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ECONOMIC COMMITTEE

APPRECIATION OF THE ECONOMIC POSITION OF NATO AND WARSAW PACT MEMBER COUNTRIES FOR THE PERIOD THROUGH 1984

Note by the Chairman

The attached appreciation of the economic position of the member countries of NATO and the Warsaw Pact for the period through 1984 has been prepared in accordance with a mandate given by the Defence Planning Committee in DPC/D(71)10.

2. The study prepared by the Economic Directorate consists, in addition to a general introduction, of two main chapters. The first examines the general prospects of the economies of Allied countries and of those of the Pact; the second considers the implications for the defence effort of the economic evolution. Statistical annexes have also been prepared.

3. To allow the Economic Committee to go ahead with its review of the report, the general introduction and the first chapter are being distributed separately. The rest of the document, the preparation of which is practically finished, will be circulated shortly.

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GENERAL INTRODUCTION

This review has been carried out pursuant to the instructions in DPC/D(71)10 which call for an assessment by the Economic Directorate of the likely economic situation in the NATO and in the Warsaw Pact countries in the period covered by the military assessment, together with comments on probable trends in military expenditures.

2. The present paper is the third in the series. It has been prepared in economic circumstances as complex and as difficult as those prevailing in the Autumn of 1974 which was the period covered by the previous survey. In the West, the medium/long-term expansion which constituted the distinguishing feature of the 60s and the early 70s has been halted for over two years and has given way to a less buoyant, more uncertain, situation. The signs of recovery which appeared in 1976 in the developed and market economy countries were not as strong or as firm as had been hoped and international economic and financial transactions are being conducted in a climate of relative instability. In the East, there has also been a slackening of growth and tighter conditions have been forecast for the period 1976-1981. Simultaneously the indebtedness of the Eastern countries vis-à-vis the convertible currency countries is rising steeply and may force those in the Soviet sphere of influence to restrict certain vital imports, thereby engendering new economic, and even social, difficulties.

3. To reduce some of the difficulties inherent in projections as lengthy - going up to 1984 - and as tentative as these - given the short-term uncertainties which overshadow future economic policy - it seemed advisable to distinguish between two major sets of factors: on the one hand, the relatively stable factors constituted by production potential and traditional trade patterns (stability does not in the present circumstances rule out vulnerability and sharp fluctuations in costs) and, on the other hand, those which hinge on economic policies, and are the result of a deliberate choice at national and international level, involving levels of employment and prices, inflation, public expenditures and international payments. Certain prospects for international relations have also been considered.

4. As regards basic factors, four types of resources have been taken into account: manpower, both quantitative and qualitative, additional investment capacity, the probable rate of technical progress capable of increasing productivity, the availability of basic commodities and the quality of international trade. These factors determine the potential economic growth of each of the two blocs.

5. Real growth over the period under review will depend not only on these factors but on the ability of national leaders to preserve or achieve a balance in certain fundamental areas: labour, the allocation of resources as between consumption and investment, prices - implying the control of inflation, public expenditure and the balance of payments (although the Eastern countries adopt extremely rigid Plans). The difficulty of striking these balances will be proportionate both in the East and in the West, to the tensions generated by the difficulty of investing on a large scale, of spreading the new technologies, of balancing foreign trade and of holding down social claims. However, while some problems are shared by both major groupings, others are less acute in the East, as for example employment, inflation or social pressures; others, on the contrary, create more serious problems such as the choice of investment or the stimulation of productivity.

6. Moreover, in a changing world, each of the two groupings will meet with varying success in its attempts to build up trusting and smooth economic relations with the rest of the world, a sine qua non for the security of supply in the case of Western Europe and essential in any case to the preservation of a stable international order without which regular growth, even on a limited scale, would be in jeopardy.

7. Within each grouping, too, the nature of economic and monetary relations between member countries will have an effect, either favourable or unfavourable, on the cohesion of the unit.

8. These four categories of variables: fundamental growth factors, economic assumptions, pull on the rest of the international community, probable cohesion within each bloc, will be examined in turn within the context of the two groupings before any attempt is made to forecast military expenditure. The situation in the Soviet blocwill be taken first, the assumption being that NATO's defence potential will have to adapt to NATO's defence programmes rather than the reverse.

9. The refinement of forecasts raises the problem of methods. While it was possible to make growth forecasts for the period 1976 to 1980-81 by using on the one hand the Five-Year Plans and on the other hand OECD studies, in other words two types of relatively similar forecasts incorporating certain general economic policy options (more precise in the East than in the West), there was nothing to underpin 1980-81 to 1984 projections except the fundamental growth factors defined above and the extrapolation of foreseeable, end-of-decade, growth trends. A careful distinction has therefore been made between the two sub-periods.

PART I

Economic outlook in the NATO countries

10. Strong potential growth factors will be a continuing feature of the NATO countries during the period 1977-1984 in the shape of human resources, capital resources and new technological breakthroughs. The growth process will however continue to be heavily dependent on supplies of raw materials and particularly energy, which are both costly and relatively vulnerable.

I - Growth factors

Human resources

11. The population of the NATO countries, 554 million in 1975 including 318 million in the NATO Europe countries will continue to increase at an average yearly rate of about 1% topping 610 million and even coming close to 620 million in 1985. These figures compare favourably with the figures for the Warsaw Pact where the total population is much smaller (360 million in 1975) and will continue to grow at the same rate as in the NATO area to 394 million in 1985.

12. In Europe, the population increase will be greatest in Turkey (2.5% per annum). In most other countries in the area there will be only a small or zero rate of demographic growth and even a negative rate in Portugal and possibly in the Federal Republic of Germany.

13. The working population which alone constitutes a growth factor, will increase from around 350 million to some 392 million in the NATO countries, making an average rate of increase of 1.2% per annum which is about the same as in the Warsaw Pact countries (about 1%) with slight differences from one country to the next, except Turkey where the average yearly increase will probably be about 2.8%.

14. Additional manpower resources will therefore have less of a bearing than hitherto on the process of expansion. Furthermore, and if growth is generated mainly by new industries which will be less vulnerable than the others (textiles, light engineering and so on) to competition from countries only embarking on industrialization, fresh arrivals on the labour market from the Southern part of the Alliance may have difficulty in finding jobs either locally or as emigrants.

