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**CURRENT REFORMS  
IN SOVIET FOREIGN TRADE**

**with Special Reference to Western Europe**

**By  
Kaare Dahl Martinsen**

**A Thesis Submitted for the Degree of Master of Letters  
at the Faculty of Social Sciences of the  
University of Glasgow**

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**Institute of Soviet and Eastern European Studies  
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Glasgow, June 1988.

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## SUMMARY

The purpose of this thesis is to analyse the reform-process undertaken by the present Soviet leadership in order to expand the foreign trade with Western Europe. The economic, political and bureaucratic aspects are treated separately.

A broad outline of functionalist writings on East-West trade is given, and special reference is made to David Mitrany's emphasis on the interplay between politics and economics, and the confidence-building and peace-keeping role of trade.

The composition of Soviet imports and exports is focused upon in chapter 2. The growing problems of the Soviet economy are reflected in the export of little else than energy, and the large imports of capital intensive goods. The effects of the short-term improvements in terms-of-trade resulting from the temporary increase in oil-prices are judged negatively, as the influx of hard currency was used to cover deficiencies in the domestic production. The peculiarities of Soviet trade transactions, i.e. seeking to avoid the use of money, are discussed and the problems this creates are pointed out.

In chapter 3 the political aspects of Soviet-West European trade are analysed. The attempts to create a socialist foreign trade based on the paradox of Lenin's insistence on continued trade with the capitalist West while at the same time use trade politically are described. Apart from a few isolated events where the Soviet Union threatened to deploy trade as a political weapon, politically motivated initiatives could not be found.

In the final chapter of part I, the policy-making process in the foreign trade sector of the state administration is analysed. The problems resulting from inadequate communication network and the absence of any integrative force in addition to the systematic avoidance of complicated transactions are discussed.

Part II commences with a discussion of Gorbachev's economic policy and the role given to foreign trade both as a growth factor, and as a bridge-builder to Europe.

In chapter 6, the Soviet attempt to become member of GATT, and the new policy towards the Common Market are analysed. The reasons for GATT's refusal are explained with special reference to the acceptance of Hungary as a member at the beginning of the seventies. The changes in the Soviet policy towards the Common Market are interpreted as expressions of the present Soviet leadership's pragmatic approach both towards foreign trade and Western Europe.

Chapter 7 is devoted to the the Soviet joint ventures initiative. The inadequacies of the legislative

basis are discussed, and the prospects for joint ventures with Western Europe are described.

In chapter 9, the reform endeavours in the foreign trade bureaucracy are discussed, and the decisive importance of their outcome for the policy of expanding the right to engage in foreign trade is underlined. The role of the plans, prices, and the lack of expertise are discussed.

In the concluding chapter, a reference is made to the attempts of enhancing autonomous decision-making at enterprise-level as a method of combatting the power of the foreign trade bureaucracy. Despite the numerous obstacles confronting the reforms, the leadership's will to reconsider entrenched dogmas allows us to draw a cautiously optimistic conclusion.

## PART I

### 1.1. INTRODUCTION

The Soviet Union plays a growing role in the world economy. The country possesses a large economic potential in terms of raw materials and productive capacity. If opened for foreign companies, the Soviet domestic market will prove to be a large untapped reserve. Soviet foreign trade has been the most rapidly growing part of the Soviet economy since the sixties. According to some analyses, the quota of foreign trade, as measured against national income has grown from 12% in 1960, to 15% in 1970 and reaching 27% in 1980, whereas the 1980 comparable figures for the United States were 34%.<sup>1</sup> The importance of foreign trade in the Soviet economy is perhaps better understood, when we know that most of the equipment used in the chemical industry, in metallurgy and various other industrial branches have been imported. For successive years, the Soviet Union has purchased a large part of its grain and fodder abroad. In addition to these examples, imports have played an important part in the development and excavation of raw materials in Siberia.

Soviet economic intercourse with the western capitalist countries make up only a minor part of world trade. The commodities exchanged and their value, as well as the importance of this trade for the countries

involved, vary greatly from year to year. One is, therefore, tempted to repeat a question posed by an expert in the field of east-west economics, Professor Marie Lavigne: **"Why take an interest in east-west trade?"**<sup>2</sup> This is, as Professor Lavigne poignantly states, a quantitative question which does not pay respect to the complexity of the problems surrounding this sector of international trade. Indeed, if one should look at the trade relations between the Soviet Union and the West, from a purely economic point of view, one would have to overlook the impressive amounts of writing published in all the countries involved, as well as the number of conferences, studies and seminars devoted to this topic. What justifies this attention from politicians, businessmen and academics? Many answers can, and have been given. Here, a few will be outlined.

Economic intercourse between a planned economy and a market economy is a direct confrontation between two systems based on different political and economic principles. The former maintaining a strict central control, only allowing the market forces a very limited scope, whereas the latter tries to restrict political control and intervention to the minimum required to mute some of the harmful effects of the market forces. In a market economy, foreign trade is encouraged by the government and only limited by the demand on the world markets. The competitiveness internationally is taken as a measure of economic development. Foreign

investments and companies are welcomed, the government's role in international trade is limited to little more than co-ordinating the activities. In a centrally planned economy, the state monopoly has ensured a total separation of the domestic market from the foreign economic activities. This has been justified politically as a measure necessary to shield the country from the recurrent crisis of the market, e.g. inflation, bankruptcy and unemployment. The cost has been the absence of the "invisible boot of the market", outdated and wasteful methods of production have not been reformed as rapidly as in the West, and without the pressures of a market, the enterprises have little interest in changes or improvements. As a result, the Soviet Union, being the largest of the centrally planned economies, and traditionally the least prone to changes, has become technologically backward in comparison with West. The foreign trade activities have been limited by availability of competitive goods. As we shall see later, the goods offered by the Soviet Union on the world market are mostly raw-material and goods of low capital intensity, on the whole not differing very much from the developing countries in the Third World. Thus, East-West trade involves partners at different levels of economic development. Bearing in mind that whereas the Third World countries are strategically and militarily clearly inferior to the West, trade between the West and the Soviet Union entails problems

that are quite unique because of the political parity.

As mentioned above, Western governments have largely refrained from mixing politics and economics, their abstention has been less equivocal in their relations with the Soviet Union. Trade between them cannot be analysed without reference to the political interests inherent in it.

The political controversy linked to East-West trade emerged soon after the end of World War II. When the "Cold War" permeated the relations between East and West, trade assumed an importance it had not enjoyed prior to 1939. Economic warfare was introduced on a large scale. Already in 1945, the US State Department assembled a lists of goods not to be exported to Soviet controlled areas of Europe. This control became institutionalised when the Co-Ordinating Committee for Multi-Lateral Export Controls was set up in Paris in 1948 (COCOM). Since US aid to the reconstruction of Europe was far more important than trade with the Soviet Union and her allies; the embargo on any commodity that could have strategic relevance was efficient. Trade between the two blocs remained negligible.

It would be an error to blame this state of relations on the Americans. Soviet policy in the post-war years aimed for the alignement of the East European economies to Soviet needs and requirements. This did not only reduce trade between Eastern and Western Europe to a level lower than before the war, but practically excluded any policy for

its expansion.

Two events paved the way for a new thinking. In the Soviet Union, the 22nd Party Congress with the criticism and subsequent abandonment of the doctrine of the inevitability of war between the socialist and the capitalist part of the world, played down the political antagonisms. In the West, although at a much later date, the West German Chancellor Willy Brandt's "Ostpolitik" was a break with the hitherto Western approach. In retrospect, this was not unexpected, the division of Europe is probably felt most painfully in the two Germanies. Chancellor Brandt's opening to the East renewed the debate on the political implications of trade. The calls for a harmonization of Western countries' trade policies were repeated, and have been voiced strongly whenever political tension between East and West has increased. In recent years, the Soviet invasion of Afghanistan in 1979, and the introduction of martial law in Poland two years later, focused on the possibility of using trade as a means to further political aims.

The relationship between trade and politics as seen from a Soviet viewpoint will be dealt with in greater detail later, let it suffice here to mention the two strategies possible in East-West trade. One can impose an embargo on certain goods to force the opponent to change his policy. The embargo will then be lifted when the desired change has emerged. Or it

will end because the embargo has proved too costly in terms of lost trade. The opposite strategy, initiated in the West by Chancellor Brandt, was to use trade as a confidence-building measure. This policy was formally acknowledged in the so-called "Second Basket" of the Helsinki Declaration on Co-Operation and Security in Europe, signed in 1975. The Declaration has been portrayed quite differently in Western Europe and in the Soviet Union. Whereas the liberal democracies in the West have underlined its implications for individual rights, the USSR with the support of her allies, have emphasised the relevance of trade, exchange of know-how and industrial co-operation for peace and the lessening of political tensions. This line has been frequently repeated by Soviet trade officials and politicians on numerous occasions, especially in connection with COCOM and when accusing the West for doing nothing to encourage trade.

Soviet claims for a "normalisation of trade", as well as Western writers' frequently used expression "natural level of trade", deserve some comments in this connection. A "normalisation" is meant as the removal of all politically imposed trade barriers, ranging from embargoes and sanctions to protectionist customs and anti-dumping legislation. The widely held belief among Soviet officials, that these measures primarily are aimed at her, is clearly an exaggeration. There is , for instance, an embargo on the export of the equipment to produce nuclear weapons which has been supported



by the USSR. Concerning protective measures in the West, Soviet complaints are mostly directed at the EEC's quotas for agricultural produce. However, they apply to other non-EEC countries, some of whom are situated in Western Europe. On the other hand, from a Western viewpoint, a "normalisation of trade" would mean a removal of the state monopoly, a topic which until very recently has been even more utopian than any expansion of the EEC's food quotas. Apart from Western protective measures and the state monopoly in the Soviet union, there are a number of obstacles preventing any large-scale expansion of trade. The most important being the generally inferior quality of Soviet goods, the inconvertibility of the ruble, the West's embargo on so-called strategic goods and the refusal to grant the Soviet Union a most-favoured-nation status.

The expression "a normal level of trade" which has found a wide usage both in Soviet and Western economic literature, is inconclusive. It is used to sum up some of the arguments covered by the concept of "normalisation", but in addition it implies that trade is below what is supposed to be normal. This level is never defined. Trade between the West and the Soviet Union before World War II was very small compared to the amount of trade conducted between the Western countries. In this respect, there is little unnatural in the present situation. However, the severance of any trade links

by a political fiat is "unnatural" from an economic perspective. Therefore, the initial phase of the "Cold War" precluded many trade agreements that could have been profitable were not concluded. The permanence of these conditions had made the low level of trade "more natural" as the countries became adapted to it. The Swedish economist Gunnar Myrdal maintained that:

**"While political forces can strangle trade almost instantaneously, it will usually be a difficult and time-consuming process to change back to more normal trading relations."**<sup>3</sup>

He continues his argument by stating that attempts to "normalise" trade may be impossible, because investment allocations in the countries involved, have been made in order to enhance self-sufficiency. Thus, without any political initiative to open up the economy to the outside, an increase in trade is unlikely. Whether such an opening would have resulted in a "normalisation", or a "natural level of trade" is irrelevant. What is important, is that this would be a development which was initiated on the political level, due to the absence of an economic incentive. Therefore, trade between the capitalist West, and the socialist East, has a political content far different from the trade within these regions. To underestimate this aspect would be a grave mistake, it would be equally grave to discuss the political and economic aspects in isolation without focusing

on their inter-relatedness.

## 1.2. A Functionalist Approach to the Political Economy of East-West Trade

International trade has attracted the attention of theoreticians for centuries. The various explanations and models explaining its importance and contribution to the growth of the countries involved, is today an integrated part of political parlance in both parts of Europe.

Despite the fact that intra-governmental organisations were set up to regulate trade during the latter part of the nineteenth century, few scholars attempted to create a theoretical framework where the interplay between international politics and international economic relations could be explained. One of the first major efforts in this respect was made by David Mitrany in the 1930s.

The international events during the immediate pre-war decade were marked by the futile efforts of the liberal democracies to combat the rise of totalitarian regimes in Europe. Among the means applied by the then League of Nations were embargoes and economic sanctions against the belligerent nations. Professor Mitrany's basic idea was that international co-operation could create a loyalty towards the supra-national aims among those involved, a loyalty that

would become stronger than their allegiance to their own countries. In his own words, the state is "too weak to secure us equality" and at the same time "too strong to allow us liberty".<sup>4</sup> International co-operation in all fields could be used to increase the welfare of the states participating, but above all, it could create, to quote the title of one of his books, a working peace system.

A unique possibility to implement Professor Mitrany's ideas, emerged after the end of the Second World War. Professor Gunnar Myrdal, who shared Mitrany's optimistic beliefs, was given the chairmanship of the United Nations Commission for European Reconstruction. However, his idealism did not convince the attitudes of the super-powers, and the primacy of political considerations brought an end to his efforts to integrate Europe economically.

The political division of the world, did not make trade entirely impossible, and scholarly interest in the thoughts put forward by men like Mitrany and Myrdal soon increased. Distinguished contributions on the peace-building effects of economic intercourse were made by others, among them Sewell, Groom, Haas and Galtung. In the late fifties and during the sixties, the debate increased and what became known as the functionalist approach was put forward. Somewhat later, the school split as the integrative processes in Europe and other parts of the world gained force. Whereas the disagreements and the formation of new groupings

are of little interest here, the core of the functionalist approach is important.


Functionalism was launched in opposition to the prevailing belief in the importance of structure among political scientists at the beginning of this century. The central idea of functionalism is in the name: primacy is given to function. The form is of secondary importance, the main requirement is that it should be flexible, changing in harmony with the changes in the function. Functionalism is not a rigid model with the emphasis on the institutional framework.

**"The implication of the functionalist mode is to see a multiplicity of forms and levels of organization, each reflecting a system of transactions which may or may not produce institutions at the world level."**<sup>5</sup>

The feeling of national security which was previously determined by the level of armaments available and military alliances signed, would increasingly be determined by international co-operation as the states grow more interdependent for the maintenance of their citizen's standards of living. According to Mitrany, this could be achieved through a gradual co-ordination of political and economic activities across the borders, growing international planning and support for international political bodies. The function of economic intercourse will be to serve as an instrument for peaceful co-existence. The following statement,

made by the then Foreign Minister of the Soviet Union, Andrei Gromyko, is representative for this view:

**"It is beyond doubt that large-scale long-term economic and scientific co-operation will form a kind of basis for material security in Europe, by providing it with an additional margin of safety."**<sup>6</sup>

This optimism has been criticised both in the Soviet Union and in the West, because interdependence  increases the vulnerability of a state to sudden changes in their opponent's behaviour. There is no automatic guarantee that a government will refrain from using trade as a political weapon. On the other hand the anticipation that an adversary may do so will have a moderating influence on the conflicts that may emerge.

Of particular interest when discussing the development of East-West trade is the heuristic approach inherent in functionalism. The gradual evolution of co-operation is understood to depend on the experience and mutual trust gained during the process, and the participants' ability to apply these skills to new tasks. This ability is not solely dependent on the will of those involved, what has been called the environmental conditions, the "functional commitments of a generation", for instance an upsurge in nationalist sentiments will influence the development of any integrative process and be decisive for its success.<sup>7</sup> The emphasis on the volitional and the heuristic

aspects makes any stringent model impossible, the function is more important than the form, i.e. the structural expression of the process.

Functionalists maintain that the most important contributions to international co-operation are not made by politicians, but by experts. Politicians will regard the protection of national sovereignty as their most important duty, bureaucrats and business-men are less occupied with questions concerning national prestige.

**"Technique keeps the trivial in its right perspective...And to keep discussion technical has the great additional advantage of keeping it undramatic...It makes the notion of triumph much less accessible, when a priori, the nature of the triumph is not intelligible enough to be news".<sup>2</sup>**

Leaving the process of co-operation to experts, i.e. not to politicians or diplomats has practical advantages.

A commission given the task, from a political authority, to facilitate trade, will be able to work continuously because their target is limited in extent. They will organise their priorities according to what is rational from an economic point of view, and ideally be immune to ideological influence. If a complex problem is split up into a number of minor issues, it becomes practically possible to solve it. The method is:

**"binding together those interests which are common, where they are common and to the extent to which they are**

common...like other forms of union it (functionalism) links together a number - any number - of political units, but for one purpose at a time...one might put it, that (it) is a limited liability association between political units".<sup>9</sup>

The functionalists disagree on the possibilities and the reasons for the emergence of a conflict. Some maintain that the aspirations of those involved are stimulated and lead to an equilibrium, that in turn prevents any conflict to terminate or affect the integrative process negatively. This somewhat naive belief has been contradicted by the course of events, Myrdal's experiences as head of the ECE illustrate this.

Johan Galtung provides a theoretical framework for the political implications of trade. His ideas are of relevance to our discussion and will be mentioned briefly.<sup>10</sup> If co-operation is to succeed it must be symmetric. Symmetry is needed to avoid dominance by the stronger, more advanced country over its lesser developed partner. Co-operation should, ideally, lead to similar changes in the national economies of those involved. This view excludes the possibility of successful co-operation between countries at an unequal level of economic and technological development. Professor Groom, although agreeing with Galtung's ideas, claim that there is a possibility of success, if the countries involved openly



acknowledge that there is a role differentiation. Such an acknowledgement can only be achieved on the basis of mutual trust and confidence, which must be initiated politically. The more advanced state would then have to moderate its claims and demands in order to lessen the political and economic effects for the other party. This would make structural violence, a favourite concept of Galtung's, impossible.

Functionalist arguments have for a long time pervaded the writings of scholars and the statements of politicians in the Soviet Union, and make up a corner-stone for the doctrine of peaceful co-existence.<sup>11</sup> The argument that security and trust can be created and maintained through international trade is frequently repeated. What is not repeated is the "futuristic" contents of functionalism, that national loyalties will dwindle and be replaced by allegiance to the international community.

The idea of a stride towards world peace is obviously appealing from a propagandistic point of view. The role of the state as protector and promoter of international links is not contradictory to the communist system. However, if the state takes on a role anything other than initiator and co-ordinator, and uses its powers to inhibit co-operation it becomes a negative factor according to functionalist thinking.

### 1.3. Soviet-West European Trade

#### Outline of Approach

Trade is the most regular form of contact between the Soviet Union and the outside world. The size of turnover changes from year to year, so has the composition of exports and imports, but economic intercourse with the West has remained an important source of contact. Because of the state monopoly, political changes have affected trade. The reforms initiated by the Gorbachev leadership do not differ from past developments in that respect. Still there are a number of factors that set the present reforms apart from previous attempts, i.e. their scale and the implications for the economic and social mechanisms in Soviet society. Earlier, the assumption of an external threat was used to oppress every deviation from the party line. Today, the international atmosphere of detente has made this argument improbable. The boldness of the present debate has made it difficult to assess what the future holds, and because many of the reforms are still on the planning stage, their implications are difficult to estimate. What is sure today, is that the reforms have envisaged a new role for foreign trade, there is an increased willingness to open the domestic economy for foreign investments, and increase industrial co-operation with the West. Foreign trade is to be used as a growth factor

to overcome the economic gap existing between the Soviet Union and the market economies.

A valid source of information to the background for the present initiatives is the debate between academics and politicians in the Soviet Union. Whereas academic debate in the West usually is without any direct relations to the political elite, and therefore does not provide the observers with anything more than an indication of the possible future path of developments, this does not apply for Soviet society. The links between the leadership and the intelligentsia are more intimate, and an article in a prominent journal or a newspaper may often serve as a signal of future changes. Vneshnyaya torgovlya, the official journal of the Ministry for Foreign Trade, Ekonomicheskaya gazeta and Voprosy ekonomiki have all been indispensable for an understanding of the most recent events. For the decade leading up to Gorbachov's election in 1985, the Soviet sources have largely consisted of books. The source material has not been limited to Soviet publications, Western books and articles are used whenever relevant.

Why Soviet-West European trade? Many answers can be given. As we have already discussed, the pattern of trade depends on the partners' level of economic development. Soviet foreign trade can be divided into three categories: trade with the members of the Council for Mutual Economic Assistance (CMEA), trade with the capitalist market economies

of Western Europe, North America and Japan, and finally trade with the developing countries in the Third World.

Table 1  
TRADE TURNOVER IN PERCENTAGES

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Socialist	65.2	65.4	64.5	58.5	54.1	56.3	55.6	57.3	59.8	56.1	53.7	52.8	54.3	56.0	57.5	61.1
-CMEA	55.6	56.2	59.6	53.9	48.9	51.8	50.8	52.6	55.7	51.9	48.6	47.6	49.1	51.2	52.1	54.9
Capitalist	21.3	21.5	22.6	26.6	31.3	31.3	32.9	29.6	28.0	32.1	33.6	32.2	31.6	30.1	29.3	26.7
Dev.count.	13.5	13.1	12.9	14.9	14.6	12.4	11.5	13.2	12.2	11.8	12.7	14.9	14.1	13.9	13.2	12.2
SUM	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Source: Vneshnyaya torgovlya, different years.

Socialist planned economies make up the largest Soviet foreign trade partner. Despite the close political ties, their share of Soviet trade decreased throughout the seventies. At the beginning of the present decade, Soviet trade with the CMEA group grew to the same level as in 1970. Soviet export largely consists of oil and gas, the imports mainly machines and equipment. This pattern, characteristic for trade between industrialised and developing countries, has become even more pronounced during the last fifteen years. It is in the interest of Soviet security to maintain close links with Eastern Europe and the other socialist countries, and the systemic similarities facilitate trade greatly. Trade between them is priced according to the average price on the world market for the preceding five years, making it possible to draw up trade agreements for the near future without fearing the rapid price fluctuations of the free market.

The developing countries are the least important trading partner. The Soviet Union purchases mainly raw-materials and perishables, Soviet exports are dominated by oil and weapons. The latter are included in the trade figures, though they are not allocated identifiably amongst trade partners.

Soviet trade with Western Europe, although much smaller in terms of turnover than CMEA-Soviet trade, has a similar composition of exports and imports. Soviet exports are dominated by energy and semi-processed products, whereas imports have a much higher technology content. In addition to these commodities, the Soviet Union is second to South Africa the world's largest gold producer.

on Western estimates. This commodity<sup>is</sup> not mentioned in Soviet statistics hence we must rely on Western estimates. Apart from the composition of trade, there are few other similarities between the West and other Soviet trading partners. The political setting makes the transactions unique. The frequent tensions and political "war of words" between the USSR and the West put quite different demands upon the Soviet negotiators than any agreement concluded with a developing country or a planned economy.

The Soviet view of Western Europe will later be discussed in some detail. I will here make some purely introductory remarks to justify singling out Western

Europe as a separate group. Although the Soviet Union conducts trade with the two most advanced industrialised countries outside Europe, Japan and the United States, the policy towards them is influenced by security reasons and economic factors different from those deciding the relationship with Western Europe. Strategically, the European continent is split between the USSR and the West. Political tensions, or alternatively detente, are nowhere as acutely felt as in Europe. For both, it is of interest to observe the developments occurring in the other part of the continent, and if possible to try to influence it.

Western Europe is not only given a high priority in the Soviet Union for security reasons. Economically, this is the most important market for Soviet energy output as well as purchases of commodities the Soviet Union does not produce at all, or in insufficient quantities. Western Europe is in these terms, far more important than the United States. On average during the last fifteen years, around 60% of Soviet imports from capitalist countries originate here, and around 90% of exports to the capitalist countries have West European destinations.<sup>12</sup> In fact the United States, despite leading in many technological fields, have a trade pattern with the Soviet Union that deviates from the general structure of East West trade. Agricultural products and raw materials make up around 80% of current US exports, the West European

percentage for the same commodity group is on average between 13 and 16. The difference is even more pronounced in the group of machinery and equipment which makes up half of West European exports, but only around 10% of US goods sold to the Soviet Union.<sup>13</sup>

The trade between the two superpowers differs from the general pattern in terms of stability as well. In Soviet literature and articles, the United States is accused of using the economic intercourse as a weapon for American interests. In Soviet eyes, the debate on the evils of too close trade connections with the Soviet Union has been started by the CIA. The American political campaign and economic sanctions against the West European linkage to the Soviet gas grid, and the US grain embargo following the invasion of Afghanistan were taken as prime examples of US discriminatory practice. Concerning Soviet-US trade, Moscow seems to opt for a separation of trade and politics, a line quite different from the insistence on the expansion of trade as a result of good political relations.

Soviet trade with Japan does not differ as much from the general pattern as that of the US. Like in the case of Western Europe, Japanese exports are dominated by technology and machinery. Soviet-Japanese trade has not shown the same degree of stability as the trade links with Western Europe. It seems that Japan was instrumental in the development of East Siberia, and as the initial phase of this

is drawing to a close, Japanese involvement has decreased markedly. Politically, it would be unwise to treat Japan together with Western Europe. The present leadership in the Kremlin seems to show a greater degree of differentiation in its policy towards the individual capitalist countries. Gorbachov's speech in Vladivostok in 1987, underlined Soviet interests in renewing relations with Japan, without any reference to the other Western countries.

#### 1.4. Outline of Thesis

Our task will be to analyse and explain the current changes in Soviet trade with Western Europe. However, a proper understanding of contemporary events is only possible on the background of past developments. Only then will we be able to describe the origins of the present problems and assess the possibility of solving them successfully. After this short introduction, where the theoretical approach as well as the reasons for the focus have been established, attention will be given to the developments of the past decade. For the sake of clarity, a distinction between the political and the economic aspects will be made. Obviously, not every topic can fit easily into these boxes. The composition of trade will be dealt with in some detail. Particular attention will be given to the effects of the drop



in the oil price on the Soviet economy, and the various attempts to cope with the rapid deterioration of the terms of trade.

The political aspects will concentrate on the various strategies behind Soviet trade with the West and the political implications of the trade. The build-up of the bureaucracy and its effects upon the trade will be assessed.

In the second half of this thesis, we will concentrate upon the reforms initiated since the election of Mikhail Gorbachev by the Politbureau in April 1985. Special attention will be given to his view on the function of foreign trade and its relationship with the domestic economy. The endeavours to become member of the General Agreement on Tariffs and Trade (GATT), and the attempts to rectify decades of Soviet disinterest in European Common Market (EEC) will be described. As will be shown in detail the future of the reforms depends to a significant degree on the relationship between the enterprises and the foreign trade bureaucracy.

The discussion and the reforms in the Soviet Union procede at a rapid pace. My discussion will focus on the period between April 1985 and January 1988.

## References to the Chapter Introduction

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- 3 Gunnar Myrdal, "Political Factors Affecting East-West Trade in Europe", Co-existence Vol.5, 1968, p.141.
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- 5 A. J. R. Groom, "Functional Approach and East/West Cooperation in Europe", Journal of Common Market Studies, Vol.XIII, 1974-75, p.21.
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- 9 Mitrany, A Working Peace System, Chicago: Quadrangle Books, 1966, p. 229
- 10 See Johan Galtung, "Cooperation in Europe" published by the Council of Europe, Consultative Assembly, Political Committee, Strasbourg, February 1968.
- 11 Groom, op.cit. p.29, and Zellentin, op.cit. pp.197-205 both refer to an extensive range of Soviet writings expressing functionalist views.
- 12 Jensen. op.cit. pp.23-24
- 13 ibid.

## 2. The Economic Aspects of Soviet Trade with Western Europe

### 2.1. Introduction

In this chapter, we will discuss the economic aspects of Soviet trade with Western Europe. The purpose is to provide a background for the reforms initiated under Gorbachev's leadership, as well as to introduce certain concepts central to the understanding of the problems. The various forms of trade conducted between the Soviet Union and Western Europe will be analysed.

Soviet economic intercourse in Western European markets raises the question how dependent Soviet economic performance is on the West. In order to assess its importance, one must distinguish between general and specific dependence. This issue is not only related to the closeness of co-operation between individual industrial sectors in the West and in the Soviet Union, but the symmetry of the relations. The composition of exports and imports decides whether the relationship is symmetric or not. The balance of trade, and the degree of indebtedness are additional influencing factors. Symmetry or asymmetry cannot be assessed on the basis of one single statistical measure, but a common measure is to compare the share of capital intensive goods of the imports and exports of a country. To avoid asymmetry, they should ideally be relatively

equal.

2  
SUMMARY  
The financial importance of foreign trade to Soviet national income is difficult to assess. The problems of doing this has been the subject of a lengthy debate among Western scholars.<sup>1</sup> No original thoughts and profound comments can be expected here. I will primarily devote my attention to the role of foreign trade to Soviet economic strategy and development.

The table below shows that the traditional Soviet economic strategy of extensive industrialisation had run into serious troubles. The economic development had been based on heavy industry and a surplus of labour resources. In the post-war era it became clear not only that the domestic resources had been depleted due to rigid planning mechanisms and wasteful exploitation of raw-materials, but that the technological development in the West was far ahead of the Soviet Union. This backwardness was thought possible to overcome through greater involvement in trade with the advanced capitalist countries. This change in policy coincided with, as stated previously, a lessening of political tensions in Europe.

Table 2

TRENDS IN SOVIET ECONOMIC PERFORMANCE. Average annual percentage growth rates, 1966-85,

	1966-70	1971-75	1976-80	1981-85
Net Material Product <sub>1</sub>	7.7	5.6	4.2	3.4
Industrial Production	8.5	7.4	4.5	3.7
Agricultural Production	4.2	0.8	1.6	2.0
Gross Investment <sub>1</sub>	7.6	6.9	3.4	3.5
Employment <sub>1</sub>	3.2	2.5	1.9	1.0
Labour Productivity in Industry	5.8	6.0	3.2	3.1
Real Per Capita Income <sub>2</sub>	5.9	4.4	3.4	2.2
GNP <sub>2</sub>	5.5	3.8	2.7	2.7

Sources: 1. Narodnoe khozyaistvo SSSR, various issues  
2. CIA, Handbook, various issues

Western Europe became an important market for Soviet purchases, and to an increasing extent of Soviet energy. The price of oil increased sharply in 1973-74, and this improved Soviet terms of trade. This improvement gave the Soviet Union the possibility to increase imports at a much faster rate than exports. In addition the growth in imports was made easy by Western credits.

