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Soviet Joint Ventures With the West: Much Talk, Little Action

An Intelligence Assessment

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November 1987

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Soviet Joint Ventures With the West: Much Talk, Little Action

An Intelligence Assessment

This paper was prepared by , Office of Soviet Analysis, with contributions from

, Office of East Asian Analysis;
., Office of European Analysis.

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, SOVA,

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Soviet Joint Ventures With the West: Much Talk, Little Action

Key Judgments

Information available as of 20 October 1987 was used in this report.

The Soviet leadership has pushed aggressively during the past year for the establishment of joint ventures with Western firms. We believe that Moscow sees such arrangements as a better vehicle than current trade and economic relationships for acquiring and assimilating Western technology, managerial expertise, and marketing skills. As part of General Secretary Gorbachev's modernization drive, joint ventures are intended to upgrade Soviet production processes and thus spur exports of manufactured goods, reducing Moscow's reliance on energy and other raw materials as its principal foreign exchange earners.

Progress has been slow, however, with nine agreements concluded since the legislation on joint ventures took effect on 1 January. The largest stumblingblock remains the inherent conflict between Soviet and Western commercial objectives. Official Soviet statements and key provisions in the legislation make it clear that Moscow's first priority for joint ventures is to earn hard currency through exports. Western businessmen, on the other hand, are more eager to tap a potentially lucrative Soviet domestic market than to help the USSR become a world-class exporter of manufactured goods who will compete with their own foreign sales. Soviet inexperience with many Western business concepts, coupled with vagueness in the legislation regarding key issues such as management control, profit repatriation, and input supplies, is further impeding progress.

The failure of Western firms to jump on the joint-venture bandwagon appears to be giving Moscow second thoughts about the concept. the Soviets are now planning to conclude only 20 to 25 projects during the first year or two and then impose a temporary moratorium on signings. They hope to use the breathing space to ensure the success of those projects already under way and to review and change the regulations as needed

We believe that the limited number of joint ventures likely to be in operation within the next two years will not have much impact on Soviet hard currency earnings or the quality of domestic production. Most of the deals concluded or close to signing appear to be relatively small endeavors, involving simple production processes, low-level technology, and little foreign capital. Indeed, the Soviet leadership may find itself returning to more conventional economic arrangements such as compensation and coproduction deals that it has largely ignored since the decree was issued.

Some joint ventures will be formed with US companies, but West European and Japanese firms appear to have the upper hand for the bulk of deals that are likely to be struck in the near term. US firms remain at a disadvantage in negotiating with the Soviets because Moscow perceives US firms as vulnerable to government-imposed trade sanctions. Moreover, non-US firms usually can offer the Soviets comparable equipment and technology and have the added advantage of access to government-backed insurance and credits. (

Over the longer term, Moscow stands to reap some benefits from even a small number of joint ventures. The close interaction between Western managers and laborers and their Soviet counterparts afforded by joint ventures will familiarize more Soviets with Western production practices and marketing techniques. These improved skills and work habits will be diffused to other Soviet industries in time, as Soviet personnel move on from their joint-venture assignments. How far and how fast this occurs, however, will hinge largely on the progress Moscow makes with its ambitious domestic economic reform package, not on the number of joint ventures in hand. Finally, joint-venture arrangements with reputable Western firms will probably provide the Soviets access to new foreign markets, albeit on a smaller scale than currently envisioned by Moscow.

We believe that the transfer of high technology will probably not be a problem for the West in the near term, but it could become one further down the road, especially if the first few joint ventures are successful. If competition develops among Western firms to form joint ventures, Moscow would be in a position to exert more pressure on them to ante up high technology to secure a place in the Soviet market. Moreover, a growing number of joint ventures—even those not requiring high technology—expands the opportunities for the recruitment of Westerners with access to such technology.

Contents

Scope Note

The USSR has embarked on a wide-ranging campaign to increase its role in international economic affairs.

This paper examines in more detail the issue of Soviet joint ventures with Western firms, the initiative that has sparked the most interest in the West. Indeed, such ventures have been the major subject of discussion at several East-West trade conferences and at a NATO meeting. This paper examines Soviet motives and Western concerns, the status of joint-venture negotiations, the likely impact of these projects on the Soviet economy, and the potential for technology transfer. Although this topic has been given wide coverage in both the Soviet and Western press, information on the terms of individual projects is sketchy because Moscow stresses confidentiality to strike the best deal possible on each contract. In addition, we have little information on how the Soviets may be planning to use joint ventures for acquiring technology, either legally or illegally.[1]

[1]

Soviet Joint Ventures With the West: Much Talk, Little Action (

Joint ventures are the logical last link in a chain. They have not developed suddenly but have emerged as a logical consequence from the cooperation between Soviet state enterprises and Western enterprises.

