CONSEIL DE L'ATLANTIQUE NORD
NORTH ATLANTIC COUNCIL

EXEMPLAIRE / COPY N° 284

ORIGINAL: ENGLISH
5th December, 1975

DOCUMENT
C-M(75)73

ECONOMIC DEVELOPMENTS IN 1975 IN THE USSR AND EASTERN EUROPE

Report by the Chairman of the Economic Committee(1)

I. MAIN FEATURES

At first sight, during 1975 the planned economies of the USSR and Eastern Europe appear to have controlled more effectively the problems of growth and inflation than the industrial market economies. Compared with the West's recession, the consequent decline in real GNP as well as some 17 million unemployed, in 1975, the COMECON countries recorded a further growth of Net Material Product (NMP)(2) which however, was down somewhat compared with 1974; taking into account serious fluctuations in agriculture this year and the overall poor performance of the Soviet economy, the latest assessment of COMECON NMP for 1975 would indicate an average growth of 4.5%-5%. Price increases which exceed 10% on average in many countries in the West do not officially exceed 3%-4% in Eastern Europe.

2. However, a closer examination of the facts show that domestic growth throughout the COMECON area which hitherto has enjoyed regular although highly varied development according to country, is now experiencing a slowdown. This affects both investments and the private consumer sector. The disappointing results in the agricultural sector in many COMECON countries during 1975 do not suffice to explain this slowdown. The decline in growth is also due to factors such as poor labour productivity, inefficient management and, more recently, the high cost of raw materials and of imported Western technology, the USSR again being less affected by these last two factors. The misuse of manpower in COMECON countries as reflected in low per capita output suggests considerable hidden under-employment. Soviet labour productivity, for example, is assessed as some 55% that of the United States. All this has led to serious lags both in the industrial and services sectors vis-à-vis plan objectives, themselves revised downward.

(1) For previous report see document C-M(75)39 of 16th June, 1975
(2) Growth of Net Material Product which excludes most services is usually 1%-2% higher than Western estimates of growth of GNP of the USSR and the East European countries.

3. In the foreign trade sector the contrast between the USSR and its East European partners is striking: the Soviet Union with its abundant natural resources is able to meet its own raw material and energy needs and, concurrently, to provide its COMECON allies with the bulk of their requirements in these sectors. The opposite is the case with the Eastern European countries - except perhaps for Poland (coal and copper) and Romania (petroleum) - whose dependence for raw materials on the Soviet Union remains paramount. Moreover the recession and concurrent inflation in the West make it difficult for East European countries to export more to that area and this in turn hampers their ability to increase their purchases from the West. In the longer run this could affect their borrowing capacity on Western financial markets. This development could act as a brake on the growth of the economy and of living standards in the next Plan period.

4. As the USSR finds itself in the final lap of the current Plan period and the 25th Party Congress is to be held early in 1976, every effort has been made by the authorities to meet as many of the, often downward revised, targets as possible. Nevertheless, in his speech of 2nd December, 1975, State Planning Minister Baibakov revealed an NMP growth rate for 1975 of only 4% (1975 target: +6.5%). Continuing emphasis will be put on increased labour productivity in an attempt to counter the slowdown in industrial growth, and a modest upturn in the energy and light industry sectors can be anticipated. Much greater stress throughout the next Plan period will also be placed on consumer goods' and industrial products' quality. Overall growth for 1976 has been set at 5.4%, somewhat lower than similar past forecasts.

5. While most Eastern European countries reluctantly admit some degree of inflationary pressure, officially this phenomenon has been avoided in the USSR. The retail price index for 1975, as was the case in 1974, will probably show no significant change from that of a decade earlier. However, hidden price increases have been detected by Western observers: these result inter alia from the replacement of cheaper varieties of goods in retail outlets by items that are more expensive, but not appreciably improved. The Soviet consumer was expected to benefit in 1975 from the implementation of postponed increases in the minimum wage and in pay for medium income workers and from the redemption of bonds worth over $1 billion, frozen since 1958. Without a commensurate growth in the supply of consumer goods, however, higher incomes will merely worsen repressed inflation as reflected in the existence of a parallel market and swollen saving accounts.