15. Mobility of labour either in the form of migration or in the form of transfers to other jobs will play an important part in bringing pre-1974 growth rates back. If a high degree of productivity is to be obtained, the willingness to acquire new skills will have to be matched by a continuous effort to prepare and train the work force to meet new market requirements.

16. Despite the foreseeable difficulties of adapting the work force in the NATO countries, and more particularly in Europe, to the new demands of growth during the period under review, there can be no question about the qualitative superiority of this labour force over the working population of the Warsaw Pact countries. As explained further on, the problems of regional migration and of the adaptation of the labour force to new forms of industrial development is keenly felt in the East and act as a break on both productivity and growth.

Additional investment capacity

17. Overall demand should, in all likelihood, remain relatively high in the NATO countries given the volume, the diversity and a certain transformation of requirements. These will remain extremely varied, some of a social nature, others stemming from urban development, others still arising from the prospection for new resources and the protection of the environment or else from the need to increase research/development and innovation or to cover the higher cost of energy and commodity imports by greater exports.

18. With the growth of the labour force restricted to 1.2% per annum, new investments together with increased labour and capital productivity will constitute the main growth factors.

19. In 1976, productive capital in the NATO zone was well above the level obtained in the Warsaw Pact area. This quantitative advantage should persist though on a somewhat reduced scale. In fact, the rate of growth of this stock of capital has dropped markedly in recent years and, in any case, more steeply than in the East, for a number of reasons which include the reduced share of profits as a proportion of receipts.

20. The propensity to invest could well remain slight if the present trend towards lower profits continues. In addition, the relatively slow growth of the population and the slow-down in the flight from the land combined with a certain saturation of available housing, will act as a break on new building. Should the proportion of fixed capital remain unchanged in relation to gross domestic product, industrial investment could go up more sharply. This increase will be all the more necessary in view of the fact that heavy investment on the protection of the environment and on the development of energy resources will be required throughout the period under review.

21. However, the existence of idle capacity at the start of the period, estimated at about 20% at the end of 1976 in the case of the most powerful of the Alliance countries, should allow for a fairly sustained period of expansion in the traditional sector even though financial capital remains scarce. On the other hand, the need for finance will grow rapidly in step with the launching of new investment programmes.

22. This overall view must however be adjusted in the light of the disparities between the different countries as regards the volume and effectiveness of available per capita productive capital. These disparities which influence the productivity of national industries may well grow inasmuch as such financial capital as there is may be attracted towards economies and industries which are competitive because of the advantages which they derive from economies of scale, technological advances, innovative capacities and the capability to invest extensively in research and development.

Probable rate of technical progress

23. The NATO countries have an undeniable lead over the Warsaw Pact countries in the field of civilian technology to which the present study is confined. This lead is borne out by the large surplus on trade in capital goods with the rest of the world and more particularly with the Warsaw Pact countries (which in 1975 accounted for $4.5 milliard-worth of exports of this type).

24. This superiority seems unlikely to be challenged since the efforts put into research/development and innovation in recent years has produced a number of potential spin-offs for the period under review in areas as wide apart as new metallurgy, biochemistry, communications and management methods.

25. In addition, the direct or indirect productivity gains to which it will give rise and the prospects of harnessing new resources which it may open up, mean that this technological lead represents a growth factor which must in no case be overlooked.

Energy and raw material resources

26. The steep and repeated increases in oil prices applied by the OPEC countries, initally after the Yom Kippur War and then in response to the rise in world prices of capital good exports, increases which were matched by rises in a large number of raw materials, have had a strong impact on the terms of trade to the detriment of the West and, ipso facto, of the NATO countries. In addition, and within the context of the present international situation in the Near and Middle-East and in Africa, the sources and lines of supply of the Alliance countries, particularly its European members, have become vulnerable.

27. There is no likelihood of any change in the situation until 1980 at the earliest. For the present and in the foreseeable short-term future, the distinguishing features comprise: 1) a cartel sellers' market with the vendors seeking, in the great majority of cases, to maximise their receipts. 2) increasing energy requirements, particularly for oil, engendered by the widespread growth of industrialization extending to the main oil exporting countries. 3) the relative scarcity of supply which prompts producers to present a common front on prices and quantities. 4) the relative inertia of the West which partly because of the high marginal costs of prospection and exploitation are hesitant to embark on a quest for alternative sources of energy.

28. The situation in Norway and to a lesser extent in the United Kingdom, is beginning to look up following the gradual harnessing of domestic resources. In the case of the United States and the Federal Republic of Germany, there is little cause for concern given the economic, and in particular the financial, strength of those two countries. On the other hand, countries like Italy and even France and, generally speaking, the countries of southern Europe which have no oil of their own and which are continuing to build their industrial growth on the this form of energy are at a serious disadvantage which could increase if international competition were to become more acute.

Estimate of potential growth

29. The conclusion to be drawn from this survey is that the growth factors in NATO countries are considerable, but unevenly spread. By comparison with the years of buoyant economic expansion (1960-1973), the situation and outlook are less favourable, both as regards the working population whose skills are now always in line with requirements and as regards access to sources of energy and to the basic products which have become more vulnerable and more costly since they must be paid for by higher exports which make corresponding inroads on availabilities. On the other hand, the NATO countries can rely on a considerable fund of potential new technology and on substantial idle capacity in terms of both manpower and capital.

The combination of all these factors should lead to further productivity gains in a number of sectors and generally speaking to steady growth.

30. This being so, the potential rate of growth up to the end of the decade can be put at 5% and perhaps 6%. A forecast for the period 1981-1984 is more difficult however since the number of unknowns is greater, viz: the volume of available capacity in 1980, the drain on resources constituted by the redistribution of resources in implementation of social policies, the protection of the environment, foreign investment, investment propensities, trade situation. It would seem wiser therefore to anticipate a slightly smaller potential average growth rate for that period.

