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SUB-COMMITTEE ON SOVIET ECONOMIC POLICY
ECONOMIC DEVELOPMENTS IN THE SOVIET UNION
AND THE EAST EUROPEAN COUNTRIES DURING
1966 AND 1967

Note by the Chairman

Having concluded its second series of examining sessions on economic developments in each of the Warsaw Pact countries taken individually(1), the Sub-Committee on Soviet Economic Policy undertook to prepare a synthesis report attempting to present a consolidated picture of the economic performance of these countries taken as a whole(2).

2. The attached draft has been established by the Economic Directorate in accordance with the suggestions made at the meeting of 7th March, 1968. After an introduction showing briefly the relative economic position of East and West the draft report provides:

- an account of the recent economic performance of the countries in question, with some key figures of Western countries for the purpose of comparison;
- an evaluation of the economic reforms in these Communist countries;
- an account of the foreign economic relations of these countries with special reference to COMECON.

3. This working paper will be put on the Agenda of the next meeting of the Sub-Committee on Soviet Economic Policy who may wish to send a report on this subject to the Committee of Economic Advisers for further consideration and possible transmission to the Council.

(Signed) A. VINCENT

OTAN/NATO,
Brussels, 39.

(1) See: Czechoslovakia C-M(67)1 and C-M(68)3; Bulgaria C-M(67)39; the Soviet-Occupied Zone of Germany C-M(67)45; Hungary C-M(67)67; the Soviet Union C-M(67)68; Rumania C-M(68)31 and Poland C-M(68)32.

(2) AC/89-R/104 Item III(2)

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DRAFT REPORT BY THE ECONOMIC DIRECTORATE

I. INTRODUCTION: The relative position of East and West at the end of 1967

1. To put recent economic achievements of the USSR and the East European countries in perspective the following comparisons, referring to 1967, between East and West are offered(1).

- (i) With a population (337 million) amounting to about 10% of the world total, the Warsaw Pact countries(2) taken together accounted for, in 1967, about 19% of the Gross World Product and 10% of World Trade.
- (ii) This total production corresponds roughly to that of the NATO European countries taken together, although the latter attained this result with a population some 10% smaller than that of the Warsaw Pact countries.
- (iii) NATO countries as a whole represent in terms of population some 50% more than the Warsaw Pact countries and are producing a total gross product two and a half times as large as the Warsaw Pact countries (amounting to over 50% of the Gross World Product).
- (iv) The economic performance of the whole of the Warsaw Pact countries is primarily determined by that of the Soviet Union whose Gross National Product amounts to 74% of the total. The next most important members of the Pact in economic terms are: Poland, the Soviet-Occupied Zone of Germany and Czechoslovakia, whose GNPs represent respectively about 9.5%, 8% and 7% of that of the USSR.

(1) See Table I at Annex.

(2) In this paper the term "East European countries" covers: Bulgaria, Czechoslovakia, Hungary, Poland, Germany and the Soviet-Occupied Zone of Germany. The term "Warsaw Pact countries" includes the Soviet Union in this group. Although still a formal member of the Warsaw Pact, Albania is not included under either of these terms as, since the break of its diplomatic relations with the USSR in December 1961, this country has practically ceased all participation in Warsaw Pact activities.

- (v) If Gross National Product figures are considered as indicative of the overall economic potential of the countries concerned, the Soviet Union ranks second in the world with a GNP amounting, according to American calculations, to 48.8% of that of the United States and about two and a half times that of Germany and Japan, which are the next largest economic national entities in the world. The relative position of the USSR is somewhat better in terms of industrial production, which amounts to over 55% of that of the United States and exceeds that of the EEC by nearly 20%. On the other hand, agriculture, which accounts for about 20% of GNP in the Soviet Union (as against 7.4% in France, 12.5% in Italy; 3.2% in the United Kingdom and 3.3% in the United States) employs about eight times the manpower (about 40 million or 36.2% of total employment) used in the United States (5.2 million or 7.1% of total employment) to feed a population only 17% larger than that of the USA.
- (vi) The NATO countries of Europe, if they are taken as a whole, have a total GNP just above that of the Warsaw Pact countries with a population about 12% less. The GNP of the six countries of the European Economic Community is roughly equivalent to that of the USSR. The GNP of Germany - the largest in Western Europe - exceeds that of all the Eastern European countries taken together, although its population is only 60% of their total.
- (vii) As far as GNP per capita is concerned the position of the Soviet Union is less glamorous. Per capita GNP in the USSR in 1967 was about 40% of that of the United States and about 60-70% of that of the major advanced economies of NATO Europe. It was slightly above the level reached by Italy and Japan but at least 10% below that of Czechoslovakia or the Soviet-Occupied Zone of Germany.
- (viii) If per capita consumption is considered as a rough indicator of the standard of living, the Soviet Union and the East European countries are even more backward, given the high proportion of GNP devoted to investment (over 26% in the USSR as against 23% in the EEC, 18% in the United Kingdom and 17% in the United States). Thus Soviet consumption per capita was about 30% of the United States level and 55% of that of the advanced Western countries. It was less than 90% of the Italian per capita consumption.

- (ix) Since the share of GNP devoted to defence in the USSR (10%) is double that of NATO Europe as a whole (5.1%), (United Kingdom 6.8%, France 6.2%, Germany 5.3%, Italy 3.7%), the share left to the individual consumer as compared to West European countries is even smaller than that indicated in the above percentages. (For instance, the share left to the consumer in the USSR would amount to about 82% of that at the disposal of the Italian consumer). The East European countries are spending roughly 5% of their GNP on defence so that the relative advantage of the Soviet Zone in Germany and Czechoslovakia as regards GNP per capita is greater still in terms of individual consumption.

II. RECENT ECONOMIC PERFORMANCE OF THE SOVIET UNION AND THE EAST EUROPEAN COUNTRIES

2. In this part of the paper indications are given on the general trend of the economy of the Communist countries of Europe, and on developments in industry, agriculture, investment and living standards. Wherever possible, comparisons are made with the West.

(a) General trends

3. The economic performance of the Warsaw Pact countries during 1966 and 1967 was, on the whole, an improvement on the slower rates noted during the early sixties. The results achieved during the first of the two years under consideration were well above average while those achieved during the second, although less impressive, particularly in the USSR, were still satisfactory, at least in most of the East European countries. According to official Communist sources(1), the National Income (Net Material Product) of the Soviet Union increased by 7.5% in 1966 and 6.7% in 1967, as compared to an annual average of 6.8% during the three preceding years. The East European countries taken together have officially claimed increases in their net material product of 8.2% in 1966 and 6.6% in 1967 as against only 5.3% per year during the period 1963-1965. Continuing rapid progress over the last two years was officially reported by the least developed countries within this group - Bulgaria and Rumania - although in the case of the latter the 1967 results have been less spectacular. Poland has shown increasing signs, particularly in 1967, of slowing down its previous pace of growth that had been above the East European average, while Hungary, which constitutes with Poland the intermediate group of East European countries, picked up rapidly after the 1965 fall. As to the more advanced countries the Soviet Zone of Germany had the lowest growth rates of all, while Czechoslovakia after three full years of stagnation resumed in early 1966 its rapid growth.

(1) See Table II at Annex.

4. This overall picture derived from Communist statistics, may be considered as a valid indication of the prevailing trends but the percentage figures given are not strictly comparable with the statistics of economic growth generally used in the Free World. Communist statistics based on the concept of "Net Material Product" which differs from the Western concept of "Gross National Product" in that it excludes a large number of services, the development of which in Communist countries has generally been less rapid than that of other sectors. Some figures may be exaggerated, e.g. agricultural output includes varying degrees of impurities, waste and moisture, generally deducted in similar Western statistics. As a result of these conceptual differences, the rates of growth in Communist countries would tend to be exaggerated if their figures were compared without correction to those of the Free World.

5. Western experts have made various calculations in order to reach rates of growth that could be compared with those of Western countries by evaluating in terms of Gross National Product the national income of Communist countries(1). These estimates show that the average rate of economic growth in the Warsaw Pact countries over the 5 year period 1963-1967 has been somewhat higher than in NATO countries, 5.3% against 4.6%. The rate has varied from one country to another; it has been particularly low in Czechoslovakia (2%).

6. There have been fluctuations in the overall performance of both Western and Communist economies, which contradicts the claims that the Communist system permits steady growth free from recessions and reflects the great influence exerted by agriculture in the Gross National Product in these countries. The acceleration in overall growth noticeable in 1966 was in part due to the bumper harvests in the USSR, Bulgaria and Rumania where agricultural output increased by more than 10% over the preceding year. During 1967 no comparable growth of agricultural output was to be expected and the maintenance of agricultural production at the high level reached in 1966 could be regarded as a success. Industrial production picked up in the most advanced East European countries, probably averaging about 5% in Czechoslovakia and the Soviet Zone; 7% in Poland and Hungary, 7.5% in the USSR and up to 11-12% in Bulgaria and Rumania(2). From the limited information available for 1968 it would seem that the rates of increase achieved in 1967 will not be maintained in 1968.

(1) See Table III at Annex.

