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1. report draft	re: response to NSSD 2-86: Soviet initiatives in international economic affairs (22pp) <i>67</i>	n.d.	P-1
2. vax	re: Soviet Politburo's members comments on internal opposition to Gorbachev's economic reforms and possible solutions to Soviet economic problems (3pp) <i>D 10/16/02 NLS MOI-010 #29</i>	10/30/86	P-1
3. vax	from Sec. of State to Am. Embassy Sofia re: GATT accession, Bulgaria charge calls on dept (1p)	9/23/86	P-1 <i>Folder 8</i>
4. REPORT DRAFT	<i>61</i> R 2/13/03 MOI-010 #29	ND	BI 7 <i>Folder</i>
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Soviet Initiatives in International Economic Affairs

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Soviet Initiatives in International Economic Affairs
NSSD 2-86

EXECUTIVE SUMMARY

On September 16, 1986, the President signed National Security Study Directive 2-86 (Appendix A) requesting an interagency examination of recent initiatives undertaken by the Soviet Union in the area of international economic affairs. The Departments of State, Defense, Treasury and Commerce, the Central Intelligence Agency and the Office of the United States Trade Representative participated in the preparation of this study. The NSSD called for the collection and review of all evidence relating to recent Soviet interest in international economic issues, a summary of past Soviet participation in international economic institutions and a forecast of potential future Soviet activities in this area. Finally, the NSSD required the preparation of analysis and conclusions drawn from the material collected. (S)

The NSSD review of Soviet activities in international economic affairs identified some increased Soviet interest in the field, most notably a Soviet application for participation in the General Agreement on Tariffs and Trade and expressions of interest in membership in the World Bank and International Monetary Fund. Other areas of some increased activity are the international financial markets and a potentially renewed interest in joint ventures with the West. The Central Intelligence Agency forecasts cautious but steady Soviet involvement in Western economic activities. (S)

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The study concludes that Soviet participation, while initially aimed at building experience, will also present the Soviets with new opportunities and forums to challenge U.S. policy objectives. It also poses some risk to U.S. security interests by creating increased opportunities for KGB activity and the potential for disrupting financial markets. (S)

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I. Review of Soviet Activities in International Economic Affairs

The interagency NSSD group identified the following developments which suggest increased Soviet interest in greater participation in the international economic system. (S)

A. Reorganization of Soviet Trade Bureaucracy

Several changes have recently been made in the Soviet bureaucracy which suggest a new Soviet approach to international trade. On an operational level, certain ministries and enterprises have been given increased autonomy to engage directly in importing and exporting without the intervention of the Ministry of Foreign Trade (MFT). To coordinate these entities, a new Foreign Economic Commission has been created made up of representatives from MFT and various other economic organizations. Other organizational changes include the establishment of a new Administration for International Economic Relations in the Ministry of Foreign Affairs, headed by Dr. Ivan Ivanov, a reform minded academic; and the establishment of a new State Commission to oversee joint venture activity. Our understanding is that GKES (the State Committee for Economic Cooperation) would oversee joint ventures. (S)

B. Soviet Interest in GATT Membership

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The recent overtures by the Soviet Union to play ~~some~~ role in the General Agreement on Tariffs and Trade is the most dramatic example of a new Soviet interest in the western international economic system. (S)

On several occasions since 1979, the Soviets have informally explored participation in GATT affairs; however, their application to the GATT Secretariat to participate in the new round of trade negotiations in mid-August was the most overt expression of interest to date. In support of their application, the USSR indicated to its trading partners that, among other things, the USSR wished to move its economy more into the framework of international economic relations, that closer associations with the GATT would help expand trade with GATT members and that Soviet interest in the GATT is "100 percent economic." With selected countries, the USSR also pointed out that it would serve as a counterweight to the United States in the GATT for smaller contracting parties over whose interests the United States "runs roughshod." (S)

Bulgaria
The Soviet application for participation in the Uruguay round was successfully sidetracked at Punta del Este because of strong U.S. and nearly unanimous European opposition. However, future Soviet pressure can be expected either directly or indirectly (through the application to the GATT of client states such as Bulgaria), especially as the GATT comes to terms with the readmission of the People's Republic of China. (S)

C. Soviet Motives for Encouraging EC-CEMA Talks

1) treat EC as political entity
2) Shifts in the Soviet Union's strategy to treat the European Community ("EC") as a political entity and to allow countries that are part of the Council on Mutual Economic Assistance ("CEMA") to have bilateral ties with the EC are key concessions that could lead to significant progress in EC-CEMA talks. (S)

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reason
R [The Soviet objective for enhancing the likelihood of success of these negotiations appears to be to gain greater political and economic access to the Community, possibly, in part, to gain EC support, or at least a softening of the EC position, for Soviet entry into the GATT. In addition, the Soviets stand to gain from direct access to the EC decisionmaking process, obtaining West European technology and enhancement of CEMA's prestige. (S)

D. Soviet Initiatives Towards IMF/IBRD Membership

1) discuss EC decision-making
2) West European food
3) CEMA
4) planning
Although a Soviet official in August said the Soviet Union is taking no steps towards IMF membership, at a conference in the Soviet Union in July, Soviet academics told their U.S. counterparts that the Soviet Union should consider seeking IMF membership. Further conflicting reports of possible Soviet interest in the IMF/IBRD have recently been received. Close attention must be paid to further developments in this area, as Soviet membership would probably result in a significant

diminution in U.S. influence in these organizations and a likely erosion of U.S. Congressional support. (S)

E. Soviet Interest in International Bond Market

In mid-July the Soviet Union and United Kingdom signed an agreement settling outstanding claims arising before 1939. Part of the agreement provided for the settlement of private claims arising from Tsarist bonds issued before October 1917. In recent days the Soviets have indicated an interest in exploring resolution of outstanding defaulted bond claims in the United States. Taken together, these actions may suggest an interest by the Soviets to create good will in the financial markets as a precursor to active Soviet bond market participation. Except for a small participation in a syndicated bond offering for a Finnish entity (as a lender), there has been no such Soviet activity.

