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RECENT ECONOMIC ISSUES AND PROSPECTS
IN THE USSR AND EASTERN EUROPE

Note by the Secretary General

The attached report(1) has been prepared by the Economic Committee in the light of detailed discussions. It examines the most important economic areas in the Warsaw Pact nations and considers possible options open to those countries. The review is supplemented at Annex by three statistical tables and a chronology of important economic events in 1980.

2. The report will serve as a reference document for the Council meeting of 11th December, 1980.

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This document includes: 1 Annex

(1) For previous reports see C-M(79)74 dated 7th December, 1979 and C-M(80)31 dated 19th June, 1980

N A T O C O N F I D E N T I A L

RECENT ECONOMIC ISSUES AND PROSPECTS
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Report by the Economic Committee

Introduction

1. The events on the world stage during 1980 have thrown into sharp relief some of the strengths and weaknesses of the economies of the USSR and its East European partners: within each country progress in some sectors has been balanced by regression in others, whilst across the whole area favourable economic evolution in one country has been outweighed by negative development in others. This situation is reflected in the much lower rates of growth generally achieved by Eastern bloc countries, indicating as it does the authorities' failure to address the basic structural problems facing their economies. The object of this report is to examine the most glaring areas of enquiry in the Warsaw Pact nations, and to consider options open to them.

Summary

USSR

2. The perennial economic problems of low productivity, depletion of readily available raw materials resources, inadequacies of the transport system, continue and have been exacerbated by two consecutive bad harvests in 1979 and 1980: their main effect, made worse by Western economic restrictions on grain exports, has been reduced meat supplies which can be only partly compensated by imports. In energy materials, whilst coal production has been disappointing, oil output continues to increase, albeit more slowly than planned, whilst the production of natural gas has outstripped expectations. In foreign trade the USSR continues to make good progress in spite of the lack of demand in the West for Soviet manufactures, and net indebtedness to the West, now of the order of \$10 billion, continues to decrease. The Soviet consumer remains unsatisfied and will continue to have to face a shortage of consumer goods, housing, meat and other food supplies for some time to come. Although Brezhnev in his October speech to the Party Plenum called improvements in the production of consumer goods "of paramount economic and political importance", there are no indications that the USSR is contemplating any reallocation of resources from the military or heavy industry in favour of the consumer, nor of pushing through the serious economic reforms needed to increase incentives and improve productivity. In sum, the USSR has leapfrogged into modern industry without creating the economic infrastructure to support it. It is doubtful whether the

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shortcomings can be remedied during the 1981-85 Plan, but to date insufficient figures have been made public to justify an analysis in this paper.

EASTERN EUROPE

3. Most far-reaching among events affecting the East European economies in 1980 were widespread strikes in Poland beginning in July, which have led to the formation and official recognition of trades unions independent of the Communist Party. The immediate economic effect of the unions was to prompt a substantial raise in many Polish workers' wages, thereby increasing the government's already onerous financial problems and fuelling strong inflationary forces in the Polish economy. Over the longer term, the principle of independent labour unions, if upheld, could have profound effects in the other East European economies and even perhaps in the Soviet Union in encouraging worker and consumer demands for higher living standards. In Poland, the strikes which preceded the formation of the unions led to a loss of nearly 2% of industrial sales planned for 1980, and probably a higher level of loss in coal production. The losses have contributed to an expected convertible currency trade deficit of around \$1 billion in 1980, which together with current repayment obligations on outstanding hard-currency debts, totalling \$20 billion net at the end of 1979, will require a financing on the order of \$8-9 billion in 1980 alone. Whilst events in Poland have dominated the scene, the other five countries of Eastern Europe have not been without troubles, as well as successes. Bulgaria's growth is slowing, largely because of labour shortages and an energy crunch, but may improve as new investments come on stream. In Czechoslovakia, both meat production and grain harvest appear unlikely to meet 1980 goals, the latter because of heavy rains. Following the "Ler experiment" which attempted to improve operational efficiency in 150 enterprises during 1978-80, Czechoslovakia will introduce reforms in January 1981 aimed at allowing greater independence in enterprise management, albeit with strengthened central controls. The GDR continues to be plagued by the fact that it must further increase its exports to the Soviet Union to cover its energy bill while its indebtedness to the West, currently at over \$8 billion, is growing. The GDR's raising in October of the minimum compulsory currency exchange for visitors has severely reduced tourist traffic. The year 1980 marked the re-initiation in Hungary of the New Economic Mechanism, with apparently positive results: although inflation continued, imports were restrained and exports grew substantially, especially to non-ruble markets. Romania's economic growth remained high, because of favourable harvests and a 10% expansion of industrial output; nonetheless, massive imports of capital equipment and higher expenditures on oil and raw materials have led to a large annual trade deficit and \$6.7 billion in accumulated hard currency debt.

RECENT ECONOMIC ISSUES AND PROSPECTS
IN THE USSR AND EASTERN EUROPE

USSR

GENERAL

4. Throughout 1980 the USSR has faced serious economic problems restraining its rate of growth. The difficulties have been generated by a number of factors varying in adversity such as disastrous performance in agriculture in two successive years, depletion of the raw materials resources in or close to Western USSR where industry needs them, inadequacies of the transport system, especially over the long East-West distances, a diminishing rate of growth of oil production which some Western analysts believe will cause difficulties for growth of the economy in general, and the continuing devotion of some 12-14% of GNP to the military. Whilst incomes are rising, the failure to provide parallel outlets for the higher incomes by way of a more varied diet, more and better quality consumer goods and services, means that no real incentives exist. Modifications to various parts of the management of the economy or of the economic structure are made from time to time, and price and wage levels are adjusted, but the inadequacies are systemic and are unlikely to be eradicated in the foreseeable future: such would require major modifications to investment policies, to allocation of resources, and to industrial management structures. In a way the economy is a prisoner in its own tentacles: its geographic extension as well as its expansion in many sectors bring new problems. Their solution in one area results in the creation of new ones in others, whilst the high level of military expenditure reflects the denial of a considerable part of the best resources available for the solution of Soviet economic problems.

