

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

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WORKING PAPER

AC/127-WP/583(Revised)

ECONOMIC COMMITTEE

RECENT ECONOMIC TRENDS AND PROSPECTS IN THE USSR AND
EASTERN EUROPE

Note by the Acting Chairman

1. Following discussion at the Economic Committee meeting of 19 October, the attached revised paper attempts to take account of points made during the meeting.

2. The Economic Directorate has aimed at reconciling the desire for a survey of general problems and achievements with the need to examine economic highlights and performance of the USSR and Eastern Europe during the first half of 1978. Inevitably, although the document is highly condensed, it is likely to exceed the four-five page form which was hoped for.

3. The deadline for sending the document to the Executive Secretariat is 6th November so that it may be included on the Agenda for the Ministerial meeting of 7-8 December as a reference document. It is hoped, therefore, that members will be able to discuss this revised version on the basis of comments from capitals on the early version. None of the points of substance has been greatly amended.

(Signed) Ph. JOSEPH

This document includes 11 pages and an Annex of 2 pages

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

RECENT ECONOMIC TRENDS AND PROSPECTS IN THE USSR AND EASTERN EUROPE

BASIC ISSUES

1. Soviet economic development has long been influenced by certain interacting factors:

(a) Continuing allocation of the best resources to military R & D, output, and infrastructure inevitably adversely affects investment in the civilian sector.

(b) As higher quality resources, both human and material, are required if targets for overall growth and consumer standards are to be met in the civilian sector, the main alternative to diverting military allocations is to import such resources in the form of technology, primarily from the West, but also from the USSR's more advanced East European allies.

(c) Imports from the West require hard currency, credits, or countertrade. Despite the Soviet propensity for compensation deals, this formula is less acceptable to the industrialized countries: few Soviet manufactures are marketable in the West because of shortcomings in design or quality ; moreover, the Western recession has seriously affected demand. Despite a relatively high level of indebtedness in absolute terms, credits continue to be made available to the USSR, partly because the debt still represents a small proportion of Soviet GNP, and partly because of the high degree of liquidity in the West. Nevertheless, the USSR has attempted to limit somewhat its hard currency debt by a more selective policy in its imports and by greater stress on compensation deals.

(d) There are difficulties in developing rapidly the less accessible energy resources in West and East Siberia. This could result in oil shortfalls, both for CMEA consumption and for export against hard currency in the early 1980s. Such a situation, in turn, would exacerbate the Soviet and East European balance of payments.

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(e) Unsatisfactory labour morale and productivity are continuing problems for the USSR in view of low birth rates in the 1950s - except for the Soviet Moslem regions: the issue is becoming increasingly relevant because of the growing manpower shortage, particularly of skilled labour in the critical industrial and agricultural sectors.

(f) As always, agricultural performance is of constant concern to the Soviet leadership. In addition to climatic conditions, a low level of mechanization and inefficient bureaucracy continue to hamper output despite high annual investment. The only apparent alternative to higher domestic farm productivity is continuing large scale grain imports from hard currency areas.

2. Despite the inherent organizational problems of the economy, Soviet planners are working on some very ambitious projects in a longer-term attempt to match their overall economic and technological capability with that of their military potential: such plans include the Kama truck plant, the Baikal-Amur railroad (BAM) in the Far East of Eastern Siberia, computer systems for national economic planning, and integrated energy development programmes.

3. The Soviet leadership assumes that Western technology will be a vital ingredient in these projects, and it is also evident to the Soviet economic planners that a powerful military establishment must be backed by an equally virile economy based on modern technology: progressive deceleration in the overall growth rate has made the Soviet leadership aware of the need for qualitative as well as quantitative development ; and they also appreciate the need for a much wider range of consumer goods to act as a morale booster for the increasingly scarce labour force.

4. The dilemmas faced by the six East European allies of the Soviet Union resemble more or less those confronting the

Soviet Union. The general economic trend seems to be that Eastern Europe has adopted an approach of selected emphasis on growth areas and cautious economic reform in specific sectors. In general the Soviet Union has proved unable to help the East European countries in their efforts to modernize often obsolescent economic structures and to raise consumer standards, and many of the bottlenecks facing the countries such as Poland, East Germany and Czechoslovakia, can ultimately be removed only by greater inputs of Western plant, equipment, and knowhow.

