CONSEIL DE L'ATLANTIQUE NORD
NORTH ATLANTIC COUNCIL

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ACTION SHEET
C-M(74)85

RECENT ECONOMIC DEVELOPMENTS IN THE USSR AND EASTERN EUROPE

Action Sheet

At its meeting on 3rd December, 1974 the Council took note of the report in document C-M(74)85.

2. See C-R(74)59, Item III.

(Signed) G. SEKERIS
Executive Secretary

Notes:

(1) This action sheet is part of, and shall be attached to, document C-M(74)85 as the top sheet

(2) This action sheet may be considered as "Unclassified" when separated from the document to which it refers

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Corr. 24/11/74
Corr. 2 6/12/74 } follows

ORIGINAL: ENGLISH
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DOCUMENT
C-M(74)85

RECENT ECONOMIC DEVELOPMENTS IN THE USSR AND EASTERN EUROPE

Note by the Chairman

In compliance with the request of the Council at its meeting of 25th September, 1974(1), the Economic Committee has prepared the attached report on "Recent Economic Developments in the USSR and Eastern Europe".

2. The Council is invited to examine this report, which will appear as a reference document on the Agenda of the Council meeting in Ministerial Session.

(Signed) Joseph M.A.H. LUNS

NATO,
1110 Brussels.

(1) C-R(74)44, paragraphs 10, 12 and 13(2)

RECENT ECONOMIC DEVELOPMENTS IN THE USSR AND EASTERN EUROPE(1)

Report by the Economic Committee

I. MAIN FEATURES

1. In contrast to current Western experience, less limited economic damage and few overt social repercussions are so far visible in the centrally controlled economies of the East as a result of the energy crisis and the associated escalation of world prices. Indeed, the USSR continues to profit financially from the change in the terms of trade and to expand its still modest level of commerce with industrialized Western countries. In most Eastern countries, increases in domestic prices have so far not been very great, and economic growth this year should be moderately rapid though less than the 1973 rate of 6%. In the Soviet Union, this slow-down reflects (i) the large share of GNP still concentrated in agricultural output, which is not repeating in full the extraordinary gain made in 1973, and (ii) a long-term decline in the rate of growth of industrial production. The principal economic damage is concentrated in other Eastern countries where trade deficits with the West have been boosted by price rises for imported commodities and Soviet economic leverage has increased.

2. Prospects for Eastern economic growth this year seem to be more or less in line with long-term trends despite the marked slow-down in economic activity in the industrial West. Eastern harvest prospects are less favourable than last year. In the USSR, production continued to rise at 7% for petroleum, 9% for natural gas, and 2% for coal, but was still below the growth rates targeted in the 1971-1975 plan. With the exception of East Germany and Bulgaria, however, growth of Eastern industrial output accelerated during the first half of 1974.

3. In the USSR, inflationary pressures are real but they are not necessarily reflected in rising prices because (i) domestic prices are fixed administratively and thus insulated against price rises in the West, (ii) most foreign commerce is directed to other Communist countries, and (iii) the rôle of money is restricted. Considerable excess demand nevertheless results from shortfalls in output that hold its growth below that of money wages. Thus, substantial

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(1) Consists of Poland, Czechoslovakia, Hungary, East Germany, Rumania and Bulgaria

shortages of goods are developing and involuntary savings are accumulating. In Poland, Rumania, Hungary and Czechoslovakia, on the other hand, such inflationary pressure is less tightly contained. Prices have recently increased for fuels and foodstuffs, whose supply has apparently been constrained by shortfalls in oil imports and the sugar-beet harvest. In Hungary, economic reforms have introduced some market elements. Poland and Rumania direct over half of their foreign trade to the West, where rising prices add a potential cost-push. Such upward pressures on domestic prices are no doubt mounting and the resulting consumer shortages might tend to increase social tensions.

4. The USSR continues to seek a significant rise in imports of Western machinery and technology, inter alia, to develop its natural resources. The Soviet Union would also probably derive more benefit in terms of overall economic development than the West from such an increase, which might become an important long-term stimulus to Soviet economic growth. To finance such imports, the USSR continues to press for Western export credits at low interest rates but clearly requires them less and less. The external financial position of the USSR continues to thrive on the relatively high world price of oil, raw materials, and gold. In time, this stimulus should also strengthen the Soviet domestic economy including its capabilities for defence expenditure. Following years of deficits, the balance of Soviet trade in convertible currencies will probably show a surplus in 1974. Records set last year are being equalled or exceeded in the case of growth of Soviet foreign trade and the value of Soviet orders for machinery in industrialized Western countries. In negotiating such orders, Moscow has gained greater flexibility in bargaining and in terms of payment, reportedly agreeing to simple barter and cash payments in some transactions and in others, Western credit financing frequently linked with compensation arrangements (plant for product).

