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SUB-COMMITTEE ON SOVIET ECONOMIC POLICY

REVIEW OF THE ECONOMIC SITUATION IN CZECHOSLOVAKIA

Record of the meeting held on 7th November, 1966

Note by the Chairman

In accordance with the decision of the Sub-Committee(1), the Economic Directorate has prepared the attached draft record of the meeting of 7th November, 1966 on the Czechoslovak economy. Should participants in the discussion wish to propose amendments, they are invited to send them to the International Secretariat before 1st January, 1967.

(Signed) A. VINCENT

OTAN/NATO,
Paris 16e.

(1) AC/89-R/84 : Item I(2)(ii).

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SUB-COMMITTEE ON SOVIET ECONOMIC POLICY

REVIEW OF THE ECONOMIC SITUATION IN CZECHOSLOVAKIA

Record of the meeting held on 7th November, 1966

The CHAIRMAN welcomed the presence of:

- Dr. CZYBULKA, Ministry of Economics, Bonn
- Mr. FOUCHET, Ministry of Foreign Affairs, Paris
- Mr. GRANIER, Ministry of Finance, Paris
- Mr. RAMASSO VALACCA, Commercial Counsellor, Italian Embassy,
Prague
- Mr. OBERHOLZER, Ministry of Economic Affairs, The Hague
- Mr. van SOEST, Ministry of Foreign Affairs, The Hague
- Mr. SLATER, Economic Adviser, American Embassy, Prague.

2. The CHAIRMAN recalled that the Sub-Committee had already, in February 1965, held a meeting on the Czechoslovak economy, and that the purpose of the present session was to bring the findings of that earlier meeting up to date. He thanked the Italian Delegation for the two papers which they had prepared as a basis for discussion(1) and also the German and United Kingdom Delegations, which had submitted comments on these papers(2).

3. Mr. RAMASSO VALACCA opened the discussion with a general statement to the effect that, while at the beginning of 1965 the Czechoslovak economy was still in a period of crisis, there had since then been a partial recovery.

4. The CHAIRMAN suggested that the discussion should embrace three main topics:

- the internal development of the economy;
- the implementation of the economic reforms;
- external economic relations.

(1) AC/89-WP/197 and AC/89-WP/197/1

(2) AC/89-WP/197/2 and AC/89-WP/197/3. Since the meeting further comments have been received from the Canadian Delegation AC/89-WP/197/4 and the United States Delegation AC/89-WP/197/5.

I. INTERNAL DEVELOPMENT OF THE ECONOMY

5. The CHAIRMAN remarked that at the time of the last meeting the Czechoslovak economy was in the throes of a severe crisis, the rate of growth during 1963-64 being virtually negligible. Since then, however, the rate of growth, at least in industry, had risen and, according to the official figures, had attained a respectable level again in 1965-1966 - about 8% per annum.

6. Mr. SLATER agreed that the rate of industrial growth had accelerated during the last two years, but he felt that the official figures had to be treated with some caution. These figures referred to gross industrial production, a concept which in the Soviet-type economies included industrial consumption of raw materials, and semi-finished products. It was probable that the rate of increase of the final usable industrial output had been lower than the rate of growth of industrial production officially claimed.

7. Asked by Mr. van SOEST whether there was any significant degree of unemployment in Czechoslovakia, Mr. SLATER replied that there was not. The problem was rather one of scarcity of labour, the number of unfilled vacancies exceeding the number of applicants. However, labour was used inefficiently. Output per man in Czechoslovakian industry was only about one third of the United States' level. One of the remedies proposed by the government to deal with this problem was the redeployment of labour into those industries where the prospects for growth were most encouraging. The reforms were intended inter alia to stimulate such redeployment of labour, and had for this reason encountered hostility from some workers who did not relish the prospect of being redeployed.

8. Mr. RAMASSO VALACCA also agreed that industrial expansion had been resumed during the last two years, but he did not consider that this trend had been accompanied by any appreciable improvement in living standards. However, the authorities had to some extent relaxed controls over the population; for example, it was now easier for Czech citizens to travel abroad, and ever increasing numbers were taking advantage of this facility.

