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Implications of the New Soviet Economic Plan

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IMPLICATIONS OF THE NEW SOVIET ECONOMIC PLAN

The USSR's economic plan and budget for 1968 and planned goals for 1969-70 reflect an apparent acceleration of the trend in economic priorities that began in 1966 in favor of the military establishment. Pressures for greater defense spending have increased during 1967 due to the USSR's concern over North Vietnam, the Middle East conflict, and the problem of China. The US decision to deploy a thin antiballistic missile (ABM) screen also strengthens the hand of the military spending advocates. The recent performance of both Soviet industry and agriculture has strengthened the USSR's economic base. In these circumstances, the Soviet regime apparently has decided that it can and will satisfy during the coming year at least some of the increased demands placed upon it by the military.

The state budget for 1968 provides for an increase of 2.2 billion rubles in defense expenditures above this year's planned total of 14.5 billion rubles. Although it is possible that actual military spending could rise by 2.2 billion rubles, this probably overstates the actual increase that will be expended for defense next year. Of this amount, some 1.5 billion rubles may represent planned real increases, with the remainder accounted for by price changes on military equipment, possible shifts in budgetary accounting practices, and the added funds required to finance a possible military pay raise.

In addition to the need to strengthen its defense posture, the Soviet leadership apparently also wants to at least imply that it can increasingly improve the living standards of its people. This is reflected in the 1968 plan's provision to expand the consumer goods industry at a faster rate than that of traditionally favored heavy industry. The provision of more butter as well as more guns in 1968, however, is to be accomplished by cutting back in investment in both new industrial facilities and in agriculture. The regime is thus taking a calculated risk inasmuch as serious problems will result if agricultural production stagnates and long-term growth rates decline.

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Background

The annual plan and budget speeches traditionally offer the most authoritative description of Soviet economic policy. Indeed, in many key areas, very little is published later to supplement the information contained in these two basic statements. Although the uncertainty surrounding military programs in the plan and budget speeches is always great, it is known that the overt defense budget does not cover all Soviet military outlays. Moreover, the degree of coverage has varied from time to time because of changes in accounting practices.

Nevertheless, when the USSR announces a substantial jump in military spending in an atmosphere of military and political tension, as it did this October, the announcement is a clear political signal that some shift in resources to military programs is almost certainly planned.

Political Considerations

Recent international developments have very likely increased the Soviet leaders' concern about the country's security, dictating the need to demonstrate a posture of strength and readiness. Some leaders may have interpreted the US announcement of its intention to deploy a thin ABM screen as a sign that the arms race is about to enter a new and enormously more expensive phase, which will tax Soviet resources but which the Soviet Union cannot avoid. Other leaders may be more

concerned that the trend in "local wars," such as in Vietnam and between Israel and the Arab states, means that the US has gone beyond "containment" and is trying to roll back revolutionary and socialist regimes. Finally, some may believe that in the relatively near future neighboring China is destined to become well-armed and potentially more hostile to the USSR.

In addition to these strategic considerations affecting its economic plans and budgetary measures, the regime also wishes to draw attention--especially during its 50th anniversary--to its ability to provide for the population's welfare while maintaining a high rate of economic growth. The Soviet leadership perennially is under pressure to stimulate the enthusiasm of the populace for "building communism" and thus obtaining willing participation from the people. In the same vein, the regime is seeking to prove to leaders in the emerging nations that "socialism" is a better way to develop national economies and improve standards of living than is capitalism.

The Soviet leaders thus appear to be in general agreement on the need to appear as resolute defenders of international progress and as capable providers for the wants of the Soviet people. The practical question of how these goals are to be reached, however, provokes sharp differences--some of long standing. This is essentially a question of making hard choices among the

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competing demands for Soviet resources. These demands are still resolved by compromise, not only between those leaders favoring more guns and those favoring more butter, but also among those favoring different types of guns and among those preferring different brands of butter.