From an interview with Yuriy Dremov, chief of the Ministry of Foreign Trade's Main Engineering and Technical Administration, Austrian broadcast, 5 May 1987

Joint Ventures in Perspective

"Joint ventures" has become the buzzword among Soviet trade and economic officials in dealings with their Western counterparts. In the past year, Moscow has received 250 to 300 project proposals and has probably concluded nine deals since the legislation on joint ventures went into effect on 1 January [2] (see figure 1). We believe that Moscow sees such arrangements as a better vehicle than current trade and economic relationships for acquiring and assimilating Western technology, managerial experience, and marketing skills. As part of General Secretary Gorbachev's modernization drive, joint ventures are intended to upgrade Soviet production processes and thus spur exports of manufactured goods, reducing Moscow's reliance on energy and other raw materials as its principal foreign exchange earners. Growth of machinery and equipment exports in general has been dismal, limited by the poor quality and outdated technology of most Soviet manufactured goods. These exports constitute less than 5 percent of total exports to the West, with the bulk going to less developed countries as part of large development projects (see figure 2).

Figure 1. Soviets and Finns discuss joint-venture project.

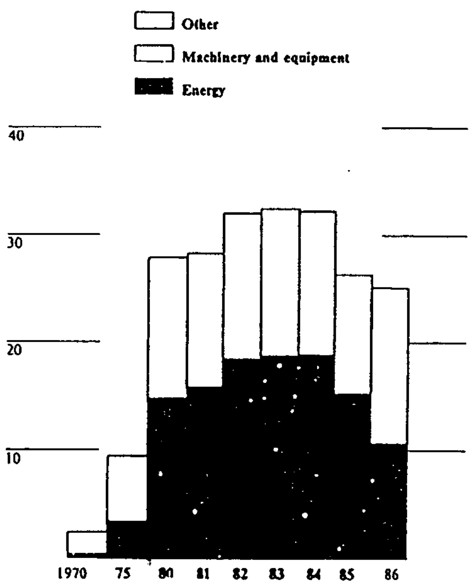
The use of joint ventures to help broaden the Soviet export base has become more important to the leadership as it seeks ways to cope with low oil prices. The collapse of oil prices has taken a heavy toll on Soviet hard currency earnings; oil export revenues reached just $7 billion in 1986, for example, less than one-half of peak earnings of $15.6 billion in 1983 and the lowest level since 1979. [3] To meet its hard currency obligations and stave off sizable hard currency import cuts, Moscow has increased both borrowing and sales of gold, but we doubt that it wishes to sustain these actions over the longer term. (

Although some Western businessmen welcome the idea of joint ventures as a radical departure from previous policy, they see an inherent conflict between Moscow's goal of using joint ventures to push exports and their own desire to secure new access to the Soviet domestic market. Soviet officials, on the other hand, see no such problem and view these partnerships as a natural progression in the economic relationship they have had with the West for decades. Indeed, the Soviets have participated in other forms of economic

[2] Soviet figures for joint-venture proposals and agreements probably include projects with all non-Communist countries, not just those involved in hard currency trade. We are including projects with soft currency nations in our analysis because they most often involve countries such as Finland and India that can provide contributions comparable to those of firms in Western Europe and Japan that deal in hard currency. (

Figure 2
Soviet Hard Currency Exports

Billion US $



cooperation such as compensation and coproduction arrangements and have for some time been active in joint ventures with Western firms on foreign soil (see inset).[4] For the most part, however, Moscow has relied on outright purchases to obtain Western equipment, technology, and turnkey plants. In recent years these imports have constituted about 10 percent of total Soviet machinery investment and have made important contributions to improving production in key sectors of the Soviet economy, including the chemical, metallurgical, energy, and automotive industries. Western imports have also provided vital inputs in the development of strategic areas, such as telecommunications and computers.

Despite these benefits, the Soviets have not been satisfied with their use of Western equipment and technology. The lengthy delay between initial contract negotiations and final equipment installation often results in the technology being outdated by the time production begins. Once the equipment is in place, the Soviet incentive system does not encourage workers to operate and maintain it properly. In sum, Moscow's bureaucratic and systemic arrangements, coupled with a reluctance to permit ongoing ties between Western firms and the end users of the imported technology, have hindered full assimilation and diffusion of Western technology. The Soviets hope that many of these problems can be avoided by joint ventures.

Legislation

Soviet interest in joint ventures with the West dates back to the mid-1970s. At that time, the USSR's Institute of the USA and Canada recommended that joint ventures with Western firms be undertaken to share technology, and discussions were held with several companies. [redacted] for example, was involved in joint-venture negotiations for a spark plug factory in the USSR. These early efforts went nowhere, however, as many of the Western firms became disillusioned with the Soviet bureaucracy and were skeptical about the profitability of joint ventures. Moscow, for its part, had a hard time reconciling joint management of manufacturing operations and profit sharing with Marxist principles, at least for projects on Soviet soil. Meanwhile, rising world energy prices

