

DEPARTMENT OF STATE

USSR FALTERS IN ECONOMIC GROWTH RACE
WITH THE US

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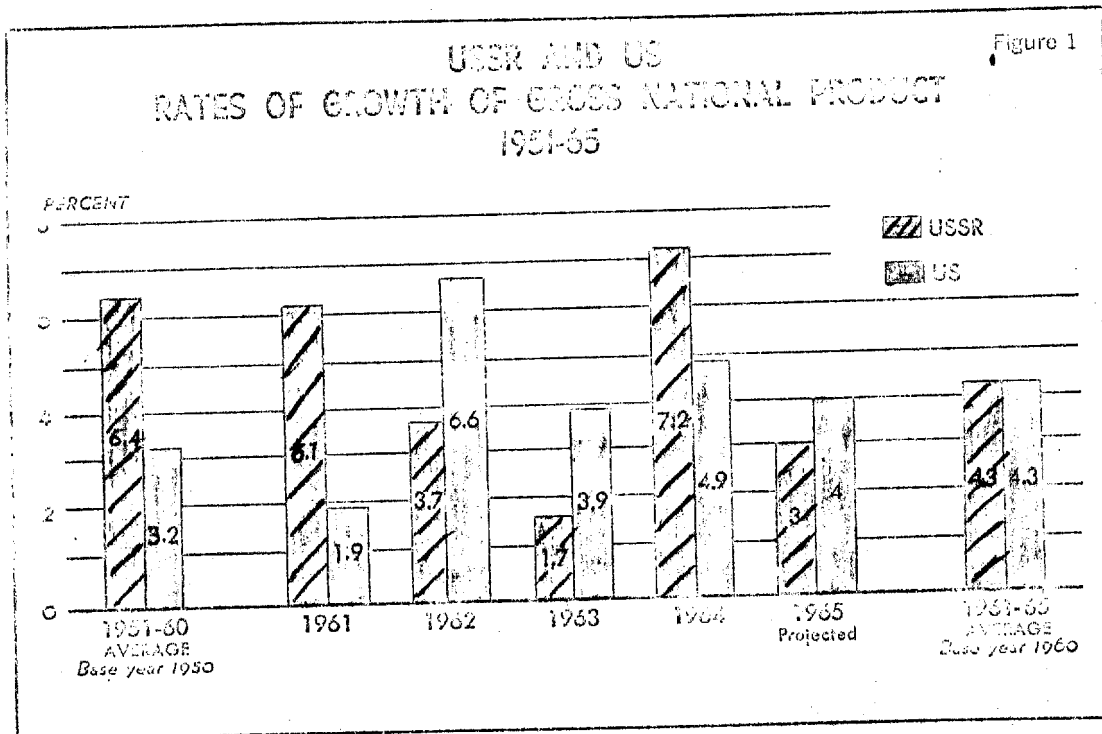
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USSR FALTERS IN ECONOMIC GROWTH RACE WITH THE US

Summary and Conclusions

Since 1960 the USSR has made no progress toward its fundamental economic goal of catching up with the US in total and per capita output. The rate of growth in the USSR -- which in the decade of the 1950's was double that in the US -- has been slowing down in the 1960's, whereas US growth has been picking up in an era of unprecedented prosperity and orderly expansion. Thus in the period 1961-65 the average annual rate of growth in the two economies has been the same, but, because the US economy is twice as large, the absolute gap in output has widened by approximately \$60 billion.* Rates of growth in the gross national product (GNP) for both countries are shown in Figure 1.



* Rates of growth in this memorandum have been calculated from data corrected for price changes. Dollar values are given in 1964 US dollars unless otherwise indicated.