(S)

F. Soviet Strategies for Coping with Hard Currency Shortages

*Oil Revenue
\$5-6 billion
\$23-26 billion*

Soviet oil export earnings, which accounted for roughly half of non-arms related hard currency earnings in 1985, will fall by about \$5-6 billion this year. This is likely to reduce total 1986 hard currency earnings to \$23-26 billion, down from a peak of \$34 billion in 1984. As noted above, the prospect that such export revenues will remain depressed for the rest of the decade is undoubtedly one reason for the new Soviet interest in

international economic institutions and stimulating manufactured goods exports. In the meantime, however, the Soviets have been forced to take steps to meet the resulting foreign exchange shortfall:

Gold Sales -- Soviet gold sales have increased significantly. Sales in the first half of 1986 were an estimated \$2 billion, the same level as in all of 1985. However, the intelligence community doubts the Soviets could dispose of major additional quantities without having a substantial depressive effect on price. (S)

Import Cuts -- Soviet planners have started to implement selected import cuts, although not of a magnitude that reduced earnings may later require. Consumer-related purchases will probably be cut most severely, and machinery and investment goods the least. Given a continued world grain glut, Soviet agricultural imports could probably absorb major cuts if the weather is reasonable and agricultural productivity improves.

(S)

Expanded Soviet Activity in International Financial Markets

Gorbachev has expanded Soviet ties to international financial markets to offset declining hard currency earnings, diversify Soviet sources of funds, and gain economic intelligence. According to Western financial statistics, Soviet commercial debt increased by \$6.5 billion in 1985, and over \$3 billion in the first six months of 1986. Although short-term borrowing

common
debt =
1985: +6.5
1986: +6.5

\$2.8 bns term
mod : long term

increased, the Soviets also took advantage of their strong credit rating to raise about \$2.8 billion in medium- and long-term syndicated loans on favorable terms. Moscow also made greater use of supplier credits and in some instances sought deferred payments for Soviet purchases. (S)

The Soviets will probably continue to be more active in international financial markets. This will take the form of

- 1) increased gold sales (including bilateral gold swaps); increased
- 2) borrowing (third party borrowings, ECU denominated borrowings, indirect supplier credits, and possible entry into the Eurobond
- 3) market); and expansion of foreign-based financial entities (e.g., joint Soviet-Arab banks, investment banking relationships). (S)

While the USSR's excellent credit rating might facilitate a modest level of additional borrowing, there is no indication the Soviets will implement a long-term strategy of ^{no} heavy borrowing as a reaction to lower export earnings. The leadership, recognizing the political dimension of borrowing, is reluctant to place itself in the position of being overly dependent on the West. The Soviets would also not want to jeopardize their ability to finance grain imports in a bad harvest year. But even the most liberal estimates of expanded Soviet financial market activity would still result in a relatively small role for the Soviet Union in international financial markets. (S)

G. Soviet Expressions of Interest in Joint Ventures

There is increased Soviet interest in the establishment of joint ventures -- to include Western management and equity participation up to 49% -- between Soviet and Western entities. However, other than indications that the Soviet Union is investigating new regulations to promote such relationships, details on the terms they are prepared to offer are still to be provided. The Soviets appear to be soliciting proposals from Western firms in order to ascertain what types of joint ventures (on what terms) are feasible. Even so, our knowledge of the extent of contact between Western firms and the Soviet Union on joint ventures is still anecdotal and fragmentary. (S)

49% Western management equity
no details on terms

The advantages to the Soviet Union of increased joint venture contacts are clear: new sources for hard currency, improvement of consumer goods, access to managerial know-how, and an opportunity to increase pressure on Western companies and government to obtain high technology otherwise unavailable to them. Yet the Soviets may be reluctant to concede real management control, or access to the Soviet industrial hinterland to prospective foreign partners, and there will inevitably be bureaucratic resistance to new ways. For their part, prospective foreign partners are likely to be interested in the Soviet domestic market, while the Soviets seem to see the program as a means to stimulate manufactured goods exports. (S)

illegal means

Overall, lack of clear new Soviet regulations and a prognosis for lengthy joint venture negotiations over differing

objectives make a marked introduction of Soviet-Western joint venture activity unlikely in the next few years. (S)

H. Soviet "International Economic Security Initiatives"

Soviet Foreign Minister Shevardnadze's September 23 address to the United Nations General Assembly included a strong pitch to establish a new, comprehensive system of international security -- the Soviet theme that ties together all of Gorbachev's disparate disarmament and foreign policy initiatives. Included in the Foreign Minister's speech is a call to establish economic vehicles to channel assistance to Third World countries and to develop a global scientific and technical cooperation program. Both efforts presumably would be carried out under UN auspices. The Soviets have formally introduced a proposal to this effect for consideration at this year's UNGA. Economic security, however, is only one small element in the proposal -- the reference to it is vague and debt is the only area specifically mentioned. (S)