[4] The US-Soviet Marine Resources Company (SOVAM), a Seattle-based firm, is a successful joint venture between a US company and the USSR that has been in operation since 1976. US trawlers catch fish in the US 200-mile fishery zone and deliver the catch to Soviet vessels for processing. SOVAM sells the processed fish in the USSR but also markets Soviet-origin seafood products in the United States

International Trade Arrangements

Joint venture:	*A contractual relationship between two or more entities that each contribute capital and share management responsibilities, as well as the risks and profits of the business. Joint ventures may provide services or manufacture goods. Distribution of profits is based on the proportion of capital contributions. Joint ventures differ from other types of trade arrangements in terms of the extent of foreign participation in production and the method of payment.*
Countertrade:	*Deals that require as a condition of original sale that goods will be taken in full or partial settlement. Such arrangements include barter, compensation, and buy-back agreements.*
	Barter. Direct exchange of goods between trading partners that occurs simultaneously.
	Compensation. Agreements in which the value of the firm's products is paid by subsequent deliveries of goods from the trading partner. Each delivery cancels part of the original debt.
	Buy-Back. Arrangement in which the seller of plant, equipment, or technology agrees to accept deliveries of resultant products or other commodities. Both partners are paid for their deliveries under separate contracts linked by a framework agreement.
Coproduction:	*The interchange between enterprises of know-how, raw materials, and components toward the manufacture of a finished product. Payment may involve the exchange of goods, cash, or credit.*
Turnkey plant:	*An agreement under which the contractor assumes reponsibility to the client for constructing productive installations and ensuring that they operate effectively before turning them over to the client. Payment is usually made in cash or on credit terms but could include some kind of countertrade deal.*

allowed Moscow to maintain the desired level of imports of equipment and technology through its energy exports

Serious interest in joint ventures resurfaced in mid-1986 when Soviet officials began approaching Western firms with proposals. The issue was formalized in August 1986 with a decree of the Presidium of the Council of Ministers granting Soviet enterprises the authority to enter into joint ventures. In January 1987, a decree outlining general guidelines on the operation of joint ventures in the USSR was published, and some modifications were announced last October. These documents include the following key features:

- Foreign firms will be allowed up to 49-percent equity in a project.

- The chairman of the board, who is responsible for management of the joint venture, and the director general, who has control over day-to-day activities, must be Soviet citizens.

- Hard currency for transactions, such as repatriation of profits and payment of foreign workers, must come from profits earned from hard currency exports.

- The joint venture will operate outside the central planning process. Foreign trade organizations will handle the purchase of raw materials on the Soviet market at contractural prices that are based on world market prices. The joint enterprise may determine the procedure for selling its product on the Soviet market.

- Soviet law will govern all aspects of employment of the Soviet labor force. The management of the joint venture will negotiate wages, vacations, and pensions with each foreign employee.

- A joint enterprise will pay a 30-percent tax on profits, and an additional 20-percent tax will be levied on profits that are repatriated by the foreign partner. A minimum two-year grace period on taxation will be granted from the time that a profit is declared by the joint enterprise.

- A joint venture may be terminated by the USSR Council of Ministers if it does not conform to established objectives.

According to the legislation, the Western firm and Soviet partner will draw up a proposal for the joint venture that must include enterprise objectives, location, participants, capital contributions, and shares of ownership. After the Western firm and the Soviet enterprise have reached agreement, they must follow an elaborate procedure to gain state approval. Once final approval is obtained, the joint venture will be registered with the Soviet Ministry of Finance and become a legal entity

We are not in a hurry. We are not in a hurry. We are not exactly sure, with the legislation in force only four months, what we want out of this.

Ivan Ivanov, deputy chairman of the State Foreign Economic Commission, The Wall Street Journal, *17 July 1987*

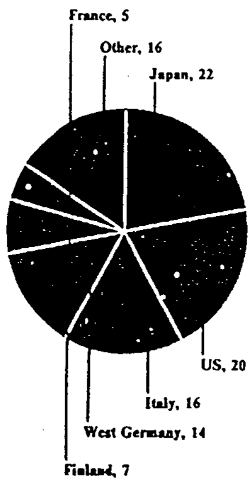
Motivations

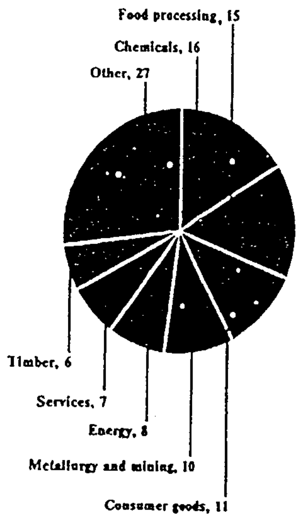
Soviet officials have made it clear that a major priority of joint ventures is to earn hard currency. They are actively involved in negotiating joint-venture proposals in a number of different areas and are especially interested in projects that will produce manufactured goods to substitute for energy exports (see figure 3). Joint ventures offer the Soviets the opportunity to produce goods that meet world market standards because such partnerships will allow for transfer of Western technology, equipment, and managerial know-how. Moreover, Moscow is insisting that the foreign partner retain responsibility for quality control of the enterprise's output. The Soviet leadership is also hoping that the Western firms will provide access to established markets and trademarks that could make it easier to sell products made in the USSR.