5. It may well seem redundant to talk of strengths and weaknesses of the Soviet economy where contradictions exist in so many sectors: in spite of the difficulties, it is claimed that national income will have increased by 3.8%, and industrial output by 4%, in 1980. Nevertheless, these characteristics are predominant in at least seven key activities. Developments in these areas are likely to determine the course of Soviet economic progress over the near and medium-term future, and the Soviet leaders are thus faced with the need to make critical decisions affecting these areas on the eve of the start of a new Five-Year Plan (1981-85) in the face of a global economic climate which could not have been foreseen when first thoughts were given to this new Plan several years ago: neither the climate itself nor the interplay between the USSR and the rest of the world could have been forecast except as one of many possible scenarios.

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The seven activities which are considered to present the most difficult problems and to offer the most restricted options are agriculture, raw materials supplies, transportation, energy, foreign trade, the consumer, and defence. In addition, two factors of a transboundary nature need to be considered: economic relations with the less developed countries, and integration within CMEA.

AGRICULTURE

6. Agriculture must be the greatest disappointment to the Soviet leaders and particularly to Mr. Brezhnev who personally undertook in 1965, soon after he took office, to provide a better, more varied diet for the Soviet consumer. Yet even though year after year a quarter of all investment has been devoted to agriculture, its inadequacies remain. Far from attaining self-sufficiency in this basic sector, the USSR has been seen to rely on several other nations, especially since the reduction in 1980 of US exports of cereals. Anticipated imports in 1980/81 of 30-32 million tonnes will nonetheless fall far short of satisfying domestic needs, let alone replacing stocks depleted by the poor harvests in two successive years, 1979 and 1980(1). Whereas meat production was planned to increase in 1980, it has decreased not only in relation to 1979 but also in relation to 1978. Milk availability has followed a similar pattern. Whilst the US measures last, and other Western potential exporters continue not to exceed "traditional levels" of supplies, the USSR is unlikely to be able to re-establish its depleted cereal stocks. The expected rewards of high investment in farm machinery, in fertiliser plants, in industrial farm buildings, etc., have not materialised and the outlook is bleak: the low productivity in the State and collective sectors is in sharp contrast to that of the private plots which supply a quarter of all agricultural produce whilst using less than 3% of arable land. There can be little doubt that the contradictions found in Soviet agriculture will centre the attention of the leaders upon reducing harvest losses, increasing productivity, with the aims of reducing the vast labour force employed and improving dietary levels.

RAW MATERIALS

7. Having concentrated its exploitation of raw materials reserves in the Western USSR, where the bulk of industry and urban population lies, the USSR now finds those reserves substantially depleted. This is not to say that the nation is not self-sufficient in most raw materials but winning them has become more costly, and transporting them from the Eastern and Northern parts of the country is restricted by deficiencies of the lengthy transport system and by the rigours of the climate.

(1) Although no firm figures are yet available for 1980, the harvest will be disappointing with a probable output of 181 million tonnes against a planned 235 million tonnes.

The options are crystallising themselves: greater investment in mining machinery, more incentives for the work force, the development of a more efficient transport network, or the importation of raw materials from such areas as Africa and South America, often in return for project and capital assistance. The last option may well be considered by the Soviet leaders to be the most rapid and effective: they have commercial assets available, they have - or might gain - the influence needed in those areas of the world where the desirable materials lie, the transport provided by their own merchant marine is considerable and can be supplemented by tonnage chartered in a world market where surplus rather than shortage has been the rule in recent times. This option will certainly be exercised for some critical materials: phosphates in Morocco, bauxite in Guinea, tin in Bolivia.

TRANSPORT

8. Building of some 9,500 km a year of gas and oil pipeline(1), much of it through climatically hostile regions, represents an appreciable achievement(2) in spite of the fact that a high proportion of large diameter pipes needed have to be imported, largely paid for by exports of the transported materials - oil or natural gas. The railways are the backbone of the Soviet transport system, providing a reasonable service but with lengthy turn-around times. The average length of haul is around 900 km. The proportion of idle to travel time is high, due, inter alia, to lack of mechanical handling equipment. Average speed of journeys has dropped slightly since 1976. Rolling stock is badly maintained and often ill-suited to the goods transported, resulting in appreciable losses, especially of bulk agricultural produce, and in a high incidence of pilferage. The development of the network, and especially the rate of progress of the East-West BAM(3) line is behind schedule. As for highway transportation, there is no continuous hard surface East-West link; most roads from farms to major communication centres are pot-holed or otherwise unsatisfactory and lead to losses of produce through vehicles with defective or ill-designed bodies. Inland waterways are closed for a significant part of the year and especially at the times when large volumes of fuel need to be transported. The shortcomings of the Soviet transport system cannot be remedied without considerable investment in equipment, especially handling equipment, and without coordination between the various branches of transport.

- (1) In the period 1971-79 the Soviets built approximately 3,300 km per annum of oil pipeline and 6,300 km of gas pipeline
- (2) The trans-Alaska pipeline, passing through comparable areas, from Prudhoe Bay to Valdez, is 1,300 km long.
- (3) The Baikal-Amur-Mainline designed to supplement the trans-Siberian railway.

There is some evidence that the USSR is planning improvement to rail transport services although the time scale envisaged extends beyond the next Five-Year Plan.

