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J-3916

11 November 1971

MEMORANDUM FOR THE RECORD

SUBJECT: Briefing of Secretary Stans and
Assistant Secretary Scott,
Department of Commerce

1. On 10 November,
Acting Chief D/U, and _____, Chief U/TT,
briefed Secretary Stans and Assistant Secretary
Scott on the economy of the Soviet Union. The
formal presentation centered on (1) the trends in
Soviet GNP, industry and agriculture, and the
comparative performance with the US; (2) comparative
allocations of total product in the two economies;
(3) production and allocational policies in the
new Five Year Plan (1971-75); (4) performance of
the Soviet economy in 1971; (5) the outlook for
the economy for the balance of the plan period;
(6) Soviet efforts to close the technological gap
by, (a) internal reforms in introducing new tech-
nology and (b) by importing Western technology; and
(7) limitations on Soviet imports due to, (a)
limited availability of foreign exchange and (b)
a relatively high level of debt.

2. The briefing lasted about 45 minutes
with Secretary Stans and Scott frequently inter-
posing relevant and penetrating questions.

The Soviet Economy

-- Selected Topics --

(S-3916)

Briefing for Secretary Stans

10 November 1971

THE SOVIET ECONOMY

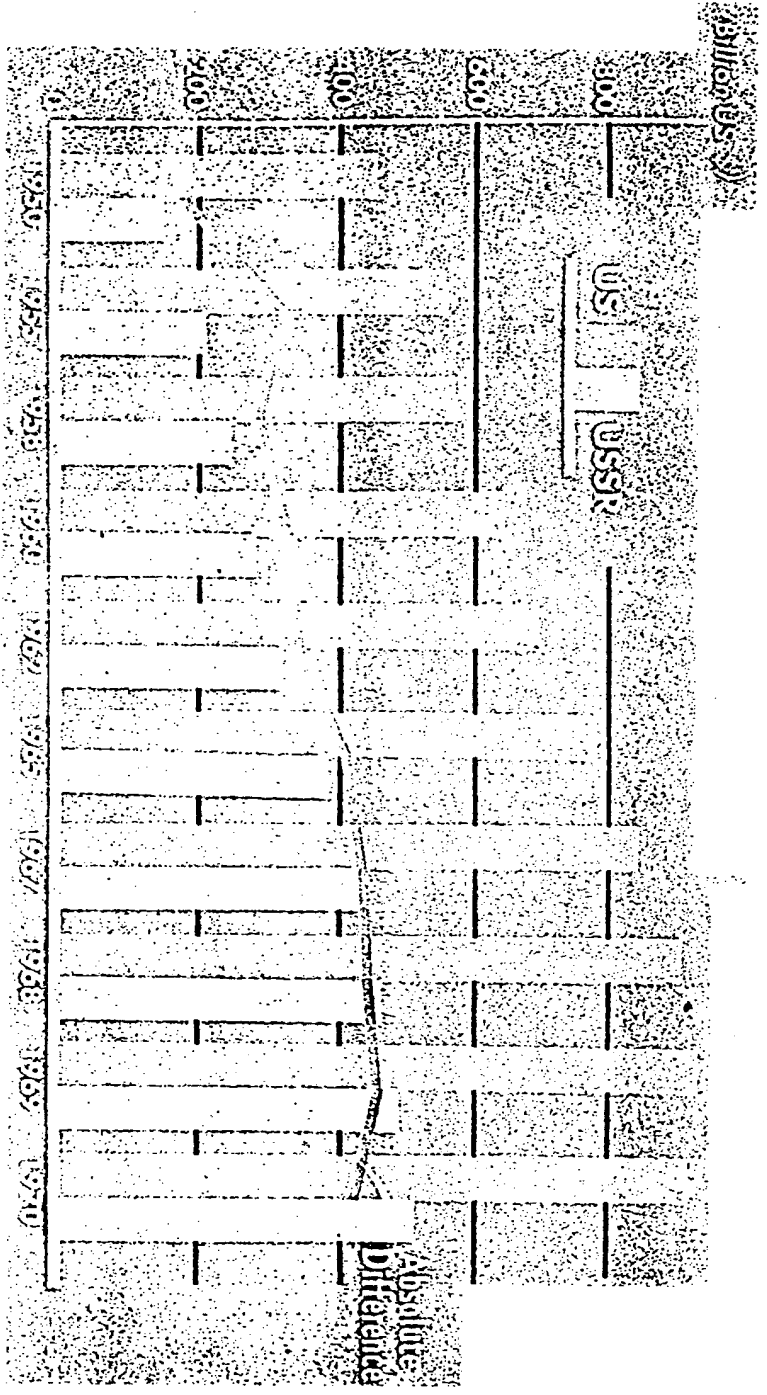
The economy has in effect a threefold assignment: to support an aggressive foreign policy and military posture, to close the production gap with the US, and to raise the level of consumption of the Soviet people. In recent years, the economy has not measured up to the regime's aspirations in these areas. Growth has slowed, and certain basic economic problems have become chronic and increasingly troublesome.

