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The attached memorandum is responsive to Senator Symington's request of 9 April.

It has been coordinated with OSR.

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The Impact of Defense Expenditures in the US and the USSR

From 1960 to 1967 defense and space expenditures* have been about the same share of gross national product (GNP) in the US and the USSR. This share, 9 to 10 percent, has been tolerable in both countries but the impact of the defense costs and the allocation of the remaining resources have been significantly different in the two countries.

Consumption (or personal outlays for goods and services plus government expenditures for health and education) in the USSR in 1966 and 1967 was about 58 percent of GNP compared with 68 percent in the US, when measured in domestic prices. Soviet consumers as a whole received about a third as much in real terms as US consumers, and on a per capita basis, about 30 percent as much.

The Soviet pattern of priorities is very clear. Except in periods of war or intense defense preparations, investment is the favored sector and has been steadily growing as a share of Soviet

* Defense expenditures in this memorandum are defined to include government purchases of goods and services for the military services, government expenditures on atomic energy development, and outlays on space research and technology. Defense excludes stockpiling activities, foreign military aid, veterans benefits and interest on the national debt. If all the latter categories of expenditures were included, the US outlays as a fraction of GNP would be significantly higher than those of the USSR, in large part because the USSR has, in effect, repudiated a large share of its national debt.

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GNP at the expense of consumption. This means that the Soviet consumer has not been receiving a proportionate share of annual increases in output. In 1967, investment was 31 percent of Soviet GNP but only 18 percent of US GNP. While investment's share of the Soviet pie grew from 1955 to 1967, consumption slid from 62 to 58 percent.

The flow of annual new fixed investment in the USSR is equal to about 3/4ths of that in the US, measured in comparable prices, and investment in industry is 20 percent larger than in the US. This massive infusion of investment into the much smaller economy of the USSR has not produced a significantly superior rate of growth which is a key manifestation of relative Soviet inefficiency. In the 1960's the Soviet GNP has grown about 5 percent per year and that of the US about 4 1/2 percent; for industrial growth the comparison is 7 percent to 5 percent.

The relative priorities are shown even more dramatically in the following table, which covers percentage allocation of durable goods in the two countries in 1967:

Share of total durable goods allocated to:	USSR	US
	(Percent)	
Investment	58	42
Defense	24	16
Consumers	18	42
Total	100	100

The Soviet consumer's desire for automobiles and household appliances, in the style and abundance of Western Europe, is a long way from fulfillment.

While defense nominally takes a share of resources no larger in the USSR than in the US, it does take a larger share of the durables, that is, the machinery and equipment. Further, this defense equipment is the most advanced, and highest quality machinery available in the USSR. The design and manufacture of weapons absorb the best of the scientists, engineers, managers, and skilled workers, in short the personnel with the innovative talent that Soviet industry so obviously lacks. This lack is reflected in the declining growth in output per ruble of net investment.

The last two years have seen a very large increase in defense spending in the US. In the USSR the increase is smaller but still substantial, from about 18 billion rubles in 1965 to about 20 billion in 1967. For 1968 the increase is slowing down in the US and may also be slowing somewhat in the USSR. In both countries the increase in defense has reduced or slowed down investment. In the USSR this has taken the form of reduced rates of growth for investment in both agriculture and industry. The slowdown in industrial investment is penalizing the much-needed modernization of industrial plant and equipment. Buoyed by two good years in agriculture the Soviet leadership is cutting back its ambitious plans for increasing the park of tractors, combines, and other equipment in agriculture.

This policy has the appearance of gambling on the weather, and is likely to be reversed in the first year of bad weather.

In the US, investment (especially housing construction), fell off in 1967 with rising defense expenditures. Consumption continued to rise but at a slower pace. While the Vietnam war costs have strained government finances and have aggravated an already serious balance of payments deficit, the impact on the allocation of resources has been moderate. Defense plus space, at around 10 percent, is about the same share of GNP as in 1955 and much less than in the Korean War period. Health and education expenditures have held steady recently at 10 percent of GNP, which is larger than in 1955 and 1960. Investment appears to be recovering in 1968, and no serious bottlenecks in capacity are likely to inhibit a renewal of rapid growth.

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