not even a date for a second round (although one may occur before year end). The Commission did not table an EC-agreed draft declaration, and discussion focused on Community "questions" on the CEMA-proposed draft.

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EC insistence that any agreement include a "territorial" clause (read a Berlin clause) met with unexpected resistance from CEMA negotiators. The EC also told CEMA counterparts that references to trade or commercial relations in the proposed declaration would have to be deleted. The Commission made clear that propaganda-style language on world peace should be deleted and that it wanted references to negotiation of agreements deleted. CEMA negotiators reportedly stated that CEMA members were free to negotiate commercial agreements and to establish bilateral relationships with the Community.

The Community is pursuing bilateral negotiations on economic cooperation agreements with Romania, Hungary, and Czechoslovakia. It is initiating talks with some of the other bloc states on possible bilateral arrangements. A cooperation agreement between the EC and Romania appears likely in the near future. This arrangement would expand somewhat the 1980 industrial-trade arrangement (the most comprehensive agreement signed to date between the EC and a bloc country). Romania is anxious to conclude an agreement with the EC lest an EC-CEMA accord reduce its room for maneuver on the bilateral front.

EC-Hungarian talks are stalled over trade concessions. Forty percent of Hungary's non-bloc exports go to EC countries, and the Hungarian Government has been pushing for (and the EC resisting) a trade agreement which knocks down some of the EC import restrictions that currently affect some 300 Hungarian agricultural and industrial products.

Background. The EC-CEMA dialogue stalled in 1978 after years of sporadic discussions, primarily because of Moscow's refusal to accept the EC Commission as spokesman for the EC. At the same time, the EC insisted that CEMA's structure did not parallel its own and that, under any EC-CEMA agreement, the EC as a whole would have to negotiate bilateral agreements with individual CEMA member states.

The dialogue received a shot in the arm when newly appointed Soviet General Secretary Gorbachev raised the issue with Socialist International President Willy Brandt and Italian Prime Minister Bettino Craxi during their visits to Moscow in May 1985, saying that Soviet attitudes toward the EC needed change. Moreover, Gorbachev cleared the way for talks by speaking, for the first time, of the EC as a "political entity."

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In June 1985 the CEMA Secretary General sent a letter to the EC Commission President Delors proposing a formal relationship between the two organizations. Subsequent exploratory correspondence from the Commission yielded a CEMA draft joint declaration (which was discussed at the September 1986 meeting between the two organizations). In December 1985 the Community approved a response to the CEMA overture. The response included separate letters (eventually sent in early 1986) to the CEMA Secretary General and to each state. In these letters the EC indicated its willingness to discuss establishment of ties with CEMA provided ties were also established between the EC and the individual members of CEMA. By June 1986 the CEMA secretariat and each CEMA member had replied indicating a willingness -- albeit with different nuances and priorities -- to proceed with the EC's "dual track" approach. Subsequent contacts between the two organizations resulted in the September 22-24, 1986 meeting.

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SECRETSoviet Initiatives Toward IMF Membership

At a conference in the Soviet Union in July, Soviet academics told their U.S. counterparts that the Soviet Union should consider seeking membership in the IMF. IMF membership would allow another point of access to the international financial community as the Soviets seek to manage the recent decline in hard currency earnings and pursue Soviet leader Gorbachev's modernization efforts. However, Ivan Ivanov, head of the newly created International Economic Relations Department of the Foreign Affairs Ministry, said in August that the Soviet government is taking no steps toward applying to the IMF. (U)

If the Soviets were to seek membership and succeed, the United States would lose some influence in these institutions as all members' quotas would be reduced and voting power would be redistributed accordingly. Based on the size of their economy and level of trade, the Soviets would gain a sizable quota which would translate directly into significant voting power-- to the possible detriment of the United States. The percentage of total votes controlled by the United States would drop and the Soviets could leverage their voting share to greater influence by encouraging bloc voting with third world and other socialist member countries. The potential for the "politicization" of both institutions would thus rise sharply. In the United States continuing financial support for the IMF might erode in Congress. (C)