6. As in 1972, poor agricultural output in 1975 has contributed to decelerate overall 1975 growth. Agriculture remains the Achilles heel of the Soviet economy. As usual the USSR has released no estimate of this year's harvest size, but US and other Western experts have revised their own calculations

downwards concluding that it could now be between 50 and 60 millions below the 1975 target of 215 million tons. Moreover, first reports from the USSR indicate that Soviet winter wheat prospects next year may already be affected by persisting dry cold weather. Large purchases primarily from the USA but also from Canada and Australia, reportedly already total over 20 million tons at a cost of at least $3.5-$4.0 billion. Final Soviet global purchases could reach 30 million tons in the period July 1975-September 1976. In addition, Soviet longer-term dependence on the West for grain is reflected in the recent grain sales accord between the USSR and the USA which commits the Soviets to buy between 6 and 8 million tons of wheat and corn per year for a five-year period beginning in October 1976. The large expenditures on grain imports will not resolve the twin problems in Soviet agriculture of unstable climate and deep-rooted inefficiency; Soviet consumers will certainly benefit in the shorter-term through a less drastic reduction in the flow of dairy products and especially meat, although shortages in this area could occur later in 1976 and into 1977. Soviet grain difficulties in 1975 may well affect traditional USSR grain exports to its East European partners, whose requirements, beyond their own output, may well exceed 7 million tons.

7. The Soviet Union has been making considerable efforts to raise exports of all major products groups, and was not unsuccessful in 1974 (total exports: +31.2%). This factor helped the USSR to reverse its deficit in its trade with industrial market economies into a surplus by the end of 1974 (around $330 million)(1). During the first half of 1975 Soviet foreign trade turnover again rose - by 28% However, a substantial deficit has reappeared in the USSR's trade with the developed industrial countries. This is primarily the result of a high level of capital equipment imports in the last year of the current Plan period (estimated value: $5.2 billion) and massive Soviet grain purchases.

8. To offset some of this burden the USSR is borrowing substantial sums on the Euromarket ($650 million so far reported plus $300 million planned), a step paralleled by all of the East European countries in their search for convertible currency to pay for their imports from market economies. The recent increase in COMECON forays to float Euro-currency loans could result in borrowings totalling over $1.5 billion by the end of 1975. Parallel with operations on the Euro-currency market, the COMECON countries continue to receive substantial Western government-backed export credits(2).

(1) Source: GATT, International Trade 1974/75, Geneva 1975
(2) Outstanding export credits by NATO countries to Communist countries as of end 1974 have been estimated at some $9.4 billion

9. The new prices introduced in intra-COMECON trade at the beginning of 1975 favour exporters of raw materials, mainly the USSR and Poland, at the expense of manufacturing nations, i.e. virtually all the other COMECON countries - oil prices, for example, increased by some 130%. This situation has plunged most of the East European countries into payments difficulties for which financial help is being sought; it is not believed however that the USSR will press its advantages too far in order to avoid social and perhaps political discontent among its COMECON partners. One solution is the Soviet extension of cheap long-term credits to its East European partners - believed to be at 2% over ten years. IBEC and IIB (the COMECON trade financing and investment banks) will most likely play a more important rôle in the financing. It is reported for example that IBEC will be doubling the paid-up part of its capital in convertible currency and gold and generally expanding its operations in these fields: in addition the IIB is reported to have borrowed some $420 million on the Euro-currency market in 1975.

10. During the first half of 1975 the value of intra-COMECON trade rose more than extra-regional commerce: this was the reflection of the improvement in the Soviet Union's terms of trade due to revised COMECON prices. In volume terms, individual COMECON countries' imports - in particular East European - from Western industrialised countries grew more than those from their COMECON partners. This factor, added to the deterioration of their terms of trade, is resulting in an increased deficit with the industrial West.

11. The trade of the USSR with the developing countries in 1974 grew less than that of the East European countries. However the entire surplus of the region with developing countries accrued to the Soviet Union but this surplus was somewhat lower than in 1973 because Soviet imports increased twice as fast as exports. Data for 1975 are still scarce, but it seems that both the value and volume of this trade continue to expand.

12. On 24th-26th June, 1975 the COMECON Council met to examine further co-ordination of Five-Year Plans (1976-1980) between the USSR and its six East European partners. Although it is not unusual for quinquennial plans to be delayed while the Soviet and East European planners co-ordinate their targets, reports on the session indicate that the revision of pricing levels has caused special problems and the final 1976-1980 projections may not be completed until early 1976. Stress was given to fuller integration within COMECON in the next Plan period, reportedly less through harmonisation of the new Plans

themselves than through greater co-ordination of large-scale c-operative ventures already agreed upon, e.g. the Orenburg pipeline and a number of other projects primarily on Soviet territory. Trade projections issued by the GDR, Poland and Czechoslovakia for the period 1976-1980 reflect the extent to which the revised pricing levels are forcing the pace of the "Integration Programme".