Key provisions in the current joint-venture legislation are geared to this export priority. By tying profit repatriation to earning convertible currency, the Soviets have ensured that the joint venture will have to export at least some of its production. Moscow apparently feels that this export requirement will ensure a better quality product [redacted] a Soviet trade official indicated that, if exports were not required, some foreign partners would produce inferior goods instead of "world-class" products. The export provision might also encourage the Western firm to periodically update production lines to keep up with changing Western demands and technology.

Figure 3
Soviet Joint-Venture Negotiations[a]

Percent





[a] Derived from a data base consisting of 153 known joint-venture negotiations as of 1 August 1987.

Soviet officials are also proposing several joint ventures to produce many of the goods that the USSR currently imports, such as equipment for energy production, mining, the chemical industry, and food processing. Output from these joint ventures could free up scarce hard currency for use in other areas. Moscow, however, has so far refused to allow the conversion of ruble profits to hard currency, a move that would make domestic sales more attractive to Western firms.

Gorbachev probably hopes to use the knowledge gained from joint ventures to upgrade the quality of domestic production, in general. For example, a joint venture that involves a substantial degree of Western managerial participation could promote more expeditious transfer of technical know-how related to organization and management of production and the use of advanced technology—knowledge that is not easily transferred through outright equipment purchases. Soviet officials have indicated that they plan to assign some of their best workers and managers to joint ventures, hoping that they can disseminate their newly acquired skills to other domestic enterprises once they are transferred. In time, Moscow believes the joint enterprise that can successfully tap into the domestic market could stimulate the internal competition that is sorely lacking.

The Soviets probably will attempt to acquire technology subject to COCOM controls through some joint ventures. They have already used other forms of cooperation, such as joint scientific research projects, to try to obtain controlled technology. They are particularly interested in production of machine tools that could require equipment regulated by COCOM, and some restricted process-control equipment probably will be needed to meet production quality standards for Western markets. The Soviets may hope to pressure some firms to overlook or circumvent export restrictions.

Despite the apparent enthusiasm for joint ventures in the top echelon of the Soviet Government, the regime is not charging ahead at full speed [redacted] Moscow has decided to limit the number of joint ventures to 20 to 25 agreements during the first year or two the new legislation is in effect. Once the contemplated number of agreements has been approved, the Soviets plan to impose a temporary moratorium on joint ventures to assess the progress of those in place and to review the regulations. Moscow hopes that limiting the number of joint ventures initially will permit close supervision of these enterprises to ensure their success, thus improving the prospects for expanding implementation of the policy in the future

Many Soviets, however, view joint ventures with Western firms with confusion and anxiety. To some extent, this is understandable since some joint ventures will probably involve Soviets who are unfamiliar with foreign trade practices. Soviet enterprise managers and workers, in particular, may feel uncomfortable operating in the type of environment that may be required by Western executives [redacted] considerable ignorance and uncertainty exists even among midlevel officials in the USSR who deal regularly with Western businessmen over what joint ventures will entail. For example, *The Wall Street Journal* recently reported that a Western businessman discussing joint ventures with Soviet representatives had to explain the concept of leasing. In another example, [redacted] a Soviet official at a joint-venture meeting was unaware that the ruble was not a convertible currency. Additionally, few of the managers under heavy pressure from Moscow to establish successful joint ventures with Western firms are willing to take the responsibility [redacted]

Moscow's Sales Pitch

Soviet officials are touting abundant resources and low production costs to interest Western firms in forming joint ventures. The USSR is the world's largest producer of oil, timber, steel, and many metal products, and lower transportation costs for these inputs alone could lower production costs. Other price breaks are also likely. Yuriy Dremov, chief of the Ministry of Foreign Trade's Main Engineering and Technical Administration, indicated that the costs of labor, rent, and utilities will be lower in the USSR than in the West.

Western firms, however, are looking at more than cost considerations in their desire to tap a potentially lucrative domestic Soviet market. Gorbachev's ambitious economic program requires more quality equipment than can be supplied domestically, and the Soviet populace is starved for Western consumer goods. Many Western manufacturing firms face stiff competition for their sales in the West and are looking for new markets. While they recognize that the Soviet domestic market will not open up all at once, some

Figure 4. Where's the beef? Western firms seek to satisfy Soviet consumers.

firms seem willing to at least stick their foot in the door now and wait for bigger opportunities to emerge later.[1]

Moscow has given both subtle and not-so-subtle signals that Western firms that currently deal with the Soviets may need to propose joint ventures to increase or maintain their share of sales to the USSR

would depend upon the willingness of foreign suppliers to undertake a joint venture. Firms from Austria, Italy, and Finland have reported similar heavyhanded tactics

[1] Few details have emerged so far from the recently conducted joint-venture deals that would explain what advantages have been provided to Western partners. The Soviets want to keep a tight lid on the details of individual projects so they will not be pressed to offer similar concessions to other firms

They're eager, but we aren't. We have questions, but they have no answers. They want to play this by ear and work out each deal on an individual contract basis. This could be chaos.

