

CONSEIL DE L'ATLANTIQUE NORD
NORTH ATLANTIC COUNCIL

EXEMPLAIRE N°
COPY

166

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

ORIGINAL: FRENCH
22nd March, 1976

DOCUMENT
AC/127-D/531

ECONOMIC COMMITTEE

THE EAST EUROPEAN ECONOMIES, THE WORLD
RECESSION AND INFLATION

Note by the French Delegation

INTRODUCTION

After having more or less openly rubbed their hands at the Western economic crisis, which was hailed by Marxist ideologues as the start of the long-awaited general crisis of capitalism, the East European leaders have had to concede that because of its seriousness the recession could not fail "to have an influence on the Socialist countries"(1).

2. The countries with Soviet-type planned economies are in fact experiencing - some time after the West and in varying degrees - a slackening of economic growth and inflationary pressures which, although not monetary, are troublesome enough.

3. It is important to avoid point-by-point comparisons between the situation in the Western and the East European countries, which are still at very different levels of development. The growth rate of national income in the latter, which was between 5% and 8% in 1975, would be considered an enviable result in the market economy countries. But it actually falls far short of the initial targets set by the Socialist planners (Annexes 1, 2 and 3).

4. Although there is no crisis in the Western sense, the drop in the growth rate which the Russians are expecting for the 1976 Annual Plan, and in all likelihood for the duration of the next Five-Year Plan (1976-1980), is symbolic of the difficulties with which the Socialist countries are having to contend.

This document includes: 9 Annexes

(1) Mr. Brezhnev's speech to the 11th Congress of the Hungarian Socialist Workers' Party in May 1975

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

AC/127-D/531

-2-

5. These difficulties have internal and external, structural or cyclical causes, of which the former would seem to be the more serious since they are related to the principles of Socialist planning.

x

x

x

A. DOMESTIC FACTORS

6. The agricultural crisis which the Soviet Union and, to a less extent, some of the People's Democracies are now going through is certainly due to the bad weather which caused a one-third drop in this year's grain harvest. Nothing like it has been known since 1963 and while it must not be underestimated, it must not be exaggerated (as some people are inclined to do at the moment) since it is purely cyclical. Agriculture will remain the Achilles' heel of the Soviet economy for many years to come but the Kremlin, aware of the importance of the problem, at last seems determined to come to grips with it in a big way(1). Sooner or later, there should be a breakthrough in a sector which has been somewhat neglected for a long time.

7. Some of the People's Democracies, like the GDR and Czechoslovakia, are almost self-sufficient in food and prove that collectivised agriculture can deliver the goods provided it receives sufficient attention.

8. There are, however, other factors which are permanent obstacles to rapid economic growth and which it will be difficult to overcome because they are bound up with the very principles of the Soviet-type planned economy.

9. These internal factors are of a structural nature and are to be found in varying degrees in all the COMECON countries and also in Yugoslavia, where the self-management system combines all the worst aspects of a planned economy with those of a market economy (cf Annex 7).

(1) In 1976, direct and indirect investment in agriculture will amount to 400 milliard roubles or more than one-third of all Soviet investments

10. The first handicap, on which it would be pointless to dwell, is the low return on investments. A cumbersome bureaucracy and a refusal to compromise with the profit notion, which is a first principle of Marxism, tend to neutralise and discourage the spirit of initiative at any level. The resulting waste, which is condemned ceaselessly and vainly by the press, leads to the immobilisation for long periods of capital and of the technical resources allotted to the major COMECON economic projects.

11. The second handicap, which is related to the first, is low labour productivity, which is due to technological backwardness in certain sectors but, above all, to a lack of motivation on the part of the workers. Because full employment is guaranteed under the Constitution, enterprises found themselves obliged, when manpower was plentiful, to indulge in overmanning with the result that the labour force has got into the way of working at a tempo which would not be possible in a competitive economy.

12. In the post-war years, industrial growth was mainly sustained by population movements from the country to urban areas, but this trend has already slackened and will probably have to be halted, at least until answers have been found to the agricultural problems.

