

CONSEIL DE L'ATLANTIQUE NORD NORTH ATLANTIC COUNCIL

ORIGINAL: FRENCH
11th May, 1970

NATO UNCLASSIFIED
DOCUMENT
C-M(70)17

ECONOMIC DEVELOPMENT OF THE COMMUNIST COUNTRIES OF EUROPE

REPORT BY THE CHAIRMAN OF THE ECONOMIC COMMITTEE

The present paper has been compiled in connection with the third round of studies of economic development in the Soviet Union and in the countries of Eastern Europe. It attempts to sum up the conclusions reached by these various studies. The Economic Committee has considered this report and, as members thought it might possibly serve as background reference material for the Ministerial Session in May 1970, they agreed to its submission to the Council as a Chairman's report.

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ECONOMIC DEVELOPMENT OF THE COMMUNIST COUNTRIES OF
EUROPE

INTRODUCTION

1. The slowdown in economic growth which in the USSR started in 1968 spread last year to all COMECON countries, and the outlook for 1970 seems hardly more favourable. This general trend, which is brought out in Western estimates and confirmed by official data from Communist sources, does not apply equally to each country. Whereas in Poland and the Soviet Union results in 1969 were especially disappointing, in East Germany on the other hand a relatively satisfactory rate of growth has been maintained. The less-developed COMECON members (Bulgaria and Rumania) made the most rapid progress but nevertheless also slowed down somewhat.

2. There are several reasons for this loss of impetus. In a number of European Communist countries including the USSR, unfavourable climatic conditions had a serious impact on agricultural production, and despite increasing industrialisation, agriculture still plays a decisive rôle in the economic development of most of these countries.

3. Moreover, what is rather more serious, the industrial sectors as a whole have over the last few years shown themselves increasingly less capable of maintaining the rate of growth which prevailed up to 1967 thus drawing attention to the growing difficulty which centrally controlled economies have in coping with their problems. Hitherto the Communist countries have relied on massive inputs of labour and capital to ensure rapid growth. There is now less surplus labour, and investment is becoming less effective. Henceforward the task must be to make most efficient use of resources.

4. Generally speaking the Communist countries have been stressing the need to improve the system of central planning and management, but following the USSR they seem unwilling to face the political consequences of really pursuing their economic reforms in the sense of delegating decision-making to the enterprises and introducing market mechanisms. Since the invasion of Czechoslovakia economic reforms in COMECON countries as a whole have been marking time.

5. The rise in the standard of living in the European Communist countries has been affected by the general slow down in economic growth. On the other hand, military expenditure of the East European countries, as notified in their official budgets, has risen faster than national income, and in the USSR continues to absorb an important share of resources.

6. Trade of the European Communist countries as a whole scarcely amounts to one-tenth of world trade and over the last two years this proportion has tended to decline. Nevertheless, the keen interest shown in Western capital equipment has not flagged and East/West trade probably grew about 12% in 1969. This figure must be seen in context: the volume of trade concerned is fairly modest relative to that of the Western partners, and none of the basic factors which hinder the development of this trade has so far been eliminated.

7. The Communist countries generally and the USSR in particular are now faced with making serious economic decisions as they have to work out new Five-Year Plans for the period 1971-1975. The decisions taken by the Soviet leaders will also determine the course taken by COMECON countries as a whole.

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A. RECENT ECONOMIC DEVELOPMENTS

(a) General Trends

8. According to official statistics, the Soviet Union, whose net material product(1) had risen 8% in 1966 and 8.8% in 1967, had a lower growth of 7.5% in 1968 and 6.0% in 1969. The 1970 plan envisages an increase of 6.3%. The countries of Eastern Europe together which, according to Communist sources, had registered an increase of 7.9% in 1966, showed rates of growth of 6.2% in 1967, 7.0% in 1968 and 5.4% in 1969. The 1970 plans envisage an increase of 5.8% for the area as a whole. According to Western estimates, the growth in the Soviet national product in 1969 (calculated in Western terms) was less than 5% and that of the other countries of Eastern Europe about 4.5%.

