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MEMORANDUM FOR: The Special Assistant to the DD/I

SUBJECT: Limitations on Trade Between the US and the USSR

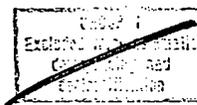
1. I understand that you asked _____ for a study on this subject. He promptly had our people look into the matter and, after considerable investigation which was of great value to them, they came up with the attached study. The problem is, of course, highly complex and legalistic and does not really fall within our sphere of responsibility. There must be several experts in the Government on various aspects of the problem.

2. We are not intending to make distribution outside of the Agency, even though we think it is a pretty good summarization. I am sending these copies for your information and study, and for providing Ray with some background on the problem. If you should wish to bootleg copies to a couple of individuals outside the Agency with appropriate caveats we, of course, would have no objection.

Assistant Director
Research and Reports

Attachment:
Subject Study (2 copies)

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20 AUG 1963

LIMITATIONS ON TRADE BETWEEN THE US AND THE USSR

I. Introduction

The desirability of US government measures to facilitate commercial trade between the US and the USSR has been considered intermittently since the close of World War II. The recent signing of the nuclear test ban agreement has again raised the question of whether a relaxation of trade restrictions could, at some stage, be used to maintain the momentum of a reduction in cold war tensions. This paper describes briefly: the principal restrictions on US-USSR trade that exist today; those impediments that might be modified by executive action; and the possible impact on trade that might occur following such action.

II. Restrictions on US Imports from the USSR

The US has never been a large buyer of Soviet goods. Probably the major cause of the small volume of US imports of Soviet goods is the limited variety and quantity of goods that the USSR has available for export. Beyond the overriding economic limitation, however, other conditions restricting sales of Soviet goods in the US are the US tariffs, a specific legislative prohibition against seven Soviet furs, and the unfavorable public image of the USSR in the US, which inhibits consumer acceptance of such Soviet goods as are available. Inasmuch as the foreign trade of the USSR is handled mainly through bilateral trade

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agreements, with a view to balancing imports against exports, the size of the market for US goods in the USSR is closely related to the amount of goods the USSR can sell to the US.

A. Tariffs and MFN

Under the terms of the Trade Expansion Act of 1962, the President must

"as soon as practicable, suspend, withdraw, or prevent the application of the reduction, elimination, or continuance of any existing duty or other import restriction, or the continuance of any existing duty-free or excise treatment, proclaimed in carrying out any trade agreement under this title or under section 350 of the Tariff Act of 1930, to products, whether imported directly or indirectly, of any country or area dominated or controlled by Communism."

While MFN privileges have not been extended by the US to the USSR since their prohibition by the Trade Agreements Act of 1951, the Act of 1962 not only continues the prohibition, but makes mandatory as well the withdrawal of MFN treatment from Poland and Yugoslavia "as soon as practicable." The effect of this prohibition on trade with the USSR is that imports from that country are subject to the full extent of US tariffs. Although the Administration has requested an amendment to this law permitting Presidential discretion in the national interest, the Congress has not yet acted.

B. Prohibition Against Soviet Furs

According to the terms of the Trade Expansion Act of 1951, seven kinds of furs and skins, either dressed or undressed, cannot be

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imported into the US from the USSR and Communist China. These are ermine, fox, kolinsky, marten, mink, muskrat, and weasel. Before this law was passed, the combined value of these furs imported into the US from the USSR was about \$7.5 million annually.

C. Consumer Resistance to Soviet Goods

Another obstacle to increased sales of Soviet goods in the US is the poor image of the USSR in the public mind. Apart from general dislike of an aggressive dictatorship, the average American is unlikely to want to buy items made in a country whose leader threatens to bury him -- or to blow him apart by rockets set up stealthily but 90 miles away from his shores. Nor has the Soviet Union built up a reputation for craftsmanship or taste such as say Germany or Italy, whose skills were so renown that they tended to counter some of the antagonisms generated by a Hitler and a Mussolini.

This anti-communist, anti-Soviet aversion has been institutionalized. The American Legion has advocated a boycott of Soviet goods, and the anti-communist campaign in the larger labor unions in the US on occasion has led to a boycott of Soviet goods by union members acting as individuals and in groups. The refusal of longshoremen to handle certain Soviet cargoes is an example of the latter. In Ohio, at least one municipality is reported to require that stores selling goods made behind the iron curtain post a sign stating "Communist-made goods sold here." The John Birch Society is alleged to have backed such action.

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Aside from such adverse publicity the Soviets have not proved themselves to be skilled merchandisers. Coming from a "have not" society, they are slow to understand the competitiveness of selling techniques existing in a "have" society such as the US. Advertising, packaging, and the concept of creating a market for goods where none existed before appears to be an operation beyond the present Soviet abilities.

