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**CENTRAL INTELLIGENCE AGENCY**  
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Washington, D.C. 20505  
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30 March 1988

**TO:** Mr. Richard Kaufman  
Joint Economic Committee  
G-03 Dirksen Bldg  
Washington, D. C. 20510

Dear Richard:

[redacted] asked me to pass on SOVA's  
comments on William Safire's recent columns  
on the Soviet economy and the burden of  
Soviet defense.

[redacted]

House Branch  
Office of Congressional Affairs

Enclosure

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MEMORANDUM FOR THE RECORD

SUBJECT: William Safire's Column on the Size of the Soviet Economy and the Burden of Soviet Defense [redacted]

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1. In a column in this morning's New York Times (attachment A) William Safire maintains that CIA has overestimated the size of the Soviet economy and, as a result, is underestimating the share of Soviet GNP devoted to defense. To support this thesis Safire cites the views of several participants in a recent symposium on Soviet defense sponsored by the Hoover Institution--which Safire did not himself attend--and an article in the Soviet journal, Novyy Mir, by economist Grigoriy Khanin. Safire also maintains that a recent speech by Soviet leader Gorbachev, which he discussed in an earlier column, provides support for his thesis. Our assessment of this earlier column--which, we believe, rests on a gross misinterpretation of Gorbachev's speech--is appended to this memorandum (attachment B). [redacted]

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2. According to [redacted] of the Office of Soviet Analysis, who was present at the recent Hoover Institution symposium, Safire accurately reports the views expressed by several of the participants but fails to give due attention to the criticisms that were made of their position by other participants in the session. In particular, [redacted] reports that the symposium's leading proponent of the thesis that CIA estimates of Soviet GNP are too high--the Swedish diplomat Aslund--was sharply criticized by Rand's Abraham Becker for a reliance on personal impressions rather than on statistical evidence or rigorous analysis. [redacted]

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3. Safire evidently is also unaware that three of the symposium participants whose views he cites approvingly--Henry [redacted]--served on a seven-member group established at the request of DDI Robert Gates some years ago to explore the hypothesis that the state of the Soviet economy was worse than estimated by CIA. The final report of this working group, issued in May 1985, dealt with the decade 1976-84, when, according to CIA, the Soviet economy was growing at an average annual rate of 2.5 percent. The report concluded [redacted]

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SUBJECT: William Safire's Column on the Size of the  
Soviet Economy and the Burden of Soviet Defense [redacted]

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that in the judgment of "several" members of the group the maximum amount of overestimation of which we might be guilty amounted to one to 1.5 percentage points a year, with one member believing that the overestimation could not be this great and only one other believing that a larger error was possible. In light of the fact that this group was established only to examine the possibility that CIA estimates were too high and the fact that its membership included the leading proponents of this view, we were encouraged by what we took to be the implicit judgment that even if our estimates of Soviet economic growth were biased upwards, the degree of bias would probably not be excessive. [redacted]

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4. Safire's comments on the article by Grigoriy Khanin reflect the columnist's lack of acquaintance with the issues that the Soviet economist discussed. It is true that Khanin argues that official Soviet statistics on economic growth are exaggerated because they include hidden inflation. It is untrue, however, that CIA was surprised by what Khanin said. On the contrary, CIA has long been a proponent of the thesis that Soviet growth statistics are inflated. It is for this reason that CIA produces its own estimates of Soviet growth which historically have been substantially and consistently lower than those reported by the Soviet authorities. (Khanin's article, incidentally, was discussed in great detail at a SOVA-sponsored conference on Soviet economic statistics under Gorbachev that was held at CIA Headquarters in December 1987. The general view of the conference participants was that the inflation problem Khanin discussed is a real one but that Khanin's estimates of its size were not supported by the evidence he cited.) [redacted]