Soviet interest in pursuing a multilateral approach to global security problems stems from ideas detailed in Secretary General Gorbachev's report to the Party Congress last February. Unfortunately, the Foreign Minister's UNGA statement sheds no additional light on the Soviet proposal beyond what was offered last February. (S)

None of these ideas in the Soviet UNGA proposal are new. For the economic items, the Soviets simply have resurrected outdated north-south themes -- areas where Soviet economic interests are small and the prospects for political visibility are high. By weaving them together in one overall framework, however, the Soviets are trying to create an illusion of newness and to lend concreteness to what Gorbachev calls "new political thinking" embodied in a series of proposals dating back to early 1986. The Shevardnadze speech is the most recent opportunity for the Soviets to plug their proposed security programs. However, Soviet reforms in this area, self-characterized as ideologically correct, promise greater compatibility with the economies of the West while maintaining the state controlled nature of the Soviet system. (S)

II. Historical Overview of Past Soviet Participation in International Economic Institutions

60 years Soviet participation in international organizations spans six decades, from the time the USSR joined the Universal Postal Union (UPU) and the International Telecommunications Union (ITU) in the mid-1920s. The USSR had a brief association in the 1930s with the International Labor Organization (from which it withdrew in 1939 and again rejoined in 1954). The other organizations under review were not established until after World War II. Overall, Soviet participation in international organizations reflects basic Soviet foreign policy interests. The USSR has

made good use of highly visible forums to attack its enemies, support its Third World friends, and defend its interests in debate and in staff studies. (S)

Over the years, Moscow has been careful to join those organizations which best serve its interests. For example, the Soviets are keen to join organizations where they can obtain information and studies on economic trends. Among the specialized agencies, the Soviets tend to congregate where they have access to sophisticated Western technology [e.g., the ~~I~~AEA]. The Soviets are cooperative with the West in a number of these venues including the World Meteorological Organization (WMO) and the IAEA. The USSR has tended to shy away from those organizations that require sizable funding commitments and or information that it considers sensitive. Thus, until recently, Moscow has avoided the GATT and IMF, where bargaining power and reciprocity count for more than polemics. (S)

Soviet behavior in international economic organizations has varied considerably from a highly propagandistic, obstructionist approach in UNESCO, and a somewhat less antagonistic stance in ILO and UNCTAD, to a businesslike and constructive approach with minimal politicization in WIPO, IAIE, and ICAO. Not surprisingly, the Soviets seem to be most constructive and least polemical when they share with us the goals of the organization

and see at least some degree of benefit to themselves. (See further discussion, Appendix B.) ~~(S)~~

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I. HISTORICAL OVERVIEW OF SOVIET POLICY TOWARD AND PARTICIPATION IN INTERNATIONAL ECONOMIC INSTITUTIONS

Soviet participation in international organizations spans six decades, from the time the USSR joined the Universal Postal Union (UPU) and the International Telecommunications Union (ITU) in the mid-1920s. The USSR had a brief association in the 1930s with the International Labor Organization (from which it withdrew in 1939 and again rejoined in 1954). The other organizations under review were not established until after World War II. Overall, Soviet participation in international organizations reflects basic Soviet foreign policy interests. The USSR has made good use of highly visible forums to attack its enemies, support its Third World friends, and defend its interests in debate and in staff studies.

Over the years, Moscow has been careful to join those Organizations which best serve its interests. For example, the Soviets are keen to join organizations where they can obtain specialized agencies, the Soviets tend to congregate where they have access to sophisticated western technology [e.g. the International Atomic Energy Agency (IAEA)]. The Soviets are cooperative with the West in a number of these venues including the World Meteorological Organization (WMO) and the IAEA. The USSR has tended to shy away from those organizations that require sizable funding commitments and or information that it considers sensitive. Thus, until recently, Moscow has avoided the GATT and IMF, where bargaining power and reciprocity count for more than polemics.

Multilateral Trade & Finance Institutions

IMF/IBRD The Soviet Union took an active part in the Bretton Woods negotiations leading to the establishment of the International Monetary Fund (IMF) and the World Bank (IBRD). Soviet negotiators made numerous specific proposals, some of which were accepted and even today are part of the IMF's Articles of agreement. At the end of the Bretton Woods conference the Soviet delegate approved the final agreement, but subsequently the Soviet Union did not ratify the Articles of Agreement (and thus did not become a member of the IMF/IBRD). Soviet representatives were still present, however, as observers at the first meeting of the IMF in Savannah, Georgia, in March 1946.

Numerous reasons have been offered to explain why the Soviet Union did not join the IMF and World Bank. The most convincing of these relates to the Soviets' voting share and the requirement to provide economic information, including the amount of gold and foreign exchange holdings. When the IMF was established, 20 percent of members' votes were required to exercise a veto. The United States alone had a 31-percent share of the total vote, while the USSR, Czechoslovakia, Poland, and Yugoslavia combined would have had only 17 percent of the vote.

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Since the birth of the IMF/IBRD, Soviet rhetoric has portrayed these institutions in a most unfavorable light. Soviet polemics and propaganda directed at the IMF in recent years have centered on IMF adjustment programs and their negative impact on Third World countries. Soviet harsh attitudes toward the World Bank may be influenced by the fact the USSR would not be eligible to borrow from the Bank--its per capita income exceeds the IBRD maximum for loan eligibility--and would be required to contribute a substantial subscription to capital. Moreover, the World Bank in recent years has placed increased emphasis on private sector initiatives, which conflict with Soviet ideology.

