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ECONOMIC COMMITTEE

RECENT ECONOMIC DEVELOPMENTS IN THE USSR AND EASTERN EUROPE

Report by the Chairman of the Economic Committee for the Ministerial Meeting in Oslo(1)

INTRODUCTION

(a) Plan results 1971-1975

In the Soviet Union and the six East European members of COMECON, the Five-Year Plans terminated in 1975. During this period, growth in the Soviet Union reflected a downturn to some 5.5% from the 7.8% average obtained in the Eighth Five-Year Plan (1965-1970): this result is due largely to one mediocre and two poor harvests. By contrast, the average Net Material Product (NMP) in East Europe as a whole during 1971-1975 grew faster than in the USSR, increasing to 7.8% from an average 6.5% in the previous plan period. This result can be explained primarily by the very strong development of the Polish and Romanian economies whose NMP growth rates even exceeded targets.

2. Compared with previous years, economic expansion in 1975 was noticeably slower throughout COMECON: growth rates in Poland, Hungary and Romania slipped by at least 2.5% with aggregate East European growth (without USSR) falling consequently to 7% from 8.3% in 1974. In the USSR growth fell from 5.3% in 1974 to 4% last year. The overall COMECON average growth rate of less than 5% in 1975 was the weakest recorded since 1963. This situation derives to a considerable extent from the bad harvest results, not only in the USSR where the 1975 grain harvest of 140 million tons was the lowest for ten years, but also in the GDR, Czechoslovakia and Poland. Additionally there was a general weakening of industrial dynamism within the Communist economic alliance: this is partly due to adverse developments in foreign trade, particularly the sharp energy/raw materials price increases together with the Western recession.

(1) For the previous report see C-M(75)73, dated 5th December, 1975

(b) Plan prospects 1976-1980: USSR

3. In the Plan period 1976-1980, a slower growth rate than in the past may be expected from all COMECON countries, including the USSR - except perhaps from Bulgaria. The Soviet Tenth Five-Year Plan reflects a deceleration for the overall economy with NMP slated to increase by no more than 24%-28% (1971-1975: 28%), in industrial output by 35%-39% (43%) and real incomes by 20%-22% (24%). This more pragmatic lowering of targets suggests that the Soviet leadership recognizes the limitations imposed by such factors as low labour and capital productivity, the high cost of exploiting Siberia's remote natural resources, the cost of environmental protection and, above all, the allocation of huge resources to agriculture, where despite such vast inputs the returns are uncertain.

(c) Prospects 1976-1980: Eastern Europe

4. In the six East European countries an average annual NMP growth rate of somewhat below 7% is likely (1970-1975: about 8%). As agricultural output in these countries can be expected to attain growth rates similar to those in the previous Plan period, this decline will be due primarily to a slowdown in industrial expansion: in this context no solution appears likely to the manpower shortages in the GDR, Hungary and Czechoslovakia. As in the USSR, further growth will depend basically on more rational use of labour and capital.

(d) COMECON

5. Increased economic and, therefore, political integration within COMECON received a further boost in 1975 through the introduction of the new pricing system for intra-COMECON trade: this main impact was the +130% increase in the price of Soviet oil to the USSR's allies and a deterioration in the East European countries' terms of trade. Most of these countries depend essentially on the USSR for oil and other energy supplies, especially natural gas. In addition new forms of COMECON integration expressed through joint investment projects on Soviet territory and through exports to the USSR of manpower and equipment, are bound further to increase East European dependence on the USSR. Both the individual East European countries and the COMECON International Investment Bank (IIB) continue to borrow substantially on the international financial markets.

(e) COMECON external trade

6. Throughout the Ninth Five-Year Plan, the USSR experienced a hard currency trade deficit. Running at a lower level in the earlier years of the Plan, this deficit grew in 1975

to reach $4.7 billion: capital equipment purchases - made to hasten Plan fulfilment - a deterioration in the USSR's terms of trade and massive grain procurement in the West were among the main causes, whilst concurrently the Western recession gave the Soviet Union little chance to increase its exports. The main problem for the six East European countries from 1974 onwards was to adapt their economies to their adverse terms of trade both with the West and with the USSR. The West's recession and the higher price of imports from the industrialised countries led to an adverse hard currency trade imbalance which reached $3.9 billion in 1974 and is assessed at some $5 billion in 1975. The USSR's global indebtedness to the West estimated at $7-8 billion appears modest compared with that of its allies which is currently around $15 billion.