9. The gross national product of the United States in constant prices rose 4.8% in 1968 and 2.8% in 1969, that of Canada 4.8% in each of the two years, but the NATO European countries as a whole enjoyed a much faster growth: 5.0% in 1968 and 7.0% in 1969. The GNP of the Soviet Union still amounts to less than half that of the United States and is about the same as that of the six Common Market countries. Moreover, in view of the large population of the Soviet Union, any comparison with Western countries in terms of national income per person is bound to be still more unfavourable to the Soviet Union.

10. Within the Communist camp, the Soviet Union easily maintained its economic preponderance with a national product amounting to three quarters of the total output of the Warsaw Pact countries. Poland which in respect of GNP is second in this group has a GNP one-tenth that of the Soviet Union. Nevertheless, as regards national income per head, the Soviet Union is well behind Eastern Germany and Czechoslovakia and, at the present rates of growth, it seems unlikely that she will catch them up in the course of the present decade.

11. The rates of growth in the Communist countries have once again varied very much, ranging between 3.5% for Poland to 7.7% for Bulgaria (official figures for 1969). Generally speaking the economically less developed countries (Bulgaria and Rumania) have advanced faster than the more industrialised (Eastern Germany and Czechoslovakia) although the differences in the rate of growth have tended to be less marked over the last two years.

12. The annual fluctuations in the rates of growth and the differences between countries bring out the importance of the part which agriculture continues to play in the general economic development of most of the Communist countries. The year 1969

(1) The socialist concept of net material product differs from the Western concept of national product, mainly in that the value of most services is excluded.

was distinctly less favourable for agriculture in the Soviet Union as well as in certain countries of Eastern Europe. However, the persistent slowing down in the rate of growth of industrial output over the last few years, and which continued in 1969 in most Communist countries (except Poland and East Germany), is probably the main concern of the Communist leaders. Indeed, as this loss of impetus cannot be explained by a fall off in demand, it points to the malfunctioning of the existing economic system.

(b) Agriculture

13. After two consecutive very good years, agricultural output in the Communist countries of Europe as a whole has hardly progressed since 1967. The fall in output in the Soviet Union in 1969 (-3.2%), in the Soviet Occupied Zone of Germany (-6.0%) and in Poland (-4.7%) correspond more or less to the increases made in 1968. On the other hand, the increases made in 1969 in Rumania (+4.8%) and in Bulgaria (+2.4%) only made up, by and large, for the setbacks of the previous year. Indeed, it is only in Czechoslovakia and Hungary that the rates of growth over the last few years correspond to the long-term rates noted in these countries (2.5% and 2.7% per year respectively).

14. The disappointing results in 1969 were largely due to atmospheric conditions which, in different degrees, affected all the Communist countries except Hungary. The earlier investment efforts, the increased use of fertilisers and the selective use of seed have, nevertheless, helped to reduce the effect of bad climatic conditions on crop production. On the other hand, there was little progress in animal husbandry. The number of cattle has been declining over the last three or four years in most of the Communist countries including the USSR and, although yields have been rising, supplies are inadequate in view of the increased demand for meat and dairy products.

15. Factors common to most of these countries are inflexibility of planning, backwardness in and slow development, of mechanisation, and the inability of the system to mobilise the efforts of the peasantry, with its lack of training and its ageing labour force. In consequence, there is very slow progress in modernising the agricultural sector, which is indispensable if needs, both quantitative and qualitative, are to be met. Relative to other countries such as the US and Canada, which use extensive methods in agriculture, the Soviet Union is backward. Very much more labour is used for smaller yields. Supplies remain inadequate, whereas in Western countries the problem is really how to dispose of surplus produce.

