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RECENT ECONOMIC DEVELOPMENTS IN THE USSR AND EASTERN EUROPE

Report by the Chairman of the Economic Committee

Some speed-up in economic growth in the East, as in many industrialized Western countries, seems likely in 1973. Polish, Rumanian and Bulgarian industrial production continued to grow at buoyant rates of 10% or more in the first nine months of the year. In the USSR and elsewhere industrial performance remained less satisfactory (e.g. Soviet oil production was 2% below the Five-Year Plan target) but unusually favourable weather has substantially increased grain harvests, though the precise growth is still uncertain. A respite thus seems likely from the declining growth trends which most European countries face in the medium-term as a result of labour constraints, technical lags, construction delays and economic centralization.

2. In an attempt to alleviate such problems, the East is still looking to Western technology provided on compensatory terms in industrial co-operation arrangements. While increased East-West trade will be no panacea for Soviet economic weaknesses, which are primarily structural, the USSR shows no readiness to apply alternative remedies. Following First Secretary Brezhnev's visits to Bonn and Washington, the priority of the goal of increased East-West economic co-operation has been elevated in Eastern doctrine. Prospects for East-West trade in 1973-1974 remain buoyant following last year's record rise: trade results to date for several Eastern countries show considerable growth; new Soviet and Polish orders for Western machinery and new East-West industrial co-operation agreements have continued at high levels. The USSR (as represented by the Soviet citizen who heads COMECON) has made a gingerly direct contact with the EEC Council of Ministers, though this move could reflect, in part, a Soviet desire to monitor East European economic relations with the West. Hungary has acceded to GATT; Rumania, where the first joint ventures with minority Western shares have been formed, was recently included in the EEC's generalized preference system; and Bulgaria has unofficially indicated interest in a similar arrangement.

3. In response to the recent world-wide inflation of commodity prices, the USSR seems to be raising the prices of key exports, e.g. oil. As a major commodity exporter, the Soviet Union probably hopes to benefit by obtaining Western knowhow at a lower relative price than heretofore. Such hopes are doubtless not diminished by the energy constraints resulting from the reduction in Middle Eastern oil exports.

A. DOMESTIC ECONOMIC PERFORMANCE

(i) The USSR

4. Advance indications are unclear in regard to Soviet economic growth, which could vary between 2% and 8% in 1973 on the basis of the somewhat contradictory information available to date. Boosted by extraordinarily favourable growing weather, the Soviet grain harvest is currently estimated at 195 million tons or more - at least 17% over the 1972 level; Brezhnev has publicly claimed a 215 million ton crop. Either of these figures would seem to imply growth of at least 6% in terms of GNP.

5. Considerably slower growth, however - 4% in terms of net material product, perhaps 2% for GNP - is implied by data announced by Politburo Member Kirilenko on 6th November. The critical element, the grain harvest, remains uncertain in regard to quality as well as quantity. Weather conditions deteriorated with excessive rainfall at the moment of the harvest and Soviet press treatment of Brezhnev's claim has been restrained, as if deliberately to dampen consumer expectations. In any case planners are clearly not counting on the recurrence of dramatic increases in agricultural output without expensive and time-consuming additional efforts. The USSR recently announced the start of construction of an elaborate system of long-distance irrigation canals based on the diversion of Siberian rivers southward to the semi-arid wheat lands of Kazakhstan.

6. Outside of agriculture, Soviet economic performance so far in 1973 has remained generally sluggish. The critical oil industry will produce about 9 million tons (2%) less this year than its target under the 1971-1975 plan, according to advance estimates announced by Kirilenko on 6th November. Shortfalls have also been indicated for investment, for production of natural gas, mineral fertilizers, and industrial consumer goods, and for housing construction. The traditional pillar of heavy industry, steel output, is expected to reach or exceed its target of 131 million tons this year while, according to a recent Soviet journal, the share of consumer-oriented industries in investment is scheduled to decrease. During the first ten months of 1973, Soviet industrial production rose at one of the lowest

rates of the past 30 years, although growth was not as slow as planned for the year or achieved during the slump of 1972. The time-honoured causes of industrial problems - dispersion of investment, delays in introducing new capacity, labour shortages, slow technical advance - have been reiterated by Soviet leaders. A plan announced last Spring to merge several industrial enterprises into "associations" has made little progress amid much evidence of opposition.