## 2.2. SOVIET EXPORTS IN THE SEVENTIES AND BEGINNING OF THE EIGHTIES

Table 3

### THE COMMODITY STRUCTURE OF SOVIET EXPORTS TO THE OECD-AREA, 1975-1984

Year	Energy	Raw-mat. and semi-processed	machinery and equip.	Industrial consumer goods.	Agricult. products
1975	53.7	36.8	4.7	0.7	3.6
1976	56.7	35.6	4.3	0.7	2.1
1977	56.5	37.2	3.1	0.6	2.0
1978	60.1	32.6	3.5	0.9	1.9
1979	64.2	28.9	3.9	0.8	1.5
1980	70.1	24.1	2.8	0.6	1.1
1981	77.3	18.8	2.2	0.4	1.0
1982	79.1	17.2	1.8	0.3	1.0
1983	78.6	16.9	1.7	0.3	1.1
1984	79.2	17.0	1.7	0.3	1.2

Source: Statshandelslandernas utrikeshandel 1975-1984

Del IX, "Sovjetunionen", Ost Ekonomiska Byran,  
Stockholm, 25.11.1986

### 2.2.1. Energy

The export of energy, in the form of crude oil and petroleum products, natural gas, coal and electricity, remained an important, but not dominant part of Soviet exports. Prior to 1973, this group accounted for only 20 per cent of overall Soviet exports to the West.<sup>2</sup> After 1973, this changed drastically. The increase in the share of energy can be explained by a ~~the steep~~ rise in the price on the world market for oil and,

somewhat later, gas. West European governments realised that a crisis in the Middle East, or a sudden increase in prices

could endanger the supplies. *[Soviet non-oil, non-gas exports to the West have not fallen absolutely, or in terms of volume, rather they have grown slowly.]*

Table 4

SOVIET ENERGY EXPORTS TO THE OECD-AREA, 1975-1984. Value in thousand dollars, and certain West-European countries shares of the OECD imports in %.

Year	Value	Britain	France	FRG	Italy	Austria	Finland	Sweden
1975	4581514	3.3	7.9	16.7	13.9	5.2	19.4	8.2
1976	6101517	6.4	6.9	16.5	17.7	5.3	16.7	5.6
1977	6851552	7.2	8.0	15.1	16.3	5.7	17.3	5.4
1978	7931272	6.4	7.6	19.1	15.4	6.1	14.6	5.7
1979	11922635	4.3	9.2	22.5	12.0	4.8	15.6	7.1
1980	16818434	2.5	16.2	18.2	14.2	5.2	16.3	3.5
1981	18359699	2.5	15.3	16.9	14.3	6.7	15.8	2.0
1982	19829958	3.7	11.6	18.5	15.8	4.3	14.1	2.9
1983	19605739	3.5	11.8	19.2	16.1	3.5	14.4	4.0
1984	20499764	3.7	10.8	20.4	17.8	4.0	12.0	2.8

Source: OECD Statistical Series C, 1975-1982, Series B 1983-84.

A desire to spread supplies was expressed by Western politicians, and the Soviet Union was able to fill the demand. The "oil price shock" coincided with an increased Soviet ability to service Western import needs. The price increase served as a strong incentive to expand the country's productive capacity, and covered the loss in income from other commodities sold to the West. Although the price increase forced Western industry to transform to more economical forms of production, demand remained high. A further expansion of Soviet production was planned involving large-scale co-operation with Western enterprises, in

particular West-German and Italian companies.

Not unexpectedly, the large profits generated from the oil sales together with the building of a pipeline for the transport of oil and gas to the threshold of Western Europe, lead to a clear dominance of oil among the various sources of energy exported. Certain developments can be detected, the sales of electricity to the West remained very limited and was increasingly marginalised during the seventies. Only the two Western countries sharing a border with the Soviet Union, Finland and Norway, imports any substantial amounts of electricity. A similar trend has been evident in the case of coal. Due to its high sulphuric content as well as a general decline in Western demand, it has decreased in importance. In 1984, slightly more than 2 per cent of Soviet energy exports to the OECD consisted of coal and electricity.<sup>3</sup>

Soviet exports of gas to the West has increased at a faster rate than oil. Yet, an increased reliance on gas need not be an exclusively positive thing. Whereas oil deliveries can be regulated relatively flexibly, the technicalities of exporting gas severely limits this quality. The main difference between the two energy sources lies in the absence of a world gas market. There is no equivalent to the spot market for gas. Whereas oil exports can be increased to meet increased demands for hard currency { home, this is not the case for natural gas. The matter is



further complicated by the fact that gas cannot be increased to counter-act a slump in oil exports, even on a long-term basis. Firstly, the price of gas is linked to the price of oil, secondly, a decreased demand for oil is in fact a decreased demand for energy, i.e. it affects gas negatively as well. However, it should be added that the long-term agreements covering the deliveries of gas are attractive from a planner's point of view.

The increase in<sup>2</sup> oil and oil products took place mainly in the beginning of the seventies. When West European demand for gas increased, this became a major export commodity, but not until the end of the decade. The growth in the export of oil was far more steady than the sales of gas. In 1984, oil and oil products accounted for approximately 65 per cent, natural gas ca. 33 per cent."

As table 4 shows, there are considerable differences in the sales to individual countries. Finland has over the years become the most stable customer, and the country with the greatest degree of dependency on Soviet oil supplies to fulfil its demand. In fact, oil accounts for almost the entire part of Finnish imports from the USSR. The purchase price is regulated by long term agreements, but the Finnish state oil company resells it according to world prices. This has generated considerable income as the Soviet price usually has been far lower than the world market equivalent. Despite this price discrepancy, the Finnish oil price for the

domestic consumer has meticulously been kept in line with the developments on the world market, thus forcing Finnish industry to economise parallelling the drive for energy-saving in other West European companies. The surplus holdings of oil resulting from the cut in domestic consumption has been re-exported to the West at considerable gains.

The sharpest increase in any country's purchase of Soviet energy has occurred in Holland. This, however, was not due to any long-term agreements, but to Dutch purchases of relatively cheap Soviet oil on the spot market in Rotterdam.

In the case of West Germany, overall energy imports from the Soviet Union have increased. The relative importance of gas has grown very quickly, and West Germany remains the largest market for Soviet gas. Politically, worries have been voiced both in Bonn and Washington over the potential vulnerability this entails for German industry. The Americans tried to influence the West-German government to buy Norwegian oil and gas, but the Soviet offer was more competitive. Still, it has been claimed that strategic considerations have refrained West Germany from importing more.

The importance of energy exports for the generation of hard currency cannot be under-estimated. According to statistics for 1985, about 80 percent of Soviet

hard currency returns came from crude oil exports (65 per cent) and natural gas (15 per cent).<sup>5</sup> Financially, the Soviet Union is therefore extremely affected by the price changes on the world market.

### 2.2.2. Raw Material and Semi-Manufactured Goods

Table 5

Certain West-European Countries' Share of Soviet Exports of RAW-MATERIALS AND SEMI-MANUFACTURED GOODS to the OECD-area, 1975-84, (in %)

Year	Britain	France	FRG	Italy	Austria	Finland	Sweden
1975	10.0	9.0	12.5	6.6	2.0	8.6	4.3
1976	19.6	10.2	14.1	6.6	1.7	5.8	3.0
1977	17.6	11.5	15.4	6.4	2.1	4.7	2.3
1978	7.8	12.3	19.5	6.4	2.0	4.3	1.7
1979	7.3	11.3	19.3	7.9	1.9	4.3	3.6
1980	7.4	12.9	13.9	9.5	2.2	5.6	2.3
1981	7.4	11.0	16.1	9.0	2.7	6.4	3.1
1982	6.7	10.1	15.4	7.6	3.0	6.8	4.6
1983	7.8	9.4	13.1	8.2	2.9	7.3	2.1
1984	7.4	6.2	12.6	7.8	3.3	6.6	4.3

Source: See Table 3.

This group has remained relatively stable in volume, but has decreased in importance as a major export commodity. Its share of overall Soviet Exports to Western Europe has gone down dramatically, from ca. 37 per cent in 1975 to a mere 17 per cent ten years later. Raw materials,

mostly wood, paper pulp, textile fibres, and ore, have dominated throughout the period. However, their relative size has declined, mainly due to the increase in export of chemical products. The expansion of this group of commodities was made possible by massive investments, and by importing Western machinery for the chemical industry. In 1984, 25 per cent of raw materials and semi-manufactured goods were chemical products.<sup>6</sup> Other main export articles were non-ferrous metals and minerals.

In an OECD context, Japan has been the major customer for this group of Soviet exports, In Western Europe, West Germany has been the most important destination, although its share has declined considerably from a fifth of Soviet exports of raw materials and semi-manufactured goods to the OECD in 1979, to around 13 per cent three years later. This negative development has been reflected in other West European countries, with Great Britain as the notable exception. The British market share has risen quite steeply from ca. 10 per cent in 1975 to 20 per cent the following year. Yet, in the year prior to Gorbachev's election, the British market had declined in importance to a mere 7.4 per cent.

Precious stones belong to this group as well. But apart from Belgium and Luxembourg which throughout the seventies accounted for ca. 60% of Soviet exports to the OECD, no countries point themselves out as dominant.<sup>7</sup>

### 2.2.3. Export of Machinery and Equipment

This commodity group makes up so little of overall Soviet exports to the West that many observers disregard it all together, and concentrate on the above groups instead. From an economic point of view this is understandable, the share has declined from 4.4 per cent in 1975 to ca. 1.7 per cent in 1984.

The most important commodity in this group has been cars, in 1984 they accounted for ca. 27 per cent of the machinery and equipment exported. This was a sharp decrease from five years earlier when they made up 43 per cent of this export group. During the same period, the importance of ship grew, the main buyer was Finland. Finland retained her position during the seventies as the most important Soviet export market for machinery and equipment. This was mainly due to a large single order for Soviet equipment for the construction of an atomic power station at Lovisa i West Finland.

### 2.2.4. Other Commodities

The picture would not be complete unless we mentioned a few other marginal groups. The share of

industrial consumer goods dwindled, reflecting lacking Soviet investments to enable exports. Some commodities which had been important during the sixties like furniture, books, records and optic equipment lost ground to antiques and works of art, mostly exported to West Germany

Soviet exports of perishables have at no point been above one per cent of Soviet exports to Western Europe during the seventies. Bad harvests together with increasing domestic demand has left little for sales abroad. A further problem are the strict quotas imposed by the EEC. The Chernobyl disaster in 1983, resulted in fears of importing contaminated perishables adding to the difficulties facing Soviet exports of food.

### 2.3. SOVIET IMPORTS DURING THE SEVENTIES AND BEGINNING OF THE EIGHTIES

Table 6

#### THE COMMODITY STRUCTURE OF SOVIET IMPORTS FROM THE OECD-AREA, 1975-1984

Year	Energy	Raw-mat. and semi-processed	Machinery and equip.	Industrial consumer goods.	Agricult. products
1975	0.3	41.5	36.6	3.8	17.3
1976	0.3	40.0	35.7	4.1	19.2
1977	0.4	41.4	39.1	4.4	13.9
1978	0.6	42.1	37.5	4.4	14.8
1979	0.5	45.1	28.9	4.3	14.8
1980	0.6	44.7	24.9	5.0	23.9
1981	0.9	41.2	21.9	5.8	29.3
1982	1.3	41.4	26.7	4.9	24.8
1983	0.9	40.1	30.1	4.9	22.1
1984	0.9	38.4	24.9	5.1	29.1

Source: See Table 3.

Whereas Soviet exports are easily described as being dominated by energy products, imports show a far greater diversity. The major commodity groups are raw materials and semi-manufactures, machinery and equipment, and products for the agricultural sector. Industrial consumer goods have taken up around 5 per cent of the imports. Energy did not surpass 2 per cent between 1970 and 1985.<sup>a</sup>

### 2.3.1. Machinery and Equipment

Table 7

Certain West-European Countries' Share of Soviet Imports of MACHINERY AND EQUIPMENT from the Soviet Union, 1975-1984, (in %)

Year	Britain	France	Switzer. Liechtenstein	FRG	Italy	Austria	Finland	Sweden
1975	4.6	12.6	2.7	29.5	8.5	2.0	8.4	2.9
1976	4.1	8.4	3.1	28.5	7.3	2.2	13.1	3.4
1977	3.5	10.7	3.0	28.0	10.4	2.3	14.7	2.4
1978	5.0	10.6	2.6	26.2	8.5	3.0	14.0	1.3
1979	5.2	14.8	2.7	25.2	9.0	4.0	11.8	2.9
1980	6.6	11.6	3.1	29.0	8.9	2.0	13.0	2.8
1981	4.5	6.4	2.7	23.2	8.1	1.7	21.0	2.3
1982	4.0	6.6	2.4	24.1	7.3	2.4	21.6	2.5
1983	3.6	10.7	1.4	27.8	11.2	2.1	22.4	1.4
1984	5.3	7.7	2.1	29.8	9.5	3.9	20.9	1.9

Source: See Table 3.

The German scholar Heinrich Machowski describes Soviet imports of machinery and equipment as being largely aimed at supporting already existing production. Thus directly reflecting the planners' efforts to do everything to fulfill the plan.<sup>9</sup> There is sufficient evidence to support Mr. Machowski's assumption, there have been no radical changes in the import of these commodities from Western Europe. During the seventies, apart from Soviet decisions to import entire plants for the production of a certain commodity, like cars, this group remained relatively stable in its composition.

Those changes that have appeared, have been



the result of large-scale projects, or politically endorsed expansion of an industrial sector resulting in increased imports to comply with the priorities. The decisions to build a pipeline for oil, and later gas from Siberia to Western European countries are examples of such large-scale projects. The equipment required was either too sophisticated or too costly to be produced in the Soviet Union, and had to be purchased abroad. There were certain political obstacles to the construction of the pipeline. The American government was staunchly opposed to Western dependence on the Soviet oil fields, and to emphasise the US. point of view, an embargo on the export of any technology related to the project was imposed. After a short delay, Soviet industry was able to fill the gaps created by the Americans, of course to great political acclaim from Moscow.

The size of imports involved in such projects can be illustrated with the Soviet import of machinery and equipment under the Gas Agreement of 1981. In 1981, this group accounted for \$ 129 millions, the following year the first purchases for the gas pipeline were made, ammounting \$ 268 millions. In 1983, imports lay at a record high of \$ 463 millions.<sup>10</sup> As has been shown in table 4, the largest market for Soviet oil and gas is West Germany, it is therefore not unexpected most of the machinery and equipment imported is West German. The country's position as chief supplier has undoubtedly been strengthened by

favourable financial conditions. A very low interest rate has attracted Soviet buyers. West Germany *supplied* between 30 per cent (1975) and 23 per cent (1981) of all Soviet imports of machinery and equipment *from the West ii*

During recent years, Italy has become an important exporter of capital-intensive goods to the USSR. The country's state-owned company Nuovo Pignone received in 1981 an order for turbines and compressors at the sum of \$ 1 billion. This order has not yet been fulfilled, exports of machinery and equipment from Italy amounted to \$ 391 millions between 1982 and 1984.<sup>12</sup>

France has not been affected by the gas project to any great extent, Soviet imports have mainly consisted of turbines, office machines, refrigerators and heating equipment.

The development of Finnish exports of this commodity group has been remarkable. Of the West European countries, only Finland and the Federal Republic were able to increase their market shares. All the more remarkable, as Finland was not involved in the gas project. The main commodity was ships, which increased steadily in importance, in 1984 accounting for more than 50 per cent of Finnish exports of equipment.<sup>13</sup>

### 2.3.2. Agricultural Products

The OECD-area has not only been an important source of much needed technology, but has increasingly been used as a larder when the Soviet Union has been struck by bad harvests. The share of imports from the OECD countries has been dominated by the grain purchased in the non-European member states, the United States, Canada and Australia. The size occupied by grain varies according to the Soviet harvest results in 1977 62 per cent of agricultural imports were grain, in 1984 it had increased to 84 per cent.<sup>14</sup>

The European share has mostly consisted of meat, and meat- and dairy products, reflecting the decrease in livestock as the fodder situation has deteriorated in years of bad harvests. However, one must conclude that the role of the West European countries as suppliers of agricultural commodities has been quite limited when compared with the grain exporting countries.

### 2.3.3. Raw Materials and Semi-Manufactures

This is the largest commodity group imported from the capitalist countries. The share has remained very stable since the mid-seventies, varying from 42 per cent in 1985 of overall imports from the OECD, to 37 per

cent ten years later. The role of Western Europe as a supplier is far greater than these numbers suggest. Apart from Japan, the non-European share in this trade is very small.

Table 8

Certain West-European Countries' Share of Soviet Imports of RAW-MATERIALS AND SEMI-MANUFACTURED GOODS from the OECD-area, 1975-84, (in %)

Year	Britain	France	FRG	Italy	Austria	Finland	Sweden
1975	3.9	8.5	26.6	11.0	1.9	10.4	2.8
1976	3.4	8.6	20.5	10.5	1.9	8.1	1.9
1977	6.5	12.2	20.5	10.8	2.1	8.8	2.0
1978	4.4	10.7	22.5	8.4	2.6	7.7	1.9
1979	3.6	9.9	23.0	7.2	2.9	7.2	1.7
1980	5.1	11.4	23.3	6.9	3.0	12.7	2.0
1981	4.5	8.5	18.0	8.0	3.6	15.5	1.8
1982	2.9	5.8	19.1	9.3	3.3	14.6	1.5
1983	3.4	6.1	22.1	10.7	3.7	12.3	1.5
1984	6.1	6.7	20.5	11.1	4.4	10.3	1.4

Source: See Table 3.

In volume, the imports stagnated during the latter part of the seventies. The dramatic fluctuations we have seen in other groups have not occurred here.

Within the group, semi-manufactures have been the main commodity throughout the period, accounting for between 60 and 70 per cent. The most important products have been iron and steel. West Germany was the chief supplier, a peak was reached in 1979 when 35 per cent of Soviet imports were made here. However, West Germany's share has declined both in relative and in absolute terms in the 1980s. This has happened over a period when Soviet imports went down.

This decline in Soviet demand has been caused by the completion of the gas pipeline.

Cellulose and paper products have been the main Finnish export commodities within this group. As this demand remains unaffected by any large-scale projects, Finland has been able to maintain her market position.

Chemical products, including the increasingly important group of plastic products, have accounted for around a fourth of overall imports of raw materials and semi-manufactures from the OECD area.

#### 2.4. Some Comments on the Soviet Import and Export Structure (1970-1984)

The sharp increase in the oil prices in 1973 raised Soviet export earnings considerably. The decline of almost all other commodities was covered by the petroleum-dollars, and it gave the Soviet Union the possibility to increase imports. Oil was an export commodity well suited to Soviet foreign trade, whereas the quality of machinery can vary greatly, oil retains the same characteristics no matter where it is pumped out of the ground. The connotations of shoddy workmanship attributed to Soviet products do not apply to oil. Another important point concerns the "planability" of energy exports, excluding the small quantities of oil sold

on the spot market, they are usually regulated by long-term agreements, and therefore easy to plan.

Soviet problems on the export side are manifold. In his book on how to increase exports, especially of machinery and consumer goods, A.V. Engibarov lists a number of deficiencies causing the bad results.<sup>15</sup> In his opinion, Soviet exporters should use long-term market forecasts so that they can be prepared to meet any demand as it emerges. At the same time he advocates greater flexibility at the enterprise level, enabling managers to adapt rapidly to changes in demand. Implicit in this view is an accusation against the rigidity caused by the incorporation of the foreign trade activities in the national economic plan. In addition, Engibarov emphasises the lack of knowledge of Western marketing techniques among Soviet negotiations. This has been repeated many times since, and is without doubt a weak point. In a domestic economy characterised by chronic shortages, advertisements or any other marketing activity is superfluous. In the West, a proper marketing method can be decisive, but whereas one may have to portray a car as something "sexy", oil does not need any glossy wrapping.

What is perhaps more interesting is Engibarov's discussion of the price. Traditionally, the competitiveness of Soviet commodities has relied on the relatively low price compared to commodities produced in the West. Engibarov

writes: "It is important to underline ... that lowering the price on any commodity for the sake of helping sales is erroneous" rather one should use "... non-price factors"<sup>14</sup> like greater emphasis on the customers' requirements, marketing, advertisements and above all, the quality of the commodity. The poor performance of Soviet goods on Western markets cannot be explained by the price, the cost of production in the Soviet Union are low. At times the country has been accused of "dumping", i.e. offering commodities for sale at a price far below the average and thus ruining competition.

Whereas a Western handbook in export would underline the relationship between high sales figures and a low price, Engibarov is right in his emphasis on the quality of a commodity as more important. Apart from a few commodities produced with Western equipment, the Soviet Union has not been able to offer a wide-range of high-quality commodities on the Western market. The increasing concentration on energy products in the export sector, and the dominance of machinery and equipment from Western Europe is a clear sign of an increasing gap between the technological levels in the two economies. Even industrial sectors that enjoy political priority, have performed badly and Soviet products fall short of Western standards. This even applies to the energy sector where the Soviet Union uses out-dated techniques and methods, increasing costs

considerably.

Another factor that should be mentioned here, is the stagnation in economic growth in Western Europe in the latter part of the seventies and first years of the eighties. This led to a decrease in import needs, affecting the Soviet Union adversely.

Some Western observers have claimed that the Soviet Union suffers from an "export-aversion and an import-hunger". The export-aversion is a legacy from the Stalinist period, when the theory of "socialism in one country" resulted in an economic development based on autarky. Only the surplus remaining when all domestic needs had been satisfied could be sold abroad. Needless to say, there is no incentive to export when the commodities are in demand at home. In addition, there was no economic incentive to produce for foreign markets. Whereas the profit-motive is an impetus to export in the West, a Soviet enterprise manager did not increase his earnings sufficiently to make up for the stringent quality requirements for a commodity singled out for export.

The "import-hunger" results from the planners' attempts to make up for the short-comings in the domestic economy. In addition, political decisions to expand a certain sector may result in increased imports. For instance, in the sixties, the food and textile industry were given priority, during the beginning of the seventies the focus had shifted to the car industry.



In the West, special attention has been given to Soviet imports of high technology. Judging from the impressive mass of literature devoted to the subject, one might be tempted to believe that Soviet imports consisted of little else. As we have seen from the statistics, reality is quite different. Even within the machinery and equipment category, export of highly sophisticated equipment is not above the average of trade between the West and other parts of the world. Looking closer at the composition of Soviet purchases of high technology, a considerable amount has been targeted to meet the expansion of the chemical industry. However, as this import decisions were taken under pressure from political priorities, there was no guarantee that the commodities purchased could be efficiently utilised. The enterprise manager did not always have the know-how, or equipment to use the imported machinery. Western exporters have sometimes complained about a hostile atmosphere at enterprise level. The following West German observations are not unique;

"The initiation phase for installations procured from the Federal Republic of Germany generally takes longer time in the Soviet Union than in Western countries.... In comparison, the time needed in the Soviet Union to assimilate technological knowledge on the fundamental features of imported installations are considerably longer. It can be observed that at least five years are necessary to copy

single machines. The imitation of complex installation can take up to ten years. The industrial plants are set on fulfilling production plans. Innovation is regarded above all as a disturbance which endangers plan fulfilment and thus jeopardizes premiums."<sup>17</sup>

Two scholars from the University of Hamburg, Andreas Wass von Czege and Raisa Tchakhmakhtcheva analysed the Soviet import and export structure. They concluded that the hierarchical rigidity of the foreign trade bureaucracy lead to an inherent tendency in the system to avoid complicated transactions, and especially commodities where the productive capacity is hard to estimate in the short term.<sup>18</sup>

The importance attributed to the import of technology for the overall performance of the Soviet economy can be further dampened if we compare import of technology with growth rates. Throughout the seventies, Soviet purchases of equipment and machines rose almost five times expressed in rubles, from 0.9 million in 1971 to 4.4. million in 1981,<sup>19</sup> while the rate of economic growth over the same period fell. Another indicator which normally increases as a result of technological innovation is labour productivity. It grew at an increasingly slow rate from 5.8 per cent in 1971 to 3.1 per cent in 1980 (See table 2). This does not discard the argument that imports of technology are important for Soviet economy, the figures could have been

worse without the Western commodities.

The role of technology imports for the defence sector is difficult to assess. There are no Soviet sources available, and Western literature on this issue are based on assumptions. However, there is no doubt that those commodities that are suited to the needs of the military sector are rapidly utilised. In 1972, it was discovered that bearings from an American company were used in Soviet inter-continental missiles. Seven years later, trucks produced in a plant bought from the West, were used during the invasion of Afghanistan.

Looking at imports in a wider perspective, it has been claimed that imports of agricultural products have had a greater impact on the Soviet economy as it has made scarce investment capital available in the civilian sector.

## 2.5. Debts and Balance of Payments

Table 9

Current Account Balance and Soviet Debts to the West 1970-1985,  
in million US \$.

Year	1970	1971	1972	1973	1974	1975	1976	1977
Gross debt (end year)	n/a	1,808	2,408	3,748	5,175	10,577	14,707	15,609
Net Debt (end year)	n/a	582	555	1,685	1,654	7,450	9,969	11,181
Current acc. balance	260	414	810	1,490	2,666	-3,882	-3,854	2,080

Year	1978	1979	1980	1981	1982	1983	1984	1985
Gross debt (end year)	16,373	18,047	17,861	20,900	20,000	20,501	20,303	24,764
Net debt (end year)	10,393	9,241	9,289	12,470	10,000	9,577	8,960	13,664
Curr acc. balance	2,944	3,668	3,484	2,600	5,176	6,582	6,235	4,390

Sources: 1970-81: Joan P. Zoeter, "USSR: Hard Currency Trade and Payments" U.S. Congress JEC Soviet Economy in the 1980s: Problems and Prospects;  
1982-84: Handbook of Economic Statistics 1984,  
Figures for 1985 derived from Wharton Econometric Forecasting Associates, CPE Service, Analysis of Current Issues, VI, 16 (24.04.86) but with net interest assumed to be 10% of end-year debt.  
Table quoted by Philip Hanson in "Soviet Foreign Trade Policies in the 1980s" Berichte des Bundesinstituts fuer ost-wissenschaftliche und internationale Studien, 41-1986, pp.56-57.

Western estimates of Soviet hard currency holdings do not correspond with the picture drawn up in Soviet sources. The greatest problem is posed by the Soviet arms export to the developing countries, it is assumed that the payment is in hard currency. Whereas this trade is part of Western calculations, they are not mentioned in Soviet statistics.

In comparison with the other CMEA-countries, the Soviet Union has been financially prudent, limiting the hard currency borrowing to a minimum. Even during the initial half of the seventies, when the interest rates in the West were low, the Soviet Union did not take up loans to finance the modernisation of industry and import of capital goods like Poland. Compared with the other East European countries, the Soviet Union could rely on its reserves of gold in cases of financial distress.

Soviet gold sales increased after the mid-seventies, a trend coinciding with a decrease in the import-growth. Net debts hardly grew at all, and the Soviet Union was even able to reverse the size of the debts until the drop in energy prices in 1985.

The Soviet balance of payments has shown a deficit only twice during the seventies, in 1975 and 1976. Various factors resulted in this deterioration. The main reason was the bad grain harvest in 1975, which forced the Soviet Union to import large amounts for human and animal consumption. Soviet trade relations had been affected by the US. Congress' refusal to ratify the US-USSR Trade Agreement in 1974. At the same time, hard currency incomes had been influenced by the temporary drop in oil prices between the two OPEC agreements in 1973/74 and 1979/80. Some of the capital goods imported after 1974 had already been ordered on credit, there was little the foreign trade policy-makers

could do to rectify the deficit until 1976, when as mentioned above, imports were limited.

## 2.6. Financing Foreign Trade

Most Soviet foreign trade, though not hard-currency trade, is bilaterally balanced. This applies to the transactions conducted with West European countries. This preference has resulted in a systemic avoidance of multilateral trade and co-operation agreements. However, the financial mechanisms used change according to the various forms of trade conducted

Most transactions are conducted in hard currency, and is thus not different from the trade between the market economies. Yet the systemic differences between the Soviet Union and Western Europe have resulted in a number of transaction forms that deviate from the ordinary manner of transactions between industrial countries by paying in kind. As the ruble is not convertible, the Soviet purchases of commodities in the West would have been severely limited if it had not been able to pay for the imports in this way. More or less willingly, Western companies have to accept to be payed, partly or completely in commodities. The best known example is the agreement between Pepsi Cola Company and Stolichnaya Vodka according to which bottle is

exchanged for bottle.

Transactions where the use of money is avoided amounts to around 10 per cent of world trade according to Gatt statistics.<sup>20</sup> This number covers many debt-ridden Third World countries, so the share of the planned economies is smaller. In East-West trade generally, 20 per cent of all agreements involve the payment in kind. Statistics for the Soviet size have not been produced. The number of agreements is not a good measure since the volume of commodities exchanged is not reflected. Bearing in mind that the Soviet Union has concluded a number of large-scale agreements with Western companies, the oil and gas pipelines being the largest, the Soviet share by far surpasses those of her allies.

So far the terminology applied to this trade has been avoided as there is considerable confusion among Western writers. Counter-trade is frequently used as a comprehensive label, covering a variety of transactions. For the sake of simplicity, the terms applied throughout this chapter are those applied by the OECD.<sup>21</sup> According to the OECD, it is necessary to distinguish between commercial and industrial compensation. They differ in content and in duration, industrial compensation agreements usually involving the partners in a long-term co-operation.

