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MEMORANDUM

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THE WHITE HOUSE
WASHINGTON

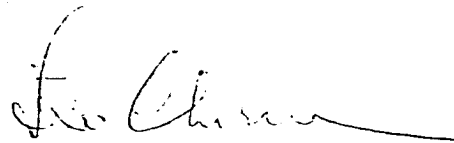
May 12, 1982

MEMORANDUM FOR THE PRESIDENT'S FOREIGN INTELLIGENCE ADVISORY
BOARD MEMBERS

SUBJECT: Proposed Report on U. S. Economic Intelligence

Attached is the proposed Report on U. S. Economic Intelligence prepared by the Economic and Natural Resources Task Force. Members of the Task Force are:

- Chairman - John Connally
- Co-Chairman - Leo Cherne
- David Abshire
- Martin Anderson
- Alfred Bloomingdale
- W. Glenn Campbell
- Peter O'Donnell
- H. Ross Perot
- Joe Rogers
- Robert Six



Leo Cherne
Co-Chairman
Economic and Natural Resources
Task Force

Attachment: a/s

(Mr. Cherne gave to DCI)

DCI gave cy to: DDI (Mr. Gates)
SA/DCI (Mr. Meyer)

ER/ES sent cy: EXDIR
ER File

3 JUN 1982

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APPENDIX A: GENERAL OBSERVATIONS

SURPRISE AND ECONOMIC INTELLIGENCE

Areas which suddenly increase in importance as a result of present or projected crisis and which require economic intelligence, are often not high on the priority ladder and, consequently, were not previously given the attention suddenly made necessary. Available economic intelligence in such situations is usually deficient in illuminating optional policy responses. This has been true of Central America, the Caribbean and Eastern Europe.

THE NEW QUICK-REACTION CAPABILITY

A corrective step taken by the DCI has already helped to overcome this deficiency. The intelligence community has been required to develop a "quick reaction capability." These rapidly prepared assessments have been provided, in fact, in recent months and they have been helpful in the policy process. Where a low priority had previously governed intelligence directed to that area, there is necessarily less depth, often of economic intelligence which has been accumulated and available to throw maximum light on the policy choices.

THE OFFICE OF GLOBAL ISSUES

A more fundamental step has been required, and personally directed by the DCI Casey, which offers considerable promise that surprise will find us less and less wanting. An office of Global Issues has been created within the CIA to deal with intelligence requirements in those parts of the world which increasingly challenge our economic strength and stability because they have developed significant technological strength enabling them to threaten our primacy as well as to impede our ability to withhold significant

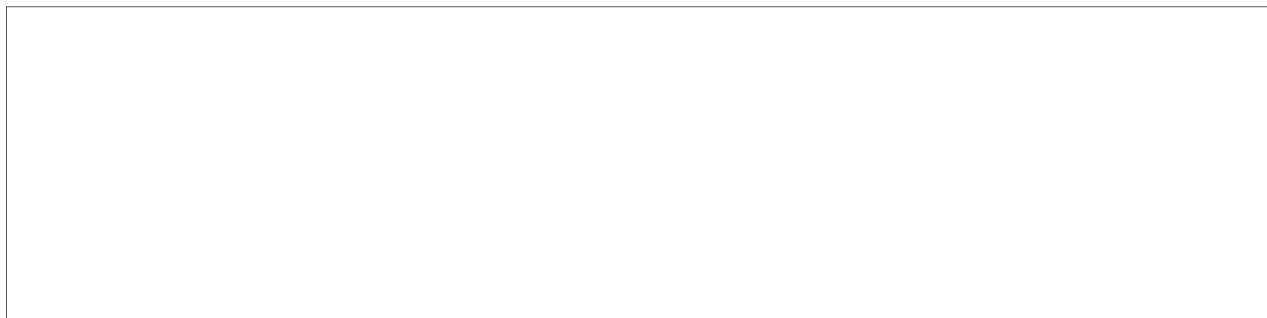
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military and industrial technology from the Soviet Union or other adversaries. The Office of Global Issues was brought into being to deal with intelligence needs that cut across geographic area boundaries as well as to develop the capability to meet a host of new intelligence estimating needs as we face the crises most likely to occur in the future.