However, it is important to realize that the Soviet economy is not stagnating. It is continuing to expand at a respectable pace, and as it does so, the capacity to increase military and space expenditures -- as well as other expenditures for national policy purposes -- will continue to increase along with the economy.

Chart 1

We can review recent comparative economic growth with the benefit of our first chart, which shows total output in the US and USSR since 1950. If you look at the rate of increase of Soviet GNP reflected

The gap between the US and Soviet GNP's increased in the 60's



1950

in the first three bars (1950, 1955, 1958), you can see that the decade of the 1950's was one of very rapid Soviet growth. The absolute size difference between the two economies actually narrowed for a few years.

As the 1950's came to an end, there was a significant deceleration in Soviet growth. With growth rates in the two countries reasonably close in the 1962-69 years, the absolute gap between the US and Soviet GNP's increased. However, in 1970, a US recession year, the USSR was able to make an appreciable dent in the gap.

The 1970 spurt in Soviet growth of nearly 8 percent and the relative stagnation in the US economy cut \$38 billion dollars from the American edge of \$458 billion in 1969. For the first time in the history of the Soviet attempt to catch up, the Soviet GNP amounted to more than half of the United States performance. Although the rate of increase in Soviet GNP in 1971 will be somewhat greater than the US rate -- 4½ percent vs. 3 percent -- absolute gap between the US and Soviet GNP's will again increase (by about \$7 billion).

Over the years, the rapid growth of the Soviet economy has been sparked by sharp increases in industrial production, which more than quadrupled in volume over the 20-year period (1950-1970), in comparison to a doubling in the US.