II. USSR

(a) Domestic developments

13. As the current Five-Year Plan draws to its close, the original 1971-1975 key target figures are unlikely to be met - with few exceptions. The current Soviet Plan provided for an annual growth in NMP of 6.5%. However, agricultural deficiencies have been a major retarding factor and the growth claimed for 1971-1974 in NMP averages some 5.9% annually. The disappointing performance once again in the agricultural sector this year has produced low growth in national income (i.e. only 4%); per capita income and wages will also be below planned projections. This lower level of growth throughout the current Plan period represents a drop not only from the high growth rates of the post-1945 reconstruction period, but also from the economic performance of the second half of the 1960s when an average growth rate in NMP of 7.7% per annum was registered.

14. Nevertheless, successes within revised targets can be reported in many traditional industries. The annual plan for industrial growth this year was slightly exceeded and the increase was 7.5%. However, very low industrial growth targets for 1976 were announced on 2nd December in Moscow (+4.3%). As in previous years, industrial output was headed by the engineering, metallurgical and chemical industries. Serious criticism continues to be made by the authorities: shortfalls persist in the output of certain producer durables - trucks and tractors, machinery and equipment - which are partly linked to failure to put sufficient new capacity into operation. As regards light industry (i.e. that geared to consumer demand), targets throughout the current plan period have never been met (except for 1971), despite assurances from the Soviet leadership that this industrial sector would be favoured over heavy industry and enjoy a higher growth rate during the period 1971-75. Reports indicate that the 1975 consumer output targets will again be unfulfilled. In 1976 the consumer section is targeted to grow by only 2.7% compared with 7.4% for the first year of the 1971-75 Plan.

15. Total investment in the economy in 1974 is reported to have reached over 105 billion rubles, marginally below the target set in the 1971-1975 Plan. Investments in the first half of 1975 reflected a 9% increase over 1974. A higher rate of investment growth over the next Plan period compared with the current period is likely to become a permanent factor. The bulk of raw materials and fuels in the USSR is located in areas where conditions require large investments for infrastructure and new, massive financial inputs for exploitation.

16. Capital and labour productivity shortfalls remain unresolved problems. Steady evolution and the longer-term planning of production are disrupted through the practice of holding campaigns to fulfil short-term output targets. The incorporation of industrial enterprises into larger production associations announced by Premier Kosygin in 1973 is still under way without there being any indication that this process is boosting efficiency, and in any case the programme of creating larger associations is well behind schedule.

17. Huge investments in the agricultural sector (over 26% of total investment in 1975) and annual subsidies to maintain low consumer prices yet boost farm manpower earnings - estimated at over 20 billion rubles, or more than official Soviet defence expenditure - have failed to remove the structural deficiencies of this sector. On-going problems in 1975 included shortage of suitable machinery and spare parts, poor maintenance, badly organized irrigation schemes, an inadequate road network, insufficient crop rotation and acute shortage of storage capacity.

(b) Foreign trade

18. The Soviet Union will almost certainly run a convertible currency trade deficit this year of at least $3.9-$4.4 billion(1). This deficit reflects continuing heavy Soviet imports of manufactured goods from the West, stagnating or declining convertible currency exports - because of sluggish Western demands, price declines in the course of 1975 for certain Soviet exports and the large volume of grain imports.

19. The foreign exchange costs for purchasing this grain is already valued at some $3.5-$4.0 billion (excluding freight). Additional purchases could cost another billion dollars. The burden represented by procurement under the recent Soviet-US grain agreement (see paragraph 3) could be offset substantially by Soviet oil sales to the United States (10 million tons annually) the price of which is still under negotiation. However, such a deal could disrupt Soviet trade patterns and exacerbate the problem of allocating scarce surplus oil to traditional foreign buyers.

(1) This figure takes account of an estimated $600 million earned by the USSR through arms sales to the developing nations and particularly the oil producing Middle East countries in 1975, and possibly $500 million on sales of gold.