THE INTEGRATION OF AREA ANALYSTS INTO MULTI-DISCIPLINED INTELLIGENCE

A substantial reorganization of the CIA's analytic community, initiated by the DCI in the fall of 1981, promises a significant improvement of all forms of analytic intelligence, including economic. The various forms of intelligence have been combined so that the specialists in the different disciplines all function together as a joint enterprise, focusing on the geographic area of the world to which their work relates. The synergism expected from the combined intelligence disciplines should make more useful and sophisticated the output of previously separate analytic staffs.

There is discontent in some sections of the analytic community as a result of this reorganization. It remains to be seen whether the dissatisfaction has any significance beyond the normal resistance to change.



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The problem of information overload is one which PFIAB urged attention in the mid 1970s. The problem has not been solved and may, in fact, be

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more severe as a result of the improvements in memory and speed of the technology employed. PFIAB should give continuing attention to this problem.

SHORTAGE OF SPECIALISTS WITH FOREIGN LANGUAGE CAPABILITY

Among the handicaps to improved intelligence is one which is frequently acknowledged -- serious shortages of personnel with adequate foreign language competence and expertise in the cultural and historic backgrounds of particular areas in crisis. Some of the areas in which there is a shortage of such competence, for example , are of obvious importance. This deficiency, not quickly remediable, is as evident in the processing of technical intelligence by the NSA as it is in the CIA. We have no information whether this same deficiency diminishes the contribution which can be made by human intelligence. To some extent, it is logical to assume that to be the case.

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RESISTANCE TO NEW AND MORE QUALIFIED PERSONNEL

Improving the quality of intelligence staffs runs into another staffing barrier. It is difficult to improve quality by attracting new professionals who have substantial capability, unless one can place these more experienced individuals at appropriate levels within the organization. The intelligence structure, like all bureaucracies, resists introducing any newcomer at higher levels of professional work than those already in place.

RELATIVE QUALITY OF VARIOUS KINDS OF INTELLIGENCE

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APPENDIX B: THE CHANGING NATURE OF ECONOMIC INTELLIGENCE

Foreign based economic problems faced by the U.S. during the 1970s were essentially defensive ones for us:

- 1) Oil shortage and U.S. petroleum dependency on unstable foreign sources.
- 2) Consequent concern about U.S. dependence on foreign sources for strategic and critical materials
- 3) High technology flow (legal and illicit to the Soviet Union)
- 4) Massive reserve fund accumulations by Persian Gulf members of OPEC -- with feared threat, now diminishing, to the stability of the Western banking and financial structure.

U.S. economic intelligence during the 1970s mirrored our concern with these threats and was, and largely continues to be, a servant of policy designed to minimize shocks and threats. This economic intelligence capability has, in the last decade, grown and improved.

Even though the need for economic intelligence for defensive policy continues, a new need has arisen which, not surprisingly, is only partially satisfied by the intelligence community.

If the essence of the need for economic intelligence in the 1970s was to enlarge our ability to defend our interests against shocks to our economy and those of our allies, an altogether new emphasis is likely to dominate today's and tomorrow's foreign policy concerns and intelligence needs. This new intelligence focus flows from the increasing need to retaliate in circumstances which threaten our national interests.

Several serious crises during the last few years illustrate this changing need for the exercise of U.S. national power through the application

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of economic and political measures rather than the traditional reliance on military strength.

--the taking of hostages by Iran resulted in the application of economic penalties.

--the invasion of Afghanistan led the U.S. to impose an embargo on the sale of U.S grain to the Soviet Union.

--the military takeover of the government of Poland and the application of martial law, led to a debate within our government, and extensive disagreement within the Western alliance, as a variety of economic responses were considered. No measure which was considered proved equally useful or acceptable in its effect on the U.S. economy and the economies of our closest alliance partners. Nor were the real and long-term effects on the Soviet's client states in Central Europe sufficiently clear. In addition, the dynamic effects on the Soviet Union, which would result from these debated reprisals, were inadequately illuminated by economic intelligence.