(c) Industry

16. Over the last three years industrial growth has gradually slowed down in the Communist countries. According to official sources the rate of growth of gross industrial output in the region as a whole was 9.6% in 1967, 8.6% in 1968 and 7.1% in 1969. This slow down was less marked in the countries of Eastern Europe where in 1969 the rate was 7.5% as against 8.4% in 1967. In the Soviet Union, on the other hand, the slow down was more rapid. Its rate of growth of gross industrial output which was 10% in 1967 was 8.1% in 1968 and 7.0% in 1969. In point of fact these results were below those envisaged by planners who had fixed a target of 7.3% for industrial growth in the Soviet Union in 1969 and of 8.1% in the countries of Eastern Europe. Two COMECON members do not conform to this trend, Soviet-occupied Zone of Germany and Poland, where planned targets were realised and even surpassed. The countries in course of industrialisation, Rumania and Bulgaria, continued to mark more rapid rates of growth than the other Communist countries (+10% in 1969). The least satisfactory industrial results, particularly relative to plan, are those of Czechoslovakia (1969 plan 7.2% achieved 5.2%) and Hungary (1969 plan 6.0%, achieved 3.0%).

17. The reasons for this slow down are various and differ from country to country. Generally speaking it appears that industrial production has suffered from a series of bottlenecks as regards supply of fuel, electric power and raw materials. Climatic conditions, on the other hand, slowed down building and transport and their effect on agriculture was followed by repercussions in certain industrial sectors. In the Communist countries as a whole the leaders continued to be worried by the over-long delays between the decision to set up new industrial capacities and their coming into use. In the past the development of industrial production was based on regular supplies of new labour. More recently there has been a decrease in the influx of labour to the industrial sectors. Communist authorities are everywhere faced with the problem of making better use of resources available. It is now a question of increasing production intensively rather than extensively. However, the Communist countries' as a whole growth in productivity has not reached the level envisaged in the plans and even fell in 1969 in Bulgaria and Hungary.

18. The slow down in the rate of growth of industrial production is particularly marked in Hungary, Czechoslovakia and the Soviet Union. In Hungary it would appear to be essentially a temporary phenomenon the result of the difficulty which industry has in adjusting itself to the economic reforms. In Czechoslovakia the unsatisfactory industrial results are the result of the general apathy which has affected the population since the Soviet occupation. On the practical level the main industrial branches are suffering from the lack of supplies

which prevents them from meeting the demand of various sectors. In the Soviet Union the results obtained in 1966 and 1967 were mainly due to the use of the reserves available in industry when the reforms started. Since then labour productivity has not risen as fast as was envisaged in the plan.

(d) Investments

19. Economic progress in the Communist countries has traditionally been based on massive investment, which has tended to grow faster than the national income. This process has continued over the last few years and the percentage of national income invested has, on the whole, been greater than in Western countries. This trend has been particularly marked over the last four years in the Soviet-occupied Zone of Germany, in Poland and in Rumania. In the Soviet Union the share of national income devoted to investment which was already very high has remained at about the same level.

20. The economic reforms which have been applied in the Communist countries all tend towards a certain decentralisation in investment. The investment funds left at the disposal of enterprises have grown and the role of bank credits has increased which has meant a diminution in direct budget financing in the form of subsidies which had been one of the characteristics of the regime. It appears that these measures are beginning to have a favourable influence on the relationship between capital and output in which there seems to have been some improvement in a certain number of countries particularly Czechoslovakia, Soviet-occupied Zone of Germany and Hungary. On the other hand, in the case of the Soviet Union, there are growing difficulties in exploiting new resources of raw materials owing to the distance from the industrial centres and to difficult climatic conditions. On the whole investment yield seems lower than in the West and the problem of distribution of resources continues to be one of the major preoccupations of the planners.

(e) Defence expenditure

21. According to the official defence budget, military expenditure of the countries of Eastern Europe has apparently increased in 1969 faster than the national income of these countries. This trend should not be so marked in 1970. As regards the Soviet Union the defence budget in 1970 is only 1% above that of 1969 which was about 6% higher than in 1968. These official figures, however, do not give a clear picture of total military expenditure nor of its trend.

