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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence

Western Competition for Soviet Contracts

ER IB 73-7
July 1973

Copy No. 71

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Automatically declassified on
Date Impossible to Determine

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WESTERN COMPETITION FOR SOVIET CONTRACTS

Summary

The USSR has long been interested in acquiring advanced equipment and technology produced in the United States. Purchases, however, have been limited in part by the poor state of US-Soviet relations, high prices, lack of competitive credits, restrictions on trade with the USSR, and other factors. Prior to 1972 the US share of Soviet contracts for Western plant and equipment was 5% or less. With the warming of US-Soviet relations, the relaxation of export controls, the granting of Eximbank credits, and the devaluation of the dollar, US firms have signed a number of Soviet contracts. The current US share is now about 20%.

US firms now have become sufficiently competitive in price and credit so that such factors as technology, know-how, and scale of operation -- areas where US firms often have a clear-cut advantage -- have been a deciding factor in some contracts. The ability of US firms to meet specified delivery dates and the willingness of firms to undertake turnkey projects and provide performance guarantees also have been important considerations in acquiring contracts.

Some US firms have lost contracts because of their unfamiliarity with Soviet trading practices and often have been deterred from doing business with the USSR because of limited knowledge of import requirements. By the same token the Soviets are unfamiliar with US capabilities and have tended to turn to traditional European and Japanese suppliers. These impediments should be largely overcome with increased US-Soviet commercial contacts, and the traditional Soviet tendency toward repeat purchases will serve to bolster US exports to the USSR in the long run.

Note: Comments and queries regarding this publication are welcomed. [redacted]

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Discussion

Introduction

1. Since the beginning of 1972, US firms have obtained roughly 20% of Soviet contracts for Western plant and equipment. The performance of US firms is in marked contrast to earlier years when the US share usually was 5% or less. This publication discusses the factors explaining the recent successes and failures of US firms in competing for Soviet contracts and the various elements involved in such competition, including Soviet methods in bargaining with foreign suppliers.

Background

2. The failure of US firms to capture a greater share of the Soviet market in the past was largely a function of the state of US-Soviet relations. As a consequence, US firms showed little interest in competing for Soviet orders. At the same time, restrictive US export controls, inadequate credit facilities, and other US restrictions combined to limit the USSR's ability and desire to purchase goods from the United States. As a result, US sales were made largely through foreign-based subsidiaries, and direct Soviet purchases from the United States were limited to those items such as large tractors, chemical processes, mining machinery, and other equipment where no foreign substitutes were available.

3. With the recent warming of relations between the two countries, a relaxation of export controls and credit restrictions, and the lower international prices of US goods, US firms have obtained a far greater share of Soviet orders. Of total foreign purchases (approximately US $3 billion), the USSR has placed $600 million in contracts with US companies since the beginning of 1972 (see the table), making the United States second only to West Germany as the major Soviet source of Western technology and equipment. Soviet orders related to the USSR's automotive industry have been particularly significant, but other sectors of the Soviet economy will also be receiving large quantities of US equipment.

Soviet Orders of US Plant and Equipment
January 1972 - June 1973

Date	Description	Million US $
Total		601
Feb 1972	Gear cutting machines for Kama	12
Jun 1972	Transfer lines for Gor'kiy	21
Oct 1972	Electric arc furnances for Kama	16
Fall 1972	Heat treating equipment for Kama	13
Fall 1972	Conveyor design for ZIL	10
Fall 1972	Equipment to produce cylinder blocks for Kama	21
Fall 1972	Equipment to produce brake drums at ZIL	12
Jan 1973	Automatic moulding lines for Kama	30
Feb 1973	Brake drum production equipment for Kama	13
Mar 1973	Gas-fired furnaces for Kama	13
Apr 1973	Truck assembly conveyor system	13
Aug 1972	Crawler tractors and equipment	40
Oct 1972	Coil coating technology	12
Oct 1972	Crawler tractors and pipelayers	68
Dec 1972	Conveyor systems for handling grain	38
Jan 1973	Oil pumping units	26
Apr 1973	Tableware plants	30
Apr 1973	Equipment to produce bicycles and motorcycles	24
Jun 1973	Gas compressors	25
Miscellaneous orders (75)		164

Soviet Modus Operandi

4. The most difficult hurdle for US and other foreign suppliers to overcome is the Soviet bureaucracy. Soviet foreign trade organizations (FTOs) have sole responsibility for effecting all Soviet purchases of Western technology and equipment, and their personnel are skilled negotiators. They are concerned with obtaining the desired equipment at the most attractive terms -- performance, price, credit, delivery, etc. The bureaucratic nature of the Soviet decisionmaking process and the ability of the USSR to plan its imports of capital goods well in advance enable the Soviets to conduct lengthy negotiations, thus improving their chances of maximizing concessions from the potential supplier.

