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SOVIET AND EAST EUROPEAN ECONOMIC DEVELOPMENTS, ISSUES, AND IMPLICATIONS

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 areas of economic activity in the Warsaw Pact countries of greatest importance to their evolution, the issues, and potential significance for the Alliance. The review is supplemented at Annex by statistical tables, showing the major economic indicators and the development of hard-currency indebtedness over recent years of the Warsaw Pact countries.

2. The report will constitute a reference document for the Council in Ministerial session on 17th-18th May 1982.

(Signed) Joseph M.A.H. LUNS

This document includes: 1 Annex

NATO,
1110 Brussels.

(1) For previous reports see C-M(81)23 dated 28th April 1981 and C-M(81)76 dated 27th November 1981

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Report by the Economic Committee

I. INTRODUCTION AND SUMMARY

A. Introduction

1. The impact of economic and financial developments, directly and indirectly, on political and military decisions in the Warsaw Pact make it necessary for NATO member governments to take account of these developments and the associated issues they raise, especially in East-West economic relations. This paper highlights important recent economic developments and trends in the USSR and Eastern Europe, and considers some areas of particular interest to NATO.

B. Summary

2. Constraints on Soviet economic growth in 1981, induced largely by three successive years of reduced agricultural output, were aggravated by developments in Soviet trade with the West, in which the USSR experienced falling prices for oil exports, its principal hard-currency earner, and deteriorating prospects for obtaining additional convertible-currency credits. As a result of the harvest shortfall, the USSR will need to disburse at least $6 billion for feedgrains during the 1981-1982 crop year to sustain its livestock herds. Such outlays will be all the more difficult at a time when oil export earnings have dropped to around $12 billion in 1981, down from $12.4 billion in 1980, and when events in Poland may have led the USSR to make further convertible-currency commitments. Efforts continue to sustain consumption growth despite a general slowdown in the rate of growth of total economic output. Production of some, but certainly not all, consumer durables grew at a respectable rate in 1981 and continued their pace into 1982; output of most basic foodstuffs stagnated or declined, however, and the trend appeared to continue into 1982.

3. Among the East European economies, Poland occupied the centre of attention in 1981. The country continues to suffer from vast dislocations caused by delivery disruptions and the crushing burden of foreign debt repayments. Industrial production fell by 13% in 1981 and shows no signs of rapidly regaining momentum in 1982. Polish Authorities have publicly evoked the possibility of a new fall in industrial production in 1982 which may lead to a proliferation of bottlenecks and to new difficulties. Food distribution remains hindered by farmers' unwillingness to make deliveries because of a lack of desired goods they might receive in exchange. Because of radically reduced imports, Poland's

convertible currency trade balance for 1981 showed a slight surplus which, however, is overshadowed by hard-currency obligations of some $10 billion falling due in 1982; moreover, the import reduction has crippled industrial output further by cutting off deliveries of essential inputs normally supplied from abroad.

4. After Poland, economic difficulties among the East European CMEA countries are most evident in Romania, and apparently least pronounced in Bulgaria. In Romania, industrial production grew little, if at all, in 1981, agricultural output declined for the second year in a row, with the result that many food items are now rationed, and the balance of payments situation continued to be precarious. Hungary succeeded in reducing considerably both its total foreign trade deficit and its convertible trade deficit in 1981, thanks to increased exports, but growth in economic output was less than expected. Czechoslovakia's economy is burdened by continuing productivity problems and rising energy costs, and was further set back in 1981 by a bad harvest. Despite strict curtailment of new investment, the GDR succeeded in raising industrial output by over 5% in 1981 and in expanding production of brown coal, the country's principal fuel. The GDR, Czechoslovakia, and Hungary in 1982 suffered cutbacks in deliveries of Soviet oil, on the order of 2-3 million tonnes or around 10% below customary levels for each country. Bulgaria in 1981 benefited from solid grains in industrial output, a satisfactory harvest, and a hard-currency trade surplus; but like most of the rest of the East European CMEA countries, it faces the prospect of slowing growth over the decade ahead, stemming primarily from rising input costs and an inability to expand productivity sufficiently rapidly to offset them. As a result of increasing convertible-currency payments difficulties, exacerbated by the currently unfavourable attitude of Western bankers toward lending to Eastern Europe, the area as a whole is being forced to reduce trade with the industrial West and to intensify intra-CMEA trade relations.

5. These developments raise questions concerning the ability of the Soviet and East European economies to support continued high levels of defence spending and to extend their economic influence in non-Communist less developed countries. Although there is little doubt that the countries' defence expenditures will continue to be given high priority, there is evidence of concern on the part of their leaderships as to the compatibility of growth in defence spending with the aim of raising living standards, which has become an increasingly important objective throughout the area. The USSR has tended to expand purchases of food items and certain raw materials in the Third World; at the same time Soviet and East European exports of arms to the area continue to rise. Trade of certain East European countries with the Third World has apparently become an increasingly important means of generating hard-currency surpluses in their merchandise trade. Current economic relations, however, are judged not to have given the Warsaw Pact countries any overwhelming influence in the less developed countries, except for the few principal recipients of Soviet arms.

6. Recent economic developments in the Soviet Union and Eastern Europe have drawn renewed attention to their implications for East-West economic relations. The large volume of CMEA debt to the West, currently standing at over $80 billion in net terms, combined with Poland's external financial position, have caused a hiatus in further extensions of most long-term Western credit to the area; there could be repercussions on current industrial output and growth in productive capacity, particularly because of consequential restrictions on imports of Western technology. The potential for Western pressure on the Warsaw Pact economies through outstanding convertible currency debt is judged, however, as limited. At the same time, reciprocal East-West deliveries of raw materials, notably grain and energy materials, are not expected to develop to such an extent that insuperable economic dislocations would result in the event of disruptions of supplies. These issues are examined in greater detail in the section immediately following which grows out of the description of significant economic developments presented in Section III.