22. According to Western estimates which seek to take into account military expenditure accounted for in the budget under headings 'Other than defence' the Soviet Union in 1969, might have devoted 8% to 9% of its GNP to military expenditure. This figure has probably not altered in the course of the last two years. On the other hand, it is not out of the question that the Soviet Union may have demanded increased efforts on the part of its Warsaw Pact allies. In most of these countries military expenditure has probably risen more rapidly and may have reached in 1969, say 5% to 5½% of GNP in Poland, the Soviet-occupied Zone of Germany and Czechoslovakia, about 4.5% in Hungary and Rumania and a slightly lower figure in Bulgaria. These estimates can only be considered approximate in view of the difficulty of evaluating real military expenditure and the gross national product of the Communist countries.

(f) Living Standards

23. The slow down in economic growth in general and of agriculture, in particular, has had a decisive effect on the development of living standards. On the whole output has not been sufficient to meet the rising demand and various shortages in consumer goods have been noted in most countries, causing rises in prices which are unusual for the centrally controlled countries. Housing conditions still remain inadequate and the five-year targets will probably not be met; in Czechoslovakia and in the USSR new housing in 1969 was only about 80% of what was envisaged for the year. Moreover, despite certain progress achieved in services, these still fall short of satisfying the most elementary demands.

24. Although nominal wages have risen in most Communist countries more rapidly than was expected, a tendency particularly marked in Czechoslovakia, Hungary and Poland, the rise in the cost of living has mopped up a large part of the increase in wages. In Bulgaria and Rumania the rise in real wages has been much slower than previously and this slow down is also apparent in the Soviet Union. In practically all the Communist countries inflationary tendencies are much more evident than in the past. In Czechoslovakia in particular inflation was more open in 1969 and at the moment is the main concern of the Authorities. In most of the other countries as in the USSR excess purchasing power not absorbed by the market has brought about a faster increase in savings.

B. ECONOMIC REFORMS

(a) General Trends

25. There has been a slow down in the introduction of new measures in most of the East European countries and attempts at

decentralisation and at making planning more flexible have been half-hearted. Most of the East European countries have tended to take greater account of the attitude of the Soviet leaders as to their policy in this respect. In the Soviet Union itself the present trend is towards delay if not towards a less flexible attitude. Moreover, the threats of inflation are not such as to encourage relaxation of control by the central authorities.

(b) Countries of Eastern Europe

26. The setback relative to earlier tendencies is most evident in Czechoslovakia where measures previously envisaged particularly those concerning the introduction of three types of prices (authoritatively fixed, fluctuating within upper and lower limits, completely free), while not being rescinded have in effect been made inoperative by other measures. It appears that the leaders are resorting to controls in practically every sphere.

27. At the moment Hungary is the leading country as regards efforts to free the system of planning and administrative management from its too great rigidity. In particular the system of price fixing based on the Czechoslovak example has been adopted. No new departure has been tried out in the course of the last year and the Authorities will use instruments such as taxation, credit, rate of interest, price and wage policy with prudence and after prior consultation with the other Communist countries especially the USSR.

28. In Poland, as in Hungary, growing importance has been given to the role of banks and also to self-financing by enterprises. The present trend is more towards a rationalisation of central planning than towards decentralisation.

29. The fairly satisfactory results obtained in the Soviet Occupied Zone of Germany in recent years are not prompting the leaders to develop and go further in the economic reforms which have been progressively developed since 1963. Up to now efforts have been mainly concerned with administrative decentralisation and simplifying the planning system. In these respects the East Germans have lead the way. However, freedom of decision at enterprise level and the introduction of certain aspects of the market economy are not much in evidence except as regards commercial relations with abroad. At the present moment no change in the direction of economic reforms as envisaged and applied in East Germany seems likely. The central organs whose job it is to fix prices have been trying to take into account both costs of production and world prices.

30. Up to now Rumania has taken relatively little part in discussions about economic reforms. The possibilities of growth due essentially to abundant labour and to the level of economic development which could be much improved have induced Rumania merely to aim at improving the efficiency of the system of planning and management which has remained very authoritarian.

31. Bulgaria is above all anxious to conform to the attitude adopted by the Soviets. The bold ideas put forward in April 1966 and which were partly inspired by Czechoslovak concepts as regards price fixing have been abandoned. A scheme has recently been adopted which aims with the support of the Soviet Union, at setting up a model of centralised economic programming with the aid of computers which, if successful, could be used as an example by the other Communist countries.