(ii) Eastern Europe

7. Rumania and Poland expect grain harvests at or above 1972 levels and during the first nine months of 1973 continued to enjoy the fastest growth of industrial production in the East - 14.7% and 12.1% respectively, over the level achieved during January to September 1972. These rates represent a considerable acceleration over the growth rates of current Five-Year Plans and 1970-1971 results, particularly for Poland. The Polish consumer continues to benefit from the upswing, with real wages up 10% at mid-year. Investment (up 25%) rose much more rapidly than planned, however. The food price freeze established in 1971 to repress consequent inflationary forces and defuse public discontent has accordingly been extended another year. Growth of Bulgarian industrial output (10.2%) exceeded the rates of both current and Five-Year Plans during January to September. The Bulgarian Authorities have recently given public encouragement to private livestock-breeding and in September acted to ease labour constraints by permitting retired personnel to work three months per year without losing their pensions.

8. In the GDR, Czechoslovakia, and Hungary, industrial production rose at 6% to 8% rates during the first half of 1973 in accordance with less ambitious plans and poorer prospects. East German industrial performance reflected a substantial acceleration of both labour productivity and output and will be somewhat strengthened in the future by a recent Polish agreement to provide extra labour. Excellent harvests are anticipated in Hungary and Czechoslovakia. Hungarian industry was stimulated by increased imports in the first half of 1973 but labour productivity remains relatively sluggish as central economic controls have been further strengthened. Inflation also remains a problem, with prices rising 3.6% during the first half of 1973. In an apparent attempt to assuage public dissatisfaction with the uneven impact of rising living costs, the Government issued a decree in June that forbids "unjust profits" resulting from abuse of monopoly positions.

B. EXTERNAL ECONOMIC RELATIONS

(i) Policy Flux

9. Acquisition of more Western technology and equipment through closer economic co-operation remains the principal Eastern solution to domestic economic problems and, with some prompting from Moscow, has received increased emphasis in Eastern policy statements since Brezhnev's visits to Bonn and Washington last Spring. To many Western observers, somewhat greater trade with the West, which now represents less than 1% of Soviet GNP, seems inadequate as a remedy for Soviet economic difficulties which are rooted mainly in structural weaknesses. The Soviet leaders nevertheless appear eager to apply this policy and even to endorse its application by their Allies. The communiqué of the COMECON meeting of June in Prague described economic dealings with the West as means to the traditional objective of COMECON integration. Following separate visits by East European premiers to Moscow in August, even Czechoslovak and East German spokesmen who had previously been reticent about the virtues of commerce with the capitalists suddenly found voice. "Socialist economic integration and economic relations with industry capitalist countries ... can even fertilize each other", according to an August article by the GDR Minister of Foreign Economic Relations. At the Brno trade fair in September, the Czechoslovak Minister of Metallurgy stated that COMECON integration depended on particularly rapid technical advance in some industries, which in turn necessitated greater technical co-operation with the West.

(ii) Current East-West Trade Outlook

10. East-West trade prospects for 1973 are consistent with such policy emphases. In comparison with the January to June 1972 period, United States commerce with the East as a whole approximately tripled during the first half of 1973. The buoyant Polish economy expanded its imports from the West 60% - an increase double that of global Polish imports. Hungary increased its purchases from the West 18% while reducing them elsewhere. Czechoslovak-Western commerce in both directions grew half again as much as total Czechoslovak foreign trade. For 1973 as a whole, Soviet commerce is expected to rise over 100% with the United States and 35% with the FRG. At mid-year, Soviet foreign commerce was up almost 100% over its level of a year before and most of the acceleration was probably attributable to Western exports.