III. Restrictions on US Exports to the USSR

The principal restrictions on US exports to the USSR consist of the US program of export controls (frequently referred to as the US program of economic defense), the ban against private US credit being made available to the USSR, and the enormous conceptual and institutional differences between the market economy of the US and the planned economy of the USSR. Both the export controls of the US and the limited availability of credit to the USSR have been criticized frequently and lengthily by all of the Soviet hierarchy. Although these two limitations can be altered significantly by US executive action, the differences between the two economies would persist and continue to have limiting influences on US-USSR trade.

A. Export Controls of the US

The basic legislation restricting US exports to the USSR is the Export Control Act of 1949 and its subsequent amendments. The law was passed originally as an emergency measure, prompted in part by

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domestic shortages and threats of inflation created by abnormal foreign demand. It also plainly recognized the important relationship between exports and our foreign policy and national security. The Act conferred on the President very broad general powers to restrict and control export trade and permitted him to delegate this authority. Since its passage, delegation has been made to the Secretary of Commerce.

Under the Export Control Act, the Department of Commerce has developed an extensive system for licensing exports from the US, both of commodities and technical data, for the purpose of denying direct and indirect shipments of strategic commodities to Communist countries. All commercial exports from the US, except to Canada, are prohibited unless the Department has established a "general license" or has issued a "validated license" permitting such shipments.

A general license is a broad authorization issued by the Department of Commerce permitting the export of some commodities under specified conditions without requiring the filing of an application by an exporter. The bulk of US exports (85 - 90% of total US exports) moves to friendly countries under general licenses.

A validated license is a formal document issued to an exporter by the Department. It authorizes the export of commodities within the specific limitations of the document and is based upon a detailed application submitted by the exporter. Validated licenses must be obtained to export items carried on the "Positive List"* to any country

* The Positive List is maintained by the Department of Commerce, in collaboration with several other agencies, including CIA. About 1,000 items are presently on this list.

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except Canada. Most items on this list are considered strategic or critical in some way to the military industrial mobilization base of the Soviet Bloc. The remainder are items in short supply in the US which if exported would contribute to inflationary pressures in the US.

Validated licenses are also required to export any item to the Soviet Bloc (excluding Poland), except a small number of items identified on the GLSA list (General License Subgroup A),* within the general license category. Items on the GLSA list are considered to have no strategic significance and are not in short supply in the US. Therefore, there are no limitations on their export to the USSR or Eastern Europe. Although there are no licensing or other administrative restrictions on the sale and shipment of these items, the USSR and its European Satellites have shown little interest in buying them in large quantities. On the other hand, the goods that the Bloc has shown the greatest interest in buying are not on either the GLSA list or on the Positive List. Before such items can be exported to the Soviet Bloc, however, a validated license must be issued by the Secretary of Commerce. In deciding whether to issue such licenses, he determines -- usually after inter-agency review -- whether the item falls under the control criteria of the Export Control Act of 1949 and its subsequent amendments, which provide that:

"The Congress hereby declares that it is the policy of the United States to use export controls to the extent necessary (a) to protect the domestic economy from the

* Subgroup A relates to the nations of the Soviet Bloc.

excessive drain of scarce materials and to reduce the inflationary impact of abnormal foreign demand; (b) to further the foreign policy of the United States and to aid in fulfilling its international responsibilities; and (c) to exercise the necessary vigilance over exports from the standpoint of their significance to the national security of the United States."

In 1962 Congress added the following sentence (known more widely as the economic criterion):

". . . Such rules and regulations shall provide for denial of any request or application for authority to export articles, materials, or supplies, including technical data, from the United States, its Territories and possessions, to any nation or combination of nations threatening the national security of the United States if the President shall determine that such export makes a significant contribution to the military or economic potential of such nation or nations which would prove detrimental to the national security and welfare of the United States."

Thus although the 1962 criteria are more restrictive than those previously applied, the legislation seems to permit the Secretary of Commerce latitude within which he could moderate somewhat its restrictive effects. For example, the Secretary could add more items to the GLSA list, and he could interpret more liberally the control criteria. As far as a substantial relaxation of controls is concerned, however, the consensus is that Congressional action would be required.

Part of the US legislative program of export controls is the Battle Act, which requires countries that are recipients of US aid to support our policies regarding the export of strategic goods to the USSR and its satellites. Under the terms of this act, only munitions,

atomic energy materials, and such non-military items that have direct strategic significance and might affect the security of the US are involved. As a practical matter the Battle Act covers fewer items than the US Positive List. Therefore, the GLSA list could be expanded to include all of the items available for export except those on the Positive List without interfering with Battle Act regulations.

