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ECONOMIC DEVELOPMENTS IN THE SOVIET UNION  
AND THE EASTERN EUROPEAN COUNTRIES

Report by the Committee of Economic Advisers

This paper is essentially a summary of the Report(1) of the Sub-Committee on Soviet Economic Policy prepared at the end of the Second Series of Examining Sessions which met to consider economic developments over recent years in the Soviet Union and the East European Countries; it also reflects, however, the views of the Committee of Economic Advisers on the economic implications of recent events in Eastern Europe. The paper comprises the following parts:

- A. comparison of the economic situations of the East and the West at the end of 1967;
- B. the economic performance of the Soviet Union and the Eastern European countries during 1966 and 1967, and the prospects of future development;
- C. progress and problems of economic reforms in the Communist countries;
- D. foreign economic relations; COMECON.

A. COMPARISON OF THE ECONOMIC SITUATIONS OF THE EAST AND THE WEST AT THE END OF 1967

2. The USSR and the countries of Eastern Europe taken together accounted, at the end of 1967, for about 10% of the world population and 19% of world output in terms of Gross National Product (GNP). The NATO countries as a whole, with 15% of the population, produced about 51% of the world output. The economic potential of NATO Europe alone, in terms of GNP, matched that of all the European Communist countries including the USSR. The total GNP of the six countries of the European Economic Community was roughly the same as that of the Soviet Union. The economic potential of the USSR, expressed in GNP, amounts to less than half of that of the USA; the Soviet Union

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is relatively stronger as regards industrial output (55% of the USA) but much weaker in agriculture. In living standards both the USSR and the other Communist countries are lagging behind the West, although on each side there are important variations between country and country. In the Communist countries the share of resources allocated to the consumer is lower than in the West, as investment and, in the USSR at any rate, defence absorb a considerable part of total output.

3. The GNP of the Soviet Union amounts to 74% of the total of the Warsaw Pact countries. In terms of income per head, however, the USSR still lags behind the two most advanced of its small Warsaw Pact partners. (Czechoslovakia and the Soviet Zone of Germany). The GNP of the United States represents nearly 60% of the NATO total, but income per head in the United States is well over twice the NATO European average and 1.8 times that of the most advanced Western European members of the Alliance.

B. RECENT ECONOMIC PERFORMANCE OF THE SOVIET UNION AND THE EASTERN EUROPEAN COUNTRIES AND PROSPECTS OF FUTURE DEVELOPMENT

4. During the five year period 1963-1967 there have been wide fluctuations in the annual performance of Communist countries. After a general slowing down in the early 1960's, there was a resumption of a more rapid rate of growth during 1966 and 1967 due partly to the excellent agricultural results in these two last years. Official rates of growth of Communist countries are not strictly comparable with Western figures; taking into account the necessary adjustments and corrections, Western calculations show that the yearly increase of GNP over the period 1963-1967 was 5.3% in the Warsaw Pact countries taken together, as against 4.6% in the NATO countries as a whole. Progress in the Warsaw Pact countries has, however, been uneven - the most rapid growth rates being recorded in the less developed countries (Rumania and Bulgaria) and the lowest rates in the most industrialised ones (the Soviet Zone of Germany, and especially, Czechoslovakia).

5. Information available on developments during the first half of 1968 indicated that the trend of recent years would, on the whole, be continued. Although the economic impact of the invasion of Czechoslovakia on the economies of the invading countries is at present hard to assess, it would seem that the loss incurred could be absorbed without too much difficulty. Some of the soldiers sent to Czechoslovakia and part of their transport equipment might otherwise have been used in their home country to assist in bringing in the harvest as had happened in the past. The use of rolling stock to transport men and equipment must have caused some loss to the domestic economy and in respect of foreign trade. Depleted stocks of fuel and food will have to be replenished. In

Czechoslovakia the actual loss has been more severe. The Czechoslovaks will have to foot the bill for damage to buildings and roads, for loss of work in investment and production, and for delay in transport. All this may not amount to a serious economic setback, but it will reduce the rate of growth which otherwise would have been achieved. There will be a delay in the rise in living standards and in the plan to modernise industry. Trade with COMECON and especially with the Soviet Union will have to be stepped up. On the credit side, it may be anticipated that a stop on wage increases will relieve inflationary pressure, and the extra Soviet wheat deliveries already agreed should reduce somewhat the Czechoslovak need for convertible currency.

