

6482

*7 June 76  
Revised*

CIA HISTORICAL REVIEW PROGRAM  
RELEASE AS SANITIZED  
1998

Soviet Efforts to Increase Exports  
of Manufactured Products to the West

May 1976

JEC Paper

Analyst:

SOVIET EFFORTS TO INCREASE EXPORTS  
OF MANUFACTURED PRODUCTS TO THE WEST

Table of Contents

	<u>PAGE</u>
INTRODUCTION	i
Conclusions	1
Economic Rationale for Expanding Export of Manufactured Products	4
Evolution of Policy	5
The Economic Setting in 1965	10
First Period of Change, 1966-72	
Reorganization within the Foreign Trade Ministry	13
Foreign Commercial Operations	16
Export Councils	18
Zagranpostavkas	19
Incentives	21
Second Drive to Increase Exports, 1973-75	22
Compensation Agreements	24
Joint Ventures	25
Leasing	26
Actual Growth in Manufactured Goods Exports, 1965-74	27
Factors Behind Sales Successes	30
Prospects	35

Table of Contents  
(Continued)

TABLES

Table 1: USSR: Distribution of Manufactured Goods Exports by Purchaser	29
Table 2: USSR: Distribution of Manufactured Goods Exports by Type	31
Table 3: USSR: Sample Soviet Prices for Manufactured Products, 1974-75	32

CHART

USSR: Measures Taken to Stimulate Export Sales of Manufactured Products	14
---	----

FIGURE

USSR: Exports of Manufactured Goods to the West	28
---	----

## INTRODUCTION

Since 1965, the Soviet Union has attempted to expand significantly its exports of manufactured products to the developed West. This paper analyses the economic rationale behind such a decision and the steps taken by the USSR in an attempt to spur export sales. The problems encountered are discussed in detail, with particular attention paid to the basic conflict between the highly planned Soviet productive system and the flexibility and innovation required to compete successfully in Western markets. Actual performance is examined and areas of relative success discussed. The paper concludes with an assessment of the potential for increased exports during the balance of the decade, with emphasis on those hard decisions which must be made before the USSR can significantly upgrade its ability to export manufactured goods.

## Conclusions

Soviet exports to the developed West consist largely of raw materials and semi-manufactured products; manufactured products<sup>1</sup>/ constituted less than 5% of such exports in 1974. Several economic factors argue for a marked increase in the sale of Soviet manufactured goods to the West. These include the increasing cost of developing raw material resources and the need to expand exports to pay for imported Western technology and equipment.

Soviet leaders have been aware of the need to increase export of manufactured goods for some time. This interest has grown markedly in recent years as a result of the Soviet decision to increase the use of Western equipment and technology to upgrade the Soviet economy. Heightened leadership interest has led to the institution of new programs and sales of these products have risen sharply since 1972 in absolute terms. They still represent only a small share of total exports to the West, however.

1. For the purposes of this study manufactured goods are considered to consist of Soviet products falling under sections seven and eight of the Standard International Trade Classification (SITC 7,8). They include exports of machinery and equipment; transport equipment; consumer goods such as furniture, footwear, and clothing; and other finished goods. Since the study is concerned with the ability of the USSR to manufacture and market highly differentiated finished goods in competitive Western markets, Soviet manufactures falling under SITC 5 and SITC 6 were excluded. For the most part products falling under these two categories are intermediate goods where a higher degree of standardization allows for a greater role of price respective to other competitive factors.

Despite Moscow's efforts, the manufactured goods export program remains characterized by poor product appearance and quality; inadequate spare parts, servicing, and technical documentation; a separation of Soviet producers from Western buyers; and inflexible production schedules which limit Soviet ability to quickly respond to Western needs. These and related problems must be eliminated if manufactured goods are to occupy an important share of Soviet exports to the West. These problems, however, affect all Soviet economic planning and production, and past attempts at change have been frustrated by the large and conservative politicized bureaucracy which controls Soviet production and sales.

Statements by Brezhnev and Kosygin at the 25th Party Congress in February 1976, suggested the possibility of radical reorganization of foreign economic activity, including the establishment of firms and/or industries to produce solely for the export market. In this connection the USSR has in fact begun to encourage compensation-type agreements for manufactured goods<sup>2/</sup> and is in the final stages of drafting

2. Compensation agreements are characterized by collateral purchase guarantees signed by the Western firm(s) exporting plant and equipment to the USSR. By this means the USSR is certain of an export market for project-associated production and, in turn, its ability to repay the long-term credits extended by the West to cover original Soviet imports of plant and equipment. Until recently this type of agreement has been limited to resource development projects where Western firms have agreed to purchase Soviet raw materials, fuels, or chemicals.

joint-venture legislation allowing for Western participation in Soviet production.

If the USSR follows up on the recent leadership pronouncements with meaningful change, the large Soviet industrial base could eventually provide the basis for a substantial growth in sales. It would take time, however, for changes to work their way through the system. For the balance of the decade, Soviet manufactured goods should continue to account for less than 10% of exports to the West.

## Economic Rationale for Expanding Export of Manufactured Products

1. Key economic factors which argue for a greater share of manufactured products in Soviet exports to the West include (1) a need to expand total export earnings to finance growing import requirements, (2) the increasing cost of developing natural resources, (3) the benefits which accrue to domestic production from a developed export program. Over the long run, import capacity is tied to the growth in export earnings. To the extent that Soviet manufactured goods exports add to rather than supplant exports of raw materials Soviet import capacity from the West will be increased.<sup>3/</sup>

2. The development of new raw material deposits and efforts to increase production from existing sites have proven increasingly costly in recent years. Many of the undeveloped raw material deposits are located in remote areas where climate, terrain, and working conditions are difficult. The USSR not only faces the costs of developing the new deposits per se, but must also bear the costs of developing a supporting infrastructure -- rail lines, housing, roads, and power. Also, expensive Western technology and equipment must often be acquired if Moscow is to exploit the new deposits efficiently or increase production from existing projects. This is particularly true in the case of crude oil.