II. ISSUES AND IMPLICATIONS

A. Defence Burden on the Warsaw Pact Economies

7. Defence spending in the USSR continues to grow at a rate of approximately 4% annually and now is estimated to absorb 12-14% of GNP. With growth in national income at only 3.2% in 1981 and planned at 3% in 1982, the prospect presents itself that future increases in defence spending cannot come entirely from the parallel expansion of total national output alone, as in the past, but will have to encroach on growth of investment or civilian consumption. If current defence spending trends continue, this dilemma will make itself more apparent especially by 1985, when spending for defence is expected to account for some 15% of estimated GNP. Even if the USSR eventually opts for a reduced rate of growth of defence expenditure, however, absolute levels of spending will still be very high, allowing for substantial modernization programmes throughout the Soviet forces. Considering current priorities, allocations to defence are expected to continue to grow at an annual average rate of around 4% until 1985 at least.

8. In Eastern Europe, although defence outlays account for a lower portion of economic output than in the USSR(1), there is evidence that the problem of a conflict in priorities with investment needs and civilian consumption is becoming more acute as economic growth slows and defence expenditures continue to rise. Reportedly planners have become increasingly concerned over the portion of production of potential consumer goods pre-

(1) In the GDR, for example, published defence spending figures, which as elsewhere in Eastern Europe are thought to be nearer actual defence spending levels than published figures in the USSR, amounted to some 5.6% of national income in 1981; if expenditures on internal security are included, the figure comes to 8%.

empted by the military, especially in light of the tensions generated by suppressed consumerism in Poland. It is alleged, for instance, that out of total sales of passenger cars and trucks in Eastern Europe, one out of every three or four vehicles is distributed to the defence sector(1).

B. CMEA Economic Penetration of the Third World

9. CMEA economic influence in the non-Communist less developed countries continues to stem primarily from arms sales, foremost by the USSR, but also by Czechoslovakia and the GDR. Preliminary data indicate that Soviet arms sales, which account for over one-half of Soviet exports to less developed countries, continued their upward climb in 1981. Principal recipients, as in the past, were Middle East countries. The Soviet Union and Eastern Europe continued to influence certain Third World economies through participation in joint ventures and the provision of services, such as shipping, but data on these activities is incomplete. More visible economic effects have arisen from radically enlarged Soviet imports of meat and grain from South American countries in 1981, which aided these countries' balances of payments, adversely affected the Soviet Union's balance of payments and, statistically, increased the share of the non-Communist Third World in total Soviet trade from its previous level of nearly 20%. On the other hand, merchandise trade of several East European countries(2) with the Third World showed apparent convertible-currency surpluses in 1981, perhaps indicative of a trend toward increasingly important trade relationships with this area. Soviet imports of certain metal ores from the Third World also increased in 1981, in line with a tendency noticed in previous years for the USSR to purchase a high percentage of domestic requirements abroad if world prices do not justify development of additional production within the Soviet Union. In sum, current economic relations are judged not to have given the Warsaw Pact countries any overwhelming economic influence in the less developed countries, except for the few principal recipients of Soviet arms.

C. East-West Economic Relations

(a) CMEA Debt to the West

10. Standing at around $82 billion in net terms at the end of 1981, CMEA debt to the West has slowed down its rapid expansion of the 1970s. Of primary concern to Western creditors is Poland's portion of the debt, which at the end of 1981 amounted to about

(1) Frankfurter Allgemeine, 21st October 1981, pp. 13-14. The same source cites an East European estimate of the defence burden on the East European economies as amounting to about 15% of GNP.
(2) Specifically, Bulgaria, Czechoslovakia, Hungary and Poland

$28 billion. Having fallen in arrears in its debt repayment in 1981, Poland is likely not to meet financing requirements for 1982, which amount to around $10 billion. Western banks will thus probably be faced with the prospect of declaring Poland in default, rescheduling a portion of Poland's debt, or granting a moratorium on debt repayment, unless other means of dealing with the situation can be found. As evidenced by its behaviour in 1981, it is unlikely that the USSR will assist Poland to any great extent in repaying its debts to the West. In the meantime, lacking additional borrowing facilities in the West, Poland's industrial output can be expected to continue to be severely constrained by shortages of raw materials and semi-manufactures normally imported from the West.

11. Poland's current external financial difficulties, as well as the total size of CMEA's debt to the West, have caused Western bankers to reduce sharply the extension of new credits to all of the CMEA countries, apart from short-term facilities and guaranteed credits. It is now clear that other East European economies, particularly Romania and Hungary, have experienced economic disruption through their inability to obtain medium and long-term financing to pay for planned imports from the West. This has had consequent repercussions on their ability to repay existing convertible-currency debt. Even under present circumstances, however, the prospect of widespread repudiation by the CMEA countries of their Western debt is unlikely.

(b) Western Financial and Economic Influence

12. Large Soviet drawings in 1981 on its convertible currency assets in Western banks, requests by the USSR to delay payments for some Western imports, and increased sales of Soviet gold on world markets have underlined the USSR's need to obtain additional convertible currency to finance a large trade deficit and perhaps to render financial assistance to Poland.

