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ECONOMIC REVIEW OF INDIVIDUAL EASTERN EUROPEAN COUNTRIES

SOVIET ZONE OF GERMANY

Note by the Chairman of the Committee of
Economic Advisers

In its second series of examinations of economic developments in each of the Eastern European countries(1), the Sub-Committee on Soviet economic policy held, on 1st June, 1967, a special session devoted to the Soviet Zone of Germany with the participation of experts from various capitals(2).

2. The Committee of Economic Advisers thought that the Council might be interested in the results of this review. In the attached brief report, the Committee has attempted to review the economic developments of the Zone during the past two years as well as the prospects for the immediate future and to draw some conclusions.

(Signed) A. VINCENT

OTAN/NATO,
Paris, (16e).

(1) Within this second series, Czechoslovakia was examined on 7th November, 1966, Bulgaria on 27th April, 1967, Hungary on 22nd June, 1967 and the Soviet Union on 20th July, 1967.

(2) For a record of this meeting see AC/89-D/58.

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ECONOMIC REVIEW OF EASTERN EUROPEAN COUNTRIES

SOVIET OCCUPIED ZONE OF GERMANY

Report by the Committee of Economic Advisers

The economic expansion in the Soviet-occupied Zone of Germany has been meeting various obstacles: artificially cut-off from the overall German economy, it has had to find a new economic balance; the Zone had to make large deliveries to the Soviet Union as "reparations"; the exodus of large numbers of the Zone's population, including skilled workers, technicians and members of the professions who chose freedom in the Western part of the country, deprived it of some of its best manpower; in addition, once the basic task of reconstruction was more or less completed, the rigid collectivist system imposed against the wish of the population proved inadequate to ensure steady economic progress. Such difficulties were earlier mentioned in the previous report(1) submitted two years ago to the Council. That report indicated also that there had been a programme of economic reform, some signs of acceleration in the pace of economic expansion and also attempts to diversify external trade. The present note describes briefly the developments which have taken place in these various respects over the last two or three years and gives whatever indications are available on future prospects.

I. ECONOMIC REFORMS

2. It now appears that as far as economic reforms are concerned, the Zone stands with the USSR in an intermediary position between the rigidly conservative Eastern European countries (such as Rumania and Albania) and the most progressive ones (such as Yugoslavia, Czechoslovakia and Hungary). On the other hand the Zone may be more advanced than most Eastern European countries in the implementation of the reforms, but it is difficult to ascertain whether some of the institutional changes which have been decided are real or only apparent. For instance, the Central Planning Organization, so-called "Economic Council", created in 1962, has been dissolved but since 1966 a "National Planning Commission" is again responsible both for long and short term planning and its implementation and control. Ministries have largely taken over the task of supervising the various sectors of the economy, which was previously entrusted to Industrial Departments of the Economic Council.

(1) C-M(65)63

3. On the other hand, some important new features have been introduced. The number of indicators imposed on enterprises has been reduced. These enterprises play a somewhat greater part in the elaboration of the economic plan and, once goals have been set for the firm, attempts are made to enlist the support of the workers through "planning discussions". Profit has become one of the main indices of the efficiency of individual enterprises. However, the part of profit which is left at the disposal of the firm is limited, as associations of enterprises belonging to the same industrial sector are entitled to redistribute the profits among their members. The Central Bank has been given a greater rôle in the financing of investment but in the last resort the financial control of the groups of enterprises remains with the Ministry of Finance.

4. Efforts are being made to rationalise the prices and wages systems. Two additional Central Authorities have been created: the National Wage Office and the Price Office. The readjustments in prices have been made in various stages according to the products. From 1st January, 1967 new prices are applicable in all industrial branches, transport and the building industry, while agriculture has been largely excluded for the time being. The new price system has entailed a reduction of subsidies, especially on raw materials, and is aimed at compelling enterprises to operate more efficiently in the future. On the other hand, to avoid price readjustments in industry resulting in a sharp increase in the cost of living, subsidies on consumer goods have had to be maintained. The régime had seriously underestimated the difficulties in applying the new measures and while at first they were to be fully implemented by 1967, the delay has now been extended up to 1970.

5. Compared to the economic reforms projected in Hungary and partly implemented in Czechoslovakia, those carried out in the Zone are characterised by a higher degree of central planning which continues to rely more on administratively fixed goals than on economic incentives: the new prices represent a revision of former ones but no change in the pricing system; they continue to be fixed by the authorities without any built-in mechanism to reflect changes in economic conditions and without any scope for price competition between enterprises allowed to make their own price decisions.