West German experienced in Soviet trade, The Wall Street Journal, *6 April 1987*

Questionable Profitability for Foreign Partner

Western businessmen question the profitability of joint ventures in the USSR, especially given their less-than-satisfying experiences with joint ventures in Communist countries that have far more liberal legislation (see inset). Moreover, the vagueness of the joint-venture legislation has caused confusion about issues

Joint Ventures in Eastern Europe and China: Mixed Results

Chinese and East European leaders have struggled to make investment in their countries attractive to Western firms but have had varying degrees of success. As in the Soviet case, conflicting goals exist between Western firms and Communist leaders. Western firms are interested in tapping the domestic markets, while these countries are mostly interested in gaining access to Western technology and equipment to modernize their industries and boost hard currency exports.

Eastern Europe

All of Eastern Europe—with the exception of East Germany—now permits joint ventures with Western firms. Yugoslavia and Hungary—which have both permitted joint ventures for over 15 years—have had the most success in encouraging Western participation by implementing increasingly favorable laws. About 200 Western firms have formed joint ventures with the Yugoslavs because of liberal treatment of taxes and profits, despite the high domestic inflation rate and limits on hard currency access. These ventures include projects in machine building, mining, and agriculture. Recent liberalizations in Hungarian joint-venture laws, including allowing ventures in such fields as banking and tourism, have attracted more Western firms in the past year, pushing the total to about 80.

On the other hand, the remaining East European countries have attracted less than 25 joint ventures. Romania and Poland have had joint-venture laws for more than 10 years but have recorded minimal success. Many restrictive clauses in Romanian law and the country's poor economic condition discourage Western interest. Western interest in possible joint ventures with Poland has grown since the laws were liberalized last year, but problems over wage laws and profit repatriation remain. Bulgaria and Czechoslovakia—the most recent East European countries to allow joint ventures—are cautious about yielding much real control to partners but are trying to establish more Western links.

A joint venture established in the late 1970s between Romania and [redacted] *is about the only significant US–East European high-technology venture. It resulted in a plant that produces 60-megabyte disk drives for sale largely in Romania, although some are sold to East Germany and Czechoslovakia. US export-control procedures were followed to the letter in the case of foreign sales. We also have no evidence that any product was sold to the USSR, that Soviets visited the plant, or that other illegal transfer of technology was attempted.*

China

China has been accepting foreign investment in the form of equity and contractual joint ventures and wholly foreign-owned ventures since 1979 and has continued to modify investment regulations—most recently in October 1986. China absorbed $7.4 billion in foreign investment from 1979 through 1986, with the number of equity and contractual joint ventures and wholly foreign-owned enterprises totaling 7,500. This investment has been important for the development of some sectors such as energy exploration. The Chinese leadership, however, has been dissatisfied with the level of investment going to industrial or

such as raw material supply, product pricing, marketing, and valuation of capital contributions. Although these issues play an integral part in a Western firm's evaluation of a project, Moscow expects foreign partners to commit themselves to a project and then resolve these operational details on an individual basis

Sales Potential

Western businessmen, reacting to the published regulations and comments by Soviet officials, are skeptical about the volume and profitability of domestic sales.

"productive" ventures. Export-oriented and advanced-technology projects were singled out for favorable treatment in the October 1986 regulations.

China has shown a flexibility in the establishment and operation of foreign projects that has helped attract many Western firms. For example, Beijing has allowed the experimental adoption of additional guidelines at the local level and has implemented successful pilot regulations nationwide. The Chinese leadership has also reacted quickly to resolve financial and production problems of ventures that have attracted Western media attention. Foreign firms, however, have been frustrated and disappointed by several aspects of their investments in China, including their inability to sell to China's domestic market, the cumbersome and secretive Chinese bureaucracy, nonconvertible currency, the poor quality and unreliable supply of domestic inputs, high taxes and wage subsidies, and poor worker productivity. The October 1986 regulations addressed some of these topics, but many complaints still exist.

New foreign investment commitments for 1986 and the beginning of 1987 were considerably below 1985 levels and are likely to remain disappointing through at least the end of this year. Beijing will probably continue to emphasize productive investment and shut out the "easy investment" that had been attracted to the tourism sector. Meanwhile, Western firms may wait for new regulations to ease the profit-repatriation and market-access problems.