3. See also Inozemtsev, N. "Socialism and International Economic Cooperation," Pravda, 16 May 1973, pp. 4-5.

4. Soviet production for domestic use will also benefit from an expansion of manufactured goods exports to the West. Sales in Western markets depend on competitive advantages rather than on the production targets which govern Soviet output. To expand exports, Soviet producers will be forced to make their products more competitive by placing increased stress on quality control, spare parts production, and upgrading design and production. Although this would be a classic case of the tail wagging the dog, if such innovations were incorporated into products for the domestic market they would represent a major improvement over current Soviet practices such as shoddy workmanship, poor quality control, and long lags between technological advances and their incorporation into actual production. Expanded exports could also increase the efficiency of domestic investment by allowing for longer production runs. A significant share of the cost of producing an aircraft, for example, results from the initial investment in developing a prototype and equipping a plant to produce the aircraft. Longer production runs made possible by export sales would significantly increase the rate of return on such investments.

#### Evolution of Policy

5. The Soviet commitment to increasing manufactured goods exports was first evident in directives issued in 1966

by the 23rd Party Congress. The Congress recommended reforms in those areas -- poor appearance, advertising, technical documentation, spare parts, and servicing -- where the Soviet export program was particularly deficient. Reports from the Congress also indicated the desire to increase contacts between the Soviet Foreign Trade Organizations (FTOs)<sup>4/</sup> and producing ministries and to encourage initiative within the FTOs to seek additional export sales.<sup>5/</sup>

6. Changes implemented during 1966-1970 were organizational in nature and did little to spur sales. In any event, there was apparently insufficient impetus from the leadership to overcome bureaucratic inertia, especially in the Ministry of Foreign Trade. By 1970, Soviet leaders began to recognize the necessity for basic changes within the system. In his report to the 24th Party Congress in 1971, Brezhnev stated the need to improve the management of foreign economic activity and to eliminate a "narrowly departmental approach to this important matter."<sup>6/</sup> The Central Committee Report of the Congress stressed the need to combine production and commercial functions in order to be more responsive to

4. The 60 FTOs are the operational elements of the Ministry of Foreign Trade. As such they have total responsibility for all commercial negotiations in their respective areas of speciality, e.g., power equipment, chemical products. By their direct control over all negotiations they often represent a substantial barrier to needed dialogue between potential buyers and sellers.

5. Patolichev, N, 'Soviet Foreign Trade in the New Five-Year Plan', Foreign Trade, (English Edition), 1967, pp. 3-7.

6. Brezhnev LI, 'Report of the C.P.S.U. Central Committee to the 24th CPSU; Novosti Press Agency Publishing House, Moscow, 1971, pp. 101-102.

Western requirements.<sup>7/ 8/</sup> If the Soviet leadership was now more aware of the basic obstacles to expanding exports little was done about it.

7. High level concern over the need to expand manufactured goods to the West mounted during the early 1970s, particularly as the Soviets realized that an expanded export base was a crucial prerequisite to Brezhnev's commitment to an increased use of Western technology and equipment in Soviet economic development. The USSR's export effort was a major topic addressed at the April 1973 Party Congress plenum.

8. The decisions reached by the April plenum became evident from Soviet articles and statements during 1973. In a June speech to US businessmen in Washington, D.C., Brezhnev criticized Soviet foreign trade operators for "lack of initiative, timidity, outmoded ideas and for deficiencies in their performance." In an April 1973 paper and address given at the Stanford Research Institute, Dr. Ivan D. Ivanov of the Institute of US Studies discussed the role of foreign trade in the 1975-1990 period. He stated that foreign trade was becoming an important component of growth policy rather than just a means of covering temporary shortages in domestic production. He stressed the Soviet determination to become an important exporter of

---

7. The directives also emphasized the need to increase the initiative and responsibilities of ministries and enterprises in the development of foreign economic ties.

8. Kovan, I, 'The Leninist Principle of the Soviet States' Economic Relations with Other Countries', Foreign Trade, April 1973, p. 8.

machinery and equipment regardless of the rapid rise of raw material prices, and spoke of the need to expand export specialization in the most advanced industries, and to orient industrial capacities to export production.<sup>9/</sup>

9. Similar views were expressed by other officials. Nikolai Inozemtsev, a deputy chairman of Gosplan responsible for long-term planning of foreign trade, stated in June 1973 that a top priority campaign had been set to bring manufactured goods up to world quality standards and to update Soviet trading practices and institutions. Inozemtsev spoke of room for improvement in three main areas: a reorganization of the FTOs, the need for closer relations between the FTOs and producing industries, and a need for increased contact between producing industries and Western firms. He explained that the 1973 reforms called for industrial producers to be given greater responsibilities in generating exports and stated that producers would be given control over funds earmarked for the production of high-quality goods for the world markets.<sup>10/ 11/</sup>

10. A February 1974 IZVESTIYA article by Oleg Bogomolov, director of the Institute of Economics of the World Socialist System, revealed continued leadership concern. The article stated that specific reforms related to questions of improving the planning of foreign economic relations and of assessing

9 Ivanov, "Foreign Trade Factors in the USSR's Economic Growth and Some Perspectives for the US-Soviet economic Cooperation"  
10. Parks, Michael, "Russia Prepares for Trade Changes", Baltimore Sun, 29 June 73.

11. Shabad, Theodore, "Soviet Considers Shift on Trade", New York Times, 10 July 73, pp. 55, 63.

their impact on the domestic economy were under active consideration. The article criticized the parochial concept of the MFT, which views foreign trade solely in terms of Moscow's commitments to other socialist states and developing countries and relegates trade with the West to a secondary position. Bogomolov referred to the basic nature of future changes, stating that the process of change in the foreign trade sector will require "much effort" and "a certain psychological reorientation" within the economic bureaucracy.<sup>12/</sup>

11. The concerns raised in the April 1973 plenum culminated in the new directives issued earlier this year at the 25th Party Congress. The Brezhnev and Kosygin speeches and the draft directives for the 1976-1980 plan all demonstrate a commitment to improve exports of manufactured products. Brezhnev spoke of the need to expand the production of goods which are in demand on foreign markets and the need to make these same goods more competitive. He also called for the expansion of compensation agreements to include the production of manufactured products and for the search for new approaches to production cooperation.<sup>13/</sup> Kosygin's speech touched on the need for new forms of cooperation and greater involvement of the producing ministries. The speech specifically called for an examination of the possibility of organizing special production facilities to be oriented toward export markets.<sup>14/</sup>

12. Bogomolov, O., "A Demand of Life", Izvestiya, 26 Feb 74, p. 4.

13. Brezhnev, L., Opening remarks to the 25th CPSU Congress, 24 Feb 76 (FBIS-Sov-76-38, 25 Feb 76, Vol. III, No. 38, Supplement 10, p. 43).

