

CONSEIL DE L'ATLANTIQUE NORD
NORTH ATLANTIC COUNCIL

EXEMPLAIRE
COPY

N°
533

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

ORIGINAL: ENGLISH
19th. May, 1972

DOCUMENT
C-M(72)34

RECENT ECONOMIC TRENDS IN THE USSR AND EASTERN EUROPE

Note by the Chairman of the Economic Committee

Transmitted herewith is the most recent report(1) of the Chairman of the Economic Committee on this subject. The report surveys recent indications of slower economic growth in the East and continued interest in East-West economic co-operation.

(Signed) Y. LAULAN
Chairman

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(1) The previous report in this series was C-M(71)81, dated 25th November, 1971

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RECENT ECONOMIC TRENDS IN THE USSR AND EASTERN EUROPE

SPOTTY PERFORMANCE IN 1971;
BIDS FOR WESTERN ECONOMIC CO-OPERATION

Report by the Chairman of the Economic Committee

1. The economic results in the USSR in 1971 indicated a slowdown in growth in comparison with the previous year, while the performance of Eastern European countries was mixed. The main factors behind the decline in the Soviet growth rate were agricultural output and investment, which fell short of expectations. Declining trends in industrial output and labour productivity, reflected in growth rates in almost all Eastern countries, were the principal reasons for slower aggregate growth in Czechoslovakia and East Germany. Inflationary pressures were increasingly in evidence in 1971 in Czechoslovakia, East Germany, Poland and Hungary. Real income grew substantially only in Poland and Czechoslovakia (where consumer dissatisfaction had been particularly evident a year ago) and in Hungary.

2. Growth of the total foreign trade of Warsaw Pact countries slowed down from 13% in 1970 to 8% last year. Much of the decline reflected limitations established for balance-of-payments reasons on imports from industrialised Western countries. With means of financing increasingly constrained by additional overseas purchases necessitated by recent domestic agricultural setbacks, the USSR is showing continued interest in industrial co-operation with the West as a means of obtaining advanced Western equipment. Large-scale co-operation schemes continue to be canvassed. The East has also recently shown greater awareness of the increasingly active rôles of the EEC and COMECON organization in East-West economic relations.

I. GENERAL TRENDS IN INDIVIDUAL COUNTRIES

A. USSR: Economic growth slows again

3. In accordance with the modest plan target, net material product (Soviet definition)(1) grew only 6%, duplicating the slowdown of 1969. The principal causes were unfavourable weather for agriculture, a labour shortage and a decline in growth of both planned and achieved investment. Brezhnev singled out the latter weakness, stressing delays in project completions, in the economic portion of his speech of 30th March.

(1) The growth rate expressed in terms of GNP would probably be at about 4%

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4. The declining trend affected all major activities - industrial and agricultural production, foreign trade and consumption as well as investment. Real income per capita, retail trade, consumer services and average wages increased less than in 1970. While 181 million tons of grain were harvested (second only to the 1970 results) other crops suffered and fodder shortages held livestock production below plan. Industrial production grew at the third slowest rate since 1946. The oil, electricity and chemical-fibre industries were exceptions, exceeding their plans for 1971.

5. For 1972, no speed-up in economic expansion is in prospect. Relatively low growth rates are again planned for industrial production, investment and the labour force for the whole year, and the second worst winter weather since the war has hampered performance during the first three months. With transport handicapped by unusually severe ice conditions, industrial output in January-March was slower than any annual rate since the 1940s, rising only 7% over the level of January-March 1971. Increases in key indices - labour productivity in industry, production of natural gas, automatic and agricultural equipment, food and light industries - was substantially below the rates necessary to fulfill goals of the 1971-1975 plan. In agriculture, lack of snow cover has resulted in an estimated 30% loss of the winter wheat crop.

6. Recently announced details of Soviet investment policy in the economic plan for 1971-1975 suggest that any increase in consumer priorities is rather limited. Consumption is apparently not intended to rise as a share of GNP.

B. Eastern Europe: Mixed results

7. Hungary is struggling with inflationary pressures stemming in part from an acute labour shortage; industrial employment fell last year despite a planned rise of 1.5%. Side effects of the economic reform, which has decentralised some decision-making powers, may also be a factor. In 1971, investment exceeded plans by an estimated 20% and the value of projects under construction was equal to four-fifths of total investment spending. Imports rose 30% over the 1970 level, creating a trade deficit of over \$480 million.

8. In Poland, consumers, many of whom were rioting early last year, shared in the marked recovery in 1971. Bolstered by rising imports and Soviet aid including 2 million tons of grain, real wages rose 5.3% - the most rapid rate in the East. Investment still apparently retains top priority, however. It rose more rapidly than consumption last year and is scheduled to do so through 1975.