(2) The official Communist statistics indicated a rate of industrial growth of about 6.5% in Czechoslovakia and the Soviet Zone of Germany, 7.5% in Poland, 9% in Hungary, 10% in the Soviet Union and about 13.5% in Bulgaria and Rumania.

7. Because of the more rapid economic expansion in the less developed countries and a slower growth in the more advanced ones the gap between the East European countries which are still at different stages of economic development has tended to narrow. However, the lead of the Soviet Union over the other countries has not been reduced as can be seen from the following table:

TABLE IRELATIVE ECONOMIC WEIGHT OF EUROPEAN COMMUNIST COUNTRIES

(Eastern Europe as a whole = 100)

| | 1960 | 1964 | 1967 |
|------------------------|-------|-------|-------|
| Bulgaria | 5.4 | 6.1 | 6.4 |
| Czechoslovakia | 22.3 | 20.2 | 19.5 |
| Hungary | 9.7 | 10.3 | 9.9 |
| Poland | 25.9 | 26.8 | 27.1 |
| Rumania | 12.1 | 12.8 | 13.8 |
| Soviet Zone of Germany | 24.6 | 23.8 | 23.3 |
| TOTAL | 100.0 | 100.0 | 100.0 |
| Soviet Union | 259.0 | 273.0 | 269.0 |

(b) Industrial production

8. Western researchers have attempted to eliminate the double counting in Communist statistics of gross industrial output in order to make them comparable with industrial production indices in Western countries(1). Such comparisons show that relative to 1960 industrial output in 1967 had risen in the USSR by 67%, in the USA 44%, in East Europe 56% and in Japan 131%.

9. In all the Communist countries the fastest growing sectors of industrial production have been the chemical and engineering industries. In the Soviet Union non-ferrous metal production also made striking advances as did paper products and construction materials. In the East European countries oil refining could be counted among the fast growing sectors. The fuel and power industry in the Soviet Union grew, however, at a much slower pace than the overall average. On the other

(1) See Table IV at Annex.

hand in the USSR there was good performance by the non-durable consumer goods industries which benefited from exceptionally good results in agriculture. Indeed, one of the most striking features in 1967 in the Communist countries was the speed-up of the consumer goods output. As a result in nearly all the Communist countries the traditional gap between the rates of growth of producer and consumer goods has been narrowed, but only one country - Hungary - actually recorded a higher rate of growth in consumer goods. The exception to this trend was Poland where output of producer goods increased far more rapidly than that of consumer goods. In the Soviet Union the plan for 1968 provides for the first time a more rapid increase in consumer than in producer goods.

10. The improvement in industrial output during the last two years in the East European countries was achieved mainly through heavy investment. In Czechoslovakia and the Soviet-Occupied Zone of Germany fuller use was also made of the existing capacity, while in Poland, Bulgaria and Rumania substantial additions to the number of manpower employed contributed largely to the satisfactory industrial results. In the Soviet Union, however, the performance of industry has been less impressive and more in line with the general trend noted during the first half of the decade. The percentage of growth of Soviet industrial production remained about 2 points below the percentage generally reached during the second half of the fifties. The various economic reforms in the East European countries and the Soviet Union seem to have been introduced too recently, and on too narrow a basis to have influenced trends in output in 1966 and 1967.

11. Growth percentages of output may be misleading in that they provide no indication as to the extent that the goods produced are actually utilised. In fact, inventories in many of these countries have been rising owing to the poor quality and range of products available. This problem is probably most acute in Czechoslovakia where a large share of the added production was accounted for by increased stocks. Whereas in the past the main concern of the Communist leaders had been with quantitative growth, more recently the qualitative aspects of growth have attracted more attention, and some progress was made in that direction particularly in the Soviet Union, the Soviet-Occupied Zone of Germany and Hungary. In Bulgaria and Rumania consumers are less demanding and these economies depend less on exports of finished goods.

(c) Agricultural output

12. The 1966 agriculture output showed most remarkable increases over those of the preceding year: more than 10% in Eastern Europe as a whole and 10.5% in the Soviet Union, over 12% in Hungary and Czechoslovakia and even more than 15% in Bulgaria and Rumania. This upsurge was largely due to particularly favourable weather conditions but there are indications that the various measures taken over the past few years were beginning to bear fruit.

13. Given the advance in 1966, no further rapid growth could normally be expected in 1967. Output in 1967 remained generally at the high 1966 level although weather conditions were more normal, the reduction in crop production being compensated by gains in the livestock output, particularly in the Soviet Union and the more industrialised countries(1). As a result Czechoslovakia, the Soviet Zone of Germany and even Poland had to import grain to support their livestock industries. Livestock numbers did not increase in the Soviet Union; indeed there has been a deliberate effort directed at improving yields rather than animal numbers.

14. In the Soviet Union the position of agriculture in recent years has been as follows:

TABLE II
AGRICULTURE IN THE USSR

| | 1963 | 1964 | 1965 | 1966 | 1967 |
|---|---------|-----------|-----------|-----------|-----------|
| <u>Total Grain</u> (million metric tons) | | | | | |
| Soviet Official | 107.5 | 152.1 | 121.1 | 171.2 | 147.6 |
| Western estimates | (90-95) | (120-125) | (100-110) | (140-145) | (120-125) |
| of which <u>wheat</u> | | | | | |
| Soviet official | 49.7 | 74.4 | 59.7 | 100.5 | 77.3 |
| Western estimates | (40) | (60) | (50) | (85) | (65) |
| <u>Livestock numbers</u> (million head end of year) (Soviet official) | | | | | |
| Cattle | 85.4 | 87.2 | 93.4 | 97.1 | 97.1 |
| Hogs | 40.9 | 52.8 | 59.6 | 58.0 | 50.8 |
| Sheep, goats | 139.5 | 130.7 | 135.3 | 141.0 | 143.9 |

The 1967 decline in grain production was largely compensated by record harvests of cotton, sugar beet, sunflower seeds, as well as increased production of potatoes and vegetables. Similarly, milk, meat, eggs and wool all reached unprecedented levels in 1967.

(1) See Table V at Annex.

15. In all the East European countries and in the Soviet Union encouragement had been given to the farmers in the form of higher prices for their products, more freedom to choose output, improvement in investment and credit facilities. The introduction of improved varieties of seeds, increases in the use of fertilisers and earlier heavy investments in terms of irrigation and equipment were beginning to bear fruit. The 1966 crop results appear nevertheless above the normal production capacity of the Soviet and East European countries and to the extent that they affected (in terms of good feed reserves) livestock production in the following year, the vulnerability of agriculture to the vagaries of the weather should not be underestimated. Judging by the incomplete information so far available it would seem that the 1968 results may be somewhat below those of 1967. The wheat crop production of 1967 is believed to be more indicative of the average harvest capacity of the USSR than the records reached in 1965 and 1966, owing to exceptional weather conditions. Such a crop meets the internal requirements of the Soviet Union, covers its export commitments and allows some marginal addition to reserves.

16. The excellent results achieved in 1966 and 1967 should, however, not hide the continued backwardness of Soviet agriculture as compared to Western countries. The USSR employs nearly eight times more people in agriculture than the United States, but this huge amount of manpower has only about one-third of the number of tractors and about 60% of the grain combines at the disposal of the United States' farmers. Similarly, the amount of fertilisers per hectare used in the USSR is only 36% of that used in the United States. Yields per acre in the Soviet Union in 1966 amounted to about 70% of the United States yields of wheat and 40% of potatoes. Soviet production of livestock commodities in 1966 represented some 66% of pork meat produced in the United States and 40% of beef and veal, 48% of eggs. However, milk production in the USSR was nearly 25% more than in the United States, while twice as much butter and over three times as much wool was produced in the Soviet Union than in the United States. On the whole there is some danger that the Communist leaders in the USSR, over-impressed by the results achieved in recent years, and hard-pressed by increased defence and other requirements, might be tempted to reduce the priority belatedly given to agriculture; in fact investment targets in agriculture have been revised downward in the presentation of the 1968 plan as compared with those set in the five-year plan.

(d) Investment

17. Because of the preoccupation with economic expansion, the proportion of national income devoted to investment is consistently high in Communist states; between 25% and 30% in the Soviet Union and Poland, and even higher in Bulgaria and Rumania. Along with the slowing down in the growth of national

income noted in the early sixties, there was a corresponding movement in investment. Since 1965, however, the upward movement has been resumed generally(1). In all East European countries, except Czechoslovakia, the rate of growth of investment exceeded that of national income. This is especially so in Bulgaria and Rumania where ambitious Five Year Plans are under way. It must be remembered, however, that owing to differences in the price systems investment figures in these countries are not strictly comparable.

18. There is the tendency in these countries to base expansion less on extra manpower and more on modern techniques, improved equipment and prefabricated materials. This implies heavy capital investment. However, the question of the correct pricing of output so as to take account of quality and that of the real cost of expansion have not been solved. It is generally recognised that in the industrialised countries of the West a better return on investment is achieved. Some of the changes in investment policy are examined in the part of this paper which deals with economic reform.