On several occasions Soviet officials and academics have flirted with the possibility that the USSR might seek to participate in the IMF. In June 1973, M. Alkhimov, then vice minister of foreign trade, declared in an interview with Business Week that participation of the USSR in the IMF was not totally excluded, although there were strong objections to such a move, including objections to the aforementioned weighted voting system and the obligation to furnish economic information. Most recently, in July 1986, Soviet academics told a delegation of US economists that the Soviet Union is studying the potential benefits of IMF membership. However, the head of the Ministry of Foreign Affairs' new International Economic Relations Department--a leading force behind the efforts to participate in international economic fora--is quoted as saying the Soviets "are taking no steps toward participation in the Fund (IMF) or gaining access to its credits."

GATT. Until its recent formal attempt to participate in the organization, the USSR always publicly opposed the General Agreement of Tariffs and Trade (GATT) and the never realized International Trade Organization (ITO). The Soviet Union was repeatedly offered invitations to participate in the formation of GATT (which took place in October 1947) but it refused. As an alternative to the formation of the GATT, the Soviet Union pushed strongly for improving the world trade system through the United Nations. Even after the GATT was formed, the USSR attempted unsuccessfully to arrange trade cooperation agreements through UN agencies like the Economic Commission for Europe (ECE) and the Economic and Social Council (ECOSOC).

From the time of establishment of the GATT up until the recent Soviet request for participation, the USSR has denounced the organization, particularly for being unable to stop the alleged wave of protectism in the West in the 1970-80s. At times the Soviet Union has flirted with the idea of changing its policy toward international trade. During the Kosygin economic reform period of the mid-1960s, Soviet officials made strong declarations about the importance of more international trade contacts, without specifically referring to the GATT.

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The possibility of the Soviets approaching the GATT began in earnest in 1975 with studies on the subject, according to Soviet trade officials. By 1979, this initiative had gained significant support in the ministry of foreign trade. The subsequent deterioration in relations with the West as well as the general complacency of the Brezhnev government at its end put a stop to the approach to GATT.

Specialized International Institutions

Soviet interest in specialized organizations has continued through the postwar years with the USSR joining many organizations within the UN System. Along with providing key international services in such fields as communications and transportation, organizations of this type have given the Soviet Union access to a wide range of economic, technical, and regional information.

The Soviet Union initially adopted a low profile and defensive posture in these bodies. However, as the West began to lose its working majority in the UN with the arrival of newly independent Third World countries, Soviet involvement in economic and social organizations began to increase substantially. The change in Soviet response to these organizations was calculated to win the favor of Third World countries, to protect the USSR from unwelcome UN initiatives, and to further the Soviet agenda.

Among the specialized agencies, the Soviets tend to congregate where they have access to sophisticated Western technology. For example, 69 Soviets were among the 1,500 staff members of the International Atomic Energy Agency (IAEA) in 1984--which is technically not a specialized agency but an independent intergovernmental organization under the aegis of the United Nations. The IAEA is responsible for drawing up and implementing the safeguards agreements provided for in the Nuclear Non-Proliferation Treaty as well as for developing siting, safety and reliability standards for nuclear power stations. IAEA staff has access to sensitive nuclear-related information from 110 members. Not only is the Soviet IAEA contingent large, representing 14 percent of all Soviets employed by the Secretariat, but it is also high level.

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The Soviets have had a keen interest in joining organizations that exchange information and conduct studies on economic trends. This is reflected in their active involvement in UN-related economic conferences, commissions, and research organizations such as the United Nations Conference on Trade and Development (UNCTAD) and the Economic Commission for Europe (ECE), as well as various organizations and commissions that deal with commodities and resources. Membership in such groups not only provides a source of potentially useful information but also a forum for portraying Communist economic philosophy in its most favorable light and pointing out any perceived inequity in the Western economic system.

Despite their interest in cultivating Third World support, the Soviets have been selective in their participation in multilateral aid organizations and have provided only minimal contributions to UN aid organizations. The principal Soviet rationale put forward for not participating in aid-giving organizations is that Third World poverty is the result of Western colonialism and is perpetuated by neocolonialism. The Soviets argue that the USSR is not a colonial power and is therefore not responsible for Third World poverty or obligated to provide aid.

The USSR's low interest in the aid and humanitarian organizations is a factor in Soviet staffing patterns. No Soviets work for the UN High Commissioner for Refugees, the Food and Agricultural Organization (FAO) in which the USSR is not a member, or the International Fund for Agricultural Development (IFAD). Only four Soviets work for the United Nations Children's Fund (UNICEF) and four for the UN Development Program, the two key UN aid agencies.