I. SOVIET DOMESTIC PROBLEMS

A. Results for 1975

7. After an average yearly increase of 5.4% between 1971 and 1974 (5% in 1974), the Soviet Net Material Product rose by only 4% in 1975. This rate of increase, in addition to being lower than in previous years, also, and in particular, fell short - by 2.5 points, of the yearly average forecast by the Plan. The drop in agricultural output (6% less than in 1974) following a reduction of 3.7% in the preceding year affected results for 1975. Industrial production also expanded more slowly. The worst hit sector was consumer goods where the target was only 80% achieved.

8. The agricultural crisis - due in part to the poor weather - was translated by a grain harvest of only 140 million tons, i.e. a shortfall of 75 million tons or one third of the target figure and the worst since 1965. Drought also affected the fodder harvest. As a consequence, livestock had to be slaughtered on a large scale - the number of pigs was reduced by 14 million (or 20% of the total herd) - to cut down on animal consumption and milk production dropped at the end of the year. These adverse results have begun to have repercussions on production in the food industries, supplies of certain consumer foodstuffs and on imports: the Soviet Union has had to buy large amounts of grain on the international markets. Its purchases in the West have already exceeded the 20 million ton mark at a cost of over 3 milliard dollars.

9. The 7.5% increase in the industrial output index (as compared with 8% in the previous year) and the 5.9% increase in productivity (compared with 6.6%) are noteworthy performances when compared with the achievements of the industrialised Western countries. However, results vary considerably from one sector to another.

10. In the case of light industry, none of the targets was achieved except for television sets. The priority traditionally given to heavy industry and plant again carried the day. Additional proof of this is afforded by the fact that retail sales were below the Plan targets (up 36.5% as compared with the 41.8% forecast).

11. Industrial production of capital equipment was more satisfactory. Investment programmes (at least those which had been scaled down) were carried out in full. However, according to Mr. Baibakov, some ministries which exceeded their sales volume targets failed lamentably to produce certain goods for which there is a critical need. Indeed the level of production of different types of capital goods (trucks, tractors, excavators, building equipment) apparently caused by delays in bringing additional production capacity on-stream, has been sharply criticised in official quarters.

B. Results of the Ninth Five-Year Plan (71-75)

12. The results for 1975 - the last year of the 1971-75 Plan - provide confirmation of earlier evidence that Soviet economic growth has slowed down by comparison with previous five-year periods and that increasing difficulty is being experienced in achieving planning targets.

Two very poor harvests (in 1972 and in 1975) reduced the actual expansion of agricultural output to 12.9% as against the target of 22%.

Despite the support given to agriculture, this sector remains the Achilles' heel of the Soviet economy. While it employs more than a quarter of the civilian labour force and, above all, absorbs over 26% of overall investments (128 milliard roubles out of a total of 500 milliard during the period 71-75) its value-added is only about one fifth of total production.

13. Although the Plan provided at the outset for a higher rate of growth in the consumer goods than in the heavy industries sector (48.6% as compared with 46.3%), in fact the opposite happened. With the exception of 1971, targets for light industry were never achieved while investment programmes were carried through in compliance with the provisions of the Ninth Plan. As a consequence, and at the end of a long period of relatively steady growth, the Soviet Union has raised itself to a level where its potential is equal to one half of United States potential (as compared with less than one third as recently as in 1950). Its production of oil, steel, cement and fertiliser is now greater than in the United States.

14. While the Soviet economy is therefore "healthy, certain of its basic elements are holding up progress by the sheer force of their inertia"(1). One of the more serious problems is that the productivity of capital is declining while new injections of labour are getting steadily smaller. Labour discipline leaves much to be desired and the absence of material incentives acts as a brake on labour efficiency. The quality of production is also poor. "These weaknesses are becoming an increasing drag on the economy and must be remedied as a matter of urgency if the future is to be regarded with optimism"(2).