9. The failure of living standards to improve significantly was in a large measure due to the fact that agricultural production had continued to stagnate. In this connection, however, Mr. SLATER observed that the grain harvest in 1966 was expected to be somewhat better than the exceptionally bad one of 1965.

10. Questioned by Mr. AUTIER (France) concerning the part played by private plots in Czechoslovak agriculture, Mr. RAMASSO VALACCA replied that, in contrast to the position in some other Eastern European countries and in the Soviet Union, small-scale private agricultural production for the market played no significant rôle in the Czechoslovak economy.

11. Referring to Czechoslovakia's new Five-Year Plan for 1966-70, Mr. SLATER said that to judge by the figures so far available, its most striking features were its relatively subdued tone and the comparatively unambitious nature of its objectives. For instance, the national income (net material product) was planned to increase at an annual average rate of only 3.8%. The plan appeared to have been based on a more sober and realistic assessment of the resources available than had earlier plans, and thus stood a correspondingly better chance of success. Priority in resource allocation would go to the chemical, oil-refining and engineering industries. In the consumer goods sector it was planned greatly to enlarge capacity in the glass and ceramic industries, with a view to increasing exports of these products to hard currency areas. These were the broad general objectives, although, under the new system of planning and management, whereby enterprises were allowed greater autonomy in determining the volume of their investments, it was now more difficult for the planners to foresee with certainty what the level of investment in any given industry would be.

12. Mr. SLATER went on to say that the Czechoslovak Authorities appeared to have revised their ideas on agriculture. In the past the agricultural sector had been sadly neglected, and as a result its performance had been thoroughly unimpressive. Recently, however, Deputy Premier Czernik had stated that a big improvement in the agricultural sector was an essential condition for further progress of the economy as a whole. The new Five-Year Plan provided for a much more generous allocation of resources to agriculture, in the form of increased supplies of machinery, fertiliser, etc., than in the past.

13. Mr. RAMASSO VALACCA was sceptical concerning the prospects for the successful realisation of the plan. In particular, he doubted whether the planned rate of increase of industrial productivity would be attained. However, the CHAIRMAN pointed out that the principal causes of the slow growth of productivity in the past - lack of incentives, misdirection of investment funds into unprofitable sectors - should be at least partially eliminated under the new system.

II. IMPLEMENTATION OF THE ECONOMIC REFORMS

14. Mr. SLATER said that the decision to carry out the economic reforms had been taken two years ago, against a background of severe economic crisis. The performance of the Czechoslovak economy in 1963-64 was so palpably inadequate that the authorities had no choice but to abandon the old methods of planning and management.

15. The reformers had realised that it had been a mistake to apply the methods of planning and management which had evolved in the Soviet Union under Stalin, virtually without any modification to allow for the totally different conditions prevailing in Czechoslovakia. They had therefore set out to devise a new system more appropriate to their own needs, which, while preserving the fundamental features of Socialism, would also make use of Western experience where this was considered relevant to the problem of ensuring a more rational allocation of resources.

16. After much heart-searching they had reached the conclusion that the essential feature of Socialist society was public ownership of the means of production. This was sacrosanct and could not be called in question. Other features of the Stalinist type of centrally planned economy were, however, to be subjected to searching criticism and rejected if necessary. The reformers had thus elaborated a new set of general principles, allowing market forces a greater rôle in price formation and resource allocation, granting greater responsibility to enterprise managers and providing stronger material incentives to both labour and management. In general, the planners were to maintain control of the overall pattern of economic development through the manipulation of fiscal and monetary levers, rather than by administrative fiat as in the past.

17. The leadership, recognising that the old methods were no longer viable, had been driven to accept, albeit with reluctance, the basic principles advocated by the reformers. These principles had accordingly been approved by the Party Presidium in December 1964, and the debate since then had been concerned with the manner in which they were to be applied in practice. There was clearly a divergence of opinion on this subject between the conservative and progressive elements in the top ranks of the Party and government hierarchy.