5. Soviet bargaining power in East European countries has been strengthened by the changed terms of trade together with Moscow's commanding position (except in Rumania and Poland) as provider of energy and industrial raw materials. Perhaps in anticipation of future Soviet pressures, Poland, Hungary, and Czechoslovakia have mounted import booms that have bolstered industrial performance but also boosted trade deficits with the West.

6. These indications underline the importance of Western credits for East European countries, whose commerce with the industrial West and rates of economic growth probably depend increasingly on the availability of such financing of trade deficits. In the present era of severe inflation in the West, all Eastern countries stand to benefit additionally from credits that postpone payments until a future time when they might be facilitated by the decreased value of money. The main Eastern beneficiaries may well be Hungary, Czechoslovakia, East Germany, and Bulgaria, whose long-term capabilities for alternative means of settlement - e.g. barter or cash payments - are probably weaker than those of their allies.

II. USSR

(a) Domestic Developments

7. Prospects for Soviet economic growth to date in 1974 appear moderately favourable though less than the estimated 6% growth of GNP last year. The grain harvest is expected to be between 190 and 205 million tons(1) - the second largest in history, but somewhat below the 1973 level. Such a decline would slow general economic expansion and would leave a substantial deficit of feedgrains needed for the high-priority livestock programme, which is intended to provide a protein-rich diet of meat and dairy products by 1975.

8. In industry, performance has been stronger. Production rose 8.2% during the first nine months of 1974, somewhat faster than the low rates of recent years but well below the average of the 1960s. The acceleration stems from a 6.7% rise in labour productivity and partly also from the 1973 harvest, which has boosted output of the food industry. The speed-up still appears insufficient to put major goals of the ambitious 1971-1975 plan within reach. During January to September, oil production met its scaled-down output plan (2% under the original schedule of the Five-Year Plan) while output of natural gas fell slightly short of its planned 1974 pace (which is 6% below the initial Plan target). Production of electricity and consumer goods were considerably less than assigned under the 1974 plan and output of agricultural equipment was 7% under the 1973 level.

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(1) An estimated 15% to 20% consists of moisture and losses due to inadequate storage and transport

9. A number of economic reform measures are in progress or being drafted, though none envisages any real departure from centralized planning and control of the economy. Industrial enterprises are being grouped into larger associations, although more slowly than planned, and a similar organizational scheme is being prepared in agriculture.

(b) External Economic Relations

10. The Soviet international financial position is expected to be further strengthened this year. Grain imports are decreasing and opportunities to sell arms abroad for convertible currencies have increased. Above all, the considerable improvement in the Soviet terms of trade, stemming from the recent rise in prices of gold, oil and raw materials, has been maintained. As a result, the Soviet gold stock is currently valued at more than $10 billion(1), or almost four times the Soviet debt to Western countries. In the case of oil, the price increase will permit the USSR to increase its earnings in the West appreciably without a proportionate rise in export volume, which is constrained by shortfalls in oil production, by obligations to Eastern Europe, and by increases in internal consumption. On the other hand, natural gas deliveries to the West are beginning to grow. The substantial hard-currency trade deficit of the past years will probably give way in 1974 to an appreciable surplus, with Soviet exports rising as much as two-thirds in value. At mid-year, total Soviet trade had risen 20%, equalling the record pace of 1973.

11. The increasing credit-worthiness of the USSR has widened its options in external payments and in commercial tactics, enhancing its capabilities to obtain Western grain, equipment and advanced technology, which are important to the economic growth. In time, these stimuli may also ease the Soviet defence burden and strengthen the economic foundations of the Soviet military effort. Thus far in 1974, advance commitments by the USSR to purchase grain abroad amount to about 5 million tons ($800 to $1,000 million). With two months remaining in 1974, Soviet orders for machinery and equipment from non-Communist industrialized countries are already estimated at over $3,000 million - well above the previous high of about $2,500 million set in 1973. The USSR has shown a growing tendency this year to pay cash for such purchases, as in the case of a $1,000 million steel plant and $100 million in construction machinery. Simple barter also seems to be regaining some favour in Soviet commerce with the industrialized West. In September, the USSR placed an unusually large order for $1,500 million of wide-diameter pipe to be delivered during 1976-1980 and to be paid for in kind, i.e. raw materials.

(1) At a price of $160 per troy ounce

12. Nevertheless the Soviets continue to rely on Western credits, e.g. in recent orders of $300 million in lorries and $200 million for four ammonia plants; such borrowing is all the easier because Soviet credit-worthiness has been reinforced. Given the current high rate of inflation of world prices, credits at relatively low interest rates would obviously benefit the USSR. Long-term credits are also closely related to large-scale, self-liquidating development projects where repayments can be made with goods; thus, a $450 million Soviet order for Japanese mining and transport equipment last June will be paid for over time with coking coal to be mined by the equipment at Siberian deposits.