C. Prospects for 1976-1980

15. In preparing the new Five-Year Plan, the Soviet leaders have set themselves lower and more realistic targets than in the past. "Less but better" has become the order of the day and improvements in labour productivity and in the quality of output are the new priorities.

16. The Plan provides for a noticeably slower rate of growth by comparison with the 1971-1975 Plan. In particular, planned increases in the national product (24-28%), suggest an average annual rate of growth of GNP of 4.4 to 5% in real terms. Evidence of this lowering of sights is apparent in all the major aggregates. Labour productivity is intended to account for 85-90% of the increase in the national product.

17. The lower volume of planned investments, up by 25% as compared with 41% for the period 1971-1975, can be explained in part by the cautious attitude of the planners towards expenditure, to take account of inflationary factors, and also by the shortage of basic products, particularly fuels, needed for industrial development. To get round this difficulty, the Soviet Authorities plan, over the next five years, to raise the level of investment in Siberia where operating and infrastructure costs are extremely high.

18. The 30% growth target in the consumer goods sector (making an average of 5.4% per annum) will be hard to reach particularly in view of the very modest increase of 2.7% planned for 1976 in Group B: a yearly increase of about 7% in the remaining Plan years would be necessary, a figure well above the average increase in the Net Material Product. However, 1976 may also be the year for replacing obsolete equipment in the light industry sector as well, in which case a strategy designed to achieve a better balance between quantity and quality might have a greater chance of success during the last four years of the Plan.

(1) Speech by Mr. Baibakov, Vice-President of the Council of Ministers and Chairman of the Gosplan, fourth session of the Supreme Soviet, 2nd December, 1975

(2) Speech by Mr. V.F. Garbuzov, Minister of Finance, fourth session of the Supreme Soviet, 2nd December, 1975

D. Prospects for 1976

19. The volume of industrial production is scheduled to increase by only 4.3% in 1976 as compared with 7.5% in 1975, a development which can probably be explained by the desire to bring about improvements in production and management methods as well as the quest for higher productivity from new investments and for better quality in the goods produced. More specifically, the rate of expansion in heavy industry (Group A) will be not more than 4.9% and in the consumer goods industry (Group B) not more than 2.7%, as already stated. This low percentage rate of increase is the consequence of the inadequate agricultural yields which followed the poor harvests in 1975 and of the delay in bringing new productive equipment on-stream.

20. Initial reports on the 1975-1976 winter harvest, likewise discouraging, point to a probable shortfall of 25% of the output planned. Meat production will begin to fall short of consumer requirements by the end of the summer and meat will probably have to be imported. The large-scale purchases of wheat, mainly from the United States, which were made in 1975 are expected to be repeated this year. The total volume of Soviet purchases during the period July 1975-September 1976 can already be put at over 30 million tons.

21. Capital investments will increase by 4% in 1976 with a quarter of the total amount channelled, as in the past, into agriculture. The remainder will go to meet the requirements of the national economy in the fields of oil, metals, electricity and metallurgy. Funds will also go towards the development of the consumer goods industry. 64% of the total amount (i.e. 5.1% more than in 1975) will be used for the replacement of plant and for the rebuilding and development of existing enterprises.

22. Following the increase in national income, per capita income is scheduled to increase by 3.7% (as compared with 4.2% in 1975). The average monthly earnings of the factory worker and office employee will climb to 150 roubles (an increase of 2.7%) and those of a farmer will go up to 98 roubles, an increase of 5%. In consequence, the 1976 percentage increase in per capita income will rise faster than the production of consumer goods, leading inevitably to a widening of the inflationary gap.

II. INTERNATIONAL TRADE AND THE CURRENT EXTERNAL BALANCE

23. During the period of the preceding Five-Year Plan, the Soviet Union made a considerable effort to diversify its exports. This effort notwithstanding sales of energy and

basic products, both to its COMECON allies - whose main needs it continues to meet - and to the industrialised countries of the West, continue to hold pride of place.