5. The above general pattern of economic development in CMEA is reflected in the performance over the past half year reviewed in the paragraphs below, and tabulated at Annex.

USSR

OVERVIEW: GENERALLY SLUGGISH

6. Indications on the size of this year's harvest suggest on-target performance which would contribute to improved overall economic results compared with 1977. Insofar as industrial results in the first 8 months of 1978 were above the modest targets set for the year they are a qualified success; but they reflect continuing deceleration in industrial growth compared with aggregate Five Year Plan targets; heavy industry grew faster than the consumer-oriented branches - in keeping with current Soviet objectives. Labour productivity continues to be of major concern because of its low rate of growth. The construction sector, accounting for some 60% of total industrial investment, was well behind its goals, especially in the heavy industry and oil/gas sectors. The energy balance remained basically unchanged with oil output somewhat above last year's level, the coal sector performing weakly and only natural gas output exceeding the Plan.

In foreign trade the growth rate of exports declined and imports grew faster than exports, thus reversing last year's favourable trend, but second half results may show an improvement.

INDUSTRY: MODEST SUCCESSES DESPITE
LABOUR PRODUCTIVITY DIFFICULTIES

7. Labour productivity continues to be of major concern and grew by 3.7%, compared with 4.1% in 1977 and the Plan of 5.5% ; as in previous years it accounted for 75% of industrial growth, well below the 98% projected for 1980. This concern is reflected in the advocacy of a wider adoption of the "Shchekino" experiment, in which wages saved by dismissing inefficient workers should be distributed among the others. The latest industrial figures show an increase of 5.1% against a planned 4.5% ; however only three of 23 branches cited exceeded plans by more than 1%. One in four enterprises failed to meet targets, notably in mineral fertilizers, cement and steel pipes: these failures could have serious repercussions in farming and in the oil gas industries.

ENERGY: A GENERALLY STABLE PATTERN

8. Natural gas remained the star performer continuing its above Plan growth of 8% ; electric power showed a 5% increase (1977: 3%) ; oil production growth, including gas condensate, slowed to 4% (1977: 6%), although output may well increase in the remaining four months of 1978 and the final outcome should be close to the target of 575 million tonnes. The coal industry continues to perform with apathy: seams west of the Urals are gradually becoming exhausted whilst inadequate mechanization and delays in putting new mines into operation could reduce the prospects for coal and oil substitution in the shorter term. The energy sector thus faces substantial problems which can only be solved by massive investments and injections of Western technology.

AGRICULTURE: A BRIGHTER PICTURE

9. Soviet concern over agriculture was reflected in the July 1978 Central Committee Plenum, devoted exclusively to agriculture: it continues to receive over 25% of total investment and its slow evolution was the subject of considerable debate. Latest data and Western estimates suggest a promising harvest close to the target of 220 million tonnes gross. Heavy rains, however, although promoting growth, could affect grain quality ; this factor together with continued poor storage and transportation facilities may cause the net usable crop to be 20-25% below the gross result. Grain imports in 1979 are unlikely to fall below 15 million tonnes as in 1977/1978 because of the need to replenish and increase stocks. Herds continue to increase satisfactorily and State purchases of meat have reached the levels attained in 1975 before the widespread slaughtering. The consumer can thus look forward to a slightly higher meat diet next year.

FOREIGN TRADE: TRADE DEFICIT UP

10. In 1977 the hard currency trade deficit was reduced partly by cutting down on machinery imports and increasing arms and gold sales. Although six months trading cannot necessarily be extrapolated the favourable trend has been reversed, weak Western demand adversely affected Soviet exports and imports rose faster than exports. The hard currency deficit at six months totalled some US \$3 billion, compared with a deficit of about \$2.5 billion for the same period in 1977. In the second half of the year grain imports will probably be below the first half level: efforts will be made to reduce foodstuff and raw material imports from the LDCs and to gradually reduce machinery purchases from the West, so that the total trade deficit for the year might well be no higher than US \$4 billion, i.e. an increase of some US \$700 million over last year. The high price of gold and the arms market will help to keep the deficit within reasonable limits. Control of hard currency outlays will continue to be stringent, and pressure is likely to be applied to increase the amount of compensation trading in view of the debt service ratio now approaching some 30%.