II. RECENT ECONOMIC DEVELOPMENTS

6. During the two year period 1965-1966, the economy of the Soviet Zone seems to have grown at a rate of roughly 4.5%(1). This confirms the recovery which, after the stagnation of the previous years, was already announced in the previous report. The progress achieved in 1965-1966 is below that of other Communist countries and also below the targets of the Zone. On the other hand, it compares rather well with the economic expansion in the West, and it is probably somewhat higher than the rate achieved in the Federal Republic, during the same period.

7. The economic expansion of the last two years is not due to the economic reforms, whose effect will take more time to be felt, nor to any increase in employed manpower. It results entirely from progress in labour productivity and shows that the "flight to work" of the population after the building up of the Berlin Wall has continued. This increase in labour productivity has been facilitated by a fairly high rate of increase of investment and perhaps also by a better distribution of such investment. In previous years there had been a marked tendency to prolong the life of old equipment and to diversify the industrial basis of the country; and this resulted in many unfinished projects. It seems that the authorities have recently placed more emphasis on modernisation of existing industries for which the Zone is best suited, while relying more, for a number of industrial products, on external trade.

8. In industry, which accounts for over two-thirds of total production and makes the Zone whose area contained important industrialised regions already before the war the tenth industrial power of the world, progress had been uneven. In 1966, for instance, it has been particularly good in chemicals and electricity production, and the Zone, with few years delay, now has its first nuclear plant. The growth has been smaller in heavy engineering; there has been a levelling off in mining and shipbuilding, and even a further decrease in the rate of newly constructed dwellings. In industry as a whole for the two years 1965-1966 the rate of growth of output may be estimated at some 6.3%.

9. In agriculture collectivisation has been reinforced. On the other hand the ideological pressure on the agricultural population has somewhat abated. Many economic measures designed to raise production and increase the yield have proved successful. The use of fertilisers, high quality fodder, various machines and tractors, has expanded. Incentives have been granted in the form of price increases for various agricultural products and bonuses

(1) This figure applies to the "national income" which is a somewhat different concept from that of "gross national product" in the West. For this reason comparison between the economic growth in the Zone and in Western countries is necessarily imprecise.

for overfulfillment of output targets. Crop yields have increased and progress has been made also in animal production. As a result, for the years 1963-1965, the planning goals were exceeded. Nevertheless the Zone is far from being self-sufficient in wheat and other bread grains which it will continue to import.

10. The growth in the economy has allowed some improvement in the standard of living of the population although nothing spectacular has taken place in this respect. The supply of consumer goods does not yet meet the demand either in respect of the choice or in quality. As a result, excess stocks of certain goods accumulate in factories while the population increases its deposits in savings accounts. The housing is especially inadequate and the pace of new construction has been slowing down over the last years.

11. While the standard of living in the Zone is the highest among European Communist countries; it is exceeded by that of most Western industrialised countries and especially by that of the Federal Republic of Germany, whose standard of living is among the highest in Europe. Although economic growth in the Federal Republic has been slow over the past two years the starting point was so much higher than in Eastern Germany that the advance of the Western part of the country in absolute terms has been not only maintained but also somewhat increased.

12. For the future, the authorities of the Zone expect an acceleration of economic progress, although their objectives are more realistic than they have been in the past. According to the Five Year Plan for the period 1966/70 which has just been published, the rate of growth of the economy will be some 5.5%. A special effort will be made in scientific research, nuclear and chemical industries, and also in the transport sector, where obsolescent material is still in use. Agricultural output and production of consumer goods are due to increase more slowly than that of investment goods. This means that the improvement in the standard of living of the population will be kept within fairly narrow limits. On the other hand, it is expected that labour productivity will continue to increase substantially. Various measures of a social character are envisaged: from September 1967, the five day week will be introduced and there will be a better and more differentiated wage and bonus system as well as an increase of the minimum wage and of the minimum pension.

13. The achievement of the various targets set in the new Five Year Plan, though not impossible, implies rather favourable conditions. It would consolidate the advance of the Zone over the Eastern European countries as far as industry and even standard of living are concerned. On the other hand, it would probably not reduce the gap which exists in this respect with industrialised countries of Western Europe, and in particular with the Federal Republic.