5. In choosing potential suppliers, the FTO is strongly influenced by previous dealings with Western firms whose performance has been satisfactory, but it will also solicit bids from other firms known to have the capability of supplying the equipment in question. Representatives of both the responsible FTO and the end user assess the technical merits of individual proposals. The FTO, however, has the final responsibility for the successful conclusion of the negotiations and must convince higher authorities that it has obtained the best possible deal.

6. Although the Soviets know a great deal about the capabilities of many Western firms, they are less sure of their needs when negotiating for complete plants or complex production lines. To overcome this unfamiliarity and better understand the options open to them, the Soviets require competing Western firms to submit complex bids providing detailed descriptions of proposed engineering processes, plant layouts, and required capital equipment. The Soviets may then require competing firms to resubmit their proposals based on revised Soviet specifications which incorporate the best features of the original bids. These new proposals may in turn be used as a basis for new specifications as the Soviets seek to refine their requirements further.

7. Soviet demands for detailed proposals, and the lengthy negotiations which characteristically follow, allow Soviet negotiators to document their decisions in detail. Moreover, the Soviets usually attempt to place the maximum degree of responsibility on the Western supplier by including performance guarantees in the contract where appropriate. The willingness of a Western firm to enter into such an agreement may prove to be the deciding factor in the actual contract award, particularly when the Soviets are unfamiliar with the process and equipment being purchased and the possibility of failure is most pronounced.

8. Price is clearly a major consideration in placing orders. Even if the Soviets have a preference for a particular supplier, they may still seek competing bids as a means of putting pressure on the desired firm to lower its own bid. In order to obtain the lowest price possible, the Soviets have also been known to quote the exact prices offered by competing firms, including those of firms offering a lower quality product. A US firm recently won a Soviet contract after rebidding below foreign competitors whose initial bids had been lower than its own. The Soviets have even gone so far as to attempt to elicit competition between US firms and their foreign subsidiaries. A fear of failure influences Soviet price negotiations. Fear of being second guessed by superiors will lead Soviet negotiators to drive contract prices downward until the Western representative actually walks away from the table rather than accede to further price reductions.

9. The Soviets often attempt to minimize the hard currency costs of equipment and technology by proposing some type of barter. Such deals may involve a direct swap of Soviet for Western products, or part payment in Soviet products. Soviet purchases are sometimes made contingent upon Western acceptance of goods which will be produced using the Western plant and equipment whose purchase is being negotiated. Although the USSR can usually be counted on to propose such agreements, Western acceptance is often less crucial to the winning of the contract than for many East European countries, for which hard currency constraints have often necessitated a far greater reliance on such transactions.

10. Credit is often an important element in Soviet decisions to buy, and as a result the Soviets have made a determined effort to insure the availability of long-term credits at competitive rates. The Soviets have applied considerable pressure on Western governments to provide such credits, either through direct intergovernmental negotiations or indirectly via firms competing for Soviet orders. The USSR has been successful in using such tactics to obtain sizable long-term credits at favorable rates from all its major Western suppliers.

US Competitiveness

11. Several major factors underlie the recent success of US firms in competition for Soviet orders. The availability of competitive credits and the increased US price competitiveness resulting from the devalued dollar have proved to be important to US companies' successes. The ability of US firms to offer competitive terms, credits, and prices has allowed the USSR to place contracts on the basis of other factors -- know-how, technology, and delivery -- where US firms often have an edge. US firms have suffered, however, from their long absence from the Soviet market. To a large extent, US companies represent an unknown quantity to Soviet buyers and are at a disadvantage with respect to the USSR's traditional suppliers. For their part, some US firms undoubtedly have been deterred by their unfamiliarity with the Soviet bargaining process and the prospect of lengthy negotiations. The following paragraphs examine those factors which proved to be most crucial in the winning of Soviet orders. A discussion of negotiations for specific contracts in contained in the Appendix.

