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WARSAW PACT: ECONOMIC DEVELOPMENTS, PROSPECTS AND IMPLICATIONS

Note by the Secretary General

The attached report by the Economic Committee, summarizing recent economic developments in the Warsaw Pact Countries and their implications for the Alliance, is submitted to the Council for noting. It is based on a more detailed report(1) which is currently undergoing revision.

(Signed) Joseph M.A.H. LUNS

This document includes: 1 Annex

NATO,
1110 Brussels.

(1) AC/127-WP/666, dated 15th October 1982

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Report by the Economic Committee

SUMMARY

USSR

1. The rate of growth for the economy as a whole in the first nine months of 1982 has been affected by a fourth successive unsatisfactory harvest. Industrial production so far this year has increased by 2.7% whilst labour productivity has grown by 2%, both of which are less than growth achieved in the corresponding period in 1981. Certain sectors, however, are developing as planned or even better. This is the case in the key energy sector where gas output has again put up a particularly good performance, and pipeline construction is progressing (including the Urengoy-Ushgorod gas export pipeline). As for external trade, the USSR reduced its convertible currency deficit from $6.1 billion in the first six months of 1981 to $2 billion in the corresponding period of 1982. The USSR's normally positive trade balance with Western Europe improved substantially in the first half of 1982, largely because of increased oil sales and sharp cuts in imports, while trade with Japan and the United States registered larger deficits, the latter mainly because of increased cereal imports. The USSR continues to finance its current trade deficit through sales of gold and arms.

2. Despite the basic strength of the Soviet economy, perennial economic problems continue to erode future growth prospects. Among them are increasing investment constraints and declining capital productivity, an insufficient and overstretched transport system, management shortcomings and labour apathy and, most importantly perhaps, inability to expand grain production as planned, so as to provide larger supplies of meat to the consumer. To improve agricultural performance, the USSR introduced a Food Programme in 1982: so far more stress is being placed on bureaucratic re-organization than on the fundamental reform of the agricultural sector. At the same time, the present substantial level of investment will be at least maintained.

3. Despite lower annual growth rates in the economy as a whole, military spending is projected by Western experts to increase by 4% a year in real terms, at least for the next few years. This will mean a steady expansion of the share of national

resources devoted to the military, and thus will exacerbate the competition for shares of the remaining resources in other sectors of the economy. Labour productivity might thus be adversely affected, at a time when demographic factors will constrain increases in the labour force, if declining growth in investment cannot be offset through more effective planning practices, better motivated management, or faster technological advances.

4. The USSR will continue to use trade mainly to meet shortfalls in domestic production and to promote domestic productive efficiency. Its principal imports from the industrial West will continue to be grains and machinery and equipment, although the USSR has shown a tendency to limit purchases of machinery in recent years. Oil remains its most significant hard currency export earner. As these exports are expected to decline during this decade, they may be partly compensated by increased earnings from natural gas. To the extent that the USSR might not be able to finance its hard currency purchases through exports, it may seek to increase its borrowing from Western banks; its present hard currency debt does not pose a repayment problem. As a result of Eastern Europe's convertible currency financial difficulties, the USSR's trade relations with the area will probably intensify. The Soviet Union appears unlikely to underwrite the convertible currency trade or debt of its East European allies.

Eastern Europe

5. Most non-Soviet Warsaw Pact states continue to face difficulties in servicing hard currency debts accumulating since the 1970s, and all confront growing domestic stringencies. There are indications that cutbacks in 1982 of about 10% in Soviet oil deliveries at subsidized prices were suffered by the GDR, Czechoslovakia and Hungary; further reductions may occur in 1983. Energy shortages and severe conservation measures are thus putting a further brake on economic growth. Industrial production in the non-Soviet Warsaw Pact countries in 1982 showed no appreciable deviation from the established trend towards lower growth rates, except in Poland where output remained, for the most part, below 1981 levels. The grain harvest was good in all Eastern Europe. None the less, inflation and inadequate consumer goods supplies continue to pose problems in most of the countries, contributing to social discontent, notably in Poland and Romania. Labour productivity remains low. Reform efforts will try mainly to make management more effective and labour more responsive, but may not be successful; Hungary and Bulgaria continue to conduct the most noteworthy experiments in economic reform.

6. The most serious external economic problem for most East European countries in 1982 was their hard currency debt, which has been aggravated by the world recession and high interest rates. At a staggering level for Poland, but also extremely onerous for Romania, the GDR and Hungary, the level and structure of the debt, plus political uncertainty generated by events in Poland, has caused Western banks to adopt a much more cautious attitude regarding loans towards East European countries. Hence, the countries have tried, with relatively little success, to promote hard currency exports, and to obtain more Soviet raw materials at subsidized prices. They have also consciously restricted hard currency imports, but this has reduced essential supplies for some industries and deepened the economic difficulties. In addition, Hungary and Romania have sought and received assistance from multilateral financial organizations.

7. East European growth in output, particularly industrial output, will be adversely affected over a considerable period of time, and the East Europeans will find it increasingly hard to balance the conflicting requirements to increase exports both to the West (for hard currency balance of payments reasons) and to the Soviet Union (which is pressing its partners to eliminate their soft currency trade deficits). Meanwhile, they may be expected to continue to seek more markets and raw materials supplies in the Third World, although such trade links probably cannot contribute substantially to resolving East European economic problems over the short term.