14. Kosygin, A, Address before the 25th CPSU (FBIS-Sov-76-46; Vol. III, No. 46, Supplement 23, 8 March 76, pp.

### The Economic Setting in 1965

12. The Soviet economic system was singularly ill-equipped to make the changes required to manufacture products that could compete in sophisticated Western markets. Designed to service a vast internal market in an autocratic fashion, the Soviet economy was totally isolated from the competitive forces prevailing in the West. The highly structured and politicalized system of central planning which governed Soviet economic decisionmaking was to prove particularly resistant to change.

13. FTOs dealing in manufactured products had little perception of what was required to establish marketing and sales-service organizations capable of supporting export expansion. They also did not appreciate the importance of such factors as product reliability and appearance, and spare parts availability which are important elements in the sale of manufactured products in the West. Soviet sales of manufactured goods traditionally had been largely confined to the developing nations -- where equipment exports were backed by low-interest credits or outright grants -- or to other Communist nations in accordance with plan targets. Equipment exported to the West was often part of a larger deal involving Soviet purchase of Western equipment. Western firms accepting Soviet equipment in this fashion often resold or discarded the equipment.

14. The FTOs not only had little perception of the problems in expanding exports but had little incentive to do so. The quality of personnel employed by the export organizations was often poor; the brighter graduates of the Soviet Foreign Trade Institute gravitated toward importing FTOs. The concept of businessmen, moreover, had long held an unfavorable connotation in the USSR,<sup>15/</sup> and prior to 1965, personnel employed by the FTOs were paid substandard wages. FTOs were judged by their ability to dispose of a targeted amount of goods rather than on their ability to expand export markets. <sup>Any</sup> /attempts at expansion were difficult because of inelasticities <sup>either</sup> and the unwillingness of producers to/alter products to Western standards or to provide for export a wider range of types and sizes. Most production was geared to the domestic and East European markets where sales were guaranteed. Promotions and other incentives were based on management's ability to meet or exceed planned targets.

15. Managers of producing enterprises also tended to avoid change. Innovations were considered risky because they could endanger current plan fulfillment, and they carried little potential for future reward because output targets or quality standards would simply be ratcheted upward if the innovations were successful. Producer avoidance was further encouraged by a bonus system that produced no rewards for underfulfillment but substantial rewards for exceeding plan targets.<sup>16/</sup>

15. ... "Zvestia" Discovers the Businessman; BI/Eastern Europe Report, 22 March 1974, p. 86.

16. Gregory, P. and Stuart, R., Soviet Economic Structure and Performance, Harper & Row, New York, 1974, p. 187.

This risk aversion was most pronounced in areas where technological advances are incorporated into production.

16. Additional problems faced Soviet producers who attempted to upgrade their production or otherwise alter their output to meet Western standards. Since they had little contact with potential buyers it was difficult to ascertain what changes were needed. Attempts to alter product design or upgrade quality were also inhibited by the suppliers of component parts. These suppliers, lacking sufficient capacity or incentive to produce the new parts, would neither agree to the application of their products in additional models nor listen to any talk concerning the upgrading of quality or the creation of new models of the items they manufactured.<sup>17/</sup> A final problem stems from the material balances approach and full production targeting used in the Soviet Union. While Western firms often attract business as a result of their ability to guarantee deliveries within a short amount of time, Soviet producers are often forced to make delivery commitments contingent upon future production plans leading to long delivery lags.

---

17. ... "A Heavy Machine Tool Ministry Innovates", The Current Digest of Soviet Press, Vol, 26, No, 3, p. 23.

First Period of Change, 1966-72

Reorganization within the Foreign Trade Ministry

17. During the 1960s the MFT made several bureaucratic changes designed to place increased emphasis on manufactured goods exports (see chart). As late as 1962 there were only two main export administrations, one for raw materials and a second for machinery and equipment. By 1969, the main export administration for machinery and equipment had been split into four main export administrations, one each for the export of industrial equipment, transportation equipment, road-building and agricultural machinery, and manufactured and consumer goods.

18. The FTOs dealing in manufactured goods were also expanded in an effort to establish a greater parallelism with the producing industries. In July 1966, Mashinoexport, for example, was reorganized into three separate FTOs -- Mashinoexport, Tekmasheexport, and Energomasheexport -- each concentrating on specific lines of equipment. Other FTOs were subsequently created in support of Soviet efforts to expand exports of particular product lines. In 1971, for example, Electronogtechnica (ELORG) was founded to handle the export sales of Soviet computers. The MFT also established two FTOs to support the entire export program: Zapchastexport (in 1965) to handle the export of spare parts and Vneshtorgreklama (in 1964) to undertake the advertising requirements of Soviet export organizations.

USSR: Measures Taken to Stimulate Export Sales  
of Manufactured Products

Chart

Year	Program	Goal
1965	Raise salaries of workers in the Ministry of Foreign Trade	To encourage higher quality personnel into foreign trade sector.
1965	Allow for form of accelerated depreciation	To encourage increased use of new equipment in production.
1965	Formation of a Foreign Trade Organization to handle spare parts	To centralize, and thus improve, spare parts availability.
1966	Formation of additional Foreign Trade Organizations and Main Export Administrations	To place increased emphasis on exports of manufactured products.
1967	Formation of Export Councils by Foreign Trade Organizations	To increase producer-exporter contacts.
1968	Formation of new Soviet-controlled firms in the West	To give Soviet exports direct access to Western markets and to establish sales/service centers.
1968	Formation of zagranpostavkas by producing ministries	To centralize control over export activities.
1968	Increase in bonuses for export production	To encourage production for export.
1973	Formation of leasing companies	To take advantage of widely used method for manufactured goods sales.
1973	Application of compensation agreements to manufactured goods industries	To encourage production for export.