20. The Soviets can finance the trade deficit from current production of gold (estimated output in 1975: 395 tons) and their ample gold stockpile (at least 2,000 tons)(1) and convertible currency borrowing from various Western sources - the Soviet credit rating remains strong. It is likely that the USSR in its oil exports to the West will continue to align itself on oil prices generally quoted by the OPEC countries. In the shorter run the Soviet terms of trade with the West could well improve again because of a new rise in world prices of basic products although this may be compensated by a similar rise in the prices of industrialised countries' exports. There are, however, reports that the Soviets - increasingly concerned about their trade deficit - might cut back on their purchases from the West. So far there is no evidence of such a development.

III. EASTERN EUROPE

21. The main economic problem in 1975 for the six East European partners of the USSR has been that of adjustment to the deteriorating terms of trade both as regards the West and the Soviet Union. In addition to the considerable upturn in intra-COMECON prices this year, especially that of oil from the USSR, part of the East European countries' economic problems derives from the Western recession and from higher import prices from the industrialised West. The foregoing will affect future growth, bringing about a slower rise in living standards or, at worst, their decline.

22. In the GDR, striving to maintain its standard of living - the highest in COMECON - industrial production, although below Plan target, was reportedly good. Consumption nevertheless expanded more slowly in 1975 than expected as shortages for certain types of consumer goods occurred. Wholesale raw material prices are to be revised upwards as of January 1976 with assurances given that these increases will not be passed on to the consumer; the costs would be absorbed partly by greater industrial rationalisation and economy. As in the other East European countries, it remains to be seen whether the dual pressures exerted through Western recession and Soviet price increases will in the shorter-term connote a shift from a policy which was becoming more consumer orientated.

23 In Romania domestic demand increased less than output in 1974. By contrast, in the first half of 1975, the expansion of demand and output accelerated and agricultural growth (below Plan targets in 1974) seems to have recovered. However, in the second half of 1975 Romania suffered a number of unexpected

(1) Production costs of Siberian gold per ounce are reportedly very high ($80-$90), hence the Soviet interest in maintaining a high price of gold on the world markets. Some Western sources assess Soviet gold stock at 2,800 metric tons.

economic setbacks due to failure in distribution arrangements, especially in the foodstuffs sector, and the serious July floods. This complex of difficulties has been aggravated by the country's rising trade deficit which will certainly surpass the $270 million deficit of 1974. Consequently the Romanian authorities have taken measures both in the foreign trade and domestic sectors. Imports are being restricted to those goods most urgently needed for industrial production. On the domestic front price increases in many basic staples have been introduced; additionally, unpaid overtime has become the general rule in the hope of boosting productivity and moving closer to plan targets in the final year of the current period. It is clear that the government's goal of fulfilling the current Five-Year Plan in four and a half years will not be met.

24. Bulgaria is in a similar situation to Romania in that it is currently going through a phase of considerable investment, and has warned, as have the other Eastern countries, that it will have to reduce its imports from the West unless the latter is able to purchase more in return. A very high ratio of investment to national income remains one of the main driving forces of Bulgaria's industrial expansion, and the indications are that this rate of investment will continue in view of Bulgaria's privileged commercial and economic relations with the USSR (the prime source of industrial equipment and aid).

25. After four years of remarkable growth (+10% a year on average) the Polish economy in 1975 has been characterised by a general slowdown in the rate of economic growth, substantially lower investment and worsening of the foreign trade deficit. As regards foreign trade, the Polish leaders have stated their determination to maintain emphasis on exports - excluding meat and dairy products - so as to earn currency from the West. In both 1974 and 1975 Polish imports were characterised by investments including large flows of modern technology and by an increase in the purchase of high quality consumer goods. Although Poland will continue to seek credits abroad: at least $660(1) million on Euromarkets in 1975, a major goal remains that of reducing the convertible currency deficit which rose to $2,250 million in 1974 and has tended to grow quite rapidly in the first half of 1975.

26. On the domestic side the politically sensitive issue of the price freeze on basic foodstuffs initiated after the December 1970 riots continues to complicate matters for the leadership; it is clear however that the leaders cannot both continue to subsidize consumer prices and to grant real wage increases indefinitely.

(1) Including $200 million planned for the development of the coal industry.