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5. Although disagreeing with Mr. Safire's thesis, we recognize that the issue he discusses is important. We also believe that participation in conferences like the recent Hoover Institution symposium and our own gathering of academic experts on Soviet statistics is essential to a thorough airing of the questions involved and--to the extent that our mandate to protect classified sources and methods will allow--of the pertinent evidence. We have listened to the arguments of those whom Mr. Safire cites and believe that our estimates take proper account of the insights they have to offer. Indeed, we regard much of the evidence cited by Mr. Safire as support for long-standing CIA

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SUBJECT: William Safire's Column on the Size of the  
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positions and theses. Gorbachev and Khanin, after all, have acknowledged what we have argued for years--that official Soviet claims of economic growth are exaggerated. In our view, these acknowledgements underscore the need for the estimates that we provide and that we regard as the most useful tools available anywhere to US policymakers or academic analysts concerned with assessing Soviet economic performance.

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Chief, Defense Economics Division  
Office of Soviet Analysis

Attachments:

- A. NYT Column by William Safire, "The Genscher Line,"  
28 March 1988, page 21.
- B. SOVA/DEIG Memorandum, "Comments on Gorbachev's February  
Speech and William Safire's Analysis of It," 3 March 1988.

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ESSAY | William Safire.

## The Genscher Line

SAN FRANCISCO

On April 15, 1986, when U.S. bombers gave a permanent headache to Libya's Muammar el-Qaddafi, Bill Casey brought a group of non-C.I.A. economists in to see the President. As bombs fell on Tripoli, statistics about the Soviet economy rained on Ronald Reagan.

"What does all this mean?" he asked as the hourlong presentation ended.

It meant, the outside consultants explained, that the conventional wisdom about the Soviet Union's size and strength was wrong: instead of steadily growing, Soviet production had been stagnant for years.

This meant further that the Kremlin's new leader, Mikhail Gorbachev, would soon be faced with an internal crisis: he would have to shake up the economic system radically to force new growth, or accept a reduction in what was becoming an unsustainable level of military spending. Soviet economic weakness could profoundly affect arms talks and the maintenance of the empire from Afghanistan to Cuba.

The President wanted to know what the effect of this new interpretation would be on his policy planners.

"They'll say, 'Help this nice man,'" replied one of the economists.

Mr. Reagan nodded: "I know, the Genscher line." He was referring to the Ostpolitik urgings of West German Foreign Minister Hans-Dietrich Genscher, who is eager to finance the revival of Moscow's trade.

That was just two years ago, when Mr. Reagan presided over an Administration split between Defense-C.I.A.-N.S.C. hard-liners and the accommodationists at State.

Then, a year ago, an iconoclast among Soviet academicians, Grigoriy Khanin, was permitted to publish in *Novy Mir* a refutation of all past Soviet figures, exposing the use of hidden inflation — "figure-padding and price manipulation" — in estimating growth rates. C.I.A. analysts gulped; their own estimates for 1986 were closely in line with the earlier, officially rosy Soviet figures, which were in the process of being discredited.

A couple of weeks ago, as reported in this space, Mikhail Gorbachev put his stamp on the gloomy Khanin account in a speech to the Central Committee. If the Russian leader can be believed, the Soviet economy is about one-fourth smaller today than Soviet statisticians — and our own intelligence analysts — have led our defense planners to believe.

Last week, at the Hoover Institution in Palo Alto, the best-of-the-West analysts of the Soviet economy held a friendly intellectual shoot-out.

Henry Rowen, a Stanford University

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### Failing to exploit Soviet weakness.

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professor and former Rand Corporation president who ran studies for the C.I.A. a few years ago, was the organizer; Charles Wolf of Rand, co-editor with Professor Rowen of "The Future of the Soviet Empire," coming out next month, presented a paper that shows, among other stunners, how China is likely to outproduce the Soviet Union soon after the year 2000. Prof. Richard Ericson of Columbia University's Harriman Institute was, I'm told, a star performer, along with a Swedish economist I want to take to lunch. To its credit, the Agency had its team, headed by the economist Derk Swain, in the thick of the argument.