Chart

USSR: Measures Taken to Stimulate Export Sales  
Of Manufactured Products  
(Continued)

Year	Program	Goal
1973	Study of possibility of joint-ventures involving Western participation in Soviet production	To examine possibility of obtaining Western technology and know-how on a continuing basis
1973	Use of Western consultants to assist in marketing and product design	To improve Soviet product appearance and knowledge of Western marketing conditions

### Foreign Commercial Operations

19. The late 1960s saw a rapid expansion in the number of Soviet-controlled commercial outlets established in developed Western countries which dealt with manufactured goods.<sup>18/</sup> Soviet FTOs organized 17 such firms during 1968-1975, bringing the number of Soviet-controlled establishments to 22. In some cases, the FTOs bought a majority interest in Western firms already dealing in the sale of Soviet products; in other instances new firms were created to handle the sale of Soviet manufactured goods. The FTOs have allowed for minority equity participation by Western firms or businessmen who were also given a major role in the management of the new firms. Stankoinport, Avtoexport, and Mashpriborintorg have participated in the formation of five firms and Machinoexport, Tractorexport, Aviaexport, and Technashexport have also established outlets in the West.

20. The new firms gave the FTOs direct control over sales efforts and allowed for badly needed exposure to the marketing techniques and competitive conditions existing in Western markets. Showrooms, spare parts depots, and service facilities were usually established by the new firms and, where required, these firms also sought to organize branch dealerships and repair facilities. Foreign workers designated to service Soviet products were given specialized training, often in Soviet-based facilities.

18. During the 1965-1975 period the USSR also rapidly expanded the number of banks in the West, opening commercial banks in West Germany, Switzerland, and the Netherlands. Several firms were also established which deal in raw materials or intermediate goods, and the USSR opened a series of firms to service its growing role in international shipping.

21. The FTOs were not fully committed, however, to providing the initial investment and subsequent marketing environment which was required to support the export expansion they desired. Merchandising outlets and service facilities were often limited to one or two locations within a given country and Soviet firms were often unable to obtain the amounts or types of equipment which could most readily be sold. Even the ability of the Soviet-owned firms to operate within their respective Western markets was limited by the rigid control exercised by the parent FTOs over their day to day operations.

#### Spare Parts

22. The Ministry of Foreign Trade reacted to the problem of insufficient spare parts in a typically bureaucratic fashion. In 1965, a new foreign trade organization, zapchastexport, was organized to centralize spare parts storage and delivery to foreign customers. By the end of 1970, Zapchastexport accounted for 80% of all Soviet spare parts exports. A large central warehouse was established in Moscow and smaller consignment depots were set up in the West. Spare parts inventories were also maintained by most of the Soviet-controlled firms operating in the West.

23. While this reorganization has led to a greater centralization in the handling of spare parts and has been supported by specialized associations within the production ministries and by special production bonuses, spare part shortages continue to plague Soviet export efforts. Many producers remain unwilling to commit production facilities to spare parts production. Moreover, Zapchastexport's spare parts supplies -- and hence the amount of parts which are made available abroad -- are determined by the production ministries' estimates of spare parts needs rather than by foreign demand.

24. The problem of spare parts is compounded by the attitude of some FTO personnel who find it hard to accept the importance potential buyers' attach to assured spare parts deliveries and the efforts Western firms make to insure a prompt response to buyer requests for needed parts. They often state that Western buyers should bear the responsibility of manufacturing their own spare parts from engineering designs provided by the producer, arguing that this is the manner in which Soviet importers handle their spare parts problems.

#### Export Councils

25. In response to the 1966 directives, the FTOS began to consult more regularly with industry representatives in the planning and implementation of foreign trade. Industry participation in FTO decision making was formalized in late

1967 with the establishment of permanent Export Councils. The Export Councils consist of high level representation from the production ministries, exporting enterprises, and the FTOs handling their products. The Councils provide a forum for the discussion of export-related problems and serve as a vehicle for producing enterprises to acquaint the FTOs with the possibility of new export products or of additional production of existing export lines.

26. Some tangible results have resulted from the work of various Councils including improved packaging, production according to Western standards, and the introduction of technical documentation and advertising. However, the Councils' ability to effect more basic changes is limited. Designed to serve as consultants they can only suggest, not require, changes in production or sales techniques.

#### Zagranpostavkas

27. In the late 1960s, the decision was made to centralize the foreign trade operations of individual production ministries by establishing specialized associations or zagranpostavkas.<sup>19/</sup> The zagranpostavkas were given main departmental status and in some cases the ministries created the office deputy minister for export to head the newly-formed association. It was hoped that the zagranpostavkas would

<sup>19.</sup> Zagranpostavkas (delivery to foreign countries) are known to have been created by the Ministries of Aircraft Industry, Non Ferrous Metallurgy, Machine Tools, and Instrument Making.

relieve the FTOs of some areas of responsibilities not strictly connected with commercial negotiations. Staffing of the zagranpostavkas is financed by the FTOs dealing in the products produced by the parent ministry.

28. Zagranpostavkas are responsible for the punctual fulfillment of export contracts, the observance of quality regulations, after-sales service, and installation work. In practice they have usually assumed industry-wide responsibilities in maintenance and spare parts supplies for exported equipment. In some cases, the zagranpostavkas have been assigned more substantial roles similar to those normally assigned to the FTOs. The zagranpostavka for the ministry of non-ferrous metals is responsible for compensation negotiations with Western firms, while members of the Ministry of Aviation's zagranpostavka have taken leading roles in discussion involving demonstration flights of the Yak-40.