Credits

12. To date the US Export-Import Bank and US commercial banks have together agreed to advance roughly $1 billion in long-term credits to the USSR in support of Soviet purchases of US machinery and equipment. In addition, earlier in 1972 US commercial banks provided more than $100 million without Eximbank participation to cover Soviet purchases of US tractors and pipelayers. Given the current Soviet hard currency requirements associated with

recent massive grain imports, it seems certain that in the absence of such credit facilities Soviet purchases from the United States would have been limited to technology and equipment unobtainable elsewhere. In the case of the Kama truck plant, the Soviets might have limited US purchases in the main to technology and know-how while procuring the majority of the machinery and equipment from other countries. Several contracts signed by the USSR -- those for tableware plants for example -- have in fact been made contingent upon Eximbank credit. For most contracts, the interest rate on Eximbank guaranteed credits approximates those available in Western Europe and Japan, but the length of US credits made them particularly attractive. Immediately following the US announcement of 12-year credits with two-year repayment deferments for Kama purchases, the Soviet negotiators discussing the purchase of equipment for a large fastener plant told the US firm involved that all imported equipment should be of US origin, as opposed to the smaller percentage decided upon earlier.

Prices

13. Between mid-December 1971 and 1 July 1973, the US dollar has been effectively devalued by approximately 16% and 38% against the Japanese and West German currencies, respectively. This has greatly reduced the price disadvantage US firms faced earlier and has permitted Soviet decisions to buy to turn on other factors -- technology, know-how, performance guarantees, etc. -- as in the contracts for the tableware plants and the heavy-duty tractors. Alternatively, US bids for the $125 million Kama transmission plant and a $40 million paint line for Kama were competitive in price, and the US firms' failures were based upon other considerations.

Scale

14. The productive capacity of US firms has also proved to be a decisive factor in obtaining several Soviet orders. In early 1973, for example, a US firm received a $26 million contract for 500 oil well pumps. The Soviets tried to drive down prices, but the US firm was well aware that other

Western firms could not meet the delivery dates. The Soviets probably would have purchased these pumps on a cash basis if necessary. Similarly, the ability of US firms to produce the number and type of tractors and pipelaying equipment desired by the USSR probably outweighed other considerations.

Technology and Know-How

15. The USSR traditionally has given high marks to US technology. US superiority led to US firms gaining several important Soviet orders and undoubtedly played a role in almost all contract negotiations. Technological superiority was the critical factor behind Soviet purchases of gear cutting machinery from the US Gleason Corporation, which holds a worldwide monopoly over the production of the type of equipment required by the USSR. Similarly, the level of technology was the overriding consideration enabling Swindell-Dressler to capture the engineering and design contract for the Kama foundry. US suppliers have been chosen for virtually all the equipment for the foundry. The Soviets apparently believe that to ensure that the foundry performs to the same high standards of the Swindell-Dressler designed foundry at Ford, the same suppliers should provide the equipment for Kama.

Turnkey Processes and Performance Guarantees

16. The Soviets are often anxious to obtain performance guarantees as part of the purchase of complex equipment lines and/or plants from the West, particularly when they themselves have little or no knowledge concerning the processes and equipment being imported. The success of two US firms in winning Soviet contracts can be traced in part to their willingness to conclude contracts on a turnkey basis, including the requested performance guarantees. In the case of the tableware plants, [redacted] competitors offered similar equipment at prices lower than those of the US firm, but the US firm was able to obtain the Soviet order because it alone was willing to provide the plant on a turnkey basis and to give appropriate performance guarantees. Similarly, a major US engineering firm seems certain to obtain a major Soviet order

for a complete fastener plant, largely because it is willing to guarantee the plant's initial operation.

Previous Lack of US-Soviet Commercial Ties

17. The major disadvantage faced by US firms has been the lack of previous US-Soviet commercial ties. Soviet buyers, familiar with the ability of West European [redacted] [redacted] suppliers to meet their needs, are less certain about US firms. Several US contracts were obtained only as a result of chance meetings with the proper Soviet officials. A US firm, for example, was able to arrange for the Kama purchasing commission to take an unscheduled tour of its production facilities. The Soviets had not planned to include the US firm in the contract bidding, but were impressed with the firm's capability and invited the company to bid on some $30 million to $40 million in press lines for Kama.

