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File Folder: [Washington Summit:] Background Book for
Meeting Between President Reagan and
General Secretary Gorbachev, Washington, DC,
12/08/1987-12/10/1987 (4)

Date: 08/25/2004

DOCUMENT NO. & TYPE	SUBJECT/TITLE	DATE	RESTRICTION
1. background paper	re Soviet economic performance, 1p R 3/16/06 NLSR 97-066/7 #164	n.d.	B1 →
2. background paper	re Soviet international economic initiatives, 2p R u u #165	n.d.	B1 →
3. background paper	re US-Soviet trade, 2p R l u #166	n.d.	B1 →
4. background paper	re grain trade, 1p R u u #167	n.d.	B1 →
5. background paper	re fisheries, 1p R u u #168	n.d.	B1 →
6. background paper	re textiles, 1p R u u #169	n.d.	B1 →
7. background paper	re Gorbachev's leadership, 1p R u u #170	n.d.	B1 →
8. background paper	re USSR political and economic reforms, 1p R u u #171	n.d.	B1 →
9. background paper	re recent trends in Soviet foreign policy, 1p R u u #172	n.d.	B1 →

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V.

U.S.-SOVIET ECONOMIC ISSUES

1. Soviet Economic Performance
2. Soviet International Economic Initiatives
3. U.S.-Soviet Trade
4. Grain Trade
5. Fisheries
6. Textiles

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SOVIET ECONOMIC PERFORMANCE

- o Economic turmoil is slowing growth in 1987. GNP will rise only 1 - 1.5%, less than the pre-Gorbachev average and well below the strong 3.8% pace of 1986. Turmoil results from harsh winter weather, new inspection procedures for industrial output, new managerial and financial arrangements, and massive industrial retooling.
- o Industrial performance is poor. Overall output will rise less than 2.5%, versus the 4.3% target. Energy sector is doing well, but output of basic materials was slowed by harsh winter. Crucial machine-building sector is far below plan in both quantity and quality of output, calling into question Soviet ability to succeed in what is top-priority focus of Gorbachev's modernization drive.
- o Agriculture is having a second good year. Overall output will nearly match the record level of 1986, despite less advantageous weather. Productivity gains are producing good results in grain, meat, milk, and eggs. Unless quality proves a problem, another record forage crop will reduce need to import grain for livestock feed.
- o But Soviet consumers have little to cheer about. State retail sales are up only 1% through September, compared to 3.5% annual average in 1981-1986. Soviet leaders are concerned that slow growth in consumption could undermine public support for economic reforms. They are trying to accelerate improvement in food and durable goods supply and distribution, and promising more attention to consumers next year.
- o Soviet trade balance has improved but hard currency is still tight. At midyear the USSR enjoyed a \$1.2 billion hard currency trade surplus, versus a deficit of \$1.5 billion in early 1986. Earnings rose 14% thanks to higher volume and value of oil exports and higher arms sales (on credit) to Third World; spending fell 8% due to less need for grain imports and cutbacks in industrial imports. Low levels of foreign borrowing and gold sales suggest Soviets will keep tight lid on imports in second half of year.
- o Annual plan for 1988 keeps targets unrealistically high: GNP and industrial output are to rise 4% and 4.5% respectively over planned - but unachieved - 1987 levels. Such targets fit the 1986-1990 Five Year Plan mold, but don't allow for the inevitable disruption of the comprehensive economic reform program announced in mid-1987.

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SOVIET INTERNATIONAL ECONOMIC INITIATIVES

- o Designed to assert international economic role commensurate with superpower status, give Moscow more say in international economics, buttress domestic reforms, improve the balance of payments, and reduce technological lag.

GATT Membership

- o Stated goal is to participate in formulation of international trade policy, expand trade with GATT members, acquire experience for possible eventual full membership.
- o In August 1986 Soviets sought to participate in Punta del Este round of multilateral trade negotiations. The bid failed as most GATT members reacted negatively, but Soviets still pursue participation as a long-term objective.
- o The US strongly opposes Soviet participation in GATT fora:
 - Soviet centralized economy and non-market trade system are incompatible with GATT's underlying free market-oriented philosophy.
 - Without substantial changes in Soviet economic and trade systems, Soviet participation offers little to GATT members. The Soviets could not fulfill GATT's membership commitments.
 - Some changes pursued by Gorbachev suggest Soviet practices might eventually move in direction of greater compatibility with GATT norms, but it is far too soon to draw more definitive conclusions. We should await outcome of these changes.
 - US shares concern of other GATT members that Soviet participation could lead to politicization of an economic forum that plays a central role in world trade, thereby undermining its efficacy.