The Soviet Union is in a period of significant demographic, economic and political stress. The economies of Central Europe are extremely troubled. In Europe, our conventional military responses are at best hobbled and our capability deficient. Yet our economy, despite the difficulties we presently confront, has no equal. But we are unable to bring this overwhelming strength to bear to meet our necessities and opportunities as we face the actions of our adversaries. To do so, in the very first instance, requires that our intelligence be able to play its role in providing the essential knowledge and judgments to illuminate our options and their short and long run consequences.

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The most important judgment this Board can make is that further strengthening of economic intelligence, a process already underway, is essential if we are to be able to use the most powerful element of our national strength -- the size and strength of the American economy. To do this, economic intelligence must, while continuing its defensive attention, move more creatively to production of estimates and analysis which provide vital judgments on the range of tactical and strategic measures which may be required to:

- a) Assist in the rapid adoption of tactical policy decisions needed to discourage or respond in retaliation to threatening or adverse Soviet behavior.
- b) Assist in the formulation of strategic economic policy designed to stimulate or coerce long-range modification of Soviet directions and capability.

PROPOSED REPORT ON U.S. ECONOMIC INTELLIGENCE

May 10, 1982

It was the decision of this Task Force that its initial effort should be focused on the adequacy of intelligence in the following areas:

Assessment of Soviet strengths and weaknesses

Economic means of maximizing:

Soviet dependency
Soviet vulnerability
Soviet injury

Dynamic assessment of impact of:

denial of U.S. grain
denial of gas pipeline assistance
denial of credits
denial of specific technologies

and other methods of reprisal against Soviet repression, aggression, adventurism and the exploitation of instability elsewhere in the world.

We identify this as the first effort, but it should not be understood to mean that we are content with existing economic intelligence, either in areas of resource stringencies or constraints which threaten our national security. There are other areas as well to which this Board will devote its future efforts.

The urgency and value of this effort to see that economic intelligence more adequately meets the needs of policy in these directions is clear from the consensus judgment about the problems the Soviet Union is likely to face in the years immediately before us.

The assessment presented to us by the top Soviet analysts within CIA conveys the following:

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The 1980s will be a decade filled with considerable difficulty for the Soviet Union. An unprecedented congruence of economic difficulties together with problems which flow from a change in Soviet leadership succession is likely to occur in an environment of significant pent up tension. The demands on U.S. policy -- to capitalize on opportunities to advance U.S. and Western security interests, and minimize undesirable outcomes in a timely fashion -- are likely to be heavy.

If any doubt remains about the urgency of this intelligence task, it was dissipated by a candid judgment made to this Task Force by DCI Casey: "We do not know sufficiently the way in which the Soviet Union operates."

STRENGTHS AND WEAKNESSES OF THE SOVIET ECONOMY

The operating consensus within the CIA as it assesses Soviet industry, labor force inadequacies, demographic change, present and future resources and their geographic location, an inadequate infrastructure, particularly of transportation systems, stress the following economic facts and projections.

Major Elements of Soviet Strength:

The principal strengths of the Soviet economy are its size (second largest), large base of natural resources, a labor force that is 1½ times that of the U.S., an unchallenged commitment to military growth, and the ability to produce modern and formidable weapons in quantity.

Principal Basic Chronic Weaknesses:

On the other hand, production of consumer goods is abysmal, and the agricultural sector is one of the least efficient areas

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of the Soviet economy. Additional resources applied to agriculture have produced little or no return.

The Soviet system tends to reproduce its industrial structure in the same form and in the same locations with consequent weaknesses and deficiencies.

The USSR's dependence on external technology is believed to have caused a consequent degradation in their own technology base, except in the production sector devoted to meeting military needs.

There are no built-in balancing forces. Thus, for example, heavy industry continues to be emphasized at the expense of consumer goods. This may lead to political problems for the leadership. It is likely to exacerbate both the labor force problems and the demographic tensions which lie ahead.

