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INTELLIGENCE MEMORANDUM

ECONOMIC GROWTH IN EAST GERMANY
1951-60

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ECONOMIC GROWTH IN EAST GERMANY
1951-60

Summary and Conclusions

Since World War II the East German economy has gone through 6 years of reconstruction (1946-51), 3 of transitional adjustment (1952-54), and 3 of relatively stable growth (1955-57). The rate of annual increase in national income has fallen from between 15 and 20 percent in the years of reconstruction to the present rate of about 5 percent. The present rate may be maintained for another year or two but will not be maintained in the 1960's unless the USSR decides to make a substantial net investment in the East German economy.

The growth of East German production to date has been obtained at a large hidden cost. Much of the output of goods and services no longer meets the quality standards of Western Europe. The plant capacity is older and in worse shape. The existence of such discrepancies is not only a serious economic handicap but also a heavy political liability. Some Soviet officials apparently have argued that East Germany must overtake West Germany in economic development, but it seems quite unlikely that this view has been adopted as Soviet policy.

The USSR has a big stake in keeping the East German economy going and has protected this stake by normalizing its economic relations with East Germany, although the USSR continues to obtain an economic advantage from its position as the dominant partner. The USSR has also extended the credits needed to finance East German capital exports to other Satellites. It has not, however, made, and may well be unwilling to make, a significant net investment in the East German economy.

From its own resources, East Germany cannot long maintain its present rate of growth, which is still higher than the average rate of growth in Western Europe. The maintenance and replacement of facilities throughout industry and transportation and the expansion of raw materials production from high-cost domestic resources will preempt a large and increasing part of East German savings, leaving very little for new investment in the consumer goods, capital goods, and export industries -- too little to maintain the present rate of increase in productivity. To these handicaps must be added the exorbitant cost of persisting in the "socialization" of agriculture and a continued slow decline in the size of the labor force (as long as emigration goes on at the steady rate of the past few years). The prospective decline in the rate of growth of the

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national income of East Germany in the next decade poses an important political problem for the USSR which will make it increasingly difficult to avoid a choice in East Germany between the risks of a more rigid and repressive regime and the risks of a considerably more flexible and "liberal" regime.

1. First Five Year Plan (1951-55).

The First Five Year Plan marked the transition of the East German economy from a period of reconstruction to a period of relatively stable growth. In spite of errors in planning this transition and in spite of the heavy load of Soviet exploitation, East German national income increased by about 60 percent during the period -- that is, at an annual average rate of 10 percent. The achievement of so great an increase reflects the underutilization of capital and labor in the base year, in which East German national income was still at an extremely low level. It also reflects the regime's policy of maximizing industrial production while allowing quality to deteriorate, ignoring consumer preferences, neglecting the replacement and maintenance of capital equipment, and postponing urgently needed expansion of capacity (especially in fuels and power).

a. Production by Sector.

The growth of the East German economy during the First Five Year Plan was dominated by the increase in industrial production. The official index of "gross" production, which shows an increase of almost 90 percent for the 5-year period, overstates the growth of industry, and if the output of small (handicrafts) producers is included, industrial production (net output) increased by less than 75 percent. The increase in industrial output was accomplished without large new investments except as urgently required to compensate for the partition of Germany and the dismantling of plants by the USSR after World War II. Large new investments were made in metallurgy and heavy machine building. Mining and electric power also received substantial investments, especially at the end of the period. Otherwise, relatively small additions to the plant capacity available at the beginning of the plan period were enough to permit a considerable rise in industrial employment and large increases in industrial production. The increases in output of finished goods generally exceeded the increases in output of basic materials (except for iron and steel), which were supplemented by rapidly increasing imports.

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In spite of the increased use of fertilizers and increased crop prices, the performance of agriculture and forestry during the plan period was poor because of adverse weather and the deadening effect of government policies intended to "encourage" the formation of cooperatives. Although there was some increase in market production over the period, consumption in kind fell, material costs increased, and the net product of agriculture probably increased only slightly if at all. There was a good deal of surplus labor in agriculture in 1950, almost all of which was absorbed in the urban economy by 1953. By the end of the period the regime was trying to recruit agricultural labor.