13. At present there is a general manpower shortage in all the COMECON countries, and the potential surplus in Poland and Rumania are not enough to make up for the lack in the other countries. This situation, which is already causing concern in the GDR and Czechoslovakia, will get worse in the early '80s when the lower birthrate generations come on the labour market. There is a real bottleneck here which can only be overcome by recourse to foreign workers(1) from the developing countries or to material incentives, which alone can bring about a rapid rise in labour productivity.

14. The third handicap, which has come to light more recently, but which is perhaps more serious because it represents a challenge to the principles of Soviet-type authoritarian planning, is the inelasticity of supply and demand where consumer goods are concerned.

(1) Only Yugoslavia has a large manpower surplus (cf Annex 8) but Yugoslav workers prefer to go to the West, and particularly the FRG, where they are paid high wages in convertible currency

AC/127-D/531

-4-

15. The consequences of this inelasticity, which is not a recent phenomenon, were not felt so long as the Eastern economies were in fact austerity economies. But for some years now, because of the big rise in the standard of living (between 30% and 40% during the 1971-1975 Five-Year Plan), East European workers, except perhaps for the Rumanians, have gone beyond the minimum living wage level and are becoming more exacting as regards the quality and variety of the consumer goods and durables they want to be able to buy.

16. Since at present production is inadequate to meet the increased demand resulting from improved purchasing power, the workers find themselves willy nilly saving quite a lot of their earnings. This channelling of solvent demand into savings represents a form of "repressed inflation" or deferred consumption which will have to be satisfied one day (cf Annex 6).

17. The planners, who until now took their decisions with very little regard for popular wants, now find themselves in a different and more difficult situation. The existence of substantial savings which cannot be put to good use has, in itself, the makings of a crisis. It can lead to shortages which Socialist planning is unable to make good quickly or, on the other hand, to the inflation of stocks because of a miscalculation of requirements(1).

18. The inflexibility of Soviet planning is certainly a major obstacle in meeting the growing and increasingly varied needs of populations which look very kindly on the positive aspects of the Western consumer society. So far, only Hungary has attempted, with the 1968 reform, to introduce new economic machinery designed to provide a better balance between planning and market requirements by decentralising pricing and relating domestic prices to international prices. The attempt has proved an undoubted success but has also led to a high level of inflation (about 8% for wholesale prices in 1975) which is unacceptable for a planned economy subject to intra-COMECON co-ordinated planning.

19. Price stability is a sine qua non of a planned economy, which may collapse if, in addition to the very many bottlenecks, there is confusion. The inelasticity of supply and demand leads

(1) In the market economy countries, these stocks can be sold off cheaply because the prices incorporate a large proportion of profit. This is more difficult with a planned economy where the profit margin of the distribution circuits is no more than 10%.

to price rises which are controlled and curbed artificially by means of State subsidies (cf Annex 5) but this unwieldy system can get out of hand in the long run, as is the case now in Poland, Hungary and, above all, Yugoslavia, if it also has to contend with foreign-generated inflation.

x

x

x

B. EXTERNAL FACTORS

20. Although the foreign trade of COMECON as a whole is only a small and declining proportion of world trade (8.6% in 1974 as compared with 10% in 1970), the People's Democracies are by no means immune from the effects of the world recession.

21. Dependence on the West varies considerably from one country to another. It is very heavy for Yugoslavia, fairly so for Hungary (6.9%) and Poland, but does not exceed 2.4% of Soviet national product, which makes the Soviet Union the least vulnerable of the COMECON countries. Despite this comparative weakness, trade with the West in 1975 was an important factor in Eastern economic growth, more by virtue of the imported technology than the volume of trade.

22. Since there is no question of returning to self-sufficiency, the East European countries feel the effects of the Western economic recession differently, depending on their energy situation and their foreign trade pattern.

23. The satellite countries have felt the full force of the rise in the price of Middle East oil, followed a year later by a rise in the price of Soviet oil deliveries, and have had to take measures to curb consumption and increase the price of petrol and other refined products by between 40% and 100%.

24. The only country to gain from this was the Soviet Union which, for the first time, was able to balance its books with its trading partners(1).