B. Credit Restrictions

Under the terms of the Johnson Act of 1934, loans by private persons to countries that have defaulted on repayments of loans made by the US are prohibited. Because the USSR has refused to recognize the loan the US made principally to the Kerensky Government, which amounted to \$193 million in principal and on which about \$410 million in interest has accumulated, the Johnson Act is said to restrict US loans to the USSR.

The Johnson Act also is involved in the dispute between the US and the USSR over the amounts owed the US for certain lend-lease goods received by the USSR. There are three aspects of these lend-lease obligations: (1) the "pipe-line" purchases after V-J Day; (2) settlement for civilian-type lend-lease goods on hand in the USSR on V-J Day that would be useful during peacetime; and (3) disposition of lend-lease merchant ships and other watercraft still in Soviet custody.

The first derives from the fact that the USSR agreed to pay the US for lend-lease goods shipped to the USSR from the US after V-J Day

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an amount of \$222 million in 22 installments. The USSR has been making only partial payments on this account, and the accounting records of the US show an arrearage of nearly \$47 million as of 1 July 1962.

The second aspect of the lend-lease settlement relates to the

". . . approximately \$10.8 billion worth of lend-lease assistance furnished by the US to the Soviet Union up to V-J Day. In seeking a settlement of this lend-lease account of the Soviet Government, the United States had followed the basic principles and policies, previously described, which governed lend-lease settlements with other governments. The Soviet Government has been asked to pay the reasonable value of civilian-type lend-lease articles on hand in the Soviet Union at V-J Day which would be useful in peacetime. Since the U.S.S.R. did not provide an inventory of such articles, the United States prepared one which showed the value as \$2.6 billion.

"During the initial negotiations the United States in 1948 requested the U.S.S.R. to pay \$1.3 billion as the first step in the negotiating process. The Soviet Government had offered to pay \$170 million. During subsequent negotiations in 1951-52, the United States figure was reduced to \$800 million. In the interest of obtaining a prompt settlement, the United States indicated its readiness to reduce this sum further provided the Soviet Government increased its offer, which at the time was \$240 million, to a sum more nearly reflecting the value of the articles in the peacetime economy of the Soviet Union. The U.S.S.R. increased its offer to \$300 million. The United States did not consider this sum adequate and rejected the offer in 1952.

"At the request of the United States, negotiations were resumed on January 11, 1960. The United States proceeded on the understanding that the negotiations were to deal solely with a lend-lease settlement. When the discussions began, however, the Soviet Government insisted that a lend-lease settlement could not be considered as a separate and independent problem. It took the position that any settlement of lend-lease would have to be accompanied by the simultaneous conclusion of a trade agreement

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giving most-favored-nation treatment to the Soviet Union, and the granting by the United States of long-term credits on terms acceptable to the Soviet Union.

"During the negotiations the United States explained why it is not in a position to negotiate on either a bilateral trade agreement or the extension of long-term credits. It was pointed out that existing law prevents the granting of most-favored-nation treatment to the Soviet Union and that other laws and policies have an effect upon Soviet-United States trade. On the question of credits the United States took the position that legal and policy considerations made it impossible for the United States to discuss this matter in the lend-lease negotiations. The Soviet position remained unchanged.

"Under these circumstances there was no agreement on the terms of reference of the negotiations and there appeared to be no common ground for continuing the discussions at that time. The last meeting was held on January 27, 1960. The United States informed the Soviet Government that it is prepared to resume negotiations for an over-all lend-lease settlement at any time the Soviet Government is ready to negotiate on this as a separate and independent issue."*

The third aspect of the problem relates to the disposition to be made of 84 lend-lease merchant ships and 49 miscellaneous army and navy watercraft still in Soviet custody. The foregoing sums do not include settlement for any ships, since these were to be dealt with as a separate part of the over-all negotiations on the lend-lease material. As of this date no settlement offer for these ships has been received by the US from the USSR. Because an agreement has not been reached on the size of the Soviet indebtedness with respect to the

* Department of State, RD, Washington, D. C., October 1962.

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civilian goods and the ships, these are considered by the US Government to be "accounts" rather than defaulted obligations.

While the Johnson Act prohibits US private loans to countries in default on their debts to the US, a ruling of the Justice Department allows normal commercial credit, the time limit for which is considered to be six months. Despite this ruling, however, it is clear that as long as the Soviets are considered in default on their obligations, the Johnson Act will serve as a prohibition against the five-year credits that are being extended to the Soviets by Western European countries and Japan. Moreover, it is questionable, even if the Johnson Act no longer applied, whether substantial credit from private sources could be found for the USSR and Eastern Europe unless such credit were guaranteed in some way by the US Government. Guarantees of this kind have been worked out by the governments of some Western European countries and Japan, but the establishment of similar arrangements by the US would be likely to encounter formidable Congressional opposition unless there were a marked and tangible improvement in US-Soviet relations.