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FUTURE SOVIET ACTIONS

✓ How Moscow proceeds relative to recent initiatives will depend, in large measure, on future leadership decisions regarding (a) the role of Western technology and equipment in Gorbachev's modernization drive, (b) the extent of Western managerial involvement and corporate ownership, and (c) the acceptable level of hard currency indebtedness, (d) the degree to which Gorbachev is able to implement the "restructuring" of the Soviet economic system. Moreover, it will take some time before these decisions are made:

o The leadership will likely spend the next year or two assessing the sufficiency of ongoing domestic programs--shifts in investment priorities, management reorganizations, and the discipline campaign--before reconsidering their conservative positions regarding Soviet reliance on foreign technology and equipment and systemic economic reform. (S)

o It will take awhile for Gorbachev's new team of managers to acquire the experience and expertise necessary to confidently move heavily into the international financial and commercial arenas. (S)

Until the Soviets complete the formulation of their long term trade strategy, we can expect cautious but steady movement into the international economic arena. In the area of joint ventures, the first contracts could be signed as early as next year. Although with less fanfare, the Soviets are likely to encourage expansion of coproduction and utilization of Western management services. The Soviets are also likely to look for more opportunities to participate in joint projects in the Third World with Western firms. While the Soviets have used Western equipment to enhance the competitiveness of their bids on projects in the Third World in the past, they have rarely formed direct partnerships with Western firms when bidding on these projects. Arrangements like the one they are negotiating with Kuwait could provide the necessary funding without Moscow having to offer credits. More remote is the possibility of Soviet multinationals, primarily in cooperation with Western firms. According to a reliable source, Soviet provisions for joint ventures will include the right to establish subsidiaries in third countries. (S) *variant* *SK*

Progress along these lines is apt to be slow. While some Western firms may be willing to make a relatively small investment to gain entry into the Soviet market, most are likely to take a wait-and-see attitude. Years of dealing with cumbersome Soviet bureaucracies, shoddy Soviet manufactures, and unimpressive results from joint ventures with other socialist countries will make most businessmen wary. The Soviets themselves are apt to approach actual negotiations cautiously.

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Granting the amount of Western control of production decisions that would be required by the Western parties would go against the grain of most Soviet managers. At present, it appears that there is still a considerable amount of uncertainty among mid-level Soviet officials who deal regularly with Western businessmen over what exactly joint ventures will entail. (S)

Even if impediments to successful joint ventures can be overcome, the level of investment is likely to be too small to have much of an impact on expanding Soviet exports of manufactured goods. Nor will the recent changes in the foreign trade apparatus likely have much success in expanding exports. Although they will probably improve the operation of trade by removing the MFT as a cumbersome middleman for some trade actors, the changes do not remedy the lack of domestic incentives for producers, the irrational price structure, and the inadequate technological base that underlie the poor position of Soviet manufactured goods in world markets. In addition, depressed earnings from traditional exports will severely constrain purchases of foreign equipment that could compensate for some of these shortfalls. (S)

How the Soviets will respond to lackluster export performance is difficult to predict. They are most likely to introduce piecemeal adjustments to deal with some of the specific problems that develop. They might try isolating the export-oriented producers and joint ventures from the inefficiencies of the economy, much as the defense industries are protected. However, the benefits of trade--especially in areas of technology assimilation and diffusion--would be similarly isolated. (S)

As long as Moscow continues its conservative approach towards reliance on Western technology, an increased role for the USSR in the international financial arena is unlikely. The Soviets will probably become more adaptable to new financial instruments and more flexible in the management of their assets. For example, a reliable source reports that Soviet-owned banks are now permitted to hold certain Western bonds in their portfolios. But the present limitations on Moscow's currency earnings, coupled with some vestiges of traditional Soviet conservatism, are likely to restrict sharply any large-scale speculative approaches to financial management. Gold trading and real estate scandals involving Soviet-owned banks and the resulting tightening of central control from Moscow are indicative of Moscow's attitude. (S)

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GATT 11/1/74

The Soviets will continue their approaches to a variety of multilateral economic organizations for both political and economic reasons. GATT will probably remain a key area of interest to the USSR both for the prestige factor and the chance to participate in negotiations which they consider will affect their interests. Lackluster trade performance and a trade sector that remains largely under the control of central authorities will, however, undermine Soviet arguments that their system is becoming more compatible with the aims of the GATT. (S)

For largely political reasons the Soviets will continue to press for formal EC-CEMA relations although probably without expectations of anything but minimal economic gains. IMF and World Bank membership are not likely to be pursued actively at least not at the present time. Disclosure requirements and less control over its economic aid are likely to deter any serious Soviet interest. Nor would the Soviet leadership be willing to accept being labeled as developing country in order to get access to World Bank credits. (S)

Time
would
be
lost
if
they
did

The USSR will almost certainly become more active in promoting its own solutions to international economic issues. It may perhaps go as far as proposing new international forums for dealing with such issues, especially if it feels strongly enough that it is being unjustly discriminated against by existing institutions. What forms the new Soviet proposals are likely to take are difficult to predict. We will probably see a repackaging of old proposals with slightly different nuances rather than bold new proposals. To the extent that the content of Soviet initiatives remains similar to past proposals, international response is likely to be lukewarm at best. In addition, the small Soviet share of world trade coupled with the expected lackluster trade and economic performance could weaken Soviet positions. (S)

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Analysis/Conclusions

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On the basis of the relevant information identified in the interagency review, the following conclusions can be drawn in response to the questions posed in NSSD 2-86:

1. Increased Soviet interest in participating in international economic affairs is driven by: (a) a desire to establish a role for the Soviet Union in international economic affairs commensurate with its global role in political and security affairs, (b) a means of increasing East-West contacts for the purpose of gaining access to Western high technology, management skills and economic intelligence, (c) a necessary step to offset hard currency earning declines resulting from lower oil prices, (d) as a means of diversifying its source of funds, and (e) in order to develop an export policy that shifts its emphasis from the sale of natural resources to finished products, as a spur to Soviet modernization and global competitiveness. (S)