The joint enterprise will need to export its product to earn hard currency for raw material and equipment imports, salaries of foreign employees, and repatriation of profits. The state is unable to guarantee the domestic sale of the enterprise's output because the joint enterprise will operate outside the centrally determined plan. A further stumblingblock is pricing. Soviet officials have indicated that the prices of the goods produced by the joint enterprise are negotiable but could be as high as the Western market value. These goods, albeit of higher quality, may be priced too high to find a ready market. Additionally, Western firms probably will not be able to repatriate the profit from domestic sales since the ruble is currently not convertible.[4]

Many Western firms also doubt their ability to earn the requisite hard currency. Marketing of the joint enterprise's output could be difficult because of the stigma often attached to Soviet-made goods—even if a well-known Western name is involved. Western businessmen also question whether the Soviets would be willing or able to deliver to a joint enterprise any markets outside the Soviet Union that are currently inaccessible to the foreign partners. In fact, Western firms believe they will ultimately find themselves competing against production from their own facilities in their home country.

Management Control

Under the current joint-venture regulations, the Western partner will be responsible for quality control of production but may not be given the desired flexibility to manage the labor force. At present this power is likely to reside with the general manager, and the regulations state that he must be a Soviet citizen. According to a Western journal, most companies with experience in East European joint ventures believe that the choice of general manager is key to the success or failure of a project. Western partners are pushing for a role in the choice of candidates but are skeptical that suitable managers are available.

[4] A convertible ruble is currently under discussion in Moscow, but many structural changes must take place in the Soviet economy before it is feasible. Moreover, the Soviets will first implement the convertible ruble within CEMA trade

Western firms also worry that they will have little or no voice in selecting and training Soviet employees. The regulations state that joint enterprises will be manned mainly by Soviet citizens, and the deputy chairman of the State Foreign Economic Commission, Ivan Ivanov, reportedly indicated that they will be selected by Soviet authorities. If unqualified workers are selected, they will probably need a long training period to learn to handle the equipment and production procedures.[7] Western firms are seeking guarantees that workers be allowed to train in the West and that these workers be available to the joint enterprise on a long-term basis. Western businessmen are also unclear about what methods will be available to them to motivate the work force. For example, the decree requires that worker discipline issues, including firing, be resolved through Soviet trade unions rather than the enterprise management.

Material Supply

Despite its relative independence from the state planning process, the joint enterprise will be dependent on the government for allocation of material inputs. Dremov indicated that the joint enterprise must inform its supervising ministry each year of the types and quantities of raw materials needed for the coming year. The ministry will pass this information to the State Committee for Material and Technical Supply (Gossnab), which will allocate the materials. Such a scheme lacks the freedom and flexibilty under which most potential Western partners operate and does not guarantee an adequate supply of production inputs should demand for the enterprise's output increase.[8]

Valuation of Capital Contribution

The valuation of the equity that each partner brings to the joint venture is important because it determines profit distribution. Many contributions such as Western technology and Soviet real estate, production facilities, and services will be difficult to value. For example, a project between Intourist and to renovate and manage a Moscow hotel reportedly has encountered a snag on capital valuation, with the Soviets claiming an excessive value for the unrenovated hotel building. [ ] Western firms are also concerned that their contribution would be undervalued by the USSR's inflated official ruble exchange rate

Accounting

The potential profits of the joint venture may also be affected by the use of Soviet accounting principles. The joint-venture decree states that the accounting method used by the joint enterprise must be the same method employed by all Soviet state enterprises—a system that differs sharply from Western practices. According to the Western press, one firm has flatly refused to accept this methodology. The problems inherent in this approach are numerous. For example, depreciation periods for machinery and equipment may be up to two times longer in the USSR than in the West. Another sticking point is that interest payments on capital are not tax deductible. In addition, the joint enterprise is not permitted to provide accounts to any foreign state under the current rules, which undoubtedly will cause problems with Western tax authorities

Termination

The decree gives Moscow the right to terminate a project if the activities of the enterprise are inconsistent with the objectives laid out in the joint-venture contract, but is vague on how the Council of Ministers will determine inconsistency. Although the foreign partner is guaranteed compensation for the residual value of its contribution in case of termination, agreement on this value could prove difficult to obtain. Western businessmen are unclear whether this guarantee would still apply if the legislation were repealed or Gorbachev does not retain his power. Moreover, the decree does not appear to provide protection for the foreign partner's patents, trademarks, or licenses if the joint enterprise is unsuccessful

[7] Moscow recognizes the seriousness of the labor problem and included a section on measures to provide personnel for foreign trade activity, including joint ventures, in the October decree. The decree calls for improvements at higher educational establishments, training of personnel in other countries, and the transfer of specialists from foreign trade associations to enterprises dealing with foreign markets

[8] One way that this problem may be addressed is by including a joint venture's input needs in the requirements levied on input suppliers by the Soviet state. To date, we have not seen this solution suggested

[redacted]