II - Economic options

31. Following this evaluation of potential growth, three major questions must be answered. The first relates to the conditions in which this rate of growth can be achieved, in other words, to the chances in the NATO countries of reconciling fairly substantial growth with the preservation of a fundamental balance of prices, public expenditure and payments; the second is whether growth on this scale would solve the employment problem in the Alliance countries, a problem which, were it to continue, could undermine their political and social structures. The third question relates to the chances of spreading this growth throughout the Alliance with the major industrial powers acting as the motive force. This propagation is essential to the continuing cohesion of the Alliance; it would likewise play a positive rôle in the improvement of the employment situation in the less-developed Alliance countries.

32. There is even a fourth question; namely, whether the relations between the Alliance and the rest of the world, particularly the less-developed countries, will be such that international trade can expand peaceably, if not buoyantly, and will not cause political tensions which could have a grave effect on the NATO countries' security of supply.

Inflation and rising prices

33. The inflation which was a feature of the early Seventies has continued to undermine the economies of most Alliance countries where it is fuelled by rising prices and the enormous public sector deficit. While it is true that the rate at which price increases dropped between 1975 and 1976 from 11.3 to 7.5 per cent OECD-wide, this rate is still twice as high as

it was during the Sixties. The OECD outlook for 1980 is based on the forecast of an average price increase of 5 per cent that year. In 1977, this rate is only likely to be achieved in Germany and in Switzerland. The efforts made in most of the other OECD countries to draw closer to this figure could well lead to higher unemployment. The system of floating exchange rates adds a further element of fluidity by removing the brake on monetary upheavals in the form of fixed parities.

34. Certain inflationary pressures could die down during the period under review such as, for example, increases in labour costs (which are normally held in check during periods of unemployment but which could resume their upward course in the event of a sudden recovery) and excessive domestic demand. On the other hand, the recent and foreseeable increases in the price of oil and other basic products will push up costs and because the producers enjoy additional revenue this will contribute to an increase in demand (external demand which will help NATO country exports).

35. The outlook therefore is one of continuing inflation which will however slow down by comparison with recent years without perhaps settling down at about 5 per cent before 1980. This average rate will inevitably embrace sharp discrepancies, particularly between the industrialized and the southern European countries and there will be a number of intermediate stages. The case of Norway will be a special one inasmuch as the upward pressure on prices may be fuelled by the oil boom.

36. The revamping of the international monetary system and the return to more stable exchange rates would obviously contribute to internal monetary stabilisation in member countries but this solution will be pointless unless matched by some co-ordination of economic policies, failing which monetary commitments would have to be paid for in some instances by an extremely high level of unemployment.

Public finance

37. The recession has led to a slower rate of increase in fiscal receipts but also to a much larger redistribution of resources for social or economic ends, to provide a guaranteed income for the unemployed and in some cases assistance for firms in difficulty. As a result, there were large public-sector deficits in most Alliance countries in 1976 and these deficits constituted a further inflationary factor.

Balance of Payments

38. The steep rise in the price of oil and other commodities at the end of 1973 sparked off a big and widespread deterioration in the terms of trade of the Alliance countries which was only partly off-set by the subsequent increases in their export prices. The recession added to the imbalance by hampering the exports of the smaller Alliance countries to the hard currency countries. The recovery which took place in 1976 stimulated sales to some extent but also generated an increase in imports, particularly of energy. The 1976 deficit of the NATO Europe countries could therefore total $12 milliard as compared with $5 milliard in 1975 and $13 milliard in 1974, which was the peak year. In the United States alone, the 1976 deficit could total some $8 milliard whereas in 1975 there was a surplus.

39. In one of its recent forecasts, the OECD anticipated that the external payments and receipts of member countries would be balanced by 1980. This forecast is based, however, on an assumed increase of 4.3 per cent up to 1980 and of 4 per cent between 1980 and 1985; figures which would reflect a 33 per cent increase in demand for oil by member countries between 1976 and 1985 despite the eight-fold increase in the production of nuclear energy, the 45 per cent increase in the output of solid fuels and the 27 per cent increase in the production of natural gas. In the event of an annual growth rate of 4.8 per cent up to 1980 and of 4.5 per cent thereafter, requirements would increase by about 12 per cent, rising to 37 million barrels a day. However, these requirements could only be met from national resources up to maximum of 80 per cent in the case of the United States or of 50 per cent in the case of Europe (as compared with 40 per cent at the present time). The prospects for the OECD zone (and for the NATO zone) of balancing external receipts and payments are therefore somewhat limited. Furthermore, as in the case of inflation, these general prospects would mask extremely wide variations between the different countries which would be an aggravating factor. While the United Kingdom and Norway would be in an increasingly strong position, whereas the Federal Republic would keep its priviledged status and whereas the United States, because of its special international financial strength could cope with large deficits, the indebtedness of certain other countries, including Italy, Portugal and even France, lacking as they are in energy and basic resources - could reach a critical threshold which might compel their governments to adopt restrictive policies that would be harmful to expansion and generate even greater unemployment.

The problem of employment

40. At the end of last year, there were 14 million unemployed in the OECD countries which represented 5% of the working population, and there is little likelihood of any reduction in these levels in the short term. The growth forecast issued by the OECD in the summer of 1976 which was based on the assumption that fairly stringent anti-inflation and trade policies would be followed, gives an unemployment rate of about 4% for an average annual growth rate of 5% up to 1980. This rate or even a slightly higher figure would be acceptable if it were spread uniformly over the NATO zone. However, it is in fact an average rate taken from the OECD implicit model. In actual fact, and if international trade continues to be dominated by insufficient mobility of labour and capital, much higher rates of unemployment will prevail in the less-advanced economies, in those less able to stand up to international competition and again in those which overreact in their attempts to correct the situation through the adoption of deflationary policies. The Southern European countries have most to fear in this respect. Yet an unemployment level of 10% or more over a long period could have dire internal political and social consequences with possible adverse effects on the choice of defence policies.

Economic development and cohesion of the Alliance

41. This review of economic policy problems shows that the ability to cope with them successfully varies considerably from one country to another. The United States and Canada will undoubtedly continue to be faced with inflationary pressures and with balance of payment deficits but these are unlikely to lead to a serious economic crisis given their economic wealth and the privileged financial position enjoyed by the United States.