Exports of oil and primary commodities, payable in convertible currencies, only partly covered Soviet imports, mainly of plant and machinery, and in some years its trade balance was adversely affected by the poor grain harvests. Thus, the trade gap of about half a milliard dollars at the beginning of the Five-year period, widened to 1.4 milliard in 1972 and to 1.7 milliard in 1973. In 1974, export earnings improved as a consequence of the increase in world commodity prices and the convertible currency gap then dwindled to 912 milliard dollars.

24. In 1975, the severity of the Western recession in the first half of the year, the shakiness of the economic recovery in the second half of the year and the reversal of the terms of trade which hit commodity exporting countries did not allow the USSR to improve very substantially on its 1974 export performance. On the other hand, imports of capital goods - which increased during the final year of the five-year plan, rose by 1.5 milliard dollars and it also became necessary to buy more grain to offset the poor harvest that year. The convertible currency deficit rose to 4.7 milliard dollars. A large proportion of this deficit - about 2.5 to 3 milliard dollars - was covered by credits and by drawing on currency reserves. Soviet Euro-currency holdings in London fell from 1.3 milliard to less than 800 milliard dollars while drawings on medium and long-term credits are reported to have passed the 1.4 milliard mark. In addition, several loans were obtained or are being negotiated on the Euro-currency market, including three five-year consortia loans for a total of 750 million dollars.

25. As for 1976, it seems likely that Soviet trade with the industrialised West will continue to grow, possibly by the 13.5% provided for in the Plan. Grain imports are going ahead as quickly as they can be unloaded in Soviet ports (2.2-2.5 million tons a month). The Soviet Union can also be expected to increase its purchases of industrial equipment in the United States in the course of the year. Trade between the USSR and other Western countries should also continue to increase since transfer of technology will be of increasing importance as a stimulus to economic development.

It seems probable, moreover, that during 1976, the Russians will continue to finance their purchases of capital goods from export credits or through the international money markets.

THE EAST EUROPEAN COUNTRIES

A. 1971-1975

26. During the period 1971-1975 the NMP growth rate either reached or exceeded the planning targets throughout the area. The big expansion in the Polish and Romanian economies helped to push up the average. The increasing industrialisation in Romania, particularly since 1972, has gone hand-in-hand with a noticeable improvement in labour productivity, which can be ascribed to the greater use of advanced technology. Imports of capital equipment and technology from the West largely contributed to this performance.

27. The inflation and recession with which the West has been having to contend since 1974 have variously affected the economies of the People's Republics. There was a serious worsening of their terms of trade with the Soviet Union - which used the rise in world prices as an opportunity to boost the price of some of the basic commodities it sells them - but also with Western Europe, partly as a consequence of the rise in the cost of industrial commodities. At the same time, Eastern Europe's exports were affected by stagnating demand in the West.

28. These factors go some way towards explaining the slower expansion in these countries in 1975. The authorities have taken this into account in their planning for the period 1976-1980, for which they have set more modest and realistic targets. In view of their growing convertible currency debt burden - which exceeds $15 milliard and makes debt servicing more and more onerous - these countries may have difficulty in paying for the imports required for their development programmes.

29. During the next five-year period there will almost certainly be price rises and the living standards are likely to mark time as a result of the expected slowdown in the expansion of production and consumption.

B. DEVELOPMENTS IN INDIVIDUAL COUNTRIES

(1) **Romania**

30. Production made great headway in 1975, with national income rising by 9.8%. Although this was below the 14% target, it did not prevent the fulfilment of the average growth target for the period (11.3% for a forecast of between 11 and 12%) and was the best result in Eastern Europe. The flooding which caused heavy damage to crops and industry was responsible for the non-fulfilment of some of the targets. Agricultural output, for instance, was only 2.5% higher than the fairly low 1974 level. Industrial production is expected to rise 10.2% in 1976 as against

15% in 1974 and 12.4% in 1975. Among the industrial sectors, the chemical industry - where output is expected to rise 18.5% during 1976 - will continue to pace Romania's industrial development.

(2) Bulgaria

31. Bulgaria, with one of the lowest per capita incomes in COMECON ($1,500 to $1,700), has reached the targets for agricultural and industrial development set under the 1971-1975 Plan. The average rise in agricultural output was 3.5% and in industrial production 9.1%. The 1975 results (7% and 9.9% respectively) even indicate an acceleration of the rate at the close of the period; NMP reportedly increased by 8% in the same year, which is the rate recorded for the period as a whole.