"Team B," as the new-estimate types will inevitably be called, holds that Soviet income is the equivalent of \$3,000 per capita; that means the Soviet Union would be producing roughly one-fourth as much as the U.S. produces. But the old C.I.A.-academic consensus is said to put Soviet output at one-half the United States'; that's about as much as economists can disagree about anything.

Another schism: The old consensus says the proportion of G.N.P. that the Russians spend on defense, plus underground facilities and the "cost of empire," is still under 20 percent; the Team B estimate of the same items ranges from 25 percent up to 35 percent of all production. (Our spending on the same breadth of items is only 7 percent.) The first estimate would put Mr. Gorbachev in some difficulty at the summit meeting; the last estimate would take him to the brink of desperation for a deal.

As Mr. Reagan would ask, What does this mean? It means that we should not be in such a hurry to help this nice man.

Unfortunately, the "Genscher line" has taken hold in the Reagan Administration; all the hard-liners have been routed. Secretary Shultz has just agreed to link Start to "Star Wars," a huge concession. Although both superpowers have sold the world's media on the seeming impossibility of a Start treaty at the summit, the fix is in for a rush to sign in Moscow.

The Russians are exploiting Mr. Reagan's yearning for a blaze of glory; we are failing to exploit the urgency of the Russians' need to catch their breath. □

Comments on Gorbachev's February Speech  
and William Safire's Analysis of It

Safire has made a not uncommon error in interpreting Gorbachev's remarks as referring to the level of national income when the Soviet General Secretary was describing increments--or additions to--national income. Thus, when Gorbachev said that additions declined in the early 1980s-- meaning that national income grew more slowly--Safire interpreted this as meaning that national income was falling.

1. In a speech to the Central Committee on 18 February, General Secretary Gorbachev said that if the increase in the production of alcoholic beverages and the increase in trade that resulted from the large rise in the price of oil in the 1970s are "purged" from Soviet indicators of economic growth, "for the last four 5-year periods there has been no increase in the absolute growth of the national income, and at the beginning of the eighties it (the annual increase in growth) had begun to fall" (FBIS Daily Report, SOV 88-033, 19 February 1988). This provocative statement was the subject of columns by William Safire in The New York Times on 25 February (Attachment A) and Wesley Pruden in the Washington Times on 2 March (Attachment B). Safire concluded that Gorbachev's statement amounted to an admission that Soviet economic performance has been considerably worse than Western analysts believe and that, therefore, the burden of Soviet defense must be correspondingly greater as well. Pruden accepted Safire's findings.

2. Safire misinterpreted Gorbachev's statement. Gorbachev said that the annual addition to the level of Soviet national income had not changed in the 1960s and 1970s and that this increment had, in fact, begun to fall in the 1980s if the effects of rising alcohol production and changes in terms of trade are netted out. In effect, Gorbachev was describing the situation shown in Figure 1 (Attachment C), where the absolute annual growth reported for Soviet national income was almost constant from 1965 to 1980 while total national income was rising (see box insert in Figure 1). Gorbachev added, however, that the growth shown for 1981-85 would be less if there had been no increase in alcohol production or in foreign trade financed by rising oil prices. Safire interpreted Gorbachev's statement to mean that the level of national income (rather than the additions to this level), had been relatively flat in 1961-80 and had begun to fall at the beginning of the 1980s.

3. Our own, independently-derived estimates of the growth in Soviet GNP show a trend that is even worse than the one described by Gorbachev--with the increments to GNP declining in each of the Five-Year periods rather than remaining flat as Gorbachev claimed (Figure 2, Attachment

C). \* Our estimates are not affected by shifts in terms of trade, and the influence of changes in alcohol production is negligible because we value such production at the cost of production rather than at retail prices including a high turnover tax, as the Soviets do.

4. Mr. Safire, having misinterpreted Gorbachev's statement to mean that total GNP had first levelled off and then declined, went on to assert that defense therefore must have taken up an increasing share of total GNP. His implicit assumption is that defense did not go down, and that it therefore took an increasing share of a falling GNP. As pointed out above, however, total GNP did not shrink (nor did Gorbachev say it did); it merely grew more slowly (see box insert in Figure 2). And our calculations of Soviet defense spending show that it too--while not shrinking--began to grow more slowly in the mid-seventies. Defense, therefore, continues to take up roughly the same share of GNP as it did in 1970.