The output of construction has been reported by official sources to have risen more than 90 percent in current prices during the period 1951-55. This increase reflects some understatement of the volume of construction in 1950. Construction costs, moreover, rose rapidly -- possibly by as much as 50 percent -- because of rapidly increased wages and continued inefficiency in the use of labor. As a result, the real growth in construction was much less than reported -- probably between 30 and 45 percent for the plan period -- and was accounted for in considerable part by increased employment.

The value of the services of trade rose by about 90 percent during the period in response to increased industrial output -- in particular, the output of consumer goods. The growth in transport and communications was much less, probably about 40 percent, because of the small increases in the use of transport by agriculture and by households. This increase mostly reflects increased utilization of inherited facilities, with relatively large increases in employment and small increases in productivity.

b. End Uses by Sector.

The low level of personal consumption in 1950 (by prewar standards) required -- and the comparably low level of utilization of capacity for producing consumer goods and services permitted -- rapid increases in consumer welfare from 1950 to 1955. Personal consumption rose by somewhat more than national income, or by about 70 percent. Retail sales (in constant prices) more than doubled during the period, whereas other elements of personal expenditures rose very little. These estimates reflect real increases, but they overstate the improvement in living conditions. Available consumer goods were characterized by poor quality and a limited range of choice. The negligible improvement in the supply of housing (chiefly resulting from the decline in population) has too little effect on the measure for personal consumption, because of the artificially low level at which rents have been kept. In general, even

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though the standard of living was the highest in the Soviet Bloc,* the East Germans were still worse off than before World War II, and the standard of living was perhaps one-third below that in Western Europe.

"Social" consumption, which includes, among other things, reparations, occupation costs, other uncompensated deliveries, and expenditures on military end items, was officially reported to have declined as a share of national income. Covert information for 1955 indicates, however, that "social" consumption had become a slightly larger proportion of national income than in 1950, implying a growth somewhat in excess of 60 percent for the plan period. Because most of the components of this category did not grow so rapidly as national income, the chief reason for the over-all increase was probably the rapid growth of expenditures for military end items.

The East German government has refrained from making any claims directly relating to investment at constant prices. The large increases in investment costs that occurred during the 5 years have been acknowledged in the economic journals. The rise in costs was between 20 and 35 percent (possibly more). As a result, the official index of 164 for "accumulation"*** in current prices represents a "real" growth of between 20 and 35 percent. Covert information on the distribution of national income in 1955 indicates that the actual growth was probably near the lower end of this range.

The "rate of accumulation" (net investment as a proportion of national income) was much lower than that prescribed in Soviet theory and claimed by the USSR and the other European Satellites during the period. The announced average rate was 13 percent.*** Investment was held down during the early years of the plan by the weight of reparations deliveries together with occupation costs and probably direct subsidies to uranium mining. The cancellation of reparations and the small reduction of occupation costs after 1953 were more than offset by increased military expenditures and personal consumption and by the repayment of indebtedness to the USSR. It seems probable that during the years 1951-55 fully one-third of East German savings was in effect devoted to "net foreign investment" -- in the Soviet economy.

* The standard of living in Czechoslovakia was about the same.

** For practical purposes, "accumulation" during the First Five Year Plan was the same as net domestic investment, including additions to inventories and state reserves.

*** Believed to be calculated from data in 1950 prices.

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c. Fixed Capital Investment.

Net fixed capital investment, valued at current prices, increased by about 90 percent during the plan period, a rate of growth greater than that for total net investment in current prices. Accompanying this rapid rise, however, was the sharp rise in investment costs, so that in terms of constant (1950) prices net fixed capital investment probably increased by less than 55 percent. Construction costs rose more rapidly than other investment costs during the period. The impact of rising costs was least in the industrial sector, where construction was a smaller (and declining) part of the total investment effort and where construction costs rose less rapidly.

Throughout the entire period the regime systematically used the allocation of investment to promote the centralization and "socialization" of production. Very little in the way of investment funds was allocated to local, cooperative, and private industry and construction; handicrafts; private agriculture; and private retail trade. Local, cooperative, private, and handicrafts enterprises employ about one-half of the labor force* and supply the greater part of the requirements for personal consumption.