13. It has been suggested that Western nations affect Soviet and East European economic growth, and indirectly their military capabilities, through trade and the extension of trade-related credits. Undoubtedly such is the case, since the CMEA economies import from the West largely to expand productive capacity or to make up for domestic production shortfalls, including foodstuffs. Such effects are virtually impossible to quantify, however, and in value terms would doubtless be minuscule in comparison with the CMEA area's total economic output(1). Moreover, it is hard to conceive that through trade leverage the West could force the Communist authorities to reforms leading to less rigidly controlled economies and to liberal factory management. Trade disruption with the West might lead the Communist economies to invest in domestic production of items

(1) Total Soviet imports from the industrial West are valued at only 1-2% of estimated GNP, and the percentage of high technology items imported from the West is much smaller.

which could otherwise be procured more cheaply abroad; but the effect on the Warsaw Pact economies would be of a one-time nature for a given item, once investment in domestic production had been made, and would also have repercussions on Western firms engaged in trade with the East.

(c) Supply Vulnerability

14. Continuing substantial deliveries of Soviet oil to the West and increasing shipments of Western grain to the USSR give rise to a question of respective vulnerabilities should deliveries be reduced or cut off. Although Soviet oil deliveries account for as much as 10% of some Western nations' oil imports, they are felt not to represent a particular threat if delivery is interrupted, because of possibilities for quickly switching to other sources of supply and because of the fact that the deliveries are in any case tending to decline in volume. At the same time, Western shipments of grain to the USSR, whilst vital, contribute less than 20% to total grain supplies in any year.

15. Annually increasing deliveries of Soviet gas to Western Europe, at present accounting for no more than 15% of any nation's total gas supplies, may, by 1990, approximate in energy terms to current oil deliveries. The potential disruption of these deliveries is seen as more difficult to overcome than a cessation of Soviet oil supplies, since gas supplies are still provided mainly by pipeline. The vast network of pipelines in Western Europe should allow for alternative deliveries, however, providing surge capacities and storage facilities have been adequately developed.

III. RECENT ECONOMIC DEVELOPMENTS

A. USSR

16. The year 1981 saw the USSR's worst grain harvest since 1975 - output is estimated to have been at least 60 million tonnes below the planned level of 236 million tonnes. As a result, the total value of agricultural output fell some 15 billion rubles, or 11%, short of its planned value(1). Although expanded winter sowing may contribute to a better grain harvest in 1982, the USSR is expected nonetheless to import at least 45 million tonnes of grain mainly to feed its livestock populations, which at the beginning of 1982 remained virtually at the levels of the previous year(2). The cost of these imports will be at least $6 billion, absorbing a quarter of current annual Soviet hard-currency export earnings. Besides the weather, inadequate machinery and infra-

(1) If the Soviet harvest had met plans, national income growth in 1981 would have been more than double the achieved rate of 3%.
(2) The fall in milk production in 1981, following the trend of the previous three years, suggests that cattle continued to be underfed, although the total slaughter weight of meat regained the average of 1976-1980.

structure shortcomings continue to hinder Soviet agriculture despite the massive investment, allocated each year - in 1982, a planned 27% of all fixed investment funds, which will be devoted primarily to improving rural living conditions, increasing supplies of farm machinery and fertilizer, and expanding land reclamation. Considerable sums will be spent also on establishing more agro-industrial complexes, which allegedly help crop processing to be carried out more efficiently and reduce the need for product transport.

17. In Soviet industry, principal gains in production in 1981 appear to have been made in the areas of consumer goods, and machine tools and related items, estimated to contribute two-thirds to advances in labour productivity. Nonetheless, there are indications that the Soviet machine tool industry continues to produce equipment which is slow, cumbersome, expensive, and subject to costly design errors, leading to a need to import many items from the West to make up for shortcomings in domestic production. Moreover, below-plan production of iron ore in 1981 caused iron and steel output to fall behind schedule in 1982, with repercussions throughout the Soviet economy.

18. Output of energy materials - oil, gas and coal - whose production development currently absorbs around one-fourth of all industrial investment funds annually, expanded in calorific terms in 1981 by the equivalent of some 25 million tonnes of oil or 2% above the 1980 level. The expansion was achieved despite a decline in coal production to 704 million tonnes, the third annual drop since 1978, when output stood at 724 million tonnes: the industry suffers from slowness in mine development in eastern USSR needed to make up for rapid depletion of deposits in the western parts, notably in the Donets Basin. Additional natural gas output, however, made up almost four-fold in calorific terms for the coal shortfall, with investment allocations about equivalent to those of the coal industry. Production of oil and gas condensates, with investment spending nearly triple that of either coal or gas, appears to be reaching its peak: in 1981, it stood at 609 million tonnes, only 1% above the 1980 level, and in 1982 it is scheduled to grow by only 5 million tonnes, i.e. less than 1% above the 1981 output. For the USSR, the path of cheapest energy development during the 1980s is clear: boost natural gas production to make up for declining coal output, and possibly soon declining output of oil. Beyond the 1980s, however, coal and nuclear energy should begin to register increasing shares in total energy supply, as a result of continuing development efforts throughout the current decade(1).

19. In 1981, capital investment restraint caused growth in its total amount to expand by only 3%, some 1% below Plan. Such restraint continues under the 1982 Plan which calls for virtually

(1) Soviet sources project that, by the year 2000, coal may account for slightly over one-fourth of total primary energy production in the USSR, up from approximately one-fifth in 1980, and nuclear energy might supply one-tenth of total primary energy, as opposed to its current 1%.

no growth in gross capital investment over the 1981 level of 138 billion rubles. The policy of forcing the completion of outstanding projects is thus pursued and investment funds will have to be channelled into priority sectors. Whilst agriculture in 1982 will continue to receive over a quarter of all investment, housing construction and consumer goods industries are to be given additional emphasis. Heavy investment in the development of new production capacity in Siberia for natural resources continues to hinder efforts to raise productivity elsewhere: only 17% of industrial investment in 1981 went into modernizing and retooling existing plants, on which the USSR must rely for most of its additional capital machinery.