8. Poland's especially severe hard currency debt and domestic economic decline pose special problems for the USSR in particular, in its rôle as sponsor of the present Polish régime. Hard currency aid the USSR extended to Poland in 1981 is estimated at some $1.5 billion (including almost $500 million near gift). In addition, considerable rouble aid was extended. A slight increase in Polish industrial production starting in August 1982, due mainly to improved mining output, may signal the beginning of a slow upturn in the economy in general. Even if this trend should continue, a return to the pre-1980 level of economic activity will take several years.

Conclusion

9. The Soviet Union's economic weaknesses, which are especially evident in its agricultural and food-processing sectors, are likely to continue throughout the decade. Despite underlying economic strength deriving from extensive natural resources and vast potential productive capacity, the USSR has to deal with declining growth in productivity. The allocation of investment and productive resources among the main competing sectors of the economy is likely to give rise to considerable additional difficulties if Soviet military spending

continues to increase in keeping with present trends. Moreover, the USSR will continue to rely on foreign trade to meet certain of its agricultural and industrial requirements. The resulting dependence on foreign suppliers probably cannot be significantly reduced in the near future, despite the USSR's deliberate attempts to do so, and may possibly lead the Soviet Union to seek additional credits from Western banks, depending on its hard currency export earnings and its decisions regarding imports. East European economic growth will remain adversely affected by the costs of large external hard currency debts and by energy shortages. It will continue to be affected, even if remotely, by the international environment. For these reasons, to which must be added greater caution in Western lending, imports from the West are likely to diminish, thus leading to greater trade dependence on the USSR. Poland constitutes a special case: the considerable decline in industrial output since 1980, which shows no sign of quick recovery, exacerbates its foreign trade and payments difficulties.

(Signed) J.N. GIBAULT
Chairman

ANNEX to
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TABLE 1

USSR & EASTERN EUROPE: SELECTED INDICATORS OF ECONOMIC GROWTH

(Percentage change over previous year)

USSR	1978	1979	1980	1981	1982 (9 months)
National Income (a)	5.1	2.2	3.5	3.2(d)	...
Industrial Production	4.8	3.4	3.6	3.4	2.7
Ind. Labour Productivity (b)	3.0	2.0	2.6	2.7	2.0
Agricultural Output	2.7	-3.1	-3.0	-2.0	...
Foreign Trade (c):					
Exports	7.3	18.9	17.0	13	12.8 (h)
Imports	14.8	9.6	17.4	9	9.3 (h)

	Bulgaria					Czechoslovakia				
	1978	1979	1980	1981	1982 (6 months)	1978	1979	1980	1981	1982 (6 months)
National Income (a)	5.6	6.5	5.7	4(i)	...	4.1	2.7	3.0	0.2	...
Industrial production	6.9	5.4	4.0	5	4.6	5.0	3.7	3.5	2	1.4
Ind. Labour Productivity (b)	6.3	4.1	2.8	5.4	...	4.1	2.9	2.5	1.6	.5
Agricultural Output	4.3	6.0	-4.5	3.6	...	1.5	-3.9	6.0	-3.4	...
Foreign Trade (c):										
Exports	10.4	15.3	16.1	10.5	9.3	9.2	10.3	14.3	9.4	10.1(k)
Imports	12.2	8.3	12.5	19.7	3.7	7.7	11.3	7.6	5.8	4.8(k)

	GDR					Hungary				
	1978	1979	1980	1981	1982 (6 months)	1978	1979	1980	1981	1982 (6 months)
National Income (a)	3.6	4.0	4.2	5.0	3	4.8	1.9	-0.8	2.0	...
Industrial Production	4.7	4.5	4.7	5.1	3	4.9	3.0	-1.6	2.3	1.4
Ind. Labour Productivity (b)	3.2	4.4	5.1	5.0	3.4	4.9	4.6	0.7	4.5	3.3
Agricultural Output	1.4	2.0	0.2	...	...	2.0	-1.1	4.3	0	
Foreign Trade (c):										
Exports	10.5	13.5)	10.0(e)	15.4	10(e)	1.5	-12.5	0.9	2.6	0.7
Imports	0.8	11.3)		6.4		12.6	-3.3	-1.2	0.2	0.6

	Poland					Romania				
	1978	1979	1980	1981	1982 (6 months)	1978	1979	1980	1981	1982
National Income (a)	3.0	-2.3	-6.0	-13.0	...	7.6	6.3	2.5	2.1	...
Industrial Production	4.9	2.7	0.0	-12.6(f)	-7.8(f)	9.0	8.2	6.5	2.6	...
Ind. Labour Productivity (b)	4.9	2.6	-0.2	-12.2(g)	-2.7(g)	7.1	5.6	4.2	2.4(j)	...
Agricultural Output	4.1	-1.5	-10.7	4.1	...	2.4	5.5	-5.0	0.9	...
Foreign Trade (c):										
Exports	9.7	12.3	3.4	-14.2	0.9	5.5	18.0	24.5	11.3	...
Imports	4.9	6.6	7.3	-10.8	-20.9	16.5	20.1	21.8	-7.4	...

(a) Produced national income, i.e. utilised national income plus losses and net exports ;
(b) Gross production per employed person ;
(c) At current prices and exchange rates, fob; Hungary's imports, cif;
(d) Utilized national income (consumption plus investment);
(e) Total trade turnover
(f) Production sold in socialised industry;
(g) Production sold per employee in socialised industry;
(h) Six months
(i) ECE Geneva
(j) In net terms
(k) First five months.

Sources: CMEA Yearbooks, National yearbooks, and official Press releases unless otherwise indicated.

... = not available.