5. Two additional points are worth making:

-- Safire states that "our intelligence analysts" have been saying that Soviet economic growth during the Reagan years "has averaged slightly over 3 percent annually", a total gain of about one-fourth". In fact, our current estimates show that growth of GNP averaged about 2 percent per year during 1981-87, an overall gain of 14 percent.

-- The New York Times columnist also says that the defense share of Soviet GNP has been given as 14 percent. In fact, the share was given as 15-17 percent in our JEC testimony last year (March 1987). (U)

\* GNP and the Soviet concept of national income both measure the final output of goods and services. The Soviet definition of final output is narrower, however. It excludes depreciation and services that do not contribute directly to production of material goods.

Attachments:

- A. NYT Article, "Bailing Out Moscow"
- B. WT Article, "One More Chance to Do Good"
- C. Two Graphics: Growth in Soviet National Income and GNP

During  
*NY Times - 25 Feb*

**W**ASHINGTON — We have just been told by a well-placed informant inside the Kremlin that the Soviet Union is not the economic power our intelligence analysts have long thought it was.

Throughout the Reagan years, our experts have assumed that Soviet growth averaged slightly over 3 percent yearly. That is a vital statistic: we then put a price each year on what we knew the Soviet military machine cost, and get what we hope is a clear idea of what percentage of its economy Moscow is devoting to armament.

That's just about the most important intelligence number of all. In the 70's, a "Team B" of outsiders was brought in by the C.I.A. to challenge the conventional wisdom, and doubled the previous estimate to 13 percent in the Soviet Union. That laid the basis for our own increased defense spending, which now amounts to 6 percent of our gross national product.

In a little-noted passage of his long speech last week to his Central Committee, Mikhail Gorbachev made a stunning revelation that kicks our estimates into a cocked hat.

He pointed out that during the Brezhnev years, economic growth had been artificially hiked by the sale of oil at high prices (the U.S.S.R. is the world's largest producer) and the accelerated sale of vodka (Soviet spending on alcohol may have reached 10 percent of total output, compared with less than 2 percent of ours).

"If we purge economic growth indicators of the influence of these factors," said Mr. Gorbachev, "it turns out that, basically, for four five-year periods there was no increase in the absolute growth of the national income and, at the beginning of the 80's, it had even begun to fall. That is the real picture, comrades!"

No doubt the current Kremlin leader is trying to make the present bad economic picture look better by saying the old days under his predecessor were really much worse. But we should allow for the possibility that, concerning the 80's at least, Mr. Gorbachev may be telling the truth.

If that is the real picture, comrades, we have to do some fast reassessing of our own. During the 80's, as the price of oil has been cut in half, and the Soviet gulping of booze has been restricted, the total Soviet output is not likely to have risen much, if at all, from what Mr. Gorbachev says was its falling state in 1980.

Here is what that new assessment leads us to deduce: the Soviet economy has been stagnant (or possibly declining) for seven years — most definitely not growing steadily at the over-3-percent rate per year our ana-

lysts had been assuming. That means our assessment of total growth of about one-fourth to this decade has been egregiously mistaken. That supposedly seven-foot giant turns out to be closer to five feet tall, same as he was in the Brezhnev years.

Apply that new assessment to arms control. The way we estimate Soviet arms expenditures is by simple bean-counting, mainly from satellites, and that total is not affected. What does change is the percentage of the output devoted to arms; if it was 14 percent by the old assessment, it must be an unbearable 20 percent in the new reality Mr. Gorbachev reveals.

Thus, under pressure to reduce arms spending, he seeks treaties; forced to cut losses, he announces withdrawal from Afghanistan and may offer to reduce subsidies in Central America; faced with the prospect of having to match serious Star Wars spending, he rails at the idea of strategic defense.