Foreign Trade Sector Reorganization

- o Soviet goal is to increase and diversify exports, restructure imports, improve access to Western capital and high technology, some of which may seem innocuous but in fact have security implications (e.g., air traffic control equipment).
- o Central to effort is greater autonomy for selected ministries and enterprises, including self financing and

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more direct participation in foreign trade: legislation granting autonomy passed last January, but implementing measures not yet enacted.

- o Ministry of Foreign Trade and many foreign trade organizations restructured; Foreign Economic Commission (under Council of Ministers) created to oversee changes and coordinate activities of trade entities.

Joint Ventures with Western Firms

- o Goal is to tap Western capital and management, marketing, and quality control methods, broaden access to Western technology, increase exports and substitute for imports.
- o Legal framework was established in January 1987. Law has flexibility to tailor regulations to a given project, but restrictions and lack of clarity prompt Western concern over transfer of profits, management control, protection of Western partners' rights.
- o Western firms interested but skeptical. Most firms discussing joint ventures with Soviets already do business there. Many see joint ventures as entree into Soviet domestic market, few interested in promoting Soviet exports to compete with their own products in third countries.
 - Soviets have signed 14 joint ventures to date, mostly with West European firms.
 - Two joint ventures recently signed with U.S. firms, Combustion Engineering and Occidental Petroleum.
- o To create attractive conditions for Western investment, Soviets are being pressed to reduce barriers against outside world and central political controls over economic decision-makers.
- o Any joint venture must comply with US and COCOM export controls. Commercial risks must be borne exclusively by the private sector.

United Nations Activism

- o Each year since 1985, in context of their proposals for a "Comprehensive System of International Security", Soviets have introduced to the UN General Assembly, and won majority support for, resolutions on "International Economic Security". These advance Soviet and Third World rhetoric along "New International Economic Order" lines.
- o The US opposes such Soviet resolutions as extremely vague, duplicative of the purpose and role of the UN Charter, and wasteful of the UN's scarce time and resources.

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US-SOVIET TRADE

- o Bilateral trade looms small in overall picture -- never more than 1% of total US trade, 3-4% of Soviet trade. Nevertheless, Soviets major grain market, potentially large untapped market for US manufactured and consumer goods.
- o Soviets consistently run trade imbalance in our favor, averaging \$1.9 billion in recent years, on strength of grain sales. Surplus fell to \$600 million in 1986 with drop in bilateral trade.
 - In 1986, US exports were down 46% because of decline in sales of grain, manufactured goods, crude materials. US imports increased 44%.
 - Little change in 1987, but imports from USSR are down.
- o Major obstacles remain to significant expansion in trade:
 - Soviets face hard currency shortage, unwilling to risk heavy international borrowing needed to purchase items economic expansion would require. Also, Soviets produce hard-to-sell, low quality goods.
 - Congressional mood distinctly anti-Soviet: Bills have been tabled to restrict bank credits further, ban imports of goods allegedly made by forced labor despite lack of evidence; for example, in last two sessions Congress failed to drop 37-year old ban on Soviet fur skins, despite Administration support for repeal.
 - Administration policy and existing legislation ties trade to Soviet emigration: Jackson-Vanik Amendment prohibits official US-backed credits and withholds Most Favored Nation tariff treatment of Soviet exports; Stevenson Amendment imposes further barriers on official lending.
 - On-going Soviet effort to acquire military-related technology undermines mutual trust.
- o Administration policy since 1985 has been to seek expansion of mutually beneficial non-strategic trade

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consistent with our export controls and regulations, improvements in human rights/emigration, and demonstrated progress on other bilateral political issues.

- o Soviets' bottom line: trade is a two-way street -- lack of possibilities for Soviet exports will "sharply reduce" prospects for purchase of US exports.
- o Soviets want to expand trade with US, in many ways prefer to do business with American firms. But past sanctions and embargoes have caused Soviets to view US as unreliable supplier, caused them to turn increasingly to Western Europe, Japan.

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GRAIN TRADE

I. BACKGROUND

- o In 4th year of 5-year Long Term Grain Agreement (LTA), Soviets met wheat and corn purchase commitments (after receiving Export Enhancement Program (EEP) for wheat), but fell short of overall minimum grain purchase commitment. In 2nd and 3rd years they failed to honor commitment on wheat purchases because US prices were uncompetitive.
- o In 5th year, Soviets have already bought large quantities of US wheat and corn, and record amounts of soybeans. The Soviets have already indicated they will take this year's LTA wheat quantity (4 MMT) plus 750,000 tons to make up for last year's shortfall; EEP for that amount has been authorized. Their needs are higher, and if we remain competitive with the European Community through EEP, wheat sales could go above 4.75 MMT.
- o Current LTA expires in September, 1988. We have agreed to discuss future of LTA in early 1988.