OUTLOOK: FIVE-YEAR PLAN TARGETS UNATTAINABLE ?

11. In view of the modest economic performance in 1977 and the reduced targets for 1978, it is unlikely that the Five-Year objectives can be met: for the first half of the current period, industrial production has been growing at an annual 5 1/4%, well below the increase of 6.3% needed to fulfil overall targets. Soviet planners are faced with uncertainties over ever-costlier energy supplies as well as growing needs ; investment policies are thwarted by organizational and incentive problems ; innovation and technical change is introduced very slowly and there is little sign of effective economic reforms. These factors are particularly serious in view of low labour productivity, the decline in the farm population, and the shortages of skilled manpower. At this time, therefore, there seems little reason to doubt the best Western estimates of a continuing decline in Soviet economic growth over the next decade.

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EASTERN EUROPE

BULGARIA: GROWTH RATE HIGH BUT DECLINING

12. The growth of the economy continues to decline. Plans in all major sectors remain unfulfilled and national income, retail sales, investment, labour productivity, agricultural and industrial output in 1977 were all below the target. The trend has continued in 1978 despite changes in top personnel. Industrial output in the first half of the year has increased by 5.9%, almost two points below the annual Plan; labour productivity increased by 6.6%, virtually the same as last year, and exports are behind schedule. The nation's main external problems are its foreign trade deficit and an unusually high hard currency indebtedness - more than six times the annual exports to the West. Reforms in the agro-industrial complexes, far from improving performance, have entailed the current disorganization of production, and bad weather hit agriculture again in the spring. Labour shortages and energy problems are key factors which reduce the possibility of meeting economic targets and cast doubts on the economy as a whole, despite its still high growth rate of material production.

CZECHOSLOVAKIA: FOREIGN TRADE GLOOMY;
CONSUMER PROSPECTS BRIGHTER?

13. Industry as a whole turned in an above Plan rate of growth in the first six months of 1978, and the harvest appears to have met most of its targets, despite delays through cold and rainy weather. Major problems continue to be the development of exports to Western markets and satisfying consumer demand. Exports to the non-Communist world increased by only 4.2% in the first five months of 1978, far below the year's targeted expansion of 14.5%. Construction failed to effect the planned rate of improvement and many plants were not completed in time to receive capital equipment. Although retail turnover picked up in 1978, helping to absorb a large pool of accumulated savings, there were signs of continued shortages of foodstuffs and other consumer goods. The economy was plagued by continually rising

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industrial costs, largely because of higher-priced imports of raw materials and energy.

GDR: LARGE FOREIGN TRADE DEFICIT: STRINGENT INVESTMENT CONTROLS

14. The biggest problems facing the GDR economy mid-way through the current five-year period were a continuing large foreign trade deficit and proliferating unplanned investment expenditures, partly because of rising import prices and partly because of organizational and managerial shortcomings. In addition, consumer-oriented measures and heavy welfare expenditures, including substantial price subsidies, continued to make heavy inroads on the state budget. Both retail trade expansion and the growth of net personal incomes were slowed in the first half of 1978, although wages continued to rise at a rate above Plan. In the same period, the GDR's foreign trade picture improved, as exports grew more rapidly than in 1977, especially to developing countries. To deal with its salient economic problems, the government on 1st September, 1978, introduced stringent criteria on all new investments. The all-important grain harvest appears to be on time despite damage to 217,000 hectares of crops from storms in early August.

HUNGARY: EXPORTS DIFFICULT: REFORMS CONTINUE

15. The economy continues to suffer from two major inter-related difficulties: the hard currency deficit, now at about \$3.5 billion, and shortcomings in the organization of the economy leading to poor manpower allocation and training, ineffective management and unrealistic pricing. Efforts to become more competitive in world markets met only limited success in the first six months of 1978 for which data are available, with exports increasing by only 1.9% - imports rose by 8.2% - in current prices. Gross industrial production has performed according to Plan with substantial rises in the pharmaceutical and precision engineering branches, whilst agricultural output appears to be above average: these results may help to redress the balance of payments, since farm production accounts for almost a third of hard currency

earnings. Subsidies - which amount to about one-third of the budget - on consumer goods will be phased out by 1980: undoubtedly this "reform" of the New Economic Mechanism will introduce some stresses but may not lead to a price inflation greater than the currently ideologically acceptable 4%.