29. Those ministries which have formed zagranpostavkas view them, in part, as an alternative to the FTOs themselves. Zagranpostavka personnel not only have a vested interest in the parent ministry's operations and capabilities, but have also gained increasing knowledge of world market conditions and potential markets for Soviet exports. Apparently out of concern for losing centralized control over foreign trade, however, in 1975 Soviet officials indicated that the zagranpostavka would continue to serve solely in an advisory capacity to the FTO dealing in the ministry's products.

## Incentives

30. The incentives provided for in the directives following the 23rd Party Congress did little to increase producer desire to expand exports of manufactured products. They proved too negligible to compensate producers for the extra efforts required for export production. The bonus system in effect during the 1960s provided producing enterprises with foreign exchange allocations based on export receipts which, in turn, could be used for the purchase of imported machinery and equipment. Managers were also rewarded on the basis of the share of exported goods in total production. Soviet disappointment over the failure of the bonus system led in 1968 to an increase in the hard currency allocation from 3%-5% to 4%-6% of the value of exported items.<sup>20/</sup> As Deputy Foreign Trade Minister Smelyakov commented in a 1973 article on Soviet exports to the West, however, the new incentives failed to solve the problem.

"First of all we must provide incentive for the export of machinery and equipment. The decade of the sixties was characterized by the fact that there was practically no such incentive. Unfortunately even until quite recently the export of machinery, equipment, and replacement parts has been considered by some plants as a kind of punishment... Financial, administrative and other responsibility for export deliveries makes export unpopular in the Soviet Union. It is difficult to recall an instance where plant management submitted a proposal to the MFT calling for additional above-target export delivery...." <sup>21/</sup>

20. Leznik, A.D., "Economic Stimulation of Production for Export"; (Translated in JPRS 55,223, 15 Feb 72, p. 12).

21. Smelyakov, N., "Soviet Deputy Foreign Trade Minister Discusses East-West Trade", Novyy Mir, December 1973 (Translated in JPRS 61148, 5 Feb 74, p. 25.)

31. The bonus was made even less attractive by being tied to Western acceptance of the exported equipment. Moreover, the production ministries were not given discretion over the use of the bonus funds; desired purchases had to be channeled through (and were contingent on) FTO approval.<sup>22/</sup> Recent policy statements indicate that, as part of a proposed reorganization of foreign economic activity, industries producing for export will receive hard-currency allocations and considerable independence in making purchases with those funds. Penalty clauses for faulty production will be maintained.<sup>23/</sup>

#### Second Drive to Increase Exports, 1973-75

32. The high-level concern evidenced at the April 1973 party plenum has been reflected in new approaches taken by Soviet planners and exporters attempting to increase the export of manufactured goods. The 1973-1975 period saw a markedly increased Soviet interest in Western market conditions and requirements. Soviet producers and FTO officials began to more seriously examine potential markets for their products and the changes in production required to sell in the West. Interest was largely directed at the US market where Moscow felt Soviet goods could be sold in quantity once the USSR was granted most favored nation (MFN) status.

22. Leznik, A.D., pp. 14-15.

23. See also all article by Yu. Samokhin in EKONOMICHESKAYA GAZETA, No. 12, March 1975, which explains additional steps taken to increase producer incentive.

33. Soviet officials touring the US in 1973 were most interested in recommendations for marketing their products. They sought to determine those changes required in their products, which products would be of greatest interest to US buyers, the proper advertising and retailing techniques, and the best method of distributing and servicing the goods they wished to sell. In many cases they sought US companies to act as distributors for their products or otherwise assist future sale efforts. Although the subsequent failure to achieve MFN status muted Soviet attempts, Moscow's newest approach to the marketing problem was unique and demonstrated growing Soviet awareness of the need to tailor production and merchandising to Western markets.

34. The Soviets enlisted US marketing and design consultants to assist in their efforts. In November 1973, the USSR reached an agreement with the industrial design firm of Raymond Loewy/William Snaith Inc. to design selected Soviet products for the US market.<sup>24/</sup> In addition, the US firm was to undertake studies of consumer-requirements for Soviet products and to exercise some quality control over any Soviet productions advertised as being designed by Raymond Loewy. The Soviet contract was for 2½ years and recovered the design (or redesign) of automobiles, motorcycles, cameras, watches

24. Farnsworth, Clyde H., "Loewy Got A 'DA' for Many Consumer Designs but 'Nyet' on Vodka", New York Time, 5 December 73,

tractors, and hydrofoils. Concomitantly, other US consultants were hired to undertake other marketing studies on the USSR's behalf.

#### Compensation Agreements

35. Soviet expansion of compensation agreements in the manufactured goods sector dates back to 1973 when State Committee for Science and Technology (SCST) officials stated that production industries could obtain hard currency credits for equipment purchases if such credits would be covered by subsequent hard currency exports. At the same time, an IMEMO official indicated that a new foreign trade policy was under discussion which would involve the development of profit oriented industries designated to manufacture goods for export.

36. Soviet exporters began to solicit Western participation in compensation agreements whereby the USSR would pay for imported Western capital goods with manufactured products. They offered to set up special production facilities or to otherwise tailor production to Western specifications. Some compensation-type agreements have been concluded. One involves Soviet production of machine-tools designed with West German assistance. The West German firm involved will produce the initial prototypes and subsequently supply the Soviets with equipment required to set

up production in the USSR. The West Germans will take production from these facilities in repayment.<sup>25/</sup> In most cases, however, potential Western partners have shied away from such deals because of uncertainty over the quality of Soviet-produced products and over the ability of Soviet producers to meet assigned production targets and to supply spare parts.

#### Joint-Ventures

37. The Soviets realized that a more comprehensive form of cooperation was needed to entice Western firms into taking production as repayment and, more importantly, into sharing technology and production know-how on a continuing basis. In late 1973, the USA Institute began a study of the various forms of ownership and management control commonly employed by Western firms. By querying Western firms directly the USA Institute hoped to develop a form of cooperation which, while inducing desired Western participation, would result in minimal conflict with traditional Soviet insistence on complete control over domestic production.