III. EXTERNAL ECONOMIC RELATIONS OF THE ZONE

14. The overall economic picture of the transactions of the Zone with the outside world including trade with both foreign countries and the Federal Republic shows that this intra-zonal trade represents about 10% of the total, trade with the other fourteen NATO countries - which increased more rapidly from 1963 to 1965 (62%) than intra-German trade (34%) - represents about 8%, trade with Communist countries about 75%, trade with the Soviet Union along some 45% and trade with the developing countries of the free world some 4%. Recent years have been marked by a fairly rapid rate of expansion of trade of the Zone with the outside world. This seems to be a result of a deliberate policy of the Zonal Authorities in order to, from an economic point of view, take advantage of the international trade and, for political reasons, to be less dependent on intra-German trade.

(a) Intra-German trade

15. The development of intra-German trade has been very uneven. The deliveries of the Federal Republic to the Zone increased by 2.7% in 1965 and 37.2% in 1966. On the other hand, the deliveries from the Zone to the Federal Republic expanded by 12.3% in 1965 and 6% in 1966. This is partly due to the difficulty of finding products of interest to the Western part of the country, which buys in the Zone mostly agricultural products, mining products, oil and textile which it could easily procure elsewhere. The Zone on its side obtains chemical products, some agricultural products, steel, machinery and modern equipment in the Western part of Germany. In 1966 and during the first quarter of 1967, Soviet-zonal purchases of goods from the Federal Republic of Germany exceeded deliveries to the Federal Republic by about DM. 500 million. Since the swing in intra-zonal trade clearing is limited to DM. 200 million, the Soviet Zone has been able to make these additional purchases only by using credits granted to the Zone by private firms in the Federal Republic.

(b) Foreign trade

16. During the last two years, the expansion of the trade of the Zone has been faster with the industrialised free world (19.3%) than with the COMECON countries (4.6%). To some extent, the larger participation of the Zone in the world trade may be considered as one of the most important symptoms of success as far as the quality of its products is concerned. On the other hand, the foreign trade of the Zone is unbalanced: while it achieves a surplus with the Communist countries it shows a growing deficit with the free world which is covered by increased export credits granted to the Zone. By the end of

1966, NATO countries alone (excluding the Federal Republic) had extended \$169 million of such credits, of which \$26.4 million with a duration of over five years.

17. The Zone imports from the West mostly machinery and industrial equipment, and it exports a wide range of products, especially finished goods. An effort is also made by the Zone to develop its trade relations with the developing countries of the free world where it can buy raw materials, and some tropical consumer goods. The trade of the Zone with other Communist countries covers also a wide range of goods; however, industrial equipment enters for an important part in the exports of the Zone while its imports include a large share of raw materials. The Zone has remained faithful to the division of labour within COMECON but the significance of this organization to the Zonal economy seems to have diminished over recent years.

IV. CONCLUSIONS

18. Since 1965, the Zone has accomplished steady, although by no means spectacular, economic progress both in industry and agriculture. While it has kept its advance over other Communist countries in Europe, it has continued to lag behind most industrial countries of Western Europe and, in particular, behind the Federal Republic. Any economic comparison between the two parts of Germany remains to the advantage of the Federal Republic, in spite of the slowing down in its economic expansion, and it will certainly be so in the foreseeable future. Economic reforms are being implemented in the Zone along the lines decided in 1963, but they are less far reaching than in some other Eastern European countries. Although the price system is being to some extent rationalised, the effect of the reforms on the economy is not likely to be substantial and their effect on the political system is not apparent. As far as relations with the outside world are concerned, the Zone remains very much dependent on the Soviet Union economically as well as politically. In spite of a fairly rapid increase in its trade with the West, the Zone is still conducting nearly half of its total trade with the Soviet Union and about three quarters of it with the Communist countries taken as a whole. In the total transaction of the Zone with the outside world, intra-German trade represents about 10%. As a proportion of the total exports of NATO countries to the Zone, the deliveries of the Federal Republic have somewhat declined over recent years to about 60% in 1966.

19. In their trade with the Zone, the NATO countries have to take account of various considerations. Such trade may be economically advantageous to them and may contribute to improve the living conditions of the German population in the Zone. It may also become to some extent an instrument of

pressure: its development would increase the efficiency of economic countermeasures which, if the need arose, could be jointly applied by member countries in case of a crisis in Berlin. On the other hand, fast expanding economic relations between the Zone and the free world may serve the political aims of the régime and its attempts to enhance its status on the international scene. In any case it is very important to bear in mind that an expansion of trade with the Zone, if it were achieved at the expense of intra-German trade, would weaken one of the last ties between the two parts of Germany and might reduce the effectiveness of one of the instruments to protect free access to Berlin.