Apply that no-growth, one-fourth-smaller fact to economic diplomacy. It explains why the Russians finally settled the old Czarist debt for a dime

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## How to deal with a hungry adversary.

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on the dollar, paving the way for a recent \$77 million Soviet bond issue. That's also why the Kremlin will be seeking entry into the International Monetary Fund, GATT, and the World Bank at the next meetings (in West Berlin) this fall. Soviet Communism is starving for capital.

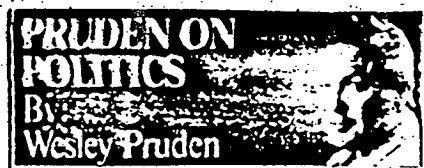
Our European allies are rushing to lend Moscow money and to subsidize pipelines, while accommodationists here want to offer the Russians most-favored-nation status on trade. Commerce and State Department détente-niks await only vague "economic reforms" to end our opposition to Soviet entry into Western credit markets.

Here is a genuine issue to toss at the candidates in our election. In light of what the Soviet leader admits is "a very serious financial problem," should U.S. policy seek to finance our adversary? Or should we "stress" Moscow now, as it surely would do to us if the roles were reversed?

Or should we use this moment of admitted Soviet economic weakness to put an irrevocable, verifiable, behavior-modifying price on every concession we confer? □



= 2 March 1988



## One more chance to do good *W. Jmie*

The people who love to knock the CIA, for its excesses but mostly for its successes, may at last have a legitimate gripe.

But so far, nobody's hearing a peep out of them.

The implications are not politically convenient.

The Soviets, say the No. 1 Kremlin insider, have mismanaged their economy much more miserably than the most dedicated commie-bashers have dreamed of, and the CIA, which missed all this, made a miscalculation of truly dumb proportions.

William Safire took note of this startling phenomenon last week in *The New York Times*, but, oddly, nobody seems to have noticed. For years, the best U.S. intelligence estimates have assumed an annual Soviet growth rate of 3 percent, and it is on this number that Ronald Reagan's administration based its reckoning of what the Russians were spending on armaments — and on what we should be spending to counter Soviet arms.

The CIA reckoned that the Soviets were spending about 13 percent of their gross-national product on arms.

But Mikhail Gorbachev made a painful and stunning confession last month to his party's central committee: when the proceeds from the sale of Soviet oil and Soviet vodka are extracted from the statistics, there was no growth in the Soviet economy at all.

This means that the Soviets are spending not 13 percent of their gross-national product on defense, as the CIA figures led the administration to believe, but something closer to 20 percent. Not even the Soviet Union, with its vast array of ways to abuse its people and make them like it, could continue to spend such an incredible portion of its national income on guns and tanks and planes and missiles. (Or even baby buggies.)

And this, writes Bill Safire, may explain why Mr. Gorbachev feels such pressure to reduce arms spending, seek treaties reducing missiles, announce a withdrawal from Afghanistan, encourage speculation that he might even cut subsidies to the Sandinistas, and, last but by no means least, trash the Star Wars shield that he knows he cannot match.

Herbert Meyer, the former vice chairman of the National Security Council in the early years of the



Easy mark

Reagan era, thinks the Safire analysis is right on. He, too, wonders why nobody's talking about it.

Of course, nobody likes to admit mistakes, particularly in Washington. This was first of all a mistake of intelligence. "Intelligence" may be the ultimate oxymoron, since most of it is half-baked at best and all wrong at worst. Warriors crave it, but the most intelligent of them are contemptuous of

those who peddle it. "I have no confidence in any scout," said Robert E. Lee on the outskirts of Gettysburg, just as he was reduced to finding one who could tell him something, even if it was wrong.

The CIA's mistake about what has been going on in the Soviet Union was a mistake further compounded by a lot of other people. Herb Meyer writes about "intelligence addiction" in his new book, *Real-World Intelligence* (Weidenfeld & Nicholson), and how deadly it can be.