42. In Europe, the outlook is less promising although the situation will differ from one country to another, with Germany and Norway in the strongest positions. In most of the other countries, the growth of foreign trade supplemented, where appropriate, by different forms of co-operation and aid appears essential if the momentum of expansion is to be sustained in conditions where the national base has become inadequate. This judgement applies in particular to those European countries which will probably be coping simultaneously with public-sector deficits, trade gaps and unemployment and which can only hope to overcome their difficulties if neighbouring countries are once again willing to take their surplus manpower and products.

43. The OECD forecasts for the 1980 timeframe highlight the sustained level of trade and imports required of the United States which will continue to act as the main pacemaker for the world as a whole.

Table 1

OUTLOOK FOR WORLD TRADE 1975-1980 IN THE MAIN OECD COUNTRIES

	Growth of imports(a)		Growth of exports(a)	
	Average yearly rate of variation in volume			
	Early 1970s	1975-1980	Early 1970s(b)	1975-1980
Canada	10.3	8½	4.3	9
United States	5.4	9	9.8	8
France	11.4	11½	11.3	9½
Germany	10.8	9	11.0	8
Italy	7.9	7¾	8.4	9
United Kingdom	7.4	4½	6.8	7
Belgium	10.0	10	9.8	9
Denmark	6.7	6½	7.1	6¾
Netherlands	5.1	8	8.3	7½
Norway	7.0	4½	5.1	11
Total	9.0	8	9.5	8½

(a) Goods and services according to national accounts definition.
(b) For details of the periods taken into account, reference should be made to table 54.

As for the prospects of growth and price increases in the OECD forecast for the timeframe 1980, these also differ widely and in the most favourable circumstances the position for the ten NATO countries would be as follows :

TABLE 2

FORECAST OF GROWTH AND PRICES FOR THE PERIOD 1976-80

	Early 1970s	1974-1975	1975-1980	1975-1976	1979-1980
Canada	5.4	0.6	6	8 ¾	5 ½
United States	3.0	-2.0	5 ¾	5 [illegible]	4 [illegible]
France	5.3	-2.4	6	11	6
Germany	4.3	-3.4	5	3 [illegible]	4
Italy	4.5	-3.7	4 ½	17 [illegible]	7
United Kingdom	2.7	-1.6	3 ½	16 [illegible]	6
Belgium	5.0	-1.4	5	10	5 ½
Denmark	3.8	-0.8	4	9	6
Netherlands	3.8	-1.0	4 ½	8 [illegible]	5
Norway	4.3	3.3	7 ½ (c)		
Total OECD	3.9	-1.3	5 ½	7 ¼	5

(c) 4½ % excluding the oil sector.

44. Since then, prospects have deteriorated somewhat, mainly as a consequence of the scaling down of the 1977 overall growth rate to only 4 %, in relation to 1976. With the average rate at this level, certain of the Alliance countries face the risk of a low rate of growth leading to social and economic difficulties which could threaten the cohesion of the Alliance.

The Alliance and the rest of the world

45. Another of the conditions for prosperity in the Alliance countries during the period 1977-1984 is the development of international relations, particularly between the industrialised countries and the Third World in a climate of trust. The fact that a growing number of countries will start to expand as a result of the acquisition of technology, the investment in new areas of oil revenue and the probable increase in Western aid to the less developed countries means that world demand for energy and basic products will rise and that the difficulty of balancing the market will be heightened. In addition, the harnessing of new resources such as those on the seabed will only be appreciated and accepted by the less well-endowed countries which ipso facto, will get less out of such operations, on condition that they derive additional benefit from their trade with the rich countries.

46. In a situation of this kind, the West, and particularly the European countries whose major trade routes, particularly those round Cape Horn, are already relatively vulnerable, will have to take special care to protect their supply lines. Success in this endeavour will be commensurate with the increase in trade with the less developed countries and with the contribution which they make to the economic development and even to the harnessing of certain, as yet an untapped, resources in those countries. This means that there must be no deterioration in the terms of trade of the poorer countries which are already handicapped by a high level of indebtedness and have been deprived of the ability to make external payments following the increase in the price of energy and certain raw materials.

47. To stimulate the economic development of the less favoured nations, the richer countries will also have to step up their aid. As matters now stand, and in the years ahead, the advantage will lie with the West, and in particular with the NATO countries whose efforts are far greater than those made by the Warsaw Pact countries ($ about 1.9 milliard as compared with $ 0.9 milliard in 1974) and who will probably be able to draw on larger hard currency reserves over the decade.

48. The efforts and financial sacrifices which will have to be made by the West will be easier to bear if they are spread between the different countries in relation to their resources and capabilities. Effective co-operation in the West and particularly between the NATO countries is thus another prerequisite for success.

Conclusions with regard to the NATO countries

49. This brief review of the fundamental economic data which will probably determine the future of the NATO group of countries and of the economic problems which require solution, shows that there is a possibility of fairly strong growth. A potential rate of 5-6 % which seems feasible for the period 1976-1980 and even beyond and which, in the light of all the evidence, is the minimum compatible with the avoidance of grave crises engendered by underemployment, will however prove difficult to achieve as witness the very modest recovery at the start of 1977. New forms of economic policy will no doubt have to be devised if the countries are to throw off stagflation and to pave the way for growth beyond 1980.

50. In the domestic area, and particularly in the major industrial countries which act as pacemakers, there will be a need to stimulate innovation and capital formation, by fiscal and other measures which will likewise provide the basis for the improved distribution of the factors of production to meet demands of all kinds (protection of the environment, harnessing of new basic resources, redistribution of resourses to social ends and so on). This policy will have to be combined with measures to boost employment and keep up a high rate of domestic demand while avoiding the pitfall of excessive inflation.

51. On the international scene, the sine qua non for such growth will be increased co-operation particularly within the OECD group of countries, so that the beneficial effects of growth and improved employment figures in the economically and technically more advanced countries, particularly the United States, spread to those countries which do not share the same potential assets and protect them from excessive distortion of their balance of payments or labour market.

52. The capacity of the NATO countries to preserve and even to increase their defence effort will obviously hinge on the pace of economic growth but will also depend on the ability of States to ensure that excessive overall demand does not force them to introduce public expenditure cuts which would inter alia affect the military budgets.