20. At the same time that growth in investment in the economy is constrained, expansion of the labour force is slowing down. In 1981, only 1.6 million workers were added to the paid labour force, as opposed to 1.9 million in 1980, and an average of over two million annually throughout the 1970s. As a result, the USSR must strengthen efforts to use labour, as well as capital, more efficiently. The wholesale price adjustment which came into effect at the beginning of 1982 may encourage managers to use labour more sparingly to offset the higher cost of raw materials, if they will not otherwise be compensated for higher-priced materials inputs. In addition, the machine-tool and control equipment industries, both vital to efforts to increase labour productivity, registered respectable output gains in 1981 of over 5%, although there are indications of wide-ranging deficiencies in machine-tools being produced. Nonetheless, in 1981 labour productivity in industry failed to reach its 3.6% growth goal, instead increasing by 2.7% and accounting for an alleged four-fifths of all production gains, as compared with a scheduled 90%.

21. Partly in reaction to events in Poland, the USSR has shown increasing concern over the structure and functioning of its labour unions. In March 1982 Alexei Shibayev, Head of the Soviet Trade Union Organization since 1976 was replaced, partially, it appears, because of his lack of vigour in trade union efforts to correct management shortcomings and abuses and to promote labour morale and productivity. Further, at the Soviet Trade Union Congress in the same month President Brezhnev devoted the major part of his speech to ways of strengthening labour organization activities. Among them he proposed improving food distribution, partially through factory subsidiary farms, promoting the use of work teams, and expending greater efforts to better protect workers against abuses of their interests.

22. Soviet output of consumer goods, increasingly emphasised to boost worker morale and productivity, showed some solid gains in 1981, especially in colour television sets, tape recorders, and passenger cars, which advanced by 7-15%, admittedly from a relatively low base by Western standards. The total value of clothing and furniture produced advanced by 6-8%, perhaps partially as a result of earlier price adjustments, although production of knitted items and leather shoes showed little change. Output of basic foodstuffs, apart from meat, was generally below 1980 levels, notably for such items as milk, sausage, and vegetable oil. Animal fat production also declined, probably signifying a deterioration of meat quality, but fish production advanced by 3%.

23. Transport remains one of the principal obstacles to rapid economic development. Railroads, the backbone of the Soviet transport system will receive an increase of 30% in investment funds in 1982, in an attempt to make up for past periods of neglect, but much will be absorbed by the BAM(1) throughout the 1981-1985 period to the detriment of other forms of surface transportation. In 1981 labour productivity in rail transport was reported to have grown at half the rate planned, and although the total distance of rail shipments increased somewhat over the 1980 level, the volume of goods shipped showed a negligible gain reflected in failure to deliver required materials, especially coal and oil, and causing dislocations in the economy.

24. In recent years the USSR has relied to a growing extent on sales of oil and gas in particular(2) to the West to gain convertible currency earnings to pay for desired imports, most notably agricultural products and meat, Western machinery and equipment, and certain intermediate products. In 1981, however, because of weakening prices on world oil markets the USSR turned increasingly to sales of gold and arms and to other means, such as large drawings on its assets in Western banks, to make up for extensive hard-currency outflows resulting primarily from record agricultural imports and secondarily from aid commitments to Poland(3). Soviet convertible-currency foreign trade at the end of 1981 showed a deficit of $4.1 billion(4), as against $2.5 billion in 1980, stemming from a larger increase in the total value of imports than of exports. The USSR could face

(1) Baikal-Amur-Magistral line, roughly paralleling the Trans-Siberian railway between Lake Baikal and the Amur River, in an area projected for important mineral extraction. It is probably the most ambitious rail transport project anywhere in the world to have been started in the 20th Century.
(2) Hard-currency sales of oil and gas in 1980 amounted to approximately $15 billion or nearly two-thirds of total convertible currency earnings.
(3) Soviet hard-currency financial assistance to Poland reached about $500 million in 1981, according to UK estimates.
(4) According to official Soviet foreign trade statistics, discounting the residual of trade with unspecified Third World countries; ruble denominated foreign trade statistics have been converted at a rate of 1 ruble = $1.40 for 1981 and 1 ruble = $1.55 for 1980.

continuing difficulties in the next few years in earning sufficient convertible currency if the prices of oil, of gold, and of other traditional raw materials remain depressed, or if probably declining exports of oil, the main hard-currency earner, are not made up by increased sales of gas. Further bad harvests, which would necessitate more large grain imports from the West, would of course compound hard-currency earning problems, thus perhaps causing the USSR to cut back on other "non-essential" imports. The apparent unwillingness of commercial banks to increase exposure to any CMEA member-country will also probably cause problems for the USSR in obtaining additional convertible-currency credits. Nonetheless, barring further unforeseen obstacles, these difficulties should not render the USSR unable to repay its convertible-currency debt, amounting to around $12 billion.