18. Mr. RAMASSO VALACCA said that the implementation of the reforms was proceeding very slowly. It had originally been intended to apply the new system throughout industry and in certain other sectors, with effect from 1st January, 1966, but the deadline had subsequently been postponed until 1st January, 1967. The measures scheduled for immediate implementation were relatively cautious. There was to be some concentration of industrial enterprises; enterprises were to be granted financial autonomy; investment was henceforth to be financed mainly through bank credits, on which interest (normally 5% to 6% per annum) would be paid, rather than through budgetary grants, as in the past; the facilities available for contacts between the Czechoslovak enterprises and their clients and suppliers abroad were to be improved. As to prices, it was still far from clear how they would be determined, although some of them were to be permitted to fluctuate according to supply and demand. His general impression was that many of the more radical measures of the reformers, in particular concerning the rôle to be allotted to market forces, had been watered down almost beyond recognition.

19. In general, Mr. RAMASSO VALACCA thought that the success of the reforms would depend to a large extent on the human factor, on the success or failure of the authorities to arouse the enthusiasm of the population for the idea of economic reform and economic progress. However, one of the most striking features of the Czechoslovak economy was the complete apathy of the workers, which was reflected in the poor quality of production and in the extremely casual attitude towards the observance of working hours. This apathy was encouraged by the excessively egalitarian wage structure in Czechoslovakia. The highest paid workers earned only 2.5 times more than the lowest

paid, whereas in the Soviet Union the ratio between the maximum and minimum earnings was 7:1. This general apathy extended to the technicians and management, who, under the old system, had little incentive to display imagination or initiative.

20. The CHAIRMAN quoted from a report in the Financial Times of 26th October, 1966, as follows:

"At the start of 1965, some industrial enterprises were put on a new management system. This system scrapped most of the paraphernalia of central planning and instead left the factories free to produce what they liked and to keep the resulting income - subject to taxes and to payments to the State for the use of the factory's capital. The new system was much the same in its working and effect as the "profit motive" system introduced in the Soviet Union.

The first effects of the new system seemed to be beneficial and in 1965 the Czechoslovak economy began to move ahead again. In a final dispute at the political level in May 1966, the protagonists of the new system were victorious and it was resolved to introduce it throughout the economy in January 1967."

21. The CHAIRMAN pointed to the contrast between the picture of the way in which the reforms were being carried through given in this report and the observations of Mr. RAMASSO VALACCA. The latter agreed that there was a considerable difference and suggested that, paradoxically enough, the greatest success of the Czechoslovak reforms had been in the Western press. This was because Czechoslovak publications and Czechoslovak representatives abroad often gave an exaggerated impression of what had been done. Those who lived on the spot, however, could see that the reality did not always correspond to official pronouncements.

22. The CHAIRMAN referred to another report according to which wholesale prices for industrial products and freight rates in Czechoslovakia were to be raised on average by 24% when the new measures came into force at the beginning of 1967. Mr. SLATER observed that as at this stage the price revision would apparently cover wholesale prices only, retail prices would not necessarily be affected, nor would foreign trade prices. The Czechoslovak foreign trade agencies would continue to buy and sell in foreign markets at the most advantageous prices they could obtain, irrespective of the internal Czechoslovak prices of the products which were bought and sold. However, he thought that as a first step towards putting their cost-price structure on a basis that was more easily comparable with that of Western countries, the Czechoslovaks might soon replace their present system of multiple exchange rates by a single rate valid for all types of transaction.

23. Mr. GRANIER thought that one of the main objects of the reform was to facilitate the growth of Czechoslovak exports, in particular to hard currency areas. Henceforth, the Czechoslovaks might seek to claim that the prices of their goods were related to their costs of production, and that these costs of production were

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calculated in a manner essentially similar to that employed by most enterprises in Western market economies. If it were accepted that their enterprises operated on the same footing and according to more or less the same rules as their Western competitors, it would be more difficult to justify the quantitative restrictions on Czech exports that were still in force in most Western countries.