Fixed capital investment in industry accounted for about 40 percent of total gross fixed capital investment (in current prices) during the period of the First Five Year Plan. Including the construction sector, net investment in industry probably about doubled during the 5-year period. The greatest increases in industrial investment were made during the first 3 years of the plan. In 1954, a year of readjustment, there was a decline in industrial investment, followed by a rise of about the same amount in 1955.

Very nearly three-quarters of the net fixed capital investment allocated to industry was devoted to the basic materials and heavy engineering industries. The big investments were made at first in metallurgy (iron and steel) and the heavy engineering industries, but substantial and increasing investments were made in mining, electric power, and chemicals. The remaining investment was divided in roughly equal proportions between light engineering and the consumer goods industries.

Agriculture was allocated only about 10 percent of total investment, and much of this was wasted in the attempt to promote the "socialization" of agriculture. Transportation, chiefly rail, received probably less than 15 percent of the total. Allocations to the other producing sectors -- construction, trade, and communications -- amounted

* Exclusive of employment in public administration and defense.

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to just under 10 percent of the total. The remainder, something over 25 percent of the total,* was allocated to public welfare, housing, defense, and administration. These sectors, of which housing was the most important, felt most severely the impact of rising construction costs. In the case of housing, for example, the increase in allocations during the last 2 years of the plan was almost entirely cancelled by the sharp rise in construction costs.

d. The Legacy for the Future.

In no small measure the growth of the East German economy from 1950 to 1955 resulted from the increasing utilization of available resources. Although it is not possible to provide an accurate yardstick, there seems to be no question but that the average capital-output ratio declined considerably during the years of the plan, particularly in the finished goods industries. At the same time, much of the increase in labor productivity achieved reflects the underutilization of labor at the beginning of the period. Although opportunities still existed for increasing output through the more intensive use of resources, they were certainly more restricted in 1955 than in 1950, except perhaps in agriculture. Prospective increases in output would be much more closely related to new investment than would be indicated by the experience of the 1951-55 period, and the demand for increasing managerial efficiency would be more intense.

The need for future increases in personal consumption ran in direct conflict with the need for future increases in new productive capital. Although there was a large real increase in personal consumption from 1950 to 1955, the gap still remaining between living conditions in East and West Germany was very large. Not only were the supply, the mix, and the quality of consumer goods poor, but housing space per person was only about one-half the prewar level and the state of repair was worse. The differential between East and West Germany was one important reason for the high rate of emigration during the period (greater than the natural increase in the population of working age). Besides the probable continuation of emigration at a high rate, East Germany faced a prospective decline in the natural increase in the population of working age. If only for this reason, increases in personal consumption deserved quite as serious consideration as investment in the allocation of East German resources during the preparation of plans for the years 1956-60.

* If the investments in public welfare under investment in industry, agriculture, and the other producing sectors are included, the proportion is almost one-third.

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2. Second Five Year Plan (1956-60).

The Second Five Year Plan, now at the halfway point, has been characterized by a stable rate of growth. The annual rate of growth of national income has remained at the level to which it had declined by 1955, about 5 percent. The government expects to maintain this rate of growth through the end of the period. This goal is within reason, though it will probably not be fulfilled. Even if it is fulfilled, the rate of growth cannot be maintained in the next period unless the USSR decides, unexpectedly, to invest a substantial amount in the East German economy. East German plans through 1960 do not assume an import surplus.

a. Original Plan.

The present 5-year economic plan was adopted only after prolonged dispute within the East German government. The first draft of the plan, circulated in the spring of 1956, called for an annual average rate of economic growth of about 8 percent. This version of the plan represented the views of Walter Ulbricht, First Secretary of the SED. He believed that the rate of growth had declined further than necessary in the previous period. He held that there remained large enough untapped resources -- in the form of underutilization of capital and wasted time and materials -- to continue to increase labor productivity almost at the average annual rate in the preceding period. This conviction rested in part on his realization of the inefficiency of the East German nationalized economy and in part on his faith in the efficacy of "socialist" attitudes, organization, and methods as they should take further effect.