Soviet growth, which in the 1950's averaged an impressive 6-1/2 percent a year, has slowed down to a yearly average of about 4-1/2 percent. This lower rate of growth is still respectable by the standards of modern industrial nations but is below both what the Soviet leadership has come to expect and what is necessary to support the leadership's worldwide ambitions. The slowdown is attributable especially to three fundamental developments: (1) the expansion of Soviet military programs that have taken high-quality men, machinery, and materials needed for modernizing the economy; (2) the failure of Soviet agriculture to provide a rapidly expanding and reliable supply of food and industrial raw materials; and (3) the using up of most of the possibilities for low-cost exploitation of Western advances in science and in manufacturing techniques. Furthermore, Soviet economic institutions are inherently sluggish in absorbing modern technology and turning out the complex products of present-day economic life. On the other side of the equation, the rise in US growth in the 1960's is the result of a combination of favorable factors, including vigorous and sustained spending by business firms on new capital plant, the success of government fiscal measures, and steady advances in consumer income and spending.

Comparing a market economy valued in dollars to a planned economy valued in rubles is a notoriously uncertain business. The present comparisons are biased in favor of the USSR in that the poor quality of Soviet production and the failure of the system to respond to the demands of industry and consumers have not been fully taken into account. But a caution in the opposite direction is even more important: in spite of the slowdown in growth, the Soviet economy is still growing rapidly, and its very considerable energies are still being concentrated on uses that seriously challenge US national security interests.

As shown in Figure 1, year-to-year rates of growth differ widely within both the Soviet and US economies, but for entirely different reasons. In the USSR, agriculture accounts for a large part of GNP, and changes in weather conditions result in great fluctuations in agricultural production and hence in GNP. In the US, in contrast fluctuations in annual growth are tied to changes in nonagricultural business inventories, in business needs for additional plant capacity, in consumer spending on durable goods, and in government fiscal policy.

For the year 1965 a forecast of economic performance can be made with much greater assurance in the case of the US than the USSR, where final agricultural results are still uncertain. In the US the pattern of business conditions for the past 6 months foreshadows business conditions for the next 6 months, especially in a period of sustained and balanced prosperity. The forecast for 1965 of the President's Council of Economic Advisers, for a 4-percent increase in GNP in real terms, is used in this memorandum. In the USSR the overall rate of growth

in 1965 will be much less than the 7 percent achieved in 1964 because the 12-percent increase in agricultural production in 1964 makes that year hard to improve on. In 1965, crops will show a drop from 1964 -- a drop that may be only partly offset by gains in livestock which is benefiting from the large feed crops of 1964. Drought in the "new lands" has damaged the wheat crop, and on the basis of current evidence, Soviet agricultural output as a whole is estimated to drop 4 percent in 1965. Soviet industrial production in 1965 will grow at a rate of roughly 6 percent -- up from 5 percent in 1964 because of the improved supply of agricultural raw materials carried over from 1964. Because of the current agricultural difficulties, Soviet GNP probably will increase only about 3 percent in 1965.

The long-run slowdown in Soviet growth is the result of persistent underlying economic forces and is not likely to be reversed over the next five years. In 1966-70, Soviet growth possibly will be greater than in the US -- but this is not assured. Suppose that over the next five years the USSR is able to halt the declining trend in the rate of growth which has developed in recent years and maintains for example a rate of 4 1/2 %, while the US economy continues to grow at a rate of 4%. Then Soviet GNP in 1970 would still be about 50% of US GNP, and the absolute gap between US and Soviet GNP would have widened by \$60 billion more.

I. Introduction

From the beginning the leaders of the USSR have made the growth race with the West the heart and soul of Soviet economic policy:

1919 -- Lenin

... either perish or overtake the advanced countries
... and surpass them economically.

1931 -- Stalin

We are fifty to a hundred years behind the advanced countries. We must make good this distance in ten years. Either we do it or they will crush us.

1961 -- Khrushchev

Some people in foreign countries used to ask, "Mr. Khrushchev, do you really expect to catch up with America economically?" Today no one raises this question in this way; instead I am asked, "Mr. Khrushchev, ... in what year will you catch up with America? ... My reply is, "You can write down in your little notebook that we will overtake you in per capita industrial production by 1970."