(1) The People's Democracies import about 13% of their oil from the Middle East, i.e. about 11.5 million tons a year. Out of a total production of some 480 million tons of oil a year, the Soviet Union exports 116 million tons, of which 74 million tons go to COMECON countries.

AC/127-D/531

-6-

25. Coming as a direct consequence of the rise in oil prices, the increased cost of imported Western technology has an even greater impact on the Communist economies. Since fulfilment of the Plan is a must, planned imports cannot be deferred without entirely upsetting domestic production programmes.

26. Forced to import at high prices, the Socialist countries, with their non-convertible currencies, are faced with payments problems. Since the recession makes it more difficult to export to the West, it becomes necessary for them to borrow on the international money markets and therefore to incur debts (cf Annex 9).

27. The debt burden of the Communist countries, which is now about \$10 milliard, concerns all of them and even the Soviet Union, notwithstanding its oil earnings, has to borrow on the Euro-dollar market to pay for its grain purchases (cf Annex 4).

28. Continued massive capital equipment purchases in the West, which are necessary to keep up the present national income growth rate and reduce the East-West technological gap, therefore depend on the granting of export credits by the market economy countries. Only the Soviet Union, whose debt burden is small in relation to national income and which has large gold reserves (2,000 tons), might be able to get by without Western credits (cf Annex 8).

29. The second consequence is that the rise in the price of imported goods has accentuated the existing imbalance between domestic prices, artificially stabilised by means of State subsidies, and the prices obtaining on world markets. These external inflationary pressures have so far been contained but they exist nonetheless and, as admitted by Mr. Gierek at the VIIth Congress of the Polish United Workers' Party, the pricing mechanism will have to be adjusted so as to reflect production costs.

30. The adjustment of domestic prices both for the producer and the consumer and the gradual withdrawal of State subsidies, give rise to difficulties in a planned economy, which is not flexible enough to adapt itself rapidly to changes in the international economic situation.

31. Although they know how important this is, the Soviet planners, after one or two cautious attempts, have so far failed to face the issue and it may well be asked whether the Hungarian exercise is really applicable in a country as big as Russia. The problem exists, however, and the continued recourse to imports from the West is bound to contribute to further rises in consumer prices.

32. Moreover, the granting by Moscow of convertible currency to the COMECON countries to enable them to pay for their Western imports is only a half-measure and further increases the dependence of the satellites on Moscow.

x

x

x

C. CONCLUSION

33. Although they are less vulnerable than the West to international economic ups and downs, the East European countries are nonetheless having to contend with difficulties which stem from the incompatibility between the Soviet planning system and an advanced industrial economy.

34. During the stage of emergence from underdevelopment and even that of industrial "take-off", the system worked reasonably well and ensured a fairly even distribution of available resources. But as soon as the Socialist countries reached an industrially developed stage, serious imbalances in prices became apparent. The commodity balance system, on which inter-industry trade within the national economies and at COMECON level was based, is difficult to apply at a time when trade with the West is expanding.

35. Monetary problems, which until now it has been possible to overlook to some extent, are now making themselves felt with a vengeance. When making foreign trade assessments, the Eastern planners must take account of the effects of Western inflation and fluctuating exchange rates and can no longer base themselves solely on barter arrangements.

36. As matters now stand, only the introduction of a more flexible planning system or, failing this, increased COMECON integration, will enable the planned economy countries to maintain their rate of development.

37. Moscow prefers the second option and is trying to overcome the reluctance of its partners. It is against any tampering with doctrine and wants above all to increase the cohesion and economic autonomy of the Soviet bloc.

NATO,
1110 Brussels.