Commercial countertrade transactions normally last between 12 and 18 months. Barter trade is the most primitive form of countertrade, money is not used and the payment is

entirely in kind. No third party is usually involved, and the transactions are conducted simultaneously and over a brief period of time. Pure barter agreements were quite prominent during the sixties. At that time there was a greater demand in the West for Soviet products and the Western partner did not have any great problems selling the goods.

More sophisticated is compensation trade, a label covering several widely used sub-categories. In its strictest sense, a compensation deal is based on a single contract, stipulating the deliveries as well as the counter-deliveries. The Western exporter may be paid in a convertible currency, but only as a credit until the commodities received have been sold. However, the fluctuations of the exchange rates together with frequent deficiencies and delays on the Soviet side, have put many obstacles in the way of this trade. According to the OECD, it is today "only of historic interest, having practically fallen into disuse".<sup>22</sup>

Still, the second sub-category, counter-purchases is the most frequent mode of countertrade transactions between the Soviet Union and the West. Counter-purchases involve not one, but two mutually independent contracts. The basic contract covers Soviet imports from the West, the second is an obligation on behalf of the Western company to purchase Soviet goods at approximately the same value. I have not found examples where the the basic contract concerns imports of Soviet goods. The reason for the dominance of this kind of



transactions is the possibility of transferring the second contract to a third party. If the Western company cannot find any suitable Soviet goods, the contract can be bought by another company. Not seldom, these agreements span a period up to five years, in some cases with no set termination date.

Other variants of counter-purchases, like parallel transactions and pre-compensation purchases are less used. The former has been called "a gentleman's agreement". It involves no formal obligations, but a mutual understanding that the Western seller will purchase goods for roughly the same value in the Soviet Union. The latter does not appear in trade transactions between the USSR and Western Europe as the Soviet partner has problems fulfilling the characteristic features of this trade form. The more advanced East European countries, like Hungary and the CSSR have engaged in this kind of transactions. A pre-compensation purchase involves the delivery of the countertrade goods before the Western exports are realised. This kind of trade can only be carried out if the counter-purchase goods are easily marketable in the West. Usually a market-survey jointly conducted between the Eastern and Western firms is carried out before the agreement is signed. As Enigbarov stated, this is a technique alien to a Soviet enterprise. In addition, a pre-compensation purchase is only possible if the two companies are able to work together intimately.

Industrial compensation agreements are usually divided into buy-back contracts and industrial co-operation. The former has been used with some frequency in trade with the Soviet Union, especially in connection with turn-key plants. A part of the commodities produced are delivered to the Western partner, partially or completely replacing cash. The time lag between the construction of the plant and the export of the finished products may be substantial, and the Western partner may receive a bridging credit or the cash amount of the payment first.

Both the oil and gas agreements belong to this category, pipelines and equipment were exchanged for energy. However, buy-back agreements are not restricted to large-scale projects. During the seventies, Finnish construction companies build hotels in the Soviet Union. Finnish tourist authorities payed the workers in return for the right to use the hotel for a specified number of nights.

Industrial co-operation agreements are sometimes omitted in the listing of various forms of countertrade.<sup>23</sup> A concise definition may be difficult to arrive at, the Austrian economist Jan Stankovsky has defined it as "an intensive and long-term form of economic cooperation at the enterprise level between partners belonging to different economic and social systems".<sup>24</sup> As has been stated above, co-operation between enterprises are more prevalent between the West and Eastern European countries where the

bureaucratic obstacles are fewer than in the Soviet Union.

The incentives to engage in industrial co-operation differ according to the economic environment of the enterprise. Co-operation, like any other trade, can only occur if the profit prospects are greater than the costs incurred by the co-operation. The prospects of new markets, cheap labour and raw materials together with low costs of production are the major incentives for the Western partner. From the Soviet point of view, import of new technology is positive. Yet, there seems to be signs of ambivalence in the Soviet attitude on this point. The most recent technological equipment is not welcomed as its output may be difficult to assess, on the other hand outdated production techniques are refused. Yet, the free flow of innovations and information resulting from co-operation is a considerable incentive for the Soviet planners because it may spread within one industrial sector. Apart from that, it has certain benefits in the form of constant Western supervision and improvements. The output from a turn-key plant quickly lags behind the Western equivalent in terms of production and quality. Periodical modernisations have to be imported from the West at considerable costs.

The profit potentials of industrial co-operation depends upon the kind and scale of the technology transferred. It must be segmentable, that is divisible between two production units. Not every kind of technology

falls within this category. Another factor influencing the feasibility is the size of the Western firm. Not unexpectedly, large, multi-national companies have the means to bear the costs of the prolonged negotiation- and introduction-phase. Equally important, as the name implies, they have experience in technology transfer. Large firms, and especially multi-national companies have channels for the marketing of countertrade commodities at their disposal. A German survey on industrial co-operation concluded that the degree of satisfaction increased proportionally with the size of the Western enterprise.<sup>25</sup> If the counter-goods are sub-standard, or they are difficult to sell due to low demand, a small firm has less capacity to carry the losses than a large enterprise. Jan Stankovsky's conclusion that the future of industrial co-operation is largely dependent on the participation of multi-national companies and enterprises of similar size, is based on this assumption.<sup>26</sup>

In the cases where the Western partner is a small firm, the co-operation is usually less intimate<sup>27</sup>, often involving little more than the selling of a production license. Industrial co-operation agreements are dominated by large Western enterprises, as the smaller frequently are unable to offer the Soviet partner commodities in the desired quantities. The share of small companies in co-operation agreements between West Germany and the Soviet Union was almost halved from 28.2 percent in 1972 to 15.0 per cent in 1979.<sup>27</sup>

Questions concerning the administration of the co-operation often give rise to problems. For the Western partner, the ability of the production to change according to the demands of the world market is crucial. A Soviet manager will assess this flexibility negatively when compared with the stability and security of being part of an overall plan. The possibility of state intervention endangering the production may be a disincentive for a Western enterprise. However, the survey referred to above, showed that a mere 25 per cent had insured against this eventuality. In fact, it seems unlikely that this would happend. Industrial co-operation agreements is given great importance by Soviet spokesemen as evidence contradicting any claims of backwardness. The conclusion of an industrial co-operation agreement is announced in the Soviet press in terms quite out of proportion with its economic importance.

Industrial co-operation agreements are a relatively recent feature of Soviet-West European trade. They were used during the latter half of the seventies to implement the transition to a more intensive mode of economic development. The idea was to create "islands of modern technology", transforming the surroundings. The same strategy had been used by other countrys with considerable success, so-called "reverse engineering" played an important role in the transformation of Japan into a leading industrial nation. If modernisation had been dependent on the diffusion of new

ideas alone, this might have been successful in the USSR. Apart from the fact that the diffusion mechanism in the Soviet economy is controlled by the economic planners, there were no incentives to improve and expand the new methods that were imported. Industrial co-operation has had only a marginal effect on the Soviet economy. In fact, the only country where this kind of trade has had any sizeable impact has been Hungary. In contrast to the USSR, economic reforms transferring responsibility and decision-making power from the planners to the managers, were carried out prior to the conclusion of co-operation agreements.

Industrial co-operation agreements remained limited in numbers and importance. The enthusiasm surrounding the Second Basket of the Helsinki Declaration has been quite out of proportion with the results. Soviet hopes of modernising their industry with a more diversified export structure as the result, were not realised. Although the "spirit of Helsinki" undoubtedly helped the Soviet Union to attract Western interest, the economic slowdown in the West made businessmen less willing to risk their capital on long-term agreements in an unknown market.

The main reason for the lacking results, was the absence of any changes in the economic mechanisms of planning and management. Encouraging innovations is one thing, but to make them function is quite another. As any new technique carries risks in terms of output and profitability,

often requiring a considerable period to give maximum performance, the planners will view them quite differently from the politicians. The planning of the unknown is impossible.<sup>28</sup> Concerning the entire strategy of importing modernisation, it is interesting to recall that Marx had underlined its futility. He repudiated the idea that a partial mode of production can be imported without changing the surrounding economic mechanisms.

The problems arising from the attempts to import techniques and ideas from a market economy to an alien setting, were not solved during Brezhnev's leadership, and only those co-operation agreements given high ranking political support were of any longevity.

#### 2.6.1. Trade in Licences

A license is a document giving the buyer the right to use a patented process of production. The trade in licenses is thus a trade in innovations. The difference from industrial co-operation is clear, the purchase of a license does not result in any long-term contact, or supervision and control of the end-result by foreigners. If foreign participation is considered undesirable, licenses is an ideal way of importing modernisation. Bearing in mind the

avoidance of cross-border contacts and exchanges of ideas and innovations outside the scope of the planners, it is not unexpected that Soviet writers repeatedly has emphasised the importance of the licence trade. This view is well reflected in the following statement, made by a Soviet economist:

**"The exchange of licenses remains one of the most efficient channels for the transfer of technology: utilising licences accelerates the technological development of countries in the corresponding fields by 7-8 years, at the same time, co-operation in production (can only achieve) 1-2 years".<sup>29</sup>**

No Western economist has substantiated this claim to the influence of licenses on a speedy modernisation of the production.

The export of licenses from the Soviet Union to the capitalist countries is often presented in Soviet media as the best evidence against Western accusations of sluggishness and backwardness. Mr. A. S. Voskoboy, Head of the Main Administration for Scientific and Production Co-operation of the USSR State Committee for Science and Technology, claims:

**"It is often said that scientific and technological cooperation benefits the USSR alone and that, allegedly, the Soviet Union receives more information than the Western partners. The facts, though, prove differently. By today, the USSR has registered 1600 US patents, whereas**



the United States has registered 5600 Soviet patents - practically four times as many. This fact alone proves who is gaining more."<sup>30</sup>

Although there is no reason to doubt his figures, they represent only a part of the truth. The United States is a very bad example. American prudence in exporting technology and patents is politically founded, and applies to any communist country, or indeed neutral country suspected of re-exporting know-how eastwards.

Still, we are left with the puzzling fact that the Soviet Union seems to lead in the field of industrial inventions. According to statistics, the country has more engineers and scientists employed in the industrial research sector than any Western country. Based on this number the size of the export of licenses does not compare favourably with other industrial countries.<sup>31</sup>

Two arguments contradict any assertion of Soviet leadership. First of all, the Soviet export of licences is largely within the metallurgical and chemical sectors, both have been the cornerstones of Brezhnev's industrial policy. Apart from those, there are serious weaknesses in the domestic economy concerning inventions and innovations. This was admitted by Mr. Voskoboy:

"....Soviet foreign trade associations may draw on the help of competent R & D centers which are frequently highly successful in their work on the

laboratory level, where they obtain effective results, but who experience certain problems in their practical realization of their developments because our national production facilities are overburdened".<sup>32</sup>

The second reason can be found in the strict central control of foreign trade applied to the purchase and selling of licences. Import and export are strictly regulated by Litsenzintorg, a sub-division of the Ministry for Foreign Trade. The access of a Soviet enterprise manager to the innovations in the West is virtually non-existent. Every channel of information is controlled by the foreign trade bureaucracy. The free flow of know-how, considered indispensable in the West, is unknown. Deprived of the knowledge of recent changes in the West, a Soviet manager has no reason to press Litsenzintorg for the purchase of a license. In fact the entire bureaucratic procedure is so cumbersome and time-consuming that it alone explains the imbalance in the Soviet license trade. If a Soviet manager has been made aware of any innovations that can be used by his enterprise, he must first make inquiries whether this innovation can be recreated by domestic scientists without the purchase of a license. If the answer is negative, a formal request can be made by the manager to the branch ministry responsible for the industrial sector concerned. The branch ministry will then send an application to the State Committee for Inventions and Discoveries and to Gosplan.

The planning organs must be convinced that the license can reduce production costs, according to Philip Hanson, at least by one third when compared to improvements available domestically.<sup>33</sup> In addition, the license must give minimum a 12 per cent return, the present value of the production will be calculated with an 8 per cent discount rate. The assesment is based on shadow exchange rates, which are not available to the Western seller. He will therefore not be able to adjust his offer to meet domestic competition.

Throughout the seventies, the "non-commercial" channels of information, for instance exchanging technicians, engineers and scientists with the West was negligible. These practices play an essential function for the cross-border diffusion of ideas in the West.

Finally it should be stated that there are ceratin contradictions between various statistical sources on the trade in licenses. An article written by the then Deputy Chairman of the State Committee for Inventions and Discoveries, E. I. Art'emev, in 1979, illustrates this.<sup>34</sup> He states that from the late sixties to 1977, The Soviet Union sold 550 licences to the West. Over the same period the import of licenses from the same area was 2.5 times bigger, clearly contradicting Voskeboy's claims, and the statistics published by Litsenzintorg. The latter only supervises pure license transaction, Art'emev on the other hand was in charge of industrial co-operation agreements and turn-key plants,

both embodying import of production licenses.

#### 2.6.2. Countertrade, Advantages and Disadvantages

Throughout the seventies, Soviet officials maintained that countertrade was the most progressive form of international economic intercourse. These claims were made despite accusations from the International Monetary Fund, and leading Western nations that it disrupted the natural pattern of trade. Although there is no evidence that countertrade has adverse effects on international economic relations, we have seen that there are aspects of countertrade that makes it a mixed blessing for the Soviet economy.

The catchement area is limited, only enterprises of a certain size can engage in countertrade. This would not have mattered if innovations were restricted to large companies. Clearly, that is not the case.

Countertrade practices are not wide-spread. Engaging in negotiations requires skills and experience. This has lead to the present situation where a small number of specialised West European companies function as intermediaries, levying charges for their expertise.

A valuable point of criticism often voiced by Western business men concerns the superior position of the

Soviet negotiator. He is both purchaser and seller, a role that gives him considerable power. This would be avoided if the pattern of bi-laterality could be broken. Although it is easier to achieve a balance on the basis of bi-lateral trade, it is less flexible than multi-lateral economic relations. The monopoly position of the Soviet partner is regarded as a negative aspect, but might have been slightly more acceptable if the Soviet side had not attempted to control the sales of the countertrade commodities in the West. As mentioned above, it is quite common for a Western company to sell the goods to an enterprise which has specialised in countertrade. These companies have marketing channels at their disposal not available to the receiver of the goods. The problem arises when the Soviet trade officials claim that this is a breach of the initial agreement. In some cases, these accusations have been made against selling the commodities by a subsidiary firm of the Western partner. Apparently, the Soviet trade officials believe that this reselling of the goods leaves their partner with huge profits. Though this is unlikely, it would not be a breach with common business practice in the West. To avoid the embarrassment of a long complaint procedure, it has now become common for the Soviet side to demand a "right of transfer" paragraph in an agreement.

Countertrade makes up a kind of transactions that are regarded in the West as costly, cumbersome and

consequently to be avoided. Despite strenuous Soviet efforts to counter these views, countertrade still lacks prestige internationally.

One of the most serious complaints made against countertrade, is that it sometimes results in dumping massive amounts of cheap goods and ruining the market. The protective measures taken by the West to avoid this is frequently reported in the Soviet press, either as "trade-imperialism" or as signs of "the cyclical crisis of capitalism". Obviously, the Soviet selection of countertrade commodities is limited due to the sub-standard quality of output. There have been cases where foreign trade negotiators have counted on the ignorance of the Western counterpart and offered items already sold in the West by a company with the exclusive selling rights. Lada cars is just one of these commodities frequently appearing on the list of countertrade goods.<sup>25</sup>

## 2.7. Some Concluding Comments

Above we have discussed some of the problematic aspects of the economics of Soviet-West European trade. By using the term economics, we have refrained from analysing the political and bureaucratic reasons behind many of the problems.

Even though Soviet trade officials measure their achievements in terms of total turnover, and on that background may claim considerable success, voices have been raised in Soviet media maintaining that the opposite is true.

The heavy reliance on a single export commodity has created instability. The effects of the changes in the energy prices have hit the Soviet purchasing power severely. Other countries are in a similar situation, but one may conclude that the loss of stability is more serious in a planned economy than in a market economy. Not only does the entire planning process become more difficult because the hard currency income can not be estimated, but the economic mechanisms do not have the flexibility to cope with rapid changes. Any deviation from the planned amount of foreign trade endangers the other sectors of the economy. This touches upon the question of Soviet dependency on the foreign markets. If foreign trade had little prominence, the effects of the changes in prices or demand abroad would not have any serious repercussions on the domestic economy. As stated in the introduction, foreign trade was during the 1970s, increasingly used as a growth factor in the Soviet economy. During the years of extensive economic growth, characterised by massive industrialisation programmes, only the surplus left when domestic demands had been met was exported. The enhanced role given to foreign trade has reversed the priorities. According to the present

policy on foreign trade, the planning process will commence with an estimate of the import required to sustain the politically set targets of modernisation and intensification of production. The final step in the process will be to determine the level of exports needed to generate the hard currency for the purchases in the West. This is one of the fundamental differences between the foreign trade of a market-type economy and a centrally planned economy, not only is the latter limited by the availability of commodities, but the imports decide the economic development and growth to an extent unknown in the West. In a market-type economy, the economic growth depends on the volume and value of exports.

On the export side, economists have referred to the price flexibility of capitalist enterprises. The Soviet rigidity has made it far easier for their competitors to make more attractive offers. Apparently, this is not the case in the area of energy, here the Soviet observers follow price developments very closely and have been able to compete with Norway, their main rival in Western Europe.

The depreciation of the dollar, the base currency for energy transactions with the West together with the decrease in the oil price lead to a shift in Soviet imports. During the early seventies, it had been possible to purchase both food in years of bad harvests, as well as expensive machinery in the West. Most of the food and fodder were



bought in the non-European OECD countries, Australia, Canada and the United States for US. Dollars. The machinery and equipment were bought chiefly in the Federal Republic for German Marks. The changes in the exchange rates between the mark and the dollar limited Soviet purchasing power severely. Faced with the options between food and machinery, imports of the former increased at the expense of the much-needed capital-goods from the West. The politically set priorities of intensification of the economy and modernisation of the productive sphere suffered a set-back. As has been pointed out previously, the domestic economic setting is ill-suited to the transplants of sophisticated equipment from the West, and the beneficial effects cannot easily be estimated. The gains from increased food imports are easier to see. The change from machinery to food on the import side has been encouraged by the down-ward trend in world food prices. The Common market countries as well as other OECD countries have large surpluses of food. It should be emphasised that buying grain and food with the hard currency generated through sales of oil and gas is highly cost-effective for the Soviet Union. According to estimates presented by Jan Vanous, the Soviet domestic marginal costs of grain production in 1985 is 12.8 times that of gas, and 2.5 times that of oil.<sup>36</sup> The exchange ratio ton for ton of oil against grain equalled 0.67 tons of oil per ton of wheat in 1985. Whereas the exchange ratio for oil against all other

products fell during the first part of the 1980s, this trend was only reflected to a minor degree in food and grain.

The various kinds of trade we have looked at, all have in common that they are easily controllable. But the supervision of the central foreign trade bureaucracy is imposed at the cost of open information channels. Any exchange of ideas between managers and engineers, as well as the incentives to use them, is impossible without them. Without any contacts with the Western market, the enterprise manager is deprived of any knowledge concerning the competitiveness of the commodities. If the future of his enterprise depended on the sales in the West, he would have implemented the necessary improvements to increase sales. Attempts were made to link managerial bonuses to sale figures, but as the statistics for Soviet manufactures show, this *did not lead to a considerable increase in the demand for* commodities beside oil and gas.

The commodity structure of the import and export sector is a fact contradicting the image of a progressively developing industrial state. Soviet commentators have pointed out the general lack of skills required to compete in an alien setting, i.e. the market. "The problem of marketing" was given considerable attention during the latter half of the seventies. However, the debate did not lead to any radical changes. Still, it was by no means without impact, no real changes can be carried out

with the hope of success without any previous discussion. The old arguments about Western trade imperialism and protectionism could not cover the systemically determined reasons for the poor Soviet performance. The important point here is that Gorbachev was not given a "tabula rasa". Many of his ideas had been put forward during the final years of the Brezhnev-period.

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### 3. The Political Aspects of Soviet Foreign Trade with Western Europe

#### 3.1. The State Monopoly of Foreign Trade

The previous chapter has discussed the composition of Soviet foreign trade, its destination and origins. This chapter will discuss the political aspects. As has been shown, the Soviet foreign trade profile differs considerably from that of the Western countries. Politically, the fundamental difference between the two economic systems lies in the Soviet state monopoly over all foreign trade activities. The principle of state control was established as early as 1918, and was not interrupted by the brief NEP-period in the twenties when foreign investments, private initiative and ownership was permitted to give the economy a brief respite. At first the People's Commissariat for Trade and Industry was given the responsibility for the foreign economic activities. The Civil War together with the Western blockade had effectively severed most trade links. When the hostilities ceased, foreign trade was revived and a separate Commissariat for Foreign Trade was established.

State monopoly does not only mean state ownership (I refrain from the term 'public'), but the

legitimacy of political influence on foreign economic activities. Western doctrine asserts the independence of foreign trade from the sphere of politics, aptly illustrated in Great Britain's continued trade with South Africa despite the government's condemnation of apartheid, the Soviet Union repeatedly emphasises the unity of foreign trade and foreign policy. Foreign trade is to be applied in the fight for global peace, and co-operation between the capitalist and the socialist parts of the world. Thus, the Soviet doctrine is that trade is an extension of the foreign policy, just by other means. The Minister for Foreign Trade for the greater part of the seventies, N. S. Patolichev, describes the grand aims of the foreign trade of the Soviet Union thus:

"The decisions of the CPSU on the development and protection of foreign economic links enjoys the unanimous support of the entire Soviet people. The strategy of the party to develop mutually beneficial co-operation with every country in the world has the approval of ... progressive forces abroad and all sober-minded activists, it completely corresponds to the strengthening of peace and international security, and with the interests of workers. The economic relations between West European countries and the socialist countries safeguards the works of hundred thousands or even millions of people under the conditions



of economic crisis and unemployment."<sup>1</sup>

This chapter will try to answer to what degree this viewpoint is reflected in the foreign trade activities. We will therefore expect that a deterioration in political relations between the Soviet Union and a West European country is reflected in the economic links between the two. As has already been pointed out in the introduction, the decrease in trade in the period of the Cold War can be explained as a result of political tension, as well as a result of Soviet efforts to integrate Eastern Europe politically by using economic means.

Finally in this part of the thesis, the foreign trade bureaucracy will be described in order to explain the policy-making process and the relations between the domestic and the foreign economy. The party and the state are two separate structures. Yet, there are several links between them at every level, both in the form of party members in high ranking post in the bureaucracy and in the party's duty to combat any "formalism" in the state administration, usually understood as any attempts to act without consulting the party. Although the relationship between the party and the state undoubtedly is ripe with conflict, the basic problem for Soviet foreign trade negotiators is the combination of the stability and predictability preferred by a planned economy, and the ability to act flexibly in Western European markets where

the future may be impossible to envisage. The foreign trade policy makers are set to implement politically set targets, and at the same time must meet both their obligations to foreign partners, and assure a sufficient hard currency income by means of exports. It is necessary to emphasise that despite every effort or initiative undertaken by the Soviet side, the reactions of the foreign markets will be decisive, not only in terms of success or failure but also for the range of options available. Thus, Western sanctions and embargoes, while triggering Soviet resentment and protests, will seriously limit the range of commodities available for import by the Soviet Union.

### 3.2. Towards a Socialist Foreign Trade Policy

According to Soviet spokesmen, state influence on foreign trade is by no means exclusive to Soviet foreign economic activities. In his description of Western foreign trade policy, Vladislav Malkevits claims that:

**"The system of means to influence the national economy can be found in the arsenal of state-monopoly, regulation, management to secure the basic conditions for the capitalist mode of production....".<sup>2</sup>**

The socialist foreign trade is aimed at more than merely reproducing the system, as apparently is the function

given to foreign trade under capitalism. Patolitsev states that:

**"The development of the foreign economic links of the Soviet Union is conducted according to the path drawn up by the Party, serving the task of communist construction in our country, responding to the interests of peace and global co-operation for the benefit of all people.**

**The foreign economic strategy of the CPSU therefore has, a great international significance".<sup>3</sup>**

In the same article Patolichev asserts that the legacy of Lenin still influences decisions. This merits a few further comments. Lenin in fact left a dilemma which has troubled Soviet politicians ever since. Although Lenin strove to use every opportunity to propagate the ideals of Soviet communism with a number of enemies in the West as a logical result, he was quite aware of their economic and technological superiority. Lenin expressed the situation of the Soviet Union quite bluntly, socialism could not exist if all the relations with the West were severed. Without capitalism, socialism could not be successfully implemented.<sup>4</sup> The feasibility of realising socialism **"depends on the relation of Soviet power and authorities with the most recent progress achieved by capitalism".<sup>5</sup>** From Lenin's point of view, and Patolichev's for that matter, trade with the West builds communism and helps to stabilise the system.

This viewpoint does not differ from that held by

Western economists or politicians. A country purchases abroad what it does not produce at all, or in insufficient quantities. It exports what it produces above the demands of the domestic industry if the price is competitive when compared with the prices charged by other countries. In this respects, the Soviet Union complies with the doctrine of comparative advantages, i. e. due to natural resources, human skills, capital goods and geographical conditions a state will have the opportunity to produce certain goods at a more advantageous price than its competitors. The degree of involvement in international trade will decide the extent of development of a country's comparative advantages. It is relevant to emphasise that "comparative advantages" are not a set of factors fixed for perpetuity, but depends on the adaptability of a country's economy to the emerging wishes of its trading partners. Consequently, a strategy of autarky and self-sufficiency is incompatible with the intentions behind this doctrine.

An accusation sometimes made in the West, is that Soviet trade is conducted in order to realise **"the internationalisation of administrative-socialist conditions globally"**.<sup>4</sup> This goes somewhat beyond the mere political statements made at every CPSU Congress and points towards the technicalities of the trade transactions. As was pointed out in chapter two, there is a clear tendency in Soviet foreign trade to avoid the expenditure of hard currency.

However, as the share occupied by countertrade of world trade is comparatively marginal, the imposition of Soviet trade behaviour as the rule and not the exception seems utopian. Attempts have been made by the Soviet Union to gain support for her trade behaviour in international fora. Yet, in comparison with smaller states, the Soviet Union does not have a high profile on foreign trade policy issues. As was pointed out in the introduction chapter, the USSR's share of world trade is far too small to give Soviet policies any particular weight. The USSR has frequently participated in international meetings under the auspices of UNCTAD (United Nations Conference on Trade and Development). Although Soviet delegates have voiced their support for the Third World countries' attempts to achieve a supra-national control over international trade, the Soviet Union has been careful to avoid any commitments that could limit national sovereignty. On the other hand, it has been a clear tendency from the Soviet side to support initiatives aimed at undermining or limiting the principles of free trade. This has been the case in the United Nations' divisions for industry (UNIDO) and trade (UNCTAD) where Soviet support for a New Economic Order has been vigorously propagated. However, there seems to be a discrepancy between the political statements and practice. As is shown in table 1, apart from sales of weapons, Soviet trade with the developing trade with the developing countries has remained low.

It should be mentioned, that despite the developing nations' expressed preference for countertrade the Soviet Union is an insignificant trading partner. For both, the trade with the capitalist and industrialised West is clearly more important. This difference in political statements and actual behaviour is a consistent part of Soviet foreign trade.

### 3.3. The Political Determinants of East-West Trade

As stated in the introduction chapter, the differences in political and economic principles between the Soviet Union and Western Europe has given rise to antagonistic tensions. The level of international detente or, alternatively, tension will therefore play a role in East-West trade. On the background of this, it is possible to compare the development of trade in the seventies and early eighties with the progress of international events.

The first signal of a relaxation of international tensions was given as early as 1967, when the NATO summit had declared that **"military security and a policy of detente are not contradictory but rather mutually complement each other."**<sup>7</sup>. Shortly after, the West German government launched its "Ostpolitik", in full awareness that Germany held the key improved relations in Europe. The political

initiatives resulting in the different "Ostvertrage", facilitating movements of individuals and acknowledging the Oder-Neisse border, the improved relations lead to an agreement on Soviet exports of gas to West Germany. In October 1972, the United States signed a comprehensive trade deal with the USSR. The basic idea was that a close economic integration of East and West would make a conflict too costly for it to emerge. Undoubtedly, there was great interest in the possibilities of trade relations on both sides. However, the initial euphoria could only be realised if trade relations would entail profits. Henry Kissinger commented realistically that:

**"We must be mature enough to recognise that a relation-ship, if it is to be stable, must offer both sides advantages and that the most constructive international relations are those in which both parties see an element of profit. Moscow will derive benefits from others. Here one cannot balance accounts daily in each case, but only for the whole area of relations and over a period of time."**<sup>a</sup>

Kissinger argues along the lines of Myrdal, stating that although political initiatives can open up for improved international relations in most fields, including trade, political pledges alone cannot sustain the improvement in the long run. The increased trade during the first half of the seventies was stimulated by political detente and

a rapid economic growth in the West. After the first oil price "shock" in 1973, the OPEC countries were left with a considerable financial surplus, and these petro-dollars were recycled into the Western banking system. This sudden influx coincided with the a lowering of credit demands in the West due to the onset of an economic recession. The Soviet Union took advantage of these favourable financial conditions and borrowed money to pay for the increase in imports. Although compared with other East European countries, the Soviet borrowing was characterised by considerable financial prudence. In retrospect, it is clear that the increase in the energy prices had adverse effects on Soviet economic development. Debate between Soviet economists had stressed the need for a shift towards a more intensive path of economic development, with increased labour productivity and less reliance on continuous increases in inputs to expand output. The developments in the price of oil had a short-term beneficial effect as it increased the influx of hard currency, yet this enabled the Brezhnev leadership to disregard the pressure for change. This inertia resulted in a widening of the gap between the technological level of development in the Soviet Union and in the west. Today, we may conclude that the task of modernising Soviet industry would not have been as Sisyphean in its extent and complexity if the hard currency had not been solely used to cover domestic deficiencies.