Growing Resource Stringency:

The Soviet Union is moving into an era of great resource stringency. The Soviets have exploited areas of rich resources to the fullest, and are now finding it increasingly difficult to sustain, let alone increase, production of oil, coal, and iron ore (but not precious metals, including non-ferrous strategic metals such as titanium).

They have depleted the areas that geographically are easily accessible and which incur lower extraction and production costs. They have large resource reserves but the quality of those unexploited resources is not as good and their locations make them more difficult and costly to exploit. Extracting these new resources will require enormous additional investment and an infrastructure not now in existence.

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For example, the Donets coal basin that produces the world's best grade of coking coal is in decline. The vast coal fields of Siberia produce a much lower grade of coal that must be shipped via the single Trans-Siberian rail line to the industrial concentration west of the Urals. Much of the coal is lost enroute because it auto-ignites and smoulders on exposure to air and significant quantities are eventually reduced to ashes.

The Russians (or anyone else) have yet to develop the technology to permit electrical transmission over the great distances involved, thus negating the option of transforming the coal into energy in Siberia. Any other alternatives, such as building factories in the east, would involve enormous cost, vast transportation problems and labor force resistance or unavailability.

Declining Oil Output:

To sustain oil production during recent years, the Soviets have resorted to pumping water into the more depleted oil fields in order to salvage as much oil as possible. Unfortunately, as more water is pumped into the oil fields, there is more water and less oil in each barrel pumped resulting in higher and higher costs per barrel of oil produced. Because oil exports are a major source of hard currency for the USSR, they have cut back on shipments to the Bloc countries. The foregoing premise is the essence of the CIA analysis of future Soviet oil stringency. We nevertheless remain restless without, at this point, being able to challenge this conclusion. Our discontent flows from the fact that so long as there is oil in the ground in significant quantities, and this fact is conceded, one cannot conclude that they will refrain from finding ways of extracting that petroleum. There is, for example,

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the possibility that the new leadership in the Soviet Union in the course of the succession transition, may choose this area as one of priority concern.

The New and Growing Labor Force Problems:

The present premise which animates the following expectations is that of the CIA Soviet analyses.

Although the total population of the Soviet Union continues to grow, the Russian proportion of the total population is gradually declining, resulting in an increasingly inadequate skilled labor force. (The overall population increase results from a growing in the non-traditional Great Russian population area.) Sixty percent of the population is under 40. Until the mid 1970s, they were accustomed to yearly increases in their standard of living, but in recent years the standard of living has remained static. This both reduces labor incentive and may find these younger workers less docile.

Given that (1) the economy is very dependent on labor-intensive processes; (2) the skilled labor force is not growing adequately; and (3) there are severe restraints on the availability of capital for investment in labor-saving methods, the Soviet economy is expected to take an abrupt and steep down-turn in the mid-1980s.

Severe Decline Expected in the Economy of the USSR:

Labor productivity has already fallen drastically. There has been a continual slide in capital investment. Whereas they used to invest 5 to 6 percent of GNP per year, planning through the mid-1980s calls for only 1.6 percent of GNP for investment per year. The outlook through the mid-1980s is one to two percent growth per year in economy. There may be a one-time rebound next year if the weather permits a good harvest.

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(We insert here a strong caution about being seduced by any one coherent premise when it is one of the functions of the intelligence community, and certainly the function of this Board, to raise questions about the reliability of assessments, no matter how logical they appear to be at the particular moment. If one were to examine in our own economy the surprises which have been thrust upon us by changes that have taken place within the last decade or two, a certain measure of humility would emerge.

These comments are not made in criticism of either the professional capability of the economic intelligence analysts or the logic which leads them to their present conclusion.)

Deficient and Archaic Transportation Capability:

The Soviet transportation system (consisting primarily of railways since the USSR has neither a highway network nor numbers of trucks comparable to the U.S. or Western Europe) is stretched to the breaking point now. It is not expected to be able to meet future needs. As an example, harvest time requires a huge diversion of available transport to move harvested grain, resulting in a period during the fall and early winter when materials to be transported become back-logged. Each year the period of back-log has become longer and this year it wasn't cleared until February of 1982.