### Industry

6. Industrial growth in the Communist area continued on the whole to be faster than in the West, but the performance in Czechoslovakia and the Soviet Zone of Germany was far from spectacular. A relatively new feature has been the emphasis at last given to the consumer sector. 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, although the output of the former has continued to advance more rapidly than the latter. Gross percentages of output do not provide any indication as to the extent that the goods produced are actually utilised. The problem of unsold and unsaleable stocks has attracted the attention of Communist economists. In the case of Czechoslovakia, a large share of the added production was accounted for by increased stocks and the realisation of this problem contributed to the urgency for economic reforms in various countries. As a consequence, within the context of economic reforms, there has been a tendency to attach less importance to maximum output and more to quality, but complaints on this score still abound.

### Agriculture

7. In the Soviet Union, where overall economic development depends on agriculture to a much larger extent than is the case in the industrialised Western countries, the 1966 harvest was abnormally good. The effects were still apparent in 1967 in the improved livestock situation. Preliminary information on the 1968 grain crop indicates that this year's harvest will be better than in 1967, but below that of 1966. This tends to support the view that the successes of recent years were not exclusively due to good weather and that a more flexible control of agriculture, together with past investment efforts, are beginning to bear fruit. Nevertheless, there is still considerable room left for improvement in Soviet agriculture. Too much labour, and too little machinery and fertilizers are used. Nearly eight times as many agricultural workers are employed in the USSR as in the United States. It is not to be excluded that the Communist leaders in the USSR, over-impressed by results achieved in recent years, and hard-

pressed as regards defence and other requirements, might be tempted to reduce the priority belatedly given to agriculture; investment targets in agriculture have been revised downwards in the plan proposed for 1968.

### Investment

8. The improvement in total output during the last two years in the East European countries has been achieved mainly through heavy investment. The proportion of national income invested remains higher than in the West, and the annual rate of increase in investment is generally higher than that of national income. However, the return from investment in these countries is thought to be less than in the West. During recent years, this discrepancy has increasingly attracted the attention of Communist economists. Resource allocation remains a major preoccupation of the planners, as the consumer sector (including services, the importance of which has been belatedly recognised) competes more obviously with capital formation and defence.

### Standard of Living

9. Real wages have been rising more modestly than the overall expansion of agricultural and industrial output, but the gap between rural and urban income has been narrowed. Retail trade has been expanding at about the same rate as national income, but it is realised that the quality of goods and the standard of services and housing are still far from adequate. It has been calculated that, in 1967, actual private consumption per head in the USSR was only about half the level reached in the Federal Republic of Germany.

## C. PROGRESS AND PROBLEMS OF ECONOMIC REFORMS

10. The slowing down of economic growth in the early 1960's relative to Western countries and the problems of managing economies which are growing in complexity have stimulated the discussion of economic reforms. This discussion was made possible by the freer intellectual atmosphere following the death of Stalin. The economic reforms concern both the methods of running the economy and the aims of economic policy.

11. As regards policy, the Russian leaders seem to have become increasingly conscious that rising living standards favour further progress, that it is no less important to enhance the quality of goods than to increase their quantity, and that the interests of producers must be directly geared to that of consumers. All this implies moving further away from the former priority system and the adoption of one in which a large variety of objectives are balanced and also recognising that economic criteria cannot be disregarded or twisted to suit ideological views.

12. To adapt the methods of running the economy to the new requirements of their policy, the following main reforms have been envisaged:

- some decentralisation of control to reduce both the burden of the central authorities in respect of detailed supervision and the dead weight of bureaucracy on enterprises;
- more stress on incentives for management and labour, and an attempt to link producer incentives and consumer interests;
- a coherent price system reflecting the real costs of production.

13. These elements can be combined in various ways, and countries in different stages of economic development might well choose different combinations. As regards administrative decentralisation, the Soviet Zone of Germany was the first to introduce fully a new system. Looking at reforms from this angle would indicate that the Zone was a forerunner in the field. If, however, the freedom of enterprises to make decisions as regards production and some acceptance of the market mechanism is considered as the real yardstick, the reform movement could be divided into an orthodox conservative one aimed at streamlining the existing system and a more liberal approach accepting some limited market elements. According to this distinction, reforms in the USSR, the Soviet Zone, Poland and Rumania would fall into the first category, while those announced in Czechoslovakia, Hungary and Bulgaria would come nearer the second. In no case have the reforms introduced, or even those proposed, been based on the Yugoslav(1) system: in all these countries the pace of development, the basic pattern of production and the scope of the social services would ultimately be decided by the State.