These three quotations are only a sample of the many statements by Khrushchev and his predecessors of the importance -- and the inevitability -- of catching up with the US economically. First the US would be overtaken in the production of major commodities, then in total output, and finally in per capita output. Sheer physical growth was to be the criterion of success, and here the Soviet leaders seemed to be loading the dice in their own favor, for in spite of its rough edges the Soviet economy appeared to be a powerful engine of growth. However, as Khrushchev found out, other major requirements besides growth -- the military and space programs are the most dramatic examples -- had to be accommodated, and the economy became overloaded. Economic commitments grew faster than productive capacity. Khrushchev's erratic and unsuccessful attempts to cut the suit to fit the cloth were an important element in the events leading to his downfall last October. Even before he was deposed, less and less was heard of the claim that the USSR would soon overhaul the US economically. Khrushchev's successors have been quite cautious in dealing with this theme. Thus, Premier Kosygin has spoken of the general strength of the Socialist system in the economic competition with capitalism, but he has not referred specifically to catching up with the US.

The rate of growth of Soviet GNP has slowed down from about 6-1/2 percent in the 1950's to about 4-1/2 percent in the 1960's. In examining the causes of the slowdown, three components of Soviet GNP may be identified: (1) industrial production, which has declined fairly steadily from an average annual rate of growth of 8 percent in 1956-60* down to 6 percent in 1961-65; (2) agricultural production, which has been subject to wide year-to-year fluctuations and has grown at an average annual rate of about 3 percent in 1956-65; and (3) trade, transportation, and other services, whose combined rate of growth normally lies somewhere between the rate for industry and the rate for agriculture but closer to industry. The fairly steady long-term decline in industry's rate of growth gives a long-term downward trend to GNP growth, whereas the erratic performance in agriculture leads to short-term fluctuations in GNP, as shown in Figure 2.

The slowdown in Soviet economic growth is the result of many factors, but from the vantage point of mid-1965 a few key points may be singled out for attention:

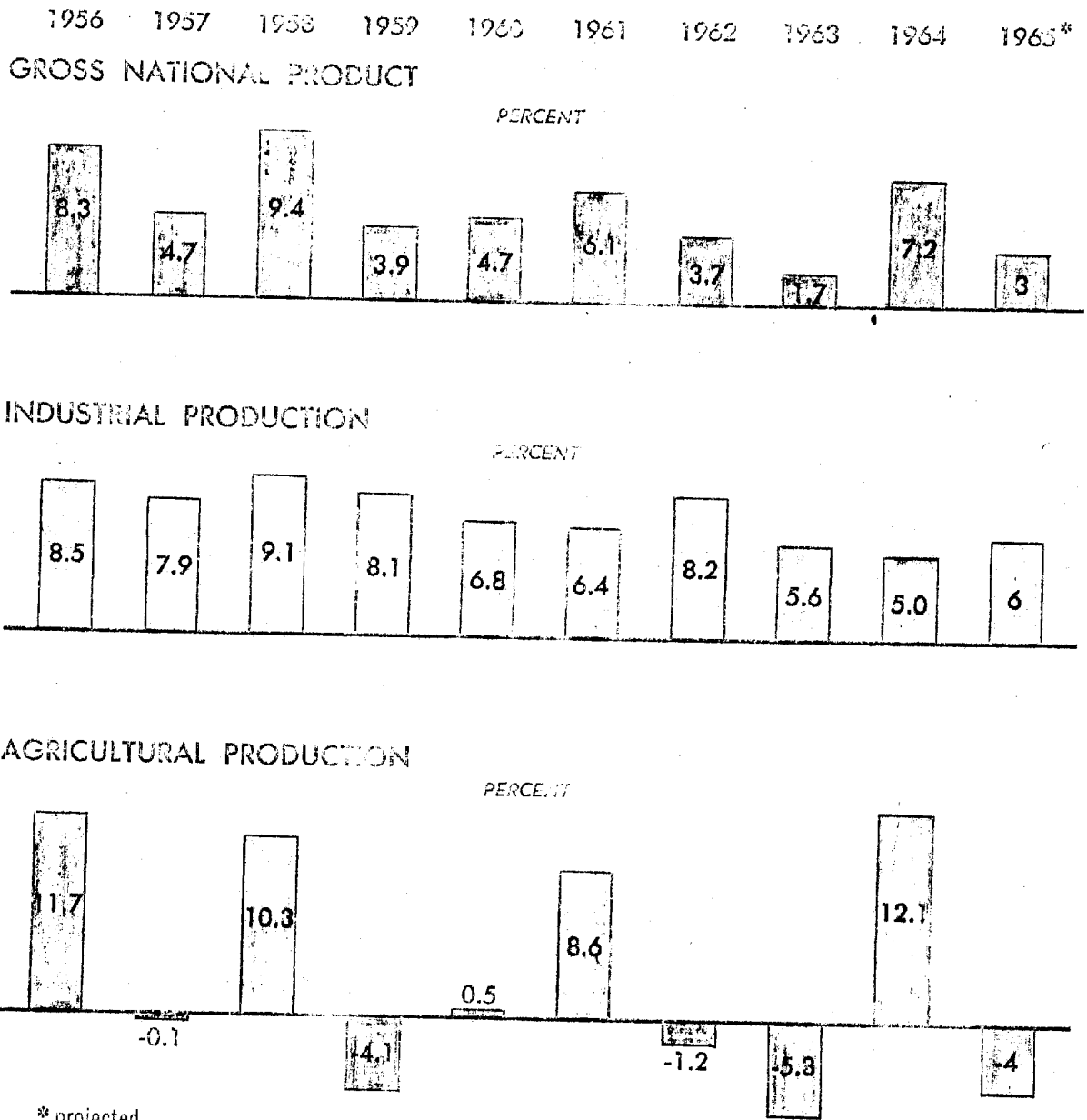
(1) The expansion of defense expenditures after 1958 preempted a large share of the high-quality resources most needed to modernize industry and agriculture. The new military programs proved to be voracious consumers of the best scientific and engineering talent, the most costly and complex machinery, and the newest alloys and other high-cost materials.