1) Prestige
2) Tech
3) Hard currency
4) Diversify funds sources
5) Shift to finished products for export

2. The NSSD process identified the following evidence of increased Soviet interest in international economic affairs:

- a. Application to the GATT.
- b. Expressions of interest in the World Bank/IMF.
- c. Reorganization of the Soviet trade bureaucracy.
- d. Some additional activity in the international financial markets.
- e. Encouragement of EC-CEMA talks.
- f. A possible new approach to joint ventures with the West. (S)

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3. Future Soviet activity in the international economic arena will probably be cautious, but steady. Possible areas of increased activity:

-- GATT will probably remain a key area of interest to the USSR both for its prestige and the chance to participate in negotiations which they consider will affect their interests. Lackluster trade performance and a trade sector that remains largely under the control of central authorities will, however, undermine Soviet arguments that their system is becoming more compatible with the aims of the GATT. (C)

-- IMF and World Bank membership are not likely to be pursued actively at the present time. Disclosure requirements and the risk of less control over its economic aid are likely to deter any serious Soviet interest. Nor would the Soviet leadership be willing to accept being labeled as a developing country in order to get access to World Bank credits. (C)

-- A sharply increased role for the USSR in the international financial arena is unlikely. In particular, large-scale speculative approaches to financial management will be sharply restricted by current limitations on Moscow's currency earnings, coupled with some vestiges of traditional Soviet conservatism. (C)

-- For largely political reasons, the Soviets will continue to press for formal EC-CEMA relations although probably without expectation of anything but minimal economic gain. (C)

In general, the USSR will almost certainly become more active in promoting its own solutions to international economic

issues. It may perhaps go as far as proposing new international forums for dealing with such issues, especially if it feels strongly enough that it is being unjustly discriminated against by existing institutions. What forms the new Soviet proposals are likely to take are difficult to predict. We will probably see a repackaging of old proposals with slightly different nuances rather than bold new proposals. To the extent that the content of Soviet initiatives remains similar to past proposals, international response is likely to be lukewarm at best. In addition, the small Soviet share of world trade coupled with expected lackluster trade and economic performance could weaken Soviet positions. (C)

4. Increased Soviet participation in the major international economic institutions would generally not be helpful to U.S. objectives. Past history indicates that the quality of Soviet participation in international economic institutions depends largely upon the degree to which they share with the U.S. the goals of the specific organization and recognize some benefit to themselves. The nearly total incompatibility of the Soviet economic system with that of the West, however, would make Soviet membership in certain key institutions, such as the GATT and IMF/IBRD, extremely undesirable. This would be for both technical reasons and because of the risk of politicizing heretofore non-political institutions. (S)

An additional risk would be the increased numbers of Soviet officials in the West necessitated by expanded membership in

international fora, which would provide opportunities for increased KGB activity. (S)

5. There are several implications for the international economic system presented by increased Soviet interest and activity in economic affairs. To the extent that Soviet activities on international markets bring it closer to the international economic community, the West probably benefits since it gives the Soviets a greater stake in working to solve problems within the system. Such a stake, however, is not likely to weigh heavily in Soviet decisions where political and strategic interests are involved. (S)

Increased cooperation with Western firms is likely to improve Soviet assimilation of Western technology in given enterprises, although diffusion throughout the economy is likely to continue to be difficult. Soviet ability to make effective use of Western equipment and technology has been constrained in the past partly by the inability of Soviet managers and engineers to work hand-in-hand over an extended period with their Western counterparts. A vested interest by Western business in the effective use of Western equipment and technology, backed by a sustained on-site presence, could substantially improve their use. Moreover, Western firms involved in joint ventures with the USSR are likely to want to incorporate state-of-the-art technology into these projects and could press their governments to relax COCOM controls. Furthermore, joint ventures established outside the USSR or subsidiaries of joint ventures in third countries could give Soviet technicians greater access to

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controlled-technology without it being transferred onto Soviet territory. ~~(S)~~

Greater Soviet involvement in international trade and financial markets would make it easier for Moscow to hide the level of its financial activities through the use of numerous instruments such as interbank deposits, borrowing from non-bank institutions or banks outside the BIS reporting area. In the past, Soviet reliance on government-backed credits and a select grouping of major commercial banks in the U.S. and Western Europe provided Western governments with the ability to effectively monitor, and, to some extent, control the level and terms of Soviet borrowing. ~~(S)~~

Increased trade with the LDCs could recoup some of the lost Soviet prestige and influence in the area. The Soviets would likely be willing to lend to debt-ridden LDCs at attractive rates to obtain contracts for projects, particularly those that would generate repayments in raw materials needed for the domestic economy. While this would not represent a shift from current Soviet policy toward the Third World, higher quality Soviet exports combined with LDC debt problems would make trade with the USSR more attractive than in the past. ~~(S)~~

If the regime decides in several years that it must rely more heavily on Western technology and equipment for its modernization efforts to succeed, we would expect to see a much bolder Soviet entry into the international economic arena and an even greater impact on U.S. policy interests. Under such circumstances, we could expect a major increase in the flow of

Western technology to the USSR with a commensurate rise in Soviet hard currency borrowing. Moscow's low indebtedness, substantial reserves of near-monies such as gold and energy, centralized control over resources, and large unexploited internal markets would make the USSR an attractive market for Western direct investment. (S)