ENERGY

9. The production of natural gas and electricity is satisfactory; that of oil continues to grow, in a country which is already the world's largest producer, and for 1980 will reach 600-606 million tonnes thus practically meeting the Plan of 606 million tonnes. Coal output is falling. The shortfall in coal production could be serious if the result amounts to only 713-716 million tonnes (745 Plan) and a severe winter has to be faced. For 1981 the best information at present available gives targets of 610 million tonnes for oil and 738 million tonnes for coal, but the fuel balance, according to Soviet statistics, will be very tight. Even so, the USSR has undertaken to supply its East European allies during the period 1981-85 with annual average amounts of oil at least the same as in 1980. In spite of the success of the natural gas industry and the possibility of gaseous hydrocarbons replacing liquids for both power station and petrochemical inputs, it is generally held that energy will be a constraint on Soviet (and East European) economic growth in the next few years. Reliance is being placed on large-scale plans to develop West Siberian oil and gas resources over the next ten years, according to Brezhnev in his speech to the CPSU Plenum on 21 October 1980. But even by best estimates, the outlook for the immediate future suggests that resources will have to be carefully husbanded if modest plans for overall economic growth are to be satisfied.

FOREIGN TRADE

10. The economic recession in the West has compounded the difficulties the USSR normally has in marketing its manufactured products in industrial countries: such products are generally considered to be inadequate in quality, in presentation, and in styling. Partly as a result, Soviet trade figures for the first six months of 1980 show a deficit of over 1 billion rubles (\$1.6 billion) in trade with the industrialised West. Nonetheless, energy trade, arms and gold sales, and invisibles should provide ample means to gain the convertible currency with which to repay outstanding net indebtedness to the West, which is estimated will be below \$10 billion by the end of 1980. A major factor in the development has been the ability of the USSR to earn considerable amounts of hard currency from exports of oil and gas - over 60% of revenues from exports to the West. Continuing improvement in trade will depend in part on the availability of fluid hydrocarbons: a possible reduction in exportable oil volumes may be compensated by higher oil prices and by increased availability for export of natural gas which is becoming far more acceptable to Western industry as an alternative

fuel and feedstock. Moreover, because gold prices are likely to continue their fluctuating though generally upward trend, the USSR should have no major problem in acquiring the hard currency needed for its imports of cereals, food, machines, and technology. The restrictions placed by Western exporting nations in response to Soviet foreign adventures will be the limiting factor to imports rather than the availability of hard currency to the USSR.

SATISFYING THE CONSUMER

11. The present generation of consumers in the USSR is no longer quite so totally isolated as its forefathers from the influences of the West, or of those of Eastern Europe which, however, are perhaps of less consequence insofar as the East European standard of living is less strikingly superior. Neither is the present consumer as voiceless: this has been borne out in the course of 1980 by work stoppages at a number of plants allegedly in response to shortages of food and poor working conditions. Besides inadequate food, especially meat, supplies and lack of a more varied diet promised over the years, discontent arises over insufficient supplies of consumer durables as well as day to day expendables, and unsatisfactory housing, both in terms of quality and space per family(1). But the problems are not only ones of supply: they are compounded by uneven distribution regionally and differences between urban and rural availabilities; and perhaps worse still, there is increasing popular awareness of - and less willingness to accept - the difference of distribution through the strata of society. The discontent manifests itself in a variety of ways: industrial action, relatively easily controlled by the government; alcoholism, not easily controlled and the subject of constant official complaints; the development of an immeasurable and uncontrollable secondary economy including a black market; an increase in theft and in cheating generally; and in a nationwide common apathetic attitude to duty. The evidence is mainly anecdotal, and the causes may be as politico-social as they are economic. Whilst the results are not quantifiable, there is no doubt that the discontent is an important

(1) Mention should be made of the considerable government consumer price subventions - amounting to over 20 billion rubles a year for food alone - which perhaps diffuse to some extent consumer discontent over supply shortages, but at the same time limit the government's room for manoeuvre: reducing the subsidies, while allowing more resources to be put into consumer goods production would only serve to exacerbate consumer discontent - perhaps with unforeseen consequences.

element in the low productivity in most sectors of the Soviet economy and this is fully recognised in Soviet economic statements. The options available to remedy this major deficiency are examined from time to time: increase investment in machinery and plant, but already too many projects remain uncompleted and plant lies idle; favour production of consumer goods and services at the expense of producer goods, but the distribution inadequacies would remain and would be magnified if transport equipment production is reduced; establish a better distribution network - but the materials required - rolled steel, cement, etc. - are not produced in sufficient quantities. Two major options remain - firstly the reallocation of resources from the military, but this would directly cut across the interests of a privileged class and, in Soviet eyes, would jeopardise the expansion of global influence and an ironclad rule regarding the necessity of Soviet strategic security. Secondly, the establishment of a market system throughout a much broader section of the economy, but this would be counter to the ideology still professed by the leadership and could conceivably lead to economic chaos: it is unlikely to be advocated by old leaders, and young aspirants, even whilst possibly believing such a change desirable and expedient, are unlikely to offer their future career as a sacrifice on the altar of reform.

DEFENCE EXPENDITURE

12. The Soviet defence effort has been estimated to cost some 73-78 billion rubles a year, representing 12-14% of the gross national product, and in current rubles, in 1979, is expected to grow about 4-5% a year in real terms. Most military equipment generally reflects a higher degree of technical sophistication than is found in civil products; it can be reasonably deduced that military R & D and production use superior materials, machines and personnel. But it is also known that diffusion of technology between the military and civil sectors is virtually non-existent or, at best, is slow so that there is an absence of spin-off for the consumer. The military also absorbs the output of a large sector of basic industry - steel-making, mechanical and electrical engineering, construction, etc., which otherwise could well be used in improving the economy generally, in providing housing and roads. Large volumes of transport for men and materials are called upon. In the budget for 1981, a small reduction appears in the announced defence budget, representing 0.3% of the 1980 vote of 17.1 billion rubles: even if such a percentage reduction were applied to the entire estimated defence spending, thus yielding 2 billion rubles, it could not compensate for the larger increase in defence in relation to the low growth of the economy as a whole, and the decrease announced will not benefit the consumer noticeably. There is no evidence at present that the Soviet Union is thinking of cutting back on the growth of its military spending but it is possible that continuing economic difficulties

might prompt a new leadership to consider such a cut-back for the late 1980s.