14. 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 the enterprise level, rather more freedom has been given to managers who are expected to pay more attention to sales rather than maximum output. Greater emphasis has been put on incentives at this level and an interest charge on enterprise capital supplied by the Government has been introduced. A new price structure laboriously worked out by officials and covering

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(1) Yugoslav problems are not dealt with in this note. A separate paper (C-M(68)66), dated 8th November, on the "Vulnerability and Economic Problems of Yugoslavia" has already been prepared, and the question of developments in Yugoslavia will be examined more fully at a meeting of economic experts which will take place shortly.

millions of items has been imposed. Managers are still controlled from above rather than exposed to the discipline of market forces; the planned level of output must still be achieved. Although there is as yet no clear evidence that Russia's modest economic experiments are seriously questioned after the recent events in Czechoslovakia, it appears that the main stress has more recently been put on administrative measures dealing with decentralisation, while the possibility of introducing market economy elements in the Soviet system seems as remote as ever.

15. The Soviet Zone of Germany introduced its new system already in 1963 with a new series of prices and some freedom for large trust groupings of producer enterprises. This was the first Eastern European country where the revised system went fully into operation. In Poland, after the earlier attempts at reform had come to nought, efforts are being made to retain and streamline central control so as to reduce its inefficiencies. The fixing of prices and deliveries provides the central authorities with some control over Polish agriculture, which remains uncollectivised. In Rumania, discussion of reform did not start until recently as the leaders had been satisfied with the pace of economic advance. The draft directives on improving management and planning, formally adopted in December 1967, aim at streamlining the existing system along orthodox lines.

16. In Czechoslovakia the economic reformers proposed to allow greater scope than in other countries to the influence of market forces in determining prices. The scope of central planning and direction was to be restricted to broader issues, enterprises were to be grouped into trusts which would have some autonomy, and the capital was to be allocated largely by banks against a charge amounting in fact to payment of interest. Individual firms or groups of firms would have been allowed direct contacts with abroad. Some prices were to be fixed centrally, some to fluctuate within limits, while others were to be free. The State would still have exerted influence on the economy, but by the use of market forces, using economic rather than administrative levers. Though it is not yet clear to what extent the reform programme will be altered, some change seems inevitable, and some of the more promising features of the reform are likely to be sacrificed. Thus the idea of permitting enterprises wide freedom in deciding their production programmes and in maintaining direct contacts with foreign firms will no doubt be reconsidered, and the Party, which was willing to relax to some extent its control over the economy, will keep the chief and final say in economic affairs.

17. The system gradually introduced at the beginning of 1968 in Hungary was to be in many ways similar to the Czechoslovak model, although the introduction of trusts with some freedom to make production decisions, was not envisaged. The consequences of recent events on the Hungarian reform programme will probably lead to at least more caution if not more distrust of any developments that would not be in line with the orthodox principles. Hungarian leaders have been stressing that whatever measures they envisage had been submitted for approval to the other Communist Parties. Bulgaria adopted in April 1966 a type of reform copied mainly from the Soviet Union, but experimenting also with the three-tier price system of the Czechoslovak model. Here again, the real extent to which these experiments will be put into operation remains uncertain.

18. The actual results so far achieved by the reform measures introduced are not very impressive but the problem is complicated, and it was realised from the start that it would take years before the full effect of the reforms became apparent. 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 introduction of market elements into a centrally controlled economy, however, could lead to inflation or alternatively to redundancy and social unrest. Recent developments in Czechoslovakia may affect the future of economic reforms in general, and the East European states may be more cautious and slower in implementing their reforms. The reforms are continuing, however, in the USSR and are hardly likely to be dropped in Eastern Europe.

D. FOREIGN ECONOMIC RELATIONS AND COMECON

19. The total foreign trade of the European Communist countries has expanded in the same proportion as world trade: both have about trebled in the period 1956-1967. Because of its size and the extent of its domestic resources, the Soviet Union, like the United States of America, is not very dependent on foreign trade, but the small Communist states are; their trade considered in relation to their GNP is much larger.

20. In Communist countries the adjustment of production patterns to the requirements of world trade based on comparative costs has not been the primary concern of the economic planners, and in the early post-war period trade with the West was also limited for political reasons. There has, nevertheless, been great interest in capital equipment from the West in most of these countries which has been stimulated by the possibility of receiving large commercial credits. It would seem, however, that more recently the USSR has shown distrust at the growth of its Communist neighbours' trade with the West. The argument that the Communist countries may become dependent on this trade has also been voiced in other Communist countries.

21. 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 rôle was passive, but since the mid-1950's 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. Trade settlement is essentially through bilateral clearing procedures handled by the COMECON Bank using transferable rubles. The COMECON Bank has not lived up to expectations in promoting multilateral trade or currency convertibility.