POLAND: IMPROVED FOREIGN TRADE; ENERGY PROBLEMS

16. The years of accelerated economic expansion are giving way to a period of moderate growth. At mid-year the investment rate had dipped about 1.5% below the 1977 level, industrial growth (6.2%) was slightly below the year's target, and agricultural output will be marginally better than 1977. Foreign trade performance was encouraging: exports were up by 9.3%, and imports down by 3.8%. The net hard currency deficit now stands at about \$13 billion, which might cause Poland to ask for re-scheduling of the heavy debt repayment due next year. Two other major difficulties will persist throughout the year and into 1979. First is the continuing imbalance in the internal market, where average income, fuelled by a huge upward adjustment in pensions and in the minimum wage, is 8% above 1977 levels and has been rising more rapidly than the supply of goods: this has resulted in persistent shortages and has led to continuation of consumer discontent. Secondly, in the energy sector, the electricity supply has been unable to meet domestic demands: power cuts, which have been forecast for next winter again, will cause factories to face disruption and production losses and may be the early warning of a major crisis in 1979 if Poland is unable to increase rapidly its electricity output.

ROMANIA: GENERAL IMPROVEMENT; PRODUCTIVITY AND EXPORT PROBLEMS

17. In the first half of 1978 the main Plan targets were met, including a 9.9% increase in industrial production, thus reversing the trend of underfulfilment of 1977. However, labour productivity and exports continued to be major problems and lagged far behind expectations. Agriculture performed satisfactorily, thus recovering from the setback of last year.

Although labour and energy problems are gaining momentum, annual Plan objectives appear to be attainable - including an 11-11.5% growth in national income - and Romania will probably continue to be the fastest growing country in the CMEA.

CMEA INTEGRATION: PROGRESS BUT NATIONAL INTERESTS PERSIST

18. Intra-CMEA trade, strengthened by the 18 major multi-lateral projects, has risen perceptibly since the beginning of the present five-year period, as has trade stemming from production specialisation agreements, especially in machinery. Also on the basis of the 1975 Plan, the CMEA at its June 1978 Thirty-Second General Session at Bucharest adopted three of five projected programmes of long-term "directional" cooperation to 1990: these programmes call for the building of nuclear power plants to provide an additional 37,000 megawatts of generating capacity for the countries of Eastern Europe - nearly half their 1976 installed capacity ; for expanding raw materials and agricultural production through national specialization ; and for coordinating increased output of agricultural, energy-related, and transport equipment. The cooperation is presented as a step forward in the CMEA integration process, in that the programmes form the basis for mutual planning among the participating countries at the stage where decisions are taken concerning future directions of each country's economic development.

19. East European sensitivities to any concept of supra-national planning and policy-making are marked and were strongly expressed at the Thirty-Second Session itself: it is open to question, therefore, whether the programmes will be an effective step in the integration process. For the time being, the principal mechanism in CMEA integration is likely to remain East European participation with the Soviet Union in major investment projects undertaken at Soviet initiative and mostly located on Soviet soil.

20. With the admission of Vietnam in 1978 the problem of extending aid to lesser developed members of CMEA arises: already it has been estimated by one CMEA member that Vietnam will need a development fund of \$3 billion over the next 3 years.

USSR: SELECTED INDICATORS OF ECONOMIC GROWTH
(Percentage change over previous period)

	<u>1976</u>	<u>1977</u>	<u>1978</u> (6m)	<u>1978</u> Plan
National Income	5.0	3.5	n.a.	4.0
Industrial Production	4.8	5.7	5.2	6.3
Ind. Labour Productivity	4.1	4.1	3.7	5.5
Agricultural Output	4.1	3.0	n.a.	6.8
Foreign Trade:				
Exports	16.6	18.7	4.7	n.a.
Imports	7.7	4.7	9.9	n.a.