53. The problem of the volume of resources required for defence can however only be tackled in the light of an analysis of military expenditure trends in the Warsaw Pact countries during the period under review. This matter is discussed in fine.

PART II

Economic Prospects in Warsaw Pact Countries

54. The aim of this Part II is briefly to describe the projected economic evolution based on the 1976-1980 Plans for the Warsaw Pact outlining possible strengths and weaknesses. The development of the economies of the Soviet Union and the East European countries has not been similar over the 1971-1975 Plan period; the former experienced a slowdown in growth over the previous period while the latter generally witnessed a satisfactory increase in their NMP despite the fact that in 1975 their performance was disappointing. The current Plan period 1976-1980 is marked by greater caution and by a scaling down in the rate of growth for all these economies.

I - Main Growth Factor

Population and Manpower

55. The population of the Warsaw Pact areas reached 360.3 million in 1975 and is projected to rise slowly to 393.7 million, or 0.9% a year, by 1985. This is a continuation of the slow growth trend registered which emerged in the mid 1960s. The population growth in the USSR will be slightly above this average or 1.0% a year and total Soviet population in 1985 will reach 280.4 million; East European growth will be somewhat lower at 0.69% per year and will reach 113.3 million*.

56. This low rate, coupled with the desire to maintain very large armed forces and general propensity towards over-employment in agriculture, factories and services, will mean that there will be difficulties in obtaining sufficient additional labour, though the size of the problem will vary from country to country. Severe manpower shortages will continue in Hungary and Czechoslovakia and NMP growth will have to occur almost solely through increases in productivity and new technology. Labour shortages will be less evident in Poland, the GDR, Romania and the USSR in the present Five-Year Plan period, although there will continue to be a shortage of skilled workers and absence of inter-COMECON labour mobility. It is unlikely that the system of "Gastarbeiter", prevalent in the West, will be established due to the on-going national and cultural differences within East Europe.

* Figures based on US Department of Commerce, Projections of Populations of Communist countries of Eastern Europe (Washington, 1976), and Joint Economic Committee (ed), Soviet Economy in a New Perspective (Washington, 1976) using the medium range.

57. In the Soviet Union, for which projections of the labour force are available, the working population will increase at an average annual rate of 1.2% between 1975 and 1985. However, in the case of East European countries, projections are only available for the population of working age (15 to 64 years); although this concept does not correspond to that of labour force, the trend over a decade is more or less similar in both cases. For the six East European countries, the annual average growth rate will be of 0.7% (highest rate for Poland: 0.9%; lowest rate for Hungary: +0.1%).

58. More serious for the Soviet Union, both economically and militarily, is the steep drop in new manpower availability after 1980 and the projection that the increase in the able-bodied ages will mainly originate in the less technologically-oriented Central Asia and Kazahkstan. In addition, there are the factors of the incessant urbanization, perennial housing shortage and soaring divorce rates which provide little scope for the population's growth rate to improve. Given the increased labour demand for the development of Siberian resources, the USSR also faces the need to solve the problem of persuading workers to remain in Siberia and not to return to the relative comforts of European Russia. If this difficulty is not overcome, Siberian development may be seriously hampered.

Investment Patterns

59. Over the 1976-1980 period, a slower, more cautious economic growth is anticipated in COMECON countries with targets generally below 1971-1975 results. With growth prospects reduced, the average yearly COMECON investment increase will drop from 9.6% in the last plan period to 7.4% in 1976-1980, and the amount of new construction will drop quite fast. In the case of the USSR and Poland, targets are dramatically lower than those of 1971-1975. There are several reasons for these lower investment projections: the low factor productivity in the investment structure (i.e. poor labour productivity, under-utilization or obsolescence of equipment, lack of spare parts, general deterioration of the economic value of land due to erosion, poor fertilizers); the scarcity of capital as the Pact's fast growing interest in foreign loans shows; the necessity to complete the large number of unfinished projects rather than continuously embarking on massive new ones as had been the pattern of the past, and the increasing cost of raw materials, energy supplies and manpower which require much more judicious use of existing assets. Lastly is the realization by all countries that substantial investments do not always guarantee success but rather may encourage waste and inefficiency. The 1976-1980 Plans are determined to avoid following this pattern.

60. The consumer or non-productive aspects will continue to languish as productive investments in 1976-1980 will make up 78 % of COMECON investment total of $ 1,287.7 billion (1). The stress on investment for COMECON will, however, vary according to the need for each member to remedy particular weaknesses. Both Poland and the USSR are allotting 30-34 % of their productive investment to agriculture in yet another effort to overcome the deficiencies; e.g. the share of capital inputs allotted to their industrial sectors will be considerably lower than in the case of the other COMECON countries, especially the GDR and Romania. Nevertheless, industry will still have first claim on investments and most countries have realized the need to increase investments in fuels and raw material supply, expansion of metal and engineering industries, as well as the chemical and electronic sectors, and continued purchase of Western technology.

Technology and Productivity

61. The Warsaw Pact suffers in the civilian sector from technological backwardness in comparison with the West, in particular in regard to automated production technology. Obsolescent plants, lack of incentives, non-diffusion of available know-how, poor market conditions, low educational standards in several countries, have all contributed to this in the past. It has become apparent that to compete and develop effectively the Warsaw Pact has to rely on technological imports from the West. Weakness has been evident in those fields that require very sophisticated R & D programmes and a market economy in which to test the products; electronics (computers, micro-circuitry), automated machinery, wood and mineral processing equipment, fertilizers, chemicals and all aspects of advanced hydro-carbon extraction. Moreover, and this applies more to the Soviet Union than to Eastern Europe, the system of incentives based on quantity instead of quality growth in the economy trends to have a negative effect on technical standards, innovation and resources at hand. There also exists a very weak link between institutional R & D and commercial exploitation by State enterprises as well as a lack of well-trained technical support personnel in both science and industry.

62. The principal aim of the planners apart from any covert military implications, is to incorporate the new technology into each country's industrial strategy , to improve efficiency and to raise labour and capital productivity. This is especially necessary for plan fulfilment in the GDR, Czechoslovakia, Hungary and the USSR . In the latter country, factor productivity in the GNP registered a minus growth of -0.3 % and contributed significantly to the drop in the growth level (2) during the period 1971-75.