(2) Linked with the first factor was the failure of agriculture to provide a reliable domestic source of food and raw materials for industry. Growth in agriculture had always trailed growth in industry, and indeed the backwardness of Soviet agriculture was part of the price paid for rapid industrial growth. Under Khrushchev, large investments were made in agriculture, yet time and again agriculture failed to meet the goals set by the central planners. The near-disastrous harvest of 1963 dramatized the failure of the Soviet leadership in dealing with agricultural problems; on this occasion about 11 million metric tons (mt) of wheat and flour had to be imported from the capitalistic West at a cost of almost \$1 billion. And again in 1965, agricultural failures are resulting in large-scale imports of grain and are dimming what hopes the Soviet leaders still cherish of restoring the old rates of economic growth.

* Throughout this memorandum, when a rate of growth is given for a period of years (say, 1961-65), the base period for the calculation is the preceding year (in this case, 1960).

Figure 2

USA:
RATES OF GROWTH OF GROSS NATIONAL PRODUCT,
INDUSTRIAL PRODUCTION, AND AGRICULTURAL PRODUCTION
1956-65



* projected

(3) The Soviet economy in the 1950's benefited greatly by adopting new technology and manufacturing processes from the West at relatively little cost. But when the Soviet leaders had to solve their own problems --for example, in the space field--they could no longer bypass the costly research stage by leaning on the West, and when imported Western technology became more difficult to absorb in the Soviet economy--for example, in the chemical industry--large gains in output were no longer easy to achieve without incurring normal "start-up" costs.

(4) Investment in new fixed plant and equipment in the USSR in the 1950's increased at the amazingly rapid pace of 12 to 13 percent a year, while GNP increased at 6-1/2 percent a year. These rates meant that fixed investment was rapidly increasing as a share of Soviet GNP, from 17 percent of GNP in 1955 to 24 percent in 1960. After 1960, however, when other commitments grew, investment increased at less than half its former pace and no longer grew as a percent of GNP. Thus the growth in the Soviet economy in the 1950's was powered by a rapid step-up in investment, whereas in the 1960's the planners have had to settle for smaller percentage increases in investment--and in overall economic growth. Moreover, the Soviet leaders have tried to compensate for the decreased rate of growth in investment by keeping old capacity in operation. Consequently, the inability to sustain the extraordinarily high rates of growth in investment has carried with it a general obsolescing of productive capacity and production methods.