19. The question of resource allocation remains a fundamental issue of policy. It was again brought into the limelight when the targets initially fixed in the Soviet plan for the period 1966-1970 underwent a reduction in order to allow an increase of military spending and the production of consumer goods. The Soviet Authorities have apparently abandoned the idea of publishing the final version of the 1966-1970 Five Year Plan, and have adopted the simpler procedure of annual plans. Little change is, however, to be envisaged since Mr. Kosygin stated recently that it would be impossible to increase the share of consumption at the expense of investments because this might slow down economic development, nor would it be possible to reduce the share of national income devoted to defence. The evolution of the resource allocation in the Soviet Union can be seen in Table VII at Annex.

20. During recent years in most of the East European countries the share of total investment devoted to industry has been declining slightly in favour of construction and services, with the exception of Hungary and Rumania where the industrial sector has been receiving increasing priority. Housing has also received increased attention in most of the East European countries.

(e) Standard of living

21. Considerable expansion of industrial and agricultural production in those countries has been accompanied by a relatively smaller improvement in living standards. The cost of

(1) See Table VI at Annex.

living has been rising quite slowly (something around 1% per year) so that the rise in money wages does not much exaggerate the rise in real wages. According to figures given in the ECE publication - The European Economy in 1967 - the figures for real wages are as follows:

TABLE III
ANNUAL RISE IN REAL WAGES (%)

| | 1963 | 1964 | 1965 | 1966 | 1967 |
|----------------|------|------|------|------|-------|
| USSR | 1.0 | 2.0 | 4.0 | 2.0 | 4.0 |
| Bulgaria | 1.0 | 2.0 | 3.0 | 5.0 | n.a. |
| Czechoslovakia | -0.6 | 2.4 | 1.2 | 2.3 | 3.9 |
| Soviet Zone | 1.6 | 3.2 | 2.9 | 2.0 | n.a. |
| Hungary | 4.0 | 3.0 | - | 2.0 | 3-3.5 |
| Poland | 2.4 | 2.1 | - | 3.3 | 2.5 |
| Rumania | 5.0 | 2.0 | 6.0 | 6.0 | n.a. |

Judging by these figures, real wages have risen most consistently in Rumania and Hungary, but because of the different levels of income too much should not be read into these international comparisons. What does seem fairly certain, however, is that peasant incomes have risen faster than those of other workers; the gap between urban and rural labour is thus closing. Social benefits and services provided by the state constitute a significant element in real incomes in Eastern Europe. On the whole these have continued to expand at about the same rate as the real wages.

22. Retail trade has been expanding at about the same rate as national income. The figures given below are not strictly comparable as in some cases trade outside the socialised sector is excluded.

TABLE IV
EXPANSION OF RETAIL TRADE (%)

| | 1963 | 1964 | 1965 | 1966 | 1967 |
|----------------|------|------|------|------|------|
| USSR | 4.7 | 5.3 | 9.8 | 8.7 | 9.4 |
| Bulgaria | 9.1 | 6.1 | 7.4 | 8.3 | 11.5 |
| Czechoslovakia | 1.4 | 2.8 | 5.4 | 5.2 | 6.5 |
| Soviet Zone | 0.3 | 3.3 | 4.3 | 4.1 | 3.0 |
| Poland | 4.5 | 4.3 | 8.3 | 6.6 | 6.8 |
| Rumania | 8.4 | 8.0 | 7.4 | 9.4 | 9.8 |

23. Savings deposits increase in Eastern Europe at 10-20% a year but in most countries the yearly increase is only a modest fraction of the trade turnover ranging in 1967 from 1.6% for Hungary to 6.3% for the Soviet Zone. The accumulated deposits represent in most countries between 20% and 50% of trade turnover except in the Soviet Zone where in 1967 they amounted to 70%. In recent years there has probably been a certain accumulation of purchasing power as the result of the increase in peasant incomes, greater flexibility of wages in industry and the effects of increased investment. Consumer demand has not been satisfied in respect of quantity, quality and range of product. The leaders recognise that standards of living must be improved and recent declarations about increased output of consumer goods reflect their decision to tackle this problem as does the increased attention now being given to services such as laundries, repair shops and petrol stations.

24. Housing still constitutes one of the most formidable problems facing Communist leaders. The annual number of newly-built dwellings in the Soviet Union decreased from 1960 to 1964, since when it has remained practically unchanged. A similar trend is discernible in Rumania and Bulgaria. In 1967 progress in this field was reported in Poland, Czechoslovakia and the Soviet Zone of Germany, but total floor space per inhabitant remains clearly inadequate in most of these countries, including the Soviet Union.

25. All in all the basic characteristics of Communist economies have not much altered. As a result of the emphasis on maximum physical output, the relatively low yield on investment, the cost of defence, especially in the Soviet Union, economic expansion has to a very modest extent indeed served the well-being of the population. For instance Western observers have calculated that the average German family of four persons earned in the Federal Republic in 1967 an income of DM 926. To buy the equivalent in the USSR an income of 350 roubles would be needed. The average man and wife would, together, earn only about half this amount so that consumption in the USSR can be said to be about half of what it is in Germany. Obviously the price structure is very different; rents in the USSR are very low, a "rent" rouble being equivalent to DM 19 in Germany, but housing conditions in the USSR are very bad. Clothing is much more expensive and a rouble will buy only as much as a mark in Germany. In practice the Russians have to be satisfied with less of the essential products and practically go without some of the more sophisticated ones. This poor deal for the consumer is in striking contrast with the West where economic progress is measured in terms of consumer satisfaction.

(f) Prospects for the future

26. In the USSR the pattern of production for the current five year period is now set and it is unlikely that any serious setback will be experienced: the revised targets for 1970 published last year should be achieved.

| | Increase 1965-70 | Annual Yearly Increase |
|-----------------------------------|---------------------|---------------------------|
| National Income | 39% | (6.8%) |
| Real Income per head | 30% | (5.4%) |
| Industrial Output | 53% | (9.5%) |
| Investment (centrally controlled) | 41% | (7.1%) |
| Retail Trade | 44% | (7.6%) |

27. It is realised, however, that the real problem of the Soviet economy involves certain structural changes. To some extent these are already prepared but the main work is scheduled for the seventies. The changes envisaged are (a) overcoming the lag in consumption relative to production, it being realised that a high standard of living greatly affects scientific and technical progress, productivity of labour, economic effectiveness, social consciousness and the world revolution, (b) a shift in emphasis from further "extensive" development to other aspects of development such as quality, raising the technical level of production and economic effectiveness, (c) further industrialisation which implies mechanisation of agriculture, and subsidiary industrial processes, and the introduction of automation where appropriate, (d) improved working of the economic system so as to reconcile individual incentives and public interest. Conditions fostering technical progress and greater economic effectiveness should be the object of planning and control, price policy and finance and the whole system of economic relations in production and trade.

28. As regards the other European Communist countries the economic problems facing them depend to a large extent on the stage of development they have reached. In Bulgaria and Rumania what is termed extensive development is still going on and there is little urgency about structural changes. At the other end of the scale Czechoslovakia and the Zone are highly developed areas in which the structural problems of which the Soviet leaders are becoming conscious are already acute. For political reasons these have been ventilated in Czechoslovakia but treated much more discreetly in the Zone. In Poland there is likely to be some difficulty in absorbing all the new labour presenting itself.

III. PROGRESS OF ECONOMIC REFORMS IN THE EUROPEAN COMMUNIST COUNTRIES

29. All proposals for economic reforms in Communist countries have stemmed from the realisation that the centralised system of economic control is cumbersome and unsuited to the tasks ahead. Even under Stalin the deficiencies of the system had been noted but open criticism was banned, and changes undertaken were mainly administrative, aiming at overcoming temporary bottlenecks without questioning the overall efficiency of the system.

30. During the period of "de-Stalinisation", which started early in 1956, the improved intellectual climate favoured more open discussion of economic policy too. After the 1957 reform introduced by Khrushchev, public debate in this matter practically ceased in the USSR for several years though discussion was carried on in a quiet way by a few economists. The revival of interest in economic reform in the USSR - associated in the West with the name of Liberman - started in 1962 and undoubtedly was stimulated by the slowing down of economic growth in the USSR in the early sixties, the stagnation in many East European countries and a real recession in Czechoslovakia at a time when in the United States and most Western countries economic performance was improving relative to the late fifties.

31. In the following paragraphs, after a brief examination of the purpose of the reforms, a distinction is drawn between the conservative and the more liberal reform programmes, and a short appreciation of the prospects of economic reform in the Communist countries is given.

(a) Main aspects of Economic Reform

32. The movement of economic reform which is common to all the European Communist countries comprises a number of elements each of which can be applied to a greater or lesser degree. Given that the countries concerned are in different stages of development, that the current problems facing the countries are different, and that the political situation differs from country to country it is not surprising that there is considerable variety in the solutions proposed, not to mention the results obtained.

