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17 February 1972

MEMORANDUM FOR:
ONE, Eur/Sov

SUBJECT : OER/U/U Contribution to NIE 11-72: Soviet Foreign Policies and the Outlook for US-Soviet Relations

1. Attached is a copy of the OER/U/U contribution to NIE 11-72. The contribution addresses the question of the likely impact of the domestic economic situation in the USSR on the posture taken by Soviet leaders during the President's visit.

2. If additional information is desired we shall be glad to expand upon this contribution.

Attachment:
As noted

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Contribution to NIE 11-72

The Soviet Economy as a Factor in US-Soviet Political Relations

Introduction

The state of the USSR economy as viewed by its leaders will be an important factor affecting their negotiating posture during the President's visit. Certainly, the current Soviet leadership displays a greater preoccupation with the domestic economy than any of its predecessors. And, like any economy, the Soviet economy has both strengths and weaknesses that permit the leadership to pursue certain noneconomic goals and prohibit it from undertaking others.

The State of the Economy

The USSR is the second largest economy in the world. The basis of Soviet economic strength lies in its great natural wealth, providing self-sufficiency in nearly all important raw materials, and a labor force that is about half again as large as the US. Deployed under strong central direction, these resources have permitted rates of economic growth that are high by international standards, a military complex about equal to that of the US, and a steadily rising standard of living.

During the Eighth Five-Year Plan (1966-70), Soviet GNP grew at an annual rate of 5½ percent. By comparison the rate posted in 1961-65 was about 5 percent and for the decade of the 1950s about 6 percent. Because of the wide fluctuation in agricultural production, however, year-to-year growth in GNP has varied considerably in recent years -- from a low of 2.5 percent in 1969 to a high of 8.2 percent in 1970. All of the increase in the growth rate of GNP since 1965 can be attributed to an improved performance in agriculture and construction. Industry, the largest contributing sector to GNP, grew at about the same pace as in the first half of the decade. The rate of growth of Soviet GNP for the past five years was less than half that of Japan, roughly the same as that of France and Italy, but substantially above that of the United States, West Germany, and Great Britain.

Preliminary results for 1971 suggest that, contrary to planners'hopes, the new Soviet five-year plan got off to a slow start. Gross national product grew by only about 3.5 percent. A decline in agricultural output from the record level in 1970 was largely responsible, but the pace of industrial growth also sagged, especially in the last six months of the year. The failure to meet the goals for labor productivity and for putting new plant and equipment into use suggests that some of the key goals of the five-year plan are threatened.

In the new five-year plan ending in 1975, the main objectives of Soviet economic policy remain roughly the same as in recent years. The average annual rates of increase planned for GNP and industry are somewhat above the average annual growth achieved in 1966-70. No major shifts are apparent in the allocation of resources among the principal claimants -- defense, investment, and consumption. As before, investment is to grow at a slightly higher annual rate (6½) than GNP, and consumption at a lower rate (5%). The directives place unusual emphasis on bettering the lot of the consumer, but the figures given imply that the rate of progress planned for the standard of living is somewhat lower than that achieved in 1966-70. Although the available data do not permit precise estimates of defense outlays, it appears that the plan would allow expenditures for military and space programs to rise at least as rapidly as GNP.

Most Western (and many Soviet) observers believe that the economy of the USSR faces a number of serious economic challenges including: (1) declining rates of growth, (2) discontent among consumers, (3) low efficiency caused partly by a marked gap between Soviet and Western technology, and (4) an agricultural sector that remains the Achilles' heel of the Soviet economy, absorbing vast resources and retarding overall growth. Although it has been argued that these problems are a strong inducement to the Soviets to seek a SALT agreement and to increase trade with the US, Soviet leaders rightfully view such agreements with the West as no panacea for domestic economic problems.

Economic Implications of a SALT Agreement

The short-run economic benefits of a SALT agreement are limited and insufficient to make an agreement compelling for the USSR. The USSR has achieved parity with the US in important military areas, and continued economic growth will permit maintenance of the parity without adding to the share of resources devoted to military programs. Moreover, the amount of resources likely to be released under the kind of agreement being discussed does not bulk large in relation to the scale of economic activity. If, for example, the rubles that might be saved in the next few years from a curb on strategic programs could be transfered entirely to investment projects, the effect on the growth of fixed capital would be too small to raise the rate of economic growth appreciably. Moreover, whereas swords may be beaten into plowshares, the transferability of the resources of the missile programs and military R&D is limited in the short run and problematical in the longer run.

Regardless of the long-term economic benefits, the Soviet Union, having achieved military parity, may believe that the US will spend enough to prevent Soviet superiority so that a new round spending to arrive at the same "relation of forces" would only be a waste. Moreover, knowing US capabilities, especially in R&D, they cannot be sure they could keep pace if military spending spirals.

The Effect on the Soviet Economy of Expanded Trade with the US

Despite a bent toward self-sufficiency, the USSR has traded with Western nations when there were clear advantages in doing so. Usually, the USSR has used its limited foreign exchange to import Western technology.

The technological gap, however, remains, and productivity is low. The relatively low standard of living provided to Soviet workers explains some of the differences between productivity in the USSR and in the West. To improve incentives and dampen consumer discontent -- the lesson of the 1970 riots in Poland has not been lost on Soviet leaders -- agricultural products and consumer goods have been purchased abroad in increasing amounts. Indeed, the rush to spend hard currency on feed grains in the past few months after two good harvests seems explicable only by a determination that the plans to increase meat consumption shall not fail.

The USSR can buy most industrial and agricultural products in other western countries, but some kinds of machinery, some licenses, and some agricultural products (feed grains and oilseed meal in the quantities desired) can be purchased only from the US. To this extent, at least, the Soviet leadership has reason to promote trade with the US. Nevertheless, the volume of such trade will be limited, and its contribution to the economy will be small, except perhaps in selected areas related to consumer welfare.