The decision to provide more guns as well as more butter during the coming year means that investment in future capacity may not be forthcoming in sufficient quantity to provide for future needs. The present decisions on resource allocation could therefore lead to a decline

in long-term growth rates and to stagnation in agricultural production. The political consequences of such developments could be serious, inasmuch as the recent compromises probably do not fully satisfy any of the individual leaders and any future shortcomings probably would become the subject of acrimonious disagreement.

Adjustments in 1968-70 Goals

Although the increase in the announced defense budget for 1968 has drawn the most attention, the plan and budget announcements contain other

USSR: Revision of 1970 Plan Goals

Table 1

	Unit	Original 1970 Goal	New 1970 Goal
National income a/	1955 = 100 (index)	138 to 141	139
Industrial production	1965 = 100 (index)	147 to 150	149 b/
Individual products			
Oil	Million metric tons	345 to 355	350
Natural gas	Billion cubic meters	225 to 240	215
Electric power	Billion kilowatt- hours	830 to 850	807
Steel	Million metric tons	124 to 129	124
Fertilizer	Million metric tons	62 to 65	62
Plastics and resins	Million metric tons	2.1 to 2.3	1.8
Chemical fibers	Thousand metric tons	780 to 830	707
Motor vehicles	Million units	1.36 to 1.51	1.36

a. Soviet concept, which excludes services.

b. CIA calculation from Soviet announcements.

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indications of increased emphasis on military programs in 1968-70. The original goals for a major increase in national income and industrial production in 1966-70 have been reaffirmed, but a number of the original 1970 goals in key nonmilitary areas were pared back. Either the original goals are actually reduced or the new 1970 goals are now set at the lower limits of the ranges originally set out by Kosygin in 1966.

Not only have production goals been cut back in certain major sectors of industry, but also investment goals for those sectors are lower than those originally set for 1970. The concentration of the cutbacks

outside of the military-oriented machinery industry, coupled with the reaffirmation of the target for industrial production as a whole, suggests a plan revision that would accommodate a boost in military expenditures above levels previously planned.

Economic Implications

Soviet gross national product (GNP) grew at an estimated annual rate of nearly six percent during 1966-67, which was somewhat faster than during 1961-65 but still below the average for the 1950s. During 1966-67, a rising share of GNP was allocated to defense. Consumption also may have increased somewhat faster than GNP. Investment, essential

USSR: Average Annual Rate of Growth
in Gross National Product and Its Components
1951-70

Table 2

	<u>1951-60</u>	<u>1961-65</u>	<u>1966</u>	<u>1967 b/</u>	<u>1966-70 Plan</u>
Gross national product <u>a/</u>	6.7%	4.8%	7.8%	3.8%	6.0%
Agricultural output	4.1	3.0	10.9	-3.4	4.7
Industrial output	9.7	6.5	7.5	8.5	8.3 <u>c/</u>
Other <u>d/</u>	7.2	5.4	5.9	6.3	6.3

a. Unless otherwise noted, all data are CIA estimates.

b. Preliminary.

c. Mid-point of Soviet official plan range.

d. Construction, transportation, communications, and services.

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for future economic growth appears to have been only the residual claimant in these two years.

Agriculture

Planned agricultural investment is likely to have been one of the first victims of increased military spending. Net

agricultural output increased an average of 3.5 percent per year in 1966-67, largely because of favorable weather. Total grain production is estimated at about 140 million metric tons in 1966, and at 115-120 million metric tons in 1967. This allowed grain stocks to be rebuilt, with the result that the USSR did not have to use its

USSR: Planned and Actual Flow of Resources to Agriculture 1966-70							Table 3
	1966		1967		1968	1966-70	
	Plan	Actual	Plan	Actual	a/ Plan	Plan	
<u>Machinery deliveries</u>	Average Annual Rate of Growth (Percent)						
Tractors	9.8	15.7	3.6	0.4	10.4	13.7	
Trucks	85	51	41.5	-13.2	79.3	40.9	
Other agricultural machinery	n.a.	3.6	11.6	0	19	13	
<u>Mineral fertilizer deliveries</u>	9	12.8	5	9.4	5.4	15.2	
<u>Land reclamation program</u>	Million Acres						
Gross additions to irrigated and drained area	2.5	2.8	2.4	2.4	2.8	21 to 23	

a. Preliminary.