25. Most notable of recent developments in the USSR's trade relations with Eastern Europe is the diminution of Soviet oil exports to the GDR, Czechoslovakia and Hungary by 10% starting in 1982. The cutback may have been effected partly to force the countries in question to adjust to world market prices and to help the USSR to underwrite its economic support to Poland. As a result, Eastern Europe, with the possible exceptions of Poland and Bulgaria, will be further constrained to conserve energy use, to seek additional supplies in the West, and to pay increasing hard-currency sums for energy from the USSR. Thus the East European countries can be expected in the 1980s to increase their share in total Soviet foreign trade above their present approximate one-third(1). Many of the additional East European exports to the USSR will be in the form of products which might have been sold in the West.

B. Eastern Europe

(a) Poland

26. The 13% drop in national income in 1981 demonstrates the extent to which the Polish economy has deteriorated. This negative trend can be mainly attributed to difficulties in the industrial sector, where output fell by some 13% in relation to 1980 as the result of a decline in individual labour productivity coupled with a reduction in working hours and a general shortage of raw materials, semi-manufactures and spare parts largely due to the 40% fall in convertible currency imports. Imports were affected more than exports (a 35% drop) and this enabled the country to redress its trade balance. Despite this favourable development, external payment commitments in 1981 exceeded Poland's financial resources with the result that it had to negotiate with both Western governments and banks over

(1) Soviet statistics report that trade with Eastern Europe, Cuba and Vietnam increased by 17% in 1981, and 14% in 1980.

the consolidation of a large proportion of its maturing debts; moreover, the remainder of its financing requirements had to a large extent be met by heavy recourse to officially-backed Western credits. On the domestic market, consumer goods were in even shorter supply since a wage increase was accompanied by a reduction in the volume of articles offered for sale. All this has worsened shortages, pushed up inflation and completely disorganized the distribution network.

27. The trends noted since the imposition of martial law declaration show that industrial output continued to decline: -13.6% in January 1982 and a similar drop in February (year-on-year figures). There has been some progress in certain priority branches such as sulphur, cement and, above all, coal, where an upturn in output has been achieved by means of longer working hours and the concentration of available resources. For the rest of industry the production decline has apparently worsened because of a shortage of intermediate goods, communications difficulties and doubtless a further drop in productivity caused by certain forms of passive resistance practised by a portion of the work force. Everyday household consumer goods continue to be in short supply. At the same time, with the exception of meat, the food supply position picked up in January and February as a result of the improved 1981 harvest and perhaps also because of destocking and a reduction in demand in the wake of big price rises. The public have apparently resigned themselves to these price rises. However, the supply situation in the short-term will depend in large measure on the government's ability to encourage, or oblige, private farmers to delivery their produce. The real impact on consumers of the price rises introduced early in 1982 will be felt in April.

28. In the near term, the outlook for the Polish economy is grim, uncertain, and very difficult to forecast. The biggest strain on the economy, namely the convertible currency external payments situation, has a two-fold aspect: firstly, it appears impossible to reimburse the debts maturing in 1982 ($10 million for principal and interest) without obtaining agreement to the rescheduling of the bulk of that amount and, secondly, even under the most favourable circumstances - achievement of the planned amount of rescheduling and of the predicted trade surplus - $3.7 billion will still have to be funded and this will be difficult without further credits. Poland is attempting to redirect its trade towards the COMECON grouping but this entails the risk of further disorganizing industry by changing the production pattern; moreover, it is possible that certain East European countries will be reluctant to go along with a large and prolonged Polish deficit in bilateral trade. The Warsaw authorities' handling of their economic difficulties is still characterised by vacillation: some reforms (particularly where prices are concerned) have been introduced but their effectiveness is limited because they have not been consistently applied. A revival of the Polish economy is more than ever dependent on the implementation of a stabilization programme designed to restore gradually the basic economic balance and provide for a rational use of production capacity.

29. The military régime seems to be experiencing great difficulty in controlling the economic situation and has reduced the planning period to two months. A further slackening of industrial production, which is likely in 1982, will compound Poland's economic problems.

(b) Romania

30. The 1981 returns, as published in the Romanian press, together with information from Western sources and recent economic decrees adopted in Bucharest show that the economy's performance was much worse than average and was a far cry from plans, including those submitted to the IMF and World Bank to obtain credits. The only bright spot in 1981 was a $303.8 million surplus in the hard-currency trade balance, but this barely corresponds to 35% of the deficit on "invisibles" in the 1980 balance of payments. The announced 2.1% (Plan: 7.0%) real increase in National Income (NMP) is lower than in any year during the seventies and is probably due more to an understatement of inflation than to real gains.

31. Industry grew by an official 2.6% (Plan: 6.5%), with serious shortcomings in the extractive sector (particularly coal and oil), in electric power generation, and in chemical production. Agricultural output decreased for the second year running (down -0.9%, after a -5.0% decline in 1980). This explains acute scarcities of foodstuffs, with a resulting negative impact on the standard of living. Indeed, most staples are rationed, and in October 1981 bread and flour were added to the list. Later, in February 1982, substantial consumer price increases were enforced, averaging from 35% (official) to over 50% (US Embassy estimate). Certainly, realising external surpluses in order to meet the debt service and restore the country's financial credibility - almost totally eroded by accumulating arrears in payments of foreign debts - is proving to be a painful process in a context of an adverse international economic situation, stagnating domestic energy production, bad agricultural performance, and only limited support by the USSR, whose strained capacity is reserved for more needy - and more pliable - clients.

(c) Hungary

32. Dramatic rises in oil prices, and the continuing imbalance between consumption and production, resulting in a perennial foreign trade deficit, caused resource-poor Hungary considerable problems in the late 1970s. Several measures have since been taken, aimed at increasing productivity and the competitiveness of exports, preserving the standard of living and curbing investments in new projects. Moreover, a new price and credit policy has been introduced through a set of financial regulators.