If the Soviets were in fact to seek membership, they would have to weigh the gains in influence and status made by joining the IMF against their reluctance to provide the economic information that would be required. The Soviet sense of secrecy in such matters would probably preclude any substantial movement toward a formal application. (C)

If the Soviets did make a serious attempt to join the Bank--and, subsequently the World Bank--the United States alone would be hard pressed to keep them out. The United States cannot veto a Soviet application. (C)

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SECRETExpanded Soviet Participation in International Financial Markets

Under Gorbachev the Soviet Union has expanded its ties to the international financial markets significantly, diversifying its sources of funds and increasing borrowings. This development is probably a function of three factors: 1) need for new sources of hard currency as oil export earnings decline, 2) the present participation within the international community, and 3) recognition that participation in western financial markets is a potentially lucrative avenue for gaining economic information of intelligence value. (S)

The Soviets responded to the decline in hard currency earnings in 1985 by reducing imports by 5 percent and increasing sales of gold by \$800 million to \$1.8 billion. Hard currency borrowings also rose by \$6 billion, raising the level of net debt to over \$14 billion. (S)

Similar efforts can be expected in 1986. The Soviet Foreign Trade Minister Aristov has indicated that western imports could fall by 25 to 30 percent. The Soviets have already concluded numerous long term syndicated loans worth \$1 billion in 1986, three of which were over subscribed. The Soviet Union can be expected to borrow \$1-2 billion per year over the next few years. (S)

Increased gold sales have the best potential for a significant increase in revenues. In the first quarter of 1986 the Soviets sold 100 tons of gold (75 tons in direct sales to the Japanese government) totaling \$1.1 billion. The Soviets may try to increase direct sales and bilateral gold swaps to avoid dealing in the international gold exchanges. One of the Soviet's wholly-owned western based banks, Moscow Narodny Bank (MNB) in London, has been ordered to sell as much gold as possible short of allowing the price to drop. According to some analysts the Soviets could sell as much as 450 tons this year without affecting market prices, and thereby raise at least \$3 billion. (S)

The Soviets can also be expected to follow a plan of segmenting the financial markets through borrowings from a variety of sources. This would both obscure their debt position and prevent their credit rating to slip in any one of the available markets. No one source will provide the Soviets with a large increase in funds. Moreover, exploiting them will require a high, sustained level of flexibility and sophistication. (S)

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Third party borrowings involving Soviet owned banks in the west could increase the Soviet's access to hard currency funds. Through a series of complicated transactions involving non-BIS banks, Soviet-owned banks in the west could borrow funds in the interbank market that would ultimately show up as deposits of the Soviet Union. No evidence exists that the Soviets have made significant use of this source of funds. Given the Soviet Union's high credit ratings, such short-term borrowings don't provide significant amounts of lower interest credit compared to standard long-term syndicated loans. (S)

Another example of the Soviet's increased sophistication in the international capital markets is demonstrated in the increased use of ECU denominated borrowings in 1985. Such loans help cushion against the swings in an erratic foreign exchange market. (S)

The Soviet Union is also increasing its activity in the forfait market using indirect supplier credits. This secondary market allows western exporters to sell Soviet issued notes for a discount in exchange for immediate cash payment. (S)

The Soviets have also used clearing account arrangements with other non-CEMA nations willing to pass on hard currency imports for credit on such accounts. (S)

In the area of the Eurocurrency markets, the Soviets recently helped underwrite a syndicated bond offering in which it assumed about \$3 million worth of the total of \$100 million. This reflects an acknowledgment by Soviet Foreign Trade Bank officials of the need for Soviet-owned banks to remain active in the international capital markets on the investment side to maintain the viability of these banks. Although the Soviets have yet to issue any instruments in western financial bond markets, recent information point to a possible Soviet dollar or yen denominated bond offering in the Japanese markets. (S)