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scarce reserves of gold and hard currency to purchase large emergency wheat imports either this year or last as it did in 1963-65.

The success in agriculture apparently has led to a significant cutback in prior plans for 1966-70 to allocate large additional investment resources to that sector. Shaken by the grim necessity to import large quantities of wheat in the early 1960s, the regime incorporated in plan directives for 1966-70 large increases in machinery deliveries above those of 1961-65, a doubling of the output of mineral fertilizer, and the irrigating and draining of more than 20 million acres of land. These plans are far behind schedule.

Two other elements of the 1966-70 agriculture programs--a greater role for private activity and greatly increased monetary incentives--have been carried out in varying degrees and probably contributed to the agricultural success in 1966-67.

The agricultural successes of 1966-67 apparently have resulted in large cutbacks in Brezhnev's many-faceted program "to get agriculture moving again." Historically, commitments to agriculture have provided a convenient investment to cut when crops happened to be large and other claims on resources seemed more urgent. This seems to be happening again, but the regime cannot count exclusively

on above-average weather plus rubles in the hands of the peasants to cure the chronic ills of Soviet agriculture.

A recent article by politburo member Polyansky, published after the 1968-70 plans were approved, asserts that agricultural investment is indeed being slighted in the new guidelines. In any case, the 1966-70 goals for agricultural production cannot be met cheaply; investment in real resources will have to be revived if the goals are to be realized.

Industry

Industrial production in 1966-67 grew at an annual rate of 8 percent, somewhat above the 6.5 percent average annual rate for 1961-65 but below the average of the 1950s. The output of most major industrial commodities is approximately on schedule.

Contrary to long-standing Soviet doctrine about the primacy of heavy industry, production of consumer goods--both durable and nondurable--increased at approximately the same rate as the output of producers' goods. In 1968 the growth rate of consumer goods is planned to exceed that of producer goods. The especially rapid rise in the output of the food and light industries was made possible by the sharply increased availability of agricultural raw materials from the bumper harvests in 1966. Indeed, the growth of these industries accounts for

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almost one half of the acceleration in over-all industrial growth.

Two notable developments characterized machinery output in 1966-67. First, unlike the recent past, the rate of growth of military-oriented machinery

was much more rapid than that of civilian machinery. Second, also in contrast to past practice, the consumer-durables component of civilian machinery increased far more rapidly than the producer-durables component. These two developments indicate a significant diversion of