38. In 1975, Institute members stated that the concept of joint-ventures was being considered in light of the Hungarian and Romanian experiences and openly discussed those changes which would have to be made in Soviet law to enable foreign equity investment. By the end of 1975, Soviet planners had decided on the guidelines for such joint-ventures. The USSR would allow Western participation in the management of

25. ... "ECOTASS", 11 March 1974, p. 11.

Soviet firms involved in the joint venture and would grant special exceptions to cover imports and exports connected with the joint venture. While the USSR will not consider Western equity ownership of Soviet-based production facilities, Soviet officials indicated that Western investment would be guaranteed by Gosbank and that other provisions, amounting in theory to joint-ownership, might be included. Such guidelines are recognized by the Soviets as being very provisional; the final form of Soviet joint-venture legislation will probably be defined after agreements with Western firms have been reached and experience has been gained in operating joint-ventures with the West.

#### Leasing

39. Soviet FTOs did not begin leasing operations in their export efforts until 1970 when the Soviet-owned United Machinery Organization began leasing heavy duty construction equipment to British firms. Soviet interest in the potential of leasing resulted in the organization, in 1973, of two jointly-owned companies to promote and finance leasing operations in Europe. In October, East-West Trading Company was founded by the Soviet Moscow Narodny Bank and the UK's Morgan Grenfell bank, and in December the Soviet-owned Banque Commerciale Pour l'Europe de Nord (BCEN) in Paris joined with France's Credit Lyonnais to form Promolease. The new firms are supervised by the leasing subsidiaries of the Western banks involved. While the leasing operations are intended

to assist Soviet imports, they are principally concerned with increasing Soviet exports of manufactured goods to the West.

Actual Growth in Manufactured Goods Exports, 1965-74

40. The absolute growth of Soviet export of manufactured goods (albeit from a small base) has been impressive. Annual sales rose from \$48 million in 1965 to over \$100 million in 1970 <sup>26/</sup> (see Figure 1). Growth has been particularly striking in recent years, rising from \$134 million in 1972 to \$268 million in 1974 (the last year for which detailed figures are available). The USSR has ~~been~~ unsuccessful, however, in raising the share of manufactured products in total exports to the developed West. In 1965 manufactured goods sales accounted for only 3.3% of total exports; by 1974 the level had risen slightly to 3.4%. For most of the intervening years the annual share ranged from 3.4% (in 1969) to a high of 4.6% (in 1972 and 1973).

41. Sales of Soviet manufactured goods in the West have been concentrated in Europe (see Table 1). More than one-fourth of such exports in 1974 went to Finland reflecting, in part, the special trading arrangements between the two countries. The United Kingdom has also been a major recipient of Soviet products,

<sup>26.</sup> Based on official Soviet foreign trade statistics as presented in "Vneshniaia torgovlia S.S.S.R."