EASTERN EUROPE

BULGARIA

13. Zhivkov has no reason to be happy about the economy of the country he has been ruling for decades. To believe his statisticians, national income grew by 6.5% last year and the average for 1976-79 is 6.2%. But more realistic calculations lead to 4% and about 3.5% respectively - still good, in a world of short booms and long recessions, but not satisfactory for an economy which is still far from being developed and is clearly moving down a slope of lower and lower growth. Agriculture, a traditionally flourishing activity, is increasing slowly (2.3% a year in the period 1976-79), and enormous investments and brand new expensive imported technologies are still to bear their fruit. The era of sacrifices, industrialisation at any cost, and high investments has not brought about an affluent Socialist society in Bulgaria any more than in the USSR, and dramatic improvements are not to be expected.

14. The real impediments to growth are lack of natural resources and the exhaustion of manpower reserves. The concept of large gains if productivity in manpower were better utilised is unrealistic within the present framework of a command economy. Thus, as "extensive" growth is coming to an end, fast growth will cease, the more so as the trade balance constraint is a real straightjacket. Although in 1979 a surplus of over \$650 million with non-Communist countries appeared, the long series of deficits in preceding years has brought the country to heavy indebtedness both to the East and the West (\$3-\$4 billion in hard currency at the end of 1979). The régime's reaction to the unfavourable prospects of the economy - particularly labour shortage and an energy crunch - is to stick ever closer to its Eastern allies, first of all the USSR, with which 57% of foreign trade is conducted. Although more trade within CMEA is possible, the Soviets are not likely to provide more oil.

CZECHOSLOVAKIA

15. The constraints in the Czechoslovak economy stem from scarcity of raw materials, of fuel and energy, of labour, transport difficulties and foreign trade. As Soviet shipments of oil and other raw materials will remain at present levels, the CSSR must acquire these commodities on international markets in hard currency, except for especially agreed above-Plan quotas. To avoid a widening trade deficit from rising prices for such imports, Czechoslovakia must be able to sufficiently expand exports of heavy machinery. Such exports fail to compete with

Western standards, because of their poorer quality and out-dated technology. The extraction of brown coal in Northern Bohemia is becoming more difficult and costly and deposits are unable to satisfy domestic demand. With no additional reserves to rely on, it is imperative that Czechoslovakia exploit more efficiently, through advanced technology, those resources which she does possess. Two nuclear power generating plants, still under construction and suffering from shortcomings in design, material, and labour, are part of a programme (in conjunction with the Soviet Union) to supplement the country's energy needs. The government, to alleviate the present labour scarcity, resulting from falling birth rates and a large section of the population past retirement age, has implemented schemes to reactivate pensioners. The over-worked transportation system causes delays in the timely delivery of fuel and raw materials which further hinder production. In agriculture, particular attention is given to the growing of high quality wheat for human consumption and malt barley for export, neither of which is likely to attain production targets for 1980. According to six month statistics, meat production is already down and its availability is unlikely to improve owing to grain shortfalls, and meat shipments for Poland to calm the situation there.

16. The "Ler experiment", a reform introduced in 1978 and due to terminate in 1980, involves the participation of 150 amalgamated enterprises (VHJs-Higher Production Units) which combine more economically the processes of research, manufacturing and supply. Reforms, coming into effect as of 1st January 1981, will provide for more comprehensive and detailed Five-Year Plans, subdivided into annual ones, to serve as the main production guidelines. Enterprises will be accorded greater independence in management, although central controls over production will be strengthened. Within CMEA Czechoslovakia has become increasingly involved in long-term projects of specialisation and integration with other countries. Export burdens to both East and West and existing economic problems do not indicate a likely improvement in the selection, quality and availability of goods for the domestic consumer. To maintain present standards and some degree of modest growth, greater efficiency in production and conservation of resources are necessary.

GERMAN DEMOCRATIC REPUBLIC

17. Ensuring adequate supplies of energy and raw materials is the major economic concern for the GDR government. This is especially so as Soviet oil and gas deliveries will remain at 1980 levels, and costs for alternative supplies on international markets are constantly rising. Agriculture and, in particular, livestock farming is an area receiving attention in an effort

to boost production and to achieve a measure of self-sufficiency for cereals, sugar beets, and forage plants: despite this emphasis, the GDR must continue to import fodder, because harvests still fail to cover the nation's requirements. As a result, foreign trade is vital, but is hampered by a lack of competitiveness, by Western standards. The present concentration in developing the GDR's microelectronic industry for foreign markets will probably channel resources away from the domestic consumer: this will prove unpopular, as demand for consumer durables has increased along with rises in salaries and living standards. Reductions in subsidies and price increases have absorbed some excess purchasing power, but the government is aware, from events in Poland, that a selection and availability of goods must be maintained. Employment is very high and the birth rate has only recently begun to increase: expansion in production must be accomplished largely through improved technology. Two recent reforms in agriculture and industry have sought to raise productivity and efficiency. The merging of cooperative farms into associations was designed to improve agricultural performance and food processing through specialisation and economies of scale, whilst a more streamlined economic structure and the amalgamation of enterprises into larger units known as "Kombinaten" is aimed at similar ends in industry. The GDR has concluded agreements of co-operation and specialisation spanning the next ten years with other CMEA countries and particularly with the USSR. The GDR is overwhelmingly dependent on Soviet supplies of oil, gas and raw materials, in return for which the GDR delivers heavy machinery and equipment. The GDR economy will have difficulty serving two fronts: producing microelectronics for the West and heavy industrial goods for the East. Exports to the Soviet Union do not cover its energy bill and indebtedness to the West is growing.