Such faith, highly resistant to evidence, was shared by very few, if any, other officials dealing with economic problems. Nevertheless Ulbricht had his way. The preparation of the original draft of the Second Five Year Plan was controlled by his views on the rate of growth. In order to provide for such a rate of growth, unrealistic calculations were made in projecting the coefficients that express relations between the use of scarce resources -- raw materials, capital, and labor -- and the value of end products.

Large economies in the use of fuels and power and metals were to be obtained by more careful management and by changes in processes, designs, and product mix. In planning for fuels and power, reductions were projected in coefficients (1) for the consumption of coal, notably in rail transport and electric power production; (2) for network losses of electric power; (3) for electric power consumption in chemicals and nonferrous metallurgy; and (4) for coke and coal consumption in metallurgy. It is illustrative of the way in which the fuel and power

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balance was drawn up that a last-minute change was made in the rate of increase for electric power production without any apparent changes in plans for the supplies of coal. Although the change (from an increase of 42.5 percent to one of 53 percent) was a step in the right direction, inasmuch as industrial production was to increase by 55 percent, it was under the circumstances almost meaningless. Very large "savings" of metals also were to be made -- in particular, reductions of over 20 percent in the inputs (per unit of output) of both rolled steel and copper. Such economies were based in considerable part on the assumption that all plants could come much closer to the efficiency in the use of materials (in more or less comparable processes) already reached by those plants with the best workmen, managers, and equipment. The proposed "savings" also involved the assumption that improved scheduling and quality of supplies -- variations in which had had a great deal to do with the records of individual plants on material consumption -- would permit a more economic use of materials. They finally involved the introduction of changes in production mix in industry which would raise the average value of products in relation to the value of inputs of scarce material. This last expectation greatly influenced estimates of the requirements and output of the chemicals industry and to an even greater extent the engineering industry.

In calculating the capital requirements of the Second Five Year Plan, the East German planners projected the steady increase during the previous period in the value of output relative to increases in the value of capital assets in the finished goods industries. There was still some plant capacity in these industries which was not fully utilized, as a result of continued difficulties in obtaining material supplies and of remaining bottlenecks in plant capacity. There remained no such reserves of capacity, however, as in 1950, and there was no reliable basis for overruling the cautious estimates of management on the additional production that might be obtained.

A lack of realism entered likewise into estimates of the size and efficiency of the labor force. It was recognized, to be sure, that the low birth rates of World War II would result in a very small net addition to the labor force by 1960, even if large-scale emigration to West Germany, which had been an almost constant factor during the preceding 5 years, could be eliminated. It was also recognized that there were no significant labor reserves, with the chief exception of pensioners who might be willing and able to go back to work. Even the small projected gain in total employment, however, of less than 1 percent per year was probably too high, if emigration was assumed, and much too high given the prospective continued emigration at the same rates as in the past.

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The efficiency of labor was projected in much the same way as the efficiency of capital. This practice introduced a strong upward bias in plans for the finished goods industries. Labor productivity in these industries had increased rapidly through most of the preceding period because of rapid improvements in materials supplies not likely to be matched in the future.

Besides the use of unrealistic coefficients in balancing the domestic plans, the other great weakness of the original draft of the Second Five Year Plan was the extent to which export markets and import availabilities were taken for granted. The other Soviet Bloc countries were proceeding on similar assumptions in their own planning. Like East Germany they fixed their principal goals and developed their material balances before examining the likelihood that the assumptions as to foreign trade would be satisfied. It would have been a remarkable coincidence if their plans had matched even reasonably well. Even in cases in which they did match, of course, they often reflected optimistic estimates by other Bloc countries as well as by East Germany about the productivity of labor and capital. Moreover, projected requirements for East German export goods are especially liable to revision, since East German exports to Bloc countries consist to such an extent (on the order of three-quarters of total exports to those countries) of engineering goods and thus relate to investment requirements, which are highly specific and are often revised.

b. Revision of Plans.

