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INNOVATIVE MARKETING STRATEGIES IN
SOVIET BLOC ECONOMIES

by

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INNOVATIVE MARKETING STRATEGIES IN SOVIET BLOC ECONOMIES*

by

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The centralized control over the economic system and the handling of exports and imports through state controlled monopolies makes trading with centrally planned economies (CPE) different than trading with most other developed and some less developed countries. Many trade enhancement or restrictive devices used in free market economies, such as tariffs and duties, health, safety and packaging regulations, quantitative restraints, special fees and credits, and domestic production or marketing taxes or subsidies are often of little concern or consequence when dealing with CPE's (Hillman, p. 499). There are, however, a different set of restrictions involving trade with these countries.

For example, several major trade restrictions grow out of the military adversary role between Soviet Bloc and many Western countries. This prevents trade in some non-agricultural products and makes trade in other products subject to sudden and severe adjustments, e.g. embargo.

Other trade restrictions grow out of differing concepts of political and economic planning and control between free market and centrally planned countries. The subordination of the economic system to the political system in CPE's creates special trade relationships. The monopoly control of the foreign trade organizations (FTO's) over imports and exports bestows significant economic leverage over potential trading firms. This control also imposes substantial responsibility since trading mistakes may effect the entire country.

The CPE's are becoming increasingly important importers of agricultural commodities (Hathaway). The share of U.S. agricultural exports to CPE's increased from 2.6 percent in 1970 to 16.6 percent in 1979 before declining to 13.0 percent in 1980 (USDA, For. Agric. Trade).

*Research for this paper was conducted under regional research project NC-139, Economic Analysis of the United States Grain Exporting System, under a cooperative agreement with the Agricultural Cooperative Service, USDA, the University of Illinois and the University of Idaho.

Poor harvests in Soviet Bloc countries combined with the desire to maintain or expand livestock production has required large increases in imports of feedstuffs, primarily from western developed countries. Hard currency constraints in several countries have required increased credit to finance imports. Total hard currency debt of Eastern European countries to western countries has increased rapidly and by the end of 1980 was estimated to total \$73 billion (USDA, Agric. Situation). Several Eastern European countries are experiencing serious problems in debt repayment. Poland, in particular, has requested rescheduling of debt repayment.

Most Soviet Bloc countries have frequently experienced trading restraints due to hard currency limitations. A common response is to restrict imports and to encourage exports. A number of options are available for doing this including internal taxes and subsidies, quantitative goals and restrictions, reallocating investments and encouraging relationships with outside firms including joint ventures, counter trade requirements, technical assistance projects, and others.

To date food and feedstuffs have usually been allocated a sufficiently high priority for foreign exchange that, despite hard currency shortages, these commodities have escaped drastic trade restrictions. The deteriorating debt position of several countries and the changing economic situation in some countries, however, presents the possibility of trade restrictions also being placed against foods and feedstuffs; or at least forcing the development of special trade relationships (ones we call innovative marketing strategies).