22. 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. Intra-COMECON specialisation cannot develop spontaneously and has to be arranged, which tends to become a political issue. Khrushchev's plan in 1962 to cope with the problem of specialisation by imposing a supra-national planning function on COMECON failed owing, largely to Rumanian resistance.

23. Previous to the Soviet intervention in Czechoslovakia there appeared to be two main possibilities as regards the future of economic relations between the European Communist countries. One was the eventuality, always perhaps a little remote, of a gradual adjustment of the European Communist countries to the world trading system; this would have taken some time to effect and would have entailed basic changes in the Communist economies. The other option was to retain COMECON, amending it to meet either Soviet requirements or in accordance with the wishes of the other members.

24. Had the first alternative been accepted, it would have meant a growing market in the USSR and Eastern Europe for Western products, and a corresponding expansion of Soviet and East European exports to the outside world. The new efforts to produce goods suitable for Western markets and the structural changes in the economy implied in this more open pattern of trade would have created problems for the Soviet Union and the countries of Eastern Europe. These latter, at least, would no doubt have looked to the West for the credits necessary to effect the structural changes. These developments in economic policy would have been accompanied and facilitated by a more determined and speedy application of economic reform.

25. There were indeed some tentative steps towards the opening up of Eastern Europe to the outside world. The example of Rumania gave the impression that the Eastern European countries enjoyed considerable freedom of action in matters of trade, and it appeared possible that the other countries would follow Rumania's example of trading more freely with the outside world. At the same time, there were signs that the Russians were suspicious of this trend. One of them was the setting up of a Bureau early this year to co-ordinate purchases from the West; this was clearly an indication of their concern to supervise the relations of their neighbours with the capitalist West. Any far-reaching restructuring of the economies and the trade patterns of these countries was bound to entail a weakening of COMECON in its present form and, therefore, in the control exercised by the USSR. However, Soviet intervention in Czechoslovakia has shown to what lengths the Russians are ready to go to defend their interests. The limitation of the sovereignty of Socialist states implied in the new interpretation of the concept of the "Socialist Commonwealth" could have important economic consequences, especially as regards the freedom of the East European countries to determine the geographical pattern of their foreign trade.

26. In the new circumstances, the Russians are likely to stress the political and ideological aspect of economic relations between countries and to point to COMECON as the appropriate organization in this field for the socialist countries. This does not mean that they would not accept changes in COMECON, indeed they would probably wish to introduce some themselves. As against the political advantage of having a certain hold over the trade policies of other COMECON members, the Russians complain of having to supply large quantities of raw materials at uneconomic prices and of receiving industrial goods which often are not of a high quality. They would therefore like some changes in the price system which, however, other members will try to resist. Beyond this, although the Russians do not openly speak of the Khrushchev integration plan, many of them cling to the idea of a separate socialist world market with its own price system and agreed specialisation schemes, which, if applied, would in practice push the economies of the COMECON countries along the road envisaged by Khrushchev.

27. Such an extreme solution would be resisted not only by Rumania but probably also by Czechoslovakia, Poland and Hungary. As far as these countries are concerned, COMECON even in its present form has disadvantages which offset to some extent its positive aspects. As socialist countries they may feel obliged to belong to a common organization such as COMECON which moreover undoubtedly facilitates bilateral trade between members. On the other hand, the organization

institutionalises Soviet influence over ~~their~~ policies, saddling them with a pattern of trade which serves Soviet purposes rather than their own needs, and which stands to some extent in the way of economic reform. These countries therefore are likely to consider critically any Soviet plan to reform COMECON and to put forward proposals which would improve their own economic position.

28. As regards East/West trade, the Russians, who themselves derive benefit from it, are not likely to call upon their COMECON partners to reduce their trade with the West, as most of them have long adhered to a more or less agreed geographical pattern of trade. Rumania is admittedly an exception; the shift of trade from East to West Europe which Rumania has effected over the last few years cannot be to the liking of the Russians, and the question arises whether some pressure might be put on Rumania to oblige her to revert to a more acceptable pattern. Though the Russians, who will not wish to arouse the opposition of the Poles or Hungarians, are unlikely to seek to curb East/West trade they will probably oppose the idea of any significant increase. Among the accusations levelled against the Czechoslovak leaders was the charge that their policy would have permitted capitalist penetration of a Socialist country. The Russians are capable of using the same argument to inhibit their COMECON partners from developing trade patterns not approved of by the Soviet Union.

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