33. Although Hungary's terms of trade have not improved significantly since 1979 its total foreign trade deficit has been reduced from nearly 25 billion forints to approximately 18 billion forints in 1980 and 15 billion forints in 1981. An increasing portion of Hungarian foreign trade, however, is accounted for by the Socialist countries which took 55% of Hungary's exports in 1980, and 3% more in 1981, when imports from these countries also rose by 2%. In 1981 Hungary's trade deficit with OECD and developing countries rose slightly by 5 billion forints, although Hungary recorded a surplus in its dollar trade with the CMEA and a declining deficit in its ruble trade. The country's overall hard-currency trade deficit, after the dramatic decrease in 1980, further decreased and stood at only 83 million dollars in 1981. The price reform, which envisaged the gradual introduction of free prices based on world market prices for both inputs and end products, seems to have encouraged Hungarian enterprises to export, for which they become eligible for tax rebates.

34. On balance, however, the overall performance of the economy in 1981 was not satisfactory. The main targets of the plan were not met, causing National Income to grow less than expected. Hungary took another step in its currency reform and abolished dual exchange rates (commercial and tourist) as of 1st October 1981 and applied for membership in the IMF. In view of the economy's 1981 performance, targets for 1982 have been set lower.

(d) Czechoslovakia

35. Energy, manpower and foreign currency constraints caused growth in National Income during 1981 to rise by only 0.2%, the lowest increase in eighteen years. The 1982 target for growth in National Income also shows modest expectations and is far less than would be required for Czechoslovakia's stated goal of 10-13% to be achieved by 1985.

36. The 1981 Plan results for agriculture registered a decrease of 3.4% in overall production, although the livestock sector met its plans. The 1.6 million tonne shortfall in the grain harvest will not affect human consumption, but will impinge directly on livestock needs. Faced with more expensive energy imports in the wake of reduced Soviet exports, the country can afford to import only some 500,000 tonnes of grain this year from the West. In view of the possibility of eventually tighter supplies of meat and other foodstuffs, and in an effort to offset State food subsidies of 40% at the wholesale level, the government raised meat prices in January 1982 by 27% on the average and, in some cases, by as much as 41% for prime quality cuts. At the same time, prices for rice rose by 100%, sea fish 26%, tobacco 30-39% and wine 18%.

37. The already difficult energy situation is exacerbated by a 10% (2.6 million tonne) reduction in 1982 in Soviet oil deliveries, which stood at 19.2 million tonnes in 1980. The cutback will probably increase in the coming years to 3.5 million tonnes. Because reserve depletion makes substantial increases in domestic coal production virtually impossible, the country will be hard-pressed to meet the 124 million tonne target for 1982, even though this represents an increase of only 0.8 million tonnes over 1981 output. Moreover, in 1981 the country felt the effect of reduced coal exports from Poland for power-generating purposes and shortfalls in electricity from Romania. To conserve energy initial steps were taken in the transportation sector with 20-25% price increases for gasoline for privately owned vehicles. Diesel fuel was subject to an even sharper rise of 75% and home heating costs have increased steeply.

38. Industrial output in 1981 increased by only 2%, slightly short of target. Expansion of industrial output is expected to be lower in 1982. Substantial growth rates are needed in the engineering and electronics industries to provide the means for modernizing Czechoslovakia's technically sub-standard industry, as well as for boosting export competitiveness. Industrial managers cannot expect to promote growth through increases in workforce or larger capital investments: the labour force will grow by only 1% during 1980-1985, and the Plan for 1982 foresees a 3.3% decline in capital investment from 1981.

39. Foreign trade evolved in favour of Czechoslovakia during 1981: exports to non-Communist countries grew by 4.0% while corresponding imports declined by 3.6%, resulting in a hard-currency trade surplus. Similarly, in trade with Socialist countries, export growth led increases in imports. Targets set for 1982 envisage a strongly rising rate of increase in exports to non-Communist countries.

40. For the consumer, a 2% growth in real per capita incomes in 1981 was achieved despite the price increases for gasoline and home heating fuels; the January 1982 price rises for meat, tobacco and alcohol may tend to erode whatever gains are made this year, however. Growth of output in light consumer industry over the 1981-1985 period is forecast at less than half that scheduled for the engineering and electronics industry.

(e) GDR

41. 1981 growth rates of 5% in National Income and 5.1% in industrial production were among the highest reported in Eastern Europe: such accomplishments are noteworthy especially under a programme of stringent energy and raw materials

conservation. Soviet oil deliveries have not increased beyond the 1980 level of 19 million tonnes and will be cut by 2 million tonnes during 1982 leading the GDR to make a concerted effort to boost brown coal output and implement a series of radical conservation measures. Brown coal output, the largest in the world, reached a 267 million tonne peak in 1981 (3.3% over 1980). The target for 1985 at 295 million tonnes is particularly ambitious, but necessary if brown coal is to be a substitute for oil in the coming years.

42. The industrial production increase of 5.1% exceeding the Plan goal of 5% was achieved almost entirely by increasing labour productivity. Expansion of labour productivity appears to be thus well on its way to meeting the 29% growth foreseen for the period 1981-1985 in order to overcome labour shortages. A strict curtailment in investment, as demonstrated by the low 1981 growth rate of 2%, is a further impetus for greater efficiency and rationalization. This declining trend in investment is reflected in the building industry, where older sites are to be modernized and rebuilt. Agriculture experienced good results and potato, sugar beet, corn and fodder production were all above Plan; but despite a grain harvest of 9.2 million tonnes, cereal imports will be necessary to maintain extensive livestock herds. Last year's volume of imports totalled 2 million tonnes at a cost of $370 million. The Five-Year Plan envisages increases of 7-10% for grain, potatoes and sugar beet: the realization of these targets will depend, in part, on improvements in agricultural organization.