The Growing Need for Hard Currency and Foreign Credits:

Perhaps their most vulnerable area is that of credit. They are in a hard currency bind, with their debt now at \$20 billion and growing. A \$20 billion debt would normally be readily manageable, but for the essential unconvertability of their currency, an

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urgent need for imported grain and industrial equipment, the dependence of the increasingly troubled Bloc nations and the consequent need for credits. (The debt of the Bloc states adds an additional \$50 billion which they find increasingly unmanageable.) The USSR is running out of hard currency earning capacity with problems in oil, coal and steel production; no new clients for arms sales, while facing the continuing need to import grain.

As a result of population growth, nearly static grain output and Brezhnev's decision to increase meat production, the Soviet Union moved from being a grain exporter in the sixties to being an importer in the seventies and continuing into the eighties.

There is an essential and unstated premise in the CIA projections that, having learned the lessons we already have, especially in Central Europe, further credits in significant amounts are not likely to be readily forthcoming. We register skepticism that this in fact will prove to be the case.

The vigor with which capitalist institutions, including the financial institutions, respond to real or illusive benefits cannot be underestimated. The fact that private interests will be moved to serve private purposes makes all the more urgent the maximum intelligence illuminations of the effects of the options under consideration. In any event, as the Soviet ability to earn hard currency degrades, they will find it increasingly difficult to maintain the required level of food imports. There will be other problems for the Soviets resulting from the decline in export earnings that they are now facing. How can they (1) continue to support their clients, (2) continue military growth, and (3) satisfy the 60 percent of the population that is under 40 as the country faces a static standard of living?

The Increasingly Imminent Change in Leadership:

There are additional uncertainties and difficulties added to the mid-1980s period for the Soviets as a result of Brezhnev's approaching replacement. There will be increasing jockeying for succession within the Politburo. Every change of leadership since Stalin has seen a major change of some aspect of national policy, so whoever succeeds Brezhnev is also likely to institute major changes as well.

THE CRUCIAL PROJECTED CHANGE IN THE SOVIET ECONOMY

If the preceding CIA assessment is essentially accurate and there is no reason to question major elements of it (birth rates and the changing demography are already unalterable), the problem for the Soviet Union may be quite starkling. For the greater part of Soviet history, the location of its key industries, its basic energy sources (oil, coal and water), the location of its trained labor force, its major universities and the location of its scientific, technical and managerial personnel, the location of the bulk of its grain and meat output, was concentrated in the heartland of European Russia. While widely dispersed and with chronic transportation deficiencies, this, nevertheless, provided the base for an integrated economy.

The economy which will emerge during the balance of the 1980s in some profound ways changes and stresses the dynamic interplay of each of these basic elements in the economic structure. The bulk of industrial activity, including that segment devoted to military production, will continue, as in the past, to be located in the Soviet European heartland. So too will the increasingly deficient agricultural production as well as the Institutes and

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Universities which produce the Soviet's scientific, technical and managerial personnel.

More and more, however, energy production will concentrate in the distant areas where new oil and gas, as well as the hoped-for additional coal, will be exploited. Climate, and inadequate manpower, will exacerbate the fact of distance and the inadequacies of transportation. Increasingly, the growth of populations needed to un this scattered industrail structure will be located in distant south eastern sections of the Soviet Union. This growth sector of the labor force of tomorrow will be increasingly Islamic, increasingly untrained, and increasingly unmotivated either for the work which will be required or the shift in their location made necessary by the new demands in industry and energy exploitation.

In the opinion of the Board, this conclusion is all the more convincing because it tells us what we would like to hear, and is therefore needful of careful and objective scouting within the Intelligence Community. This may prove to be a most useful area for competitive analysis involving, on the one hand, the very best of the Intelligence Community's Soviet experts, and on the other hand, outside economists trained in the expertise of economic forecasting.

WHAT WE KNOW AND DON'T KNOW ABOUT THE SOVIET ECONOMY: THE IMPLICATIONS FOR ECONOMIC INTELLIGENCE

The following judgments emerged from the series of briefings presented to this Task Force, amplified by additional meetings with the key officials in the Soviet Division of the CIA.