He liken secrets to a bowl of peanuts. Nobody can stop with just one. "... intelligence professionals can become so addicted to secret information that they focus exclusively on this category of raw information; as a result they haven't got the energy or time to collect and analyze open information. And it isn't just the intelligence professionals who are so susceptible to secrets. Consumers of intelligence have been known to become so addicted to secret information that eventually they have lost interest in open information — to the point where they ignored it when it landed on their desks or otherwise hit them between the eyes."

We can expect still further compounding of original error. Once it is firmly established that the Soviet economy is worse than we thought it was, the detente freaks within the administration will no doubt push harder to rescue the Soviets with breaks on loans, trade, technology and the crucial necessities they are desperate for.

If Mr. Gorbachev is telling the verifiable truth, and even bad guys sometimes tell the truth, this could be one, last golden opportunity for the businessmen in the Reagan administration, who imagine themselves such wizards and wise men, to extract from the Soviets a fair price for everything the West does to bail them out.

But don't hold your breath until they do. That wouldn't be intelligent.

Figure 1

### USSR: Average Annual Growth in National Income (Soviet Measure)

Billion 1983 Rubles

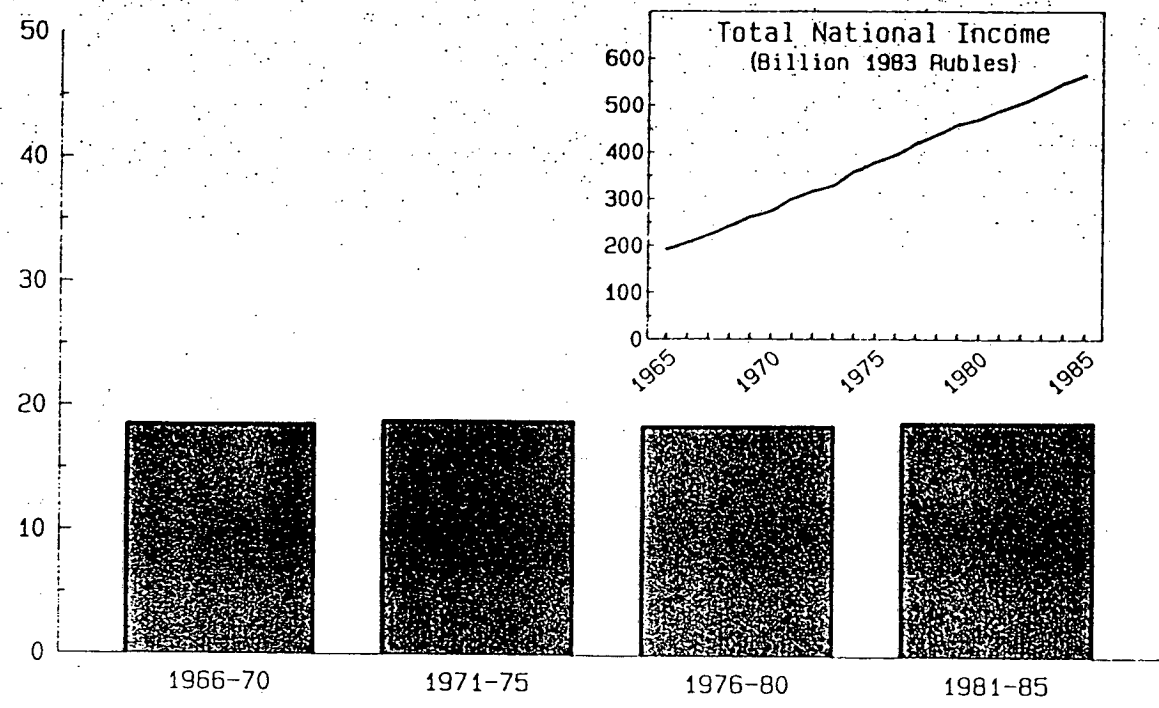


Figure 2

### USSR: Average Annual Growth in GNP (CIA Measure)

Billion 1982 Rubles