III. EXTERNAL ECONOMIC RELATIONS

(a) Relations with COMECON countries

24. Mr. FOUCHET thought that Czechoslovakia's economic policy was essentially to achieve an improvement of its own competitive position within the group of Communist countries, which had deteriorated during the last three or four years. The Czech planners were pursuing various aims. Firstly, Czechoslovakia was seeking to free herself from excessive economic dependence on the Soviet Union. The USSR, upon which Czechoslovakia depended for imports of many essential raw materials and foodstuffs, especially grain, some of which was supplied under three-year credit arrangements, was able to maintain considerable leverage on the Czech economy. The best Czech machinery was exported to the USSR. Secondly, Czechoslovakia was attempting to improve its competitive position with regard to the other Eastern European countries. The plan for a division of labour originally envisaged in COMECON, according to which the developed countries, such as Czechoslovakia, were to concentrate on industrial production, while the less-developed member countries would give priority to agriculture, had now been shelved. The other COMECON countries had started a programme of rapid industrialisation building up modern factories while Czechoslovakia's industry was much too widely diversified and now suffered from the lack of modern equipment in the competition with its Communist neighbours. Finally, Czechoslovakia would seek to restore its external financial balance in order to be in a position to diversify both its sources of supplies and export markets.

25. Mr. SLATER said that the Czechoslovak Authorities were conscious of the need to free themselves from excessive dependence on the USSR. As enterprises would henceforth enjoy some autonomy, investment should gradually be concentrated in the most successful industries which in general would be those best placed to find additional markets not only in Eastern Europe but also in the Free World. Over a period of time this might considerably increase Czechoslovakia's freedom of manoeuvre in the economic field. A modified pattern of investment might be the most important consequence of the economic reforms, and the future development of this pattern deserved close attention. Attempts to diminish Soviet leverage also became apparent from recent trade agreements concluded with developing countries of the Free World, where Czechoslovakia hoped to find some alternative sources of supply of raw materials. In this connection might be mentioned Czechoslovakia's interest in the possibility of importing oil from Middle Eastern countries, the imports of liquified gas from North Africa and the iron ore imports which are under negotiation with Brazil. The attempt of Czechoslovakia to gain some bargaining power in prices for similar products supplied by Communist countries was pretty obvious.

26. To a question by Mr. de BROUWERE regarding the development of COMECON in the direction of more economic integration Mr. RAMASSO VALACCA replied that the centrifugal forces had now been prevailing for sometime and that the Soviet Union was worried about a too rapid growth of economic relations between Eastern European countries and the West. Even the Czechs who should have been, and still were, supporters of the COMECON idea, were against Soviet predominance. As a result, COMECON had not moved ahead very far. Little progress had been made with the development of the COMECON Bank, or towards a solution of the related problem of currency convertibility within COMECON.

27. Mr. SLATER said that the Czechs were giving top priority in their discussions within COMECON to their own national interests. He felt that the time might have come where it was necessary to reassess the position of Czechoslovakia in the COMECON group of countries, for it had been long assumed that Czechoslovakia was one of the most faithful among the Communist countries. This opinion might have to be revised as Czechoslovakia now appeared to be one of the Communist countries with the fewest restrictions on individual freedom.

28. Mr. RAMASSO VALACCA explained that trade relations between the Soviet Union and Czechoslovakia could hardly be described as exclusively beneficial to either of the two countries. It had sometimes been argued that Soviet export prices for raw materials had been high in comparison with world prices, but on the other hand, those of Czech exports to the Soviets, for goods which could not be sold on Western markets, were probably also much too high by world standards. Therefore nobody knew exactly who was exploiting whom.

(b) Relations with the West

29. The CHAIRMAN asked whether the measures taken in some Western countries this year to facilitate trade with Czechoslovakia had yet had any effect.