18. It is yet too early to assess how the recent East German action of raising the minimum compulsory exchange to 25 GDR-Mark per diem for visits to the GDR and East Berlin(1) will affect economic relations in the long term. Since the application of the new regulation as of 13th October 1980 the number of visits has decreased significantly although hard currency revenues have remained at much the same level. Visits from relatives with gifts of money or of items unavailable in the East helped supplement gaps in consumption: now that trips are more expensive and visits likely to be less frequent, the East German consumer will be obliged to make do with the domestic market.

(1) The payment has to be effected in convertible currencies (e.g. 1 GDR-Mark = 1DM). Before 13th October 1980 the minimum payment was 13 Marks, but for visits of one day to East Berlin it was reduced to 6.50DM; pensioners were exempted, but they now have to pay the full amount of 25DM. Apart from the minimum exchange a visa fee has to be paid (5 Marks for visits of one day, 15 Marks for stays of more than one day).

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HUNGARY

19. The year 1980 sees the continued renewal of the New Economic Mechanism of 1968. This strategy is mainly aimed at export promotion and stabilising the economy. To this end a set of regulators is used, by which true production costs are reflected through higher input prices and profitable enterprises are encouraged by selective credits; the wage fund is almost frozen to achieve both a more rational distribution of labour, which is in short supply in general and usually misplaced, and a decrease in production costs; higher productivity is fostered through wage incentives and adjustments.

20. This strategy seems to have made some headway as the results of the first five months of 1980 show. A 1.4% increase in productivity was achieved despite an overall decrease in production. Exports increased by 7.4% over the same period in 1979, although exports to Communist countries fell by 2%. More important than that, exports to non-ruble markets increased by 29.3%, resulting in a positive balance in convertible currency trade. Overall investments decreased as envisaged. Moreover, Hungary has achieved remarkable success in raising agricultural production. Hungary's agricultural output per capita is by far the highest in CMEA, and exports are surging ahead of the traditional exporter, Poland. Inflation, running at 12.8% in the first part of 1980, was largely the result of price changes in 1979 and was not unexpected. Price increases, while helping the basic materials and energy sectors to grow, resulted in a decrease in turnover in some sectors such as the hotel and catering. The guidelines for the new National Plan covering 1980-85 has not been disclosed but it can be assumed that Hungary will continue to follow its current economic strategy.

POLAND

21. The economic scene in Poland in 1980 highlights the gravity of the economic crisis which is affecting the country particularly as a consequence of the persistence and, in some respects, of the accentuation of fundamental imbalances both internal and external. The strategy of intensive growth accompanied by a steep increase in income which was launched in the early seventies did not result in a sufficient rise in the supply of consumer goods and the significant surplus in purchasing power which had been generated was only partially absorbed by inflation, currently running at 10-15% per annum(1) The corrective mechanisms operated by the authorities mainly affected investment which was reduced and partially contributed to a 2% drop in the national income in 1979, but without restoring

(1) Depending on various national sources. German estimates, for instance, set the rate of inflation for the Polish economy as a whole at 6-7% in 1976 and 1977, and 9-10% in 1978 and 1979. In the private farmers' markets it is thought to be currently at 10-14% per annum.

the balance between internal supply and demand(1). In addition, the development of industry is being held up by cumulative delays in the energy and transport sectors. As for agriculture, bad weather has been responsible for a poor 1980 harvest and additional imports will be needed to meet food requirements at a time when the convertible currency balance of payments is causing particularly severe constraints.

22. Poland's convertible currency indebtedness represents a severe drag (2) on the economy and involves the refinancing of a substantial proportion of its repayments. The country's continuing solvency will depend on its ability to correct the current account situation in the short term, which implies, in the first instance, the constitution of a substantial trade surplus, given the foreseeable continuation of the deficit in invisibles generated by the payments of interests on the debt. The likelihood of such a change taking place in 1980 is doubtful since the trade deficit with the non-Communist world will probably reach some \$1 billion and the deficit on current account between \$2.5 and \$3 billion. Total financing requirements are likely to be of the order of \$8.9 billion. Poland is faced with a two-fold problem in its efforts to improve its convertible currency trade balance: on the one hand, increased selectivity in imports of capital equipment and semi-finished goods could place serious constraints on industrial production, and a reduction in purchases of consumer goods would be incompatible with the government's promise to increase the supply of these items; on the other hand, the possibility of a substantial increase in the export of manufactured goods is limited, whereas more diversion of raw materials away from the domestic market would have serious consequences for economic activity.

23. The work stoppages which took place in certain enterprises during the summer of 1980 have led to overall production losses estimated by the authorities at close to 2% of the value

(1) The drop in national income in 1979 is attributable to at least three causes: (1) a reduction of available investment funds, both from the state budget and from enterprise-generated funds; (2) a fall in industrial production of around 5% from the 1978 level, as a result of economising in materials use, of energy shortages, of transport inadequacies, and of lower labour productivity, itself stemming from deteriorating labour morale and discipline and the entry of fewer workers into the workforce; and (3) a bad harvest, which caused a decline in total agricultural production of around 1.5%. Agricultural difficulties have continued into 1980, during which Poland experienced a 30% decline in the sugarbeet harvest from the 1979 level and a 50% fall-off in potato production.