(1) D. Lascelles, COMECON to 1980 (London, 1976), p. 17

(2) USA Delegation paper "Soviet economic plans for 1976-1980: A First Look", March 1976, p. 46 as corrected by Errata sheet.

63. Recent purchases in the West of entireplants (e.g. Kama truck factory) reflect a conscious bloc decision to forego expensive and time-consuming indigenous R & D. Examples of considerable economic COMECON progress made possible with Western technology are especially noticeable in the Soviet Oil/gas production in Siberia, using Western pipe, compressor stations and pumps. Hungarian agricultural output is increasingly dependent on specialized Western machinery. Another example is the projected increase in the Polish export trade based on new Western plants and equipment.

64. At the same time the Warsaw Pact shows a certain degree of economic co-operation within the context of various COMECON institutions such as Interinstrument, Interatompribor and others. Technological consultation and harmonization of long-term plans help eliminate some duplication of costly R & D or investment programmes; this is evident in East European contributions to the development of Soviet energy sources.

Energy and Natural Resources

i). Energy

65. The availability of energy for the USSR is not considered a major domestic problem area in the period under review, unlike Eastern Europe which is dependent upon the USSR, and the OPEC countries for oil and an increasing amount of natural gas. Nevertheless, for the Warsaw Pact as a whole, the huge natural energy resources of the Soviet Union as well as the on-going Soviet efforts to integrate COMECON joint energy projects, has given the Pact a large degree of self-sufficiency in the major fuel materials. The USSR is the world's largest crude oil producer, with an output forecast to rise by 5 % a year to 640 million tons in 1980. Natural gas production is scheduled to rise at an even faster rate with exports to reach over 60 billion cubic meters in 1980.

66. Soviet exports of oil to both East and West Europe will continue in 1976-1980. This trade gives the USSR a very definite economic leverage in East Europe and is the country's largest earner of hard currency ($ 3 billion in 1975). Although the West seems willing to meet Soviet requests for oil and natural gas technology imports necessary to expand output, a major difficulty facing the USSR could be the industry's inability to grow fast enough to meet the projected increases in both domestic and export demands: this could lead to shortfalls in supplies in the 1980s.

67. In addition, there is some doubt about the country's ability to meet the Five-Year Plan targets for electricity, as on-going administrative delays and inefficiency in the supply of the necessary power plant have delayed construction of both conventional and nuclear stations.

68. The energy situation in Eastern Europe will continue causing concern. This area has set itself two main goals: achieving large savings in fuel and power and adapting the energy balance to the new (higher) price structure set by both the USSR and OPEC. Principally this means reducing their dependence on hydrocarbons. Most countries are therefore busy reversing or at least halting the decline in coal production and consumption, and building thermal power stations. This, however, is not an easy task as coal is generally poor in quality (except for Poland), hard to extract (Czechoslovakia) or of limited supply (GDR). Consequently, East Europe is also going ahead with nuclear power projects using uranium from Czechoslovakia, Poland and the USSR, with Bulgaria presently taking the lead in construction of reactors.

69. The 1976-1980 period will also see a relative reduction in East Europe's dependence on the Soviet Union for oil because of Russia's inability fully to meet the requirements of her Warsaw Pact partners. The East Europeans, however, will continue to invest in Soviet energy projects to ensure a primary flow of fuels in the coming decades and the Orenburg gas pipeline, due for completion in 1979, is an example of this type of co-operation. At this stage the USSR is encouraging East Europe to turn to OPEC for some of its oil needs. It is estimated that OPEC deliveries of oil to East Europe may be as much as 33 million tons a year by 1980. This will take the pressure off Soviet export demands, a comprehensive new East European-Middle East economic link-up could, however, cause some political and economic implications in face of Soviet determination to maintain COMECON as a tight economic unit.

ii) Natural Resources

70. The COMECON area contains many, though not all, of the most important raw material resources, but here again it is the Soviet Union and not East Europe that possesses the bulk of the wealth. The former has a large share of the world's most critical metallic raw materials including copper, tungsten, chromium and vanadium, although it is poorly endowed with bauxite and fluorspar, and her production of tin is not sufficient. Some East European countries are producers of certain materials such as bauxite (Hungary, Romania), lead

(Bulgaria, Poland), copper (Poland), zinc (Bulgaria, Romania), but the GDR and Czechoslovakia depend almost entirely upon imports. Overall East European output however does not meet increasing demand and the region has been forced to import metals and minerals from the Soviet Union, the West and the LDC's for currency or commodities.

71. Products the area does frequently lack are grain and fodder due to the fluctuating state of COMECON agriculture. Up until now, the West has been able to meet COMECON demands from its own large surpluses. It is possible, however, that a series of mediocre Western harvests, coupled with poor Communist crops, could be disastrous for the Warsaw Pact and lead to a period of severe belt-tightening and economic slowdown.

II - Economic Evolution and Relations with the rest of the World

Potential Growth: 1976-1985

i) 1976-1980

72. Over the 1976-1980 Five-Year Plan period an average NMP* growth rate of 5.4% a year (1971-1975: 6.4%) is forecast for the Warsaw Pact area. Romania, Bulgaria, Hungary and Poland targets are above this average, while the GDR and Czechoslovakia have rates somewhat below. The Soviet Union, still suffering from the crop failure of 1975, also forecasts reduced growth in NMP on the order of 5% a year in 1976-1980**.

73. Caution also tends to permeate growth targets throughout the various sectors of the economy over the next five years: for example, industrial production in the Warsaw Pact area, except for Bulgaria, is expected to increase at a yearly average of some 1-1.5% less than in 1971-1975. Poland's industrial growth rate in particular is substantially less than the last period's achieved target. In all cases, stress will be on expanding the engineering and chemical industries which are to represent 41% of the total Warsaw Pact area share of Group A (heavy industry) production. Agricultural growth will not differ substantially in the East European countries from the 1971-1975 rates, except in the case of Romania and the GDR, both of which have set rather more ambitious targets. The Soviet Union has revised its estimates upwards due to the record 1976 crop, but this target can easily be untenable if poor weather and continued bad management are much in evidence.

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* NMP is estimated to be about 1-2 percentage points higher than the Western concept of "GNP".