18. On the other hand, a US firm lost a $40 million contract to supply paint line equipment for Kama to a French firm which had previously supplied similar equipment to other Soviet automotive plants. This lack of familiarity also contributed to a US firm's failure to obtain a $125 million Soviet contract for the Kama transmission plant. The US firm did not help its case, however, when it refused to incur additional costs in providing supplementary technical specifications without an assurance that it would receive the contract. Not even the offer to take copper in partial repayment was sufficient for the Soviets, who wanted iron-clad assurances that the very large hard currency outlay would result in a transmission plant that would fulfill Soviet requirements and perform satisfactorily.

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APPENDIX

Case Studies of US Competitiveness

The individual experiences of several US companies in dealing with the Soviets are examined in this Appendix. Particular attention is paid to US advantages and disadvantages in light of the Soviet decisionmaking process.

Fastener Plant

In early 1968 the Soviet FTO Stankoimport contacted several Western firms to discuss the possible turnkey construction of a $125 million fastener plant to support Soviet production of agricultural equipment. A major US engineering firm was contacted, largely as a result of a suggestion made in Moscow by an agent of the US firm's European subsidiary. By 1972, after having incurred more than $200,000 in preparation costs for the technical and commercial proposals required by the USSR, the US company was the only Western firm still in contention for the order. A letter of intent was signed in November 1972, and a protocol was signed in March 1973 calling for the signing of a firm contract by mid-June.

The negotiations for the fastener plant were prolonged by Soviet indecision about the size of the plant and the availability of hard currency. Present plans seem to call for the plant to be built according to the original specifications, but with some modifications. The Soviets probably will use domestically produced equipment where possible and may spread out the hard currency costs by equipping the plant in stages. The March protocol stated that total hard currency expenditures would be limited to $50 million, of which $15 million to $20 million will go to the US firm for engineering and related services. The Soviets originally planned to buy some of the equipment in Europe [redacted] but following the announcement of 12-year Eximbank credits for the Kama plant, the Soviets told the US firm that they wished to purchase all of the required equipment in the United States.

The US firm's initial decision to become involved in such prolonged and costly negotiations was based, in part, on a Soviet promise to cover proposal costs by concluding other contracts in the event that the firm did not win the contract for the fastener plant. The USSR has had difficulty in operating its fastener plant at Tol'yatti, and Stankoimport representatives were particularly anxious to saddle the US firm with the responsibility for putting the proposed plant into operation and guaranteeing plant performance. The willingness of the US firm to accept this responsibility and thus agree to a turnkey arrangement -- even with some Soviet-supplied equipment -- evidently was one of the deciding factors in awarding the contract.

Tractors and Pipelayers

The 1972 Soviet purchase of $40 million worth of crawler tractors and equipment from International Harvester, and $68 million worth of crawler tractors and pipelayers from Caterpillar, is attributable largely to the dominant position of these firms in the construction of this type of equipment. In addition, the Soviets are familiar with Caterpillar equipment, having previously purchased $40 million worth of pipelayers and other equipment in 1970 as part of the West German - Soviet pipe-for-gas deal. The Soviets considered a major [redacted] firm, which had made substantial sales to the USSR in the past, but the [redacted] firm was still developing large tractor-pipelayers and the Soviets were unwilling to purchase the smaller machines offered.

The Soviet decision to buy in the United States was also based in part on the availability of financing offered by US commercial banks at attractive rates. The Caterpillar contract is being financed by a consortium of 13 US banks headed by Bank of America. The USSR will pay 10% down and repay the balance over seven and one-half years at 6% interest. The Caterpillar contract also included an 18-month moratorium on payment. The financial arrangements of the $40 million purchase from International Harvester are unknown.

Oil Pumps

In early 1972 a US firm received inquiries from the FTO Machinoimport for 15 submersible oil well pumps. As negotiations progressed, with the Soviets apparently trying to assure themselves of the competence of the US firm, their requests were raised to 60, 300, and finally to 500 pumps late in 1972. Once serious negotiations began, a final contract was reached in January 1973 for 500 pumps to be delivered over the ensuing 12 months. The Soviet purchase, valued at $26 million, is being financed jointly by the Eximbank (45%) and a consortium of seven US banks (45%). The Soviets will pay 10% down, with the balance paid over seven years at 6.25% to 6.50% interest.

