

USSR: THE ROLE OF FOREIGN TRADE IN THE ECONOMY

Foreign trade plays an important, albeit not critical, role in Soviet economic development. Although the Soviet economy is largely self-sufficient--purchases from abroad account for only about 10 percent of GNP--imports have helped Moscow improve consumption, boost productivity, remove industrial bottlenecks, and modernize weapon systems.

East-Versus West as a Source of Imports

The USSR has traditionally favored its Communist allies in its foreign trade.

- o About 65 percent of the USSR's machinery and equipment imports come from its Communist allies, mostly the East European countries.
- o These imports represent nearly half of all Soviet purchases from Communist countries. (See Figure 1)

Although East European machinery and equipment is often of lower quality than Western equipment, it is equal to or better than Soviet produced goods in many instances. The USSR also looks to Communist countries for manufactured consumer goods to supplement its own production. More than half of such imports -- primarily clothing and furniture-- are purchased in Eastern Europe.

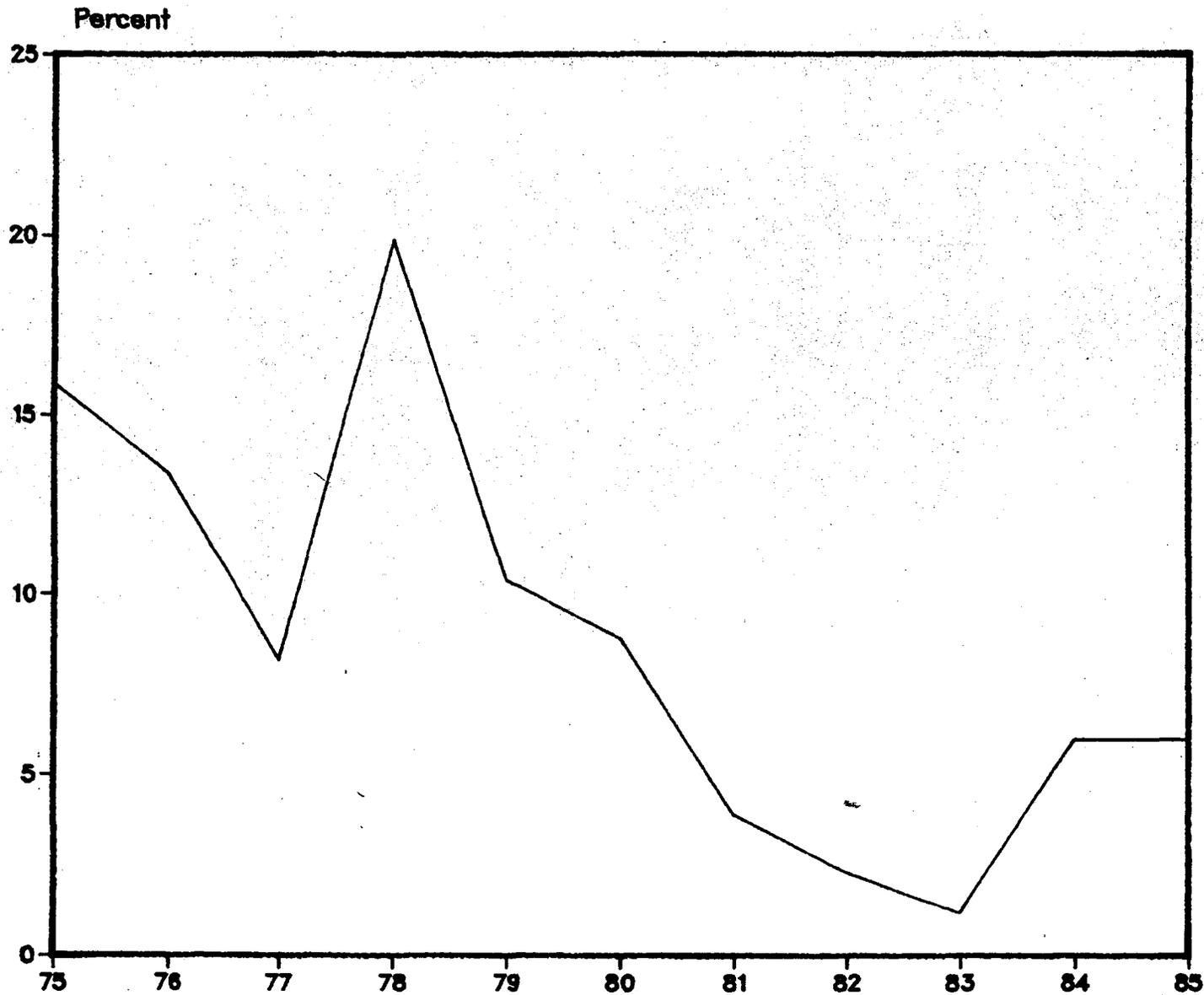
While relying on Eastern Europe for much of its machinery and equipment needs, imports of Western technology and equipment have been essential to expand selected Soviet industries (e.g. chemicals and automobiles), despite difficulties in assimilation.