The initial half of the seventies have been regarded as an era of detente, during which the arms race was replaced by economic and political competition. There was seemingly less willingness to revert to threats of violence, although the conflict itself was not removed. It had only changed character. One question that must be asked when discussing the relationship between politics and trade is therefore how can detente be measured? Some attempts have been made to answer in terms of the number of superpower summits or trade agreements signed. There is no clear definition of detente, and there can be no single answer. The issue is further complicated by the fact that international contacts remained relatively relaxed throughout the latter half of the decade (until the invasion of Afghanistan in 1979) despite a decline in the economic relations. The reasons were those envisaged by Kissinger, without any long-term prospectives of profitability, Western business lost interest.

The prevailing point of view among many Soviet economists and writers in the seventies, was that the decline in trade was politically motivated.<sup>9</sup> This development was regarded, and propagated as a threat to peaceful co-operation and co-existence.

To claim that trade promotes peace is not new. This view originates in 19th century liberal thinking on the virtues of free trade, and was taken up by the

functionalists. Mitrany argued that an improvement in one area of international relations would have a spill-over effect. According to functionalist thinking, after a certain period of time, the beneficial effects of international co-operation become evident, and will subsequently be institutionalised in the form of intra-governmental agreements. This had happened in Western Europe, and explains the pressure exerted upon the Carter Administration by her allies, to adopt a less hostile attitude towards the Soviet Union. The frequent disagreements between the United States and Western Europe on the state of East-West relations can partly be explained by the relatively extensive trade relationship between the Soviet Union and Western Europe when compared to the size of US-USSR trade.

Some Western observers and scientists have attempted to assess the relationship between politics and economics in East-West trade by giving estimates for the possible size and intensiveness it would have had in the absence of "non-economic factors".<sup>10</sup> The problems of defining a non-economic factor are considerable. Complete absence of politically set (but often economically motivated) barriers is like a Weberian ideal-type, an aim that cannot be fully realised. Even in the absence of trade barriers, the poor quality and limited availability of Soviet goods would preclude any dramatic rise in economic intercourse. Conditions of detente will, presumably, result

in a lessening of obstacles. However, there are those who have argued that the relationship between trade and detente is spurious. Two American scientists, David Jodice and Charles Taylor have concluded that the improvement in political relations did not lead to any fundamental changes in the economic contacts.<sup>11</sup> Though not discarding their findings entirely, there are considerable problems of interpretation attached to them. The spill-over effect is not easily quantified, and to assess if politics or economics have the primacy in East-West relations is difficult, if not impossible. A related question that should be posed, concerns the possibility that a political conflict might have deteriorated even further without the mutual contacts and common interests generated by trade.

#### 3.4. The Carrot and the Stick Approach

Soviet writers and spokesmen frequently accuse Western politicians of imposing limitations on the economic intercourse. CDCOM is often given as the most blatant example.<sup>12</sup> As has been pointed out, Western behaviour has only marginal influence on Soviet foreign trade performance, but accusing the West of creating obstacles is a convenient excuse for Soviet inadequacy. There are several examples of attempts made by Western governments to use trade

as a means to obtain political concessions, the U.S. grain embargo following the Afghanistan invasion is a recent example. Yet, economic warfare has not been limited to the West. When the West German government accepted NATO's intermediate range missiles, the Soviet Union threatened to cut trade relations. If this had been carried out, German energy supplies would have been endangered in the short run. Thus, by the early 1980s, the Soviet attitude was quite different from the spirit of the Moscow Agreement signed between the two countries in 1970. The threat did not materialise and the trade relations remained unaffected by the political accusations. If a temporary embargo on all trade contacts between the Soviet Union and the Federal Republic had been occurred, it is not difficult to see who would have been the looser. According to Angela Stent, less than one per cent of the German labour force depends on the trade with the Soviet Union.<sup>13</sup> The largest company is Mannesman Anlagebau, and they have stated that a severance of links would just mean a redirection of trade to other countries with only temporary losses.<sup>14</sup> The Federal government has foreseen that a Soviet energy embargo, the largest import commodity, would have serious effects on the German industry. To counter such a move, large reserves have been built up, and it would be possible to receive the required amounts of oil and gas from Norway. Soviet policy-makers are aware that economic sanctions against West

Germany, and any sanctions would include energy, would lead to West German reluctance to rely on Soviet supplies in the future. A West German counter-move in the form of an embargo on machinery and equipment would have dire consequences for the Soviet economy as it would mean a severance from the largest supplier of these coveted commodities. These motives must have influenced the Soviet politicians and limited their behaviour to verbal accusations.

Finland has often been cited by the Soviet Union as an example of the benefits that can be gained by close economic contacts with the Soviet Union, and the impressive increase in the volume of trade is often quoted to substantiate claims that political friendliness generates economic advantages:

"The USSR does not co-operate with any other capitalist country on such a large and extensive comprehensive scale. This is no accident, the achievements we have recorded are the results of the consistent and peace-loving policies pursued by both countries, are the fruits of good neighbourly relations. In the current difficult international situation, Soviet-Finnish co-operation is a good example of how states with different social systems can and must build their relations."<sup>15</sup>

One must disagree, Finland is not a good example,

but rather an anomaly. The present close involvement between the two countries originates in the Finnish defeat in the "Continuation War" of 1944 and the immense war debts levied on Finland. In order to meet the obligations, Finland was forced to build a machine industry with the Soviet Union as the sole purchaser. The political and economic influence of Moscow was expressed in the 1948 Treaty on Friendship, Co-Operation and Mutual Assistance.

The experience and skills earned as a result of the trade, gave Finland a unique position in Western Europe. As has been showed, Finnish trade does not differ significantly from the general West European-Soviet trade pattern in terms of commodity structure. What is radically different has been the long-term agreements that form the basis of the economic intercourse between the two. The USSR is the largest single trading partner for Finland, and the duration of the trade agreements has given the Finnish economy a cornerstone marked by stability and predictability. The beneficial effects have been considerable, in the cases when the world market prices have slumped, Finnish exporters were still able to sell to the USSR and receive payments far higher than would have been achieved on any other market. As has been mentioned, Finland refines Soviet crude oil and resells it on the world market. There have been cases where the Soviet Union has met competition from Finland when negotiating energy sales.

This is of course contrary to Soviet interests, and recently there have been signs of a change in the Soviet policy towards Finland. Worries have been voiced from Finnish businessmen that the long-term agreements will decrease in proportion and that the Soviet Union has become more price conscious.<sup>16</sup> The State Bank of Finland has reported changes in the currency exchange rate.<sup>17</sup> So far trade has been conducted on the basis of a clearing account in rubles, controlled by the Bank. There have been statements indicating that this will be changed, with adverse effects on Finnish profits. If this is done, there "uniqueness" of Finnish trade will be a part of the past.

### 3.5. Soviet Trade Strategies

This section will discuss how Soviet trade with Western Europe is influenced by the needs and requirements of the domestic economy. A main purpose is to point out how the Soviet foreign trade policy makers try to accomodate to the changing domestic context. Previously, the exposition has been limited to point out the shifts in foreign trade and to what extent the Soviet Union is open to new modes of trade. Soviet trade with Western Europe has experienced changes both in the preference of exports and imports and in the Soviet debts and payments balance. Throughout this period, it has become increasingly clear that that the Soviet economy

is unable to compete with the industrialised countries in term of labour intensive output and quality of products. Various strategies have been applied by the policy-makers to overcome this backwardness.

Generally, there are five different alternatives facing the Soviet economic planners in their efforts to raise output and quality. The most radical measure would be to adapt a policy of autarky, thus avoiding the loss of prestige occasioned by the dismal performance of Soviet capital intensive goods on the foreign markets. As has been mentioned, this strategy was adopted during the Cold War. Apparently, spokesmen for this alternative can still be found among senior Soviet economists. In an article on foreign trade and the domestic economy, N. Shmelev states that this option has been advocated.<sup>18</sup> The debate on the feasibility of this move was spurred by the policy of sanctions and embargoes initiated by the US. Administration following the invasions of Afghanistan. However, there were no indications in official speeches or statements that an autarkic strategy was contemplated seriously. What is important is that sanctions and Western hostility resulted in Soviet resistance to engage in any long-term trade agreements with the West. According to Shmelev, fears had been voiced over the potential vulnerability of the Soviet economy. Incidentally, this echoes the debate in Western Europe at the time of the Gas Agreements in the early seventies.



The option favoured by the Soviet leadership during the greater part of the 1970-1985 period, was to strengthen the role of the plan combined with large-scale industrial projects. However, it would be only a part of the truth to claim that the entire export and import structure was the result of prior planning. There was a clear tendency to use foreign trade as an emergency solution whenever the economy was faced with a bottleneck. The best example is the fluctuations in the Soviet import of food and fodder from year to year. Yet, this strategy is not limited to the agricultural sector, the import of industrial products have been affected by this as well. A bottleneck can emerge when the Soviet industry is unable to meet a sudden domestic demand, either because it has not been foreseen by the planners or because the productive capacity is overburdened. It is difficult to assess the reasoning in every case. This is illustrated by the US. embargo on equipment for the pipeline project. This initiative was based on the assumption that the Soviet Union would be unable to produce the desired quality and quantity domestically. After a short while, Soviet industry produced the desired equipment.

There are Western economists who claim that overcoming bottlenecks is the single most important function of Soviet foreign trade.<sup>19</sup> This is debatable, and the validity of this interpretation cannot be correctly estimated without an inside knowledge of the motives behind every

transaction. It is more relevant to emphasise that this particular function depends on the domestic context. If the economy is characterised by stagnation and the absence of dynamic innovations, foreign trade may be relied upon to cover the shortcomings to a large degree. This was the case in the Brezhnev years. Yet, importing solutions are not exclusively limited to lack of progress. Radical transformations of the economic mechanisms may result in short-term productivity losses, and an enhanced role for foreign trade. Friedrich Levchik, an Austrian economist, points out that this was the case in the sixties, when certain sectors of the Soviet economy were subjects to reforms.<sup>20</sup> Even to a lesser degree, imports can be used to facilitate changes in the domestic economy. For instance, a political promise to expand the range of consumer goods may take a long time to materialise, imports can be used to overcome the time-lag between a political decision and a restructuring of consumer-goods production. In his discussion of this particular strategy, Ulrich Wagner mentions Poland as the prime example.<sup>21</sup> Whereas the imports of consumer goods in Poland were done to meet strong public demands, there has been a tendency in the Soviet Union to let the import of consumer goods increase for a short while as a result of "political cycles", i.e. changes of leadership. The present leadership has not followed this strategy. Without doubt though an increase in Soviet gold sales would

bring more consumer goods to the country and thus providing the population with an incentive to work harder, and even more important, the leadership with popularity.

One of the main problems at issue here, is the fact that despite political initiatives to modernise production, increase output and quality, the targets have remained unattainable. The political legitimacy of the system is at stake unless the grand promises of a higher living standard fail to lead to some kind of visual results. Consequently, foreign trade can at best be used to cover the time lag, and at worst be used as a permanent solution. As has been stated previously, the import of machinery and equipment has become an indispensable solution to the problems in a few, but important industrial sectors. This is the case in the excavation and drilling sector. Here, the import of machinery was necessary because the domestic industry was unable to meet the demands. It would have been a rational solution to rely on imports during the initial phase and then copy the goods. However, imports for this branch have not ceased nor been reduced. Bearing in mind that this is one of the industrial sectors that enjoys preferential treatment from the politicians, it is significant that the domestic industry does not have the capacity to copy imported techniques sufficiently to meet Western standards.

It has been pointed out by Ulrich Wagner, that the integration process undertaken by the CMEA might affect the

Soviet trade relations with Western Europe.<sup>22</sup> It is reasonable to assume that intra-CMEA trade in those commodity groups that traditionally have been imported from the West will increase. At the 25th session of the CMEA countries in 1971, a "Comprehensive Programme for Socialist economic Integration" was adopted. What has been called "Long-Term Special Programmes for Co-Operation" have been set up in every industrial field, including technology and machinery. This has obviously been done in order to decrease the dependency on Western supplies of capital-intensive goods.<sup>23</sup> The shift in trade towards the CMEA after 1975 was facilitated by the integration process started in 1971.

Western observers disagree as to what extent Soviet foreign trade is conducted in order to import innovations.<sup>24</sup> There is little doubts that all imports are screened to see if they can be used by the defense sector, or alternatively be copied by the domestic R (research) and D (development) sector. As Soviet exports of capital goods have been in decline since the beginning of the seventies, this strategy has not been successful. The inadequate ability of industrial production to meet requirements, has been acknowledged officially for a number of years. Concerning the reasons for the lack of commodities fulfilling societal needs, this author tends to agree more with the Hayek statement referred to previously on the impossibility of planning the unknown, than the moralising judgement on Soviet innovation

made by Ulrich Wagner.<sup>25</sup> According to the latter, a centrally planned economy is ipso facto a totalitarian dictatorship, anyone who makes an innovation thus contributes to the stability of the system. His conclusion infers that the Soviet union is full of suppressed inventors.

A more reasonable explanation, more in line with recent Soviet debate on industrial policy focuses on the inadequate channels of diffusion available, and even more important, the stifling effects of the plan which effectively excludes any modernisation that may interrupt production even temporarily. A study on the import of technology for certain sectors concluded that:

**"...in most of the technologies we have studied there is no evidence of a substantial diminution of the technological gap between the USSR and the West in the past 14-20 years, either at the prototype/commercial application stages in the diffusion of advanced technology." <sup>26</sup>.**

We must conclude that the strategy of importing modernisation, has only had a marginal impact on the national economy, not so much because imports were insufficient when compared with the requirements but because there were no accompanying changes in the domestic economic mechanisms that would encourage and facilitate their application and diffusion.

The problems connected to an efficient usage of the imports are crucial to the future of the Soviet economy. Soviet press has brought reports of wagonloads of expensive

Western machinery remaining forgotten and rusting at a distant side-track. Foreign trade representatives were set to fulfil import plans issued by the planning authorities, with scant attention to the end-users' needs and requirements. Under Brezhnev's leadership, the answer to the problem of inefficient diffusion channels and modernisation, was a massive expansion in the number of industrial institutes. The emphasis put on enterprise network analysis, budgeting and management practices in Western economic literature, was imported to the Soviet Union, but not to the corresponding level. In the Soviet context these principles were applied centrally, to enable the bureaucracy to respond more flexibly to the problems of the economy. No attempts were made to strengthen the responsibility or expand the autonomy of the enterprise manager like in the West.

Attempts were made to attach scientists and engineers to the individual enterprises. This strategy of cohabitation had previously been tried out in the defence-, and space-sectors, with considerable success. The decisive difference is the political endorsement and economic priority given to these sectors, which do not suffer from the endemic shortages in the civilian sectors of production. Neither space- nor defence-products are exported to the West, and the foreign trade sector is at the mercy of what the domestic industry can produce. It is clearly in the interest of the Soviet Union to offer competitive products. However, the

surrounding bureaucracy, material shortages, and constant interference from the central authorities force enterprise managers to make decisions that are rational seen on the background of these factors, but resulting in output that have few chances on the Western markets.

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#### 4. The Policy-Makers

##### 4.1. Introduction

Soviet debate on the problems of bureaucracy increased in momentum during the latter part of the seventies. Special attention was given to the inadequate communication structure wherein all information was channelled vertically to the top levels, the poor quality of the information, as well as the overlapping scopes of responsibility which lead to insecurity and institutional conflicts in the decision-making process. One of the most valuable contributions to the literature on this topic was made in 1975, by V. P. Gruzinov.<sup>1</sup> His book contains a very thorough analysis of the function and responsibility of the various participants and their interaction patterns. Most of this section will draw upon his findings, because they provide more interesting and credible reading than the frequent complaints against petty tutelage and narrow-minded bureaucracy so often found in Soviet media. Gruzinov goes further, the detailed description of the systemic inadequacies of the bureaucracy implicitly attacks the entire decision-making structure. Gruzinov's work has been a pre-cursor to the discussion currently taking up much of the debate on the problems of the economy in the Soviet press.

Certain common features can be found in any bureaucratic structure, and they deserve to be mentioned as they will influence decisively the outcome of any reform attempts:

- The behaviour and the decisions taken by the participants are influenced by the tasks they are set to fulfil. These tasks are given according to their position in the bureaucratic hierarchy. In the Soviet context, party affiliation will be an additional and important factor.

- The information channels are decided by the various functions. Nobody apart from the very top echelons have potential access to all the information. In the Soviet foreign trade apparatus, this means the Minister of Foreign Trade, the Director of the Bank of Foreign Trade (Vneshtorgbank) and the planning authorities (GOSPLAN and GOSSNAB). What is important here is that the quality and the quantity of information in a Soviet bureaucratic body differs significantly from a Western counterpart. When we take into account that the state administration in the West does not interfere in the decisions taken at enterprise level, the difference between the scope and function of the decision-making process in the West and in the Soviet Union becomes clear. In the West, the information is allotted according to what will be rational from the point of view of fulfilling the task. In the USSR, the rationality is based on what is important from a political point of view.

The neutrality of the civil service is a principle contradictory to communist dogmas. In reality, the political control of the bureaucracy has resulted in an extreme degree of secrecy. Therefore, what may seem to be rational solution from a Western perspective rarely is so for a Soviet bureaucrat. Needless to say, that many of the problems emerging during trade negotiations are based on lacking Western knowledge of the Soviet decision-making process.

The difference in rationality explains why certain forms of trade are preferred to others. It has already been pointed out, that transactions which are easy to estimate in terms of output and return, as well as forms of co-operation with minimal Western interference have played a major role. What should be added here is that the Soviet bureaucracy, like any other bureaucracy, will tend to monopolise its expertise and power. This monopoly has adverse effects on the economy as it insulates domestic producers from knowledge about trading practices, as well as preventing any efficient delegation of responsibility outside the foreign trade bureaucracy.

International trade poses great demands on the decision-making process and the ability to react rapidly and adapt to economic changes on the world market. This section will attempt to draw up a picture of the foreign trade bureaucracy in the Soviet Union to see how suited it is to

fulfil the task it is set to perform. The initial problem will be to identify the various bodies influencing the final outcome of the decisions taken. There is no single decision-making unit, rather a number of instances involved according to the character, duration and contents of the transactions. The central bodies in the Soviet foreign trade sector are: the Ministry of Foreign Trade, the State Banks, the state planning authorities (GOSPLAN and GOSSNAB), the State Committee for Science and Technology. Whereas these are all part of the state sector, the political leadership should not be forgotten, as the principle of state monopoly de facto is the influence of the political power.

#### 4.2. The Constituent Organs of the Foreign Trade

##### Bureaucracy

The function of the various units differ as their names imply, and their influence upon the decisions varies according to the phase of the planning process; the drawing up of the plan, the contact with the Western partners, the implementation of the plan, the link with producer/consumer at home etc.

Political influence on the foreign trade activities is expressed through the constitutional right of the highest

organ of state power, the Supreme Soviet, to dismiss and appoint the Minister of Foreign Trade. In the time between sessions, this task may be performed by its Presidium. In addition, both chambers of the Supreme Soviet, the Soviet of the Union and the Soviet of Nationalities, have a standing Commission for Foreign Economic Affairs which supervise the foreign trade activities. They may issue recommendations and proposals to the Supreme Soviet. Their power is, however, at best marginal. Any fundamental changes or innovative moves of radical importance are not made by these organs but in the highest echelons of political power with the Politbureau of the Communist Party as the most important decision-making body. The degree of involvement in foreign economic questions cannot be correctly estimated in every case. As has been shown, the degree of political control of foreign trade has <sup>not</sup> resulted in any strong, politically motivated moves of significance in Soviet-West European trade. The threats to cut off trade with West Germany being an exception. Likewise would the foreign trade sector get in contact with the political leadership if certain trade issues would touch upon sensitive political questions. One example is the Soviet invitation to Norwegian companies for the drilling of oil on the Kola peninsula and in the Barents Sea, in the latter case the maritime border between the two countries has still not been settled. Yet, it is probably correct to assume that political influence is much stronger in the trade between the USSR and the

developing countries in Asia and Africa where the export of armaments has been a frequently applied method to consolidate political influence.

The long-term outlines of the trade is set by the politicians, but these outlines usually amount to little more than the routine pledges to expand the economic links with foreign countries as a part of the general policy of peaceful co-existence. The large majority of import and export transactions between the Soviet Union and Western Europe are of a non-controversial nature, any high-ranking political interference is unlikely in the everyday conduct of trade.

The Council of Minister, the supreme organ of state power, is important as a co-ordinative and integrative force of the country's economic activities. This function becomes evident when one considers the composition of the Council. The financial institutions, the planning authorities all have representatives here in addition to the various branch-ministries. Attached to the Council of Ministers is the Commission for Foreign Economic Questions which deals with the problems and plans concerning trade with the non-socialist countries, a separate Commission has been set up for CMEA-trade. The Commission does not take any decisions but prepares and collects the material required by the Council. The Council of Ministers does not have the capacity to control the details of the trade transactions. This should not be taken as a sign



of lacking influence or importance, the Council is not a rubber-stamp organ like the Supreme Soviet. General questions concerning the profile of imports and exports will be taken here. The allocation of resources to the enterprises supplying the export sector as well as any signals of future shortcomings that should be covered through import will be discussed and the possible solutions drafted.

Among the representatives of the various ministries, there are two cross-sectional bodies that are represented in the Council. Both play an important role in the Soviet economy, one is the state planning organ, GOSPLAN, the other is the State Commission for Technical and Material Supplies, GOSSNAB. GOSPLAN draws up plans for the entire economy. Formally, it is entrusted with the duty to co-ordinate the various sectors of production by means of five-year plans. In actual life, the importance and influence of GOSPLAN is perhaps best felt in the seemingly continuous issuance of readjustments and counter-plans. For instance, if the domestic industry is unable to meet a set target for various reasons, GOSPLAN may, provided that the shortcoming will have serious repercussions on the rest of the economy, push for a purchase of the desired commodity abroad. GOSPLAN is a central link between the domestic economy and the foreign trade sector.

GOSSNAB's responsibility is to ensure the the material basis for the fulfilment of the targets set by

GOSPLAN. The plans are disaggregated, and the allocation of the necessary quantities of material for the fulfilment of export-agreements as well as the amount of imports, and their composition are decided upon. GOSSNAB is thus an important body in a foreign trade context. The "import-hunger" of Soviet industry will make it the prime target for petitions to import commodities from the West. It is a part of GOSSNAB's duties to ensure the fulfilment of contractual deliveries abroad. However, GOSSNAB is not a direct signatory in agreements with foreign partners, complaints concerning Soviet fulfilments of a contract are not made to GOSSNAB although it would be involved insofar as the rectification would require any additional supplies of input.

The State Committee for Science and Technology (GKNT) is responsible for the implementation of the targets set for the scientific development and the industrial research programmes. This Committee has a screening function, ensuring that similar scientific equipment is not imported for two different branches. In addition to preventing import-overlapping, the Committee is responsible for the diffusion of technological innovations. The annual plans for "The Introduction of New Technique" and "Scientific and Technological Co-Operation with Foreign Partners" are supervised by the GKNT. In comparison with GOSPLAN and GOSSNAB, the GKNT is directly involved in foreign trade

activities and has the right to sign trade agreements. This aspect of GKNT's work is entrusted to a separate foreign trade organisation Vneshtekhnika.

On the basis of the political priorities set by the Politbureau, and the economic targets composed by GOSSPLAN and GOSSNAB, the Minister of Foreign Trade, together with his deputies draws up a plan for their implementation. According to Gruzinov,<sup>2</sup> the integration of the various activities is the responsibility of the First Deputy Foreign Minister. Together with the other deputies, around twelve in number, they form the foreign trade policy unit, deciding upon the division of the tasks to ensure the implementation of the long-term strategies. The cross-sectional units, GOSSPLAN, GOSSNAB and the GKNT can be called upon to assist in the decision-making process. However, it is just as likely that these bodies will try to extend their role as advisors into lobbies, endeavouring to influence the decisions in accordance with their interests. The Minister of Foreign Trade may leave the leadership of this cabinet to his First Deputy Minister, although decisions cannot be signed without him. If no solution can be arrived at with a majority, he has the final say.

In 1978-79 the Ministry for Foreign Trade was the subject of a major reorganisation.

**"The purpose was to improve the management and planning activities of these organisations, to make them more**

efficient, improve the quality of their commercial work on a self-supporting basis and achieve higher end results".<sup>3</sup>

In reality, the reforms aimed towards closer relationships between the Ministry of Foreign Trade and the various branch ministries. Internally, the bureaucratic structure and the delegation of power was altered. A major result was a singling out of a number of sectoral interests into individual foreign trade organisations (FTOs), most representing a particular industrial branch.

So far, the levels directly involved in the policy-making process have been described. The next strata in the ministerial hierarchy is concerned with managerial issues. Far from being a sign of unimportance, this level which mainly consists of the leaders of the various foreign trade associations, is where "the immediate leadership of the foreign trade policy"<sup>4</sup> lies. This level serves as the linkage between the policy-makers and the implementers. The targets set by the planners are broken down, and the most feasible way of realising them is decided upon. On the background of their central position, one may be tempted to say that this is where the "eminences grises" of Soviet foreign trade are. Their importance is by and large a result of the excessive specialisation expressed in the delegation of tasks. As stated initially, the flow of information is subject to centralised control. Information is directed according to the tasks the various divisions of the

bureaucracy are set to perform. This creates severe obstacles to an efficient and comprehensive integration of the Ministry's activities. These problems are of course not limited to Soviet bureaucracy, they are just much more pronounced due to the sheer size number of employees and the vast amount of tasks it has been set to fulfill. The strict division of the tasks into around seventy foreign trade organisations makes the efforts to integrate the activities almost impossible. Any supervision becomes slow, difficult and inefficient. As a result a vacuum is created, which is rapidly filled by informal contact channels and interaction patterns made necessary by the need for rapid decisions concerning transactions with the outside, the foreign partner.

In his analysis of the hierarchical structure within the Ministry of Foreign Trade, and the resulting problems, Gruzinov claims that there is no single unit with the duty to supervise and direct the overall development of exports and imports. Instead, there are four separate offices dealing with imports, and three supervising export. The integration of foreign trade therefore becomes close to impossible. Moreover, the organs that are supposed to co-ordinate and integrate the Ministry's work, are overwhelmed with what Gruzinov diplomatically labels matters of an "operational character".<sup>5</sup> Judging from the hierarchic structure, these matters are probably bureaucratic

conflicts, emerging from a general overlapping of responsibilities and tasks. "As a result, the moment emerges when the overloading becomes exorbitantly large".<sup>4</sup>

Gruzinov's book was published in 1975, and one may expect that the reform efforts towards the end of that decade would have taken his complaints into account. However, no efficient measures were introduced counter the excessive bureaucracy. On the contrary, the expansion and the increased importance of the all-union foreign trade organisations strengthened the functional differentiation. Initially, it had been decided to establish 45 FTOs, but in a short time, the number had increased to more than 70.

The importance of the FTOs should not be underestimated despite their position at the bottom-level of the foreign trade bureaucracy. They are given the task to implement the foreign trade decisions taken by the policy-makers. They form the link between the the Soviet Union and the foreign markets. They are the signatories to trade agreements with foreign partners. After conferring with the directives issued by GOSPLAN and GOSSNAB, they decide the contents and volume of the agreements.

The separation of the power to conclude an agreement from the decision-making process hardly contributes towards speed and efficiency. This split is one of the crucial obstacles to a more active foreign trade profile. However, one may assume that the de facto power of

the FTOs is greater than the formal division of tasks within the foreign trade bureaucracy allows for. The picture is further complicated by the fact that the FTOs seem to have more influence in export than import questions. In the latter case, the FTOs merely function as import agents fulfilling the targets set by the planning authorities. On the other hand, their powers over the Soviet supplier are quite extensive concerning exports. As the FTOs are the link between the foreign purchaser and the Soviet producer, they have to make sure that the demands and specifications of the purchaser are met. The FTO is a juridic person, thus if the commodities exported are not according to the contract, the foreign partner has the right to sue the FTO. In order to make the FTOs efficient and price-conscious, they are run according to the principles of full cost-accounting. They run an economic risk if the commodities exported are judged substandard and payment withheld. However, this would not lead to bankruptcy, and in practice the only consequence would be a loss of bonuses for the managerial staff and a reprimande from superior levels.

The internal structure of the FTOs merits some further comments.<sup>7</sup> The functional differentiation we have seen elsewhere in the Ministry is mirrored here. The managerial leader is the director. The top level of the FTO consists of three councils, one for export activities, one for one for market developments, and one for operational

activities. Directly subordinate to the director are three separate sectors, one responsible for the commercial activities engaged in the export and imports of the commodities, there is one section for economic affairs with offices for planning, transport and marketing. In addition to these, there are two offices with considerable power, the currency office and the office for complaints. The former is the link between the state banks and the foreign economic transactions. Throughout the seventies, the FTOs did not possess any holdings in foreign currency apart from the amount allotted for the day-to-day transactions. Whenever the world market prices rose, or additional imports were required, this had to be cleared with the state banks.

The Office for Reclamations is important as this is where the foreign partners must turn with their complaints. The duration between the time a claim is made and a settlement reached is very long, a problem which probably can be explained as a result of the division between the office responsible for the transactions and the reclamation authorities. The reforms of 1978 did not improve this problem.

The final section is responsible for managerial and staff problems, and therefore of little relevance here.