33. Among the elements of economic reform the following are perhaps the most important:

- (a) some decentralisation of control in order to relieve the planners of unnecessary work and place more responsibility at lower levels. This can take the form of decentralisation on a geographical basis as in the case of the 1957 reform in the Soviet Union or the delegation of some power to key enterprises, a number of enterprises grouped in associations or trusts, or even to enterprises as such. In any case enterprise managers are supposed to exercise more initiative but whether or not the entrepreneurial function is exercised at enterprise level is one of the major issues of the reform movement;
- (b) clear recognition that economic laws have an objective existence and cannot be wished away to suit ideological views. Aspects of this realism are recognition of the validity of profits, interest and financial control;
- (c) increased stress on incentives as regards enterprise management, staff and workers, and an attempt to link bonuses to forms of production which genuinely conform to public interest and consumer satisfaction;
- (d) acceptance of a coherent price system reflecting the real costs of production. There is, however, a very big difference between those who favour constant prices and are content with periodic revisions to bring them into line with current costs and those who are ready to accept the concept of the market mechanism where prices, however fixed, are intended to influence the producer and be influenced by the user.

34. Taking the area as a whole, the reforms adopted so far in the European Communist countries fall into one of two categories:

- (i) an attempt to streamline the existing system, making concessions to economic realities, but firmly maintaining central control not only of general economic development but also of the enterprises in their productive function. Little, if any, scope allowed to the market mechanism;
- (ii) a more far-reaching loosening up of the traditional system, the central authorities, in principle at least, contenting themselves with guiding domestic development but allowing considerable powers to enterprises or groups of enterprises and permitting the market mechanism to function to a greater or lesser extent.

It would appear that the USSR, the Soviet Zone of Germany, Poland and Rumania have accepted the first type of reform while Hungary, Czechoslovakia and even Bulgaria have wished to apply the second type.

(b) Orthodox-type Reforms

35. In the USSR, after a great deal of discussion, some experiments were tried out in 1964 but the reforms as such were only approved by the Party in 1965 and implementation started in 1966 in the industrial sector. By the end of 1967 some 7,000 enterprises accounting for about 40% of total industrial production and employing one-third of all industrial workers had been converted to the new economic methods. By mid-1968 13,000 industrial enterprises were working under the new system, accounting for half the total industrial output and about 60% of profits.

36. The Soviet reforms are of two types. The first concerns the planning and control. The 1957 regional system has been abolished and that of production sector control by ministry restored. Changes of this kind have taken place in the Soviet Union before and certainly do not constitute any basic alteration in the economic system. The creation of intermediate bodies, such as producer associations along the lines experimented with in the Soviet Zone, is still under consideration by the Soviet planners. The second type of reform aims at improving the efficiency of the industrial enterprises by extending somewhat their autonomy. Thus the number of indicators to enterprises has been decreased from 20 to 8. Considerably less importance is attached to the volume of production and more to sales. Some limited freedom has been given to managers with regard to labour, capital is increasingly to be obtained through bank credits. In general a 6% charge per annum on enterprise capital supplied by the government has been introduced. A new fixed price structure has been laboriously calculated for several millions of different products by the central planners and officially imposed.

37. The Soviet reform, therefore, is hardly liberal or revolutionary. There is clearly a determination to retain central control and hardly any concession to market elements. Within this framework the Party would no doubt wish to saddle enterprise managers with more initiative and responsibility but directives are still imposed from above with sanctions for non-compliance. Very great stress is laid on incentives. Prices have been recast but the new structure is still rigid:

consumer demand will not alter these prices and they will to a most unsatisfactory degree guide enterprise managers as to output or reward them for introducing new products or technology at the appropriate moment. Moreover, quite apart from the hesitations by the Party which fears that it might lose its grip on the economy if central control is relaxed, in the short-term at least the inertia of the bureaucracy is an obstacle to the smooth introduction of reform designed to improve the existing system.

38. In the Soviet Zone general directives for the revised economic system were adopted as early as July 1963, and this is the first East European country (Yugoslavia excepted) where a new system is fully in operation. New prices were introduced but they are fixed by the central authorities. As might be expected the Soviet Zone reforms have been conservative. Enterprises are controlled by organizations or Trusts at a level between them and the ministries.

39. In Poland early attempts at reform came to nothing, and new discussions were started by the Party in 1963. A programme was accepted in principle by the Party Congress in 1964, and the Central Committee was to introduce gradually during the years 1965-1968 reforms of a nature broadly similar to those envisaged by the Soviet Union. That is, an attempt is being made to retain and streamline central control so as to reduce its inefficiencies. Prices remain fixed, associations of enterprises are being introduced and the number of indicators imposed on management is being reduced.

40. In Rumania discussion on reform started later than in other countries, largely, no doubt, because of the different economic circumstances. The issue was first raised at the Party Congress in July 1965 and draft directives on improving management and planning were adopted in December 1967. They are essentially measures to streamline the existing system on orthodox lines. It was intended to set up "centrals" or trusts between ministries and enterprises but it is doubtful whether this proposal will be carried out.

(c) Liberal-type Reforms

41. The most striking attempts at real reform have been made in Hungary and Czechoslovakia. In the latter country the new system of Planning and Management was approved in January 1965 by the Party Congress and tested in the course of the year by about 20% of the industrial enterprises. On 1st January, 1966 the reform was introduced in industry as a whole and on 1st January, 1967, together with new wholesale prices, throughout the economy. However, the practical significance of the reforms was not expected to be felt seriously before 1970.

42. The Czechoslovaks intended to create a socialist market model limiting the role of the centre to setting overall goals and a small number of specific investment projects and production targets. Enterprises grouped in vertical "trusts" or horizontal "combines" were to be allowed to operate in market conditions. A 6% charge on capital obtained largely from banks was to be levied as well as a 12% tax on the wage fund. The chief success indicator was to be "gross income", a category corresponding to the Western concept of "value added". A three-tier price system was envisaged. Prices of a number of basic materials and foodstuffs were to be fixed centrally. A second category of prices would range between upper and lower limits. Finally a third group concerning the less essential consumer goods would be free to fluctuate. Although it was intended that prices of consumer goods would not be affected by the changes, they did in fact start to rise and there was concern lest the new system would cause the cost of living to mount and perhaps even occasion some unemployment. In agriculture, improvements in credit facilities and the cost accounting system and more freedom of choice in production have already benefited the farmers whose earnings have increased.

43. It was realised in Czechoslovakia that in addition to reforming the economic system a restructuring of industry was necessary and that real progress in both spheres depended on a new political attitude. The changes which took place in Czechoslovakia in the first part of 1968 seemed to open the door to far-reaching changes: a gradual alteration in the production pattern and an introduction of market elements including enterprise links with abroad, flexible prices, a convertible currency, though there was some concern lest the costs of the change should hit the public before the advantages had had time to make themselves felt.

44. Recent events in Czechoslovakia have made it very unlikely that the reforms as recently envisaged will in fact be carried out. The new political atmosphere will make such projects as massive aid from the West to re-equip the Czechoslovak industry and the creation of real markets for goods, labour etc., untenable. It is to be feared that the reform movement will degenerate into something similar to that applied in the Soviet Zone.

45. In Hungary the reform system has been introduced gradually since the beginning of 1968. It is to be based on an "active market" with elastic prices and fluctuating profits. No associations or trusts are planned, but as in the case of Czechoslovakia a "three-tier" price system is being introduced. It is not out of the question now that the Hungarians may come under pressure to tone down somewhat their economic reforms and bring them into line with other countries'. Bulgaria adopted in April 1966 a type of reform copied mainly from the Soviet Union but adding the Czechoslovak "three-tier" price system.

(d) Prospects of the Economic Reforms

46. Compared with the long drawn out discussions on economic reforms in the European Communist countries, the results obtained have been rather meagre. The difficulties, however, are considerable.

47. There has been relatively little problem about accepting economic concepts such as profit, interest, or the allocation of investment funds by means of banks rather than the budget, though incidentally it is proving necessary to create or train a race of bankers.

48. The granting of freedom to enterprises is a more difficult problem. It implies a limitation of the authority of the central power, and necessitates an alternative method of co-ordinating enterprise activities - such as the market.

49. The experience of Yugoslavia shows the difficulty of running a mixed economy in which the market mechanism is permitted to play an increasingly important role. The fact is that when market elements are introduced (i.e. where individuals may influence production and investment) in a country where hitherto the dominant Party has been used to deciding the pace of development, the pattern of production and the scope of social services, there is almost bound to be excessive pressure on resources, resulting in inflation. Moreover, where market elements become strong, changes in employment are likely, which may give rise to social unrest and jeopardize the success of the reforms.

50. In addition to the doubts by each National Party about the results of economic reform, there is in the USSR some concern about the overall long-term effects on the Soviet area as such. The Soviet leaders are ready to accept some experiments at home and in the neighbouring states to the extent that they are likely to improve the efficiency of the existing system, but they are predictably concerned about the effect advanced thinking elsewhere will have both on their own citizens and on the economic policies of the other European Communist countries.

IV. FOREIGN ECONOMIC RELATIONS AND COMECON

51. Just as the system of economic control and the pattern of production and investment have distinctive features in Communist countries, so trade relations with the outside world and among themselves differ somewhat from what is usual in the West. This part of the paper deals with the significance of foreign trade in these countries, calls attention to the special problems of COMECON and attempts to assess prospects for the future.