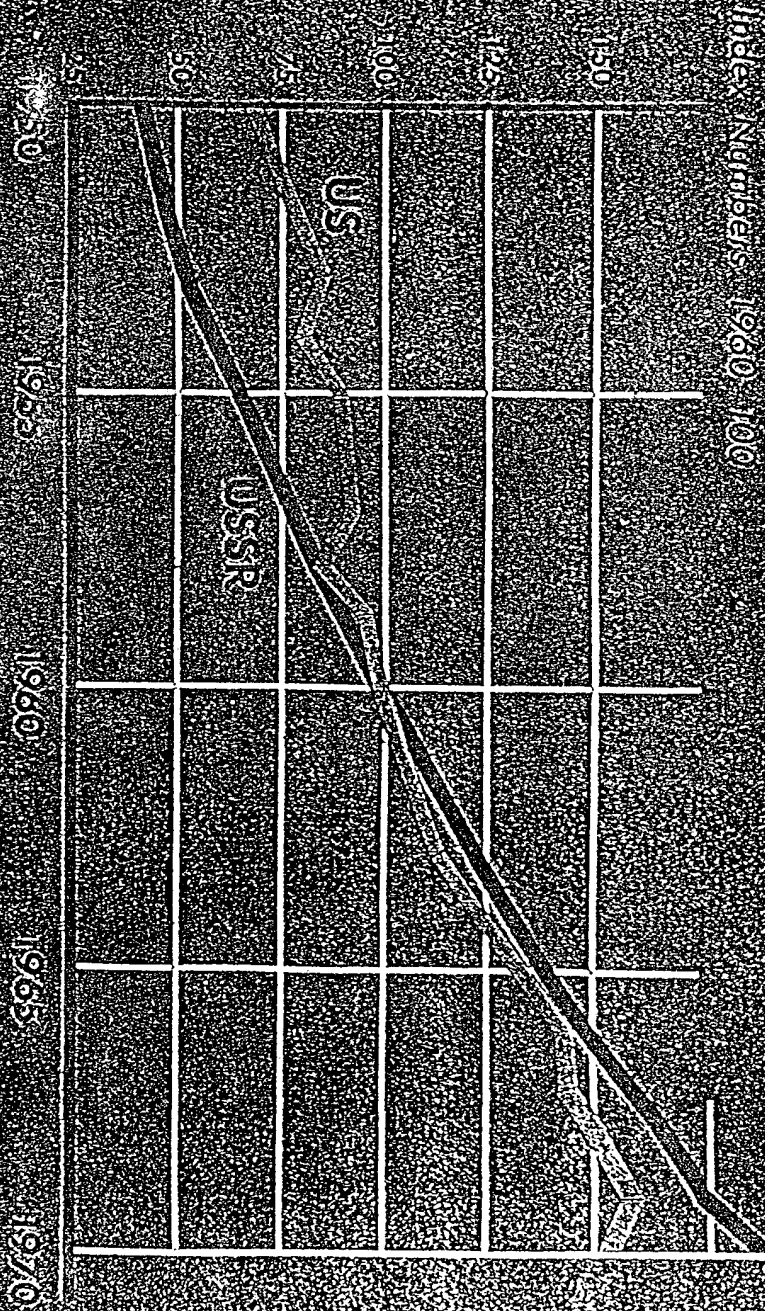
CHART 2

Between 1960 and 1966, industrial production in the US grew more rapidly than in the 1950's, while the opposite was true in the USSR. Over the last four years, however, US industrial output has increased very little. As a consequence, ^{Soviet} USSR industrial output now stands at about 60%-65% of that of the United States. Increasingly, the United States is becoming a service economy, with most increases in employment coming in areas which probably contribute little to war-supporting capabilities.

A few words about Soviet agriculture. Agri-cultural output has been moving ahead slowly over the past two decades. Despite increased attention in the form of higher inputs of fertilizer and machinery, and higher farm prices, the response has been disappointing. The USSR still experiences embarrassing shortages, such as the need ^{this} last year to import large quantities of meat and ~~some~~ grain from the West. In terms of efficiency, its record is a poor one. With an agricultural labor force more than 10 times the size of that in the US, Soviet agriculture produces commodities whose total value is only about three-quarters of US

