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Washington, D.C. 20505

Telephone [redacted] 27 January 1988

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

Dear Richard:

Hope the enclosed answers your
questions.



House Branch
Office of Congressional Affairs

Enclosure

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15 January 1987

Outline for the 1988 Joint CIA-DIA JEC Paper,
Gorbachev's Economic Program: Grappling with Reality

Focus: Building on last year's testimony, this year's paper will focus on the economy's performance under Gorbachev during the three years of his tenure. It will present our first comprehensive assessment of how well Gorbachev's industrial modernization program is faring (as opposed to a description of its elements), as well as our evaluation of other components of his economic program. We will also discuss the changes in economic reform efforts since the June 1987 Plenum, and to what extent the Soviet leadership appears to be raising the priority of improving quality and efficiency at the expense of lower output in the short run. The paper will also detail what policy options Gorbachev has for dealing with the difficulties his economic program is encountering and the political risks he runs in choosing various options.

- I. Introduction--(1/2 page; DED)--Brief statement of what the paper will cover.
- II. Gorbachev's Program (1-2 pages; DED)--Initial section that will briefly detail Gorbachev's economic gameplan and the inherent conflicts among some of his policies.

- A. Gorbachev came in late in the planning cycle--unable to introduce wholesale changes.
- B. Tried to force existing system to work better through traditional means, such as discipline campaign (including anti-alcohol campaign), personnel shifts, and bureaucratic reforms.
- C. While pushing traditional remedies, however, Gorbachev also tried to lay groundwork for more fundamental changes involving the wholesale modernization of industry and major economic reform. There are, however, inherent conflicts in many elements of his program.
- D. Gorbachev is looking to reverse a decade of slow economic growth and to improve product quality across the board. His overall goal is much broader, however, and reflects a desire to transform society. Programs of glasnost' and democratization reflect as much, if not more, political and social concerns as economic ones.

III. Where Does His Program Stand Now? (10-12 pages; A,B,C--EPD; D--DID; C2--DED; D3--DPD)--This section will begin with a review of the economy's relatively poor performance in 1987. GNP by sector of origin and end use will be covered briefly, with the exception of defense, which will get a somewhat more extended treatment. The major focus of this section, however, will be devoted to evaluating where Gorbachev's modernization program stands now. In particular, we will attempt to answer the question of whether the low growth in 1987 reflected the type of disruption one would expect with major changes--but which would yield benefits in later

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years--or whether the disruptions were more serious.

- A. After good year in 1986, economy came up short in 1987. Section will consist basically of a table of major results, a summary of the table, and a discussion of what happened to productivity trends. (A detailed discussion of GNP growth by sector of origin will be handled in Appendix A.)
- B. Causes of the slowdown.
1. Disruptive impact of gospriyemka, retooling, and reforms. (Paid a price in 1987 for anticipated future gains from these efforts. Was this price especially large? 1-2 paragraphs on the impact of reforms plus box on details.)
 2. Diminishing returns on human factor efforts. (What happened to productivity? Cite press reports of increasing problems.)
 3. Transportation bottlenecks and problems caused by bad winter in first quarter. How much of 1987's problems were due to poor 1st quarter?
- C. End use trends.
1. What happened to investment? (growth and allocation patterns)
 2. What happened to defense? (include box evaluating defense spending under Gorbachev--what's happened and why.)
 3. What happened to consumption?
 4. What happened to foreign trade?
- D. Where does Gorbachev's program stand now?

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1. 1987 was a year of transition in the modernization program-- reliance on top-down, administratively directed push now is lessening in favor of a more decentralized, reform-driven program to achieve goals of product and process renewal.
2. Evaluation of administrative measures in 1987:
 - a. Weak growth in output (discussed above)
 - b. Disruptive impact of gospriyemka (discussed above)
 - c. How much quality improvement really occurred?
 - d. Some progress in renovation of capital stock.
 - e. Product renewal is actually looking good.
3. Status of economic reform--how has it changed since June plenum?
4. 1987 sluggish in part because of Gorbachev's conflicting goals (high output, retool, boost quality, change product mix), but Soviets probably anticipated that some disruption would occur. 1987 not so bad if seen as a step toward systemic change. 1987 results may suggest that Soviets willing to sacrifice growth goals for some systemic change and improvements in quality.

IV. Prospects for Gorbachev's Economic Program (8-10 pages; A,C--EPD; A3--DED;B--DID)

Having detailed the economy's recent performance and the fact that Gorbachev has not made major adjustments to his overall investment policies so far--although there has been a shift in emphasis towards reforms since the June 1987 plenum--where do we see the economy going?

- A. 1988 plan--no reduction in plan.