1. We do have adequate to good understanding of the operation of particular Russian industries. Our knowledge is best concerning those sections of the economy directly related to military output.

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2. We do not have uniformly adequate knowledge of the work and relative progress of the research, technology and scientific communities in the Soviet Union.

3. We have an excellent knowledge of the acute deficiencies of that portion of the economy devoted to consumer goods.

4. We have superior knowledge of the output of Soviet agriculture and a remarkable record in crop forecasting.

5. The intelligence community, for obvious reasons, has devoted considerable attention to the outlook for Soviet petroleum production. We appear now to have a reasonably good fix on this. Nevertheless, we are concerned that there exists a potential for projective error, with large policy implications.

6. We know that the Soviet economy has experienced increasing problems; that it suffers from a severe shortage of hard currency; that the completion of the gas pipeline will provide substantial European currencies; that credits are all important to the growth of the Soviet economy which, in the last few years, has been slowing down markedly.

7. Knowledge of the dynamic interplay among various segments of the Soviet economy is the most vital element in which our intelligence is deficient, and in a closed society, difficult to rapidly remedy. The absence of this knowledge is a serious impediment to the making of policy designed to have the effects upon the USSR which we seek. Among the policy issued in which decisions should be made with greater confidence that intelligence has provided adequate illumination of the dynamic or ultimate consequences, are the following:

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- a) the building of turnkey industrial facilities by foreign contractors
- b) specific retaliatory measures in response to crises such as those which have occurred in Afghanistan or Poland
- c) specific decisions which are made in relation to the transfer of technologically advanced knowledge, components or products. The depth of knowledge and the dynamic effect of any of these measures does not exist sufficiently to provide the policymaker with the widest range of available options. In many instances, existing intelligence can only provide knowledge of the immediate effects expected to result from particular denials or reprisals.

"For want of a nail, a kingdom was lost." Our knowledge of which nails hold what together is deficient. This is essential when we need to know the ultimate economic consequences, beneficial or detrimental, which are the results of each option under consideration. Such intelligence is especially essential if we are to correctly identify which measures will, in the longer run, have the effect on the USSR which our policy seeks.

In one area we can be confident that we have identified a vulnerability, and a policy directed to that vulnerability, of which the short and long range effects appear reasonably clear -- the denial of credits. Yet, even in this connection, intelligence adequate to understanding the dynamic operation of the Soviet economy is deficient. The relationship between the Soviet economy and the Warsaw Pact economies dependent upon the USSR is inadequate. The absence of confident, economic intelligence assessments addressed to these vital connections is of immediate significance as we face U.S. decisions and those of our allies made necessary by the worsening economic plight of Poland, Rumania, Czechoslovakia and Hungary. Similar economic difficulties in Yugoslavia involve related but separate assessments.

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Unfortunately, those with the requisite skills, e.g., economists trained in forecasting, are found neither in CIA nor in any other government agencies.

INTELLIGENCE TASKS FOR THE FUTURE

Each aspect of this increasingly fragmented and stressed economy requires the most detailed and accurate continuous observation and assessment.

William J. Casey, then as a member of PFIAB in late 1976, summarized the needs of economic intelligence as directed against the Soviet Union:

Over the period 1977-85 policymakers will have a need for more precise intelligence and estimates on--

the level of the Soviet military effort and its impact on the Russian people.

the stability and the vulnerabilities of the Soviet economy and its ability to carry the military burden placed upon it.

the economic leverage we may have to induce the Soviets to scale down their military effort.

the significance of technological, financial and organizational impacts provided by the West to the growth and vigor of the Soviet economy and its ability to sustain a high level of military effort.

It is encouraging to conclude our observations by reporting that the new intelligence need is now understood not only at the top levels of the intelligence community, but also by those who direct Soviet economic intelligence within the CIA. Since the most urgent policy decisions likely in the immediate and long range future will be within this context, maximum effort must be devoted to converting this awareness into more adequate economic intelligence.