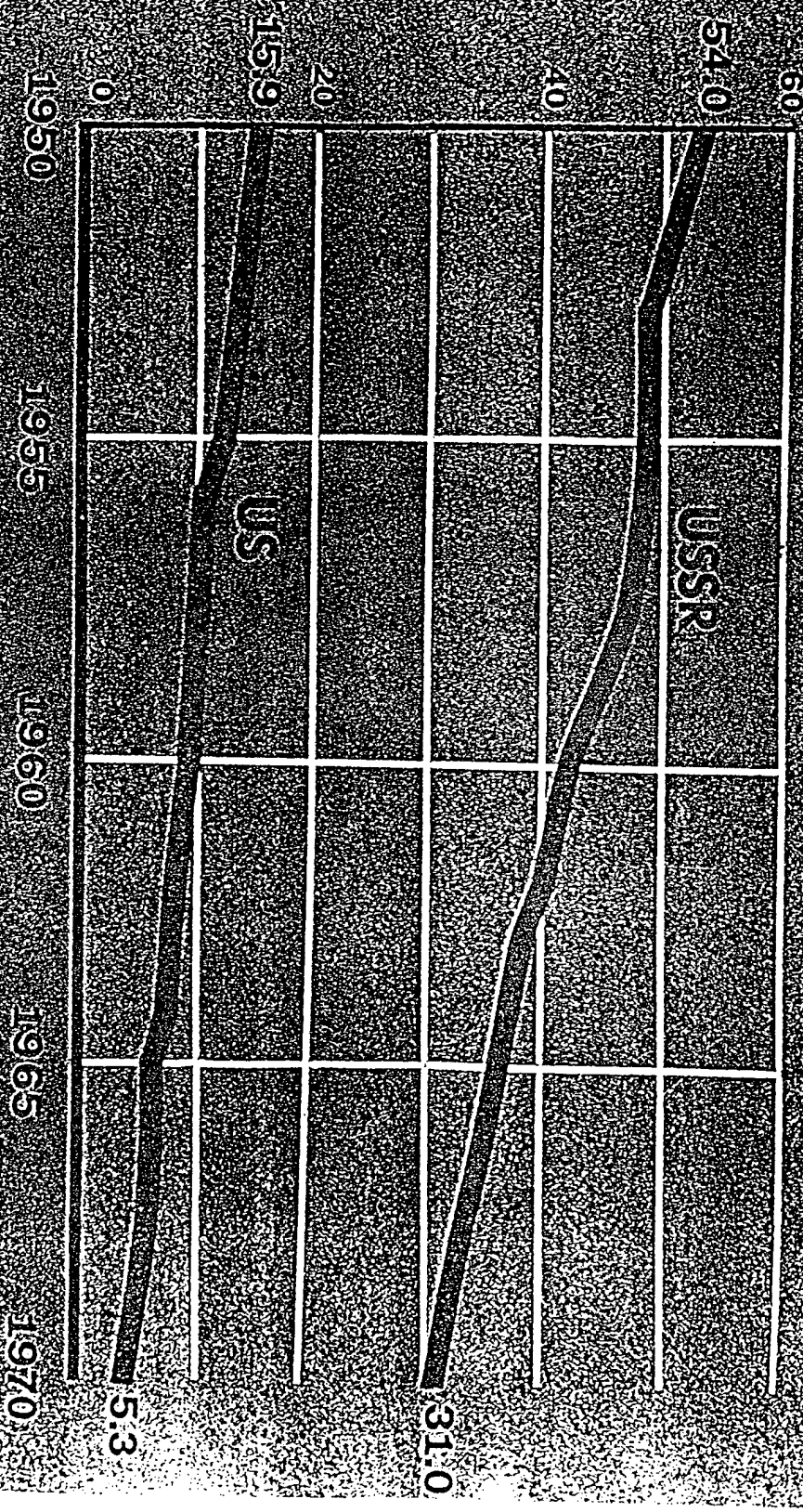
CHART
3

The differences between the US and Soviet industrial growth rates has increased.



The share of the total labor force still on Soviet farms remains large

Percent of total civilian labor force



STATES

~~four~~
agricultural output. In the USSR, one person in
the agricultural labor force feeds five others
in the total population; in the US the ratio is
1 to 52!

You can see that, while the share of the
labor force still on farms has been falling,
about one-third (31 percent) remain in agriculture.
One-third is a higher percentage by far than
exists in any other industrialized nation.

Despite relatively heavy capital invest-
ment -- 18 percent of the total in the USSR vs.
4 percent in the US -- the withdrawal of man-
power from Soviet farms is relatively slow,
~~although it is continuing.~~

Soviet regimes have been plagued not only
by management difficulties in agriculture but
also by weather uncertainties. Annual fluctua-
tions in output are quite large. Located at high
latitudes -- Moscow is 55° North, on roughly
the same parallel as the middle of Hudson's Bay --
the USSR has harsh winters and short growing
seasons. This year, because of generally
favorable weather, crop prospects are good and

grain output is likely to approach the record high reached in 1970. Nevertheless, the USSR has already contracted to purchase over $8\frac{1}{2}$ million tons of Free World grain indirectly to increase food supplies, especially livestock products.

Grain and meat imports ~~in FY 1972~~ ^{between 1 July 1971 and the end of 1972} are expected to be at least \$600 million.

The Soviet diet is adequate in calories, but it is heavily weighted with bread and potatoes. Supplies of meat, fruits, milk, although increasing are nearly always inadequate to satisfy consumer demand. Consumers have to queue up for these products and they do not like it. This is why the Soviets are making a major expansive effort to raise meat production and are spending scarce hard currency on meat imports.

Soviet growth in the past has been fueled by continuing large and increasing outlays on investment -- both absolutely and when expressed as a share of GNP.