11. To a large extent, the surge in Eastern imports probably reflected the high level of advance orders placed for Western machinery or grain in 1972 - a record $2 billion in each category by the USSR alone. Soviet global hard-currency trade this year is expected to incur a deficit of about $2 billion financed partly by gold sales and industrial co-operation agreements that combine long-term credits with compensatory repayment terms. Such credits are "self-liquidating" - i.e. they create their own means of repayment by developing Eastern export industries. Industrial co-operation of this type thus permits Eastern beneficiaries to incur large temporary trade deficits with little loss of financial strength or credit-worthiness. Thus, exports of Soviet natural gas to West Germany, commenced on schedule 1st October, are expected over the next 20 years to repay the $630 million odd in pipeline equipment and credits offered by the FRG in industrial co-operation agreements of 1970 and 1972.

(iii) Co-operation and Contacts

12. Future East-West trade prospects are also being strengthened by the continuing expansion of organizational contacts and industrial co-operation arrangements. About 85 industrial co-operation agreements between Eastern and Western enterprises have been concluded this year, maintaining recent rates. In addition, new 10-year inter-governmental agreements on economic, industrial, and technical co-operation have been concluded in 1973 by the USSR with the FRG and France; by Poland with Belgium-Luxembourg, Norway, the United Kingdom and Austria; by Rumania with West Germany; and by East Germany with Italy and France. Like the less elaborate accords of the late 1960s, these agreements establish joint commissions, working groups, and a framework for exchanges for information and experts and for exploration of industrial co-operation possibilities.

(a) The USSR

13. Grain purchases abroad reported so far this year amount to only about 7 million tons (compared with 29 million tons in 1972), but by October Soviet orders of Western machinery had already passed the record $2 billion level of 1972. At least half of this total (and well over half of total outstanding Western credits extended to the USSR) are self-liquidating: $500 million in Italian chemical plants repayable over time in products of the plants themselves (ammonia and urea); $400 million in US port facilities on the Black Sea repayable ultimately in port services; $180 million for a French cellulose plant repayable in cellulose; and $100 million in Japanese paper-making equipment. During 1973, the USSR has also concluded

over 20 agreements on technical co-operation with Western companies. Moreover, a joint Soviet-Japanese company has been formed to oversee the shipment of Japanese cargo containers westward over the Trans-Siberian railway, such shipments being provided free by the USSR in repayment of Japanese credits covering earlier deliveries of equipment for a new Siberian container port. The USSR has also found another market for its services as a land-bridge to Europe, agreeing in a triangular deal in October to provide West Germany with additional gas in exchange for Soviet imports of Iranian gas over a projected new pipeline.

14. Soviet policy toward the EEC is beginning to exhibit some co-operative features. In response to Eastern initiatives, the Chairman of the EEC Council of Ministers held talks in August with the COMECON Secretary General, who proposed further discussions between EEC and COMECON Representatives. (In a cautious reply, the EEC stated that it took note of this proposal and, if COMECON suggested possible subjects for discussion, would be willing to study them.) Since the COMECON official is a Soviet national, he might conceivably serve as a continuing channel for direct Soviet-EEC contacts.

15. Regular EEC-COMECON contacts might have the additional advantage in the Soviet view of channelling East European economic relations with the West through COMECON where they might be more easily monitored. The USSR has also made other efforts to this end, using the COMECON Investment Bank as a conduit for Western loans to Eastern Europe and supporting the idea of a new supranational organization to co-ordinate East-West trade. Such moves, which might tighten the Soviet grip on Eastern Europe, are clearly not popular in many capitals of that area.