32. This performance is partly attributable to Bulgaria's special relationship with the Soviet Union, which is estimated to have granted Sofia $2 milliard in financial aid. This would cover more than 25% of the country's new industrial investments; 80% of foreign trade is carried on with the Soviet Union.

33. Contrary to what is the case elsewhere, the new 1976-1980 Plan calls for no slowing down in growth, an NMP growth rate of between 8.2 and 8.7% and an industrial growth rate of between 9.2 and 9.9% a year is expected.

(3) Hungary

34. The growth of NMP over the 1971-1975 five-year period is only slightly lower than that for the previous Plan (6.2 as against 6.8%), although it went up by only 5% in 1975.

35. From 1970 to 1975, industrial production went up at an average annual rate of 6.5% (as against 6.3% during the previous five years), with a fall-off to only 5% in 1975. Like Czechoslovakia and East Germany, Hungary sees no serious chance of increasing its agricultural working population, so any big increase in the output of this sector can only come from improved productivity. This is a permanent headache for the Hungarian agricultural planners.

36. The 1976-1980 Plan calls for increased technological inputs, better labour productivity and savings in energy and raw materials of which Hungary has none. It also provides for greater integration with the other COMECON countries. During the period in question, real income should rise by between 18 and 20%, i.e. by a maximum of 3.7% a year, and wages by between 14 and 16%, or 3% a year at the most. These figures are well down on those of the previous Plan, which provided for average annual

increases of 11 and 7% respectively. This is explained by the fact that domestic output of consumer goods and foodstuffs falls far short of demand, with the result that the growth in the purchasing power of the population has to be reduced accordingly.

(4) Poland

37. By increasing average incomes by around 40% since 1971, making far more goods available to the consumer and modernising industrial plant, mainly by means of imported technology, in terms of overall economic growth Poland has become a pacemaker within COMECON. The average NMP growth rate between 1971 and 1975 was 9.8% and that of industrial output and investment 13.6%, which is far and away the most achieved by any COMECON member. One of the highest priorities after production was the acquisition of foreign currency on the international markets to pay off the external debt burden which rose from $1 milliard in 1971 to around $7 milliard in 1975.

38. The 1976-1980 Plan provides for continued dynamic industrial development, although the authorities are aware that this will only be possible through improved productivity, better industrial management and the use of all available human and material resources. The average annual NMP growth will be lower than it was during the period 1971-1975 (between 7 and 7.3% for 1976-1980 as against 9.8%), the growth rate of industrial output should be between 8.2 and 8.5% as against 10.7% and the average rate for agriculture is net at 3%, although the Plan calls for an expansion of the cultivated areas, bigger wheat and fodder output, an increase in herds and the promotion of agricultural mechanisation.

39. Lastly, the planned increase in investments of 5.8% for 1976, compared with the 2.2% achieved during the period 1971-1974 and with the 14% in 1975, points to a noticeable deceleration in their growth rate; similar trends are observable in the manpower sector, where the planned increase in the labour force is 9% compared with the 19% claimed for the period 1971-1975.

40. The Foreign Trade authorities have announced that Polish exports of raw materials and finished goods will increase during the next five-year period as a result of the improved economic situation in the West, with which Poland does 50% of its trade.

(5) Czechoslovakia

41. The official results of the 1971-1975 Plan show that in terms of net material product, industrial output and, to a lesser extent, agricultural output, the planning targets

were reached or exceeded. The figures for 1975 reveal that NMP increased by 6% compared with 1974, as did industry, whereas agricultural output marked time (under 0.7%) for the first time in the period concerned. Investment in the construction sector was again disappointing.

42. Trade with the market economy countries plummeted, with the growth rate dropping from between 30 and 35% to 0% as a result of a fall-off in imports from all trading partners for the second year running.