USSR: Average Annual Rate of Growth
in the Allocation of Machinery
1961-70

Table 4

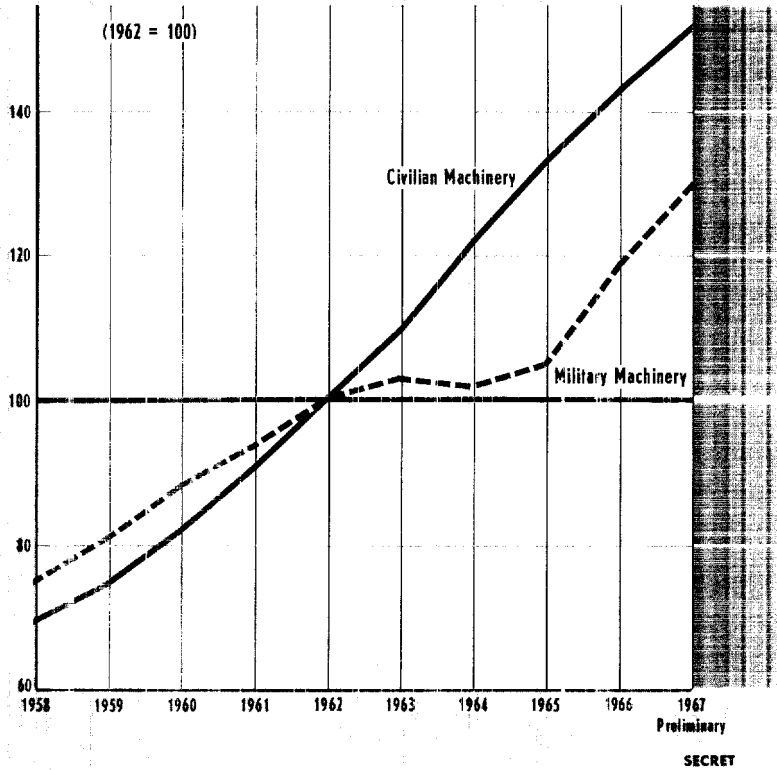
	<u>1961-65</u>	<u>1966</u>	<u>1967</u>	<u>1966-67</u>	<u>Original 1966-70 Plan</u>
Total machinery <u>a/</u>	7.4%	9.7%	7.2%	8.4%	10 to 11%
Of which:					
Military	3.5	13.6	8.9	11.2	8.5 to 12
Civilian	10.3	7.2	6.2	6.7	11
Of which:					
Equipment for investment	10.4	5.4	4.7	5.0	10.5
Consumer durables	10.1	13.2	10.8	12.0	13.0

a. Data on performance in 1961-67 are CIA estimates. Figures for the 1966-70 plan are CIA calculations based on Soviet plan announcements.

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Figure 1

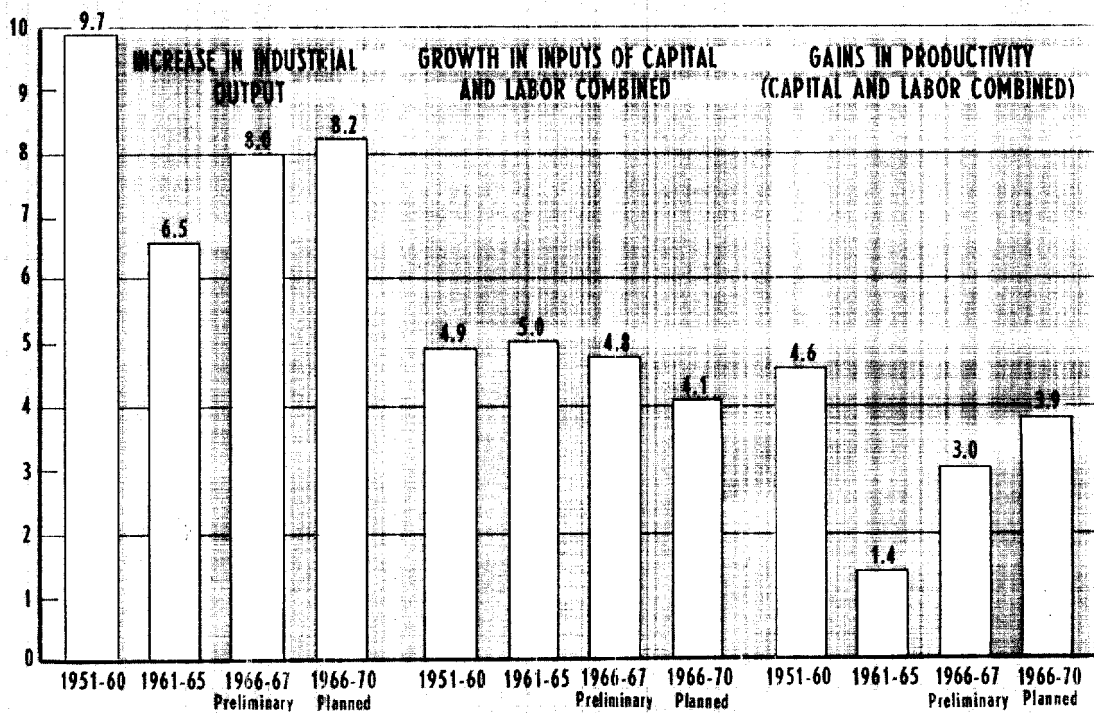
USSR: Indexes of Production of Civilian and Military Machinery
1958-1967



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Figure 2

USSR: Growth of Industrial Output, Capital and Labor, and Productivity 1951-1970
(Average annual rates in percent)



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machinery output in 1966-67 away from investment purposes to military and consumption purposes.