Ideally, the FTOs should be able to choose between the various alternative forms of transactions and apply



their expertise to find the most profitable one. To a large degree they do this, but as the analysis and description above shows, the differentiation and split between the various tasks and sectors must be a severe impediment. The supervision from above, in addition to the considerable number of instances that have to be contacted to enable a transaction to go through, do not exactly add to efficiency, clarity and speed. As a result, the Soviet negotiators find themselves in a constant dilemma between the market demands and the pressures from the bureaucracy. Bearing in mind that the principle of full cost-accounting leads to personal interests in the outcome and profitability of an agreement, the result is a clear tendency to avoid deals which may involve risk taking, and a transfer of all difficult questions to superior levels. Obviously, this is very unfortunate as it adversely affects the superior levels ability to co-ordinate and supervise the foreign trade activities. Undoubtedly, this was what Gruzinov implied in his statement about the over-whelming amount of administrative matters confronting the higher echelons of the bureaucracy. In addition, the scope of independence the negotiators may have, can at any time be limited by the interference of superior levels. The Communist Party as well has the right to interfere as a part of its duty to fight against bureaucratic "formalism".

The upward transfer of difficult decisions and

problems has highly negative consequences. The superior levels do not have the time to go through the details of a matter and the final outcome may be far from rational. Gruzinov emphasises this point, stating that **"the success and efficiency of managerial work largely depends on the quality, completeness and the timing of information..."**<sup>8</sup>

The foreign trade bureaucracy functions as a gate-keeper. As stated previously, one of the chief intentions behind the state monopoly has been to prevent any undesirable influences from the foreign markets. The cycles of inflation and unemployment, any dumping of cheap goods on the Soviet market, are avoided. At the same time the Soviet Union is participating, and drawing advantage of the international markets from being fully realised. As has been shown so far, the structural complexity hinders these targets from being fully realised. The multitude of bureaucratic organs involved and the cumbersome and long negotiation process are severe obstacles to a dynamic foreign trade. However, the problems far from end here. Some attention must be given to the relations between the foreign trade bureaucracy and the domestic productive sector.

The laudable motives of avoiding the evils of capitalism, apart from the point that the success of this strategy is disputable, has had the additional effect of isolating Soviet industry from the Western markets. The gap between Soviet output and the West has been discussed in detail above. Based on the analysis of the bureaucracy, it

is relevant to expand this issue a bit. The measure of success in the bureaucracy is based on quantifiable parameters, not entirely different from those imposed on Soviet industry where performance is assessed according to value and volume, consequentially, there are no incentives to facilitate the transfer of information. Apart from patents, copyrights and licences, information does not carry a price tag and its effects cannot easily be judged in economic terms. The Soviet producer, cut off from the export market by a huge bureaucracy, does not know how his commodities compare with Western equivalents. He cannot keep pace with the developments and stands to lose his share of the market.

It is probably correct to assume that the relations between a Soviet enterprise and an FTO is abundant with conflicts. The enterprise does not have any interests in the performance of his commodities, he does not reap any profits and will prefer the stability of state-set plan targets instead of constant demands for alterations and improvements made by the FTO. Decisions on what to export are usually taken without prior consultation with the producer. Production for export will therefore easily be regarded as a punishment by the enterprise. The criteria are higher for goods destined for the foreign markets, the State Committee for Standards (GOSSTANDARD) will return anything it finds faulty with a subsequent loss for

the producer.

As mentioned above, the productive sphere has a larger degree of influence in import questions. The Soviet enterprise may put a request forward for permission to import a given commodity. Yet, even in this case, the lack of contact between the domestic consumer and the foreign producer will have adverse effects. Only the end-user can estimate correctly the qualities of the various alternatives and the how they correspond to his requirements. The negotiator from the FTO does not possess all the necessary information.

In order to facilitate the import of innovative techniques, every FTO set up an office for this purpose in the wake of the 1978 reform. The intentions were to reduce the dependency on the West for high technology goods, and increase Soviet exports of capital intensive commodities. This strategy, called the "technological-gap-trade-approach" is based on the assumption that the difference in development is not a permanent feature but transient.<sup>9</sup> There is a possibility that this may apply to trade between countries at different developmental levels and in due time result in increasing similarity of the export and import structures. This belief has constituted the fundament of Soviet trade with the West since Lenin. However, the basic condition for this strategy's success is that the two countries display the same systemic features. This has been a major reason behind

the success of Japanese trade with the West since the War. As we have seen, this strategy has not resulted in any differentiation of Soviet exports to Western Europe, and the dependence on the West for innovation and modernization has not decreased.<sup>10</sup>

#### 4.3. Some Concluding Remarks

In chapter two, the problems of Soviet export and import were pointed out. In this chapter, the problems arising from the bureaucratic structure have been analysed. As has been stated briefly, some measures have been introduced in an effort to improve the foreign trade performance. However, the inherent tendency in the system to avoid risk-taking and transactions that may be difficult to estimate in terms of output and profitability, leads to a deliberate avoidance of a vast range of trade forms that may have been profitable from a Western point of view. The reform-attempts of 1978 far from solving the problems, enhanced the difficulties as they led to an even stronger division of the sector along commodity structure. The multitude of different state and party-organs with a right to be consulted, or with an interest to further, contribute to the problems of co-ordination and integration. In addition, one should remember that this increase the

complexity of a trade agreement, not only for the Soviet side, but for the Western partner as well. The cost of transactions, or rather the principle that "time is money", is consequentially considerably larger for the Western partner entering into a trade relationship with a Soviet FTO. The potential profitability of the deal must therefore be higher than in a trade agreement between two Western enterprises to merit the time and efforts spent.

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- 8 Gruzinov, op. cit. p. 161.
- 9 For a further analysis of this approach, see Gary C. Hufbauer, "The Impact of National Characteristics and Technology on the Commodity Composition of Trade in Manufactured Goods", in The Technology Factor in International Trade by Raymond Vernon (ed), New York: Praeger Publishers, 1970, pp. 145-231.
- 10 One of the conditions for Hufbauer's hypothesis was a steady import of technology goods. The Soviet import figures deviates from this prerequisite, for instance import of capital intensive equipment for the chemical industry show considerable fluctuations throughout the seventies despite the fact that this is a high priority sector.

## PART II

### 5.1. The Gorbachev Leadership's Point of Departure

By the end of the seventies it had become increasingly clearer that the Soviet Union was faced with an economic and political crisis of utmost gravity. As shown in Table 2, economic growth had virtually stagnated, labour productivity had fallen drastically. Despite the considerable amounts of capital made available for industrial investments, the renewal of extant equipment and machinery had reached a dismally low level. Around three per cent of the annual share of industrial investments had been targeted for this purpose. According to Western estimates, the return on capital investments had been falling since the beginning of the sixties, largely following the downward trend of other economic indicators.<sup>1</sup> Summing up the Brezhnev era in Soviet economy, attempts to introduce a strategy of intensive growth had failed. The economic development based on extensive growth equated more input of labour, raw materials and labour with higher output. Cheap labour from the countryside and natural resources in abundance made this development possible. The repeated official statements that the Soviet Union was on the threshold to a more intensive growth, with emphasis on human skill and capital intensive output had no impact. Ironically, the name given to the 10th Five-Year Plan was



"The Five-Year Plan of Quality and Efficiency".

Before the development and status of Soviet foreign trade in the years immediately preceding the election of Mikhail S. Gorbachov in 1985 are discussed, it is interesting to go into some detail on the efforts undertaken to improve the foreign economic profile of the country. Special attention will be devoted to the official policy on a few key sectors of relevance to foreign trade, agriculture, the energy and the defence sectors.

As has been stated, the Soviet Union became a net importer of commodities needed for the agricultural sector, mainly fodder in the form of grain, and fertilisers. It became increasingly impossible for the domestic agriculture to supply the country with the desired quantities of the mentioned goods. The U.S. grain embargo was aimed at crippling the Soviet economy by striking at the weakest point. However, the grain embargo did not have the intended effect. The Soviet officials could claim that the U.S. sanctions had been a failure and a sign of declining U.S. influence over the world economy. Still, the basic fact remained that the Soviet Union had to spend large sums of hard currency on grain, instead of purchasing high technology and machinery imports from the West. In order to comprehend fully the extent of this problem, one should remember that around a quarter of the Soviet labour force is employed in agriculture. This is more than in any other industrialised country.

Traditionally, additional labour resources like students or army recruits, have been called upon during harvests in order to secure the yields. Although increased agricultural output and a lessening of the dependence on the West frequently had been propagated as official policy, little had been done to alter the methods of production. Not surprisingly, the introduction of new labour methods was one of the first changes initiated under the Gorbachev leadership.

Whereas grain purchases have been a heavy drain on the Soviet hard currency holdings, sales of natural gas and oil have been the main commodities generating the income making the purchases possible. As has been discussed previously, the fall in the energy price, and the subsequent deterioration of the U.S. Dollar, had serious effects on the Soviet purchase power. However, the increasing difficulties in producing the required quantities of energy to keep up with the fall in price and exchange rate, is a reason for worry. Climatic conditions, an under-developed infrastructure, technical problems and shortages of labour have dampened Soviet plans for increased exports. This is shown by the fact that the plan-target for oil in 1980, 620-640 million tonnes, were not expected to increase during the subsequent four years. In reality, production fell short of the plan target both in 1980, output = 603 million tonnes,

*Official Soviet figures put the 1985 figure at a mere 592 tonnes 2*

To keep up with its obligations

to foreign partners as well as domestic consumption, the Soviet Union has been forced to import increasing amounts from the Middle East.

The idea of opening up the defence sector, to the domestic economy was suggested by L. Brezhnev in his opening speech to the Party Congress in 1981.<sup>3</sup> The various reasons for the subsequent failure of this strategy have been pointed out. It is sufficient in this context to point out that Soviet exports of machinery and equipment did not improve during the eighties, and that this strategy did not have any noticeable effects.

These are not the only economic problems affecting the foreign trade performance of the Soviet Union. Other issues of a more cross-sectional character deserve to be mentioned as they influence overall economic development. Some of them were summed up by M. Gorbachev as early as in 1974, at a time when he was Secretary to the Central Committee:

**"It often happens that the latest automatic production lines, robots and programmed machine tools are not effectively used because of insufficient skills on the part of the workers, engineers and technicians."**<sup>4</sup>

The severe effects of shoddy workmanship on the overall economic performance was recognised without any serious attempts to improve the quality of production. It had been officially recognised that many of the problems resulted from

truancy and alcohol. To counter this, campaigns to make the workers show greater discipline were launched at regular intervals. Although resulting in short-term efficiency rises and a fall in absenteeism, they did not have any permanent impact. Apart from higher output figures for the enterprise or factory, and a small rise in the workers' pay, there were no material incentives for the labour force to be persistent in their strive towards more efficiency. Due to the poor selection of consumer goods, a rise in take-home pay is meaningless.

It should also be added that even a short-term increase in output that had not been foreseen by the planners, may cause difficulties as it will have repercussions on the supply industry. The latter may have problems fulfilling existing plan targets, let alone additional demands for material.

Some of the problems were caused by inadequate skills among the labour force. In 1986, plans for the reform the technical education, the introduction of introduce comprehensive quality checks in every enterprise were announced.<sup>5</sup> The relationship between domestic production and international competitiveness was clear to Gorbachev. In 1984, the year prior to his election by the Politbureau, he gave a speech focusing on the gravity of the situation:

**"We have to achieve a breakthrough. Only an intensive**

and highly developed economy can ensure the strengthening of the country's position on the world scene, and enable it to enter the next millennium in a manner befitting a great and prosperous country...There is no alternative."<sup>6</sup>

Turning our focus to foreign trade in the first half of the 1980s, the statistics show that the turnover with the outside world expanded at a higher rate than the rest of the economy in 1983 and 1984.<sup>7</sup> The relative importance of the two most important groups, socialist countries and the market economies varies according to our indicators. Measured in current prices, the socialist countries were more important. On the other hand, the differences in price developments were to the West's favour, and the capitalist countries were the most important trading partner in 1983. This was changed in the following year when purchases of machinery and equipment in the West were reduced, at the same time imports of this commodity group from Eastern Europe were increased. As a result, the balance of trade with the West was improved, debts were payed off, and the Soviet Union could boast of record surplus. Despite this short respite, the commodity structure was not changed, the importance of energy had not been decreased.

In 1985, Soviet foreign trade with the West did not yield returns similar to those of 1984. Total hard currency surplus fell sharply from the 1984 record of

\$ 3.8 billions to a mere \$ 0.2 billions, trade with the West remained firmly " in the red" as the surplus of \$ 2148 millions dropped to a deficit of \$ 784 millions in 1985.<sup>8</sup>

The fact that the atmosphere of detente had cooled considerably during the first half of the eighties must account for a certain part of the decline in trade. Political tensions increased in the wake of the Polish crisis, and the US grain embargo. On the 26th Party Congress in February-March 1981, Brezhnev stated that disarmament and co-existence had suffered setbacks.<sup>9</sup> In his opinion, the reasons were to be found in the economic climate of recessions prevailing in the capitalist part of the world. Other reasons are probably closer to the truth: for instance the introduction of martial law in Poland in 1981, President Reagan's refusal to acknowledge the SALT II Treaty, and the continuation of the war in Afghanistan did not contribute towards detente on the European continent. As a response to suspected Soviet involvement in the Polish crisis, the U.S. President announced an embargo on high technology goods and a strengthening of COCOM-rules. Soviet hopes to widen the perceived split between the United States and her NATO allies after European refusal to follow the grain embargo, did not materialise. Apart from Finland, relations between Moscow and Western Europe did not reach the levels of cordiality achieved during the seventies. The

dialogue remained strained. The Soviet Union suffered a political setback when the influential Italian Communist Party protested against Soviet involvement in Poland. In France, a country with long traditions of a relatively pro-Soviet attitude, President Mitterand publicly supported the American disarmament proposals in Geneva and Vienna, thus distancing himself from the policies of his predecessors. The French expulsion of 47 Soviet diplomats, journalists and businessmen led to a deterioration of the relationship between the two countries. Western determination to go ahead with the decision to station nuclear missiles must have dampened the Soviet expectations of detente created by the Madrid Conference on European Security in 1980.

However, Soviet policy on foreign trade showed no signs of fundamental alterations, politically motivated changes could not be detected during the eighties.

At the CMEA-summit in 1984, the Soviet Union together with the other member states, issued a statement favouring closer connections with Western Europe, and more significantly, any policy of autarky was declared impossible. The Summit would "...in the spirit of the Helsinki and Madrid Conferences" work for an expansion of the trade.<sup>10</sup>

## 5.2.CHANGES IN SOVIET FOREIGN TRADE SINCE 1985

### 5.2.1. Introduction

The changes of cadres in the Soviet leadership in 1985, and in the immediate period after the election of Mikhail S. Gorbachev as the new General Secretary of the Communist Party of the Soviet Union, resulted in a new policy towards Western Europe as well as a new interpretation of the role played by foreign trade in the national economy. As has been mentioned previously, many of the ideas that have been implemented since 1985, had been voiced during the interim rule of Gorbachev's predecessors, Andropov and Chernenko. Albeit many of the ideas had been advocated by Gorbachev himself, a group of reformist economists and sociologists had emerged not as a fringe group, but within the establishment ready to implement their plans when the political climate changed.

Reformist ideas had been voiced previously, but with little effect. Thus, the radical novelty of the post-85 Soviet leadership lies not so much in the new openness surrounding political debate, but in an officially endorsed investigation of the fundamental characteristics of the Soviet system. In the sector of foreign trade, there was a will to discuss, and initiate measures that would make the foreign trade activities of the country more compatible with



the plans for the modernisation of the national economy. An integrated part of these new plans is a far more positive approach to the Common Market. Although Brezhnev had at various occasions expressed Soviet interest, Soviet invitations to enter into co-operation agreements were turned down by the West for various reasons. Gorbachev realised that a new policy towards Western Europe would be meaningless without an acknowledgement of the Common Market as a unity of considerable political and economic power. Part of Gorbachev's attempt to give the Soviet Union a more positive image, as well as more international prestige, was the application for membership as an observer in the General Agreement on Tariffs and Trade (GATT). Soviet relations to the Common Market and GATT will be treated in chapter 6, after an outline of the present Soviet leadership's policy towards Western Europe, and the role of foreign trade in its economic strategy.

An element in the comprehensive reform which provoked considerable debate and interest in both the USSR and the West, was the legislation permitting the establishment of joint ventures between with Western enterprises. Despite the Soviet drive to attract partners, certain deficiencies in the legislation soon became apparent, and Western investments have so far not materialised at the desired level. The joint venture legislation, and the problems surrounding it will be discussed in chapter 7.

As we have seen, the only large-scale reform during the seventies had been a restructuring of the foreign trade bureaucracy. The final outcome had not been an improvement of the performance of Soviet foreign trade, but an expansion and enhancement of the bureaucrats' power. Therefore, limiting their influence was to be a major task for the new leadership. The problems resulting from these attempts will be analysed in chapter 8.

As the performance of the Soviet Union on the Western markets ultimately depends on the performance of the domestic industry, it will be logical to end this work with an analysis of the measures implemented to create a closer relationship between the Soviet enterprises and the foreign markets. Special reference will be made to the recently issued Law on the State Enterprise.

### 5.3. Towards a New Concept of Europe

International politics have been dominated by the superpowers since the end of the Second World war. Although this approach still permeates Soviet thinking, there are signs of a much more flexible foreign policy revealing a will to acknowledge the growing importance of Western Europe. Soviet foreign policy towards this region in the past was often interpreted in the West as attempts to drive wedges

between the United States and Western Europe. It would be wrong to suggest that this element has been completely discarded, but the fact that friendly relations with Western Europe will benefit the USSR politically as well as economically, seems to have gained more importance. This new thinking has of course been provoked by Western European economic growth sustained by an unprecedented process of political integration. Even though defence and security issues formally are not on the political agenda of the Common Market, the process undertaken has definite security implications which may materialise in the future. These developments require close Soviet attention, Therefore it was not surprising when Gorbachev emphasised that: "...the European aspect, is one of the most important aspects of the CPSU's international activities."<sup>11</sup> This statement, among others, gave rise to an interesting debate in Soviet newspapers and media, perhaps best epitomized by V. Zagladin, member of the Central Committee. He envisioned an energetic and dynamic foreign policy towards Western Europe of a character comparable to the German Chancellor Willy Brandt's "Ostpolitik".<sup>12</sup> This attitude to the West becomes all the more interesting as Zagladin has been given the position of 1st Deputy Leader of the Central Committee's Department for International Affairs, a think-tank drawing up the new foreign policy of the Soviet Union.

Certain developments in the West have facilitated

the transformation in Soviet policies. The economic position of the United States have displayed worrying signs during the eighties. A weakened dollar and a growing trade deficit has undermined its position internationally. Whereas the West European economy previously "caught a cold when Uncle Sam sneezed", parallelling U.S growth or recession with a varying time lag, the difference in economic development became visible during the first half of the eighties. Western Europe fared much better, using its economic power to fill the vacuum left by the United States. Today, more than 140 different nations have permanent missions stationed in Bruxelles monitoring West European development, a fact aptly expressing West European importance.

During President Reagan's tenure, there have been some occasions where the West (notably the United Kingdom) has expressed worries on US financial policy. More important from the Soviet viewpoint, the United States and Western Europe have taken opposite standpoints within the Nato alliance over issues like expenditure, nuclear policy and COCOM. Yet, one may conclude that the Soviet perspective is more influenced by wishful thinking than facts. For instance, West European opposition towards the Strategic Defence Initiative (SDI) was portrayed as an attempt to re-establish U.S. economic hegemony in the West and the end of cohesion within Nato. The fact being that most of the opposition was voiced by leftist parties, many of whom where

not in governmental positions. A split within Nato might be a short-term gain for the Warsaw-Pact countries and the Soviet Union. Yet, if Western Europe would be able to fill the vacuum by itself, and its economic basis would probably permit it to do so, an armed Western Europe might prove to be a disadvantage. Whereas a correlation of forces between the Warsaw-Pact and Nato can be established with relative certainty, it will be far more difficult for the Soviet Union to sustain military parity with two mutually independent blocks.

A fundamental error in the Soviet attempts to promote a split between the United States and Western Europe, has been a lack of understanding of the latter's unity and strength. As will be discussed later, much of this has resulted from the economic growth of Western Europe. However, there is nothing to suggest that absence of US. military bases will reduce the continent to a congregation of "finlandised" nations. In this context, it is relevant to mention the comments made by one Soviet observer about the dangerous tendency to draw up plans for independent defence systems in Western Europe.<sup>13</sup> This suggests that there is an understanding in the Soviet Union that too great a split within Nato would not be to the Soviet advantage or lead to more conciliatory tones from West European capitals.

In the 1970s, it was an intrinsic part of Soviet foreign policy to exploit and contribute to any grievances

that may have emerged between the United States and Western Europe. The official attitude was suitably expressed by one Soviet foreign policy expert in 1979, when she stated that:

"the objective contradictions...create new possibilities for the exploitation of the inter-imperialist rivalry from the point of view of political tactics. Without doubt, this factor will grow in importance... This confirms anew the progressive way in which the communist parties exploit the inter-imperialist contradictions with the aim to develop democracy and make detente irreversible."<sup>14</sup>

Although the Soviet Union still looks favourably upon anti-American statements from West European politicians, the somewhat paradoxical situation has emerged where both the United States and the USSR are accusing the Common Market for unfair treatment contrary to the principles of free trade. The Soviet attitude is primarily due to the EEC agricultural import quotas. The large surpluses in the West, the results of huge subsidies, have excluded imports from the outside affecting both the USSR and the United States.

However, after 1985 the strategy towards Western Europe changed as the Soviet leadership was compelled to cease regarding it as a mere appendix to the United States. The changes were not immediate. Yet the gradual liberalisation of the political debate showed signs relatively soon of a new way of thinking. Although I will

not venture to provide the reader with a thorough discussion of the debate on Soviet foreign policy towards the West, I have chosen to concentrate on two articles which summarize the changes in the Soviet approach.

#### 5.3.1. The Articles by Primakov and Bovin

On July the 10 and 11, two articles appeared in Izvestiya and Pravda respectively. Not only did they coincide in time, but the viewpoints of the authors corresponded as well.<sup>15</sup> The authors both belong to the new group within the Soviet political establishment which has been labelled "internationalists" (mezhdunarodniki). This group comprises the new generation of strategists laying the grounds for a dynamic foreign policy paralleling the domestic developments.

Evgenii Primakov, author of "A New Philosophy of Foreign Policy", is ~~the~~ *the Director of* the Institute for World Economy and International Relations (IMEMO) and a candidate member of the Central Committee. In 1986 he was given the chairmanship of the World Peace Council, an organisation controlled by the Central Committee's International Department.

Primakov's article merits our attention because it underlines the close relationship between the domestic

reforms currently being implemented and the foreign activities of the country. The principle that the state should function as a buffer between the international scene and the internal developments, belonged to the Brezhnev era. It was interpreted as inevitable, and desirable that the leadership's domestic policy should have an impact on the external relations of the country:

"The XXVII Party Congress of the CPSU and the following plenum meetings of the Central Committee defined democratisation as the most important instrument for an acceleration of all aspects of life in the Soviet Union. Openness, criticism, self-criticism, freedom from tutelage, renunciation of the principle of infallibility - all of this, originally aimed at the domestic scene finds its reflections today in the actual making and conduct of the foreign policy of our state."<sup>16</sup>

Primakov's views derives from the need to use the foreign policy to support the domestic reforms. In particular, he emphasises the beneficial effects of detente, but not in the abstract language of the seventies when the Soviet Union was portrayed as the sole guardian of world peace. If the political tension is lessened, a transfer of means from the defence-sector to the civilian sector of the economy is possible. He claims, probably with some truth, that the Soviet Union enjoys unprecedented



popularity in the West and that a redistribution of investments in favour of the consumers is now possible. He clearly implies however, that the popularity will not be sustained if there is a return to the dogmatic foreign policy of the past.

Like Primakov, Bovin's article is a departure from the ideological rigidity of the seventies. He does not believe that socialism is invincible, claiming that unless the reconstruction of Soviet society is successful, the global scenario can rapidly change to the benefit of capitalism. Although military parity with the capitalist world might have been achieved, the "correlation of forces", a Soviet concept comprising not only military potential, but economic and scientific indicators as well, is currently favouring the West. Apart from asking the very provocative question "Have we created the only possible model of socialism, even when all the historic conditions are taken into consideration?", he continues by deploring the present state of the Soviet Union claiming that the original targets had not been met:

"The most important economic tasks of socialism still remained the overtaking of capitalism in the level of labour productivity and the production of items pro capita of the population, and they were not solved. When taking all characteristics into consideration, no society was created which could have

served as an example, a model to be copied, and an incentive that could have been used in the fight for the socialist transformation of the world."<sup>17</sup>

The policy of co-operation and detente, propagated in the past in order to mollify Western Europe, was given a new interpretation by Bovin. Whereas the antagonistic relationship between the capitalist West and the socialist East previously had not been considered as incompatible with peaceful co-existence, but rather continued under a new guise, Bovin claims that the maintenance of peace must be superior even to class interests. Gorbachev later repeated the same viewpoints, well aware of the beneficial effects this would have on the image of the Soviet Union in Western Europe. Thus, the role of the Soviet Union as the defender of the purity of communism and the interests of the working class world wide, has been replaced with a commitment to universal human interests irrespective of ideology or social stratification.

However, apart from being aimed at world opinion, or more specifically the capitalist West, Primakov and Bovin's articles were written with the domestic nomenklatura in mind. The ousting of Andrei Gromyko from the influential post as Foreign Secretary in 1985, was a signal to a new way of thinking, and these two articles provide both the foreign policy establishment, the domestic and foreign audience with important signs of change. The debate on the foreign

economic relations referred to by Shmelev (see chapter 3) had its parallel in the foreign policy sphere.<sup>18</sup> The joint efforts of Shevardnadze, the new foreign minister and A. N. Yakovlev, a Central Committee Secretary with responsibilities for ideology and propaganda, to launch a campaign dismantling the legacy of dogmatic thinking from the seventies opened up for articles like these. As Primakov rightly claimed, the beneficial effects were visible in the West. If the perception of the Soviet Union as a threat to Western security was undermined, closer economic co-operation would be possible. Not only would COCOM lose its importance, but the Soviet Union would be regarded as a normal business-partner equal to any other country.

Primakov and Bovin's articles are important as foundations for a new foreign policy strategy. Although the fight between the "modernists", the supporters of Gorbachev, and what has been called the "traditionalists", probably has not ended yet, the foreign policy sector must be one of Gorbachev's notable successes as the voluntarist aspect plays a larger role here than in other sectors where the material basis will be decisive for the outcome to a much greater extent.

#### 5.4 Soviet Foreign Policy towards Western Europe since 1985

As has been stated previously, there were no attempts to create a comprehensive foreign policy strategy towards Western Europe. However, the tendency towards a trade war between the United States and Western Europe, the latter's decision to station U.S. missiles despite Soviet threats, and the disagreement between the two over Soviet oil deliveries clearly indicated the need for a more sophisticated foreign policy with a greater emphasis on the security, political and economic factors exclusive to Western Europe. Below, it will be argued that such a change has taken place since the election of Gorbachev, both in the relationship between the USSR and the Common Market, and even more pronounced in the bilateral relations with its most important members the United Kingdom, France and West Germany.

Western Europe has a special position in Soviet security policy. As we have seen in many of the statements by Soviet politicians and scholars, they believe there is a strong positive correlation between trade and detente in Soviet foreign policy. Clearly, to build a better relationship, the Soviet policy-makers have to take West European needs into account. The Foreign Minister recommended that the West Europeans "should raise their voice

and show their profile", this was the time when they should fulfil their "specific function" in the process of detente and disarmament.<sup>19</sup> Along similar lines of thought, Gorbachev tied the future of the Soviet Union to that of Western Europe, stating that their relations were characterised by interdependence:

"Some in the West are trying to exclude the Soviet Union from Europe. Now and then, as if inadvertently, they equate Europe with "Western Europe". Such plays, however, cannot change the geographic and historical realities. Russia's trade, cultural and political links with other Europeans have deep roots in history. We are Europeans."<sup>20</sup>

On the basis of this common heritage, the Soviet Union leader sees great and promising possibilities:

"There is no doubt that all European peoples without exception favor an atmosphere of neighborliness and trust, coexistence and cooperation on the continent. This would be a triumph for a new political thinking in the true sense of the word. Europe can set a worthy example. The world currently stands at a crossroads and which direction it will pursue depends largely on Europe's political position....Europe can and must play a constructive, innovative and positive role."<sup>21</sup>

The emphasis on common interests instead of the previous dominance of class-issues opened up for a widening

of Soviet contacts with political parties on the left in Western Europe, as well as movements on the fringe of the political establishment like the "greens" and various peace-groups. As a result of the Soviet foreign policy of the Brezhnev era, contacts had been severed between Moscow and many Western social-democratic, socialist and communist parties. In the case of the Italian Communist Party, there had been open accusations against what the CPI interpreted as imperialism from Moscow. This was embarrassing and required mending. However, any amelioration of relations presupposed that the Soviet leadership realised that many parties left of centre did not regard Nato membership as incompatible with their policies. Indeed, the emphasis on the European identity had been propagated by both the West German social-democrats and the Italian communists, while at the same time supporting Nato. When the leader of the CPI, Alessandro Natta, and the party's spokesman on international affairs, Giorgio Napolitano met Gorbachev in January 1986, and A. Dobrynin six months later, the talks focused on economic questions and matters of relevance to West European security.<sup>22</sup> Ideology had faded from the agenda.