- o Imported chemical equipment in the 1970s was largely responsible for a doubling in the output of ammonia, nitrogen fertilizer, and plastics during this period.
- o Construction of the Kama river truck plant, which is based almost exclusively on Western equipment and technology, has resulted in a roughly 100 percent increase in Soviet heavy truck output over the past decade.

Imports from the West also have played a key role in supporting the energy sector.

- o The rapid construction of the Siberia-to-Western Europe gas pipeline would not have been possible without purchases of Western turbines, compressors and pipe.

US Share of Soviet Equipment Orders, 1975-85



The value for 1985 based on first half data.

- o Deficiencies in Soviet drilling, pumping, and exploration have prompted Moscow to purchase almost \$20 billion in oil and gas equipment since 1975.

Imports of grain and other agricultural products have been the largest component of the USSR's western trade. A series of mediocre harvests during 1981-84 has pushed agricultural imports to record levels -- with average annual purchases of some \$10 billion during this period. Because of the limited ability of Communist countries to expand grain production, Moscow has had to rely almost entirely on Western countries to fill the gap between domestic output and requirements.

Finally, in addition to contributing to specific industrial sectors and overall consumer well-being, acquisition of gas and technology from the West has enhanced Soviet military programs.

- o Access to specific technologies has permitted improvements in a number of weapon and military support systems.
- o Gains from trade, in general, have improved the efficiency of the economy and thereby reduced the burden of defense.

Composition of Soviet Exports

In contrast to its imports, Soviet exports are composed mostly of raw materials, particularly energy. This concentration of trade has become particularly prominent since the mid-1970s as a result of rapidly rising fuel prices. By 1983, 70 percent of total Soviet exports to non-Communist countries and 50 percent of exports to Communist countries consisted of fuel shipments. (See Figure 2). Although arms exports to non-Communist countries are not specified in Soviet trade statistics, we estimate that this trade accounted for some 15 percent of total Soviet exports in 1983. Only 5 percent of Soviet exports are agricultural goods.

Soviet Trade With the Third World

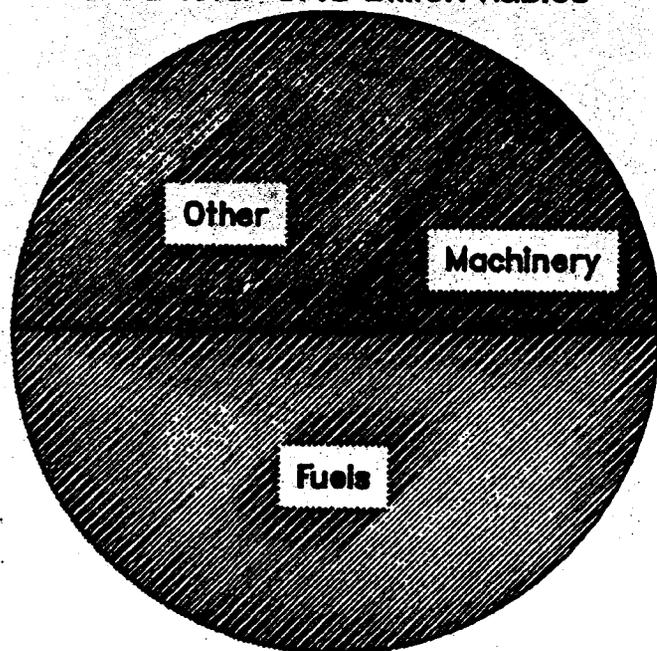
Unlike Soviet trade with the developed West, which is essentially an exchange of Soviet industrial raw materials for technology and agricultural products, Soviet-LDC trade consists of an exchange of Soviet manufactures--mainly military supplies--for industrial and agricultural raw materials. The LDCs represent Moscow's only major outlet outside the Bloc for exports of civilian and military manufactures.