Joint Venture Projects Signed or Likely To Be Concluded in 1987

Western Firm	Soviet Partner	Project
Burda Moden (West Germany)	V/O Vneshtorgizdat (State Committee for Publishing Houses, Printing Plants, and the Book Trade)	Printing of a Russian edition of the fashion magazine *Burda*
Combustion Engineering (United States)	Ministry of the Petroleum Refining and Petrochemical Industry	Production of instrumentation for petroleum refineries and petrochemical plants
Finnair (Finland) [a]	Intourist (State Committee for Foreign Tourism)	Refurbishment of Hotel Berlin in Moscow
FATA (Italy) [a]	Ministry of Machine Building for Light and Food Industry and Household Appliances	Production of commercial and industrial refrigerators
Heinemann Machine and Installations Construction (West Germany) [a]	Sergo Ordzhonikidze Machine Tool Building Plant	Production of lathes and flexible production modules
India's Tourist Corporation [a]	Moscow City Council of People's Deputies	Indian-cuisine restaurant in Moscow
Liebherr (West Germany) [a]	January Uprising Production Association	Production of self-propelled cranes
Mineraloel und Rohstoff Handel (West Germany) [a]	Nizhnekamskneftekhim Production Amalgamation	Production of ethylene glycol
Suomen Kati-Myynti Osakeyhtioe (Finland) [a]	Tallin Sewn Goods Production Association *imeni* V. Klement	Production of women's clothing
Sadolin (Finnish subsidiary of Danish Sadolin) [a]	Estonian Republic Association Estkolkhozstroy	Production of paints, varnishes, and wood preservatives
Salamander (West Germany)	Unknown	Production of shoes at two plants
Tairiku Boeki (Japan) [a]	All-Union Association Irkutsklesprom	Process high-quality Siberian broad-leaved trees into furniture paneling

[a] Already signed.

Evidently not everything in the decisions adopted by the Soviet Government is to the liking of some capitalist firms.

Sotsialisticheskaya industriya
25 February 1987

Slow Progress

The establishment of joint ventures has progressed slowly, with caution on both sides replacing the enthusiasm that reigned about a year ago. Most of the agreements concluded so far—as well as those close to signing—appear to be relatively small endeavors involving simple processes and little foreign capital (see table). The Western partners that are making the most progress are those that already have established business ties with the Soviets and are based in countries that have strong economic relations with Moscow such as Italy, Japan, West Germany, and Finland.

The Soviets have also been actively pursuing joint-venture negotiations with a variety of US firms. While ventures with McDonald's or Pizza Hut have garnered most of the publicity, many of the projects under serious discussion are related to energy production and agriculture:

- Monsanto has signed a letter of intent to form a joint venture to produce herbicides.

[redacted]

- Eli Lilly has signed a letter of intent for a plant to produce pharmaceutical and veterinary preparations.
- Occidental Petroleum is discussing joint ventures for the production of fertilizer and the development of an oilfield.
- Combustion Engineering has signed a letter of intent to establish a joint enterprise to supply process-control instrumentation, management systems, engineering technologies, and related services.
- Dresser Industries has held discussions with the Soviets about manufacturing oilfield equipment.

Agrochemical projects show particular promise because of the absence of export controls on this technology. Energy-related equipment received a boost from the lifting of controls on energy equipment earlier this year

Despite the interest shown by both sides in joint ventures, the prospects for US-Soviet projects appear quite limited in the near term. Like other Western firms, US companies are encountering problems in negotiating access to Soviet markets, convertibility of ruble profits, and other operational matters. US firms remain at a disadvantage in negotiating with the Soviets because Moscow perceives US firms as more vulnerable to government-imposed trade sanctions than companies in Western Europe and Japan. Moreover, non-US firms usually can offer the Soviets comparable equipment and technology and have the added advantage of access to government-backed insurance and credits. In an apparent effort to give a push to US-Soviet trade in general, as well as promote joint ventures, the Soviets recently ran a nine-page advertisement in *The Wall Street Journal* at a reported cost of $300,000. In addition, a consortium of major US companies and senior Soviet officials is cooperating to improve joint-venture prospects.

For the most part, the success of any joint venture with a Western firm will ultimately depend on the willingness of the Soviets to grant certain concessions that could make joint ventures more lucrative to Western firms. Moscow is going to great lengths to sell the idea by putting more competent officials in key spots to address Western concerns (see appendix). Some of these officials have stressed that the current regulations are only a starting point for negotiations, hinting that further revisions of the regulations may be forthcoming. In the meantime, Moscow has been showing signs of flexibility in discussing operational details, probably because of the guarded reponse by Western firms to the initial joint-venture decree:

- [redacted] Soviet commercial representatives indicated that joint-venture agreements may allow for long-term price agreements on supplies and raw materials. [redacted] joint ventures will be given priority for resource supply.
- The management role of the Soviets may be more limited than current regulations suggest. A foreign trade official has indicated that the Soviets have no interest in actually managing the joint enterprise, [redacted] the foreign partner may have veto power in areas specified in a joint-venture agreement.