(b) Eastern Europe

16. Over $200 million in orders for Western equipment (including $50 million for meat-packing plants) have been placed during the year by Poland which, together with the USSR, accounts for approximately five-eighths of the industrial co-operation agreements signed in 1973 by Eastern and Western enterprises. Poland requires annual grain imports of about 3 million tons but exports considerable shipping and construction services (probably over $100 million in West European orders so far this year). Western demand for Polish coal has also been rising and Poland accordingly plans to accelerate coal production through 1975.

17. Hungary recently followed Poland's example in acceding to GATT and reportedly agreed to lower its duties 53% on imports from GATT countries. Budapest continues to prefer Western bank loans to tied credits as a means of import finance, recently borrowing $40 million from a Japanese banking consortium. While leading its Allies in terms of numbers of industrial co-operation agreements concluded, Hungary currently seems to be taking stock of co-operative schemes, though it has reportedly formed its first joint venture, under its new foreign investment law, with a Swedish firm. During the year Rumania has established four such ventures - with Italian, West German, French and US companies respectively - to produce acrylic yarn, aircraft parts, heart pacemakers and computers in Rumania. Rumania's application to the EEC for inclusion under the generalized preference system was accepted last June and Bulgaria indicated a similar interest in October. Bulgaria also recently followed the example of other East European countries in concluding an industrial co-operation agreement based on profit-sharing, which is particularly suited to the tourist industry: a Japanese company is to build a luxury hotel in Sofia in return for a stated share of its hard-currency earnings from Western tourists.

(iv) Higher Soviet Export Prices?

18. While agreeing with Western partners on co-operative schemes of record magnitude, the USSR has also shown signs of raising prices of some of its key exports. The principal factor is no doubt the recent world-wide inflation of commodity prices, which affects the foreign trade though not the domestic economy of the USSR. Soviet officials have reportedly reaffirmed to Budapest their inability to provide Hungary's total oil requirements for the late 1970s. For a portion of its future energy imports, Hungary must thus look to the Middle East. Poland, which has also been heavily dependent on the USSR for oil, made its first hard-currency oil purchase ($110 million) in May from Iran.

19. Such a Soviet attitude might reflect a desire to divert future oil exports from Eastern Europe to hard-currency markets - except that Western negotiators have occasionally encountered a similar stance. In October, Premier Tanaka was informed in Moscow that Japan could only expect to receive maximum annual deliveries of 25 million tons of oil, instead of the 40 million tons that had previously been mentioned, as part of a prospective Siberian development project. Earlier in the year, Soviet hesitation had reportedly been displayed to West German and Austrian proposals for increased Soviet exports of oil and natural gas, respectively. Soviet asking prices for timber offered to British buyers last month were 40% to 50% over the June level.

20. Shortfalls in domestic fuel output and effects of East-West détente as well as inflation of world commodity prices may contribute to this Soviet commercial stance. Prospective East-West agreement on the principle of territorial integrity may well be interpreted by the USSR as an international sanction for the status quo in Eastern Europe, thus making a high degree of East European trade dependence seem less necessary to Moscow as a means of maintaining Soviet political influence. In asking higher prices in some economic negotiations with the West, on the other hand, the USSR is merely following the example of other commodity exporters profiting from the shift from a buyer's to a seller's market. A predominance of commercial motives is evident in other aspects of recent Soviet trade policy. To counter current or expected price rises, the USSR has decreased its annual cocoa order from Ghana by 20,000 tons, delayed some payments for Western goods, and concluded a long-term sugar agreement with Brazil. Political tactics regarding the Kurile Islands may have contributed to the Soviet attitude in oil negotiations with Japan. Conceivably, the USSR might desire to delay decisions and multiply options because of increased uncertainties arising from lagging domestic production of oil and natural gas and the world-wide commodity price inflation. No quenching of the Soviet thirst for Western technology is evident, however. Rather, Moscow probably now hopes to obtain it at a lower relative price. Such hopes are doubtless not diminished by the energy constraints resulting from the recent reduction in Middle Eastern oil exports.

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