43. Much emphasis in Plan reports has been accorded to living standards. In 1981 real per capita income rose by 4% and retail trade turnover by 2.5%. The 1981-1985 Plan gives assurances that stable retail prices will prevail for consumer basics and the quality of those goods in the middle range will be maintained: it is interesting to speculate the extent to which these commitments, made at a time of imminent price rises in Poland and Czechoslovakia, will be met.

44. Overall foreign trade turnover increased by 10% in 1981 and of this, trade with the USSR rose by 17%. The achievement of a positive convertible-currency trade balance probably results partly from the rare surplus during 1981 in inter-German trade, designed largely to allow East Germany to reduce its cumulative debt to the Federal Republic; and partly from a limitation of imports, particularly in trade with countries other than the Federal Republic of Germany. The tendency for the current Plan is one of closer integration within CMEA and with the USSR.

45. The apparently satisfactory results achieved during 1981 and the ambitious plans for the future course of the economy must be balanced against an increasing scarcity of fundamental industrial inputs and a continually growing convertible-currency debt. One wonders how long the continuing East German drive to boost output can keep ahead of the economic slowdown affecting other East European countries.

(f) Bulgaria

46. Despite the adverse international economic climate, internal misallocation of resources and heavy - but not unbearable - external debt, Bulgaria is still trading along a positive growth path. Errors and inconsistencies detected in Bulgarian statistics make it difficult to believe the official statement that in 1981 "the plan for the production of National Income (NMP) has been fulfilled", which would mean a 5.1% growth, but a GNP growth rate of half that much is credible. Industry, the top priority sector, grew by a notable 5.6% (as planned), whilst agriculture - although blighted by some shortcomings and falling 0.7% below a 4.7% planned increase in total output - was able nonetheless comfortably to supply the market. Practically all major crops, including grains, vegetables and fruit, were satisfactory.

47. Foreign trade was also positive: the overall trade balance recorded an unspecified surplus, whilst hard-currency exports allegedly exceeded corresponding imports by $800 million. Such a surplus, which was probably due to a large increase in exports to less developed countries, has permitted the country to honour its debt service with no apparent payments problems. The standard of living also increased, as evidenced by the fact that per capita personal incomes rose by a real 3%, thereby overcoming the numerous waves of price increases which have occurred since late 1979 (e.g. in 1980 food prices went up by an official 24.7%). The only major dark spot for consumer welfare seems to be the systemic unfulfilment of housing construction plans; as a result, Bulgarian planners have become more prudent, setting much lower targets for 1982. Lower goals in general are the rule for the 1982 annual Plan, with NMP expected to grow by 3.6%. Slower growth seems inevitable, even if Bulgaria finds itself in the unique position of receiving continuous and generous raw material supplies from the USSR, thus being an exception to widespread economic stringencies within European CMEA.

C. CMEA Integration

48. Co-operation in the fields of energy and food production continued to dominate recent CMEA meetings. At the January 1982 session in Moscow of the CMEA Executive Committee, which consists of deputy premiers of CMEA countries, discussion centered on agreements reached during the CMEA Council's 35th Session (1981) and consequential actions. Measures concerning the implementation of a general agreement on "Multilateral Co-operation in the Creation of a Single and Unified Base for Electronic Goods, and for Technology, Equipment and Materials for their Production" were outlined. Specific tasks were assigned for the joint development in the 1981-1985

period of machines and equipment to reduce the use of manual labour primarily through robots with programme control, of precision metal-working and foundry equipment, standard machine drives and other engineering items, and of machinery for agriculture and for food processing. During the session it was indicated that inter-CMEA deliveries of specialized products would almost double by 1985.

49. Cuba continues to participate fully in CMEA activities. Economic conditions in Cuba in 1981 improved somewhat from the previous year, principally because of rising sugar prices. The year 1982 may bring difficulties for the island economy, however, as sugar prices have fallen. The situation could be aggravated if the USSR cuts back oil deliveries to Cuba, as it has with regard to several other CMEA member countries. The CMEA Planning Committee, which met in Havana in January 1982, gave special attention to energy questions. Poland's proposal concerning the utilization of idle capacity in Polish industry by other CMEA members was welcomed but concrete action did not come until General Jaruzelski's visit to Prague in March 1982, when Czechoslovakia agreed to such an arrangement.

50. The economy of Vietnam, the other non-European CMEA member, showed signs of increasing weakness in 1981. Of principal concern to the West is a growing Vietnamese convertible-currency debt, which now stands at around $1.5 billion, and on which $280 million in principal and interest is due in 1982. Vietnamese hard-currency export earnings, on the other hand, are unlikely to exceed $100 million this year, and convertible-currency reserves are negligible. At the beginning of 1982, Vietnam had already fallen into arrears in repayment of outstanding debts to the United Kingdom and the IMF.