(2) In 1979, repayments of principal and interest including short-term debt, were estimated by Western authorities to be about 90% of the value of merchandise exports to non-Communist countries.

of planned industrial sales for the year. Moreover, production in certain sectors (coal-mining in particular) is apparently still below the levels recorded before the strikes. Altogether industrial production in 1980 may fall as much as 5% below that of 1979, from the continued effects of labour difficulties, and shortages of materials and parts. The injection into the economy of additional disposable purchasing power, generated by wage increases, could widen the gap between the supply and demand of consumer goods, thus leading to a probable increase in the rate of inflation and greater shortages. Perhaps one of the most significant aspects of the workers' unrest is the refusal of a large proportion of wage earners to accept an austerity programme intended, inter alia, to assist the return to more balanced consumer markets through a reduction in demand. In these circumstances, the return to equilibrium remains conceivable only through an increase in supply and this, in view of the constraints imposed by the external payments position, seems difficult and presupposes, in the first instance, a substantial rise in productivity(1). Pending the effects of such a hypothetical rise, Poland could well become increasingly dependent on outside financial help.

ROMANIA

24. Romania's still comparatively fast growth is an exception to the sluggish development of Eastern Europe. Although both annual (1980) and Five-Year (1976-80) Plans are unfulfilled(2), the economy has, according to perhaps questionable Romanian statistics, grown at an average annual rate of 6% in recent years, with agriculture passing through a cyclically favourable period and industry expanding at 10%. Such results in a time of harsh international economic development were bought dearly by the population and were made possible only by Romania's comparatively generous resource endowment, including oil. Industrial output growth is expected to be lower in 1980, however, because of reduced industrial activity brought on by a drop in oil imports as a result of the Iran/Iraq conflict. Formerly, two-thirds of Romania's oil imports were from these two countries. The curtailment of oil imports has forced several large petrochemical concerns either to be shut down or put on

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- (1) On 17 November the Government announced its intention to institute measures, as of 1 January 1981, which would allow enterprise managers to set their firm's wage and employment levels independently of central control; by encouraging more efficient use of labor resources, the measures might promote greater productivity.
- (2) In his latest economic speech of 15 October 1980, Ceausescu specified that national income increased at 8% per annum in the period 1976-80. The original target was 10.3%, unrealistically raised to 11% in December 1977.

short time; the potential loss in exports of oil products is as much as \$1 billion.

25. Forced industrialisation - the policy consistently followed by the Ceausescu clan which has been ruling the country since 1965 - had a number of negative sides: a) one-third of income was devoted to investment in the 1970s, which in a poor country like Romania meant heavy sacrifices for the consumer; b) resources were drained with little or no care for natural resource preservation and for the tremendous pressures imposed upon human resources (inurbation, depletion of the agricultural manpower reservoir); c) the myth of gigantism led to unsound industrial policy choices, such as an overgrown petrochemical complex which can process 30 million tonnes of crude, whilst the domestic production fell from 14.7 million tonnes in 1977 to 12.3 million tonnes in 1979(1). In order to keep growth high Bucharest had recourse to massive imports leading to about \$850 million trade deficit in 1979 after years of substantial balance(2). The government sees 1981 as being a year for consolidating investments, a time for completing projects rather than initiating new large-scale ventures. Restrictions have recently been imposed to overcome the deficit(3), and a definite turn to more intra-CMEA trade advocated to relieve the tight hard-currency situation. Nonetheless, the \$6.7 billion hard-currency debt still seems to be manageable although its recent growth rate seriously preoccupies the Romanian leadership.

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- (1) No improvement is foreseen: the 1981 Plan envisages an extraction of 12.6 million tonnes (15 million tonnes are still written in the 1980 Plan, but in no way can they be achieved).
- (2) The Romanian current account has deteriorated rapidly in recent years and continues to do so. Financing this deficit has led to a continuing growth in indebtedness and deterioration in its maturity structure as more short-term funds have been borrowed.
- (3) In particular, insistence on compensation and barter deals.

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USSR AND EASTERN EUROPE

CMEA DEVELOPMENT

26. The CMEA Council's 34th Session which convened in Prague in June 1980 further displayed the inconsistencies of the CMEA common development programmes and the contradictions arising from different growth concepts and structures of the members' national economies. The USSR refrained from committing itself to deliveries of fuel and other raw materials larger than those of 1980. In the vital sector of Plan co-ordination, no new concrete measures as far as integration is concerned, were taken. Plan co-ordination continued to preserve its bilateral character despite sometimes half-hearted wishes to give it a multilateral character through the CMEA Committee for Co-operation in the Sphere of Planning. This year Afghanistan was admitted to the CMEA in the capacity of an observer(1). Whether Afghanistan will finally be admitted as a full member, following the example of Vietnam, remains to be seen.

SOVIET BLOC ECONOMIC RELATIONS WITH LDCs

27. Soviet bloc economic relations with LDCs are influenced by two main factors: a) a large and continuous increase in arms sales to LDCs, and b) a rapid growth in raw materials imports - particularly oil. Economic aid programmes play a secondary rôle, in world terms(2), but they usefully buttress Soviet influence. Soviet aid is particularly effective in propaganda terms because it concentrates on a few eye-catching gigantic projects, but it is of no help in alleviating poverty and disease. The effectiveness of military and economic assistance programmes in the LDCs is skilfully and expediently supplemented by large numbers of military advisers and economic technicians. In addition, over 30,000 Cuban troops serve Soviet interests in Africa, but the cost to the USSR is \$10 million a day in support of Cuba's shattered economy(3).

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- (1) This brings the total of under-developed and non-European partners of the CMEA to nine, Cuba, Vietnam and Mongolia being full members.
 - (2) Barely 5% of \$9.6 billion Soviet exports are under aid credits, and outright grants are negligible. When counter-flows of interests and repayments are subtracted, Soviet aid became negative in 1979.
 - (3) Including nearly \$7 million a day in sugar subsidies alone.