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

ANNEX 1 to
AC/127-D/531

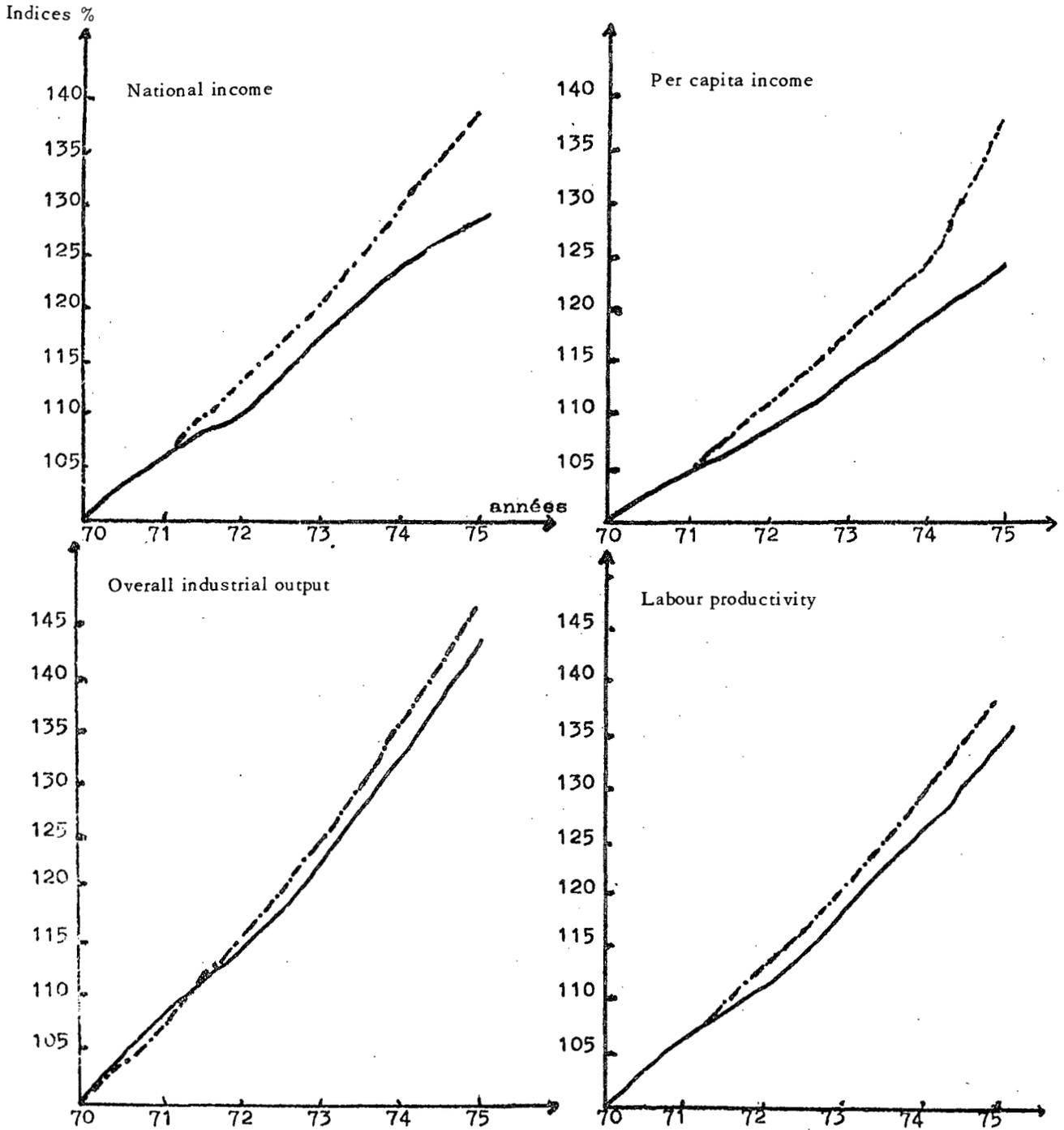
CHANGES IN NATIONAL INCOME
(Percentage annual growth rate)

	1966-1970	1971	1972	1973	1974	Average obtained 1971-1974	1971-1975 Forecasts
Bulgaria	8.7	7.0	8.0	8.7	7.5	7.8	8.0-8.5
Czechoslovakia	6.8	5.1	6.0	5.3	5.5	5.5	5.1
GDR	5.2	4.4	5.7	5.5	6.3	5.5	4.8-5.1
Poland	6.0	8.1	10.2	11.6	10.0	9.9	6.6-6.8
Rumania	7.7	13.1	10.4	10.5	12.5	11.6	11.0-12.0
Hungary	6.8	6.5	5.1	7.3	7.0	6.5	5.5-6.0
Eastern Europe excluding Soviet Union	6.5	7.2	7.8	8.3	8.2	7.9	6.8
Soviet Union	7.2	6.0	4.0	6.8	5.0	5.45	6.5-7.0
COMECON Europe	7.4	6.1	5.1	8.6	5.9	6.4	6.8
Yugoslavia	4.5	8.5	4.5	4.9	4.6	4.15	4.2

National income in the Marxist planning system, unlike Western GNP, covers only material production and does not include services.