(a) Significance of Foreign Trade in Communist Countries

52. The significance of trade naturally varies from country to country as a function of its size, wealth of resources, stage of development and economic policy. Trade, as a percentage of GNP is greater in the countries of Eastern Europe than in the Soviet Union, as it is also greater in the case of Western European countries than in the case of the United States. Both the United States and the Soviet Union have a great variety of resources, and the significance of trade for their economies is less than in smaller countries(1).

53. In the period 1955 to 1967, the trade turnover of the Communist countries of Eastern Europe has trebled, (in the case of Bulgaria the increase is six-fold(2)). This rate of growth is only slightly faster than that of world trade as a whole. The share of these countries in total world trade is 10% - about the same as their share in world population. The share of NATO countries in this is 15%, while their share in world trade reaches at least 55%. Relative to the more advanced Western countries, therefore, the importance of trade in the European Communist countries is only moderate.

54. The system of economic planning in force in the USSR and Eastern Europe does not particularly favour foreign trade. The basic task of the planning authorities is to organize national resources in accordance with the national economic programme decided by the party. In principle this could be done in such a way that national production was adjusted to world production in accordance with the principle of comparative costs, but in practice this hardly happens. National production is planned according to other criteria, and foreign trade fits in with the overall production pattern.

55. These countries have been greatly concerned to develop industry, especially the capital sector, and would have preferred to export machinery rather than agricultural produce and raw materials. This general disposition has naturally affected the pattern of trade.

(1) See Table IX at Annex.
(2) See Table VII at Annex.

56. Political considerations have also played an important part in the trade policy and foreign trade patterns of these countries. The newly established Communist regimes in Eastern Europe were somewhat distrustful of trade relations with capitalist countries and were in any case very exposed to Soviet pressure to limit contacts with the West. In the early post-war years therefore there was a shrinkage in the trade of East European countries with the West and a rapid growth of trade with the USSR and each other.

57. Over the last year or so there were signs that the East Europeans were feeling freer to step up trade with the West and that the convention of directing about two-thirds of one's trade to other socialist countries was being relaxed. Certainly, Rumania was not adhering to it and had in fact made efforts to reduce her dependence on COMECON. In 1965 as much as 60% of Rumania's trade was still with COMECON, of which 39% with the USSR alone; by 1967 the corresponding figures were 47% and 28%. Recent events now make it unlikely that Czechoslovakia and Hungary will follow this example. In the case of other East European countries the geographical pattern of trade has not greatly changed, as can be seen from the following table which compares 1960 and 1966, the last year for which comparable figures are available for all these countries.

TABLE VTrade with the non-socialist countries (%)

| | 1960 | | 1966 | |
|----------------|--------------------------|--------|--------------------------|--------|
| | Industrialised countries | Others | Industrialised countries | Others |
| USSR | 19 | 8 | 21 | 12 |
| Bulgaria | 13 | 3 | 23 | 1 |
| Czechoslovakia | 18 | 10 | 20 | 10 |
| Hungary | 23 | 6 | 25 | 8 |
| Poland | 30 | 7 | 29 | 8 |
| Rumania | 22 | 7 | 32 | 6 |
| Soviet Zone | 21 | 4 | 23 | 4 |

58. In particular, especially on the part of the East European countries, there has been a growing interest in trade with the industrialised countries of the West, which indeed is reciprocated in many West European countries. The East Europeans are anxious to obtain capital goods from the West. Most of them are still industrialising and there is a big demand for capital equipment particularly of the most modern type since one of the consequences of the drive for maximum output in the East has been to fall behind in respect of quality and know-how. The eagerness of the Eastern countries to buy Western capital

equipment has been stimulated by credit facilities granted in The West. This has enabled some Eastern countries to import in excess of their exports to the West and thus to incur medium term debts. Credits granted by NATO nations rose from \$326 million in 1959 to \$3,134 million in 1967. The overall European NATO countries' trade with Eastern Europe has grown as follows:

TABLE VI

(\$ million)

| | Exports to | | Imports from | |
|------|------------|----------------|--------------|----------------|
| | USSR | Eastern Europe | USSR | Eastern Europe |
| 1960 | 624 | 1,066 | 758 | 1,145 |
| 1963 | 630 | 1,282 | 930 | 1,450 |
| 1967 | 870 | 2,439 | 1,323 | 2,114 |

59. Apart from commercial considerations, the smaller countries of Eastern Europe, with the possible exception of the Zone, are interested in East/West trade as a means of increasing their independence. Conversely, the Soviet Union which sees in trade an important means of bolstering its influence in Eastern Europe would prefer that the other countries in Eastern Europe did not trade too much with the capitalist West.

(b) COMECON

60. Economic relations between the countries of Eastern Europe have been institutionalised in the Council for Mutual Economic Relations - COMECON or CMEA - an organization set up in answer to Marshall Aid.

61. A feature of COMECON is the disparity between the Soviet Union on the one hand and the other European Communist states on the other(1). Among themselves, too, the East European states represent a range of races, traditions and stages of economic growth. Thus the Zone was once an integral part of one of the most highly developed industrial countries in the world. Czechoslovakia was also well developed before the war and played an important rôle in international trade; during the war industrialisation continued, and destruction was relatively small, so that by 1945 its potential was considerable. Poland and Hungary were not so well developed, Rumania and Bulgaria even less so but the difference between even these last two and certain regions of Southern Europe was not so large as to preclude them from taking part in common European development had they been allowed to do so.

(1) In this paper no account is taken of Mongolia, a full member since 1962, Albania which has not participated in COMECON affairs for several years or Yugoslavia which since 1964 has had a special status in COMECON.

62. COMECON as such was largely dormant from its foundation in 1949 until the mid-fifties. At that time when in Western Europe the foundations of the EEC were being laid, the Russians came out against the concept of national autarky, which had been accepted in the earlier period, and sought to impose the idea of international division of labour within a socialist world market. In practice this has not been fully accepted, resistance to the concept being justified in the name of national sovereignty. In the following paragraphs some of the problems of COMECON - trade and settlement, prices, specialisations - are examined.

(i) COMECON Trade

63. Intra-bloc trade has always been the most important aspect of COMECON, and the signing of long-term trade agreements the main guarantee of its continuation. By planning bilateral intra-COMECON trade well in advance it is possible to ensure that a high proportion of each country's trade is with other members. The USSR accounts for about one-third of the trade of the other countries; in the case of the Soviet Zone and Bulgaria the proportion is distinctly higher.

TABLE VII

Soviet Share in the Trade of the East European Countries (%)

| | Bulgaria | Czechoslovakia | Hungary | Poland | Rumania | Soviet Zone |
|------|----------|----------------|---------|--------|---------|-------------|
| 196A | 53 | 34 | 30 | 30 | 40 | 43 |
| 1966 | 51 | 34 | 33 | 34 | 35 | 42 |

For political reasons trade with the Soviet Union is in a category of its own. Exports to that country have the highest priority. On the other hand, deliveries to other COMECON members are regarded as less important than sales to Western markets where convertible currency can be earned.

64. It has been the practice in COMECON countries to aim at a bilateral balance of payments with each trading partner and to use Exchange Clearing as a method of settlement. Though transactions are now effected officially in valuta roubles, this does not mean that a debit balance with one partner can be automatically offset by an equal credit balance with another. These so-called transferable roubles serve as a measure of value, but lack the other characteristic of real money, acceptability, as a means of exchange. The fact is that COMECON members do not particularly want rouble balances, they prefer deficits even though they now have to pay interest on them.

65. Considerable importance was attributed to the creation of the COMECON Bank, the International Bank for Economic Co-operation, which started operations in 1964. The Rumanians ensured that the Bank would have no investment function in so far as common funds are concerned, but it was intended, apart from taking over the clearing functions previously exercised by the national banks, to promote multilateral exchanges between the members. In practice, extremely little trade is done on a multilateral basis and it can be said that no progress has been achieved in this respect. There has been some pressure, especially on the part of Poland, for making the clearing balances at least partly payable in convertible currencies. It was agreed that one-tenth of a country's contribution to the Bank's capital should be in gold or convertible currencies, but this has not resulted in making the valuta rouble convertible or, indeed, transferable in the full sense of the term. A few months ago, the Czechoslovaks were even talking of working unilaterally towards a convertible crown at a realistic rate of exchange.

(ii) Prices

66. The question of prices has always bedevilled COMECON relations. Since none of these Communist economies has a rational price system, it has always been the custom to use prices quoted on capitalist markets as the starting point for inter-country bargaining. COMECON prices have tended to be somewhat higher than the outside prices on which they are based. As the Communist planners prefer prices to remain constant over a period of years, whereas prices on Western markets are constantly fluctuating, inevitably a discrepancy develops between current world prices and the COMECON system based on world prices at a given date. The most recent reappraisal of COMECON prices was in 1964-1965 as a result of which the prices of many raw materials were scaled down.