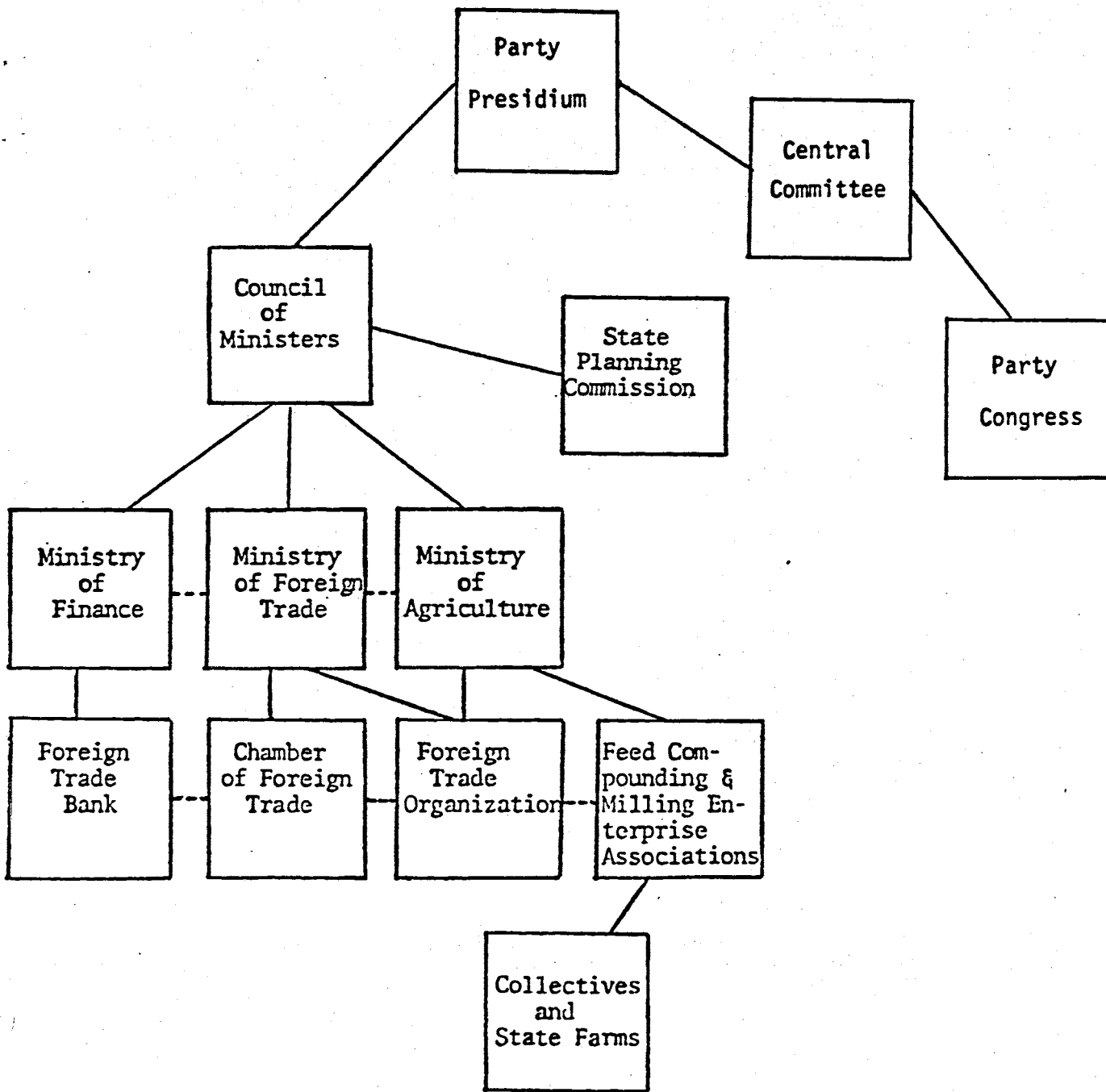
The Trading System in Soviet Bloc Countries

The state monopoly trading system was developed in the USSR in the 1930's and was applied to the Eastern European countries after World War II (Bornstein). The Eastern European countries have modified this model to varying degrees in an attempt to meet the needs of each country (Jones).

In theory the control of the economic (and political) system is held by the elected delegates of the Party Congress (Figure 1). From the Party Congress a Central Committee is selected to provide

Figure 1

Foreign Trade Structure
Of A Centrally
Planned Economy



Line of Authority ———

Line of Communication - - - -

supervision between congresses. The Party Presidium is selected (usually out of the Central Committee) and is the highest ranking level of government. The planning authority for the country rests with the Party Presidium. The responsibility for refining and implementing plans goes to the Council of Ministers, to the State Planning Commission and to their various lower level agencies.

The general model of import planning has information flowing from the Party Presidium down to the lowest level production agency and back up again. Several transfers of information both vertically and horizontally are made in estimating the agricultural and food production capability, and subsequent foreign trade needs. The lower state enterprises, including state farms, cooperatives and privately held units, have input by registering their resource needs in the production process. These needs are accumulated by the Ministry of Agriculture and evaluated in terms of achieving goals set by the Party Presidium.

If the resource base is not sufficient to produce the agriculture commodities needed for providing all food requirements, the import of commodities is planned to meet the deficit. This now involves not only the Ministry of Agriculture but also the Ministries of Foreign Trade and Finance. These import needs are sent through the State Planning Commission to the Party Presidium for their approval. If approved the Foreign Trade Organizations are directed to secure the needed imports.

The planning process is flexible enough to allow for imports that deviate from the initial plans when unforeseen circumstances such as crop shortfalls necessitate imports to meet certain priority needs. In some cases FTO's, ministries, and end-using enterprises have authority to order imports at their own discretion although this is usually not the case for major agricultural imports such as grains and oilseeds.

Central Role of the FTO - Ministries and planning commissions are the most important participants in planning for imports. Once a decision to import a particular product is reached, the FTO assumes a central role. It is usually responsible for the operations of importing including locating sources, soliciting bids, negotiating

terms of sale, arranging delivery, conducting inspections, obtaining import clearances, negotiating disputes, and in some cases arranging financing and payment terms. In performing these duties the FTO operates on normal commercial principles and may assume legal contractual obligations.