1. Brief summary of plan (include table).
 2. Relate to 1986-90 plan.
 3. Where do we see defense going in absence of any policy change?
- B. Outlook for modernization and economic reform.
1. In 1988 leadership focus shifts to "market-like" reform as cornerstone of modernization.
 2. Key uncertainties.
 - a. How disruptive will reforms likely be?
 - b. How well can Soviets boost MBMW shift coefficient to compensate for temporary negative impact of retooling?
 - c. Will indications of increased attention to consumer interests lead to labor productivity gains and maintenance of the "human factor" gains of 1985-86?
- C. What are our economic baseline projections for the next few years?
(Draw on Kellogg's work)
- V. Possible adjustments through 1990. (7-9 pages)-(A1,A5--DPD; A2a--DED; A2b,c,A3--DID; A4,B--EPD). Extent to which Gorbachev makes adjustments in resource allocation policies, pace of reform, etc. over the next few years depends on several factors, including the success of his program and on events beyond his control, such as weather and the Western military developments. We will discuss possible adjustments under two broad economic scenarios.
- A. Probably the most likely scenario, and the one we will treat in the greatest detail, is that the economy continues to be sluggish over

the 1988-90 period, and that the upsurge in productivity Gorbachev is hoping for fails to materialize. New reforms and gospriyemka continue to disrupt industry. In this situation, Gorbachev may feel pressured to retreat drastically from reform program and to return to the traditional approach--raise investment, particularly in MBMW, and minimize spending elsewhere. Pressure would build for a real reduction in defense spending, and a shift in resources from defense to civilian industry would become far more likely. This pressure would probably be accompanied by increased efforts to garner foreign support.

1. Assessment of possible retrenchment in economic reforms.
 - a. Which reforms likely to be affected?
 - b. Political implications of such a retrenchment.
2. Assessment of possible slowdown/reduction in defense spending.
 - a. Possibility for deep reductions.
 - 1) Need for stable international environment.
 - 2) Role of arms control
 - a) Box on economic impact of INF.
 - b. Possibility of increase in defense industries' support for civilian modernization.
 - c. Potential for reducing investment in defense industry.
 - 1) Relate to timing and needs for defense modernization.
 - 2) Roughly how much investment are we talking about?
3. Investment shifts?

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- a. Can more be directed towards civilian MBMW? If so, can it be used effectively?
 - b. Other investment claimants.
4. Adjustments in trade and general external relations if economy doesn't rebound. (Along the lines discussed in recent memo to DDI from D/SOVA on possible events with significant implications for US policy).
- a. Assess likelihood of greater support from Eastern Europe.
 - b. Assess potential for greatly expanded trade relations with the West.
5. Any of the policy changes will be heavily influenced by Gorbachev's political standing.
- a. How would a retrenchment on economic reforms affect Gorbachev's political standing? What political opposition would he face in any attempt to speed up or slow down reform efforts?
 - b. Similarly, how would a reduction in defense spending affect Gorbachev's standing, and what opposition would he face?
- B. A plausible, but less likely scenario, is that the economy does well in 1988-90--growth looks more like 1986 and industrial productivity improves as the disruptive gospriyemka and retooling efforts of 1987 start to pay dividends. The economy could be further helped by good weather and higher energy export prices. Under this scenario, financial reforms in 1988 cause managerial headaches, but don't cause

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production disruptions.

1. Factors that would lead to improved economic performance.
2. What programs and policies might be affected?

VI. Indicators to look for. (3-5 pages;DPD)

- A. 1988 Party conference and CPSU personnel changes.
 1. What happens to Gorbachev's support?
 2. What happens to reformers in the party? (Any more Yel'tsin-types lose their positions?)
- B. Extent of reform-related disruptions in 1988--increased disruptions accompanied by continued emphasis in the press about reforms could indicate Soviets serious about reforms, decide price they're paying. Increased disruptions accompanied by a decreased emphasis in the press could indicate the Soviets may be willing to ease up on reform efforts.
- C. Increased Soviet foreign efforts on a broad front--cut back in third world aid and activities, troop withdrawals, more concessionary in arms control talks, and increased efforts to promote joint ventures and trade with the West--could suggest Soviet decision to focus on problems with the modernization program and an attempt to create favorable international environment and minimize foreign and defense commitments.

Appendix A--1987 in Review (the sectoral details) (EPD).

In the same format as in the 1987 Annual Bulletin, only briefer.

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(See attached outline for annual bulletin.)

Appendix B--We also will include basically the same tables that appeared in Appendix B of the 1987 JEC paper (attached), with the possible exception of the ruble value table on GNP sector of origin (due to the timing of the GNP update). (EPD)

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Proposed Schedule for the 1988 JEC

- 14 January (Fri) Detailed outline circulated.
- 1 February (Mon) Contributions due.
- 16 February (Tues) First draft circulated in DEIG.
- 22 February (Mon) First draft circulated in SOVA-DIA.
- 29 February (Mon) Comments due.
- 7 March (Mon) Second draft circulated.
- 9 March (Wed) Comments due.
- 14 March (Mon) Coordinated CIA/DIA draft to DDI.
- 21 March (Mon) Copy to JEC.
- 24 March (Thur) JEC Testimony.
(We do not have a date for the testimony yet, but Kaufman said he will try to schedule it during the last two weeks of March.)

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