Western governments would have to contend with a growing interest group of manufactured goods exporters seeking more favorable trading conditions -- low-interest credits, reduced export controls, better bilateral relations in general. The pressures from the business community would be even greater if the Soviets implement internal reforms that result in internationally competitive joint venture and equity arrangements. In fact, the Soviets could dangle lucrative trade deals in front of the Europeans and reiterate the theme of Pan-Europeanism to encourage them to adopt trade policies vis-a-vis the USSR that are at variance with U.S. policy. A similar policy could be adopted with the Japanese. (S)

6. Soviet membership in the most important international economic institutions and an increased Soviet presence in international economic affairs will pose serious challenges to U.S. policy objectives. In addition, increased Soviet understanding of how international financial and commercial markets operate carries a commensurate risk that Moscow may attempt to manipulate these markets to the detriment of U.S. national security interests. The West has been moving towards globally integrated financial and commodity markets at a geometric pace. The

capability to engage in financial, equity, and commodity transactions has outstripped international agreements on regulatory conditions. This fact, along with the rapid rise in transaction volume and the relative inexperience of many of the players has, in the minds of many experts, created the clear potential for an international crisis precipitated by one or more shocks to the system. In addition, increased Soviet understanding of high international financial and commercial market operations carries a risk that the Soviets may decide at some future date to manipulate these markets to the detriment of U.S. national security interests. We believe such actions would be unlikely, however, as long as the USSR's growing role is paying off in economic and even political dividends. If, on the other hand, Moscow perceives few economic benefits and remains a minor player in these markets, then the economic loss it would suffer would pale compared with the potential for significant damage to Western economic stability. (S)

manipulate markets

The USSR could conceivably employ such tactics for a variety of reasons. (S)

-- Financial or commercial market disruption could be initiated to preoccupy the interests of Western governments at a time when the Soviets were engaged in activities -- say in Eastern Europe or the Middle East -- which would otherwise result in a united response from the alliance. In such cases Moscow would be seeking to disrupt rather than to irreparably damage Western trade and financial practices. (S)

-- If the Soviets come to the conclusion that they cannot effectively compete with the West technologically and economically and that failure in this regard carries substantial risks to their long-term ability to maintain strategic parity, they could potentially opt to precipitate a major and sustained economic crisis in the West. According to some experts, such a crisis could be effectively started should shocks to the international financial and commercial markets quickly snowball to the point at which they cannot be effectively controlled by Western government, financial and regulatory institutions.

(S)

6. U.S. policy towards the economic initiatives of the Soviet Union should be to monitor closely activities in those areas where there has been a moderate increase in Soviet interest, while firmly opposing Soviet membership in international economic institutions of primary functional importance to the United States. (S)

In the areas of international financial markets and joint ventures, there is insufficient evidence of increased Soviet activity to raise alarm. In the short run, Soviet presence in the international financial markets is likely to be small as a result of basic Soviet conservatism, lack of financial expertise and a desire not to appear to depend on the West for financing. Similarly, the poor performance of joint ventures with East European countries, the lack of clarity in Soviet regulation and the protracted time required for negotiation make it unlikely that many U.S.-Soviet joint ventures will be formed in the near

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term. These areas require further close monitoring with a view towards detecting a disruptive Soviet presence in the international financial markets, and towards discouraging joint venture activities that would result in significant Soviet access to U.S. high technology. (S) *and case fully remedy*

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Of more immediate concern is the recent Soviet application to the GATT and possible interest in the IMF/IBRD. Past history suggests that Soviet participation in international economic institutions may not be entirely negative for U.S. interests. Depending on the organization and the extent to which the Soviets and the U.S. share similar objectives, the U.S. can tolerate Soviet participation in some organizations, despite the USSR's use of such membership to gain access to Western technology, economic intelligence and as a basis for KGB activity. However, the United States must respond firmly to Soviet attempts to join the most important functional Western economic institutions, the GATT and IMF/IBRD. The fundamental importance of these institutions to the United States and the functional inability of the Soviet Union to play a constructive role in their work makes it imperative for the U.S. to block Soviet membership. (S)

-- The Soviet's GATT application was derailed through active U.S. objection on the basis of sound substantive (i.e. non-political) reasons: the incompatibility of the USSR's huge non-market economy with the functions and objectives of the market-oriented GATT. The U.S. must strongly maintain this position. Strong European support, the consensus nature of GATT business and the unlikelihood that the Soviet Union will make the

fundamental policy changes to make this system GATT compatible makes their admission to the GATT unlikely. ~~(S)~~

-- Soviet interest in the IMF/IBRD is still academic, but U.S. policy should be to block such an application if it occurs. Although the Soviets, who in the past have been hostile to these institutions, are unlikely to be willing to participate in the exchange of information that is an essential part of membership, the U.S. should be alert to further Soviet actions in this area, and be prepared to take such measures to deny Soviet membership. (S)

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September 16, 1986

NATIONAL SECURITY STUDY
DIRECTIVE NO. 2-86

SOVIET INITIATIVES IN INTERNATIONAL ECONOMIC AFFAIRS (S)

Introduction

This National Security Study Directive establishes the Terms of Reference for completing a review of recent initiatives undertaken by the Soviet Union in the area of international economic affairs. The Study will be coordinated by the National Security Council Staff. (S)

Objective of the Review

To assess the significance of greater Soviet interest in global economic institutions and affairs; to develop U.S. policy on appropriate response to new Soviet initiatives in international economic affairs; and to begin preparation of U.S. positions on economic issues for the next meeting between President Reagan and General Secretary Gorbachev. (S)

Scope

The review will address the following topics: (S)

First Stage: To be completed by October 1, 1986.