9. Shortages of consumer durables were considerably ameliorated in Czechoslovakia in 1971 as real wages rose 4%. Food items, especially meat, are still said to be irregular in supply and quality, however. The rate of growth of national income declined and fell short of plan last year while production costs increased more rapidly than labour productivity in industry. More modest production growth targets are accordingly projected for 1972.

10. The movement of the late 1960s toward economic reforms seems to be not only arrested but, in some countries, reversed. In February, GDR party chief Honecker announced plans to nationalise the last remnants of private enterprise in East Germany - small consumer-service concerns whose economic independence has been tolerated in all Eastern countries. In March the Czechoslovak Government tightened administrative controls, prohibiting overtime work rates and bank loans for enterprises that fail to economise. A Polish commission studying ways of modernising the economy has recommended that central planning be strengthened. To cure the instability experienced in 1971, Premier Fock of Hungary has recommended restoration of some central controls.

II. EAST-WEST ECONOMIC RELATIONS

A. Retrenchment in 1971

11. Increase of trade of COMECON countries with non-Communist nations decreased considerably in 1971, approaching the pace of intra-COMECON commerce and falling from 11% to 5% in the case of the USSR. In spite of a rise in world oil prices which significantly boosted the value of Soviet exports to Western Europe, the USSR cut back its imports, partly for balance-of-payments reasons.

12. Romania, Czechoslovakia and East Germany also retrenched in 1971, limiting growth of imports and improving their trade balances with the industrial West. Hungary attempted to do the same, but in fact incurred a larger trade deficit than in 1970; her exports declined absolutely as a result of weakening demand in hard-currency markets overseas and rising demand at home. Poland, the major exception to the declining trend in imports, utilised the \$100 million Soviet loan in part to purchase meat in the West.

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B. Outlook: New forms of co-operation?

13. The value of Soviet reserves was increased by the changes in currency parities and by the rising price of gold in the free market but recent Soviet agricultural setbacks have created new demands. Early this year, the USSR purchased a reported 1 million tons of sugar abroad at relatively high prices and ordered \$230 million of Canadian wheat on commercial terms. Soviet commitments to supply grain to certain Eastern European countries might lead to additional purchases in the West.

14. Such transactions, combined with recurring Soviet trade deficits with the developed West, decrease Soviet convertible currencies available to finance import of Western technology, an important element in Soviet technical advance. The USSR is accordingly showing continued interest in industrial/economic co-operation (with credits repayable in goods) as a means of financing acquisition of advanced Western equipment. In a speech of late November, Premier Kosygin indicated willingness to expand Soviet-Western commerce appreciably in the medium term - provided Western terms are sufficiently favourable. He expressed confidence that "expedient forms can be found for the realisation of mutually profitable co-operation with foreign firms and banks" regarding "use of natural resources in the Soviet Union, construction of industrial enterprises, and searches for new technical solutions." In recent months, the USSR has placed large orders in the West for equipment for the Kama River truck plant. Under discussion are several large-scale schemes whereby Western firms would provide oil and gas pipelines and other equipment and be repaid over time with products of the equipment.

15. The USSR and FRG recently initialled a trade agreement which liberalised West German import restrictions somewhat and established a commission to consider proposals for economic, scientific and technical co-operation.

16. The East has recently shown more awareness of the growing rôle of the COMECON and EEC organizations in East-West economic relations. A consortium of 16 Western banks has extended a five-year loan of \$140 million to the COMECON Bank for International Co-operation. Some Eastern governments have moved closer to direct dealings with the EEC organizations, which by 1974 is scheduled to replace governments of the Six as signatory on foreign trade agreements. Romania has gone the furthest, directing a letter in February to the Chairman of the EEC Council of Ministers to request the same type of treatment for Romanian goods as is accorded to exports of developing countries. Previously, Romania, Bulgaria, Hungary and Poland contacted the Common Market informally and on purely technical levels. The USSR, which had formally recognised a customs union for the first

time in concluding a trade agreement with Benelux last year, has recently made a measured gesture to the EEC. In an apparent effort to disarm Western opponents of ratification of the Soviet-German treaties, Brezhnev in a speech of late March explicitly acknowledged Soviet awareness of the "reality" of the Common Market, although he avoided any more formal Soviet recognition.

17. Comparatively new types of relationships are also emerging in East-West economic dealings. The USSR and Finland have apparently agreed on a \$500 million iron ore project on Soviet territory which will for the first time involve "capital participation" by the non-Communist partner. Soviet tourism officials have recently shown willingness to discuss low-cost package tours for Soviet visitors to the United Kingdom, provided Aeroflot is the carrier.

18. Prospects for realisation and expansion of such schemes and links are obscured not only by financial-economic considerations but also by uncertainties stemming from recent or prospective developments in other phases of East-West relations. As in the past, however, development of economic relations would probably not be determined exclusively by political/military considerations.