The moderate acceleration in industrial growth in the past two years reflects increased productivity. Combined inputs of labor and capital (plant and equipment) grew a bit slower than in 1961-65, but the growth in their productivity doubled. The annual gain of three percent during 1966-67, however, is still far below the rate planned for 1966-70 and that actually achieved during the 1950s.

Several factors account for the large rise in the growth of productivity: a much greater availability of agricultural raw materials; actual operating capacities in a number of major industrial plants were brought nearer to planned levels; and the economic reform currently being carried out in industry. Soviet sources, however, repeatedly attribute the initial successes of economic reform to one-time factors, such as the using up of excess stocks of products and materials.

Consumer Welfare

Soviet consumers fared exceptionally well in 1966-67. Real income per capita--which includes wages, farm incomes in kind, and payments from the state budget--rose nearly 6 percent per year, compared with about 3.5 percent in 1961-65. Thanks primarily to the good crop years, per capita consumption of goods and services in

1966-67 rose almost as fast as real incomes and double the rate in 1961-65.

Despite the increased flow of consumer goods, inflationary pressures grew stronger in 1966-67. Considerable inflationary potential already existed in the economy as a result of past policies that provided large quantities of rubles unmatched by foods and services. Per capita disposable money income rose much faster than called for in the 1966-70 plan and considerably faster than the consumption of goods and services. As in the recent past, a substantial part of the excess purchasing power was absorbed in voluntary savings; savings bank deposits increased about 20 percent per year in 1966-67. This means, however, that the people expect housing and durable goods to be made available in the future.

The single clear feature of the 1968 and 1969-70 plans in the area of consumer welfare is the announced rise in money incomes of the population. In part, the increases in incomes stem from a wage creep associated with rising labor productivity and normal higher growth in welfare payments in the form of pensions and other transfer payments. Nevertheless, the planners are carrying out a series of wage and welfare reforms that could have been postponed--a higher minimum wage, increased disability pensions, a lower retirement eligibility age for collective farmers, and other lesser benefits.

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What the new plans for 1968-70 do not say is how goods and services are to be provided to meet the swelling consumer demand. As incomes increase, the demand for more and better quality goods is bound to become more insistent. The 1968 plan suggests, however, that the regime does not intend to make any major adjustments in the original five-year plan directives in the area of consumption.

The output of consumer goods in 1968 is to grow at a higher rate than other industrial production--8.6 percent, compared with 7.9 percent. However, previous attempts to close the gap between rates of growth of consumer goods and producer goods foundered. The same elements that contributed to previous failures are present now: plans depend on an unreasonably high assumption about the receipts of consumer industry of agricultural raw materials; and, with investment being pressed down, plans for expanding and renovating consumer industry will be the first to be jettisoned.

Outlook: Two Risks

The increased allocation of resources to the military will

accentuate the current slowdown in the flow of new industrial investment and may force the USSR to operate an increasingly obsolescent industrial plant. This fall in the rate of introduction of new technology will affect adversely the potential for increasing industrial output and improving its quality. Thus, the leadership is taking a major risk in diverting investment resources to military use when these resources may be vital to improving the long-term quality of the industrial plant.

In similar fashion, Soviet agriculture in most years carries out its basic task of providing sufficient calories for the population, but needs to move to a higher level of organization, technology, and diversity of output. Greatly increased production of meats and other quality foods requires a large, sustained investment. This investment, which is one major prerequisite for sustained growth, was provided for in the Brezhnev program. The substantial cuts in this program represent the second major risk taken by the leadership--namely, that future gains in agricultural production are made more precarious. (SECRET)

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