The weakness of the assumptions made as to foreign trade was acknowledged before any of the other weaknesses of the draft plan. Negotiations and exchanges of information both bilaterally and through the Council of Mutual Economic Assistance (CEMA) during the first half of 1956 made it only too evident that such assumptions must be revised. The lesson was emphasized by the large underfulfillment of current import and export plans. Even more serious was the failure of Polish coal exports in the second half year. The final blow to all Satellite plans was the development of the crises in Poland and Hungary during the fall of 1956.

It is unlikely that earlier disputes over the internal capabilities of East Germany were renewed at the time. There was no question but that all the Satellite plans would have to be reviewed so as to bring them into balance, and it was plain that overambitious planning was not the order of the day. By the end of 1956 the economic leaders who had opposed Ulbricht's views were thus in a much stronger position than in 1955 to gain approval for a more realistic economic plan.

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The development of a revised draft plan lasted through the entire year 1957. Some preliminary figures were announced in October 1957, and the "final" plan was formally presented at the end of December 1957 and adopted in January 1958. The calculations and assumptions made in preparing the revised plan rested on the experience of the years 1955-57 in much the same way as the original plan had rested on the experience of the years 1951-55. This is to say that the important coefficients relating scarce resources to the supply of end products were projected as before rather mechanically from past experience. The great difference is that the new base period used was one with a much lower and more stable rate of growth and actually included a part of the plan period, thus considerably shortening the time over which the experience was projected. Comparisons, therefore, between the original plan and the revised plan illustrate the difference between projection of the coefficients of the First Five Year Plan as against a projection of the coefficients of the first year or two of the Second Five Year Plan. The main differences between the two versions of the Second Five Year Plan are shown by the following indexes (1955 = 100):

Category	Original Goals	Revised Goals	
		October 1957	"Final"
Gross industrial production	155	134	138
Gross agricultural production	About 125	N.A.	117
Exports	201*	N.A.	164
Imports	151*	N.A.	159**
Retail trade	140	122	127
Personal consumption	135	117	122
Gross fixed capital investment	200	150	150
National income	145	127	About 130***

Along with the evident differences, the plans have various important things in common. Both plans show personal consumption growing less rapidly and gross capital investment growing much more rapidly than national income. Both show rapid increases in agricultural production and investment. Both show the maintenance of the substantial export surplus (on commercial account) existing in the base year.

* Soon revised to 186 for exports and 159 for imports.

** Later given as 161.

*** The published plan figure (for gross product) was 134. See, however, p. 16, below.

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The development of a revised plan for the period 1956-60 began in early 1957 with important decisions relating to the basic materials industries. Fritz Selbmann, one of the Deputy Chairmen of the Council of Ministers, undertook to convince the East German planning authorities that the review of the Second Five Year Plan must be preceded by firm decisions on electric power capacity and related decisions on fuels production. He succeeded in this aim, and it seems likely that at the same time he also carried the point that existing coefficients in the use of fuels and power must be used in planning production in other sectors of industry. Apparently it was agreed that projected investment in fuels and power under existing plans represented nearly the maximum that could be allocated during the period. On this basis the planned increase in electric power production was reduced to 41 percent and later raised to 44.6 percent -- about the level originally projected by the electric power industry.

These decisions being made, related revisions were developed for the production of coal, manufactured gas, and liquid fuels. Throughout the period, coal -- chiefly brown coal -- will continue to be the basis for electric power production. The East German plans in the field of atomic energy do not provide for the commercial operation of any atomic power capacity until 1960, and it will in any event be some years after 1960 before atomic power becomes significant. The plans for coal production implied that imports of hard coal were to continue to account for about the present proportion of total fuel supplies. This projection presumably had the support of the USSR. The principal changes in the plan for fuels and power production are shown by the following index numbers (1955 = 100):

Sector	Original Goals	Revised Goals	
		Preliminary	"Final"
Electric power	153	141	145
Raw brown coal	130	117	122*
Brown coal briquettes	108	105	113
Hard coal	109	111	110
Liquid fuels	129	127	127

The decisions reached with reference to fuels and power did not, of course, determine automatically the revisions that had to be made in other sectors of industry. Selbmann urged that goals for the chemical industry, a heavy user of fuels and power and the most reliable source of exports, be determined along with the goals for fuels and power, but

* The first "final" revised goal was 124.