Bilaterally, the new Soviet leadership made several initiatives to improve relations with individual countries. The main trading partner in Western Europe, the Federal Republic of Germany, enjoys high priority in Soviet foreign policy. This is not different from the seventies, when the

USSR made efforts to maintain good economic relations despite international tensions.

"In our relations with the Federal Republic of Germany, we take into account its potentials and possibilities, its place in Europe and the world and its political role...Europe's development is impossible without active cooperation between our two states...stable relations between the FRG and the USSR would appreciably change the situation in Western Europe for the better."<sup>23</sup>

The position of the Federal Republic as a major financial centre and a strong industrial power must play an integrated part in the new approach to Western Europe. As Gorbachev stated, West Germany is in a key position. Yet, it would be incorrect to imply that the relationship between Moscow and Bonn has been characterised by friendly tones and mutual conciliation ever since Gorbachev's assumption of power. The West German government's decision to engage in the SDI programme in March 1985, provoked fierce attacks from the Soviet Union. When the US-FRG negotiations had reached their conclusion and the agreement was formally signed in March the following year, the Soviet ambassador in Bonn claimed that this was a "profoundly hostile" act of the West Germans.<sup>24</sup> When the West Germans later were affected by fallout from the Chernobyl disaster the following month, West German claims for

compensation were refused outright. (Claims made by other countries were met with the same attitude).

The German Chancellor Kohl's comparison of Gorbachev's public relations policy with that of the Nazi propaganda-minister Goebbels in October 1986 led to a further deterioration of the relationship between the two countries. However, the Soviet Union calmly pursued a policy of mutual accusations based on the expectation that the social-democrats would win the forthcoming election. When this did not materialise, a change in Soviet policy became imperative. Already two weeks after the election, the newly appointed Soviet ambassador Kvisinski, had a meeting with members of the West German government. The old grievances were not repeated by either side, and the impression that the Soviet leadership sought a fresh start was confirmed at a meeting between Zagladin, deputy leader of the Central Committee's International Department and Genscher, the re-elected foreign secretary.

West Germany's export of machinery and equipment had increased in volume and importance for the Soviet Union throughout the seventies. The present leadership's drive for a rapid acceleration of the modernisation of industry led to increased interest in the potential of trade and economic intercourse between West Germany and the USSR for this process. Efforts were made to draw up a frame agreement for scientific-technical co-operation, as a gesture of



reconciliation West Berlin was included and thus de facto acknowledged as a part of West Germany. Although of little practical significance, the symbolic value of this move was appreciated in Bonn where politicians claimed that this might be a step towards de jure Soviet recognition of West Berlin as Federal territory.

The deterioration in the Soviet terms of trade led to a decrease in the exchange of goods between the two in the 1985. However, the emphasis on modernisation expressed in the 12 five year plan promised new opportunities for West German exporters to regain lost ground. Following the Chernobyl disaster, there was a sudden demand for nuclear-energy related technology. Although this might have had potential strategic significance to the Soviet defence sector, COCOM did not object to any of the agreements signed.

The rapid economic growth of Britain and the position of Margareth Thatcher as a senior stateswoman, did not remain unnoticed in the Kremlin. Soviet politicians had previously regarded the "special relationship" between Britain and the United States as a euphemism for American dominance. The attitude of the Soviet foreign minister was quite different when he visited the London in July 1986. Not only does Britain possess nuclear weapons and has considerable forces at its disposal on the European continent, the economic strength of the country had

transformed Britain into a "superpower", equal to that of the Soviet Union.<sup>25</sup>

However, the rapprochement between the two countries had begun much earlier, even prior to the election of Gorbachev. In 1984, he headed a delegation of Soviet politicians to Britain. He met Thatcher, and found that the reforms they both wished to implement made their views surprisingly compatible. The return visit of the British Premier minister to Moscow in 1987 not only strengthened Mrs. Thatcher's position in the West, but was interpreted by Soviet media as a major victory for Gorbachev's policy of open arms towards Europe. Despite considerable differences on human rights, the relationship between the two countries improved markedly. This improvement was reflected in the trade relations, during the first half of 1987 the economic intercourse resulted in a Soviet surplus of \$ 204 millions.<sup>26</sup> No other country contributed more towards Soviet hard currency income over the same period.

France was the first West European country Gorbachev visited after he had been elected, signalling a Soviet desire to revive the cordiality which had marked the relationship between the two countries for number of years. A month after his first visit, in November 1985, Gorbachev made a stop in Paris on his way to Washington. The Soviet efforts were rewarded. In July 1986, President Mitterand visited Moscow. During his stay, he expressed his enthusiasm

over the Soviet disarmament proposal which had been issued in January the same year. The French reluctance to support the SDI programme was appreciated by the Soviet leadership, as were French support for the SALT II Treaty, and President Mitterand's insistence on Soviet participation in a Middle East peace settlement. French support had been given in expectation of Soviet recognition of the French force de frappe as a nuclear deterrent independent of Nato. This was given with reluctance, and the Soviet leadership claimed it was only a temporary solution as they expected British and French nuclear weapons to be included at a later stage.<sup>27</sup>

Despite the fact that Mitterand nominally is a socialist, the outlook of French politics is far too pro-American to the Soviet liking. The invasion of Afghanistan in 1979 and the Polish crisis two years after had a serious impact on French popular sentiment, undermining the appeal of the communist cause and speeding up the decline of an already ailing French Communist Party. According to Soviet economists, what they perceive as a shift to the right in French politics has had adverse effects on the trade relations between the two countries:

"In 1982, France was encouraged by external pressure to raise sharply the cost of credit granted to the USSR for the purchase of French goods. This naturally narrowed the possibilities for purchases in France, particularly of machinery and equipment. A certain role was played by

France's part in increasing the restrictions on trade with the USSR introduced by Nato and Common Market countries even on such goods as individual foodstuffs and telephone equipment."<sup>22</sup>

The Soviet leadership expected the diplomatic efforts to have a spill-over effect on the trade relations between the USSR and Western Europe. This was illustrated when Prime Minister Ryzhkov visited Stockholm to sign a settlement over a long-disputed area in the Baltic, he used the opportunity to voice his disappointment over lacking Swedish interest in developing trade links with the Soviet Union.

Soviet foreign policy towards Western Europe has changed under Gorbachev, as the comments above show. Whether we are faced with a comprehensive strategy or not, might be too early to answer. Some Western observers claim that there is nothing new in the Soviet policy towards Western Europe, simply a more updated and sophisticated attempt to break the relationship with the United States. However, the pan-European ideas of Gorbachev are definitely more palatable than the American President's statements about the possibilities for a limited nuclear war in Europe.

A fundamental problem in the Soviet-West European relationship rests on the fact that the latter sends out a multitude of vastly different, and not infrequently

contradictory signals. Creating a comprehensive strategy is made difficult by the fact that Western Europe does not speak with one voice. Obviously, West Germany's interests in maintaining good relations with the USSR are stronger than those of Portugal or Belgium, and the Soviet policy towards a neutral country like Ireland will differ from the policy towards the United Kingdom.

Some dilemmas in Soviet relations with Western Europe deserves to be pointed out. The Soviet Union is interested in strengthening Western independence vis-a-vis the United States. For instance the civilian technology research programme EUREKA has been given positive comments in the Soviet media as a valuable alternative to the American SDI. On the other hand, attempts to revive the West European Union as an alternative to Nato has been met with scorn.

Gorbachev's reforms have not been given unanimous support by West European communists. The hard-liners have problems adapting to a new policy where principles like openness and democracy are at the forefront. Voices have been raised, questioning the erosion of traditional values in the USSR, at the other end of the scale, the Euro-Communists have not shown any signs of repairing their broken relationship with Moscow.

Although security questions play an important role as incentives to create good neighbourly relations to quote Gorbachev, economic motives are important in the

attempts to create mutual trust between Western Europe and the USSR. The Soviet economy is in a state of crisis:

"It is necessary again and again to call to mind what the state of the economy was at the turn of the seventies to the eighties. At the time the rate of economic growth dropped to a level which in fact meant the beginning of stagnation. We began to lose one position after another....In scientific development the gap with respect to the most advanced countries began to grow to our disadvantage".<sup>29</sup>

Detente and even partial disarmament would ease the strains on the Soviet economy. However, Gorbachev's emphasis on the value of trade both to sustain and promote peace are obvious. The reader will discover the striking resemblance with views of the former U.S. Foreign Secretary Kissinger, quoted in the introduction chapter when he reads the following statement by the Soviet general secretary:

"The building of the "European home" requires a material foundation - constructive cooperation in many different areas. We, in the Soviet Union, are prepared to search for this, including new forms of cooperation, such as the launching of joint ventures, the implementation of joint projects in third countries etc. We are raising the question of broad scientific and technological cooperation not as beggars who have nothing to offer in return."<sup>30</sup>

### 5.5. The Role of Foreign Trade in Gorbachev's Reforms

Not only on the political level has Western Europe been given special attention under the Gorbachev leadership. The development of economic relations with these countries is considered to be an important measure in the reforms to modernise Soviet economy. In 1985, the General Secretary emphasised the need for a "new approach to the entire external economy of the country".<sup>31</sup> Similar statements were made during the seventies in attempts to increase the country's share in world trade and to increase exports of finished goods. The essential difference between the Brezhnev era, when a strengthening of labour discipline was regarded as the magic wand to solve all problems, and the present leadership lies in the will to adapt a comprehensive approach. The problems of the foreign trade sector and the Soviet Union's performance on the world market are no longer to be regarded in isolation. Indeed, the most promising aspect of the present discussion, is the ability to recognise that the problems of the foreign trade sector are not different from those of the domestic economy. The answer to the complaint that the USSR's share of international trade does not correspond to the country's economic potential, is basically that the Soviet Union's level

of economic development does not correspond to the requirements of world trade. From this point of view, it is insufficient to claim that the poor performance of Soviet products are caused by protectionism or trade imperialism, and that Soviet imports would have been radically different if it had not been for the artificial interference of COCOM. This new approach to foreign trade is aptly expressed by the economist Igor Dorogin, in an article from 1985:

"Foreign trade effectiveness is a part of the efficiency of the economy as a whole. It calls for a marked acceleration of the scientific and technical progress in the country and a profound restructuring of the economy by applying material- and energy-saving machinery and technologies, by raising the quality of output and lowering its costs. No less important is the role of the organizational aspect of the problem: validity and fulfilment of the decisions made by the central authorities...the effectiveness of the foreign trade activity also depends on the flexibility and efficiency of the managerial system and the level and character of interaction between the sphere of production and the sphere of foreign trade."<sup>22</sup>

A new approach was clearly needed. Traditionally, increased investments, more skilled workers and raw materials had been the common prescription to rise performance. But why then were Soviet exports of machinery and equipment



decreasing year by year when:

"the machine-building industry has been given everything that our economy has. Construction and development of a number of other enterprises has been stopped. In a word, it has been given the maximum!"<sup>33</sup>

To use foreign trade as a growth factor had been attempted as a strategy to modernise industry previously, notably in a few selected industrial sectors. The results had been dismal. The surroundings, e.g. the managerial staff and the workers were not interested in new processes or sophisticated equipment. To them it only meant an increased workload with new and unknown tools. Thus, instead of making the surrounding adapt to the imported goods, the latter were adapted to the surroundings. Any modernising effects they might have had, were soon neutralised.

To avoid importing expensive commodities without any subsequent improval of the economy, the basic economic mechanisms were to be revised. In order to understand the new strategy of Gorbachev, it is necessary to treat certain aspects of his reforms in greater detail.

The present five year plan, has been created in order to intensify industrial production and to increase the output of capital intensive goods. Not only is this necessary if the Soviet economy is to avoid becoming even more backward compared to other highly developed industrial

countries, the old extensive growth model has depleted its own basis. Raw materials which had been wastefully used for so long, have become more expensive to excavate and to transport. The old logic where more input was understood as being synonymous with more output was declared obsolete. Moreover, the chronic shortages in nearly all sectors of the economy were no longer blamed on flaws in the plan, but on too much central interference. Any curbing of the planners' authority or less emphasis on ~~the directive~~ the directive nature of the plan would logically mean greater independence for the enterprises.

The five-year plan is to remain the most important guideline for the economic activity and development of the country. Serious efforts have been made in order to improve the planning-methods, in particular with the use of "target programming" methods making it possible to estimate the repercussions fulfilling one target has on the rest of the economy. Much discussion has focused on the role of the plan, and although the need for a transition from a directive to an indicative function has been openly acknowledged, any move to curb the power and influence of the state planning authorities has been met with considerable resistance. At the plenary meeting of the Central Committee in June 1986, Gorbachev accused members of these organs of frantically defending an outmoded planning system.<sup>34</sup>

As a part of the new leadership's attempts to free

certain sectors of the economy from what in practice has been the "petty tutelage" of GOSSNAB and GOSPLAN, "unplanned sectors" were introduced allowing individual economic activity and co-operatives for the consumers. Clearly, Gorbachev needs to create some kind of tangible evidence that his reforms are improving the living conditions of the Soviet population to retain the legitimacy of his leadership. From our point of view, the impact on the foreign trade sector is non-existent. Of more relevance here are the plans to open up for wholesale in industrial consumer goods. At the present stage, only a marginal share is traded outside the plan. If this proves successful and is expanded in the future, Soviet enterprises will be capable of responding far quicker to changes in the world market and will be able to engage in more direct co-operation with other Western enterprises.

Even though the role of the plan did not change to any significant extent, the plan indicators were altered. Instead of emphasising volume and numbers, the quality and marketability were to be given increased importance. The enterprises were given a bigger say in the composition of plans. In order to make management more responsive to the demands of the economy, and not all the time on the changes in plan targets, the need for greater plan stability has been asserted. The constant plan-revisions in the past were a serious interference in production. It was expected,

and rightly so, that the more the omnipotence of the planning authorities was restricted, the more it would allow for micro-economically rational decision-making.

However, managerial autonomy and rational decisions require a financial platform. Subsequently, the enterprises were granted the rights to hold, and dispose of various funds as they found appropriate. The possibility to take up bank-loans, as well as the right to retain profits were introduced. Enterprises producing for the export markets were given a certain percentage of the hard currency earnings as a reward.

In order to encourage innovation and modernisation, the system of managerial bonuses was changed to reward the speedy installation and utilisation of imported machinery. As has been pointed out previously, the introductory phase for new machines and equipment are considerably longer than in the West. Efforts have been made to improve the relationship between the research sector and production. A leading Soviet economist, *Anchishkin* complained that:

"There is a large degree of indeterminacy in the different units of the "science-production cycle" (low predictability of scientific results, high "mortality rate" of the initial scientific ideas and technological solutions, the international character of the scientific-technical revolution etc.) require special efforts so that the socio-economic development does not walk in the

"footsteps" of such indeterminacy."<sup>35</sup> According to the Political Report of the CPSU Central Committee to the 27th Congress of the CPSU of February 1986, in the future:

"...college and university students must be drawn into research work and applying research findings in production."<sup>36</sup> In this way, the technology contents may be increased in Soviet goods, and competitiveness will improve. Integrating the engineers and scientists directly in production, the domestic setting would be far more receptive to imports from the West. The process of industrial modernisation had gone far too slow when compared with the West, Gorbachev has demanded revolutionary changes and a rapid introduction of the most recent technology into industry.<sup>37</sup>

With the danger of making premature judgements, some problems still remain unsolved. The basic issue, that there must be fundamental changes in the economic planning if the policy of "acceleration" is to have any impact, has not been answered so far. Even if the staff has been changed, and the authority of GOSPLAN and GOSSNAB has been restricted, there is still widespread dissatisfaction with their continued interference in the decision-making at enterprise level.

Another serious inconsistency in the reforms lies in the futility of introducing economic incentives to make the enterprises produce profitably, without changing the price-

mechanisms. The irrationality of state-set prices, especially on imported goods, will distort the plans to make the enterprise-sector into a viable part of the economy.

Finally, the encouragement of managerial initiative to produce more high-technology products, may easily turn out to be impossible in the long-term without a slackening of the plan. Additional input may be impossible to procure for the producers as it has not been foreseen by the planners.

The opening up for trade in industrial consumer goods is aimed at removing this danger.

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## 6. Soviet Foreign Economic Diplomacy since 1985

### 6.1. Introduction

The desire to increase Soviet participation in world trade lay behind the ~~the~~ attempts to become a member of GATT, and in the repeated invitations to the Common Market to negotiate a frame agreement. Apart from the obvious material motives behind the Soviet economic diplomacy, -GATT membership would remove some of the tariffs levied on Soviet exports, and a rapprochement with the Common Market might ease some of the quotas facing Soviet agricultural commodities; other motives played their part. The existence of the EEC had been acknowledged by Brezhnev in the seventies, but no political strategy towards it had been developed prior to Gorbachev's takeover. A new, vigorous foreign policy, as we have seen it in the bilateral relationship with individual West European countries, had to take the Common Market into account. Apart from Finland and Austria, the most important trading partners were all members of the Common Market. In the case of GATT, Soviet membership would be a recognition of the country's status as a major economic power.

In both cases, we are faced with bold initiatives from the Gorbachev leadership. In this capacity, they merit further analysis.

## 6.2. The Soviet Union and GATT

The General Agreement on tariffs and Trade was set up in the post-war period to combat protectionist measures among the market economic countries and to further trade. The signatories grant each other Most-Favoured-Nation status (MFN) pledging not to levy any tariffs on each others goods which may have adverse effects on the competitiveness of imports. A functionalist interpretation of the confidence-building and peace-keeping effects of trade played an important role in the founding of GATT, and still does.

In 1986, the GATT members were to meet in Uruguay for an annual discussion. The Soviet Union sent an application for the status of observer as a first step on the path to full membership. This was done in the expectancy that the application would be given a positive answer, other centrally planned economies were already full members. Bulgaria had been granted observer status in 1967, Poland had been accepted as a full member in the same year, Romania four years later. In 1973, Hungary was the last East european country to become a full member.

However, the examples above may give the false expression of these countries entering GATT without any further problems. For a planned economy to become a full

contracting party, a number of obstacles must be overcome. As will be argued below, the Soviet Union had not implemented the necessary prerequisites for membership.

Despite the seemingly neutral intention of GATT to facilitate international economic intercourse, the concept of free trade uninhibited by state interference is inherent in the treaty. In an economy ~~were~~ the enterprises are responsive to the market and not to state plans, tariffs will increase the price of imports and the competitiveness will be affected negatively. In stead of direct price control of production, tariffs are levied in order to make politically motivated changes in the extent and composition of foreign trade. This is incompatible with a planned economy for two reasons. Firstly, the fact that there is a plan deciding the economic development rules out equal treatment based on economic criteria, secondly, a system of state-trading makes tariffs meaningless as the state then ultimately would be charging itself. State planning of the foreign economic activities and free trade are contradiction in terms as a state enterprise cannot follow the state plan and at the same time have the autonomy to comply with the principle of non-discrimination. The validity of this central point was not grasped by the Soviet economist Vladimir Shmelov. In an article written in 1986, focusing on the Soviet Union and GATT, he wrote:

**"The organization of foreign trade as a state**

monopoly in the socialist countries in no way prevents application of the most-favoured-nation treatment in accordance with contract obligations. The mutual granting or non-granting of the most-favoured-nation treatment by states with different socio-economic systems does not depend on this or that form of foreign trade, (state monopoly or other form) but on the objectives and the orientation of the trade policy pursued by this or that state."<sup>1</sup>

Another serious problem, a direct consequence of the making the state monopoly function as a buffer against the outside world, is the constant imbalance of domestic and world market prices. Karin Kock, a Swedish economist, states that even in planned economies where the states tries to comply with the minutes of GATT, the insulation of the domestic economy makes price comparisons based on real costs impossible.<sup>2</sup> How then, if at all, can a planned economy become a member of GATT. The most frequent argument made by Western representatives against accepting East European countries, is that a membership will amount to little more than unilateral concessions. Based on this viewpoint, the English economist Peter Wiles has claimed that the only way for a planned economy to fulfil what he calls the "spirit of GATT", is by guaranteeing "global import quotas".<sup>3</sup> Although none of the socialist member states have gone that far, they have pledged not to initiate any discriminatory

practices. Professor Wiles' suggestion might if it had been implemented, made the membership of the USSR more palatable to the Western members of GATT. However, it would not alter the planned nature of the economy, and therefore not fulfil the "spirit" of GATT. In practice, it would be impossible, as Soviet purchases on the Western markets are influenced to a decisive degree by the availability of hard currency. Although many East European countries have been willing to take up loans in the West to finance their imports, the financial prudence pursued by the Soviet Union makes any guarantees unlikely.

As mentioned previously, the Soviet application was made with the expectancy that it would be met with the same answer Hungary had been given in 1973. Hungary, like the Soviet Union had been engaged in radical reforms, and the membership had been an undisputed boost to morale. Some crucial differences between the two should not be overlooked.

### 6.3. The Hungarian GATT Membership and the Soviet Union

Similar to the motives of the Soviet Union, the Hungarian application had been made in order to achieve a reduction of the tariffs levied on Hungarian exports, especially by the Common Market countries. Hungary had abstained from becoming involved in bilateral negotiations with

Western countries, as this was politically undesirable for a Soviet ally in the wake of the political unrest in Eastern Europe in the late sixties. GATT would be a neutral forum where the same targets could be pursued.

In contrast to the other East European members, Poland and Romania, Hungary insisted that the country was to be accepted as a member whose economic mechanisms were compatible with the tenets of the Treaty. The Hungarian negotiators asserted that the introduction of the New Economic Mechanisms in 1968, had increased the scope of market forces significantly, with a corresponding decrease in the directive role of the plan. It would therefore be meaningless to demand import guarantees from the Hungarian government similar to the requirements Poland had to accept in order to gain membership.

The Soviet reforms at the time of applying had not expanded the scope of market forces to any significant degree. The fact that a select group of the country's most technologically advanced enterprises had been granted the right to trade freely on the Western market did not suffice in the eyes of the Western GATT members. An article in Pravda at the time of the application, stated that these measures had been initiated in order to create "additional possibilities for businesslike co-operation with foreign countries...both in its new forms and in the framework of GATT."<sup>4</sup> The refusal must have been a severe disappointment

to the Soviet leadership.

Although the internal price mechanisms in Hungary still do not react to the development in the West with the same flexibility as Western countries, the material balancing system characteristic of Soviet type economies has been discarded. The central plan in Hungary at the time of the membership entry was more indicative than directive, only stressing the desired path of development. This target has so far not been achieved in the Soviet Union, however, it has been suggested during the debate as a task to be implemented in the future.

The existence of foreign firms, either in the way of joint ventures or as branch companies, is an important indicator of a country's participation in international trade. The amount of foreign involvement in the Hungarian economy was relatively limited in 1973. In the Soviet Union, the Law on Joint Ventures was not passed until 1987, after the application had been made to enter GATT.

Finally, another difference between the two countries which is of relevance from our point of view, concerns the time spent on the preparatory stage. Whereas the Soviet Union apparently believed that large scale debates on economic reforms and the fact that radical changes in the foreign trade sector and the economic mechanisms were promised, would be sufficient to constitute an image of readiness, the Hungarian entry was made possible after a



prolonged negotiation period of four years. During this period, the Hungarian policy-makers were eager to comply with the principles of GATT, heeding the advice given and implementing the required changes.<sup>5</sup>

#### 6.4. The Soviet Union Post-GATT

As has been shown above, the Soviet application had been made prematurely. Not unexpectedly, Soviet commentators quickly blamed this on US trade imperialism, GATT was described as an instrument in the American strategy to regain world economic dominance.<sup>6</sup>

Considering the Soviet application from an ideological viewpoint, it is relevant to recall Marx' theory of non-equivalent exchange. Here Marx maintained that only areas of equal development stand to gain from economic intercourse.<sup>7</sup> This viewpoint has later been reflected by the functionalists, most notably Johan Galtung who claims that the lesser developed partner must initiate protective measures against the influence from the superior trading partner. Trade between the USSR and Western Europe is far from equivalent, as has been amply illustrated.

What is important from our point of view, is that the application to become a part of GATT signifies an important turning point in Soviet foreign economic thinking,

signalling a will to break permanently with the autarky in international economic relations pursued in the past.

If the USSR had been accepted, a possible future pattern might have included membership in the International Monetary Fund (like Romania, Poland and Hungary), and in the Worldbank (like Romania and Hungary), both entailing international prestige and the Soviet Union's status as an important foreign trade country. The future prospects for increased Soviet participation in international fora, voices have been raised in the West supporting Soviet aspirations. Mr. Willy de Clercq, the EEC Foreign Trade Commissioner said that Soviet membership in GATT might be realised in the future, the time was not right for an acceptance from GATT's point of view.

"I am concerned that GATT should function as well. That means that it has to be as universal as possible. But it also has to be coherent and based on the principles of the free trade system."

For GATT, the problem was that a Soviet membership might not lead to a Soviet adaption to the principles and practices of GATT, but the direct opposite, GATT adapting to Soviet practices.

#### 6.5. The Soviet Union and The Common Market

The Common Market poses a considerable problem for the Soviet leadership. Western observers have commented on the lack of a comprehensive policy towards the EEC, and at the same time forgetting that the Common Market is not a political unit in every sense of the word.<sup>16</sup> The Common Market members are highly diversified in their attitudes towards the Soviet Union. This diversity, often bordering on open disagreement has been amply illustrated in the past whenever the possibility of signing a co-operation agreement with the CMEA has been discussed. Without going into too many details, may it suffice to state that the Federal Republic of Germany has gone to considerable efforts to create a formal framework regulating some of the aspects of the country's eastern trade. The Soviet leadership issued several proposals during the seventies. Yet, this was received without much enthusiasm by the Common Market members, and little else than Soviet humiliation was achieved.<sup>17</sup> The Soviet Union is therefore faced with the somewhat paradoxical situation that whereas Western Europe would be more than happy to create a framework for mutual security and disarmament, little interest is paid to Soviet proposals to engage in closer economic co-operation. As trade relations with the Soviet Union played a minor role for most of the member countries, there was no need to go above the

bilateral regulation of the economic relations to an EEC-Soviet, or EEC-CMEA agreement.

The implementation of a completely free inner market in 1992 will lead to a much closer integration of the members. As it then will be much more of a political and economic unit, it will prove to be a less complicated negotiating partner. Equally important, the EEC might find it imperative to regulate the commercial regulations with the USSR and the other CMEA countries, and therefore be far more forthcoming than in the past.

For many years, the Soviet media and political statements alike emphatically pointed out the social problems of the Common Market countries. Although these aspects still play an important role in Soviet political thinking, there is now an increased interest in the areas economic developments. Due to the poor results of the modernisation efforts of the past, there are benefits to be had from watching the developments in other countries. The present state of the EEC's economy, with an increasing emphasis on high technology and a lessened reliance on the heavy industries, is exactly what the economists in the USSR hope to see realised in their country.<sup>18</sup>

Not long after Gorbachev had been elected, an official letter was sent from the Soviet leader to EEC Commission, containing a draft proposal of a general agreement. Previous proposals had been rejected by the EEC

because the CMEA was not entitled to enter into agreements on behalf of its members. From the EEC's point of view, only bilateral agreements between the Common Market and the individual East European countries was possible. The Soviet proposal had taken this into account in order to avoid any further rejections. The deadlock of the Brezhnev years, when the Soviet Union insisted on a treaty between "equals", had been broken. The Soviet draft acknowledged the significant difference in the jurisdiction of the two organisations, and aimed specifically towards a facilitation of the bilateral relations between individual CMEA members and the EEC. Negotiations have been going on ever since the proposal was issued in 1985. At the time of writing, most obstacles to a mutual recognition have been overcome and a formal document drawing up fields of co-operation between the CMEA and the Common Market can be awaited in the near future.

There is an important compensation for this concession. An agreement will probably establish mutual representations in the two organisations. Today, the United States and the Peoples Republic of China have been granted this right. Undoubtedly, the Soviet leadership is eager to be given equal rank.

Politically, there has been increased contact between the Soviet Union and the Common Market on the parliamentary level. Simultaneous with the sending of the Soviet proposal in 1985, representatives from the socialist

faction in the European Parliament were invited by the Supreme Soviet. Two years later, a delegation from the conservative Christian-Democrats went to Moscow on a formal visit.

A successful relationship with the EEC depends to a large extent on a Soviet comprehension of the potentials of this area, as well as a consideration for the EEC members' need for security against external threats. The developments so far have been quite promising. The former attitude has been discarded, as well as the previous demands. The volte-face of the incumbent leadership is an important example of the new approach in Soviet policy towards Western Europe.

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16 Riishoy (op. cit) and Heinz Timmermann, "Die Sowjetische Politik gegenueber Westeuropa" in Sowjetunion 1986/87, Bundesinstitut fur ostwissenschaftliche und internationale Studien, Munchen und Wien: Carl Hanser Verlag, 1987, deplores this lack of understanding.

17 For a relatively objective discussion of this issue, see O. T. Bogomolov (ed), Sotsializm i perestroika mezhdunarodnykh ekonomicheskikh otnoshenii, Moskva: Mezhdunarodnoe otnosheniya, 1982, pp. 256- 272.

18 See Timmermann, op. cit.



## 7. Joint Ventures

### 7.1. Background and Introduction

As a result of the increasing integration of international trade and economic intercourse, new forms of co-operation between business partners have emerged. Industrial cooperation between enterprises domiciled in different countries is one of these. The degree of coordination and the frequency of contacts may vary. A joint venture on the other hand, is a much more intimate form of cooperation. There is a considerable divergence between the various definitions of what the concept joint venture covers. Most authors however, understand it to mean a contractual agreement between partners of different national background, resulting in the creation of a single economic unit usually in the form of an enterprise or industrial plant. Both partners contribute towards the ventures investment funds, and the profits, or losses are divided according to the proportions of the initial investments. Whereas activities like supplies of raw materials, marketing and sales may be the responsibilities of one of the partners, they are usually both involved in the daily tasks and routines of running the venture. This degree of intimacy makes a joint venture into the most sophisticated form of industrial co-operation, and needless to say, a joint venture

can only be succesful if both partners show considerable flexibility and co-operative skills. A joint venture is by no means anovelty in the world economy, and in fact not in the history of Soviet economy either. During the NEP period from 1921 to 1928, considerable amounts of Western capital were invested, and enterprises staffed with both Western and Soviet labour emerged. The autarkic line of economic development chosen by Stalin after the end of NEP, effectively excluded any kind of Western involvement.