# USSR: EXPORTS OF MANUFACTURED GOODS TO THE WEST

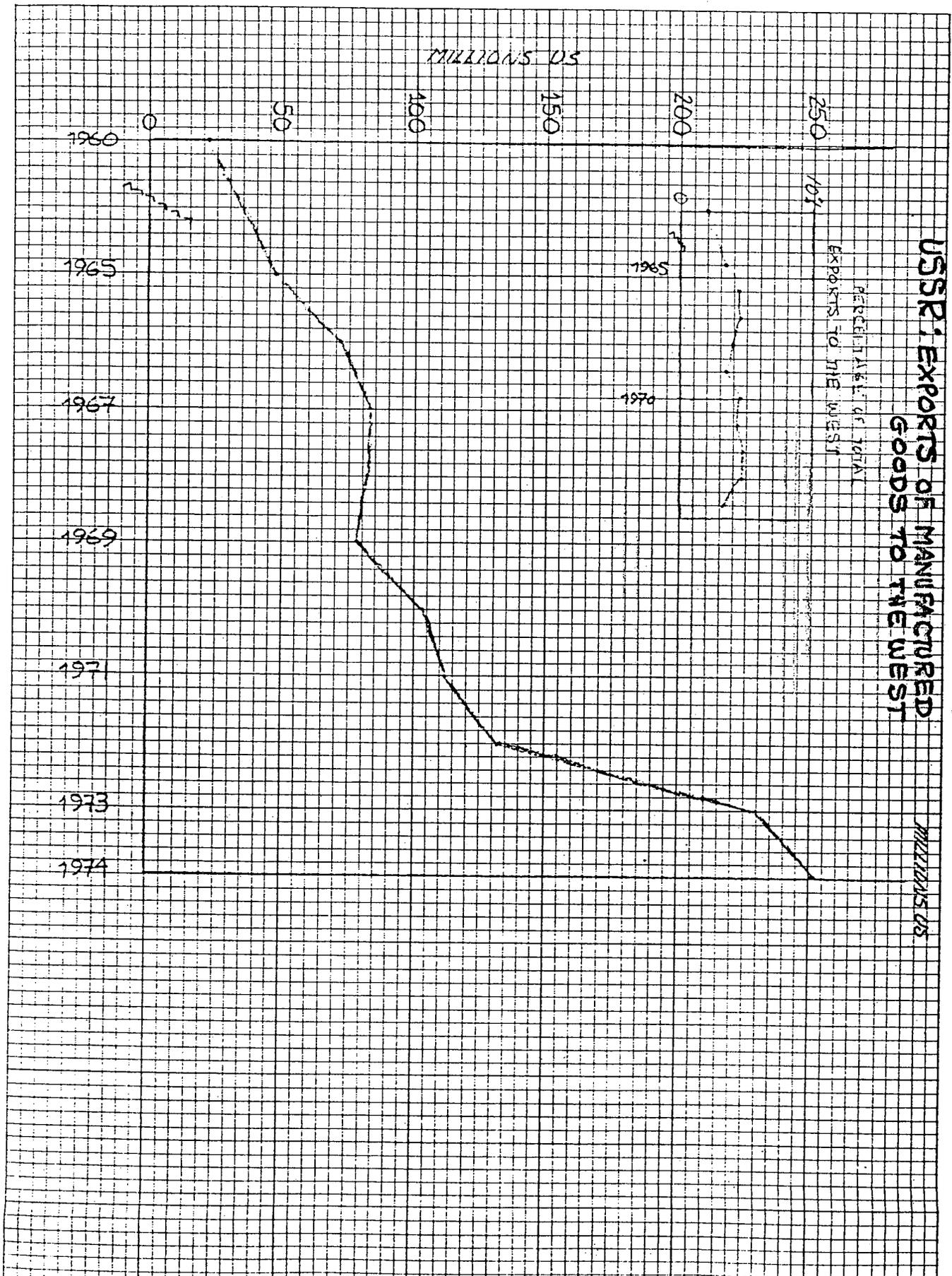


Table 1  
USSR: Distribution of Manufactured Goods Exports  
By Purchaser

	1965		1970		1972		1973		1974	
	Value	Percentage								
Total Developed West of which:	48.0	100.0	104.1	100.0	133.8	100.0	229.3	100.0	267.9	100.0
Belgium	3.8	7.9	3.1	3.0	8.0	6.0	22.2	9.7	14.0	5.2
France	2.5	5.2	9.2	8.8	14.7	11.0	24.4	10.6	27.0	10.1
Finland	17.2	35.8	16.5	15.9	26.3	19.7	57.3	25.0	72.7	27.1
Italy	1.0	2.1	5.5	5.3	7.1	5.3	14.1	6.1	20.1	7.5
Japan	2.7	5.6	6.5	6.2	8.9	6.7	9.0	3.9	11.5	4.3
West Germany	3.8	7.9	32.7	31.4	25.7	19.2	24.1	10.5	28.7	10.7
United Kingdom	10.8	22.5	8.7	8.4	17.4	13.0	26.8	11.7	40.1	15.0
United States	3.3	6.9	2.6	2.5	3.9	2.9	5.2	2.3	7.5	2.8

Million US

particularly automobiles, cameras, and watches. Soviet manufactured good exports to West Germany in 1974 were led by ship sales, while export of manufactures to Italy consisted mainly of machine tools and communication equipment. Despite its special interests in expanding trade with the USSR, France has yet to become the major importer of manufactured products that the Soviets would like it to be. In 1974, Paris accounted for only 10% of total Soviet manufactured goods exports to the Developed West; major items included agricultural and transportation equipment.

42. With the introduction of the Lada (the Soviet Fiat) in Western markets in 1972, automobiles have become the USSR's major manufactured goods export item (see Table 2). Sales of power and electrical equipment have risen rapidly in recent years to \$36 million in 1974. Ship sales have continued as a major export item, while sales of metal processing equipment -- primarily metal-cutting machine tools -- have grown steadily. In the consumer goods sector, the USSR has steadily increased camera sales and has been able to increase sharply the sale of watches in the West.

#### Factors Behind Sales Successes

43. As a rule, Soviet prices of manufactured goods are set below prices of competing goods in the West; in some cases discounts are quite substantial (see Table 4). Soviet-produced injection-moulding equipment, for example, is being

USSR: Distribution of Manufactured Goods Exports by Type

Table 2

	1965		1970		1972		1973		1974	
	Value	Percentage								
TOTAL Developed West of which:	48.0	100.0	104.1	100.0	133.8	100.0	229.3	100.0	267.9	100.0
Metal processing equipment	4.4	9.2	11.7	11.2	16.5	12.3	20.3	8.9	21.7	8.1
Power and electrical equipment	1.0	2.1	3.6	3.5	4.9	3.7	13.9	6.1	35.9	13.4
Mining, metallurgical, petroleum equipment	.3	.6	1.3	1.2	5.6	4.2	8.4	3.7	8.1	3.0
Medical and laboratory equipment	1.7	3.5	5.8	5.6	12.1	9.0	21.8	9.5	12.1	4.6
Tractors and agricultural equipment	.9	1.9	2.2	2.1	3.0	2.2		3.4	9.2	3.4
Ships and marine equipment	2.6	5.4	30.1	2.3	11.2	8.4	27.1	11.8	18.0	6.7
Autobobles	6.5	13.5	5.4	5.2	20.0	14.9	35.9	15.7	42.5	15.9
Matches	.8	1.7	2.4	2.3	5.3	4.0	7.0	3.1	11.1	4.1
Cameras	.9	1.9	2.2	2.1	3.0	2.2	6.2	2.7	6.5	2.4

Million US

Table 3

USSR: Sample Soviet Prices  
for Manufactured Products,  
1974-75

Product	Percentage Discount From Western Prices For Comparable Goods
Transformers	30%
Resistors	30%
Tractors	20%-40%
Machine tools	40%-50%
Turbines and compressors	40%-50%
Color television sets	25%-31%

offered to UK buyers at 40% below prices charged by British manufacturers; Soviet machine tool and agricultural equipment prices are routinely set 20% to 50% below the prices of comparable models produced in the West.

44. Discount pricing has undoubtedly led to a great number of orders, particularly when Soviet sales have involved component parts such as electrical resistors or other manufactured goods where other competitive factors -- appearance, technical documentation, and a repair/spare parts network -- are of minimal importance. Low prices have also served as sufficient stimulus when as in hydroelectric generating equipment, Moscow was able to offer a state-of-the-art product and integrate its sales effort into a larger deal involving a Western producer whom buyers could rely upon to rectify any subsequent problems.

45. The USSR also has resorted to collateral purchase requirements in its attempts to expand exports of manufactured products. Soviet importers of Western capital equipment have often insisted that the Western supplier accept Soviet equipment in lieu of cash payment for 5% to 10% of the contract value. While this effort was traditionally employed only in the context of Soviet equipment purchases, more recently Moscow has predicated some agricultural purchases on counterpurchases of Soviet equipment. In November 1974, for example, the Soviets indicated that purchases of agricultural products from New Zealand were contingent on New Zealand's buying of Soviet equipment.