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he was overruled on this point. The revised goals for other sectors of industry and the rest of the economy remained under discussion through the spring and summer of 1957 and were not finally announced until late October 1957. The effect of the revisions for industry was to scale back the 5-year growth to 34 percent as against the original goal of 55 percent. With this announcement the government in effect acknowledged that the planned output of end products had originally been too great for the planned output of basic materials and that industrial production as a whole had been planned at too high a level in relation to employment and investment.

Some further modifications were made in the "final" plan as adopted in January 1958. The principal modification was the adoption of the goal of a 38-percent increase for industry. This modification was accompanied by a new goal for retail trade, which was to rise to 27 percent over the 1955 level (as against the October goal of 21.8 percent). Both of these modifications apparently reflect the formal incorporation into the revised plan of a project (already mentioned in October) for "supplementary" production of consumer goods, a device already discredited in 1954. The "supplementary" production of consumer goods, about 800 million Deutsche Mark East (DME) in 1958 and 2.2 billion DME in the years 1958-60, is supposed to be derived entirely from the "inner reserves" of enterprises -- that is to say, without the allocation of additional resources. The rest of the increase in the goal for industrial production is accounted for by a small increase in the 1960 goal for engineering production.

The revised goals, as announced, compare as follows with the originally announced goals (1955 = 100):

<u>Sector</u>	<u>Original Goals</u>	<u>Revised Goals</u>	
		<u>October 1957</u>	<u>"Final"</u>
Industrial ministries			
Coal and power	131	132	132
Mining and metallurgy	150	126	126
Chemical industry	165	134	134
Heavy machine building	175	150	153
General machine building	212		
Other industry	141	129	134
All industry	<u>155</u>	<u>134</u>	<u>138</u>

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In the revised plan the gaps between the production of basic materials and finished products have been reduced greatly -- notably the gaps between chemicals and coal and power, between engineering and both coal and power and mining and metallurgy, and between "other" production (chiefly consumer goods) and agricultural production. The planned changes in the structure of domestic production show a much more objective assessment of what is possible. Moreover, even if a somewhat more pessimistic projection of employment is involved -- as is possible -- somewhat less unquestionably is expected from the "internal reserves" of the enterprises.

The investment figures in the revised plan are not comparable with those in the original plan, because of changes in investment accounting after the development of the original figures. The revised figure given for total planned investment, 55 billion DME,* represents gross fixed investment for the period, including capital repairs, whereas the original plan figure of 54.6 billion DME included only "new" investment. It excluded, that is, "replacement" investments and capital repairs valued at some 13 billion DME. The revised plan really involves a reduction of about one-fifth to one-sixth in planned investment -- partly accounted for, of course, by the underfulfillment of the 1956 and 1957 plans and at the same time involving proportionally greater reductions for the remaining years. In real terms the revised plan still provides for investments of at least half again as much as in the years 1951-55.

The changes in investment accounting also affect the comparability of available information by sector. The estimates shown in Table 1** are believed to indicate correctly the direction and, roughly, the extent of changes in plans for the various sectors, but they are still mostly approximations rather than reported figures.

A still more tentative breakdown is made in Table 2*** showing the plans for the years 1958-60 compared with actual investments in 1956 and 1957. Later information, most of it from covert sources, may be expected to result in changes in some of these figures, especially the 1957 figure for investment.

The revision in planned investments corresponds with the change in plans for the engineering industry and for construction. The planned increase over the period in availability of capital goods for investment has been cut back greatly, whereas the planned increase in construction

* For this purpose, the value of the DME may be estimated at between US \$0.25 and US \$0.30.

** Table 1 follows on p. 14.

*** Table 2 follows on p. 14.

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Table 1

Estimated Gross Fixed Capital Investment in East Germany a/
Original and Revised Plans, 1956-60

Billion DME		
Sector	Original Plan	Revised Plan
Industry and construction <u>a/</u>	31.5	23.0
Transport and communications	9.0	7.0
Trade	1.8	1.1
Agriculture and forestry	7.0	5.9
Housing	7.3	9.0
Defense	3.6	3.7
Residual <u>b/</u>	7.4	5.3
Total	<u>67.6</u>	<u>55.0</u>

a. Including investments in uranium mining and possibly all investments in defense production.

b. Chiefly accounted for by investments in civil administration and public services.

