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Quarterly Bulletin on Soviet Economic Growth



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Second Quarter 1986

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SOV SEG 86-003
August 1986

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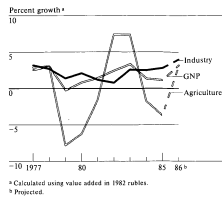
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*SOV SEG 86-003
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Gorbachev Presses Soviet Economy for Further Improvement

A. Good Economic Growth Outlook for 1986

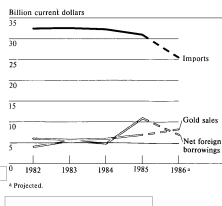
The Soviet economy is doing better under General Secretary Gorbachev, but he is impatient for improvements in the quality as well as the quantity of output. The outlook for growth in 1986 is good overall, with gross national product projected to increase 3 to 3 1/2 percent. Industry probably will come close to reaching its 4.3-percent growth target this year. After disappointing results in 1984 and 1985, agriculture appears headed for solid gains—except for a decrease in the grain crop.



After focusing on improving productivity through discipline and anti-alcohol campaigns, Gorbachev is intensifying his attack on the difficult problem of modernizing the industrial base. Toward this end, investment has shown a marked increase, especially in machinery. The recent firing of two ministers because of the continued poor quality of civilian machinery, however, indicates that he is not satisfied. Meanwhile, Gorbachev's strategy of raising the volume and quality of new investment must take into account declining hard currency earnings, which are cutting into imports of Western equipment needed for modernization.

D. Trade Problems Growing, Imports Slashed

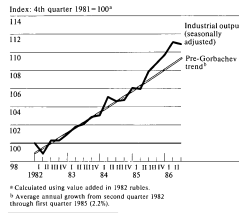
Falling world oil prices are squeezing Soviet hard currency export earnings and beginning to take their toll on imports of goods from the West. In the first quarter of 1986, the USSR ran a \$1 billion hard currency trade deficit. Export earnings for the remainder of the year are unlikely to improve and could decline further as the full impact of continued low oil prices is felt. The depreciation of the dollar has further contributed to Soviet trade problems because oil, the principal export, is sold in dollars and most imports are purchased in other hard currencies. As a result, with oil selling at lower prices and dollars buying less, we expect the ratio of export prices to import prices to drop to a 13-year low in 1986.



In response to the decline in export earnings, the Soviets have been unwilling so far to borrow sufficient hard currency to maintain imports at 1985 levels, but they have increased gold sales. Several large investment projects, which were under negotiation at the beginning of the year, have been cut back, postponed, or canceled.

B. Better Industrial Growth Continuing

Industrial production in first half 1986—which we estimate from official statistics—was roughly 5 percent higher than output in first half 1985. Part of the increase reflects unusually poor performance early last year because of the coldest winter in two decades. First-half growth this year over second half 1985 was slower—a little more than 3 percent (seasonally adjusted)—but still better than before Gorbachev assumed power. Output in the second quarter (also seasonally adjusted) was off slightly from that in the first quarter, but in the past such slips have usually been temporary.



Several problems that previously held back growth have eased. Oil production averaged 12.2 million barrels per day in first half 1986—its highest level in two years. Nearly all of the increase occurred in western Siberia, largely because idle wells returned to production, the pace of drilling and well completions rose sharply, and gas-lift operations improved. Rates of growth in transportation and the production of basic materials—metals, chemicals, cement, and timber—also are higher in 1986.

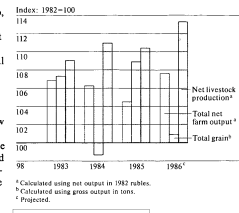
E. MBMW Report Card: High Marks for Growth, Low Marks for Quality

Despite respectable output growth, the machine-building and metalworking (MBMW) sector is under heavy pressure from the Soviet leadership. We estimate that output of civilian machinery in first half 1986 increased by a respectable 5 percent over first half 1985. Nevertheless, recent press reporting suggests that the Kremlin is worried about the sector's slow pace of industrial renovation, the marginal improvement in product quality, and the failure to upgrade its technological base sufficiently. In the past six months, seven of the 11 civil MBMW ministries have been criticized for one or more of these problems, and, in a highly unusual step, four defense-industrial ministries were recently criticized for the production of poor-quality consumer goods. The firing in July of two MBMW ministers, including one Gorbachev appointee, underscores the leadership's concern.

Ministry	Recent Actions and Criticisms
Machine-Building Ministry	Responsible for Production of Electrical equipment
Machine tools	Minister fired
Automation equipment and control systems	Minister fired
Household appliances and food and textile equipment	Minister severely criticized, under plan for quality
Construction machinery	Poor-quality, obsolete consumer goods
Chemical and petroleum equipment	Failed to meet goals for quality
Poultry, livestock, and fodder	Decline in rate of retrofiting equipment behind schedule
Heavy and transport equipment	Slow to retrofit
Automobiles and robots	Delivery of output behind schedule
Radar, computer, and radio equipment	Production of advanced equipment
Communications equipment	Minister criticized for poor-quality consumer goods
Ballistic missiles and space systems	Ministers cautioned about their "personal responsibility" for improving the quality of consumer goods
Electronic parts, components, and computer equipment	

C. Agriculture Looking Up

Despite weather-related problems with the grain crop, agriculture appears headed for a recovery this year. We estimate total farm output will increase by about 3 percent this year. This would be slightly above the previous high reached in 1983 and a welcome reversal of a two-year slide.



Production of meat and dairy products—spurred by ample feed supplies from a bumper forage crop last year—is continuing the steady growth of the past few years. Although it is too early to estimate the final output, the forage harvest is off to the best start since 1983 and should lead to further increases in meat and milk production. The outlook for grain is less encouraging. Given average weather during the harvest, the USSR should bring in a grain crop of about 182 million metric tons, nearly 15 million tons less than last year's estimated output and roughly equal to the mediocre 1981-85 average level. Perhaps indicating the regime's determination to pull agriculture out of its doldrums, deliveries of chemical fertilizers, feed additives, and some farm machinery were up substantially compared with those in first half 1985.

F. Push Toward Modernization

By the late 1980s, Gorbachev plans to rely on more and better machinery as the main source of growth in productivity and output. According to Embassy Moscow, when some Gosplan officials urged that Gorbachev settle for a slower rate of output growth in exchange for quality improvements, he refused and demanded rapid progress on both fronts. Investment, Gorbachev's key to the modernization program, rose sharply in first half 1986. State investment, about 90 percent of the total, increased by 10 percent over the same period in 1985. Investment in civilian machine building also grew rapidly—by 18 percent—but growth fell short of the 30-percent target for the year. The returns are not in yet on the call to double retirement rates of old equipment, another essential step toward modernization.

Gorbachev's View of Progress

The results... for the first half of this year... show that the positive changes in the economy, even if not to the same extent everywhere, are gaining force... The pleasing and encouraging improvements have been obtained first and foremost as a result of measures for strengthening labor, state, and plan discipline. People... have started to work better. They have pushed away drunkenness, and positive results are already there. But, along with the general favorable indexes of the half year, in some branches the rates of growth in May and June fell... An erratic pace of production continues to cause grave troubles as well as an insufficiently effective use of what we have at our disposal. The quality of output has not shown any marked changes for the better, and you know that this is our common misfortune... Any qualitative changes that would have really consolidated tendencies for an accelerated growth have not happened yet in the country... But we cannot and will not retreat. There is simply no other alternative to the strategy of acceleration.

—Speech in Vladivostok 28 July 1986

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