A number of other forces are intertwined in this tangle of causes of the Soviet slowdown--for example, the problems of management in a "command" economy and the problems of coping with more sophisticated consumer tastes and of designing and producing a more complex output mix in both consumer and capital goods. As an illustration of these difficulties, a number of expedients adopted under Khrushchev attacked certain of these problems while making others worse--when construction projects fell behind schedule, for example, housing was almost invariably the sector that suffered in the resulting reshuffle of resources.*

Even though the Soviet economy is faltering in its growth race with the US, a reminder is needed about the basic economic strength of the USSR. The present rate of growth is quite respectable for a modern industrial nation. At the current average rate of growth of 4-1/2 percent, Soviet GNP would double in 16 years. The USSR is maintaining a military and space establishment that in dollar terms costs about 80 percent of the

* The reduction in the workweek in industry from 46 to 41 hours in 1956-61 perhaps could be cited as a factor in the slowdown in Soviet economic growth. This reduction, however, was made contingent on there being no reduction in output per man and in any case is a nonrecurring factor whose effect on economic growth rates would be felt for a few years only.

US military and space establishment. Furthermore, the USSR continues to score spectacular space successes. In short, the Soviet leadership may command only half the economic firepower of the US, but this power is concentrated in support of worldwide activities of serious consequence to US security interests.

III. Rise in the US Growth Rate

As the Soviet growth rate has moved down in the last few years, the US growth rate has moved up to meet it. In mid-1965 the US is enjoying an unparalleled stretch of orderly peacetime prosperity, now well into its fifth year. Gross national product, industrial production, employment, investment in new plant, consumption--all the major indicators of economic performance--are at new heights. This memorandum does not purport to analyze the US speedup in the same detail as the Soviet slowdown, but the following factors may be noted:

(1) Investment by business in new plant and equipment has grown rapidly and has kept abreast of the need for additional productive capacity.

(2) Consumption by household units has risen steadily in concert with rapidly rising consumer income.

(3) Government expenditures and taxes have been dovetailed with the private economy in such a way that total spending has moved up parallel to rising productive capacity.

An interesting aspect of US performance in the growth race is that even in industrial production the US has matched the USSR stride for stride in percentage growth since 1961. Of course, in absolute terms US industrial production is growing much more rapidly--more than double the Soviet growth.

IV. Prospects for Soviet Gross National Product in 1965

Growth of Soviet GNP in 1965 is likely to be mediocre when judged by past Soviet standards and disappointing when compared with the hopes of the new regime. The growth in the industrial component of Soviet GNP can be fairly well estimated on the basis of information available at midyear, whereas the course of agricultural output still cannot be ascertained within wide limits. In industry, production should be approximately 6 percent above the 1964 level, a rate of growth slightly above the 5 percent rate achieved in 1964. In heavy industry, expansion in 1965 continues in the same pattern as last year and is based on the continuing and more-or-less-synchronized expansion of (1) capital plant; (2) supplies of fuels, construction materials, and other industrial raw materials; and (3) technical skill, as reflected in increased output per man and machine. In consumer goods industry, the picture in 1965

is dominated by the increased supply of livestock products and other agricultural raw materials for the food-processing branches, a result of the excellent crops in 1964.

In agriculture, crop production in 1965 is well below the record level of 1964. Wheat output has been particularly affected by drought in the "new lands" regions of Western Siberia, Northern Kazakhstan, and the Urals, which are the main spring wheat areas of the USSR. Since 1 July the USSR has purchased about 7 million mt of wheat and flour from Canada and Argentina for delivery in 1965-66. At present the yield from grain crops as a whole, however, does not appear to be as bad as in 1963. In contrast to crops, output of livestock products has risen in 1965 because of the large supplies of feeds provided by the bumper crops of 1964. A further favorable factor in Soviet agriculture in 1965 stems from the lifting of restrictions imposed by Khrushchev on the size of private farm plots and on the number of private livestock. Supplies of food products, especially in local markets, received a fillip under the new, more permissive regulations. As for the massive investment program for agriculture, announced by Brezhnev in March, these plans for the revitalization of Soviet agriculture are mainly long run, and results were not expected to show up in 1965 except perhaps in the case of some of the new higher procurement prices. On the basis of current evidence, a 4-percent drop in total agricultural production is estimated for 1965.