	<u>Bulgaria</u> (1)				<u>Czechoslovakia</u> (2)			
	<u>1976</u>	<u>1977</u>	<u>1978</u> (6m)	<u>1978</u> Plan	<u>1976</u>	<u>1977</u>	<u>1978</u> (6m)	<u>1978</u> Plan
National Income	6.5	6.3	n.a.	6.8	4.0	4.5	n.a.	4.9
Industrial Production	6.7	6.8	5.9	7.7	5.5	5.7	5.5	5.1
Ind. Labour Productivity	6.5	6.5	6.6	6.7	4.9	4.7	n.a.	5.0
Agricultural Output	4.1	-6.3	n.a.	5.0	-2.3	7.9	n.a.	3.4
Foreign Trade:								
Exports	14.5	n.a.	9.3	n.a.	11.8	11.7	7.5	7.9
Imports	3.8	n.a.	n.a.	n.a.	10.4	12.9	10.4	6.5

	<u>GDR</u> (3)				<u>Hungary</u> (6)			
	<u>1976</u>	<u>1977</u>	<u>1978</u> (6m)	<u>1978</u> Plan	<u>1976</u>	<u>1977</u>	<u>1978</u> (6m)	<u>1978</u> Plan
National Income	3.6	5.2	5.0	5.2	3.0	8.0	n.a.	5.0
Industrial Production	6.4 ⁽⁴⁾	4.0 ⁽⁴⁾	5.2	5.7	4.8	6.8	n.a.	5-5.6
Ind. Labour Productivity	5.2	4.2	7.1 ⁽⁵⁾	5.0	n.a.	7.2	n.a.	n.a.
Agricultural Output	-8.8	10.3	n.a.	n.a.	-3.0	12.6	n.a.	2-3.0
Foreign Trade:								
Exports	12.6	5.8	10.0	7.1	5.9 ⁽⁷⁾	16.0	1.9	3.0
Imports	16.9	8.7	n.a.	7.1	6.5 ⁽⁸⁾	16.0	8.2	4.0

	<u>Poland</u> (8)				<u>Romania</u> (9)			
	<u>1976</u>	<u>1977</u>	<u>1978</u> (6m)	<u>1978</u> Plan	<u>1976</u>	<u>1977</u>	<u>1978</u> (6m)	<u>1978</u> Plan
National Income	7.1	5.5	n.a.	5.4	10.5	8.6	n.a.	11-11.5
Industrial Production	9.3	8.6	6.2	6.8	11.5	12.5	9.9	10.6
Ind. Labour Productivity	7.1	4.7	6.4	3.8	8.8	9.8	8.5 ⁽¹⁰⁾	9.0
Agricultural Output	-0.7	0.8	n.a.	5.8	17.2	-1.3	n.a.	6.9-16.1
Foreign Trade:								
Exports	7.5	11.5	9.3	9.9	14.9	14.6	9.5	n.a.
Imports	10.8	5.5	-3.8	4.2	14.1	15.2	n.a.	n.a.

- (1) Source: Official Bulgarian statistics
- (2) Sources: BFA Mitteilungen, 28/88, March, 1978
RFE Research Notes (Czechoslovakia 26)
9th August, 1978
Statisticke Přehledy, 78-8
- (3) Sources: Deutsches Institut für Wirtschaftsforschung:
Wochenbericht 31/78, 3rd August, 1978;
Wochenbericht 37-38/78, 14th September, 1978
- (4) Calculated on a monthly basis
- (5) Only in firms under the industrial ministries
- (6) Sources: SWB 24th August, 1976; AC/127-WP/564;
C-M(77)59; US Dept. Commerce Foreign
Economic Trends - Hungary, No.77-078
- (7) Convertible currency trade only
- (8) Sources: SWB 3rd August, 1978; EastWest Markets, 20th
February, 1978, p.11; UK Delegation, "Poland,
Economic Developments in First Half of the
1976-80 FYP", May, 1978; BFA Mitteilungen,
Polen, July, 1978
- (9) Source: Official Romanian statistics
- (10) Five months