Soviet military exports are the largest and most dynamic element in LDC trade. Such exports totaled over \$9 billion in 1982 and 1983, an amount equal to almost 70 percent of

Soviet Exports by Commodity, 1983

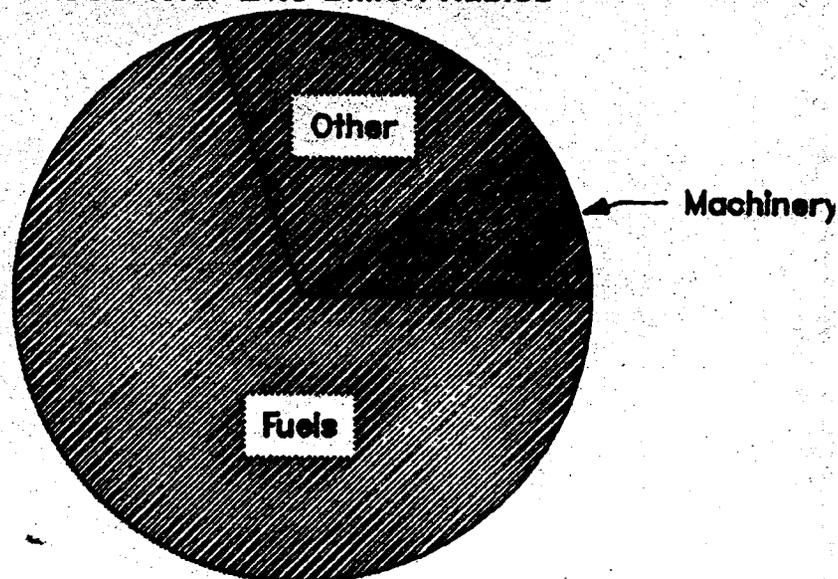
Communist Countries

1983 Total=37.8 Billion Rubles



Non-Communist Countries

1983 Total=24.9 Billion Rubles



Other includes ferrous metals, agricultural products, consumer goods and military trade.

total Soviet exports to the LDCs. The military sales program offers Moscow substantial benefits:

- o It is a major tool for establishing Soviet presence and expanding influence in LDCs.
- o It provides Moscow with one of the few export opportunities in which Soviet-manufactured goods are somewhat competitive in price and quality with Western products.
- o After credits and payments reschedulings are netted out, it generates perhaps \$5-6 billion per year in hard currency revenues or their equivalent.

US-Soviet Trade

With the exception of agricultural imports, Soviet trade with the US has been relatively small. The US did participate in the expansion in commercial relations that accompanied East-West detente in the 1970s.

- o US exports to the USSR totaled only \$100 million in 1970, or less than 5 percent of Soviet hard currency imports.
- o By 1979, US sales totaled \$3.8 billion, nearly 20 percent of hard currency purchases. (See Figure 3)

Following the sanctions imposed in the wake of Soviet intervention in Afghanistan and imposition of martial law in Poland, US-Soviet trade dwindled. US machinery and equipment sales suffered the most, plunging from a peak share of 20 percent of Soviet orders in 1978 to only one percent in 1983. Despite the partial grain embargo from January 1980 to April 1981, US-Soviet agricultural trade did not decline nearly as much. Although the Soviets have increasingly diversified their sources of grain supplies, the US, as the largest and most stable exporter of grain, remains an important source for Moscow.