In order to better take advantage of the range of financing options available, the Soviet Union is seeking to increase its participation in international financial markets through foreign based financial entities. The Soviets are reportedly interested in establishing a joint Soviet-Arab bank in Bahrain as well as joint banking operations in Kuwait (which is presently negotiating with the Soviet Union a \$150 million loan) and in other important financial centers. The Soviets are also attempting to increase ties to western bankers through consultations and investment banking relationships to provide Soviet personnel experience in portfolio investment. (S)

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Despite the Soviet's best efforts, it is not likely that they will be able to generate much more than an additional \$1.5-3 billion in hard currency revenues, all but \$500 million from gold sales. Reducing hard currency imports will be necessary to make-up the better part of the \$6 billion hard currency export earnings shortfall the Soviet Union will face in 1986. Soviet reluctance to increase borrowings beyond the levels indicated represent the Soviet's concern to maintain a high credit rating among western bankers and to avoid even the perception of dependence on the west for financing. The balance can be made up through suppressed imports of non-critical goods. (S)

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Settlement of UK-Soviet Financial Claims

On July 15, 1986 the Soviet Union and the United Kingdom signed an agreement settling outstanding claims by both parties arising before 1939. Under the agreement both sides waived their respective claims, thus unlocking 45 million pounds from a frozen Russian account in the United Kingdom to settle 400 million pounds in private UK claims arising primarily from Tsarist bonds issued before October 1917. United Kingdom claimants may receive as little as 10 percent of the value of outstanding claims. (U)

Another 2.65 million pounds were released to the Soviet Union from a separate account used to handle diplomatic expenses. (U)

Initial speculation was that this agreement was a precursor to active Soviet participation in the London Eurobond market. Except for a small participation in a syndicated bond offering by a Finnish entity (see below), the Soviets have yet to make an offering of their own in the bond markets. Within recent days the Soviets have indicated an interest in exploring resolution of outstanding defaulted bond claims in the United States. (S)

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SECRETSoviet Interest in Joint Ventures

Current Soviet interest in "new forms of economic cooperation" with foreign firms, including joint ventures, surfaced in endemic problems of the Soviet economy and the sharp reduction in ventures appears to have been made at the top earlier this year, the Soviets are far from decided on how to proceed. Therefore, Soviet plans for joint ventures will become known only as decisions are made over the next several years. (U)

Most of what we know comes from reported statements by Soviet officials to foreign businessmen and government officials. The of September 24, 1986, "On Measures to Improve the Management of of new forms of economic relations with firms in capitalist countries, including cooperation in the scientific, technical, and productions fields, and the setting up of joint enterprises," but provides no further details. Considerably less attention is given to cooperation with Western firms, in fact, than to joint ventures with enterprises of CEMA countries, which are covered in a companion resolution. (U)

Efforts to implement the joint venture decision have proceeded on two parallel tracks to date. (C)

On the one track have been the analytic efforts of key government bureaucracies which are garnering information about joint venture and drafting regulations for Politburo approval. Three competing Committee on Science and Technology, and the State Planning Committee--have been talked with analysis and, possibly, drafting of legislation. Presumably, the newly established state Foreign Economic Commission of the Council of Ministers will now have a hand in the issue also. (C)

Requests for information and recommendations went out to Western business organizations (such as the U.S.-U.S.S.R. Trade and Economic Council and the U.S. Department of Commerce). Presumably, analyses also are being made of the Yugoslav, Chinese, and East European experience, among whom only the East Germans have not adopted a joint venture law. (C)

On the other track, the Soviets have been inviting proposals from Western firms for joint ventures. Officials at the Soviet Trade Representation in the United States believe that drafting of a of a joint venture law and negotiations with Western companies will proceed in parallel. Western company proposals would provide a pragmatic guide against which to measure and decide among regulations being proposed by the Soviet bureaucracies and also would provide "instant success" for the regulations once promulgated. Without adoption of regulations, however, projects are unlikely to get beyond the proposal stage. (C)

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The Soviets have expressed interested in entering into joint ventures both in the U.S.S.R. and abroad. The latter already have some precedent, such as the Soviet-American fishing joint venture Marine Resources, and would require far less adjustment to their economic system than internal ventures. (U)