** In 1976, despite an excellent harvest, economic results have been mediocre. NMP rose 5% and fell short of the planned target of 5.4%.

ii) 1981-1985

74. During the first half of the next decade it is likely that the rate of growth of the Soviet economy will be lower than that achieved during the present decade. Investment will remain a critical matter; in this respect it cannot be altogether excluded that, after the reorganization which should take place in the present Five-Year Plan period, the planners may allocate a larger volume of resources to the light industry and to those industrial activities aimed at meeting consumer demand. Greater emphasis will be put on the development of the resources of Eastern Siberia and the Far East, the more so as the BAM railway line should be completed in 1981.

75. This anticipated decline in growth is based on a number of developments. First the rate of growth of the labour force is estimated to drop to an annual rate of only 0.9% in 1981-1985 compared with 1.5% in 1976-1980. There will even be a decrease in the numbers of the populations of 18 and 19 years of age; this will create a problem of manpower allocation to the military and civilian sectors of the economy. The conditions of growth will not be met unless labour productivity rises above its present low level. Secondly, although agriculture should continue to receive investment priority, structural weakness, inevitable adverse weather conditions and the inefficient labour remaining on the farms may well impede a regular and sufficient increase in production, the development of which may continue to be erratic. Thirdly, investment should result in smaller returns as the Authorities allocate it for capital expensive development in Siberia, environment protection, and infrastructure for the auto age. Fierce competition from other resource claimants will preclude allocating a larger share of GNP to investment in order to compensate for the lower returns.

76. US experts have made a baseline projection for average annual GNP* growth rates of 3.7% over the period 1981-1985**. Soviet economic expansion can easily deviate from these projections if domestic and external conditions change markedly. The US experts have formulated a model of the economy based on four alternatives for the Five-Year period 1981-1985:

(a) Easy conditions, both domestic and external - viz., good technological progress in all producing sectors including agriculture, favourable terms of trade, no undue political pressures. Result: average annual growth rate of 5.5%.

(b) Hard conditions, both domestic and external - viz., negative technological progress, crop failure, poor labour productivity rates, sluggish foreign trade and adverse terms of trade. Result: average annual growth rate of 2.4%.

* Western concept - in constant prices.

** Joint Economic Committee, US Congress, Soviet Economy in a New Perspective (Washington, 1976), p. 203 ff.

(c) Easy domestic and hard external conditions - viz., high level of investment, good agricultural results, but unfavourable developments in foreign trade. Result: average annual growth rate of 5.4%.

(d) Hard domestic and easy external conditions - viz., lower aggregate consumption, and poor agricultural results; trade grows at predicted rate. Result: average annual growth rate of 2.6%.

77. One factor that will further influence these rates is the level of defence spending. It is clear that reductions in Soviet defence outlays release resources that facilitate the achievement of the main Soviet economic objectives - greater consumption and greater investment in industry and agriculture.

78. The overall assessment is that Soviet output expansion will slow down over the next 10 years and the economy will be that described as "sluggish stability". This could happen particularly if domestic conditions are less than "easy". Favourable foreign trade patterns will not be enough to overcome a major defect such as poor agricultural results, or slow rates of technological or productivity progress.

79. For Eastern Europe in the 1981-1985 period the growth rates are likely to vary considerably. Romania and Bulgaria, the less developed countries of the area, are likely to continue their high annual NMP growth rates of 8-11 %. Poland, which registered a high growth rate in the 1971-1975 period has already announced a much reduced rate of 7.2 % a year over 1976-1980 due to the ongoing economic problems. The rate at which the Polish economy will grow between 1981-1985 will very much depend on the success or failure of the present Plan and of current policies to control the growth of foreign indebtedness, reduce the large delays in plant construction and to improve the lot of the consumer. It can be expected, however, that the Polish Authorities will try to maintain an even growth through the first half of the next decade and their objective could well be of the same order as that set for the present Plan. In the case of Czechoslovakia and the GDR, the expense of importing almost all their hydrocarbon fuel and raw materials as well as the tight manpower situation will continue to act as a brake on any high growth rates, and an NMP growth rate on the order of 4-5 % is realistic for the 1981-1985 period. Hungarian growth could be 5-6 % given an upswing in foreign trade and a lessening of worldwide inflation, both of which significantly influence her growth potential.

Prices, Inflation and the Consumer

80. Living standards in the Warsaw Pact vary considerably from country to country but are overall lower than in the industrialised NATO countries despite improvement in the 1971-1975 period (1). The general tendency of the population in the recent

(1) If GNP per capita (1975 US estimates) is taken as a standard of comparison we find : USSR $2,175; Eastern Europe $2,189; highest GDR $ 3,250, lowest Romania $925. NATO : US $6,317; UK $ 3,285. (Source : D. Lascelles, op. cit., p. 38)

past has been not to show dissatisfaction (Poland being the conspicuous exception) due to various factors of threats, police action, job loss, etc.., with prospects of immediate consumer relief, betterment lying mainly in parallel and, even black market activities. Nevertheless, the tensions and stresses within the social fabric are undeniable and there are reports of growing domestic criticism especially in Czechoslovakia and East Germany, and a continuance of unrest in Poland over tighter consumer supplies. If the present Five-Year Plan targets are not achieved and the consumer is once again asked to sacrifice his expectations for the sake of heavy industry and to put up with poor quality goods, there could be an acceleration of social unrest in some East European countries and even possibly disturbances in some Republics in the USSR.

81. For the most part, staple items such as rent transportation and basic food products remain low in price thanks to State subsidies. Even these prices can be increased as the January 1977 Soviet increases have shown, but many products considered routine and essential in the West (good apartments, cars, household goods, etc..), are scarce and carry prices far beyond the value of Western equivalents.

82. The so-called official lack of inflation in COMECON conceals a different reality. Repressed inflation has tended to distort certain sectors of the economy. Consequently, both Poland and Hungary have increased some prices sharply in the last three years because of the need to pay for more expensive imports and curb domestic consumption. All countries also suffer from hidden inflation illustrated in the latter instance by the introduction of so-called "higher quality" goods at higher prices which replace identical lower priced items. Moreover, the prices of goods in the parallel market, especially in the USSR, are usually higher than official levels, indicating a truer value for the goods.