The FTO may also participate in market analysis. Officials of FTO's frequently consider it their responsibility to advise other agencies on the world market situation. Within limits the FTO may sometimes alter purchase plans based on its own market analysis. While these changes in import plans are not unilateral by the FTO, they do demonstrate the leadership role the FTO may assume on occasion.

End Users - Although end users appear at or near the bottom of the organizational structure, they are important in developing plans for imports, and occasionally in determining the schedule and source of imports. Estimates of the supply and demand for grains by the end users are incorporated into production and trade plans prepared by the Ministries. Frequently end users are also charged with the responsibility of monitoring the supplies on hand and recommending the timing of imports. From time to time the benefits of granting end users import authority is considered but to date such authority is rare in major agricultural commodities.

Principles for Trade in Agricultural Products

Because of the importance of agricultural imports in most countries and the rather large annual purchases, the import FTO's prefer to deal with suppliers that have an established presence in the market. An established presence in the market means that an exporter can provide desired commodities, quantities, qualities, and related services, and can assure performance according to agreed terms. Several factors work together to establish a presence in the market in the eyes of FTO buyers.

Direct source - The import decisionmakers in Soviet Bloc countries frequently mention their desire for direct sources of grain. There seem to be two major concerns behind this desire.

First is an assurance of a supply. Assurance of a supply of food is deeply felt in these food deficit countries, especially for

principal food commodities such as meat and grains. Concern reaches the highest levels of government. Inadequate imports of grain by the FTO is likely to reach the attention of high state officials who must react to demands by the people for adequate food supplies.

Aggravating the concern over inadequate grain imports is the greater inflexibility of CPE's to deal with rapidly changing world grain situations. Increases in grain imports to cover a domestic shortfall in production also requires an additional allocation of scarce foreign exchange in hard currencies. It must be withdrawn from planned uses in other sectors of the economy, and is a difficult task for any government.

A second reason behind a desire for direct sources is the perceived opportunity for reduced prices, that is, eliminating the middleman's profits. Higher level government officials frequently mention the idea of dealing direct. Grain traders, however, mention this idea infrequently, and then most often in the context of encouraging additional suppliers to enter the international grain trade to provide additional competition. Grain traders deal with middlemen every day and usually feel that the services they provide justify their additional costs.

Adequate volume - Soviet Bloc countries import substantial quantities of grains and oilseeds. The exclusive import rights means that the FTO may often be in the market for relatively large purchases. The FTO's expect the selling organizations with which they deal to be sufficiently large to handle their requests for business. Also, the importers are reluctant to deal with sellers that can be only occasional or seasonal suppliers.

Assurance of performance - The assurance that an exporting company will deliver according to agreed terms is a major consideration of FTO's in selecting the supplying company. The most important evidence of performance is, of course, past activities in international trade. Since selling to centrally-planned countries requires some specialized knowledge and experience, the best evidence of performance is past successful trades with other centrally-planned countries. An important factor in evaluating the potential for performance in grains is the ability to originate from multiple origins, thus reducing the importing country's dependence on a single country or on a few ports.

Convenient access to exporters - One handicap of U.S. based grain exporters is the distance over which one must communicate to sell in Europe. This distance increases the cost of communications and reduces the opportunities for daily communications between buyers and sellers. Limited overlap in the normal business hours makes it more difficult to get timely information, and hampers the negotiations that might go on to close sales. Some Soviet Bloc buyers strongly preferred to deal with European-based traders with sufficient authority to make sales decisions. The greater distances also reduce the opportunities for personal contact between buyers and sellers.

Market information and analysis - Rapidly changing world grain markets require traders to be constantly updating their market information. FTO traders preferred daily or more frequent contact with grain suppliers. Each importing FTO conducts or has access to "in house" economic analysis on the world grain situation. The "in house" information is supplemented by the traders' frequent contacts with potential sellers. Multinational grain trading companies were usually viewed as excellent sources of market information and analysis. Their worldwide orientation closely matched the preferences of buyers, who usually felt they should buy from the lowest cost supplier regardless of origin.

Some western traders suggest that the daily contact with Soviet Bloc buyers is as useful to the western traders as to the FTO traders. Soviet Bloc countries are rather large buyers of grain and knowing, or guessing correctly, their purchase plans can create favorable trading positions for western exporters.