Domestically, the Soviets are likely to seek joint production and marketing arrangements with Western companies involving some sharing of managerial responsibility. They may even enter into joint ventures, which are commonly defined by experts as involving three elements: joint management, joint capital contribution, and risk/profit sharing. Any joint venture arrangement is likely to be a contractual joint venture, in which rights are established by contract rather than by ownership. Equity joint ventures, in which foreigners own elements of the enterprise, are not possible under the Soviet constitution. (U)

According to Soviet announcements, a foreign partner will be able to have capital participation up to 49 percent, eligibility for tax concessions, the ability to repatriate or reinvest profits, and the opportunity to exercise managerial and quality control. The Soviet partner will have to be an "approved enterprise." They will probably be selected from the more than 20 ministries and 70 enterprises which are to have the right to engage directly in exporting and importing as of January 1, 1987. Joint ventures are supposed to be free of the national economic plan and are to operate in a "balanced manner" (probably meaning that hard currency earnings will have to equal imports paid for with hard currency). (U)

Soviet officials have reportedly told some Japanese companies that they hope to conclude joint venture agreements by the fall of 1987. Before that, however, a myriad of complex decisions concerning capital contribution, management, taxation, pricing, labor and wages, materials supply, financing, and marketing need to be made. In view of their uncertainty as to how to proceed and the reorganization of foreign trade now getting underway, it seems likely that it will be several years before joint venture agreements are concluded on any scale. (C)

Soviet Motivations. While the Soviets discussed joint ventures in the late 1970's, their interest was never great, largely because they felt their economy was doing fine and because rising prices for energy exports made it possible to maintain the level of imports they desired. Now, because of a sharp decline in export earnings resulting from the fall in oil prices, there is a dramatic new need for the Soviets to increase exports, and to substitute for imports. In contrast to the 1970's, there is also a widespread conviction that the economic mechanism needs significant change. (U)

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During the 1970's, Soviet leaders referred repeatedly to the need to make a transition from being an exporter overwhelmingly of raw and semiprocessed materials to an exporter of manufactured goods. They desired the higher prestige accorded to exporters of industrial goods, as opposed to fuels and materials, and the advantages which they perceived accruing to exporters of value-added goods. Yet they did virtually nothing, and the structure of their exports did not change over the last fifteen years. Reportedly, the Soviets plan to exclude raw material extraction from joint ventures, and are trying to focus on ways to increase exports of manufactured goods for hard currency. (S)

In the past, the Soviets have acquired production capacity through purchase of equipment, technology, licenses, entire turn-key plants and compensation deals. Turn-key plants provided them with equipment, technology, and start-up assistance. Compensation deals, such as the fertilizer exchange arrangement with Occidental Petroleum, provided turn-key plants, credits for the purchase of the plants, and export earnings to repay the credits and cover further purchases of plant and materials from Western companies. (U)

In many cases, however, imports of Western equipment and technology did not lead to the increases expected by the Soviets in exports of manufactured goods, or modernization of products. Sometimes, when the end product went into production it was already outdated by Western standards, there were no marketing channels for it, or the products became subject to dumping charges. (U)

Undoubtedly the Soviets hope that the quality, sophistication, and modernity of the production technology that they acquire from the West will be higher in a joint venture, where the foreign partner has a stake in the enterprise using it, and that the Western partner will be motivated to update that technology over time in order to maintain the competitiveness of the enterprise. Joint ventures also could allow the Soviets access to technological and managerial know-how that are not easily transferred through equipment sales. (U)

There are other motives as well for the Soviets. They probably hope that investment by Western companies will provide another source of capital for them. Joint ventures also fit in with their hopes for encouraging Siberian development and expanded economic activity in the Pacific Basin, where for ten years they have been pursuing a Sakhalin oil and gas development project with the Japanese. Improving the availability and quality of consumer goods also may be sought in this fashion, with one report suggesting that the main thrust in joint ventures will be consumer goods. (C)