-- Soviet Interest in International Economic Affairs: Full review of information relating to recent Soviet interest in international economic issues, including but not limited to assessments of the significance of: (S)

o The reorganization of the Soviet Ministry of Foreign Affairs ("MFA") to include a new Administration for International Economic Relations. (S)

o The application of the Soviet Union to participate in the new round of multilateral trade negotiations under the General Agreement on Tariffs and Trade. (S)

o Suggestions that the Soviet Union is interested in joining the IMF/IBRD. (S)

o In the financial sector, settlement with the UK on defaulted Czarist bonds and first time Soviet participation in a Eurobond syndication. (S)

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o Increased volume and sophistication in Soviet international financial market transactions. (S)

o Soviet "International Economic Security Initiative", which will presumably be tabled at the UNGA. (S)

o Soviet motives for encouraging EC-CEMA talks. (S)

o Soviet expressions of interest in joint ventures, possibly involving western firms management and significant western on-site participation. (S)

-- Past History: The following will be helpful in preparing for discussions with the Soviets on their participation in international economic institutions: (S)

o Summary review of Soviet official comment on existing international institutions (GATT, IMF/IBRD, etc.) to which they have applied or may apply for admission. Review should focus on Soviet comments at time of creation of those institutions and in the past ten years. (S)

o Summary reports of past Soviet participation in specialized international institutions, e.g., UNCTAD, UNESCO, ILO, WHO, FAO, ICAO. Which have they "politicized"? To which have they made a positive contribution? What have been their substantive positions on economic issues in these fora? (S)

-- Forecast: An assessment of what future initiatives in the international economic field the USSR might undertake and what other international and financial institutions to which they might apply. (S)

Second Stage

-- Analysis: An assessment of the potential significance to the international economic system of the recent Soviet interest in participating in major international economic institutions: (S)

(1) What has driven the new Soviet interest? (S)

(2) What changes have taken place in Soviet domestic and international economic policy? (S)

(3) What changes are under consideration? (S)

(4) How compatible is Soviet participation to the

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functioning of the major international economic institutions? (S)

- (5) What are the general implications for the international economic system of Soviet participation? (S)
- (6) What are the specific implications for United States' national security? (S)
- (7) What are the pros and cons of possible U.S. policy responses to these expressions of Soviet interest? (S)

A paper covering these topics should be prepared under the direction of the National Security Council, and completed no later than October 15, 1986. (S)

Ronald Reagan

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II. ASSESSMENT OF PAST SOVIET BEHAVIOR IN INTERNATIONAL ECONOMIC ORGANIZATIONS

INTRODUCTION AND SUMMARY

Soviet behavior in international economic organizations has varied considerably, from a highly propagandistic, obstructionist approach in UNESCO, and a somewhat less antagonistic stance in ILO and UNCTAD, to a businesslike and constructive approach with minimal politicization in WIPO, IAEA, and ICAO. Not surprisingly, the Soviets seem to be most constructive and least polemical when they share with us the goals of the organization and see at least some degree of benefit to themselves.

Organizations

WIPO--World Intellectual Property Organization

Businesslike and Constructive; The Soviets have acted in a generally obstructed its work or U.S. initiatives. As any nation, they have periodically formed coalitions with others to advance reasonable positions that benefit them economically.

IAEA--International Atomic Energy Agency

Businesslike and constructive; The Soviets share with us a significant interest in safeguards and non-proliferation. Their participation is constructive with minimal polemics.

ICAO--International Civil Aviation Organization

Businesslike; The Soviets do not make a major contribution to the ICAO, although per U.S. rep they maintain a high standard of professionalism and are contributing in a positive manner to the current Assembly. They accelerated their financial contributions to help ICAO cope with late U.S. payments. USSR rep commented off-the-record that KAL shootdown focussed more attention to ICAO within Soviet government, and the Soviets have been more active since.

ILO--International Labor Organization

Mixed; The Soviets are trying to modify the structure of the ILO to increase the power of governments and reduce that of labor and employers, thereby making it more responsive to their own goals. In addition, they sometimes pursue propaganda lines linking economic development to disarmament.

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ECE--Economic Commission for Europe

Mixed, with some propaganda and polemics; At the technical level, the Soviets cooperate reasonably well, for example on the High Level Meeting on Environment. On the other hand, we have blocked the proposed HLM on energy, which they appear to want to use for propaganda. The Soviets occasionally use the ECE for propaganda, and have placed Soviets in the ECE Secretariat who collect intelligence and slant the organization's work toward Soviet aims.

UNCTAD--United Nations Committee on Trade and Development

Mixed, with moderate propaganda and polemics; although the Soviets are generally businesslike, they usually don't pass up opportunities to present propaganda. For example, they often try to persuade Third World nations of the validity of the Socialist approach to international trade issues. However factors that reduce the opportunities for Soviet influence in UNCTAD are their very low level of development assistance and the structure of UNCTAD, which helps to contain Soviet efforts by placing them in a separate division for non-market economies.

UNESCO--United Nations Educational, Scientific, and Cultural Organization

Highly politicized; The Soviets have politicized all aspects of UNESCO and use it as a political forum from which to attack Western interests and spout disarmament propaganda. In it, they support all types of extremist positions of the NIEO.

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