(c) Soviet Union

32. The Soviet leaders who are about to produce their new five year plan in 1971-1975 seem to be faced with a number of fundamental options and do not yet appear to have made their final decisions. The economic reforms which were adopted in September 1965 have now been applied to all major industrial enterprises. After making possible some spectacular results over the years 1966-1967 they now seem unable to infuse a new dynamism into the economy. The economic results of the past year have given rise to severe criticism but it does not seem that the Soviet Union has in mind any important development in the reforms applied so far. The leaders are aware of the need to harness initiative at enterprise level which would ensure the adoption of new technology and the elimination of waste of resources and the inefficient use of labour. Nevertheless, they are not ready to accept the logic of this situation which points towards a system less directly controlled from the centre.

C. FOREIGN TRADE

(a) Foreign trade general trends

33. The total trade turnover of all the European Communist countries has over these last two years increased more rapidly (8,6% in 1968, 9,5% in 1969) than their national product. These rates are still lower than those of world trade as a whole. The importance of foreign trade in the Communist world is very different from one country to another: whereas it is very slight in the Soviet Union, given the vast area of the country and the size of its resources, foreign trade relative to GNP is much more important in the countries of Eastern Europe. Thus, although the total of the national products of these countries is 40% below that of Soviet GNP the value of

their imports has been more than 50% greater than that of Soviet imports.

34. Over the last few years, trade with the non-Communist world has accounted for about one-third of Soviet trade and about 30% of that of all East European countries. Rumania, however, is an exception here since its trade with non-Communist countries is more than half its total. Contrary to the trend noted during the two previous years (1967-1968) trade between European Communist countries in 1969 developed more slowly than with the rest of the world. Nevertheless, trade between COMECON member countries continues to account for by far the greatest part of the trade of the European Communist countries.

35. The growth in trade in 1969 is due essentially to the rapid development of trade of the Soviet Occupied Zone, Hungary and Poland. In 1969, there was an increase of 9.8% in the trade of all East European countries as against 9% for the Soviet Union. The lowest rate achieved was by Bulgaria, which was due primarily to the fall off in imports. Czechoslovakia which in 1968 had had an exceptionally rapid increase in imports devoted its main effort in 1969 to the expansion of exports.

(b) East/West Trade

36. Communist countries are increasingly aware that the technological gap which separates them from the countries of Western Europe and North America has been getting larger. This consideration has increased their interest for Western capital goods. Over the last two years the Soviet Union and Czechoslovakia have led the Communist countries in expanding their imports of Western origin (almost 20% per year of the two years). Rumania which in 1967 had imported massive quantities of Western products and capital has since found it necessary to balance its trade with non-Communist Europe by reducing somewhat its imports and attempting without great success to develop its exports.

37. The European Communist countries purchases in the West were stimulated by the possibility of obtaining large commercial credits. In 1969 they received \$1,424.9 million new export credits, of which 66% was of a duration of more than 5 years. Although reimbursements on earlier credits also rose, the total amount of outstanding credits grew considerably, in particular, in the case of the USSR (+39.8%), Czechoslovakia (+44.8%) and the Soviet Occupied Zone of Germany (+41.9%).

38. Total trade between Western Europe and COMECON countries probably grew some 12% during 1969. But as growth in imports was about the same as for exports the balance of trade of Communist countries as a whole remains largely unfavourable. The deficit in 1969 could be about \$400 million. The problem of supplying industrial products which could interest Western countries still remains unsolved and the bad harvests in most of the Communist countries in 1969 did nothing to help the export of agricultural products. The expansion of trade between East and West European countries seems to be causing little concern to the Soviet Union insofar as the latter

has reinforced the control over the foreign trade of the other Communist countries and insofar as this expansion does not call into question the share of trade going to other Communist countries.