Moscow has slightly softened the requirement to export the final product if the primary function of the joint venture is to substitute for imported goods on the domestic market. In these cases, the Soviets are trying to set up barter arrangements to enable the Western firms to earn hard currency. For example, some firms have reportedly been offered petroleum products in return for entering into a joint venture to produce energy equipment. Negotiations can become complicated, however, if the ministry discussing the joint venture does not control production of the goods to be bartered. Additionally, Western firms will only be interested in obtaining goods in which they have marketing experience.

Moscow, however, is unlikely to change its provisions on requiring some form of exports or converting rubles to Western currencies, in most cases, until its hard currency position improves and the problem of the inflated official exchange rate of the ruble is addressed—or circumvented in some fashion. For now, Western firms interested in joint ventures most likely will need to manufacture goods that can meet Western demand, agree to some type of barter arrangement, or find innovative ways to earn hard currency in the domestic market.[7]

We welcome Soviet readiness to establish joint ventures but can foresee no great economic importance for them.

Henning Artez, member of Ost-Ausschuss (East Trade Committee) of the German Industry of Cologne, Financial Times, *6 May 1987*

Implications

The number of joint ventures likely to be in operation any time soon will be too small to have much positive impact on Soviet hard currency earnings and domestic production during the current (1986-90) five-year plan. Indeed, the leadership's emphasis on joint ventures over the past year may actually be inhibiting trade because many Soviets are overlooking other economic arrangements with the West for example Soviet trade representatives were trying to convert some existing compensation and coproduction deals into joint ventures. As a result, some deals that could have a more immediate impact on industrial modernization may be falling by the wayside

Moscow will probably ease the pressure on officials to generate new proposals as it gets closer to reaching its goal of 20 to 25 joint-venture agreements. At that time we are likely to see the emphasis shift back to more traditional economic arrangements such as countertrade, coproduction, and compensation. Western businessmen and diplomats have already noted a waning interest among midlevel Soviet officials in forming joint ventures,

More traditional types of economic arrangements can provide many of the same advantages as joint ventures. Buy-back and coproduction arrangements also provide access to Western markets, advanced technology, and quality control, but with less direct Western involvement. Some of the current joint-venture discussions probably will revert to coproduction or buy-back arrangements.[8] In many of the projects under discussion, however, the Western firms would not be interested in a buy-back arrangement because of lagging demand for the products in the West. The Soviets may be more successful in arranging such deals if they are willing to compensate Western firms with other products, especially raw materials.

In time, even a small number of joint ventures may pay dividends beyond their hard currency earnings by helping familiarize more Soviets with Western production and marketing techniques. Soviet managers have been isolated from dealing with Westerners by the Ministry of Foreign Trade and are woefully ignorant of free market business methods. This lack of expertise has hampered joint-venture negotiations and dampened the effect of the recent foreign trade reorganization that allows some ministries and enterprises to deal directly with Western firms. Moscow may also hope that skills and work habits learned by workers involved in joint ventures can "rub off" on their fellow employees once they return to a traditional Soviet plant. The type of direct contact with Western practices that is likely under a joint-venture arrangement could provide the Soviets with the best possible training.

Closer commercial ties to Western firms also could aid Moscow's wide-ranging campaign to increase its role, prestige, and influence in international economic affairs. Some joint-venture arrangements with reputable Western firms may give Moscow access to new

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has avoided part of the convertibility problem in its joint venture with the Soviets since the renovated hotel will be used mainly by Westerners, with billings for rooms, restaurants, and other services in US dollar markets. Moreover, foreign partners of joint enterprises could form powerful lobbies in Western capitals for Soviet economic interests. For example, US businessmen might increase their lobbying efforts to obtain most-favored-nation trading status for the USSR to help make output from joint enterprises more competitive in the US market. Moscow might even become more flexible on selected East-West issues to create a climate more conducive to expanded commercial involvement.

The utility of joint ventures as a vehicle for the transfer of high technology will be limited by several factors. Those deals most likely to be concluded in the next few years probably will not involve the transfer of COCOM-controlled technology. Both Western governments and firms appear concerned not only about the security issues involved but also about the potential economic costs of helping the USSR become an exporter of high-quality manufactured goods. The bulk of the joint ventures established so far in Eastern Europe or China are service oriented or involve production processes with relatively unsophisticated technology. Many firms may even have become more sensitive to this issue because of the recent publicity of the export-control violations involving Japanese machine tools.[11] To the extent that high technology is involved, joint ventures will not receive any preferential status vis-a-vis the export control regulations of COCOM-member nations and will still be considered proscribed destinations requiring export licenses.

The technology transfer issue may eventually surface, however, should the first few joint ventures in the USSR succeed and other firms begin to jump on the bandwagon. The more successful the joint ventures are, the more vulnerable the Western firms may become to Soviet pressure for technology transfer as a means of establishing a foothold in the Soviet market. Even if individual joint-venture projects do not involve high technology, they could provide the Soviets with potential targets for recruitment

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Appendix

A Who's Who List for Joint Ventures