II. US VIEWS AND OBJECTIVES

- o The U.S. goal is three-fold: To hold the Soviets to honoring their commitments under the LTA, to manage the large US/USSR grain trade so it remains non-disruptive, and to promote maximum US grain exports without subsidizing the Soviet economy.

III. SOVIET VIEWS AND OBJECTIVES

- o Soviets aim to guarantee foreign grain supplies at minimum cost while trying to improve own agriculture to eliminate import needs.
- o With the decrease in oil and raw material prices in recent years, the Soviets are carefully allocating their hard currency resources and shopping for good deals.
- o In buyers market, they are playing off grain exporting countries against each other to obtain low prices. Soviets tell US officials and grain industry they see us as an unreliable source (following grain embargo); argue that without EEP, US wheat prices are not competitive and that they intend to make us only a residual source of supply. Soviets have also complained about problems with the quality of US grain, most recently insect infestation problems.
- o Will try to use prospect of Long Term Grain Agreement extension to secure US commitment to increase imports from USSR.

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FISHERIES

I. BACKGROUND

- o Previous bilateral agreements have allowed Soviets to fish off US Pacific and Atlantic coasts. However, legislatively-mandated sanctions resulting from Soviet whaling practices have halted Soviet fishing in US waters since 1986. Only one joint venture (under which US fishermen in the Pacific barter their catch with Soviet processing vessels) continues unaffected.
- o Soviets announced an end to commercial whaling this past summer. Available evidence supports this, but we continue to sanction Soviets because they refuse, on principle, to withdraw their objection to the 1985 International Whaling Commission (IWC) moratorium.
- o Following interagency discussions, Commerce Secretary Verity provided Soviets a letter stating an intention to rescind sanctions provided the Soviets withdraw their objection to the IWC's moratorium on commercial whaling. We are awaiting a Soviet response.
- o US fishing industry wants access to Soviet waters, something we have never had. Five years of negotiations have brought us close to that goal: in August, Soviets tentatively agreed to give the US reciprocal access.
- o Whaling issue is the stumbling-block to implementing access agreement. Access to Soviet fishing waters would benefit US interests, give depressed Pacific Northwest fishing industry new economic opportunities (including joint ventures with the Soviets), and possibly open Soviet Far Eastern seaports to US fishing vessels.

II. US VIEWS AND OBJECTIVES

- o To obtain access on advantageous terms for US fishermen to fisheries resources in Soviet waters and, secondarily, to open Soviet Far East seaports to US fishing vessels.
- o To encourage Soviets to comply with IWC moratorium on commercial whaling.

III. SOVIET VIEWS AND OBJECTIVES

- o To ensure opportunities for direct access to US fisheries resources in exchange for any direct US access to resources in their waters.
- o To earn hard currency from fisheries activities.

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TEXTILES

I. BACKGROUND

- o During 3rd round of negotiations October 23-24 in Moscow, US concluded textile agreement with Soviets allotting them quota of 6 million square yards (syds) for last 5 months of 1987 and 23.5 million syds for 1988.
- o After early 1987 jump in Soviet cotton sheeting and print-cloth imports from 1986 levels, negotiations began to regularize entry of the goods into US market.
- o US industry feared large-scale, cheap Soviet imports. Without quotas, USSR could quickly have surpassed other key supplying countries in some textile categories.
- o Problem was also political: Administration opposes highly restrictive textile bill. Large-scale imports of Soviet textiles would inject new political element into an already charged issue.

II. U.S. VIEWS AND OBJECTIVES

- o Limit possibility of market disruption; maintain integrity of textile quota system. Also, provide Soviets some market access to aid efforts to improve non-strategic trade while avoiding perception they get preferred treatment. Domestic textile interests oppose rapid growth of imports from any new supplier.
- o Soviet Multi Fiber Arrangement (MFA) membership: Soviets have been told US cannot support membership at this time.

III. SOVIET VIEWS AND OBJECTIVES

- o To gain access to US textile market and increase hard currency earnings through exports.
- o Obtain "equal treatment" with MFA members and US support for MFA membership.
- o Soviets argue that US expects them to buy US goods, especially grain, but is unwilling to buy their goods in return. Every time they try to introduce an export, we put up obstacles (e.g. urea, fur skins, gold coins).

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VI.

SOVIET DEVELOPMENTS

1. Gorbachev's Leadership
2. Political and Economic Reforms
3. Recent Trends in Soviet Foreign Policy

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GORBACHEV'S LEADERSHIP

I. GORBACHEV'S IMAGE HAS SUFFERED, BUT HE IS FULLY IN CHARGE

- o He remains first among equals and has full authority to speak for the Politburo.
 - He is the regime's spokesman on the full range of international and national issues.
- o He had to use harsh methods to oust one of his strongest supporters, Moscow party chief Yeltsin.
 - Yeltsin got out of line, and his punishment reflects regime concerns over unity.
 - Gorbachev's role in the ouster is unclear, but he must now reestablish a firm leadership image.