TABLE 1

USSR & EASTERN EUROPE: SELECTED INDICATORS OF ECONOMIC GROWTH

(Percentage change over previous year)

USSR	1978	1979	1980	1981
National Income(a)	5.1	2.2	3.5	3.2(d)
Industrial Production	4.8	3.4	3.6	3.4
Ind. Labour Productivity(b)	3.0	2.0	2.6	2.7
Agricultural Output	2.7	-3.1	-3.0	-2.0
Foreign Trade(c):				
Exports	7.3	18.9	17.0	15.1
Imports	14.8	9.6	17.4	18.4

	Bulgaria				Czechoslovakia			
	1978	1979	1980	1981	1978	1979	1980	1981
National Income(a)	5.6	6.5	5.7	...	4.1	2.7	3.0	0.2
Industrial Production	6.9	5.5	4.2	5.6	4.8	3.7	3.2	2.0
Ind. Labour Productivity(b)	6.3	4.1	2.6	...	4.1	2.9	2.5	1.6
Agricultural Output	4.3	6.0	-4.5	4.0	1.5	-3.9	6.0	-3.4
Foreign Trade(c):								
Exports	10.4	15.3	16.3	10.5	9.2	10.3	14.3	9.4
Imports	12.2	8.3	11.7	19.7	7.7	11.3	7.6	5.8

	GDR				Hungary			
	1978	1979	1980	1981	1978	1979	1980	1981
National Income(a)	3.6	4.0	4.2	5.0	4.2	1.8	-0.8	1.8
Industrial Production	3.7	4.8	4.7	5.1	4.9	3.0	-1.7	2.3
Ind. Labour Productivity(b)	3.2	4.4	5.1	5.0	4.9	4.6	-1.1	4.5
Agricultural Output	1.4	2.0	0.2	...	2.0	-1.1	2.6	0
Foreign Trade(c):								
Exports	10.5	13.5	10.0(e)	10.0(e)	0.9	17.2	-0.4	6.5
Imports	0.8	11.3			12.6	2.6	-2.9	4.8

	Poland				Romania			
	1978	1979	1980	1981	1978	1979	1980	1981
National Income(a)	3.0	-2.0	-4.0	-13.0	7.6	6.3	2.5	2.1
Industrial Production	4.9	2.8	-1.3(f)	-12.6(f)	9.0	8.2	6.5	2.6
Ind. Labour Productivity(b)	4.9	2.7	-1.0(g)	-12.2(g)	7.1	5.6	4.2	1.0(j)
Agricultural Output	4.1	-1.4	-9.6	4.1	2.4	5.5	-5.0	-0.9
Foreign Trade(c):								
Exports(i)	9.7	12.3	3.4	-14.6	5.5	18.0	24.5	11.3
Imports(i)	4.9	6.6	7.3	-12.2	16.5	20.1	21.8	-7.4

(a) Produced national income, i.e. utilised national income plus losses and net exports.
(b) Gross production per employed person.
(c) At current prices and exchange rates, fob; Hungary's imports, cif.
(d) Utilized national income (consumption plus investment).
(e) GDR statistics refer only to turnover since 1980.
(f) Production sold in socialised industry.
(g) Production sold per employee in socialised industry.
(h) Five months ... = not available.
(i) For Poland, based on trade statistics expressed in current foreign zlotys.
(j) Estimated on the base of a 2.4% increase in net terms.

Sources: National yearbooks and official press releases.

TABLE 2

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

	1979	1980	1981
USSR(1)			
- Exports	19,237	23,655	23,861
- Imports	21,354	26,193	27,963
- Balance	-2,117	-2,538	-4,102
BULGARIA			
- Exports	2,276	3,063	3,301
- Imports	1,618	2,014	2,629
- Balance	658	1,049	672
CZECHOSLOVAKIA			
- Exports	3,651	4,526	4,306
- Imports	4,139	4,519	3,989
- Balance	- 488	7	317
GDR(2)			
- Exports	4,463	5,476	-
- Imports	5,211	5,686	-
- Balance	- 748	- 210	-
HUNGARY			
- Exports	3,360	3,883	3,650
- Imports	4,042	4,560	4,439
- Balance	- 682	- 677	- 789
POLAND			
- Exports	6,350	7,496	5,480
- Imports	8,037	8,477	5,414
- Balance	-1,687	- 981	66
ROMANIA(2)			
- Exports	5,297	6,503	8,275(3)
- Imports	6,518	8,037	7,971(3)
- Balance	-1,221	-1,534	304(3)

(1) Convertible currency trade, excluding residual trade with non-specified developing countries.
(2) Convertible currency trade.
(3) Official data, published in Scintea on 11th February 1982. Coverage appears to differ from figures given for 1979 and 1980 (which are those officially communicated to the IMF), in that the percentage changes reported by Romania for 1981 (a 13.5% increase for exports and a 12.6% decrease for imports) do not correspond with the values given here.

Source: Official statistics of the countries indicated, except for data for the GDR, which is taken from estimates given in Table II of C-M(82)2.

TABLE 3

USSR AND EASTERN EUROPE: CONVERTIBLE CURRENCY DEBT ESTIMATES

(Net Convertible-Currency Debt in Billions of Current US Dollars at Year-End)

	1975	1979	1980	1981(a)	Percent Change 1980-1981
USSR	7.4	9.5(b)	9.6(b)	12.3	+ 28
Poland	7.4	20.0	26.0(b)	28.5	+ 10
GDR	3.5	9.0(b)	10.4(b)	12.2	+ 17
Romania	2.4	6.7	9.2	11.0	+ 20
Hungary	2.2	7.3	7.7(b)	7.5	- 3
Czechoslovakia	0.8	3.1	3.0	3.0	0
Bulgaria	2.3	3.7	3.0	2.5	- 17
CMEA banks(c)	2.8	4.9	4.9	5.0	+ 2
TOTAL	28.8	64.2	73.8	82.0	+ 11

(a) Preliminary estimate
(b) Revised figures, different from those quoted in Annex to C-M(81)76
(c) International Investment Bank and International Bank for Economic Cooperation