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

Soviet growth indicators



Legend { Basis: 100 in 1970
 { - - - - Planned increases
 { ——— Actual increases

This is the programme of the Five-Year Plan. The annual Plan represents a downward revision of the 5-year programme so as to adapt it to the foreseeable short-term results. If the annual results sometimes exceed the annual targets they still do not coincide with the 5-year forecast, which necessarily remains the reference for Soviet economic performance.

DECLASSIFIED - PUBLICLY DISCLOSED - PDN(2012)0003 - DÉCLASSIFIÉ - MISE EN LECTURE PUBLIQUE

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

ANNEX 3 to
AC/127-D/531

DEVELOPMENT OF INDUSTRIAL PRODUCTION
(Percentage annual growth rate)

	1966-1970	1971	1972	1973	1974	1971-1974 Average obtained	1971-1975 Planning forecast
Bulgaria	10.9	9.1	9.1	9.2	7.8	8.8	9.1
Czechoslovakia	6.7	6.9	6.6	6.7	6.2	6.6	6.0-6.3
GDR	6.5	5.6	6.0	7.0		6.5	6.0
Poland	8.3	7.9	10.7	11.3	12.0	10.5	11.7
Rumania	11.9	11.7	11.8	14.6	15.0	13.3	14.0
Hungary	6.2	6.8	5.5	7.1	8.1	6.4	5.9
Soviet Union	8.5	7.7	6.5	7.4	8.0	7.4	8.0
Yugoslavia	6.2	10.4	8.0	7.0	8.0	8.3	8.0

SOVIET AND EAST EUROPEAN TRADE BALANCES IN
CONVERTIBLE CURRENCIES
(millions of dollars)

	<u>1973</u>	<u>1974</u>	<u>1975 estimates</u>
Soviet Union	-1,200	+1,400	-4,000(?)
Bulgaria	- 9	- 425	
Hungary	+ 21	- 300	- 700
Poland	-1,028	-1,732	-2,500(?)
GDR	- 456	- 194	
Rumania	- 42	- 476	
Czechoslovakia	- 59	- 254	
Yugoslavia	-1,300	-2,600	-3,500 to 4,000

NB - It is worth noting that only Czechoslovakia succeeds in offsetting its trade deficit by means of its invisible earnings (especially through the tourist industry and the export of patents). The trade balances of all the other countries are well in the red.

The worsening of the trade balances for all the above countries is due to the deterioration in the terms of trade much more than to a volume increase in the foreign trade deficit.

ANNEX 5 to
AC/127-D/531

-1-

CHANGES IN THE PRICE INDEX

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
Soviet Union (1965 = 100)	99.7	99.6	99.4	99.4	
Poland (1965 = 100)	105.8	107.3	107.3	109.2	115.3
Hungary (1970 = 100)	102.0	104.9	108.4	110.4	119.2
Rumania (1970 = 100)	100.6	100.6	101.3	102.4	104.3
Yugoslavia (1970 = 100)	115	133.4	158.7	200	
Czechoslovakia	No statistics available				

It must be remembered that the price index in the Soviet Union does not cover the kolkhoz or parallel markets where the prices are established on the basis of supply and demand and are therefore well above the official prices.

The incomplete data available from Czechoslovakia would seem to indicate that the prices are also stable and that there is no parallel market, at least for foodstuffs. Nor is there a kolkhoz market.

The rise is very high for Yugoslavia.