46. In addition to establishing their own firms, many FTOs have sought to initiate marketing and distributing agreements with Western companies. Low prices, deliveries on consignment, and easy payment terms have made such proposals attractive to a number of Western firms. The Soviets, in turn, are able to penetrate established markets by relying on Western companies familiar with retailing in established Western markets. In some cases -- machine tools and watches -- the arrangements have included a blending of Soviet with Western components and marketing under the Western firms' trademarks. Soviet watch sales are concentrated in France and the UK where such arrangements are in effect.

47. The Soviets have also been active in establishing networks of dealerships to assist in the sales and servicing of automobiles and tractors sold in the West. Some 150 dealers have been appointed in the UK to support Satra Corporation's sales of Soviet automobiles, and Soviet automobile sales efforts in Norway, Sweden, and Finland are also backed by a network of local dealerships. Soviet tractor sales in France are supported by over 130 local outlets, and Belarus Equipment of Canada -- a Soviet controlled company specializing in tractor sales -- is in the process of expanding its dealerships in both Canada and the US.

48. Another factor behind Soviet sales successes has been the willingness of some Soviet exporters to tailor their products to Western specifications. Such alterations often call for only minor changes in Soviet production, such as the painting of Soviet resistors to Western standards.<sup>27/</sup> The USSR has also sought to combine Soviet and Western components to make the product more attractive to Western buyers. Soviet-produced machine tools are often coupled with Western numerical controls and Soviet aircraft with Western avionics equipment. Most recently, the USSR signed an agreement with Italy's Worthington Italiana SPA for the joint production of pumps for use in the chemical and hydrochemical sectors.

#### Prospects

"We cannot enter the world marketplace straitjacketed by our domestic habits and traditions of planning, manufacture, and transport, basing our actions and decisions solely on the laws of the domestic market. We must be up to the level of the demands of the world market. Attainment of this level will not cause damage to our planned economy, nor to the laws of socialist production, nor particularly to Communist ideology. On the contrary, this principle will teach us much and will make us a stronger competitor with capitalism".<sup>28/</sup>

N. Smelyakov, 1973

49. Several problems must be resolved before the Soviet Union can expect manufactured goods to become an important share of Soviet exports to the West. Recently instituted changes -- accommodation to Western requirements, joint-production, and use of Western marketing expertise -- represent a

---

27. ...Soviet push sales of products in West Germany, Der Spiegel, 30 March 70, pp. 20-24.

28. Smelyakov, "Soviet Foreign Trade Minister Discusses East-West Trade," p. 20.

distinct improvement over the superficial and largely organizational measures undertaken during 1966-1972. The new programs, however, leave untouched the more basic problems related to the traditional approach to foreign trade production and sales.

50. If exports are to be expanded meaningfully, Soviet producers must be made directly accountable, and compensated accordingly, for the success or failure of their sales efforts in the West. To be effective this change would involve providing the producer with:

- direct access to potential buyers, including participation in Soviet-owned companies in the West and a direct say in marketing efforts associated with the product.
- the ability to import Western technology and equipment needed to make his output more competitive.
- the authority to have component parts produced in the quantity and quality necessary to meet his export commitments.
- considerable freedom in production, allowing him to be responsive to changes in Western demands.

51. Producing ministries have become increasingly aware of Western needs and competitive conditions in recent years by their increased participation in negotiations with Western firms. As noted earlier, the establishment of zagranpostavkas, in particular, has the potential for greater producer participation in the export process. Compensation agreements currently being advocated for the producing sectors also represent a step in the direction of tasking producers with export responsibilities. Yet, the potential for compensation agreements are limited by Western unwillingness to provide state of the art technology and marketing assistance on a continuing basis without some form of management and equity participation.

52. In addition to allowing producers direct access to buyers and holding them accountable for sales, other key indicators of a Soviet commitment to implement changes needed to significantly improve Moscow's exports of manufactured goods include:

- affirmative action on recent high-level statements calling for the establishment of firms producing solely for Western export markets.
- where required, some allowance for Western management and possibly equity participation.
- a greater availability of goods for export and a more flexible production schedule allowing for quicker delivery times.
- a greater emphasis on spare parts production and the establishment of additional outlets in the West.

53. The USSR is studying US proposals for joint-venture agreements involving US participating in Soviet production. In a December 1975 address, Deputy Minister of Foreign Trade Sushkov discussed some of the proposals forwarded by US firms which were being considered. One firm, for example, has submitted a proposal to build a plant to produce automobile parts in the USSR for resale in the West under the US firm's brand name. The proposal provides for joint management of production, with the Western firm's representatives responsible for quality control and the use of state-of-the-art technology and equipment in production. The US firm would be paid for its capital investment and services out of Soviet production of the finished products <sup>29/</sup> The USSR, however, has yet to formalize the requisite joint-venture legislation which would allow for such an arrangement.

54. Moscow will find it difficult to arrive at a meaningful program, such as joint-ventures, which will be implemented by the massive and conservative Soviet bureaucracy. Advocates of change, such as N. Smelyakov, appear to be in a distinct minority. Although their influence on policy seems on the rise, their past initiatives have been frustrated by widespread bureaucratic resistance any by the failure of the USSR to gain most-favored-nation status from the United States.

<sup>29.</sup> Sushkov, V.N., address given on 8-11 December 1975 Symposium on US-Soviet Technological Cooperation.

55. In the final analysis politics rather than economics may prove to be the major barrier to needed change. The Communist party maintains tight control over the Soviet economy and the political element plays a pervasive role at all levels of economic decisionmaking. This political element has proven very resistant to needed economic change in the past, particularly when such changes threatened to result in a diminution of its control. It is difficult to perceive of an economy responsive both to the needs of a capitalist market and the party. The creation of a special export sector, which like the military economic sector is distinct from the larger domestic economy, may prove to be the only feasible solution to this dilemma.

56. Over the next several years continued implementation of recently initiated programs should allow the USSR to continue to increase sales of manufactured products in the West. Sales will continue to be centered in those areas -- automobiles, tractors, power equipment, machine tools -- which have been the mainstay of past efforts. Until more meaningful changes are fully implemented, however, Soviet manufactured goods sales will remain a small percentage of total exports to the West; they should account for less than 10% of total exports for at least the balance of the decade.