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The move to joint ventures is thus the next stage in the Soviet search for more productive interaction with Western companies. Whether it will answer any better than the earlier arrangements or be any more successful in attracting Western producers than have Eastern European attempts will depend on how far the Soviets are willing to open their economy, how attractive conditions will be for Western companies, and the policies of Western governments. (C)

Policy Questions for Soviets. The Soviets will have many problems to solve in meshing joint ventures with their economy. For example, potential Western partners will want to have access to the Soviet market, and the Soviets will have to decide how to allow joint ventures to compete with domestic concerns. (U)

Many of the qualities of a successful joint venture are at odds with traditional Soviet philosophy and way of doing things. True joint ventures require adaptation of foreign ideas and methods of management and marketing. Large joint ventures with foreign partners sharing in decisionmaking would create a significant degree of contact between foreign company officials and local managers and, possibly, workers, something Soviet decisionmakers have gone to great lengths over the years to avoid. (U)

The key to success for joint ventures in the Soviet Union will be the degree to which the Soviets are willing to allow the ventures decisionmaking freedom and direct contact with Soviet workers and enterprises. Since this is in conflict with Soviet ideology and past practice, it will be difficult for the Soviets to allow the extent of change needed. The Soviets probably are not cognizant of the importance of this point, and may be dismayed when they discover what will be required to persuade Western firms to conclude significant joint venture agreements. Without significant pressure from the highest levels, they are likely to offer only reluctantly and gradually some of the incentives and features foreign firms will want. (C)

Response from Western Firms. The full-scale of Soviet approaches to Western firms is not known. Among firms reportedly approached were: a Danish firm for a textile production joint venture in Estonia; a Western firm of unknown nationality for processing of Soviet titanium sponge; Japanese firms for joint ventures in lumber, cutting-tool production, fisheries products processing, and production of rice based snack foods; and American firms in chemicals and agri-business. A joint venture for paper making reportedly already has been concluded with a Finnish firm, although from the sketchy information available it may be more of a compensation deal than a true joint venture. (S)

Many of the Western companies operating in the Soviet market are likely to be willing to discuss joint ventures with the Soviets. They will probably consider this necessary if they are to maintain good relations with Soviet purchasers in order to continue or expand their export sales to the Soviet market. (U)

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Firms are likely to proceed quite slowly, however, in actually concluding joint venture agreements which involve investment of significant company resources. They will have to make comparisons with investment opportunities elsewhere and consider political uncertainties. With the Soviets, companies will be starting from scratch in designing arrangements for joint management, repatriation of profits, sharing technology, marketing outside the plan in the domestic market, valuation in convertible currency of foreign and domestic inputs, limited liability for foreign partners, and free trade zones. (U)

Western firms have responded in a very limited manner to invitations from Eastern European countries to participate in joint ventures. As a result, joint ventures in Eastern Europe have not brought about increased flow of technology or capital. (U)

Negotiations of joint venture agreements will probably be protracted, and only small ones are likely to be created at first. At least initially, the Soviets will offer very little, and they will demand a great deal, such as substantial export performance clauses. As a result, Western companies probably participate on only a limited basis. The first agreements will probably be signed by companies whose leaders have a special interest in the Soviet market and encouragement from their governments. (C)

Soviet Contacts with Western Governments. The Soviets have mentioned their interest in joint ventures to government officials in several Western countries, including the United States, Japan, and Sweden. Generally, Western officials have expressed interest in Soviet intentions, without stating support or opposition. (C)

Under Secretary of Commerce Bruce Smart emphasized that the Soviets should limit their consideration of joint ventures to non-strategic areas, when he met in September with U.S.S.R. State Committee for Science and Technology deputy chairman Kirill Dyumayev. In response to an earlier Soviet request, Commerce provided the them with some Departmental publications on the international climate for investment, methods for attracting investment to local communities, and U.S. foreign trade zones. Commerce reminded the Soviets that firms conducting operations in the United States would have to comply with applicable U.S. laws and regulations, including those governing transfer of technology and equipment. (C)

As Soviet consideration of joint ventures continues, the United States and other Western countries will need to ensure that consideration of joint ventures by Western companies does not undercut policies designed to prevent export to the U.S.S.R. of strategic technology and imports at less than fair value. (C)