Table 2

Estimated Gross Fixed Capital Investment in East Germany a/
1956 and 1957 (Actual) and 1958 and 1959-60 (Revised Plan)

Billion DME				
Sector	1956 Actual	1957 Actual	1958 Plan	1959-60 Plan
Industry and construction <u>a/</u>	4.5	4.5	4.6	9.4
Transport and communications	1.4	1.3	1.4	2.8
Trade	0.2	0.2	0.2	0.5
Agriculture and forestry	1.1	1.2	1.3	2.3
Housing	1.2	1.9	1.8	4.1
Defense	0.6	0.6	0.8	1.7
Residual <u>b/</u>	1.0	1.1	1.2	2.1
Total	<u>10.0</u>	<u>10.8</u>	<u>11.3</u>	<u>22.9</u>

a. Including investments in uranium mining and possibly all investments in defense production.

b. Chiefly accounted for by investments in civil administration and public services.

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has been raised somewhat. These changes reflect an increase in the proportion of construction to total investments and a decline in the proportion of machinery and equipment. These shifts not only correspond with the reduction in planned investment in industry and the increase in planned investment in housing but also indicate some shift in the composition of investment in other sectors, notably transportation and agriculture, from machinery and equipment to construction.*

The most important change in investment plans, of course, is that for industry -- a reduction of more than one-quarter in planned investments, corresponding to the reduction in planned production of machinery and equipment. Planned investments in fuels and power have remained at about the original level, now representing over one-half of the total investment in industry and construction as against about two-fifths in the original plan. In order to maintain the planned increase in construction, planned investments in the building materials industry have been increased. Planned investments in all other branches of industry have been reduced (specific figures which seem to show the contrary are not comparable with the original figures). On a comparable basis the total planned investment for the metallurgical, chemical, engineering, and consumer goods industries is not more than three-fifths of what was originally planned. In short, it has been cut back by about the same proportion as the planned increases in production, indicating that the plan revisions involved little net change over-all in planned marginal capital-output ratios, although there were doubtless changes in some sectors. The following rough breakdown may be made of the revised investment plan for industry** (percent of total):

Fuels and power***	55
Metallurgy	9
Chemicals****	7
Building materials and construction	5
Engineering	12
Other†	12
Total	<u>100</u>

* In both plans the projected availability and requirements of investment goods were balanced by a great reduction in uncompensated deliveries of engineering products to the USSR, which had been large through 1955.

** Excluding long-term credits but including capital repairs.

*** Including liquid fuels and probably uranium mining and atomic energy.

**** Excluding liquid fuels.

† The chief component is consumer goods.

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The general rate of economic growth indicated for the rest of the plan period is about the rate maintained since 1955. The cutbacks in planned industrial production are accompanied by cutbacks in trade and presumably in transport and communications. Some reduction has also been made in goals for agricultural production, with a projected increase of 17 percent in gross production of crops and animal products as against the originally planned increase of perhaps 25 percent. The new goals are lower for yields per hectare of grains, potatoes, and sugar beets; for the production of meat and milk; and for the level of mechanization of agricultural production. The goals for agriculture are still based more on doctrine than on experience.

The present plans call for about the following growth of gross output by sector of origin over the period:

<u>Sector</u>	<u>1960 Plan (1955 = 100)</u>
Industry	138
Construction	162
Handicrafts	115
Agriculture	117
Transportation and communica- tions*	120
Trade	130
All sectors	<u>134</u>

It is likely that not too much practical dependence is put on the plans for "additional" consumer goods production and on the projected increases in agriculture. The "realists" in the State Planning Commission probably continue to work on the assumption of an average annual increase of about 5 percent in gross output (and about the same in national income). In this connection it appears that the revised plans for investment and consumption in 1960 suggest a reduction of at least 10 percent in the original goal for national income in 1960, implying an increase of about 30 percent in national income over the period.

Present plans do not imply additional Soviet help except as it may be needed to finance export surpluses with other Satellites. Although a probable deficit in foreign trade in 1957 was acknowledged,

* Including services to households.