67. The Russians now complain that the prices they get for their materials are not high enough. As an alternative to higher prices they are pressing the East Europeans to invest in Soviet extractive industries. The more developed East European countries have already entered into several engagements of this kind, the most recent of which is the agreement by the Czechoslovaks and the East Germans to provide large credits to the Soviet Union, (in the case of Czechoslovakia in the form of oil equipment and consumer goods), against payment in oil in the seventies. The Russians are also complaining that their COMECON partners buy Soviet raw material such as pig iron instead of taking processed material like steel, which would be more economic for both sides. It is sometimes argued that the solution for this is a separate price system proper to the Socialist world, that is, prices based on costs actually obtaining in the COMECON area. This would appear to imply either developing an objective price system over the whole area or simply extending the Soviet system to the other countries. However the former solution would be difficult to achieve while the latter would certainly meet with opposition.

(iii) Specialisation

68. Specialisation is perhaps the most intractable of COMECON's difficulties. For more than a decade the Russians constantly, and others intermittently, have been proclaiming Socialist international division of labour as an ideal to work for. For themselves the Russians claim the right to produce the whole range of products, which indeed is reasonable enough given the huge size of the country and the wealth of resources, material and human, but they argue that it is not rational for smaller countries to emulate them and that for political and ideological reasons the Socialist countries should set up their own "world market".

69. Everyone in COMECON admits the theoretical advantages of specialisation, but there is no agreement in putting the principle into practice. In the West specialisation develops regionally and at enterprise level as a result of particular cost situations which, although they may be affected by politically motivated measures, are hard facts difficult to circumvent. In centrally controlled economies, however, decisions as to enterprise output and regional pattern are made administratively; planners may refuse to be bound by considerations of cost which indeed have been so disregarded that nobody quite knows what the true costs are. In the absence of an objective cost and price structure to guide decisions as to regional specialisation the alternative has been to negotiate them at COMECON level. Such recommendations inevitably have a political flavour.

70. It was realised early on that national plans would have to be "co-ordinated" in order to achieve socialist specialisation. Since 1956, more than twenty commissions concerned with different sectors of the economy or economic functions have been set up to study aspects of specialisation and to make appropriate recommendations. The commission dealing with engineering questions was particularly active. The usual Soviet or East European article on COMECON gives the impression that a great deal of work has been done by these commissions, but from time to time it is admitted also that the national planning bodies have not been prepared to accept recommendations which did not suit them. In 1962, Khrushchev made his attempt to circumvent "economic nationalism" by proposing certain reforms. An economic committee comprising deputy national planners was to meet at frequent intervals to consider the recommendations of the commissions and to guide a Joint Planning Board whose function was to work out an economic plan for COMECON as a whole. This would have made COMECON a supra-national organization. Rumania resisted this solution pointing out that the COMECON charter recognised the economic independence of its members.

71. In July 1963 it was agreed that members need participate in joint actions only if they judged it to accord with their own interests. Since then the Russians have encouraged bilateral arrangements and the co-ordination of long-term plans and have sought to ensure a high level of trade in the seventies. The Rumanians are vigilant lest attempts be made to re-open this question. Recently for instance Rumania's economists refuted arguments advanced by Soviet writers that it would be desirable to co-ordinate the exports of COMECON members to avoid competition in cases where specialisation had been agreed. The Rumanians regard such a scheme as an infringement of national sovereignty.

(c) Future Prospects

72. The future developments of COMECON, and more generally of the foreign trade of Communist countries, are especially difficult to visualise in the present circumstances. It seems that there are two main possibilities:

- (i) One would be to consolidate COMECON more or less in its present form, while attempting to improve its working, in particular as regards prices, specialisation and payments. Such seems to be the intention of the USSR, the Soviet Union and, perhaps, Poland. This would be of some economic advantage to the USSR, which is still dependent to some extent on the deliveries of industrial goods from Eastern Europe, mainly from Czechoslovakia and the Zone. On the other hand, such a system is not entirely without economic inconvenience for the USSR itself, which has sometimes to accept from other COMECON countries goods of an inferior quality to those of the West, and also to supply Eastern European countries with raw materials whose cost is higher than in the West and sometimes exceeds the prices paid for it by the importers. The production of such raw materials involves large capital investment which the Soviet Union, in some cases, would find more profitable to direct to other sectors. In fact, for the USSR, the main advantages of COMECON arrangements are of a political nature; they contribute to keeping some cohesion in the Communist camp and help the USSR to maintain her influence over Eastern European countries. For this very reason, COMECON is an obstacle to those members who, following the example of Yugoslavia and Rumania, would like to emancipate themselves from the Soviet grip. From an economic point of view, it is also, to a large extent, a liability for the Eastern European countries, as it maintains a pattern of trade which is excessively geared to Soviet needs, limits the possibilities of expansion of trade with the West and, probably, also hampers the implementation of economic reforms. On the other hand, the present system, with all its shortcomings, may be favoured by some Eastern European

countries, or at least by some elements in these countries, for the reason that it dispenses with, or at least delays somewhat, the need for them to introduce the fundamental changes which would be required for the integration of their economy into the system of the world trade.

- (ii) The second possibility would be precisely such an integration of the economy of Communist countries into the world pattern of production and exchanges. In recent years, there has been a certain movement in this direction, not only in some East European countries, but also in the Soviet Union, whose trade with the West has increased and which, among the Communist countries, is the main recipient of Western credits. However, progress has so far been limited, and the bulk of the trade of European Communist countries is conducted amongst themselves. As very significant expansion of East/West trade, from an economic point of view, would certainly provide some advantages for the USSR itself, by giving greater access to Western manufactured goods and industrial equipment, and dispensing with the need to produce at excessive cost some raw materials for her partners in COMECON. However, as credits could not be indefinitely increased and have to be repaid sometime, such an expansion would imply a sharp increase in Soviet exports to the Free World. The Soviet Union might take a growing part in the supplies of some raw materials to the West, but she would have also to produce manufactured goods of the quality which could find outlets in the industrialised West and, at the same time, expand her exports to developing countries. For the Eastern European countries, integration into the world pattern of trade would necessitate an adjustment of their economies to world requirements and, for several of them, a drastic effort to modernise their industry. As they would probably experience difficulty in exporting enough to be able to pay in convertible currencies for their imports of raw materials, they would depend even more than now on export credits and possible financial assistance in other forms from the West. In both the USSR and the Eastern European countries a substantial development of trade with the Free World would probably also involve the introduction of greater flexibility in the working of the economy, that is to say the speeding-up of economic reforms.

73. It is unlikely that all these conditions will be fulfilled in the immediate future and, therefore, the best that can be expected will be only a gradual expansion of East/West trade. This has been made clear, in particular, by

the Czechoslovak crisis, that the USSR is concerned at the loosening of economic ties with her COMECON partners, which would result from a fast growth of trade with the West. Although this paper is essentially concerned with economic problems, it may be in order to note here that, while East/West trade may make a contribution to the general detente between East and West, its growth is in itself largely conditioned by the existence of a favourable political climate. This means that developments are unlikely to be always in the same direction. There will probably be, in the expansion of economic relations of the West with the Communist countries and in the implementation of the economic reforms in this area, periods of progress and periods of pause and even regression.

SUMMARY

74. The USSR and the countries of Eastern Europe account for about 10% of the world population and 19% of world output. NATO countries as a whole, with 15% of the population, produce 51% of the world output. The economic potential of NATO Europe alone, in terms of GNP, matches that of all the European Communist countries, and the total GNP of the six countries of the European Economic Community is about the same as that of the Soviet Union. The USSR has a GNP slightly less than half of that of the USA; she is in a relatively better position for industrial output (55% of the USA) but much weaker for agriculture. In living standards, both the USSR and other Communist countries lag behind the West, although on each side there are obvious variations from country to country. In Communist countries the share of the consumer has been kept down as large resources have been directed to investment and, in the USSR at any rate, to defence.

75. After some slowing down in the early sixties there has been an increase in the rates of growth in these countries, due partly to the excellent agricultural results in 1966/67. Official rates of growth of Communist countries are not strictly comparable with Western figures and tend somewhat to exaggerate achievements. However, Western calculations show that the yearly increase of GNP over the period 1963/67 was 5.3% in the Warsaw Pact countries, taken together, and 4.6% in the NATO countries.

76. Industrial growth in the Communist area continues to be faster than in the West, though not in Japan. A relatively new feature is the emphasis at last being given to the consumer sector. In the context of economic reform rather less importance is being attached to maximum output and more to quality, but complaints on this score still abound.

77. In the Soviet Union the 1966 harvest was abnormally good. The effects were still apparent in 1967 in the improved livestock situation. There are signs that the excellent results may not have been entirely due to good weather and that a more flexible control of agriculture may have contributed somewhat. However, Soviet agriculture remains backward; too much labour, too little machinery and fertiliser are used.

78. The rate of investment in the Communist countries remains high, the absolute amounts increasing annually at rates generally higher than the growth in national income(1). However, the return from investment in these countries is thought to be less than in the West. Resource allocation remains a major preoccupation of the planners, the consumer sector (including services the importance of which is being belatedly recognised) competing more obviously with capital and defence.

(1) See Table VI at Annex

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79. Real wages are slowly rising, and the gap between rural and urban incomes is closing. Retail trade is expanding at about the same rate as national income, but it is realised that the quality of goods, the standard of services and housing are all inadequate. It has been calculated that consumption in the USSR is only about half the German standard.