43. Among growth indicators for the next five years, Party Secretary Husak referred specifically to an increase in NMP of between 27 and 29% compared with 30% for the last Plan period, in industrial output of 34%, compared with 35% and in investments of 31%, which is the same as for the years 1971-1975. Basic priorities for the next five years include greater labour efficiency, energy savings, lower production costs and improved industrial technology in a country with much outdated plant and equipment.

44. One big problem to be faced during the next Plan period will be how to obtain greater increments in value-added in the processing industries and, at the same time, to improve the quality standards of exports. This is all the more important because of the unfavourable trend in the terms of trade, reflected by the appreciable rise in the price of oil and the other primary commodities which the country completely lacks.

(6) German Democratic Republic

45. The GDR's economy remains the strongest among the People's Democracies. According to the information available at present, the 1971-1975 Plan performance (NMP up by an average of 5.4% a year as against 5.2% during the previous Plan period; industrial output up by 6.4% compared with the previous 6.5%) show that East Germany has maintained its headway in terms of NMP and industrial capacity. The slow-down in economic growth in 1975 was partly the result of bad harvests which forced the GDR to purchase 3 million tons of grain abroad, far more, per capita, than the Soviet Union. As for industrial production, its 1975 growth rate also slackened thus reflecting the general COMECON rate; it increased by only 6.4% against the 1974 figure of 7.4%.

46. The 1976-1980 Plan targets assume a 5.5% average annual increase in NMP, with industrial output expanding rapidly at between 6 and 6.4%. In the agricultural sector, emphasis will be put on the achieving of economies; it is not planned to increase herds so as not to have to import greater quantities of costly animal feed. At the same time,

there are to be substantial increases in meat and milk yields. The realignment of intra-COMECON prices has had an adverse effect on the GDR's terms of trade; according to official statistics, the cost of oil bought from the Soviet Union rose three-fold during the last two years. It appears that the GDR pays 45 roubles a ton for oil (including 2 roubles to cover transport by pipeline) whereas Hungary and Czechoslovakia are charged only 39 roubles. However, during the next five years, the GDR will be allocating some 3% of all its investments to development projects inside Russia which are supposed to be offset by an increase in imports of primary commodities from that country. All this is bound to generate financial pressures which the Plan seeks to counter by insisting on economies in the use of basic commodities and a better use of manpower.

(7) COMECON

47. During the last Five-Year Plan period, the realities of the new economic situation led to a strengthening of links between the People's Democracies and the Soviet Union within COMECON. There is every reason to believe that the period 1976-1980 will see an even higher degree of integration, based mainly on industrial specialisation. The COMECON partners have dovetailed their new Five-Year Plans with that of the Soviet Union. Except for Poland, which has extensive coal and copper reserves, and for oil-rich Romania, the East European countries have little energy and raw material resources and rely permanently on the Soviet Union (Soviet energy and primary commodity sales to the East European countries in 1975 were worth $5 milliard). The Soviet view is that increased participation by its East European satellites in the harnessing of its oil and raw material resources is a precondition for boosting supplies to these countries. Some ten very large-scale COMECON joint investment projects worth more than $13 milliard are now under way. These include the Orenburg oil pipeline for which the COMECON's International Investment Bank recently granted a $600 million loan. But although the East European countries will not reap the benefit of the production resulting from the implementation of these projects until well after 1980, it is during the current Five-Year Plan that they will have to bear the financial burden of investing in the Soviet Union. It follows that they will have fewer resources available for domestic capital investment and for the consumer sector. On the other hand, the increased integration will remedy the medium-term problem of a shortfall in energy and raw material supplies.

48. Finally, mention should be made of a new trend which began in the context of Soviet-Hungarian trade and which takes the form of an increase in convertible currency business among

COMECON members. There is a ten-year agreement under which the Soviet Union will provide additional quotas of crude oil and other primary commodities in exchange for wheat and beef. Since the demand for these last two categories is strong on world markets their prices are to be tied to those obtaining on the Western markets instead of being established in accordance with the technique of "special prices" denominated in roubles which is normally applied to intra-COMECON trade.

49. Since Soviet energy supplies do not cover the normal needs of the Eastern Europe, countries other than Hungary also may very well have to sign similar agreements to meet hard currency shortages, thereby further increasing their dependence on the Soviet Union.

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