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A review will be required of relevant U.S. policies, laws, and regulations, such as travel controls; policy on Soviet purchase of property in the United States; Export Administration Act and Export Administration Regulations; Department of Defense Industrial Security Program; import legislation and procedures; and financial controls. (C)

A review of experience with joint ventures in Eastern European countries and China will help to assess the outlook for joint ventures in the Soviet Union and what is needed for effective administration of strategic trade controls and import controls. (C)

The USSR's International Economic Security Initiative

Soviet Foreign Minister Shevardnadze's 23 September address to the United Nations General Assembly included as strong pitch to establish a new, comprehensive system of international security--the Soviet theme that ties together all of Gorbachev's disparate disarmament and foreign policy initiatives. Included in the Foreign Minister's speech is a call to establish economic vehicles to channel assistance to Third World countries and to develop a global scientific and technical cooperation program. Both efforts presumably would be carried out under UN auspices. The Soviets have formally introduced a proposal to this effect for consideration at this year's UNGA. Economic security, however, is only one small element in the proposal--the reference to it is vague and debt is the only area specifically mentioned. (C)

The Soviets first broached their ideas about an economic security initiative in general terms at the United Nations last year. On 17 December 1985 they achieved passage of a UNGA resolution requesting the Secretary General to prepare a study on a system for international economic security to present at the 42nd General Assembly in 1987. At ECOSOC at Geneva in July they submitted a resolution calling upon the Secretary General to identify in that study concrete problems and to propose action-oriented recommendations for dealing with them. Only Syria cosponsored and most developing countries seemed unenthusiastic. (U)

Soviet interest in pursuing a multilateral approach to global security problems stems from ideas detailed in Secretary General Gorbachev's report to the Party Congress last February. Unfortunately, the Foreign Minister's UNGA statement sheds no additional light on the Soviet proposal beyond what was offered last February. As outlined by Gorbachev, the security initiative has four elements:

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- o A military sphere calling for renunciation by the nuclear or conventional war, a variety of arms control agreements, and a mechanism to effect proportional, balanced reductions in military budgets;
- o A political framework for confidence building measures and Helsinki type agreements to ban the use of force in international relations, and drawing up effective methods for preventing international terrorism;
- o A humanitarian component to provide a vehicle to combat "apartheid and fascism" as well as an apparent willingness to resolve family and other human rights cases;
- o An economic segment to establish a system of equal economic security, remove economic blockages and handle economic sanctions, and create vehicles to handle the international debt problems. Included in this proposal is an effort to draw up principles to govern the use of part of the funds released from military budget reductions to provide LDC's some economic relief. (C)

None of these ideas is new. For the economic items, the Soviets simply have resurrected outdated north-south themes--areas where Soviet economic interests are small and the prospects for political visibility are high. By weaving them together in 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" embodied in a series of proposals dating back to early 1986. The Shevardnadze speech is the most recent opportunity for the Soviets to plug their proposed security program. The regional and functional proposals that encompass Moscow's program include:

- o The 15 January plan for the elimination of nuclear weapons by the year 2000;
- o Shevardnadze's mid January letter to the UN calling for a worldwide congress on the problems of economic security, subsequently reiterated in Gorbachev's party congress speech;
- o The April Soviet statement on the Asian-Pacific Region which called for confidence building measure and a reduction of naval activities in the Pacific, supplemented by the Secretary General's Vladivostok proposal;
- o The 11 June "Budapest" proposal for conventional disarmament in Europe;

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- o The 11 June letter to the UN Secretary General outlining a Soviet plan for a new world space organization and a "star peace program"
- o The Foreign Minister's 8 July letter to the UN proposing an international conference on the Mediterranean and a negotiated withdrawal of the US and Soviet fleets. (C)

It remains open how serious the Soviets are about pushing their economic security initiative. Soviet officials privately have portrayed the proposal as a responsible initial bid to move economic issues of concern to Moscow into the international arena. (C)

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