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it was stressed in published announcements that a deficit must not again be incurred. The plan figures show a projected increase by 1960 of 64 percent in exports and 59 percent* in imports over 1955, when there had been a substantial export surplus in commodity trade on commercial account. Even after allowance is made for some net deficit on commercial account for invisibles (chiefly transport charges), it seems likely that a small export surplus is planned, sufficient to cover interest on foreign indebtedness.

c. Probable Rate of Growth.

For the most part, the revised plans are quite "realistic" -- that is to say, not greatly at variance with the recommendations of East German management. The plans are likewise in keeping generally with the results achieved in 1956 and 1957. In short, the revised plans are really meant to be fulfilled (except those for agriculture and "supplementary" consumer goods production).

An annual average increase of 6 to 6.5 percent in gross industrial production is entirely possible, given the increases** of 6.2 and 7.3 percent achieved in 1956 and 1957, respectively. It should be stressed, however, that industrial employment, which declined slightly in 1956, increased by perhaps 2 to 3 percent in 1957 and that the growth of productivity in 1957 was lower. The current plan for 1958 calls for an increase in output of 6.8 percent, implying further planned increases of 6.4 percent in both 1959 and 1960.*** These goals can be fulfilled approximately, even if there is some lag in industrial investment. There is very little room, however, for underfulfillment of plans for importing industrial raw materials, and some further increases in employment, probably at the expense of other sectors, will be required.

For the construction industry the annual rate of increase in 1956 and 1957 was above the annual average rate (10 percent) required to reach the revised goal for the plan period, even though there is some question about the comparability of the fulfillment figures for these years and the 1960 goal. The chief reason for improvement since 1955 is the increase in the supply of building materials, which has led to a considerable rise in labor productivity (as well as some increase in employment) in construction. The construction industry is probably capable of meeting the 1960 goal if the production of building

* A later source gives a figure of 61 percent.

** Based on absolute figures. In both years, somewhat different percentage increases were given in the plan fulfillment announcements. The latter are considered to be less reliable.

*** Given the modified 1960 goal of 138 percent of 1955 production.

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materials reaches planned levels, although, again, additional labor will be required.

The revised goal for agricultural production still calls for an increase of 17 percent in gross production over the 5-year period. Under present government policies the outlook in agriculture is for annual fluctuations in crop yields within the range of the past few years and for continued increases in output of animal products; which, however, depend on imports of fodder grains.

In both trade and transport and communications, there is no particular reason to expect that present plans for employment and investment will not permit essential increases in service, although the transport system will be operating under even greater strain.

According to official announcements, national income (at current prices) increased by 5, 3, and 7 percent in the years 1955, 1956, and 1957,* respectively. Allowance being made for price changes, the rate of increase in each of these years was about 5 percent. It seems entirely possible for the East German economy to maintain about this rate of economic growth through the present 5-year period, but the prospects are not good for maintaining it in the 1960's.

The present rate of growth can be maintained for a short time simply by providing the necessary increases in raw material supplies, with only selective investments in the finished goods industries. The "inner reserves" of labor and capacity, however, are in almost all cases quite limited, as is widely recognized by East German management. Not only is there a tight labor supply in general, but also, and more seriously, there is a shortage of skills in certain areas (notably agriculture, mining, and rail transport) in which a large part of the trained labor is nearing retirement age. Given the generally full use of capacity, the growth of industry and the entire economy will be increasingly dependent on new investment. In addition, increased allowances must be devoted to replacing old and obsolete capital equipment. At present a serious effort is under way to improve East German capital accounting in the hope that the resources available for investment can be used more intelligently. There will unquestionably be renewed disputes, however, over the rate of growth permitted by a given level of investment, and attempts probably will be made to persuade the USSR to invest a substantial amount in the East German economy. Unless the USSR should decide -- as seems quite unlikely -- to make such an investment, the East German rate of growth will fall in the 1960's. Even in prospect, this is a trend of enormous political importance which will make it increasingly difficult for the USSR to avoid a choice

* The announced figure for 1957 applies to gross product.

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in East Germany between the risks of a more rigid and repressive regime and the risks of a considerably more flexible and "liberal" regime.

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