SAVING ACCOUNTS HOLDINGS

Country	Amount in 1974 and in millions of national currency	Per capita amount (unit)	Percentage increase 1971-1974 %
Bulgaria	na		
Hungary	70,758	6.7	+ 45.8
Poland	216,213	635.9	+ 91
GDR	70,218	4.13	+ 26.2
Rumania	na		
Czechoslovakia 1973	99,326	6,803	+ 55.2
Yugoslavia	35,954	1,700	+ 85.6
Soviet Union	78.9	313	+169

Per capita savings in the Soviet Union represent two and a half times an average monthly salary; in Czechoslovakia they represent about three times an average monthly paycheck.

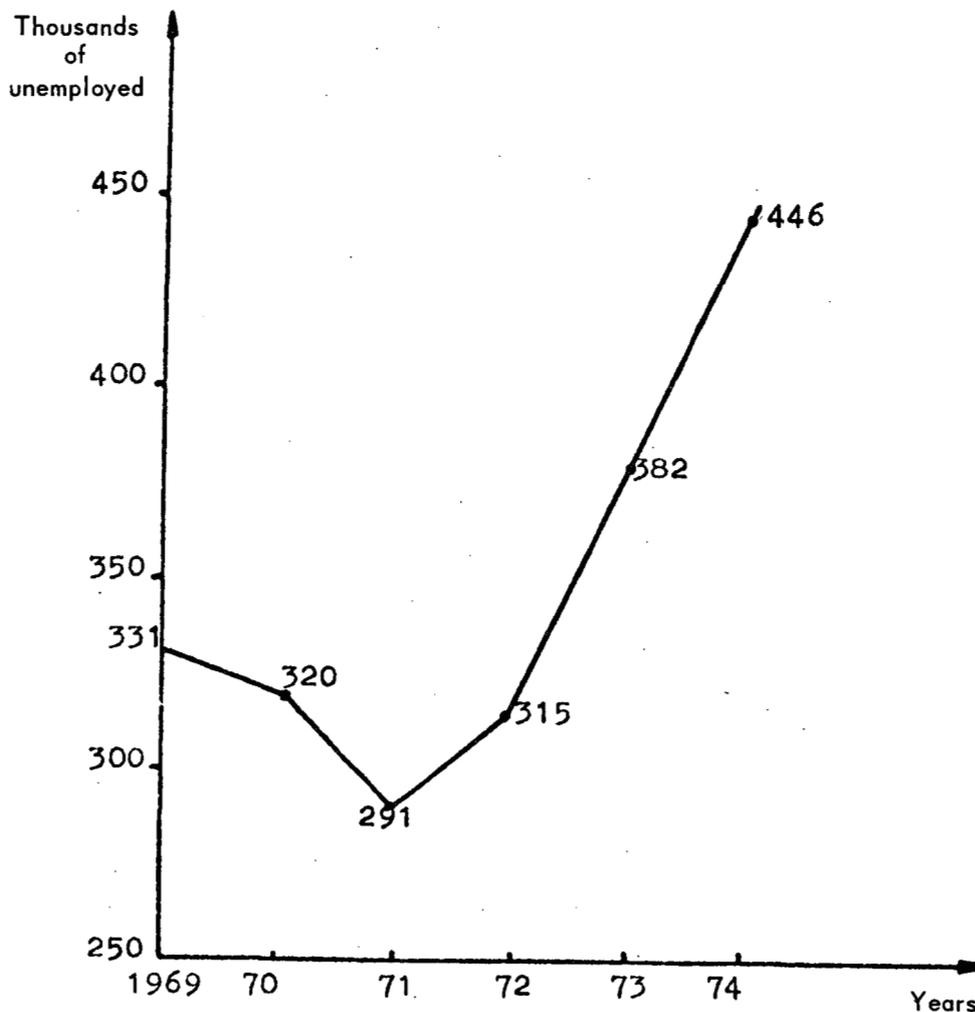
Hungary has the lowest level of savings in COMECON because of the high level of consumption which the new economic machinery has made possible.