C. Inhibitions to Trade Resulting from Institutional Differences

Although the USSR prefers to conduct foreign trade under terms specified in trade agreements, the US does not usually sign the classic type of bilateral trade agreement in which lists of commodities to be exchanged are specified. The US prefers to sign multilateral treaties

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or agreements of friendship, commerce and navigation dealing through GATT of which the USSR is not a member. Under the broad powers granted to him by the Constitution, the President of the United States is believed to have the authority to negotiate an agreement with the Soviet Union to promote trade without referral to Congress. Treaties, however, must be referred to that body. In this agreement, the President may not, of course, violate any laws of the land. He could not, therefore, incorporate MFN treatment or the like to any communist country which is forbidden by Section 231 of the Trade Expansion Act of 1962.

The agreement thus entered could, however, stipulate conditions of trade and payment arrangements. It could also contain a commodity list or lists. The latter in effect would be a kind of a "hunting license" which would enable the Soviets to look for buyers and sellers in the US with assurance that US Federal Laws would not impinge on execution of the deals. The greatest value would be a guarantee that export licenses would be made available for certain questionable areas on the export side.

At the present time, the Office of Export Supply in the Department of Commerce, advises prospective exporters on a provisional basis only as to whether or not a license can be issued for a pending export to Iron Curtain destinations. A firm ruling is given only on the filing of a formal application which calls for a relatively firm

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order having been received. There have been cases where a considerable period of time has elapsed before a decision has been reached by the economic defense community on some borderline cases, the appeals extending as high as the Export Control Review Board and the President himself. Meantime the business may have been lost to foreign competitors. The elimination of this uncertainty would be welcomed by the US exporters as well as by the Soviet purchasers.

Although executive action could be taken to mitigate the effects of the several existing restrictions on US-USSR trade, the response of US industry is uncertain. Exports to the USSR would depend in the first instance on the profitability of specific deals. Even so, many US manufacturers would be reluctant to give the USSR access to equipment embodying advanced technology, fearing that the Soviets would choose to compete in third country markets. Others, discovering that US trade with the USSR has been sporadic and risky, might be reluctant to undertake the retooling and plant modification necessary to meet Soviet specifications. Finally, there is the vexing problem of how private companies deal with state trading monopolies. A private foreign firm seeking to market its products in the USSR cannot make direct contact with domestic consumers, producers, or distributors. Nor can it advertise, supervise the servicing of its products, or establish any of the local facilities conducive to the continuation of normal trade relations. These are conditions that will continue

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to retard the development of US-USSR trade and are immune from treatment by the US executive.

IV. Shipping Restrictions

Pursuant to the Shipping Act of 1960 no foreign country can charter a US ship without approval from the Maritime Commission. At present, the Commission's policy is to disapprove charters to the USSR. Without recourse to Congress, the Maritime Commission could change its policy and approve charters to the USSR, if they were applied for. Inasmuch as such countries as Greece, Norway, and the UK can operate their ships at lower costs than the US can, US rates are not competitive. Under these conditions there is no reason to expect any Soviet applications for the chartering of US vessels.

V. Conclusions

There appear to be a number of steps that could be taken by the administration to improve US-Soviet trade relations:

- a. Controls on the export of goods and technical data to the USSR could be eased.
- b. More liberal settlement terms of the various parts of the lend-lease debt and the Kerensky obligation could be granted.
- c. US Government approval of more extensive trade between the US and the USSR could be made more explicit.
- d. Ship charters to the USSR could be approved.

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We believe that changes in the administration of existing US legislation could be offered the USSR as one of a series of moves in a dynamic negotiating situation for which the USSR would, in turn, be willing to grant certain concessions. A change that would evolve toward important or major Soviet concessions would almost certainly at some stage require fundamental modification of discriminatory US trade legislation. The Soviet government is anxious to eliminate its own segregation within the international commercial community and to be integrated on the basis of equal treatment. It has had much experience at the bargaining table and would understand that the US administration could not request legislation from the Congress permitting MFN treatment to be accorded to the USSR until after partial trade liberalization had been acknowledged by the USSR as worthy of a quid pro quo.

We do not believe that these actions by the US Government would result in any substantial increase in US-Soviet trade. If the administration and the Congress were to take all of these actions, and if a trade agreement including MFN provisions were concluded, we can conceive of US exports to the USSR rising only to a level between \$100 and \$200 million annually over the next few years. The USSR particularly could be expected to expand its purchases of technologically advanced machinery and equipment. While the Soviet Union may not be able to

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export commodities to the US in sufficient value to balance its account, it could make up the difference by re-exports, transfers of convertible currency, and by selling more gold to the Free World.

ORR/CIA

20 August 1963

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