Negotiations were complicated by Soviet attempts to drive down the price and the reluctance of the USSR to provide the data (some of which was ultimately provided) required to make a bid. The US firm was aware, however, that no other Western firm could supply the USSR with 500 pumps within a 12-month period, and consequently had a strong bargaining position. The availability of Eximbank credits may have helped, but the Soviets probably were prepared to pay cash.

Transmission Plant

In early 1972 the Soviets initiated negotiations with several firms -- Volvo, Mitsubishi, Liebherr, Textron, and Bendix -- for the turnkey construction of a large transmission plant for the Kama plant. Representatives of the FTO Avtopromimport informed the bidders that technical quality assurances and performance guarantees were to be stressed over cost in the actual award of the contract. Following several months of negotiations with these various firms, the contract was awarded to a consortium of West German firms headed by Liebherr. The $125 million contract will be financed by seven-year credits at 6.25% interest.

[redacted] Given the availability of Eximbank financing, the US firm could have offered the Soviets equal

[redacted]

Tableware Plants

The USSR began soliciting bids for the turnkey construction of tableware plants during 1971, and quotations were apparently initially restricted to [redacted] US involvement in [redacted] a fact-finding mission of a US industrial association that visited Moscow in the fall of 1971. Having received an invitation to bid as a result of this mission, a New York firm, Alliance, has since concluded contracts with the FTO Stankoimport for a $7 million stainless steel flatware plant and a $23 million holloware plant. Alliance will provide engineering, design, and equipment, some of the latter to be acquired from US subcontractors.

Initial Soviet uncertainty as to the ability of Alliance to handle the turnkey project was overcome following a Soviet visit to US plants that used Alliance's equipment and technology.

Stankoimport representatives were anxious to obtain a highly automated state-of-the-art plant on a turnkey basis, and the firm's success in obtaining the contracts was due in large measure to its willingness and ability to meet Soviet requests. The US firm's bid -- which specified US equipment only -- for the hollowware plant was significantly higher than those made by the [redacted] competitors. [redacted] US Eximbank and private financing were also a factor in the US firm's success, as the Soviets made both contracts contingent upon receiving long-term credits.

Press Lines

During 1971 the USSR solicited bids from several Western firms for forging lines for the Kama plant. Although a major US firm was not among those firms originally scheduled to receive a solicitation, officials of the FTO Avtopromimport were impressed with a May 1971 tour of the firm's plant and later requested it to bid on the press lines. The scope of the US company's potential participation grew to include several press lines, and in February 1972 a protocol was signed calling for Soviet purchases of $30 million to $40 million in equipment. The final contract, signed in May 1972, provided for only $1.6 million; the balance of the order -- $33 million -- was awarded to a [redacted] firm in January 1973.

The Soviet decision to award the contracts to the [redacted] firm occurred as a result of the US company's withdrawal from negotiations in late 1972. While the US firm felt that the Soviet contracts would be profitable to the firm, its parent company apparently decided to withdraw from negotiations in the face of a marked increased in domestic orders for the firm's equipment during the latter half of 1972. The Soviets, in fact, were angered over the US firm's withdrawal, and parried an attempt by the US company to cancel the $1.6 million order by threatening to blacklist all the parent firm's products from the USSR.

<u>Other</u>

A number of other contracts have been won by US firms, including a few for the Kama plant. Superior technology embodied in an automated Ford foundry designed by Swindell-Dressler earned a contract for that engineering firm to design and engineer the Kama foundry. The USSR placed roughly $90 million in equipment orders with the US firms that supplied equipment for the Ford foundry. The level of the technology and the ability of the vendors to install the equipment quickly were among the deciding factors in the award of contracts.

Many US companies may have lost out in bidding for contracts because the Soviets were not familiar with their competence. Thus, a US firm lost out to Renault on a $40 million contract for Kama plant paint lines. The two bids appeared close on price, but the USSR previously had bought similar equipment from a Renault subcontractor for other motor vehicle plants and apparently opted for the proven product and supplier. In another recent case a US company lost out on a lucrative contract to a [redacted] firm, in part because of Soviet uncertainty about the ability of the US company to do the job adequately. Apparently, [redacted] governmental assistance helped the company's case.

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