DECLASSIFIED - PUBLICLY DISCLOSED - PDN(2012)0003 - DÉCLASSIFIÉ - MISE EN LECTURE PUBLIQUE

UNEMPLOYMENT AND INFLATION IN YUGOSLAVIA

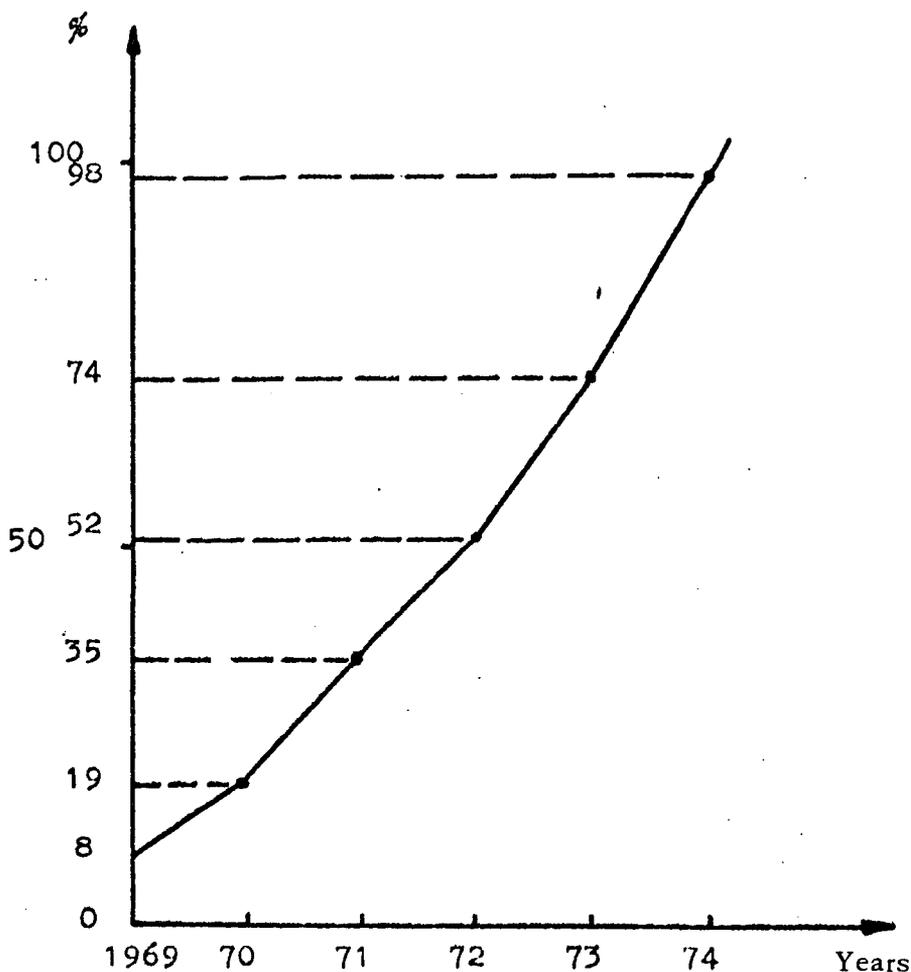
1) Unemployment

Job Seekers.
Yearly average in thousands.



SOURCE : Statistical year-book of Yugoslavia.

(2) Percentage increase in the cost of living since 1969



In 1975 the number of unemployed went up still further because of the return of workers who had lost their jobs in the West, especially in the FRG.

In 1974 the working population was 4.6 million, 10% of whom were unemployed.

Yugoslavia has been hit by all the drawbacks of Socialism and the Western recession i.e. domestically-generated inflation, foreign-generated inflation, unemployment and a low growth rate.