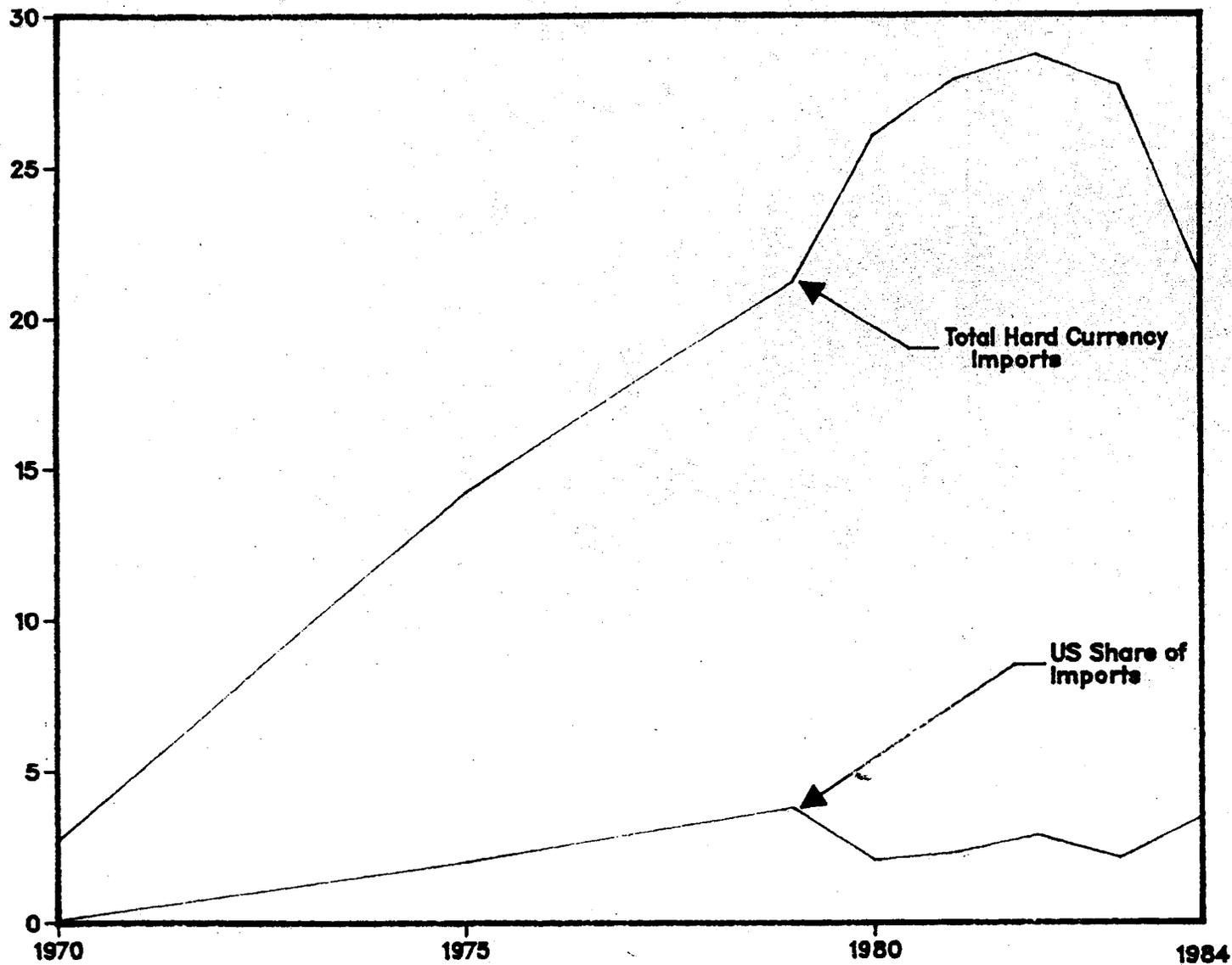
- o The USSR continues to be the single largest buyer of grain from the US.
- o During the 1984-85 market year, Soviet purchases of grain reached a record 22.7 million metric tons.

Foreign Trade Under Gorbachev

Since taking over as General Secretary in March, Gorbachev has made it clear that improved economic performance is his top priority. His plan focuses on modernizing the industrial base with more and better machinery--a

USSR: Imports from the United States, 1970-84

Billion Current US Dollars



strategy which could lead to an increased role in both Eastern Europe and the West.

Gorbachev is undoubtedly hoping for an increase in the flow of machinery from Eastern Europe and has spoken about the need for broader and tighter intergration within CEMA. While such rhetoric is not new--the USSR has long advocated joint production and specialization within CEMA as a means of getting the East Europeans to cough-up more--Moscow seems more intent than ever on pressing its allies to make firm commitments on this issue. In this regard,

- o An agreement signed by CEMA Prime Ministers in June pledged multilateral cooperation in designing and producing computer controlled systems.
- o The agreement follows a recent call in Pravda for a 50-100 percent increase in the rate of growth in machine-building in CEMA countries during 1986-90.

Moscow is probably limited in just how much it can get from its allies. Because most East European countries are constrained by their own resource and economic difficulties, any sharp increase in machinery exports to the USSR would have to come at the expense of much needed domestic investment or sales to the West that bring in hard currency. Such a shift would risk undermining growth prospects throughout the area which could cause serious political problems.

The limited prospects for sharply boosting imports from Eastern Europe increases Moscow's incentive to trade with the West. In particular, Gorbachev probably will look to the West for imports of technology and equipment for selected sectors--energy and electronics, for example -- where no good supply alternatives exist. Moreover, Moscow is presently in a good financial position to increase its purchases of Western machinery and equipment -- at least in the near-term.