(c) Economic Relations with Developing Countries

39. Commercial relations between the Third World and the European Communist countries which had developed modestly over the years 1966-1968 improved in 1969. In the earlier years the main effort had been in the export to the developing countries of capital equipment supported by development credits. The more rapid development of trade in 1969 (about 10%) was due largely to increased imports (13%) by the Communist countries of products from developing regions.

40. The fact remains, however, that both as regards trade and aid the role played by Communist countries is small compared with that of Western countries: 4% of Third World trade is done with the European Communist countries and economic aid granted by them scarcely amounts to 5% of the official aid granted by Western countries. The Communist countries seek to make good this weakness by concentrating their efforts on a small number of countries where they can have a greater economic impact than the general figures would lead one to suppose. Deliveries of arms and military equipment, mainly from the USSR, to a small number of countries, most of which belong to the Arab World, exceed in value deliveries intended to promote economic development. Military aid is unquestionably one of the most disquieting aspects of relations between Communist and developing countries.

(d) Economic Relations Between the Countries of Eastern Europe

41. Within the Communist camp trade expansion is greatly hampered by the exclusively bilateral character of this trade and the non-convertibility of Communist currencies. For more than twenty years the Council of Mutual Economic Assistance (COMECON) has been looking for a solution to this fundamental problem, hitherto without much success. Trade arrangements continue to be made within the framework of the five-year plans and are formalised at the beginning of each year. Settlement of commercial balances is effected through the clearing. Despite all efforts there has been little progress made towards multilateralisation, and studies envisaging a limited currency convertibility are once more on the agenda although the chances of success do not appear to be much greater than in the past. It should be noted that in this respect the Communist regimes have shown themselves less able to cope with divergencies in national interest than the countries of the Common Market. The economic preponderance of the USSR as well as the new doctrine of limited sovereignty go far to explain why certain East European countries are loath to increase the role of COMECON.

42. During the 23rd session of COMECON, held in Moscow in April 1969, little real progress seems to have been made but it was decided to seek means of improving the system of payment and to set up an investment bank alongside the one already

existing in order to finance common projects requiring particularly large investment. The question of what prices to use in inter-COMECON trade was not entirely solved in the way the Soviet Union would have wished but it was decided that as a general rule 'modified world prices', as obtaining in the period 1960-1964, should constitute the starting point in negotiations between partners. Finally stress was laid on the part which COMECON should play in five-year plans and in the longer-term. Moreover, interested countries could undertake joint planning or set up organs common to several countries concerned with industry, science and technology and the foreign trade aspect of certain manufacturing industries. Certain East European countries (Poland and Hungary) declared themselves in favour of strengthening COMECON but the reasons for this attitude were different or even contradictory. The Soviet Union appears to have adopted a wait-and-see attitude in face of the problems which efforts to increase the efficiency of COMECON have created.

43. A new meeting of COMECON has been announced for 13th and 14th May, 1970, the agenda of which will probably include the setting up of the Investment Bank which was decided in principle in April 1969. Despite the publicity which might surround this occasion, it seems that little in the way of practical results can be expected in the near future.

D. CONCLUSIONS

44. On the eve of the new five-year plan period (1971-1975) the European Communist countries are faced with serious economic problems. In the Soviet Union, the falling industrial growth rate has given rise to criticism at a moment when the economic reforms seem to have run out of steam. In Czechoslovakia the major problem is inflation. In Eastern Germany the leaders are concerned with the inelastic supply of labour. Hungary is faced with the need to improve rapidly labour productivity. Bulgaria has just run into serious difficulties in agriculture. Poland is suffering from over-investment and may have to face labour problems. In Rumania the persistent deficit in its trade balance with Western countries and its indebtedness to them constitute one of its major problems. It seems likely that economic growth in the European Communist countries will decline further in 1970.

45. The efficacy of the new economic efforts in these countries which should be implied in the new five-year plans now being prepared will depend essentially on the economic policy which the Soviet Union will adopt. Generally speaking, it seems there will be a tendency to more authoritarian attitudes and to what the Communists call 'social discipline'. It is, however, doubtful whether, in the long-run, such expedients will resolve the internal problems which the Communist system is facing.