Agriculture accounts for something less than one-third of Soviet GNP and industry for somewhat more than one-third. The remaining one-third is a diverse group of products and services which includes construction, transportation, trade, communications, education, health, and government administration. A large segment of this miscellaneous third rises or falls according to the fortunes of agriculture and industry. For example, the transport system carries the products of industry and agriculture and the trade network distributes them. Thus the increase of activity in this miscellaneous third, taken as a whole, typically falls between the rate of growth in industrial output and the rate of growth in agriculture but is closer to the industrial rate. In 1965, if industrial output advances 6 percent and agricultural output falls 4 percent, GNP as a whole will grow at about 3 percent, or less than in any year in the last decade with the exception of 1963.

V. Prospects for US Gross National Product in 1965

The GNP of the US for 1965 can be predicted on a much firmer basis from the vantage point of September 1965 than can that of the USSR because (1) fluctuations in US agricultural output have relatively little effect on GNP; (2) the present sustained period of prosperity in the US has a forward momentum of at least six months; and (3) US data are published openly and promptly. At the beginning of 1965 the President's Council of Economic Advisers forecast a GNP in 1965

in current dollars of \$660 billion plus or minus \$5 billion. In real terms this represents a 4-percent increase plus or minus three-fourths of a percentage point. As of September the economy is on course (perhaps even a little ahead of schedule), and the result for the whole year probably will be at least a 4-percent gain.

VI. Prospects for Soviet and US Gross National Product, 1966-70

During the new five-year period, 1966-70, the factors that have dictated a slowdown in Soviet economic growth are likely to persist. Attempts to restore rates of growth in industry would be largely at the expense of agriculture and perhaps defense, and in turn new large-scale investment in agriculture would reduce the extent to which industry could be modernized. In summary, the prospects for growth in GNP have not improved, and a matching of recent performance is the most likely prospect. Agricultural production will continue to fluctuate greatly year to year because of weather, and in individual years growth in GNP will reflect this erratic movement.

Developments in the first three quarters of 1965 reinforce the estimate of a continuation of recent growth trends in 1966-70 as opposed to the 6 to 7 percent level of the 1950's. Premier Kosygin has been speaking almost wistfully of how nice it would be to reduce the amount of resources going for military purposes as opposed to consumer use but how impossible such a transfer is at this time in world affairs. Beyond the effect of military programs on growth rates, however, there have been other signs pointing toward a continuation of the more moderate pace of growth as likely for the Soviet economy: (1) There is increasing evidence that the Soviet leadership is being pushed by a diversity of forces toward a more generous future allocation of resources to consumers -- for example, the large increase in planned investment in agriculture, more manufactured goods for rural areas, higher real incomes for pensioners, and even private automobiles for the upper middle class. (2) There is evidence that the difficulties -- both political and economic -- in reforming administrative systems and practices throughout the economy are a great deal tougher than the "reformers" had bargained for. (3) Furthermore, the present economic system of the USSR is being revealed as even less suited than was formerly believed to meeting the complex tasks of modern economic life -- for instance, the system shows up as very clumsy in distributing workers among geographical areas, among industries, and among occupations. (4) Difficulties in agriculture persist -- with a resulting need for food imports instead of the traditional food exports -- and the inputs that Brezhnev talked about for agriculture in his speech last March may not be available in the quantities or at the time specified; consequently, foreign machinery needed to modernize Soviet industry cannot be imported in the amounts hoped for by the Soviet planner because large food imports are necessary from time to time.

As for US GNP, the estimate of the President's Council of Economic Advisers is for a growth rate averaging "about 4 percent a year." Suppose that over the next five years the USSR is able to halt the declining trend in the rate of growth which has developed in recent years and maintains for example a rate of 4 1/2%, while the US economy continues to grow at a rate of 4%. Soviet GNP in 1970 would still be about half that of the US, and Soviet per capita GNP would be about 43% of the US level. Moreover, since the Soviet consumer's share in GNP is unlikely to rise, Soviet per capita consumption would remain little better than 30% of US per capita consumption.