80. It is realised that the basic task as regards the Soviet economy is to effect structural changes: to raise living standards, to go over to intensive development, to complete the mechanisation of processes to improve the working of the economic process. Tasks in the other countries depend largely on the stage of development reached.

81. The weaknesses of the centrally controlled economy have made reform necessary. Previously only administrative measures could be considered, but the decline in the rate of growth made more fundamental changes acceptable. The main reforms envisaged are: decentralisation of production control, recognition of economic laws, more stress on incentives geared to public interest, a coherent price system. Two types of reform programme appear to be envisaged: an orthodox, conservative programme as in the USSR, the Soviet Zone, Poland and Rumania, designed to streamline the existing system, and a more liberal approach, as in Czechoslovakia, Hungary and even Bulgaria, accepting some market elements.

82. In the USSR the system approved by the Party in 1965 is being implemented. Regional control of industry, introduced in 1957, has been abolished and the old ministerial system restored. The question whether enterprises should be grouped into larger associations is not settled. At enterprise level rather more freedom has been given to managers who are expected to pay more attention to sales rather than maximum output; great emphasis is put on incentive at this level. New prices have been worked out and introduced. They are, however, still fixed centrally and are not likely to affect production decisions. Managers are still controlled from above rather than exposed to the discipline of market forces.

83. The Soviet Zone of Germany introduced its rather uninspired new system already in 1963 with a new set of prices and some freedom for large trusts grouping producer enterprises. In Poland, after the earlier attempts at reform had come to nought, progress has been particularly slow. The Rumanian leaders have remained satisfied with economic advance, and it is only recently that they have espoused the idea of certain fairly limited reforms.

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84. In Czechoslovakia, on the other hand, the intention was to introduce market elements. Central planning was to be limited, enterprises grouped into Trusts which have some autonomy, capital to be allocated largely by banks and paid for. Some prices were to be fixed centrally, some to fluctuate within limits, and others were to be free. The reforms envisaged in Czechoslovakia could involve price increases in consumer goods, some redundancy and unemployment and there is a risk of social unrest before the reforms begin to yield solid benefits. Recent events in Czechoslovakia call into question the reform programme. The new system which was introduced at the beginning of this year in Hungary is similar in many ways to the Czechoslovak model, but trusts are not envisaged.

85. The results so far achieved are meagre, but the problem is great. The concept of economic law and rationality is generally accepted but the granting of freedom to enterprises involves both a loss of power at the centre and the need for an alternative co-ordinator such as the market mechanism. The mixed economy as in Yugoslavia is liable to inflation and the market forces can involve redundancy and social unrest. Moreover, the Soviet leaders are concerned at the effect advanced ideas can have on their own people and on the economic policies of the other countries.

86. Like world trade as a whole, the foreign trade of these countries has trebled in the period 1956/67. Like the USA, the Soviet Union, because of its great size and the extent of its resources, is not very dependent on foreign trade, but the smaller Communist states are, and their trade, measured as a share of their GNP, is considerable.

87. The Communist system of economic control does not adjust too well to world trade based on comparative costs. For political reasons, too, trade with the West in the early post-war period was limited, and even now the USSR is unwilling to see its Communist neighbours trade too much with the West. However, for some years there has been a great and growing interest in capital equipment from the West which has been stimulated by the granting of large credits.

88. The institutional framework for economic relations between the countries of the area is COMECON - the Council for Mutual Economic Relations. In its early years its role was passive, but since the mid-fifties the ideal of the socialist division of labour has been preached though hardly practised. Detailed arrangements for trade are made well in advance and specified at the beginning of the year, which makes it easier to maintain the COMECON pattern.

89. Trade settlement is through the Clearing, valuta roubles being used as the unit of account. There is no urge to hold these roubles, however, as they are not convertible. The COMECON Bank has not lived up to expectations. It operates as a clearing bank but has not promoted multilateral trade or moved towards currency convertibility.

90. COMECON prices, broadly based on those prevailing outside the area, are fixed for a period during which time they naturally tend to get out of line with world prices. At the moment the Russians are dissatisfied with the low prices they are getting for raw materials.

91. Intra-COMECON specialisation cannot develop spontaneously and has to be arranged, which tends to become a political issue. Khrushchev's plan in 1962 to impose a supra-national planning function on COMECON failed owing to Rumanian resistance.

92. There appear to be two main possibilities for the future economic relations of Communist countries: either to continue with COMECON in its present form with some improvements as regards prices, trade settlement and specialisation, or to make the radical changes necessary to become part of the world trade system. For the USSR, against the advantages derived under the present system in obtaining industrial goods from some of her COMECON partners must be counted the drawbacks of having to provide costly raw materials and to accept sometimes lower quality goods. The main gain for the Soviet Union is of a political nature, i.e. the maintenance of her influence over other COMECON members. These countries are inhibited in their attempts to emancipate themselves from the Soviet grip and, in addition, they have to maintain a pattern of trade which is excessively geared to Soviet needs and which may hamper their economic reforms. On the other hand, even in these countries, the present system may be favoured by some who would fear the radical changes required for full participation in world trade.

93. Such participation is, in fact, the second alternative offered to COMECON countries. There have been steps in this direction but, so far, they have been limited, and the Czechoslovak crisis has shown that the Soviet Union would frown at a sharp expansion of economic relations of her COMECON partners with the West. This second alternative would provide greater access to the USSR herself for Western industrial goods and equipment, but she would have to achieve a drastic expansion of her exports and this may be difficult. The difficulty would be even greater for Eastern European countries, which would therefore depend largely upon Western credits and assistance. In both the USSR and Eastern Europe the speeding up of economic reforms would also be necessary.

94. All these conditions are unlikely to be fulfilled and there will probably be only a gradual expansion of East/West trade. Since, moreover, this is contingent to some extent on political factors, there are likely to be periods of progress and periods of pause and even regression.

TABLE I
MAIN ECONOMIC INDICATORS - COMMUNIST COUNTRIES
SELECTED NATO COUNTRIES

1967

(US estimates)

| | POPULATION (mid-1967) | | GROSS NATIONAL PRODUCT - 1967 (market prices - US \$ 1966) | | |
|--------------------------------|--------------------------|-----------------------|---|--------------------------|--|
| | (millions) | (% of world total) | (Billion US \$ purchas- ing power equivalents) | (% of world total) | (US \$ per head pur- chasing power equivalents) |
| <u>East European Countries</u> | | | | | |
| 1. Bulgaria | 8.3 | (| 8.4 | (| 1,010 |
| 2. Czechoslovakia | 14.3 |) | 25.5 |) | 1,780 |
| 3. Hungary | 10.2 | (| 12.9 | (| 1,260 |
| 4. Poland | 32.0 |) | 35.5 |) | 1,110 |
| 5. Rumania | 19.3 | (| 18.1 | (| 940 |
| 6. Soviet Zone Germany | 17.3 |) | 30.5 |) | 1,760 |
| East European TOTAL | 101.2 | 3.0 | 130.9 | 5.0 | 1,290 |
| 7. Soviet Union | 235.5 | 6.9 | 372.0 | 14.2 | 1,580 |
| Warsaw Pact TOTAL | 336.7 | 9.9 | 502.9 | 19.2 | 1,490 |
| <u>Selected NATO Countries</u> | | | | | |
| 1. France | 49.9 | (| 114.2 | (| 2,280 |
| 2. Germany | 59.9 |) | 140.6 |) | 2,340 |
| 3. United Kingdom | 55.1 | (| 114.7 | (| 2,080 |
| 4. Italy | 52.3 |) | 75.5 |) | 1,440 |
| 5. Greece | 8.7 | (| (8.1) | (| (940) |
| 6. Turkey | 33.8 |) | (12.6) |) | (370) |
| NATO Europe TOTAL | 299.7 | 8.8 | (510.0) | (| (1,730) |
| 7. United States | 199.1 | 5.8 | 762.0 | 29.1 | 3,830 |
| NATO TOTAL | 518.8 | 15.2 | (1,332.0) | 50.8 | (2,560) |
| WORLD TOTAL | 3,410.0 | 100.0 | (2,662.0) | 100.0 | - |

Sources: "Soviet Economic Performance 1966-67"

Joint Economic Committee - Congress of the United States May 1968.

- Monthly Bulletin of Statistics - United Nations - May 1968.

() Estimates by the Secretariat.

TABLE II
GROWTH RATES OF NET MATERIAL PRODUCT
(Official Communist Sources)

% change over preceding year

| Country | 1963 | 1964 | 1965 | 1966 | 1967* |
|------------------------|------|------|------|------|-------|
| Bulgaria | 7.7 | 9.8 | 7.1 | 11.1 | 9.0 |
| Czechoslovakia | -2.2 | 0.6 | 3.4 | 10.8 | 8.0 |
| Hungary | 5.7 | 4.7 | 1.1 | 8.4 | 7.0 |
| Poland | 6.9 | 6.8 | 7.0 | 7.2 | 6.0 |
| Rumania | 11.1 | 10.0 | 9.7 | 9.8 | 7.5 |
| Soviet Zone of Germany | 3.2 | 4.8 | 4.4 | 5.4 | 5.0 |
| Soviet Union | 4.1 | 9.3 | 6.9 | 7.5 | 6.7 |

*Preliminary

Source: Economic Survey 1967 ECE Geneva.