III. EASTERN EUROPE

13. Thus far in 1974 economic activity in Eastern Europe presents a mixed picture. Harvest prospects in individual countries vary from uncertain to less favourable than last year. In regard to industrial production, the expansive tendencies of 1973 were reinforced during the first six months of 1974 in Poland, Rumania and Hungary, where growth exceeded annual and long-term plans. The opposite situation prevailed in Bulgaria and East Germany.

14. Such fluctuations in rates of growth of industrial output may be due partly to the differing impacts on national terms of trade resulting from the sharply rising world prices of oil and materials. The resultant rise in import costs may have been a factor in a reported levelling-off of East German purchases of industrial raw materials from non-Communist countries. On the other hand, Poland and Rumania, as exporters of such items, were in a less vulnerable position and indeed increased their foreign trade about 35% and their industrial production 13% to 15% during January to June 1974. In Poland the consumer was allotted a substantial share of the increment, as real wages rose 8%. In all cases, the effect of changes in world prices was only moderate, causing only marginal changes in growth rates. The bulk of the trade of most East European countries is not yet affected by recent world price movements since it is directed to the USSR or each other and governed by five-year trade agreements which have hitherto been based on average prices of past years.

15. To a certain extent, however, the accelerating industrial expansion in certain countries probably reflects an unwillingness of the authorities to restrict growth of heavy industry for the sake of external balance with all non-Communist countries. Hungary and Czechoslovakia, which are about as dependent as East Germany and Bulgaria on material imports, apparently made little effort to restrict them, increasing their payments therefore by an unprecedented 50% to 60% to non-Communist suppliers. In both countries, the resulting investment booms boosted industrial output at or above planned rates but also resulted in rising trade deficits.

16. Even Poland seems to be straining its considerable trade capabilities based on remittances from abroad; shipping and tourism services; and exports of coal, machinery, and (for the future) electricity. As of mid-1974, Polish imports from the industrial West had risen 70% over the level of the first six months of 1973 and investment was up 27%. For 1974 as a whole, a trade deficit of $1,700 million, largely with the West is planned. Poland borrowed $100 million from the Euromarket at relatively high rates in October for development of the copper industry and so far this year has ordered about $800 million in Western equipment for future delivery.

17. Prices for coal, oil, and foodstuffs have been raised in Hungary, Poland, Czechoslovakia, and Rumania in order to conserve energy and following a poor sugar-beet harvest. Inflationary pressure is especially evident in Poland and Hungary where money wages rose 10% to 15% during January to June 1974. In Hungary, growth of industrial production is planned at only 6% for the full year. The cost of living increased about 4% in Poland and in September fuel prices were raised an average 25% in Hungary.

18. The seeming unwillingness of some East European countries to retrench in the face of deteriorating terms of trade and/or rising external deficits may stem from several causes. The Polish Authorities in particular may be motivated by concern over consumer expectations which in 1970 erupted in civil disturbances after meat prices were raised. Hungary and Czechoslovakia as well as Poland are probably relying on Western credits to finance the deficits. Mounting indebtedness might in any case be of positive benefit in an era of rapid inflation which eases future repayments of credits by decreasing the value of money. Moreover, Soviet opposition to such shopping sprees might increase in coming years when COMECON trade agreements are renegotiable and the USSR will thus have the option to demand price increases for the oil and industrial raw materials it provides its allies. Such Soviet leverage could result in diversion of some of their high quality exports from the West to Moscow, thus limiting prospects for further development of East-West trade. Furthermore, the possibility of tighter COMECON integration in the near future may have prompted Poland, Hungary and Czechoslovakia to strengthen their competitiveness in this increasingly important regional market by last-minute purchases of relatively advanced Western technology and equipment.

19. The continuing import boom may well be of limited duration for some countries at least. EEC restrictions on imports of beef and livestock should curtail earnings - and import capabilities - of East European meat exporters. Hungary, which

relies partly on fiscal and pricing policies as part of its economic reform, has moved to restrain import demand by raising taxes on wealth and increasing domestic fuel prices. More stringent energy conservation measures are reportedly planned for next year in Hungary along with price increases of 33% to 100% for metals and materials.

IV. COMECON ORGANIZATION

20. Recent economic trends have also been to the advantage of the Soviet Union in the COMECON organization. The possession of ample energy and other raw material resources at a time when the world at large is conscious of its growing dependance on these commodities has greatly strengthened the Soviet economic position vis-à-vis the other members and reinforced its dominance over the East. The trend towards common development projects has gathered force and, at the 28th COMECON session in Sofia last June, it was decided to incorporate in national plans sections dealing specifically with questions of specialization and integration. Presumably, the USSR will attempt to exploit these advantages during the preparation and co-ordination of plans for the five-year period starting in 1976.

(Signed) O. DEBUNNE
Acting Chairman