Personal acquaintance, trust and responsibility - Buyers for Soviet Bloc countries seemed to attach great emphasis to personal acquaintance with sellers. This emphasis is related to the assurance of performance stressed by FTO's. Problems that may arise with the negotiation and delivery of a contract can be more easily avoided or resolved between personal acquaintances.

Pricing Considerations - It is sometimes said that price plays a less significant role in making decisions in centrally planned economies than in market type economies. This is true in the sense

that movements in world price levels do not necessarily affect the quantities of goods produced and consumed with centrally planned economies. The reason for this is that domestic prices received by their producers and paid by their consumers have been substantially insulated from world price movements.

However, firms selling grains to the centrally planned economies should not be misled by the separation of domestic from world prices. It is clearly important for grain firms to be price competitive in their offers to Soviet Bloc buyers. The FTO's usually buy from the lowest bidder, other things being equal.

On occasion the lowest bidder will not get the sale, but this is usually because of doubts on performance ability or because of non-price considerations such as credit, counter trade possibilities, or superior quality. Exceptions for the last two items are infrequent, especially for grains. There are instances where politics or other non-commercial issues will override price in selecting import sources, especially where bilateral agreements are involved with other governments, or where particular ideological matters made one seller more amenable than another.

Marketing Alternatives

As mentioned earlier, Soviet Bloc countries have accorded grain imports a high priority allocation of foreign exchange. While several countries prefer or require extension of credit, purchases are usually arranged under normal commercial and financial terms. While the bidding and negotiating techniques may vary from those used by buyers in market economies, the final sales terms are familiar.

In several countries, however, constraints on foreign exchange may force suppliers to consider "alternative marketing techniques" that reduce the expenditure of hard currency reserves. In other countries economic liberalization may allow new enterprises to acquire foreign trade rights or to assume more important roles in determining the products, the quantities and the sources for imports.

In all countries official interest is high in enhancing production capabilities as a means to improve their economic performance. For most countries this translates into official support for joint ventures

and technical assistance projects, especially in high technology areas.*

Technical Assistance - Technical assistance is a process of working with and through host country people for the accomplishment of agreed upon development purposes. The purposes are likely to have both long and short term horizons, and the purposes may change over time. Most high level Soviet Bloc officials look favorably upon technical assistance projects. Several projects carried out under the cooperator programs of the Foreign Agricultural Service of USDA are considered successful.

Not all projects, however, are successful, especially from the viewpoint of particular firms attempting to use such projects to enhance their market position. Even those officials who favor technical assistance programs try to avoid offering sales guarantees to sponsoring companies. Participation in a technical assistance projects may "enhance" trade possibilities for particular firms, other things equal. In the international grain trade it is difficult to justify expending resources on technical assistance projects and yet maintain grain bids "equal" to other exporters.

FTO traders were unenthusiastic about the restrictions on their decision-making freedoms in purchasing grains that would likely arise from the tie-in of grain imports to technical assistance programs. FTO's do not view their role to include coordinating import purchases with technical assistance projects, which in most cases would fall under the supervision of an entirely different ministry than that which supervises the FTO. Usually no agency is specifically charged with coordinating responsibility. Such a task would likely fall to the exporter.

We concluded from our interviews it is difficult to coordinate these two sides of a business relationship. Grain and oilseed sales are short term and price competitive compared to technical assistance projects which are longer term and the results less tangible.

Joint Ventures - Joint ventures (loosely defined) between eastern and western companies are quite common for industrial and consumer products. Many of these are associated with counter trade arrangements

*Interviews with Eastern European government officials in both Washington and their home country led to a number of observations on technical assistance, joint ventures and countertrade for agricultural commodities.

discussed below. Joint ventures in which the western firm obtains equity ownership in property or income is restricted to only a few countries and a few companies (Verzariu and Burgess). Most countries are not enthusiastic about joint ventures involving equity ownership or management control of enterprises within their borders. Most countries, however, would encourage joint ventures with western companies in third countries. As with technical assistance projects, coordination of the business activities of a joint venture which touched on the authority of two or more ministries would be difficult for the same reasons mentioned above for technical assistance.

Counter trade* - Counter trade is a contractual form of business wherein Western sales of goods are tied to reciprocal purchases of goods from the Soviet Bloc country. For many commodities counter trade is an important element of East-West trade. At times Western firms have found that a willingness to accept counter trade commitments can be a prerequisite to obtaining a sale to an East European partner. To date this has not been the case with grain and oilseed sales, but it may be in future sales.