TABLE III
GROWTH RATES OF GROSS NATIONAL PRODUCT
(GNP at constant market prices US \$)

% change over preceding year

| | 1963 | 1964 | 1965 | 1966 | 1967 | 5 years average 1963-67 |
|--------------------------------|------|------|------|------|------|-------------------------------|
| <u>A. COMMUNIST COUNTRIES</u> | | | | | | |
| <u>East European Countries</u> | | | | | | |
| 1. Bulgaria | 6.6 | 6.1 | 4.3 | 8.3 | 7.7 | 6.6 |
| 2. Czechoslovakia | -1.8 | 1.3 | 1.7 | 4.7 | 4.1 | 2.0 |
| 3. Hungary | 4.8 | 6.4 | 0.0 | 6.0 | 4.0 | 4.2 |
| 4. Poland | 5.9 | 5.6 | 6.9 | 4.9 | 3.8 | 5.3 |
| 5. Rumania | 3.9 | 9.0 | 8.2 | 8.9 | 5.8 | 7.2 |
| 6. Soviet Zone of Germany | 2.0 | 4.2 | 3.7 | 5.6 | 4.8 | 3.7 |
| East Europe TOTAL | 2.9 | 4.9 | 4.4 | 5.4 | 4.6 | 4.4 |
| 7. Soviet Union | 2.8 | 7.9 | 6.2 | 7.1 | 4.3 | 5.7 |
| Warsaw Pact TOTAL | 2.8 | 7.1 | 5.7 | 6.7 | 4.4 | 5.3 |
| <u>B. WESTERN COUNTRIES</u> | | | | | | |
| <u>Selected NATO Countries</u> | | | | | | |
| 1. France | 4.8 | 6.0 | 3.5 | 4.9 | 3.8 | 4.6 |
| 2. Germany | 3.4 | 6.6 | 4.6 | 2.6 | -1.0 | 3.2 |
| 3. United Kingdom | 4.4 | 5.6 | 2.4 | 1.6 | 1.5 | 3.1 |
| 4. Italy | 5.5 | 2.7 | 3.4 | 5.8 | 5.5 | 4.6 |
| 5. Greece | 8.4 | 8.9 | 7.6 | 8.4 | 6.0 | 7.9 |
| 6. Turkey | 7.8 | 4.8 | 4.6 | 9.7 | 10.0 | 7.2 |
| NATO Europe TOTAL | 4.5 | 5.9 | 4.1 | 3.4 | 2.0 | 4.0 |
| 7. United States | 4.0 | 5.3 | 5.9 | 5.8 | 2.6 | 4.7 |
| NATO Total | 4.2 | 5.7 | 5.5 | 5.0 | 2.5 | 4.6 |
| 8. Japan | 6.1 | 15.6 | 4.0 | 9.7 | 12.5 | 9.6 |

Source: "Soviet Economic Performance 1966-67" - Congress of the US.

TABLE IV
INDUSTRIAL PRODUCTION

Communist and selected Western countries

1963 - 1967

(Index : 1960 = 100)

| | 1963 | 1964 | 1965 | 1966 | 1967 |
|--------------------------------------|------|------|------|------|------|
| <u>A. COMMUNIST COUNTRIES</u> | | | | | |
| 1. Bulgaria | 133 | 145 | 162 | 179 | 200 |
| 2. Czechoslovakia | 108 | 110 | 116 | 122 | 129 |
| 3. Hungary | 127 | 138 | 144 | 152 | 163 |
| 4. Poland | 125 | 137 | 151 | 161 | 173 |
| 5. Rumania | 136 | 156 | 171 | 190 | 214 |
| 6. Soviet Zone of Germany | 113 | 117 | 122 | 126 | 134 |
| Eastern Europe | 119 | 128 | 136 | 145 | 156 |
| 7. Soviet Union [⊛] | 124 | 133 | 144 | 155 | 167 |
| <u>B. SELECTED WESTERN COUNTRIES</u> | | | | | |
| 1. France | 118 | 127 | 128 | 138 | 140 |
| 2. Germany | 115 | 124 | 131 | 133 | 131 |
| 3. United Kingdom | 105 | 113 | 116 | 118 | 116 |
| 4. Italy | 132 | 133 | 139 | 155 | 168 |
| 5. Greece | 123 | 137 | 152 | 174 | 183 |
| 6. United States | 114 | 120 | 131 | 143 | 144 |
| 7. Japan | 143 | 166 | 171 | 194 | 231 |

[⊛]Civilian production only. Production of military goods is excluded.

Sources: Communist countries: "Soviet Economic Performance"
Joint Economic Committee, Congress of the United States.

Western countries: OECD - Statistics.

TABLE V
AGRICULTURAL OUTPUT

1960 = 100

| | 1963 | 1964 | 1965 | 1966 | 1967 |
|------------------------|------|------|------|------|------|
| Soviet Union | 102 | 113 | 116 | 128 | 124 |
| <u>EASTERN EUROPE</u> | 99 | 104 | 106 | 116 | 116 |
| Bulgaria | 104 | 118 | 119 | 138 | 139 |
| Czechoslovakia | 96 | 99 | 96 | 108 | 111 |
| Hungary | 107 | 105 | 97 | 110 | 110 |
| Poland | 99 | 105 | 107 | 114 | 113 |
| Rumania | 102 | 109 | 113 | 130 | 127 |
| Soviet Zone of Germany | 93 | 96 | 105 | 108 | 112 |

TABLE VI
INCREASE IN FIXED INVESTMENT

(current prices)

| | 1965 | 1966 | 1967 |
|------------------------|------|------|------|
| Soviet Union | 6.1 | 7.2 | 8.0 |
| Bulgaria | 8.1 | 22.3 | 15.6 |
| Czechoslovakia | 7.8 | 9.8 | 3.6 |
| Soviet Zone of Germany | 9.5 | 7.1 | 9.0 |
| Hungary | 0.2 | 9.0 | 15.0 |
| Poland | 9.8 | 8.6 | 9.4 |
| Rumania | 10.0 | 10.7 | 17.1 |

TABLE VII
INVESTMENT IN THE SOVIET UNION
SECTORIAL DISTRIBUTION OF GROSS FIXED INVESTMENT
(selected years - % of total)

| | 1950 | 1960 | 1963 | 1966 | 1967 |
|--|---------------|---------------|---------------|---------------|---------------|
| Agriculture | 15 | 14 | 16.5 | 18 | 18.5 |
| Heavy Industry | 35 | 30 | 31 | 31 | 30 |
| Light & food, non-durable consumer goods industries | 5 | 5.5 | 4.5 | 4. | 4.5 |
| Housing | 18 | 23 | 19 | 17 | n.a. |
| Services | 13 | 15 | 16 | 16 | n.a. |
| Construction Industry | 2 | 3 | 3 | 3 | n.a. |
| Transport & Communications | 12 | 10 | 10 | 10 | n.a. |
| TOTAL (in billion roubles) | (100) 10.9 | (100) 35.9 | (100) 41.3 | (100) 52.2 | (100) 56.2 |

TABLE VIII
TRADE TURNOVER OF COMECON COUNTRIES

(million roubles)

| | 1955 | 1960 | 1965 | 1966 | 1967 |
|------------------------|-------|--------|--------|--------|--------|
| USSR | 5,835 | 10,071 | 14,595 | 15,069 | 16,434 |
| Others | 8,160 | 13,826 | 21,002 | 22,429 | 24,345 |
| Soviet Zone of Germany | 2,225 | 3,963 | 5,289 | 5,734 | 6,183 |
| Czechoslovakia | 2,006 | 3,370 | 4,825 | 4,926 | 5,004 |
| Poland | 1,666 | 2,538 | 4,111 | 4,290 | 4,644 |
| Hungary | 1,030 | 1,643 | 2,696 | 2,812 | 3,123 |
| Rumania | 795 | 1,228 | 1,960 | 2,158 | 2,646 |
| Bulgaria | 438 | 1,084 | 2,121 | 2,509 | 2,745 |

Source: Soviet periodical "Foreign Trade"

TABLE IX
TRADE PER HEAD OF POPULATION
AND AS PERCENTAGE OF GNP

(1967)

| | Total trade \$ million | Turnover per head \$ | % of GNP |
|------------------------|---------------------------|-------------------------|----------|
| Bulgaria | 3,048 | 367 | 36.3 |
| Hungary | 3,470 | 340 | 26.9 |
| Soviet Zone of Germany | 6,870 | 403 | 22.5 |
| Czechoslovakia | 5,560 | 396 | 21.4 |
| Poland | 5,160 | 160 | 14.5 |
| Rumania | 2,940 | 154 | 16.2 |
| Soviet Union | 18,260 | 80 | 4.9 |
| USA | 57.88 | 289 | 7.6 |
| Germany | 39.77 | 660 | 28.3 |
| United Kingdom | 32.07 | 582 | 28.1 |
| France | 23.79 | 475 | 20.8 |
| Italy | 18.40 | 352 | 24.3 |

Sources: OECD and Soviet Publications