USSR & EASTERN EUROPE: SELECTED INDICATORS OF ECONOMIC GROWTH
(Percentage change over previous year)

<u>USSR</u>	<u>1978</u>	<u>1979</u>	<u>1980 Plan</u>	<u>1980 6 mths.</u>
National Income(a)	4.2	2.0	4.0	-
Industrial Production	4.8	3.4	4.5	4.2
Ind. Labour Productivity(b)	3.6	2.4	3.8	3.2
Agricultural Output	3.0	-4.0	8.8	-
Foreign Trade(c):				
Exports	7.2	18.9	-	21.6
Imports	14.8	9.6	-	21.7

<u>Bulgaria</u>				<u>Czechoslovakia</u>					
	<u>1978</u>	<u>1979</u>	<u>1980 Plan</u>	<u>1980 6 mth.</u>		<u>1978</u>	<u>1979</u>	<u>1980 Plan</u>	<u>1980 6 mth.</u>
National Income(a)	5.6	6.5	5.7	-	4.1	2.6	3.7	-	-
Industrial Production	6.8	5.8	6.3	4.5	5.0	3.7	4.0	3.8	3.8
Ind. Labour Productivity(b)	6.3	6.2	-	-	4.2	2.9	-	3.2	3.2
Agricultural Output	4.3	6.0	3.7	-	2.6	-2.7	7.2	-	-
Foreign Trade(c):									
Exports	10.4	15.4	-	17.0	9.2	10.3	17.0	20.6	20.6
Imports	12.2	7.4	-	9.0	7.7	11.3	12.8	15.2	15.2

<u>GDR</u>				<u>Hungary</u>					
	<u>1978</u>	<u>1979</u>	<u>1980 Plan</u>	<u>1980 6 mth.</u>		<u>1978</u>	<u>1979</u>	<u>1980 Plan</u>	<u>1980 6 mth.</u>
National Income(a)	3.8	4.0	4.8	5.0	4.0	1.4	3.0-3.5	-	-
Industrial Production	5.4	4.8	4.7	5.9	5.2	2.8	3.5-4.0	-1.8	-1.8
Ind. Labour Productivity(b)	4.2	4.4	4.5	5.7	5.3	4.5	-	1.0	1.0
Agricultural Output	1.4	0.8	-	-	1.5	0	5.0-5.5	-	-
Foreign Trade(c):									
Exports	10.3	11.0	-	16.0	0.9	17.2	8.5	8.5	8.5
Imports	1.7	13.0	-	-	12.6	2.6	-1.3	-1.7	-1.7

<u>Poland</u>				<u>Romania</u>					
	<u>1978</u>	<u>1979</u>	<u>1980 Plan</u>	<u>1980 6 mth.</u>		<u>1978</u>	<u>1979</u>	<u>1980 Plan</u>	<u>1980 6 mth.</u>
National Income(a)	2.8	-2.0	1.4-1.8	-	7.6	6.2	8.8	-	-
Industrial Production	5.8(1)	2.8(1)	2.0-3.0(3)	7.0	9.0	8.0	11.4	8.0(5)	8.0(5)
Ind. Labour Productivity(b)	5.8(2)	3.3(2)	2.5-3.0(4)	7.1	7.1	6.4	8.7	-	-
Agricultural Output	4.2	-1.4	5.8	-	2.4	5.0	4.7-6.0	-	-
Foreign Trade(c):									
Exports	9.8	12.2	11.0	13.7	5.5	18.0	-	-	-
Imports	4.7	6.3	6.1	16.1	16.5	20.1	-	-	-

- (a) Produced national income, i.e., utilised national income (consumption plus investments) plus losses and net exports; (b) Gross production per employed person; (c) At current prices and exchange rates, fob; Hungary's imports, cif;
- (1) Production sold in socialised industry; (2) Production sold per employee in socialised industry; (3) Objective revised in June 1980 (previous forecast 3.0-4.2); (4) Objective revised in June 1980 (previous forecast 4.4); (5) Five months.

N A T O R E S T R I C T E D

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USSR & EASTERN EUROPE: RECENT TRENDS IN TRADE WITH
NON-COMMUNIST COUNTRIES AS A WHOLE (MILLIONS OF \$).

	<u>1978</u>	<u>1979</u>
USSR		
- Exports(1)	21,191	28,761
- Imports	20,300	25,160
- Balance	891	3,601
Bulgaria		
- Exports	1,583	2,275
- Imports	1,432	1,618
- Balance	151	657
Czechoslovakia		
- Exports	3,101	3,500
- Imports	3,529	4,000
- Balance	- 428	- 500
GDR(2)		
- Exports	3,694	4,387
- Imports	4,788	6,043
- Balance	-1,094	-1,656
Hungary		
- Exports	2,475	3,360
- Imports	3,822	4,042
- Balance	-1,347	- 682
Poland		
- Exports	5,488	6,037
- Imports	7,378	8,046
- Balance	-1,890	-2,009
Romania(2)		
- Exports	4,177	5,458
- Imports	5,120	6,889
- Balance	- 943	-1,431
TOTAL FOR EASTERN EUROPE		
- Exports	20,518	25,017
- Imports	26,069	30,638
- Balance	-5,551	-5,621

(1) Including statistical residual stemming from trade with developing countries; (2) Estimates.

Sources: AC/127-WP/626 (Corrigendum) for Eastern Europe and official trade statistics for the USSR.

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SOVIET AND EAST EUROPEAN
CONVERTIBLE CURRENCY INDEBTEDNESS

(End of Year Situation)

	Estimated Net Convertible Currency Debt (\$ billion)	Debt Service (Prin- cipal + interest as a share of merchan- dise exports to non- Communist countries
USSR		
1972	0.6	17(1)
1975	7.4	23(1)
1978	11.2	31(1)
1979	10.2	24(1)
Bulgaria		
1972	0.9	36
1975	2.3	33
1978	3.7	46
1979	3.7	38
Czechoslovakia		
1972	0.2	10
1975	0.8	14
1978	2.5	20
1979	3.1	22
GDR		
1972	1.2	18
1975	3.5	25
1978	7.5	49
1979	8.4	54
Hungary		
1972	1.1	14
1975	2.2	19
1978	6.5	36
1979	7.3	37
Poland		
1972	1.1	15
1975	7.4	30
1978	17.0	79
1979	20.0	92
Romania		
1972	1.2	27
1975	2.4	23
1978	5.0	20
1979	6.7	22
Total		
1972	6.3	
1975	26.0	
1978	53.4	
1979	59.4	

(1) Debt service as a share of convertible currency merchandise exports.