II. GORBACHEV HAS STRONG SUPPORT AT HIGHEST PARTY LEVELS

- o Personnel moves this year have strengthened his hand.
 - He has support in the Politburo and Secretariat, the two leading organs of the party.
- o Preparations are soon to begin for a party conference to be held in June of next year.
 - He intends to use this conference to get firmer control over lower party organs.

III. HE IS A SKILLED CONSENSUS POLITICIAN

- o He has built a coalition of forces, united on the need for reform but differing on its pace.
 - Some of key figures in the regime have shown uneasiness over moving too fast.
 - Gorbachev has to accommodate these elements.
 - He will periodically slow the pace to reestablish his consensus.
- o He appears to have a strong tactical sense; knows when to try to force progress and when to regroup.
 - He appears to be regrouping at present, but will probably move forward on reform issues again soon.

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USSR: POLITICAL AND ECONOMIC REFORMS

I. POLITICAL REFORMS: STRENGTHENING THE HAND OF THE REGIME

- o Both political and economic reforms are intended to strengthen the USSR and make it more competitive.
 - Changes such as openness and "democratization" are regarded as means to reach these objectives.
- o They can also be used to expose opponents of reform and force them from office, and Gorbachev is doing just that.
- o Gorbachev is trying to give the Soviet public a greater sense of having a stake in developments in society.
 - Recent months have shown, however, that there are limits on how far and fast the regime is willing to go in this; conservative opponents have recently shown their strength.
- o The challenge for Gorbachev is to make major political changes without weakening control by communist party.

II. ECONOMIC REFORMS: STRENGTHENING ECONOMIC POTENTIAL

- o Gorbachev's comprehensive reform program seeks to quicken growth and make the USSR technologically competitive in the 21st century.
- o Key program elements, including price reform, more autonomy for enterprises, and less central planning, were agreed to last summer. Main problem now is implementation.
- o Stiff resistance remains. Party fears loss of power, bureaucrats fear loss of jobs, management is confused, and workers are unconvinced of benefits.
- o At the elite level, recent demotion of the outspoken reformist Yeltsin shows strains are developing as Gorbachev's program enters implementation phase.
- o At the popular level, the immediate problem for the regime is to improve living standards, especially food availability. Otherwise the public will not support a program of hard work and sobriety.
- o Reform will be a lengthy process, liable to get bogged down but also bearing the potential to engender real change.

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RECENT TRENDS IN SOVIET FOREIGN POLICY

- o The most striking feature of Soviet foreign policy under Gorbachev has been a willingness to rethink past positions. While Soviet diplomacy has become more active and flexible, however, many of the objectives and priorities of Soviet policy remain basically unaltered. The combination has made the USSR, so far, a more effective challenger of Western interests. Whether it can become a more cooperative partner remains to be seen.
- o In some areas -- e.g., arms control -- the results have been significant. In other areas, such as regional conflicts, we have yet to see dramatic shifts.
 - Arms Control: Soviets now accept U.S. concepts--such as zero INF, deep reductions in strategic weapons, and on-site inspections--which were previously denounced by Soviet leaders as unrealistic and one-sided.
 - Human Rights: Soviets now accept the legitimacy of western concerns about human rights and its central role in East-West relations. Much, of course, remains to be done.
 - Regional Conflicts: While the substance of Soviet policies has not changed, "new thinking" has resulted in more sophisticated and active Soviet diplomacy around the globe.
 - o Gorbachev's 1986 Vladivostok speech covered Asian and Pacific issues;
 - o His recent Murmansk speech was aimed at the Nordic states;
 - o Soviet initiatives in the Middle East include the opening to Israel and emphasis on a Middle East peace conference; and
 - o They are trying to expand ties with South America (as Shevardnadze's recent trip demonstrates).
 - Multilateral Diplomacy: International bodies such as the UN have assumed more importance under Gorbachev.

OPPORTUNITIES AND CHALLENGES

- o Gorbachev's self-professed goal is to create a stable and predictable international environment in which he can concentrate on domestic economic reform. This has opened up new opportunities for furthering U.S. objectives, such as achieving equitable and verifiable arms reductions.
- o Just as importantly, Gorbachev seeks to improve the Soviet image abroad so as to foster a more favorable hearing for Soviet positions. This poses new challenges at a time when U.S. diplomacy is being affected by severe budget cuts.

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