83. The present imbalance between real earnings and desirable consumer goods has led to massive savings in all countries which represents a form of repressed purchasing power. Based on available evidence it is clear that the consumer in Warsaw Pact countries is either expected to wait still longer for greater consumer satisfaction or, as in the case of Poland and Hungary, is now required to pay a most unwelcome price for goods provided by the State sector.

Balance of Trade

84. The overall Warsaw Pact trade deficit widened substantially rising from $2.15 billion in 1974 to $9 billion at the end of 1975 and total publicized accumulated debt (export credits, Eurodollar loans, etc..) for the Warsaw Pact stood at about $30 billion at the end of 1975, and may have reached $40 billion at the end of 1976.

85. The priority given in the Warsaw Pact area to modernization of the economy and improvement of productivity means that there is an on-going necessity for the importation of Western technology and equipment. It is therefore unlikely that the Pact countries will be able significantly to reduce their imports from the West without endangering the implementation of their current economic policies. All countries plan to make greater efforts to increase hard currency exports earnings in order to be able to reduce their overall indebtedness without having to restrict the volume of their imports.

86. All the Warsaw Pact 1976-1980 Plans were supposed to have special sections on integration but little has been concretely stated due to the difficulties over the reformed pricing system of 1975 which is the heart of inter-COMECON trade. Under the new pricing system for energy and raw materials, prices are adjusted annually on the basis of a five-year moving average of world market prices. As the Soviet Union and Poland are the Pact's largest exporters of energy and raw materials, terms of intra-COMECON trade have moved in their favour; for the others, particularly Hungary, the terms of trade have worsened and contribute to the growing balance of trade difficulties. These are likely to persist until the 1980s.

Warsaw Pact economic self-sufficiency

87. The Warsaw Pact appears to be both reasonably unified and self-sufficient in economic materials. It has ample energy reserves, vast basic products resources, and a fairly broad industrial base. Although the transportation systems have lagged behind, they are in the process of improvement and should not represent a drag on a quick military mobilization. It is very likely that stocks are maintained for the few raw materials that it does not produce or that it lacks in quantity (mainly lead, tin, natural rubber, bauxite), as well as for essential grain supplies.

88. The USSR, the dominant Warsaw Pact power, meets most of the Eastern European (excluding Romanian) demands for imported fuel. It is also an important supplier to the area of raw materials and manufactured goods. It provides equipment for nuclear power

projects and promotes, in the COMECON context, numerous joint ventures which tie East Europe into a compensation arrangement with the USSR (e.g. the Orenburg gas pipeline) and at the same time allows for a pooling of resources.

The Warsaw Pact and the rest of the world

89. Several trends have emerged from the Warsaw Pact trading activity over the last five years which will extend into the 1980s. First and foremost is the fact that the Warsaw Pact countries, like those in the Alliance, rely on a recovery of world trade and export activity to finance a part of their future projects for modernization and economic growth. Any sluggish recovery, or even downturn, in Western Europe may have repercussions in those countries, notably in Poland and Hungary, that are relying on heavy export increases. Secondly, the 1976-80 projected trade figures indicate that in spite of the growing Pact trade with the developed West (1), intra-COMECON trade will continue to retain a major share of total trade flows of the area. Trade between the Pact and the less developed countries is also expected to rise, though at a slow rate. There has recently been a number of reports discussing the proposals of the Soviet Union to set up a transferable rouble, to be used in trade with the West. It is, however, unlikely that this system will be established in the foreseeable future.

90. In assessing the Warsaw Pact, one should consider the global aspect of its strength: over the past five years the Pact countries have progressed in their economic penetration in certain areas of the Third World. The inevitable concomitant is the strengthening of their political influence in key areas that straddle important shipping routes for the West: Angola, Mozambique, Somalia, in Africa, Syria and, possibly, Libya in the Mediterranean. Soviet and East European merchant and fishing fleets, together with the Soviet Navy, constitute a significant part of the Pact economic activities and of its military potential. As pointed out in a recent article by Admiral Kidd, the Pact now has "the ability to interdict or pressure international trade at points well outside the NATO area", and interfere with the supplies of energy and raw materials needed by the West and with the flow of trade (2).

(1) All Warsaw Pact countries are endeavouring to raise the share of manufactured goods in their exports to the West.

(2) Admiral Isaac Kidd, Jr. "NATO Strategy and the New Dimension at Sea", NATO Review, December, 1976, p. 7

AC/127-WP/499

III - Conclusions with Regard to the Warsaw Pact Countries

91. During the current Plan period, and probably well into the 1980s, each country's economy will still be affected by inescapable constraints - higher import prices, expensive energy, scarcity of skilled labour, and a philosophy that demands centralized decision making in planning and investment, that has in the past led to great waste and inefficiency.

92. In the period under review the chances of extensive deployment of production factors - especially manpower already critical in several countries - will become more limited, so that economic growth will depend increasingly on gains in labour and capital productivity. Consequently, growth will become more uncertain than in the past, when spare capacity was still available in the economies of many of the Warsaw Pact countries. These elements cannot but have an impact on economic trends in 1976-1984 which include the sensitive areas of private consumption and personal incomes. These internal and external restrictions suggest that caution and restraint in Warsaw Pact countries' economic development are to be the watchwords. Poland in particular faces an austere period with the threat of greater Russian "management" hanging over it until exports pick up and her massive hard currency debt is reduced.

93. The per capita national product of the Soviet Union is already lower than that obtaining in most East European countries. The gap may become greater between 1977 and 1984 and reveal a growing degree of divergence between the standards of living of the Soviet and East European populations. This phenomenon could have a non-negligible impact on the cohesion of COMECON and on the economic policies of the countries belonging to it.

94. To strengthen their economies and to give a real impetus to consumption the Soviet leaders, as well as the East European ones, should carry out in depth reforms of the economic system. These would aim at restoring the rôle of prices as a yardstick for measuring value and introduce more flexibility and competition in production. But such reforms would, ultimately, remove the bureaucratic and ideological constraints and have repercussions which might be difficult to control. This is why the Soviets and most of their Allies will not allow any substantive change in the working of their economic systems.