CHRONOLOGY OF IMPORTANT ECONOMIC EVENTS IN 1980

USSR

- Jan. - Joint Party, Government, Trades Unions decree issued, stressing need for labour discipline, material incentives ("On the Further Firming-Up of Labour Discipline and the Reduction of Various Cadres in the National Economy")
- May - Worker walk-outs at Togliatti and Gorky car plants over food shortages
- June - Work stoppage reported at Kama truck plant as protest against food shortages
- Sept. - Draft outline of 1981-85 Plan published
- Oct. - Nikolai A. Tikhonov replaces Alexi Kosygin as Prime Minister
- Communist Party Central Committee Plenum: agriculture, energy development stressed; severe 1980 grain harvest shortfall indicated because of bad weather
- 1981 Plan published: National Income growth of 3.4% indicated (vs. a planned 4% in 1980 and 4.3% in 1979)

BULGARIA

- March/
May - Intensive touring by Foreign Minister and S. G. Zhivkov to several oil-producing Middle East countries (Kuwait, Libya, Iraq and Syria). In the background, the country's serious fuel shortages
- June - Reshuffle in several ministerial posts; Zhulev is replaced by Serbezov as Minister of Light Industry
- July - Establishment of a new Industrial Economic Association to bring together all the country's industrial enterprises regardless of their ministerial subordination. Aim: to overcome the "inter-departmental barriers"

CZECHOSLOVAKIA

- 31 Jan. - Enactment of law entitled "Collection of Measures for Improving the System of Planned Management of the National Economy after 1980", designed to streamline planning: Five-Year Plans will set detailed yearly targets and annual plans will be treated as sub-divisions of the Five-Year Plan Management, and the VHJs will have more autonomy but external control over operations will be tightened.
- 9 April. - Prime Minister Strougal's speech in which he comments on fulfilment of Plan targets, problems affecting the Czechoslovak economy and the new set of reforms to come into effect as of 1 January 1981.
- 8 Oct. - Speech of Gustav Husak, addressing the 16th Convention of the Party Congress: elements of the new 7th Five-Year Plan discussed as well as improvement of material well-being, economic cooperation with the Soviet Union, foreign trade, expansion of investment in construction, and technological development.
- Speech of Strougal at 19th Session of the Central Committee of the Communist Party of Czechoslovakia, outlining the goals of the 7th Five-Year Plan for the period 1981-85.

GDR

- 21-22 May - The 12th Congress of the Central Committee of the Socialist Unity Party during which discussions took place on the GDR economy.
- 19-20 June - The 7th Construction Conference dealt with the realisation of Plan goals for the 1980-85 period.
- 12-13 July - Neues Deutschland published the 1st half-year statistics for 1980 and commentary on results in certain sectors and the future course of the economy.
- 13 Oct. - Coming into effect of a law raising the minimum compulsory currency exchange rate from 13 to 25 DM daily for visits from the West to East Germany.

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HUNGARY

- March - National Assembly passes law on Atomic Energy (the only such law besides Romania's in the Warsaw Pact)
- Hungarian-Soviet Long-Term Programme on Specialisation and Coordination (1980-90)
- Hungarian Socialist Workers' Party's 12th Congress - slower economic growth set for 1981-84 period.
- April - Hungary's plans to revalue forint 4-5% annually (as a part of its drive to make it convertible) disclosed
- July - State Planning Commission's sphere of authority redefined by decree
- Economic Committee established by decree

POLAND

- 11th-15th February - Meeting of the VIIIth Party Congress
- 4th May - Announcement of measures designed to reduce administrative expenditure
- 23rd June - Re-examination of 1980 planning forecasts comprising, inter alia, a downward revision of industrial output growth targets and of industrial productivity
- 1st July - Changes to the meat marketing system and big rise in meat prices
- 2nd July - Outbreak of strikes in the "Ursus" tractor plants
- 14th August - Start of strike in Gdansk naval dockyards
- 31st August - Signing of Gdansk agreements between strikers and government
- 3rd September - Signing of agreements between the government and the striking Silesian miners
- 6th October - Meeting of Central Committee of the Party

ROMANIA

- 8 Feb. - Initialling of agreement with the EEC on the establishment of a joint commission to develop and diversify trade
- 28 March - Initialling of industrial and trade agreements with the EEC granting substantial advantages to Romania
- 31 May - In a major speech to the Central Committee, Ceausescu sharply criticises indiscipline and irresponsibility, leading to shortcomings and notable Plan unfulfilment
- 18 June - Verdet's address to the CMEA Council Session in Prague shows a renewed interest in intra-CMEA cooperation, often confirmed later in the year by different top leaders, including Ceausescu
- 4 July - Agreement for agricultural aid to Iran in exchange for oil. Another chapter in Romania's quest for raw materials to fuel its overgrown petro-chemical industry.
- 28 July - Final signature in Bucharest of a comprehensive agreement with the EEC
- Sept. - Under the shock of Polish strikes Ceausescu announces sweeping consumer-oriented measures, which in practice will not be realised. On the other hand defence cuts (-16% of the original budget) are adopted, which may be an indication of limited reorientation of resources towards consumers' welfare.
- October - Draft bill on small-scale industry, submitted to public debate before presentation to Grand National Assembly. Aim of the Bill: to expand range of consumer goods. The tolerated level of private activity is raised - up to three workers.