- o With a relatively small debt and approximately \$10 billion in assets in Western banks at year-end 1984, Moscow can easily obtain commercial credits to finance new purchases.
- o Most West European countries are also offering generous terms on government-backed credits in an effort to balance trade with the Soviets and spur their own economies.

Over the longer term, however, Moscow's financial position is much less certain -- falling world prices for oil and declining domestic production could limit Soviet hard currency earning capacity.

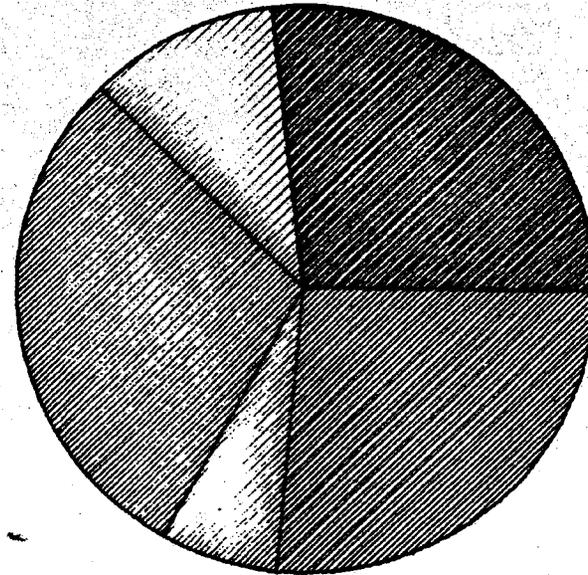
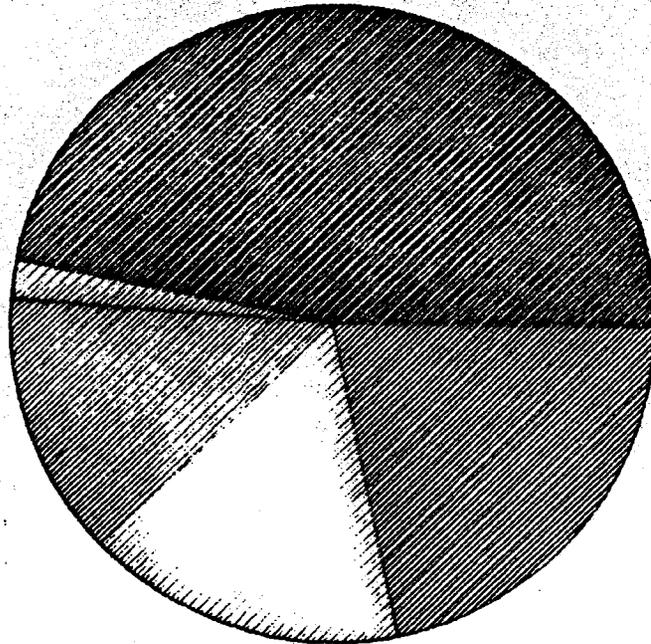
Soviet Imports by Commodity, 1983

Communist Countries

Non-Communist Countries

1983 Total=33.7 Billion Rubles

1983 Total=25.7 Billion Rubles



-  Machinery
-  Ferrous Metals
-  Agricultural
-  Consumer Goods
-  Other

Looking to the US

Prospects for an expansion of Soviet purchases of US machinery and equipment appear good -- albeit from the extremely low levels of recent years. The share of machinery and equipment orders going to the US during first quarter 1985 -- 10 percent -- is substantially above last year's 6 percent figure and, if maintained, would be the highest since 1979 (See Figure 4). Moreover, the US-Soviet Joint Commercial Commission talks in May 1985 produced a Soviet pledge to:

- o Try to do more business with US firms.
- o Put interested US firms on bidders' lists.
- o Fully consider US proposals on their economic merit.

In this regard, we have seen an improved tenor in US-Soviet contract negotiations since the beginning of the year. The Soviets are currently discussing major deals with US firms for the sale of personal computers, energy equipment, and agricultural technology. Although these negotiations may be protracted, some signings appear likely.

Nevertheless, the vast majority of Soviet purchases from the US will continue to be agricultural products. Under the current long-term US-Soviet grain agreement (which expires in 1988), Moscow is committed to purchase a minimum of 8-9 million tons of grain per year, with a value of roughly \$1 billion at current world prices. In poor crop years, Soviet purchases can be expected to be much larger.

Prepared by:

CIA