After the end of the Second World War, Soviet experts gained much experience in the field of industrial co-operation under the auspices of the newly established Council for Mutual Economic Assistance. Soviet economic requirements as well as political desires resulted in close involvement in the economies of the Eastern European countries. Although the term joint venture was not applied by Soviet economists to the various projects and integrative attempts during this period, the closeness and structure made them indistinguishable from the present joint ventures. It should be noted that the first time a formal joint venture agreement was signed between the Soviet Union and an East European country was in 1984 when the Hungarian MEDICOR company and the Soviet Institute for Medical Instruments (VNIIMP) agreed to set up a jointly owned enterprise.<sup>1</sup>

The possibility of entering into a joint venture agreement with a capitalist country had not been on the

agenda for economic reform in the seventies. Various explanations have been given by Western observers, many have underlined the barrier based on ideology. I do not believe this has been the weightiest factor, even Lenin underlined the importance of trade with the West for the Soviet economy. In my view, purely practical reasons are more valid, the inferiority of Soviet industry has been the most effective prevention. Still, the legacy of an autharkic past when Western ideas were received with suspicion, has made any kind of co-operation with capitalist countries difficult, let alone joint ventures. The Deputy Chairman of the State Foreign Commission of the Council of Ministers, Ivan D. Ivanov, stated that people frequently asked "why we should invite foreign capitalists, when we have managed for 70 years without them."<sup>2</sup> To answer this, we must look at the potential beneficial effects of joint ventures for the Soviet economy.

Direct Western involvement would entail an influx of new skills, methods, techniques and processes. Ivan D. Ivanov claims that these were the motives behind the Law on Joint Ventures of December 1987:

"1)To attract new technology and managerial expertise, 2)to stimulate import substitution, and 3)to expand our own export sector."<sup>3</sup>

As we shall see later, there is a potential clash of interests between points two and three, or rather between Western

business interests opting for a foothold in the Soviet market, and Soviet officials hoping to generate as much hard currency as possible. If the joint venture is allowed to sell some of its produce on the domestic market, it would mean a break with the monopoly of the state. Although this was unthinkable only a few years ago, articles have recently underlined the advantageous effects of such a policy:

"It is known that monopoly of production, whatever form it takes, furthers the growth of production costs and prices, hindering the overcoming of deficits and increase in quality."

A joint venture will probably be much more economical with labour, raw materials and energy, and produce more high quality goods than Soviet enterprises. To the degree that these assumptions are fulfilled, the joint ventures will serve as models of Gorbachev's industrial policies. He has repeatedly stated that a closer relationship between external and domestic economy is desirable. A joint venture based on long term co-operation is one of the means. Past short term Western involvement resulting in complete production plants have been used to boost export and to satisfy consumer demands. But this strategy has proved costly, as Soviet innovation proceeds at a much slower rate, the output rapidly loses competitiveness on the world market. After a while, spare parts and engineers are required to maintain

the productive capacity. Frequently, they have to be imported from the West at considerable costs. In a joint venture, continuous supervision by the Western partner will be an efficient means against stagnation, and the subsequent loss of market shares abroad. Unless a joint venture is able to innovate and develop along the lines of enterprises producing similar goods elsewhere, Western business interests will not emerge. The crucial question is therefore how prepared is the Soviet side to accomodate Western demands?

## 7.2. The Structure of a Soviet Joint Venture

Very little is known about the preparatory stages of the first Soviet law on joint ventures. It was therefore a great surprise to many when the Politbureau voted in favour of the issue in December 1986, later followed by a draft proposal by the Council of Ministers in January 1987. The first law which covered the conditions that are to be met as well as some regulations concerning the internal structure, were passed by the Supreme Soviet on January 13, 1987.<sup>5</sup> Other regulations have followed since. However, as there is still a number of questions that have not been clarified by the law, more legislation is expected to be passed.

On the issue of ownership, the Soviet share must in

no case be less than 51 per cent. This is not unusual in joint venture legislation, and did not influence Western response as much as the regulations on the managerial structure. A Soviet-Western joint venture will internally be divided into three levels, the top positions being divided between a president and an executive director, an executive board comprising the managers present at the enterprise, and finally a supervisory board consisting of the investors. Whereas the executive board will be meeting almost at a daily basis, the supervisory board will not be convened more than once or twice a year. At every level, the upper hand will be held by the Soviet partner. Both the posts of president and executive director are exclusively reserved for Soviet citizens, and as the majority of investments are Soviet, it seems logic that the chairmen of the executive and supervisory boards will be Soviet citizens. Herman Koebe, the head of a West German timber firm with long experience in trade with the Soviet Union, summed up the general impression in the West saying: "forty-nine percent is a lot of influence, but no power."

According to Soviet statements, the decision to exclude Western citizens from the top managerial positions, was made because one cannot expect them to be able to cope with the Soviet economic setting. Not only does this decision disregard the considerable expertise many Western firms have in Soviet trade, but it seems contradictory to the

basic intentions behind allowing joint ventures to be set up. One of the main pull-factors was, as previously stated, to import Western management techniques. This may easily become impossible to implement if the top echelons are closed to anyone who does not hold a Soviet citizenship. An article in Vneshnyaya torgovlya openly states that the Western partner's powers over the work force are virtually non-existent.<sup>7</sup> The level of wages, together with the firing and hiring of employees are the responsibility of the Soviet managerial members alone. The picture one gets then, is that the role of the Western partner is limited to importing the equipment required for the production, technological development and export strategy. But quality control, another task allotted to him, may be virtually impossible without any control of the work-force. One may therefore expect a number of problems to emerge internally in the joint venture, unless this sharp division between the managerial and productive levels is softened.

The official reason behind the ownership regulations deserves some more attention. However, as very few joint venture agreements have been signed, and even fewer joint ventures have been operating for any length of time, what follows is an attempt to explain the Soviet policy without much data to validate it. If the Soviet experts plan to let the joint ventures produce for the domestic market and thereby providing a substitute for hard currency imports,

the decision to reserve top positions to themselves may not be illogical. Few Western businessmen are sufficiently aware of the bottlenecks in the internal economy to know which strings to pull in order to overcome them. On the other hand, because the joint venture is to be entirely independent, beyond the scope of the state planning organs, it may find a large scale involvement in the domestic market close to impossible. No plans will include the input requirements, neither will the planning authorities have made provisions for the transport, storage or selling of the output in the Soviet market. It is not difficult to foresee the problems resulting from this "exclusive position". It has been stated repeatedly, that a joint venture's viability will be decided by its performance on the market, eg. profits or losses. This policy is in line with Western management techniques, but quite a novelty for the Soviet side.

The degree of autonomy given to a joint venture may at first seem unlimited. However, there are some restrictions that may turn out to be decisive for Western response. A joint venture producing for export will be given a general export and import licence from the Ministry of Foreign Trade. If the situation emerges where a joint venture is competing with a Soviet enterprise on the foreign market, the Ministry may impose obstacles. So far this kind of conflict has been avoided, and there may not be a great



likelihood that it will occur as it seems that the Soviet authorities are mostly interested in joint ventures that may cover gaps in their own export. The possibility of conflicting interests is greater in the case when a joint venture is producing for the Soviet market. How the output will be classified has not been stated explicitly, but as joint ventures producing for the Soviet market will be operating through the Foreign Trade Organisation network, it seems most likely that the output will be treated as imports. The Foreign Trade Organisation will be responsible for the prices. Ivan D. Ivanov explains it thus:

"...the contractual prices used for operation within the Soviet Union might be different from the wholesale and retail prices within the country. This is a way for the joint venture to compete in the Soviet market with our domestic industries."<sup>8</sup>

What he does not say, is that a bureaucratic price-setting may make it unprofitable for a joint venture to compete, on the other hand, this protective measure for Soviet industry may be required to avoid dumping of Western goods.

### 7.3. Taxation and Financial Questions

After the initial phase with its hopes and perspectives had calmed down, Western attention soon focused

on the lack of regulations on the financial aspects. After a while the Soviet side admitted that the present state of legislation was inadequate. Aleksander Maslov, Deputy Chairman of the Board of the Bank for Foreign Trade of the USSR, tried to mitigate the problems by stating that "many provisions that will govern the procedures of joint ventures have not yet been finalised." At the time of writing, I cannot see that the promised legislation has been passed.

The raw materials and the energy required for the production will be bought in the Soviet Union. In this way, one has avoided the creation of "Trojan horses" where the joint venture is made dependent on deliveries from the domestic company of the Western partner. Purchases of any kind in the Soviet Union must be made through the Foreign Trade Organisation in rubles. Hard currency will be exchanged according to the official exchange rate. As mentioned above, the security of supplies can be questionable. If the joint venture could have paid in hard currency for commodities purchased in the Soviet Union, delays or low quality would probably not occur. However, if this was permitted, the situation of the domestic economy would deteriorate because the shortages would increase. Let me add that using the old foreign trade bureaucracy as a gate-keeper between the joint venture and the rest of the domestic economy, is another example of how the bureaucracy distorts the intentions of the joint venture policy. Trading through the Foreign Trade

Organisation means that the diffusion of new techniques and ideas is at best seriously delayed, and at worst effectively blocked. A joint venture would consequently be little more than an island.

According to Soviet statements, a joint venture will pay for the use of facilities in accordance with the current rates levied on domestic enterprises. One interesting problem related to taxation concerns the question of land. According to Marxist principles, nobody but the user owns the land, and it can therefore not be made subject to taxation. The evaluation of land, or rather the absence of it, has long been recognised as a problem by Soviet economists. So far it has not been solved.

Taxation of the use of Soviet buildings, equipment and wages caused much debate within the Soviet political elite. The Ministry of Finance demanded that the joint venture should contribute to the state income to the greatest extent possible levying maximum tax wherever possible. The opponent to this line was the newly created Foreign Economic Commission, a body created to oversee the implementation of Gorbachev's reforms in foreign trade. A compromise was reached, only profits that were put back into trade are to be taxed. The alternative option is to put the profits into a taxfree reserve fund. The intentions are that this fund will reach 25 per cent of the initial investments after a certain period giving the venture a financial basis for expansion.

Money put into modernization and marketing will not be taxed. The remaining profits will be subject to 30 per cent tax. Tax will also be levied on the wages pay~~e~~d to the employees, irrespective of nationality, at a flat rate of 15 per cent. Wages pay~~e~~d in hard currency will not be exempt. The Soviet Union has taxation agreements with most Western countries so that double taxation is avoided, another option that might tempt some is to have the wages pay~~e~~d into a bank account in a third country. However, these problems belong to the future, every joint venture is given a two year grace period, and this period is not finished yet.

The severest disincentive from the point of view of the Western partner, are the regulations concerning the repatriation of profits. Only the surplus remaining after the costs of imports (equipment, machinery, etc.) have been deducted from the export earnings can be taken out of the Soviet Union. Still, the size of the surplus is likely to diminish after payments have been made to the reserve fund, the welfare fund for the work force, and research funds. The money left after these items have been covered, will in the case of rubles be exchanged at the official exchange rate. Two of the joint venture agreements concluded so far have cleverly avoided the entanglements of the exchange rate. The West German fashion magazine "Burda" will be financed by advertisements for Western commodities, pay~~e~~d in hard currencies. Hotel Berlin in Moscow which will be run jointly

by Intourist and Finnair, will charge its guests in Western currencies.

Obviously very few joint ventures can avoid the problem in a similar way as "Burda" and "Hotel Berlin". One attempt to overcome the confusion surrounding the repatriation of profits was made by Vladimir Kamentsev, head of the State Committee for Foreign Trade.<sup>10</sup> He claimed it was a wrong to believe it will be impossible to repatriate any surplus in rubles gained by selling in the Soviet market. According to Mr. Kamentsev, the permission to repatriate profits will be taken on the basis of net profits within the limits set by the joint venture's holdings in hard currency. The ruble holdings pose a major problem, according to the statements they must be exchanged according to the official exchange rate before transfer abroad, as Gosbank's rates are heavily inflated, joint ventures are likely to opt for payments in hard currency. In cases where the joint venture's production for the Soviet market is a substitute for hard currency imports, it would seem reasonable that the Foreign Trade Organisation would pay a certain amount in hard currency. Paying in hard currency will create difficulties for the Soviet partner insofar as the policy of overvaluing the ruble is continued. Although, various moves to create a "convertible ruble" have been discussed, this problem remains unsolved.

#### 7.4. Termination and Dissolution of a Joint Venture

A joint venture will be terminated at the end of the period agreed in the contract between the partners. This is common practice in most joint venture agreements, although the length of duration may vary considerably. The partners may agree to dissolve the joint venture before the period ends if there has been a deficit during several years and the prospects of improving the ventures's performance look meagre. Another reason for dissolution may emerge if one of the partners is unable to fulfil his obligations, for instance if the Western partner is bankrupt or on the verge of financial collapse it may wish to withdraw its foreign investments. However, this paragraph may easily be used as a threat by the Western investor if the Soviet partner does not comply with the agreement. Delays, bad quality or lacking supplies may make it impossible for the Western partner to fulfil the initial intentions.

In the case of serious disagreements between the partners, three options exist for the settling of grievances. The most common is probably to opt for a settlement without the involvement of any legal procedure, most contracts include a description of how this can be done. A second option is to involve the Soviet Foreign Trade Arbitration Commission set up by the USSR Chamber of Commerce and

Industry. This option has been used in the past when settlements have not been achieved otherwise. According to the former Professor of Law at Moscow State University, Olympiad S. Ioffe, the procedures have been just and fair. The only cases of preferential treatment have been to the advantage of the Western interest, even in cases where Soviet regulations could have led to the opposite result. This has been done deliberately in order to strengthen Soviet prestige among foreign businessmen.<sup>11</sup> The third option, which has been frequently used in the past, has been to settle disputes in the Swedish Court of Arbitration. Swedish neutrality, in addition to the country's long experience in Soviet trade have been taken as guarantees of fair treatment.<sup>12</sup> But this option is only possible if it is explicitly stated in the contract that the principle of "locus regit actum" does not apply. Whether this option will be influenced by the many joint venture agreements concluded between Soviet and Swedish enterprises, is not possible to say yet.

It is common practice that joint venture agreements have a "rebus sic stantibus" clause, meaning that the relationship is dissolved in the case of events outside the scope of control of the partners. This clause has been invoked if changes in taxation or customs rates have influenced the competitiveness of a joint venture. To calm the fears of this happening, Soviet officials have stated that no joint venture will be "administratively liquidated". But because the

meaning of this concept is not quite clear, the pledge from the Soviet side has not been given much attention in the West. Two interpretations are possible, "administrative liquidation" can either mean nationalisation overnight, an unlikely option with the present Soviet leadership, or that administrative bottlenecks will influence the performance of a joint venture negatively. This is the real danger, and Western response to the Soviet invitation would have been greater if Soviet bureaucracy was more efficient. The Foreign Economic Commission has been set up to guide potential partners through the bureaucratic procedures. As we shall later see, setting up a new administrative body to solve old problems is not a novelty in the Soviet Union, but for Western business men, this may easily add to the present confusion.

When a joint venture is dissolved, the Western partner may repatriate his share of the venture's capital. In some East European countries, this right is limited to the hard currency gained by the joint venture through export. Thus, the machinery and equipment will not be returned to the West. In this way, the domestic partner is able to continue the production on his own. If the commodity produced is covered by a registered international trademark, the possibility to export will be closed. The Western partner will receive compensation for the loss.



#### 7.5. Western Response to the Soviet Joint Venture Proposal

Various factors have been decisive for the Western response. The general deficiencies inherent in the present legislation which have already been discussed, make up a main disincentive. The Soviet trade officials seem to be aware of that, and as this will be a process of learning, much may still be rectified. The degree of influence offered to the Western partner is one important factor. Other CMEA countries like Hungary, Bulgaria, and Poland, although initially introducing a strict policy similar to the Soviet, soon discovered that this was a serious impediment. Today, the legislation in these three countries has given the partners free hands to decide the composition of management. In fact, few countries insist on having their own citizens in top positions. Therefore, it is not quite true when Soviet trade representatives claim that their laws are "a replica of international legislation".<sup>12</sup>

Quite another argument which has been mentioned by Western observers concerns the Soviet economic infrastructure. It is not sufficiently sophisticated to meet the demands of international business. Although the joint ventures will be left to decide upon their internal accountancy practices themselves, their economic relations with the outside world will go through Gosbank or Vneshtorgbank.

It is remarkable how little attention has been given to financial matters in the Soviet debate on joint ventures, attention has been focused upon management questions, relationship with Soviet economy etc. The ability to grasp the problems that are likely to emerge when the initial phase of a joint venture is ended seems to be absent.

It is beyond doubt that a joint venture with the Soviet Union requires more from the outside partner than joint ventures with other countries. This may well be the reason behind the dominance of West German, Finnish, Swedish, Japanese and Austrian firms in the agreements concluded so far. Knowledge of the bottlenecks and procedures in East-West trade is essential for a profitable outcome, and enterprises in these countries have long traditions in communicating and negotiating with the Soviet officials. The importance of understanding the opposites behaviour should not be discarded. A Norwegian trade official once put the problem to me like this: "We know by now that the Russians think differently from us, the problem is just to know how they think!"

The Co-Ordinating Committee for Multilateral Export Control, COCOM, will play an important role in the development of joint venture agreements with the Soviet Union. From its headquarters in Paris, its responsibility is to supervise and check exports to the CMEA countries preventing any technology or know-how with potential strategic importance

from being exported. The efficiency of this embargo is not a matter for discussion here, what is important from our point of view is the possible implications of COCOM sanctions against an enterprise. Because the COCOM rules are not sufficiently explicit, there will always be border-line cases of what may be exported and which commodities that are banned. This insecurity may discourage a Western enterprise from entering into direct co-operation with a Soviet counterpart by means of a joint venture as well as having repercussions on other enterprises trading with the Soviet Union. COCOM's accusations against the Norwegian state-owned company Kongsberg Vaapenfabrikk in 1986, and the ensuing trial, had a negative influence upon other Norwegian firms' aspirations of trading with the Soviet Union.

What kind of joint ventures are to be accepted by the Soviet side is not clear. To my knowledge, no joint venture proposals put forward from a Western enterprise have been refused by the Soviet side, it is therefore difficult to establish the limitations of the Soviet "open arms" policy. However, there is nothing to suggest that everything will be accepted uncritically. This can be illustrated by the negotiations between Rank Xerox and Soviet foreign trade officials. The British company wanted to set up a joint venture in the Soviet Union assembling components produced in Britain in order to sell the finished products on the Soviet market. Rank Xerox refused to give the venture access to the

world market. Knowing that this would not be well received in Moscow, they offered to sell the know-how required to make a special kind of copy paper which the Soviet Union could sell on the world market. Mr. Yu. Dragonov, head of the Ministry of Foreign Trade's Department for Joint Ventures, objected to the offer for two reasons. First of all, the investments needed to produce the copy paper were estimated to be around 500 million rubles, secondly, because the technique and equipment were judged by Soviet experts to be outdated.<sup>14</sup> At the time of writing, no contract has been signed.

In June 1987, two joint venture contracts were signed between Finnish and Estonian partners. The Finnish enterprise Sadolin Holmblad will set up an enterprise producing wood preservatives and paint, the Estonian partner will provide the chemicals required. This was not unexpected, the chemical sector has been pointed out by Western observers as an area where the Soviet Union can attract Western interests easily. The other joint venture agreement is interesting because of the size of the estimated output, the Finnish Kati Myuyunti will set up an automated production line for the manufacture of women's clothes. According to the contract, around 600 000 articles will be sent out to Soviet shops yearly. According to the Tass statement, consumer demands will provide the joint venture with its main guidelines.<sup>15</sup>

The most glossy result of the joint venture legislation is the translation and distribution of the magazine "Burda". Yet, it is not quite as illustrious in terms of a model joint venture. The amount of capital invested is relatively small, around \$16,5 million, and the degree of direct cooperation between the partners is very limited.<sup>16</sup>

#### 7.6. Future Prospects for Joint Ventures

Joint venture legislations in the centrally planned economies show great variety in terms of what obligations must be fulfilled by the Western partner. Common to all of them seem to be a general lack of detailed specifications. Instead of providing a potential investor with clear guidelines, there is ample scope for doubts and confusion. A similar conclusion must be drawn when looking at the Soviet legislation and official statements. This should not be a deterrent per se. The decision to allow joint ventures with the West, the USSR was the last European CMEA member to do so, was taken at considerable political costs. Much prestige is vested in the policy, and one may expect that joint ventures, once they are concluded, may be given a preferential treatment from the Soviet trade establishment.

If the joint ventures entail sizeable hard currency

profits as a result of export, or supply the domestic market with previously imported goods, the Soviet line may become increasingly pragmatic. The restrictions on Western participation in management and on the repatriation of profits may be eased, or completely lifted. If that happened, what appears today to be the major disincentive from a Western point of view, would be removed.

It is too early today to estimate the economic significance of joint ventures for the Soviet economy. It will take years before all the wheels are running and the production has achieved an optimal level. Much depends on the degree of penetration into the domestic economy that will be allowed. Judging from material available from Hungary and Yugoslavia, countries with a very liberal joint venture legislation and longer experience than other CMEA-countries, joint venture's contribution to the economy measured in the percentage of national income is negligible.<sup>17</sup> At the micro-economic level, from the point of view of the enterprise manager, much the same evaluation has been expressed. Mr. Henning Aretz of the West German East Trade Committee, put it quite negatively: "We welcome Soviet readiness to establish joint ventures, but can foresee no great future for them".<sup>18</sup>

Some Western experts have asked whether joint venture legislation means anything new at all? Could not much the same agreement have been concluded under the label

'industrial co-operation'? Intensive industrial co-operation in the past took on a form hardly distinguishable from the present joint venture agreements, the most prominent example being Soviet-Finnish co-operation in paper and pulp production and in atomic energy. Even though there may be reasons to claim that the present legislation merely legalises practices already featuring in Soviet-West economic relations, it would not be sufficient to explain the enthusiasm and debate displayed around the topic.

It is more logical to regard it as a natural result of recent development, as an integrated part of the General Secretary's modernisation drive. Therefore, the joint venture proposal should not be judged isolated from the rest of the economic reforms. Joint ventures between Soviet and Western partners on Soviet soil, is the consequence of Soviet integration in the world economy, rather than an infringement upon communist principles.

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## 8. Restructuring the Foreign Trade Bureaucracy

### 8.1. Introduction

The influence of the state bureaucracy on the policy-making process in the Soviet Union is considerable. The implementation of a political decision will be decisively influenced by the attitude of the bureaucrats. When Western scholars and observers pose the question "can the Soviet system be reformed", the issue narrows down to whether the state bureaucracy can be made more efficient and responsive.

Not unexpectedly much of the Soviet reform debate has focused on the state administration. According to the leading spokeswoman on the socio-economic aspects of the reforms, Dr. T. Zaslavskaya, the fate of Gorbachev's programme does not so much depend on objective factors like skills, and availability of resources to carry out the reforms. The main obstacle consists of all the middle-ranking bureaucrats who are all too satisfied with the status quo to desire any changes.

**"The reorganization of production relations promises a substantial narrowing and simplification in responsibilities for workers in departmental ministries and their organs. However, it is pregnant with just as significant reduction in their rights, in their economic**

influence and also in the number of their apparatuses: the liquidation of many departments, administrations, trusts, branches etc. that have grown like mushrooms in recent decades. Naturally, such a prospect does not suit the workers, who at present occupy numerous "cosy niches" with ill-defined responsibilities, but thoroughly agreeable salaries."<sup>1</sup>

Although written as early as in 1983, Dr. Zaslavskaya's diagnosis of the problem was repeated by Gorbachev in his formal report to the 27th Congress of the Communist Party in 1986:

"Every re-adjustment of the economic mechanisms begins with a re-adjustment of old stereo-types of thought and actions with a clear understanding of new tasks. This refers primarily to the activity of our economic personnel, to the functionaries of the central links of administration. Most of them have a clear idea of the party's initiative and seek and find a way of carrying them out... All the more so do we have to part way with those who hope that everything will settle down and return to old lines. That will not happend, comrades!"<sup>2</sup>

As Gorbachev's accession is not the result of institutional collapse or complete political anomaly, he has taken over a bureaucratic framework that has not only survived the economic crisis of the seventies, but even been strengthened as a result of lacking restructuring. The political inertia

of the Brezhnev leadership created a vacuum that was rapidly filled by an already strong bureaucracy. Gorbachev is therefore forced to use the bureaucracy for the implementation of his reforms, even in the cases where they are directly opposed to the interests of the bureaucrats.

His calls for a greater degree of autonomy at enterprise level is a direct attack on the power of the planning bureaucracies. Over the years, the five year plans and the central control of the economic development of the country has been taken by many as the very *raison d'etre* of the Soviet system.

A strategy applied by the new leadership to combat bureaucratic reluctance to the changes, has been to appeal directly to the population for support. The idea behind this move has been to evoke the nascent public opinion to criticise the bureaucracy, and force it to adapt a more responsive approach to the requirements of the people at large. The success of this policy is dubious. There are few mechanisms available for the population to launch their complaints. As before, there is every possibility to complain against the treatment received by a certain member of the state administration. Although the muckraking and campaign against corruption and negligence is more extensive today than previously, there are few efficient measures that can be used by a citizen to force a reluctant bureaucrat to change. Voices have been raised with demands to change the legal basis for

the decision-making process.<sup>3</sup> According to present Soviet legislation, a bureaucrat can only be sued on the basis of decisions he has taken. It is close to impossible to sue someone for professional negligence. Another problem that must be taken into account, concerns the effects of this campaign on the members of the bureaucracy. It is highly likely that they feel ostracised and consequentially show no desire to display the eagerness required to change the system.

In the case of the foreign trade bureaucracy, the task is even more difficult. As a result of the long-term policy of insulating the domestic economy against the vagaries of the world markets, the foreign trade bureaucracy has been isolated from the end-users: the enterprise or the individual consumers. Most of the links with the domestic economy go through the planning organs or state committees and ministries. Whereas the role of the public may be influential in other sectors of the economy, there is hardly any public to appeal to in the case of foreign trade. On the one hand the Western customers simply decline to engage in any commercial relations if they are dissatisfied, on the other the Soviet customer has no incentive either to import high technology equipment which will result in higher plan targets, or to supply commodities that have to meet higher requirements when targeted for the foreign markets. The strengthening of the State Quality Control (GOSPRIEMKA) is

one of the tools applied to increase the level of Soviet industrial output to Western standards. Some have argued that even this, fairly traditional attempt of rectifying errors is unsuccessful as the control itself is only carried out on the final stage, when the product is ready for packing and transport. If GOSPRIEMKA was to be successful, it should be a continuous process, involved at every stage of the manufacturing.<sup>4</sup>

Restructuring, or reforming the foreign trade sector will therefore largely be a revolution from above. This strategy poses certain problems which should be discussed in detail.

#### 8.2. The Basis, Targets and Limitations of the Reforms in the Foreign Trade Bureaucracy

In the chapter on the bureaucracy and the decision-making process, the problems of co-ordination of the various sectors and the integration of the different aspects of the country's foreign economic activity were analysed. The inevitable conclusion was that the foreign trade bureaucracy is incapable of swift decision-making and therefore unable to meet the requirements of international trade. In addition, the presence of the party, either in the form of party members at every level, or as external control

organs, would distort the outcome at the cost of what would have been economically profitable. In a similar way like in industry, where the construction of a brand-new factory often is preferred to the modernisation of an old one, reforms in the foreign trade sector has frequently led to the growth of an increasing number of units, each set to solve the emerging problems. As a result, even more bodies must be consulted before a conclusion is reached and the time spent increases correspondingly.

If any reform initiatives are to have a permanent beneficial impact, a correct identification of the problem is of vital importance. Most of Soviet debate were limited to a very general and relatively abstract discussion of the problems during the seventies. There are two notable exceptions, V. P. Gruzinov's analysis of the management of foreign trade, and A. V. Engibarov's analysis of the reasons for the poor Soviet export performance.<sup>5</sup> The quotations from Dr. Zaslavskaya's report earlier, albeit meant as a more general observation of the problem, goes much further than the unpolemic conclusions by Engibarov and Gruzinov. Fortunately, Dr. Zaslavskaya is not alone, others have come forward with piercing analysis.<sup>6</sup> Although no study of the foreign trade bureaucracy per se has been published since Gorbachev's assumption of power, the general academic and political debate, has played an important role in the reforms implemented since 1985.

Common for most of the proposals to reform the system, has been an acknowledgement of the need to alter two aspects of the economic mechanisms:

- the extensive centralisation of decision-making power must be broken, and delegated to lower levels. This requires a radical change in the information structure of the economy, with the establishment of horizontal communication channels. Hitherto, the principles of central planning and authority have favoured vertical channels of communication and information in the bureaucracy. If the intentions to make the state administration more flexible, the communication structure must be constructed according to what is most efficient from a trade viewpoint.

- closely linked to the argument above, is the view that the insulation of the Soviet economy from the developments on the world markets is fundamentally harmful. Only the consumer of imported goods can judge what is adequate for his requirements, in the same way can no-one but the producer of export commodities implement the necessary changes to maintain or increase his share of the foreign markets. To depend on the recommendations, or more frequently orders from a foreign trade association is cumbersome and often inadequate.