Soviet Bloc countries view counter trade as a means to conserve hard currency, to penetrate Western markets, and to gain access to financial resources and marketing capabilities of Western firms.

There are several forms of counter trade transactions. Barter involves the direct exchange of goods without money being involved. Switch transactions are based on multilateral use of bilateral clearing accounts (Verzariu). Barter and switch transactions are relatively rare.

Compensation arrangements (also referred to as buy back arrangements) involve resultant goods directly derived from the western provided goods or technology. Compensation trades are most useful when Eastern countries have raw materials in need of development or abundant supply of cheap labor. The USSR has abundant supplies of undeveloped raw materials, but other Soviet Bloc countries, with the exception of Poland, generally have limited undeveloped natural resources.

Compensation arrangements are usually relatively large transactions and frequently are long term in nature. They appear to be the fastest

*James Jones, University of Idaho, contributed much of the material on counter-trade.

growing form of counter trade (Mathesen, McCarthy, Flanders).

Counter purchase involves the counter deliveries of goods that are nonresultant products. These are the type of arrangements that would most likely be relevant to agricultural export organizations.

The potential for counter trade arrangements to increase the quantity of agricultural imports varies by countries. Since grains, oilseeds and some meats already receive high priority allocation of foreign exchange, those countries which have adequate foreign exchange, such as the USSR, Czechoslovakia and to a lesser extent the GDR, would not be expected to increase overall imports of grains and oilseeds. Countries which face severe limitations of foreign exchange, such as Poland, would likely increase total imports some if counter trade arrangements reduced the expenditure of scarce foreign exchange. Even so, in the short run increased imports would be small. But, if the counter trade arrangement is so designed, the long run increase in imports could be significant.

Despite the limited overall increase in imports of agricultural products from counter trade, the potential increase in business for individual firms can be large. To date counter trade has not been successful with grain and oilseed trade, in part due to the price competition in standardized commodities. Changing economic situations and recent efforts at counter trade involving grains could result in successful trades which would become a model other sellers may be encouraged to follow.

Counter trade is by no means a primrose path to gain access to markets in Soviet Bloc countries. Counter trade packages are difficult to establish and maintain because of the problems of arranging reciprocal purchases and the inflexibilities associated with the planning bureaucracy.

Despite official high level support for counter trade not all officials in the bureaucracy favor counter trade. Some believe that counter trade can be wasteful, time consuming and support the concept only to the extent required to do so.

One of the most serious drawbacks to a strategy of counter trade is that unsaleable, out-of-date items often tend to get shuffled into

counter trade. Eastern European FTO's often will not allow goods that are in high demand in Western markets be used as linkage items for counter trade purposes. Inferior-quality goods can usually only be disposed of at a discount, often only in third countries, necessitating the seller to absorb the discount by adding a surcharge in its own sales price. The low margins in grain sales make it difficult to "hide" such a surcharge. To date the grain importing FTO's have preferred purchasing from the lowest bidder.

Disposal of counter trade goods not useful to the exporter can be burdensome. Some products from Soviet Bloc countries are not in demand nor of sufficient quality to be marketed in the U.S. or other developed Western countries. Frequently such products can be marketed in less developed countries. Several firms exist that specialize in disposing of counter trade goods. Also several international trading companies have special departments to handle such transactions either for inhouse trades or for outside firms.

Another problem is that in many cases counter trade involves products that come under the jurisdiction of separate ministries. Often there is minimal horizontal coordination between ministries. It usually becomes the responsibility of the Western firm to provide coordination of the counter trade agreement between ministries. As far as we know, Poland is the only country that has a separate agency that is charged with the responsibility of coordinating counter trade arrangements. However, it was not clear to us that counter trade could be co-ordinated.

Negotiating counter trade arrangements can be difficult and time consuming. Usually it is preferable to have assistance from experienced counter trade companies, especially if disposal of inferior goods is expected to be a problem.

Counter trade arrangements with Centrally Planned countries face the potential of encountering import restrictions in Western countries, particularly if they are large enough to threaten domestic industries. Because of state ownership of production and artificial pricing, products from centrally planned economies are often viewed as being subsidized import items in Western countries and, hence, subject to

trade restrictions.

Summary

Counter trade, joint ventures and technical assistance projects are marketing techniques that have been used in varying degrees for marketing non-agricultural products in Soviet Bloc countries for a number of years. Increasing hard currency deficits and continuing demands for large grain imports in several countries has increased the interest in using these techniques for agricultural imports. However, implementation at this time appears difficult.

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