30. Mr. FOUCHET said that as far as France was concerned, a number of liberalising measures had been taken unilaterally on 30th January, 1966, without demanding any explicit quid pro quo from the Czechs. His Authorities could always reimpose restrictions if the Czechs took advantage of the more favourable conditions now accorded them to sell their products at "dumping" prices. It was not expected, however, that the measures introduced at the beginning of this year would have an immediate effect and he felt that it was still too early to attempt any assessment of their likely long-term consequences. The Czechs were apparently not eager to purchase complete industrial plants as had been the case with other Eastern European countries like Bulgaria or Rumania. They were rather seeking to obtain enough pieces of equipment to replace outdated machinery and were therefore entering into a number of limited deals, the average value of which was about three to four million French francs.

31. Mr. SLATER indicated that United States-Czechoslovak trade had increased rapidly over the last four years. It amounted to \$14 million in 1963, \$20 million in 1964, \$44 million in 1965 and would amount to between \$60 and \$75 million in 1966. Commenting on these figures he said that the considerable increase in 1965 was in part due to the bad harvest which had obliged Czechoslovakia to import substantial quantities of grain. The balance of payments of Czechoslovakia with the United States was in chronic deficit. Although Czechoslovakia's trade with the United States had increased faster than its trade with the world as a whole, the share of the United States in total Czech trade did not exceed one half to three-quarters of 1%. The measures envisaged to facilitate trade with Eastern countries according to which MFN treatment would be extended to Czechoslovakia and credits could be made available by the export/import bank might well lead to a further considerable increase in Czech-United States trade. During the period 1960-65, imports from the West had risen at a rate of 13% annually while exports had expanded at the rate of 11% annually.

32. Regarding the problem of Czechoslovakia's relations with international economic organizations such as GATT, IMF, IBRD, European Common Market, ECE Geneva and OECD, Mr. RAMASSO VALACCA recalled that Czechoslovakia was among the founder members of GATT. Recognition of all consequences of its GATT membership would improve the Czech position in its discussions with Western countries for obtaining further measures of liberalisation and opening Western markets to Czech exports. As far as the IMF was concerned, the main interest of Czechoslovakia might be to be able to obtain credits from this fund. Czechoslovakia had joined the IMF just before the 1948 Communist coup, and had withdrawn from it shortly afterwards. It would probably not consider applying for re-entry before it had co-ordinated its move with the other Communist countries since at present by far the greatest part of its trade (about 73%) was with the Communist world. Czechoslovakia is known to have requested the right to send an observer to the European Common Market while it has occasionally sought to play a positive rôle at the ECE Geneva.

33. Mr. FOUCHET said that as far as external economic relations were concerned, Czechoslovakia remained among the Communist countries which relied most heavily on the Soviet Union. In its efforts to reduce its excessive dependence on the Soviet Union, and on other COMECON countries, Czechoslovakia was faced with difficulties that resulted both from the Soviet desire to maintain economic hegemony in Eastern Europe and from the hesitation which characterised the attitude adopted by Western governments in their dealings with Czechoslovakia. Western countries had generally looked at their own trade with Czechoslovakia mainly as a means of expanding their exports. Real improvement in trade relations must necessarily also allow for a growth of Czech exports to Western countries. If Western countries sought to increase their trade with Czechoslovakia, they should be ready to import more from Czechoslovakia and to make the sacrifices which this might entail.

IV. CONCLUSIONS

34. The experts agreed that the general conclusions reached in the last report submitted to the Council (C-M(66)41) remained, on the whole, valid. The last report might have been a little bit too optimistic as far as the repercussions of the economic reforms then announced were concerned. This, however, was not to say that the present outlook for the Czech economy was particularly gloomy, but rather that progress might be less rapid than previously expected, although it might be steady over a number of years to come.

35. The CHAIRMAN thanked the participants for their valuable contributions to the exercise which had proved to be highly fruitful. As at previous meetings, it was decided that the Secretariat would prepare a record of the meeting to be submitted to the participants for approval, as well as a report that would be submitted to the Sub-Committee which might decide to send it to the Committee of Economic Advisers, which in turn might send an abbreviated version of it to the Council.