27. In 1974, Hungary increased its borrowing in Western countries in order to accelerate capital formation, raise living standards and improve industrial capacity utilisation. In the first half of 1975 the growth of output slowed down, but demand appears to have maintained its momentum. Delays were reported in capital projects which probably affected exports. Imports rose by 32% and exports by only 10%, the bulk of the difference between these two rates deriving largely from price changes as in 1974. The Hungarians continue to be concerned by the serious deterioration in their terms of trade towards the USSR, other COMECON partners and the West. In the first half of 1975 Hungary's trade deficit was as large as for the entire period of 1974, with the additional problem that the COMECON price adjustments wiped out most of the country's traditional surplus on trade within the grouping. The cumulative deficit for Hungary's 1971-1975 trade with Western countries may exceed 25% of Hungarian exports to the West in the same period, in which case debt servicing may place a considerable burden on the economy.

28. Recent price increases domestically have been relatively modest and accepted without too much difficulty by the Hungarian population. Success in controlling prices well into the next Plan period while improving enterprise efficiency and preserving a relatively high living standard will determine the continuing effectiveness of the New Economic Mechanism. In this connection there are signs that the government will introduce a heightened degree of central supervision of industry via its recently announced revised economic regulators.

29. Essentially, these regulators will aim at correcting the imbalance which has arisen in wage rates between domestic and foreign trade oriented firms; wages will depend less on a firm's profits, especially where profit originates from price increases outside Hungary. Some wage increase decisions will be centralised. Additional longer-term objectives include the fight against imported inflation, reduction of state subsidies and the return to central government control over the 5%-6% of national income it has lost in recent years. The new approach does not suggest, at this stage, that the scope of the New Economic Mechanism will change fundamentally. Nevertheless, possible closer COMECON integration and increased Hungarian dependence on the USSR for raw materials would seem to preclude for the time being further expansion of the 1968 reforms.

30. In Czechoslovakia the downward revised 1975 Plan targets have reportedly been achieved and relatively high industrial growth figures are claimed. By contrast, there has been a slowdown in investment as well as problems in completing main investment projects, especially in the important petro-chemical industry. Both in 1974 and 1975 the total trade deficit, primarily in convertible currency, increased (some $460 million in 1974). Restrictions on demand and imports were intensified in 1975 in order to check this trend.

31. There have been no salient changes in the country's internal economic policy and all talk of in-depth reforms has been postponed despite some pressure for a restructuring of the country's aging industrial sector. Presumably, as in Poland, the Prague Government will try to avoid consumer goods cutbacks for as long as possible in order to stem social unrest.

IV. COMECON

32. The 29th COMECON Council session held in June 1975 apparently achieved little in the way of innovation and discussed primarily energy and greater integration via joint construction projects. A series of new agreements on plan co-ordination, on specialisation for various industrial sectors, such as the chemical industry and machine-building, were signed and a draft plan for multilateral integration measures was approved. As part of this programme a unified electric power grid scheme for the European members of COMECON will be submitted to next year's Council session.

33. Very little information has emerged from the session on the impact of the new intra-COMECON trade pricing system. Nevertheless, information from Hungarian, GDR and Czech sources indicates that the USSR in return for pegging its oil and other resources at less than world market prices (e.g. $7-$8 a barrel of Soviet oil compared to $11.50 for Middle East oil) has already begun to exact a price for its concessions by demanding substantial longer-term East European contributions to develop Soviet resources presumably against guaranteed future deliveries.

34. It has been suggested that the new prices could bring an element of greater realism in Eastern Europe's domestic prices and thus provide a stimulus to greater efficiency. Much will depend on the extent to which resources allocated to investment in Eastern Europe will be affected by the cost of energy and on the effectiveness of energy conservation and substitution measures now being implemented in Eastern Europe. In general terms, however, it seems very possible that growth rates in a number of the Soviet Union's partners (especially Hungary) will either decline or stagnate until the end of the next Plan period. A clearer idea of trends will emerge when the next Five-Year Plans are published, but already Communist planners predict rather adverse longer-term growth effects as a result of what constitutes a major change in COMECON trade relationships since January 1975.

35. There has been no progress in COMECON-EC preliminary contacts and scant mention of the subject was made at the last COMECON session. In keeping with past tradition Romania stressed the importance for COMECON members to be able to conduct direct

bilateral negotiations with the EC. This proposal doubtless has the tacit support of most other East European countries which would like to preserve some flexibility in promoting individual links with the EC, while concurrently supporting Soviet wishes for a more institutionalised COMECON-EC relationship. The USSR will certainly attempt to achieve a unified COMECON position on the issue before entering into any further high-level talks with the EC.

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