DECLASSIFIED - PUBLICLY DISCLOSED - PDN(2012)0003 - DÉCLASSIFIÉ - MISE EN LECTURE PUBLIQUE

Soviet gold output, sales and reserves
(estimated in tons)

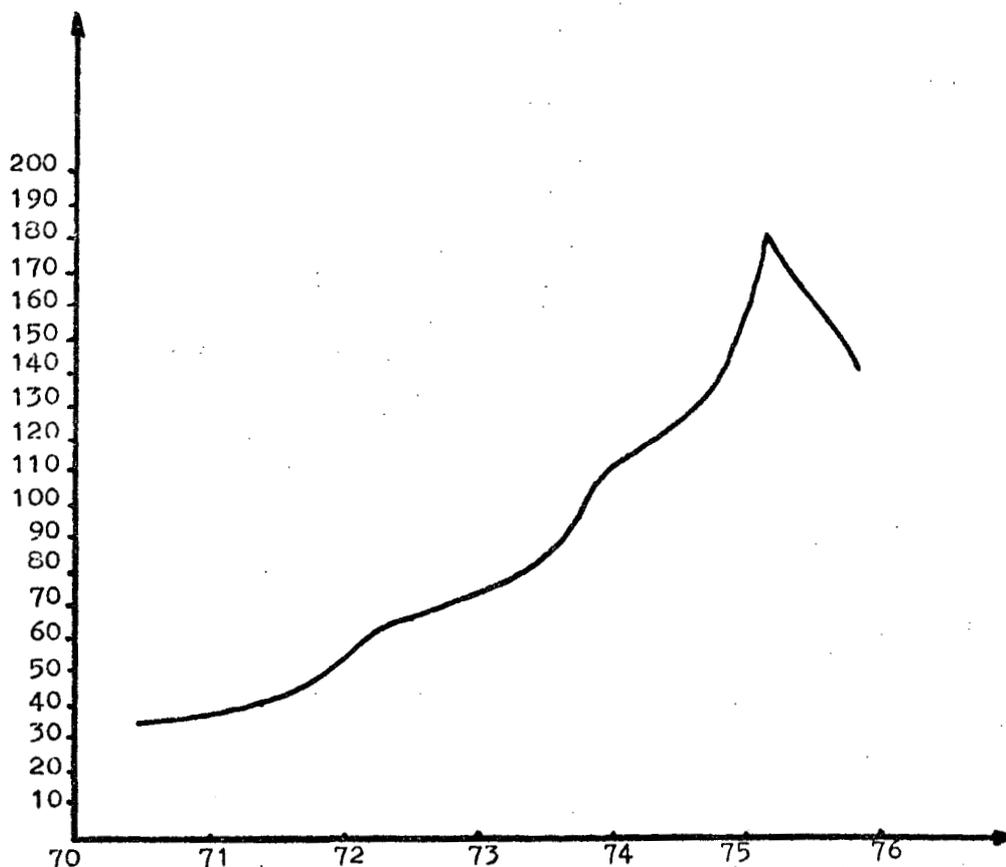
	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>
Output	227	225	230	371	387	395
Domestic consumption	-	-	-	91	110	117
Sales	50	90	200	330	150	130(1)
Reserves	-	-	-	1,725	1,850	2,000

(1) At 1st October, 1975

NB - Rumania, Yugoslavia, Czechoslovakia and Bulgaria, which are the only gold producers apart from Russia, only extract 12 tons or so a year in all.

The trend of gold prices over the last 5 years
(quarterly average values)

Price of 1 oz. in \$



1 oz. = 31.1 grammes

Note: Soviet production costs are fairly high and are estimated at around \$80 an oz.

ANNEX 9 to
AC/127-D/531

-1-

Commitments and debts of credit bodies in the Communist countries vis-à-vis similar bodies in the following ten countries: Belgium, Luxembourg, France, FRG, Italy, Netherlands, Sweden, Switzerland, United Kingdom, Canada, Japan (from 31st December, 1973 to 31st March, 1975).

(in millions of dollars)

<u>Date</u>	<u>Commitments</u>	<u>Debts</u>	<u>Balance</u>
31.12.73	7,701	3,751	-3,950
31.12.74	10,309	5,039	-5,270
31.03.75	12,364	4,538	-7,826

It should be noted that the trend became more pronounced during the second half of 1975.

The figures shown do not include Eastern commitments in Beirut and Tehran where the Communist credit institutions have been most active. The same applies to dealings in the United States since the beginning of 1975, which are not recorded by the Bank for International Settlements.

DECLASSIFIED - PUBLICLY DISCLOSED - PDN(2012)0003 - DÉCLASSIFIÉ - MISE EN LECTURE PUBLIQUE