A revolution from above usually leads to the establishment of new, supervisory bodies to ensure that the extant bureaucracy complies with the directions issued by the



politicians. The current reforms are no exception. As will be seen in the next section, this has resulted in a large degree of overlapping responsibilities and conflicting interests. Already at this early stage of the reforms, the multitude of bodies supposedly there to facilitate the expansion of trade with the West has created confusions as there does not seem to be any unit with the exclusive power to conduct negotiations and sign a transaction. Needless to say, the obstacles increase parallel with the complexity of the transactions. A problem in this relation is to create conditions where the systematic avoidance of risky transactions and the transfer of complicated decisions to a superiors level is prevented. One way of doing this may be through legislative changes, as suggested previously .

Another, more complicated but nevertheless more promising approach is to reduce the scope and power of the decision-maker. Implicit in this, is that the bureaucracy ideally should not occupy more than an advisory position in the transactions of trade. The inherent tendency towards stability, security and predictability are not compatible with the characteristics of trade. Far from suggesting a rapid introduction of a completely free market, not only would this be utopian as the effects would be devastating, it is more relevant to see how the reforms attempt to permit a greater degree of scope for the market forces as well as trying to make the bureaucracy more compatible with the requirements of

international trade.

Previous reform attempts have not altered the principle of state monopoly of foreign trade. The recent extension of the right to trade on foreign markets to a small number of enterprises in principle does not touch upon this legacy.

In 1965, efforts were undertaken to strengthen the ties between the foreign trade sector and industry.<sup>7</sup> However, these measures resulted in a stronger branch differentiation and made cross-sectional co-operation virtually impossible. The links between the foreign trade bureaucracy and the domestic industry were vested in a number of newly established Foreign Trade Organisations. These associations were to hold a key positions in the conducts of the Soviet Union's foreign economic activities. After the reforms in the late seventies, their power was consolidated and their number had increased. Any reforms which aim for a radical improvement of the foreign trade must therefore attempt to transform the role of these organisations.

A further problem is caused by the relatively small share of the foreign trade in relation to the national economy. Although various definitions of the relationship between the two has been given and this has caused much debate among scholars, the importance of foreign trade to the Soviet economy differs vastly from the reliance on foreign markets in smaller CMEA countries. Due to this fact, there is no

imminent pressure to reform the foreign trade system as the economy will be able to muddle through at much the same level it does today. When compared with Hungarian debate, it is clear that the country's increasing problems on foreign markets play a much larger role in the drive for new reforms than in the Soviet Union. The cost of not participating is in the short-term comparatively smaller for the Soviet Union. Stability is valued much higher by the foreign trade bureaucrats than the loss of a potentially profitable deal, with the result that the trade today is at a sub-optimal level. This is openly acknowledged by the present leadership and constitutes the reason for the desire to engage in a level of trade corresponding to the economic potentials and material needs of the Soviet Union.

We will now turn to a more detailed analysis of the changes in the foreign trade bureaucracy, discussing the establishment of new organs influencing the decisions-making process, as well as the reorganization of the existing units.

### Reforming the Bureaucracy

The general lack of integration between the requirements of the domestic economy and the foreign economic activities of the USSR, was widely discussed at the 27th CPSU Congress:

"Participation in the international division of labour is becoming an important factor for developing the Soviet economy. However, the scales, structure and forms of our trade, scientific and production ties built up over the years now contradict the requirements of the intensification of the economy and acceleration of scientific and technical progress. This is especially noticeable on the background of deep changes in international economic relations due to the scientific and technical revolution."<sup>8</sup>

To supervise the implementation of the reform plans of the political leaders and the co-ordination of all the various foreign economic activities of the USSR, the State Foreign Economic Commission has been set up. Clearly, the task given to this body is considerable. Under the pre-85 system, the supervisory role was vested with the Council of Ministers and the State Committee for Foreign Economic Links.

The Commission includes senior civil servants from a number of ministries engaged in foreign trade, the chairman has been given the rank of Deputy Chairman of the Council of Ministers. It is perhaps too soon to assess the influence this body will have or to what extent it will be able to fulfill its tasks, embracing four different areas according to Ivan D. Ivanov, Deputy Chairman of the Commission:

- "...1) strategic decision-making,  
2) collaborating on national foreign economic policy,  
3) supervision of the planning procedure, and  
4) enactment of the appropriate legislation within the  
limits of its competence...."

Inevitably, there is a certain sense of *deja vu*, creating a committee for a problem that should have been solved if the extant structure was functionally adequate, has been a common strategy in the past. Today, there are too many organs with a supervisory function. However, to claim that this will be the outcome of the Commission may be a premature judgement. The body is to be subordinate to the Council of Ministers, and therefore enhances the supervisory and integrating role that was intended for the Council. As was amply illustrated in the wake of the 1978 reforms, a delegation of power to the bureaucracy may be used in the latter's interest. Apparently, the legislative power vested in the Commission may be used to prevent a repetition of this development.

There is one particular problem that has been pointed out in Soviet debate on foreign trade, that is the scarcity of trade experience and know-how of the functioning of a market. Any expansion of the right to trade to other bodies than the Ministry of Foreign Trade will have to overcome this obstacle. This may be one of the major tasks of the Commission to solve. It is unlikely that the Ministry

of Foreign Trade will lend its knowledge and experience to other bodies, as this will effectively undermine the Ministry's monopoly.

To assess the role of the Ministry of Foreign Trade according to the reform plans is very difficult and somewhat confusing as the statements may differ considerably according to the speaker's institutional affinity. There are no indications that the reforms and restructuring of the foreign trade sector have ceased, thus the role of the Ministry may yet be the object of changes. In an interview on the effects of the reform, the First Deputy Minister of Foreign Trade, Vladislav L. Malkevich did not give any impression of radical changes at all, when he asserted that:

"The Ministry of Foreign trade has been and continues to be one of the most important parts in the foreign economic complex of the Soviet Union and will remain so in the future...The Ministry of Foreign Trade will retain its functions in trading, through its FTOs, in many types of machinery and equipment, important raw-materials and foodstuffs as well as in a number of goods of national importance. Besides those individual and amalgamated factories with the right to enter foreign markets will be able to import and export products on the basis of contractual relations with ... with the Ministry of Foreign Trade. A Considerable part of the total trade turnover...will go through the Ministry of Foreign

### Trade."<sup>10</sup>

Bearing in mind the composition of Soviet foreign trade with Western Europe, the last sentence becomes almost an understatement. Practically everything will be traded as previously, maybe only consumer goods will remain outside the scope of its foreign trade associations. Apparently, even in the cases where there has been a delegation of the right to engage in trade, the lack of experience will force the activities to be channelled through the Ministry. Not only will this prove as inefficient and costly as under the old system, but the fact that the principle of full cost accounting has made it lucrative for the FTOs to impose charges on their services will increase the costs for any enterprise that may ponder on the prospects of foreign trade.

There does not seem to be any changes in the monopoly situation of the Ministry of Foreign Trade. Although its formal rights may have been curbed, its powers are unabated. This is clearly contrary to the intentions of the reforms, and Malkevich's statement contrasts strongly with the optimism of Ivanov who declared that the expansion of foreign trade rights was the "bedrock of reforms" and that the Ministry of Foreign Trade was "invited to join this new commercial market."<sup>11</sup>

One might be tempted to alter Mr. Ivanov's statement and say that it is not the expansion of rights that are the bedrock of reform, but how the rights of the

FTOs have been altered. According to a decree published in March 1987, their financial status has been changed.<sup>12</sup> As mentioned above, full cost accounting still remains the fundamental principle, but under the new regulations they are to be self-sufficient in hard currency. It should be added that the official statement uses the word valuta, which may cover both convertible and non-convertible currencies. If an FTO wishes to expand its activity, further funds may be borrowed at a low interest rate from the Vneshtorgbank, the bank for foreign trade. However, despite this, one remains with two fundamental questions, what can the FTO do with its earnings, and what happens if it does not make any profits at all?

Seemingly, the intention was that any surplus holdings of foreign currency may be used for additional purchases on Western markets. It is difficult to see how this can be undertaken when there has not been made any provisions for such a move in the plan. To a certain extent, this depends on the character of the plan, a point which will be discussed below. But it is problematic to see what the FTOs can do with a spontaneously purchased amount of goods.

What makes the sudden granting of financial independence to the FTOs problematic, is the great potential for contradictions between by the financial prudence pursued by the state banks and the FTOs' seemingly unrestricted right to spend any surplus. Not only does this betray a certain



degree of naivety in the reforms, it reveals the basic contradiction between the granting of autonomy while still retaining central control. If the interference of the state banks equals the previous restrictions, there will be no incentive for the FTOs to expand their trade.

As has been discussed previously, the Foreign Trade Organisations are representatives of branch interests whereas the ultimate responsibility for their performance is vested in the Ministry for Foreign Trade. The State Committee for Foreign Economic Relations (not the Commission) has been given the task to check on their performance. Quite how this supervisory role is to be divided between the Ministry and the Committee has not been explained. May it suffice here to repeat, that having two mutually independent bodies watching a third is a fertile ground for institutional conflicts. In the confusion this will create the association may find it easier to pursue their old functions and not pay heed to contradictory directions from the Committee and the Ministry.

The State Committee for Foreign Economic Relations is given an advisory role, functioning as an intermediary organ providing foreign business-interests with information and help to find a suitable Soviet partner. The Committee is also responsible for drawing up forecasts and surveys in the fields of metallurgy, energy and geology, all being of particular interest to foreign business. The

Committee monitors developments on the Western markets.

This lack of knowledge about the vagaries of Western markets... has for long been a weak point in Soviet trade with Western Europe. As will be discussed later, some measures have been proposed to provide the foreign trade sector with long-term prognosis and short-term forecasts.

As a result of the diffusion of responsibility and decision-making power, the need for the large central bureaucracies has disappeared. In addition, the task of curbing the influence of the foreign trade apparatus can only be effectively carried out if the number of employees is reduced. The staff subordinated to the Committee has been cut by 30 per cent, cuts at a similar scale have been announced for the Ministry of Foreign Trade as well.<sup>13</sup>

Although one of the targets of the reforms was to facilitate the negotiation process between the foreign partner and the Soviet enterprise, the present changes has introduced a multitude of advisory bodies. For someone who has been engaged in long-term trade connections with the Soviet Union, the old system might seem more preferable. In addition to the Commission and the foreign trade associations, the Chamber of Commerce and Industry is given the task to supervise the trade contacts between the West and the Soviet Union. Its main responsibility will be, as in the past, the arrangement of exhibitions and fairs for Soviet industry at home and abroad. According to

the Chairman, Evgenii Petranov, the Chamber will concentrate its efforts in the field of machinery and equipment. As these are commodities that will be given high priority under the new reforms, the Chamber will probably play a much more prominent role than in the past. Ye. Petranov states that the most important aspect of the Chamber's function rests on the fact that:

**"over 70 Soviet industrial enterprises that now have the right to operate independently in foreign markets are members of the USSR Chamber of Commerce and Industry."<sup>14</sup>**

The number given here covers all the enterprises which have been granted the right to trade abroad. Although the Chamber ostensibly is there to aid them in their foreign operations, its central position suggests also that it may have a screening function. Thus, we may have to conclude that despite the assertion that the granting of foreign trade rights to individual enterprises is a break with the monopoly previously enjoyed by the Ministry of Foreign Trade, the monopoly has de facto been transferred elsewhere. At the same time, the enterprise have been given the financial responsibility for the preformance of their output on the Western markets.

#### 8.4. Three Key Factors: Plan, Price and Expertise

As we have seen in the past, structural changes have been without much impact on the general performance of the Soviet foreign trade sector, because the basic mechanisms have remained unaltered. The scope of action, and the scope of autonomy in a Soviet enterprise may have been slightly expanded, only to be retracted by the central bureaucracy as soon as a reform-wave has ended. The ultimate decisions has always been taken by the central bureaucracy. Reforms are therefore little more than structural changes in the state administration. This has been convincingly argued by Soviet analysts,<sup>15</sup> and pointed out by this author. On the background of this, the reforms undertaken within the bureaucracy will undoubtedly be of some relevance and facilitate trade to some extent, although there are ample grounds for conflict and confusion not only among the decision-makers but for the foreigner who might be interested in entering into a co-operation or trade agreement with a Soviet enterprise.

One may be forced to draw a somewhat sombre conclusion based on the observations above. That might be premature, so far we have limited the discussion to the "superstructure", the plan has not been analysed. There are several reasons for this, the reforms have started by changing what is visible. This might easily turn out to be a

A fatal strategy, as one cannot expect an enterprise or a bureaucratic body to function according to the intentions of the reforms as long as the fundamental mechanisms remain unaltered. It should perhaps be added that it is far more easy to change people, responsibilities and targets, than the fundament of the system itself.

There are however, certain aspects of the reforms that reveal a will to change the fundamental mechanisms of the Soviet economy. In particular has the debate focused on the role of the plan, the function of prices, and the access to adequate and relevant information. Unfortunately, it should be added that these are all topical issues, and that because of the short time the reforms have been active, there is no material available to estimate their impact on the performance of Soviet foreign trade.

Concerning the plan, the main instrument of state control over foreign trade, Ivan D. Ivanov announced that: "It will be less deliberate."<sup>14</sup>. Whereas the exact meaning of this statement is difficult to define, one may assume that measures have been undertaken to move away from the directive nature of the plan towards a more indicative role. This assumption is confirmed elsewhere by Ivanov.<sup>17</sup> He states that the previously applied strategy of allocating any surplus products for export will cease. This has proved both costly and inefficient as it would often have been more economical to have used the surplus in the

domestic industry. The restrictions on imports will be removed, as the decisions to purchase abroad will be taken by the enterprise managers on the basis of the enterprise hard currency fund. As has been stated earlier, demand for foreign imports by far exceeds the central funding allocated for that purpose. This problem will therefore partly be solved under the auspices of the expanded foreign trade rights. However, the central authorities role in foreign trade will not be cut back as much as one might be tempted to think natural due to the reforms. The previous policy of preventing foreign purchases whenever domestic industry can supply what is needed will be continued for those enterprises that have not been given the foreign trade rights:

"...requests (excluding goods and services that may be used at their own discretion) will be examined more carefully bearing in mind the availability of domestic products and comparable value and quality."<sup>18</sup>

The extent of this liberalisation can only be measured if we know the number of enterprises and organisations with hard currency rights. Although this is a frequently misunderstood point in Western debate, this category is apparently larger than the number of 70 enterprises, 20 ministries and 10 interbranch scientific organisations with foreign trade rights.<sup>19</sup> The large majority of Soviet enterprises will still be at the mercy of

the State Committee of Science and Technology when they apply for imports. Thus, one must conclude that unless the domestic mechanisms of innovation and diffusion are significantly improved, the impact of imported modernisation will remain marginal.

On the export side, the idea is that the enterprises will be encouraged by the potential hard currency profits to produce more and better commodities for the foreign markets. According to Ivanov, resources for factories producing for exports, will be given top priority when the allocation of raw-materials and other input materials is planned. This hardly solves the fundamental problem caused by the rigidity of the plan. If the Soviet Union is to participate more actively in world trade, the enterprise must be able to respond more flexibly to the developments on the world markets, either by seizing an opportunity the moment it emerges or stop producing whenever a commodity loses its competitiveness. Today, input materials are scarce and cannot be purchased unless they have been made available by the planners. Any enterprise manager that stops production will be left with an excess holding of material, all of which is illegal to resell either to the producer or to another company. Under Soviet law, hoarding materials is a criminal act, and the manager will be liable to fines or imprisonment. One is therefore forced to conclude, that there is little incentive for a Soviet

enterprise to enter into the foreign markets because the domestic setting does not permit him to react flexibly. It is highly likely however, that the enterprises with the full trading rights already are involved in foreign trade and that the reforms will enable them to participate more fully.

In 1979, a decision was taken to reform the industrial wholesale price system. New price lists were set up, and two years later they became effective. The motives behind the reform initiatives were laudable, economising was to be encouraged and the quality of output to be increased. The new prices were calculated to reflect costs more correctly than the old system.

Then, as now, it was regarded as a major task to promote the introduction of new machinery. Technological progress and the intensification of the Soviet economy is impossible if the resistance towards innovation is not broken. Various models were applied to facilitate a change of attitude on behalf of the management, and to give an impetus to the integration of more cost-efficient techniques of production.

During the seventies, the most dominant pricing method was effectiveness prices. According to this principle, the products are given a price high enough to encourage producers, and sufficiently low to attract buyers. The "effectiveness" derives from the gains achieved by substituting an old product for a new, the resultant profit



will be shared between the producer and the purchaser.<sup>20</sup> Mostly new products belonging to the top quality categories are made available for effectiveness prices. Despite this, the effectiveness pricing has had a very limited impact. Not only has there been numerous complaints against the standards set by the GOSSTANDART as there seems to be a fair amount of arbitrariness in their categorisation, but more important because even products given top certificates of quality fall short of international standards.

The emphasis on a priori knowledge of the productivity and profitability is the main cause for the inapplicability of this price model. A possible solution to this problem would perhaps be to give the enterprises the right to set the prices and restrict the directive powers GOSKOMTSEN, the state pricing authority. But this could only function in a context with competition among the producers, and not in a situation marked by endemic shortages as today. A reform of the price-system will therefore have to proceed step-wise towards greater flexibility. There are encouraging signs that this is the strategy applied at present. Nikolay Ya. Petrakov, Chairman of GOSKOMTSEN, states that the current reforms are in favour of a transfer of power on price-issues to micro-economic level, while at the same time retaining a fair measure of central control:

"...the planned price system performs the important role

of reconciling national economic and enterprise interests... First, prices as economic normatives determined directly by the plan, must preclude, (make unprofitable or economically disadvantageous) socially unjustifiable expenditures for production. Second, prices should provide a profit sufficient for the further development of production at planned rates of growth, and the formation of material incentive funds according to plan normatives. Such price structure creates a genuine economic base for the conversion of enterprises and associations to samou<sup>o</sup>okopayemost and ...self-financing."<sup>21</sup>

How succesful this will be depends to a great extent on the character of the plan. Petrakov is regrettably vague on the interrelatedness between price and plan.

It is inevitable that the attempts to create closer links between the Soviet economy and the world market must result in a levelling out of domestic and international prices. As discussed previously, the FTOs price the exports according to the prevailing price levels abroad, and resell imports to domestic customers at a price which is heavily subsidised by the state. Despite the expansion of trading rights and the right to hold hard currency, most foreign trade activities will be conducted as earlier, and a less rigid price system will be a natural move in the near future.

An aspect of the reforms rarely mentioned in the Western debate, but frequently focused upon by Soviet scholars, is the dangerous lack of adequate skills suited to international trade. Engibarov hinted at this deficiency by describing the problems of marketing.<sup>22</sup> Lowering the price was seemingly the only technique applied to attract new customers and widen the market share. The debate today goes further, underlining not only the importance of a more sophisticated approach to advertising and selling, but points out the importance of a thorough knowledge of the fluctuations on the foreign markets. In an article in Vneshnyaya trgovlya, P. Zav'yalov states that:

"One of the decisive factors for the success on foreign markets, especially concerning scientific goods, is the regular outlining, and ability to implement a policy for the export of the commodities. Working out a strategy opening up foreign markets for new commodities should become an important part of the export policy of industrial enterprises, foreign trade associations and firms."<sup>23</sup>

Zav'yalov recommends the establishment of a nation-wide information network offering its services to any enterprise interested in foreign trade. Related to this, a new role should be given to the foreign trade missions attached to the Soviet embassies:

"...the main target of these must consist in the

preparation of analytical materials on foreign markets, forecasts, concrete recommendations and suggestions to individual enterprises, export co-operations and foreign trade organisations."<sup>24</sup>

The ability to implement the intentions inherent in the reforms depends on the skills of the managerial staff and the employees of the state bureaucracy. Apart from individual articles in the press and scholarly journals, there are few signs of any official initiatives to apply western-style managerial skills as a part of the general training of new managers or civil servants. According to the curriculum of the Academy for Foreign Trade for 1986/87, the courses on "the organisation of foreign economic links" and "analysis of the foreign economic activities of the enterprise" are given less teaching hours than "contemporary problems of marxist-leninist philosophy" and "current problems of scientific communism".<sup>25</sup> It should be added however, that there has been a certain diffusion of marketing skills through the reduction and re-employment of staff from the central bureaucracy. In addition, the Chamber for Commerce and Industry has set up of training and consultation office as part of its task to facilitate foreign trade.

The plan, the price mechanisms, and the skills to use the newly given autonomy are interdependent. It will take some time before we can fully comprehend the scope of the reforms and the impact they have had on the USSR's

foreign trade profile. The entire pattern of interaction between the state and the productive sphere will be changed... radically. Unless the reforms benefit the enterprise managers, it will be impossible for the politicians to curb the power of the bureaucracy through declarations alone. At this early phase it is impossible to say whether Gorbachev's "revolution of the minds" has made the managerial staff receptive to the ideas of profit, competition, responsibility and possible bankruptcy. If the answer is negative, and enterprise managers join ranks with the bureaucracy, any reform attempt will fail.

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vneshnei trgovlei s 1986/1987 uchebnogo goda.

## 9. Conclusion

The most radical aspect of the reforms in Soviet foreign trade with Western Europe is the departure from the insistence on a planned nature of the economic relations. This move has been reflected most clearly in the expansion of foreign trade rights, the establishment of joint ventures and the attempts to engage in closer co-operation with the Common Market and GATT. As we have seen, the present leadership has adopted a policy aimed not solely at strengthening traditional export commodities, but has attempted to open up the foreign markets for a much larger share of the domestic economy. Many commentators have focused on this development as the most visible sign of Gorbachev's strategy of using foreign trade consciously as a growth factor, and not only to cover up deficiencies or solve the bottlenecks of the domestic economy. Yet, I would like to conclude that this is only a part of the truth. If the foreign profile of the country is to be improved, the prerequisite is internal change. It is crucial that the domestic structure, be it the bureaucratic hierarchy or enterprise management, is able to respond to and be influenced by the changes in the world markets. As was shown in the first section, reforms were undertaken during the seventies, but without attempting to consider the problems of foreign trade as part of a greater



whole. The principle of isolating the domestic economy from external developments was not altered. This has been changed since 1985. The measures that have been undertaken in the past two years have aimed towards a greater degree of integration with the world economy.

The current reforms are not restricted to the state bureaucracy, but have been reflected at enterprise level.

The Law on the State Enterprise which was passed in June 1987 provides for a radical expansion/managerial autonomy.<sup>1</sup>

In addition, the participation of the work force is regarded as a crucial element in the democratisation process. When recalling that the average size of a Soviet enterprise is far larger than its Western counterpart, I have certain problems comprehending how this will be carried out in practice.

Nevertheless, it would be a major victory for the reformers if the entrenched attitude of "they pretend they pay, so we pretend we work" is broken. This would be a far more valuable contribution to the improvement of the Soviet foreign trade relations than any short-term increase in the export of machinery and import of consumer goods.

The awkward and lengthy negotiating process which arises from Soviet trade practices were analysed in the first section of the thesis. The expansion of foreign trade rights will probably change this feature, and greatly facilitate trade relations with more middle-sized and small Western enterprises. As mentioned, counter-trade practices lack

prestige. If the insistence of payment in kind became a thing of the past, the USSR would be able to claim a position as an equal trading partner of the West with more credibility than today. It should be added that this development would make a future GATT-membership more likely.

The bureaucratic obstacles still identifiable despite the reforms, may distort the political initiatives considerably. There is a precedent for this. In 1965, reforms were passed, which aimed at giving managers more freedom to choose what to produce as well as expanding their autonomy in managerial questions. The resistance of the state administration, combined with a lack of understanding for the contents of the reforms on behalf of the managers, forced the political leadership to retract the reforms before they had been fully implemented.<sup>2</sup>

Yet certain important factors make a similar negative development less likely under the present conditions. Internally, the debate on the necessity for economic reforms has raised popular awareness of the impending crisis and stagnation if nothing is done. Enterprise managers have been given the possibility to give their opinion in the media, and thus had ample opportunity to exert pressure on the reform proposals. In addition, the Law on the State Enterprise provides them with legal protection against attempts to curb their newly gained autonomy from the outside, e.g. bureaucrats or local politicians.

The plans to expand the share of unplanned sectors, as well as opening up for wholesale<sup>2</sup> of industrial consumer goods outside the scope of the central plan, will entail a certain degree of competition among the domestic producers. The ability to cope with competition at home will be an important lesson for future success on Western markets. If the development in the Soviet economy will introduce phenomena like bankruptcy and freedom to hire and fire staff, the barriers between a planned economy and a market system will become smaller.<sup>3</sup>

A problem closely linked to the issue of managerial freedom concerns the question of ownership, a question that takes us back to the introductory chapter on the systemic differences between the Soviet Union and Western Europe. Although the powers of the state bureaucracy have been restricted, it remains to be seen if the state ownership of the means of production have been transferred de facto to the enterprise. Commenting on the reform process, a leading expert on Soviet law, Harold J. Berman claims that:

"The genius of it was that it preserved the Marxist-Leninist conception of legal ownership as part of the ideological superstructure built upon the base of economic ownership. The theory of rights of operative administration was, and is, to be sure, a major concession to the requirements of economic efficiency..."<sup>4</sup>

The external dimensions of Soviet foreign trade has been expressed in a vigorous economic diplomacy. To a certain degree, this link between foreign policy and foreign economic relations is a novelty. Under the leadership of Brezhnev, throughout the seventies and early eighties, there were few international events or political crisis in Western Europe that triggered Soviet threats to use trade as a political weapon. Despite the occasional war of words, trade was not cut off at any point with the aim to force concessions from Western Europe. Since 1985, there have been several attempts to use trade more constructively by linking an improvement in trade relations to the a lessening of political tensions. In this respect, the ideals of the functionalists have been revived. It is perhaps relevant at this point, when the disarmament process seems to yield tangible results, to recall the quotation in the introductory chapter taken from Mitrany:

"binding together those interests which are common, where they are common and to the extent to which they are common...like other forms of union it (functionalism) links together a number - any number - of political units, but for one purpose at a time...one might put it, that (it) is a limited liability association between political units."<sup>5</sup>

Trade is one of the most obvious issues where both Western Europe and the Soviet Union have common interests. It is not an exaggeration to claim that the present Soviet leadership

enjoys unprecedented popularity in Western Europe. This political credibility has spill-over effects on trade and the prospects for an expansion of economic intercourse are positive at least in a short-term perspective. Whether we are at the beginning of a lasting expansion of economic and industrial relations depends on the profitability. One may once again turn to the warning issued by Henry Kissinger at the beginning of the seventies that without profit, trade would dwindle.<sup>6</sup>

I will not venture to present any guesswork on the future of Soviet-West European trade,<sup>2</sup> above the conclusion that the preconditions for <sup>1</sup>an improvement in the relations are present. Most important is the understanding displayed by the Gorbachev leadership that the pre-1985 trends in trade and economic development could not be continued any longer. Not only did the reliance on a single commodity create serious instability in Soviet hard currency income, but it contributed to an entrenchment of the country's economic backwardness. To the question I have tried to answer on the pages above, to what extent is the Soviet economy and foreign trade bureaucracy adapted to the requirements of international trade, there is no clear cut answer. Rather I am tempted to conclude that it is still a long way to go before the Soviet Union can compete successfully in Western Europe, but the situation today is radically better than just a few years ago.

The power of the bureaucracy is still considerable, a fact that will have adverse effects on any modernisations attempts. The multitude of organs has not been decreased, on the contrary (have) new bodies with overlapping responsibilities been created. The inherent tendency to avoid innovative forms of transactions which entail considerable risks, as well as the transfer of difficult decisions to superior levels, have not been broken. Unless the expansion of trading rights is further enhanced to cover new sectors of industry, there are substantial reasons to fear that the problems of the past will continue under the guise of new committees, commissions and supervisory councils.

I believe it is too simple to claim that the problems of Soviet foreign trade are due to the general lack of sophisticated high quality goods. The absence of extensive and uninhibited channels of communication between the domestic and foreign economy is the prime reason for this backwardness. The formation of a communication network passing on the information required for an adaption of production to the requirements of foreign customers will not only be an efficient attack on the monopoly of the Foreign Trade Organisations, but give the enterprises incentives to use their newly granted rights.

The basic issue remains, as was stated in the introduction, the systemic differences between a planned and a market economy. To engage in international trade is

impossible without a domestic economy capable of reacting swiftly to changes. The conduct of trade and the transfer of knowledge do not, and cannot follow a rigid plan. Much therefore depends on the long-term effects the recent changes and future reforms will have on the economic mechanisms of the Soviet economy. In 1982, two West German scholars concluded that:

"An organisational form, comprising both the requirements which increasingly emphasise the innovative, high-cost and therefore risky forms of foreign trade transactions, with the demand for the supremacy from the party and the state, is so far not found."

Based on the analysis we have presented here, we may conclude, although with considerable caution, that measures of a radical character have been undertaken to facilitate international trade, at the cost of the state and the party.

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2        Olympiad S. Ioffe, "Law and Economy in the USSR", 95 Harvard Law Review, 1591, 1982.

3        The possibility of declaring an enterprise bankrupt is open to the authorities, yet it remains to be seen if this will be carried out to any significant extent in practice

4        Harold J. Beerman, "The possibilities and Limits of Soviet Economic reform" in Soviet Law and Economy by O. S. Ioffe and Mark W. Janis, p. 33.

5        See note 9, chapter 1.

6        See note 8, chapter 3.

7        A. Wass von Czege and R. Tchakhmakhtcheva, Die sowjetische Aussenhandelsbuerokratie, Stuttgart und New York: Gustav Fischer Verlag, 1982, p. 331.



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