Chart #4

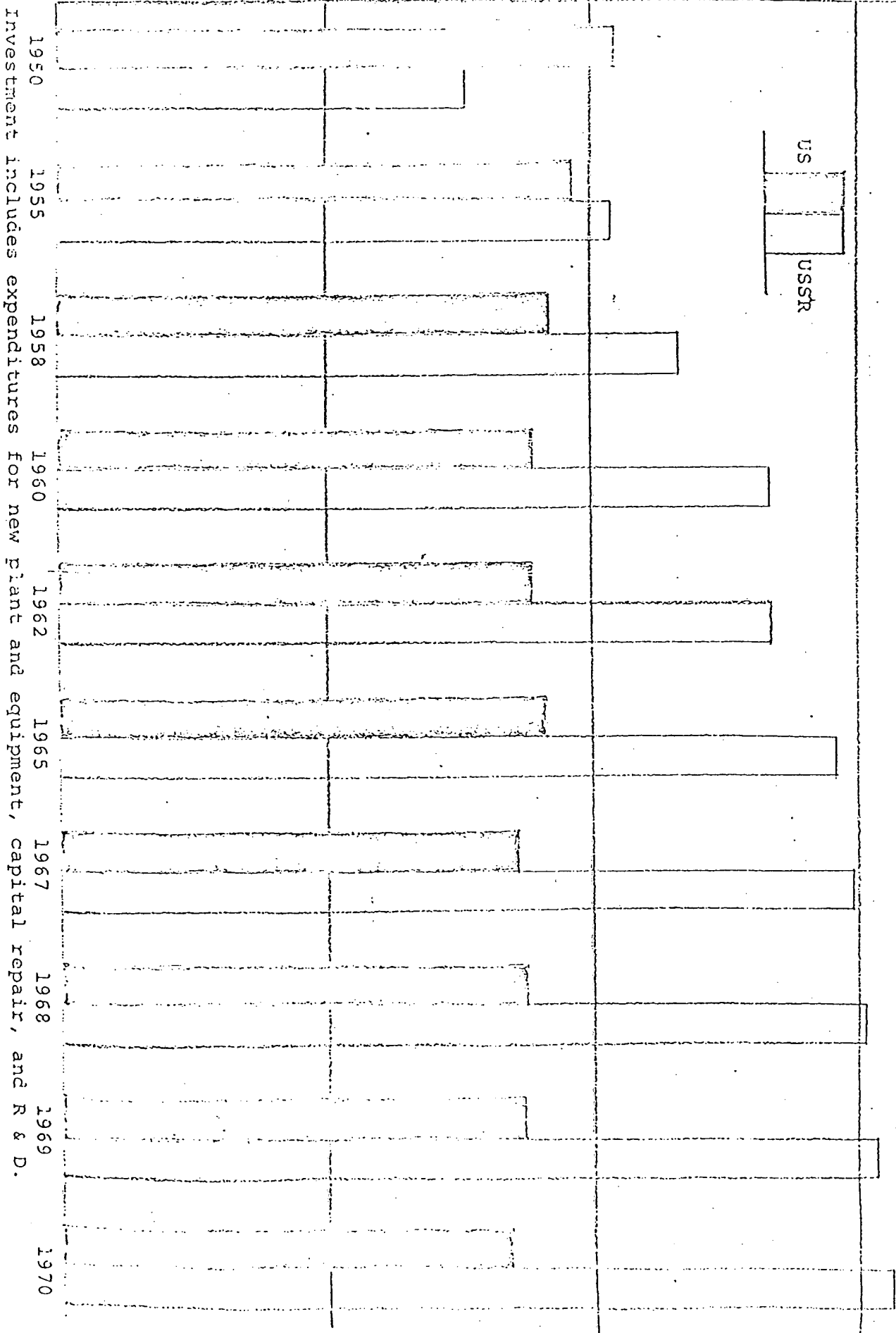
When investment growth in the two economies is viewed in this context, ^{the} leadership must surely be disappointed in the Soviet economy's failure

percent)

30

20

10



Chart

to post a better performance in closing the gap between the two economies ^{both} in GNP and its two primary components, industry and agriculture.

As reflected in the chart showing comparative investment shares of national product, the USSR allocates its total output much differently than does the US.

Allocation of Output

(CHART 5)

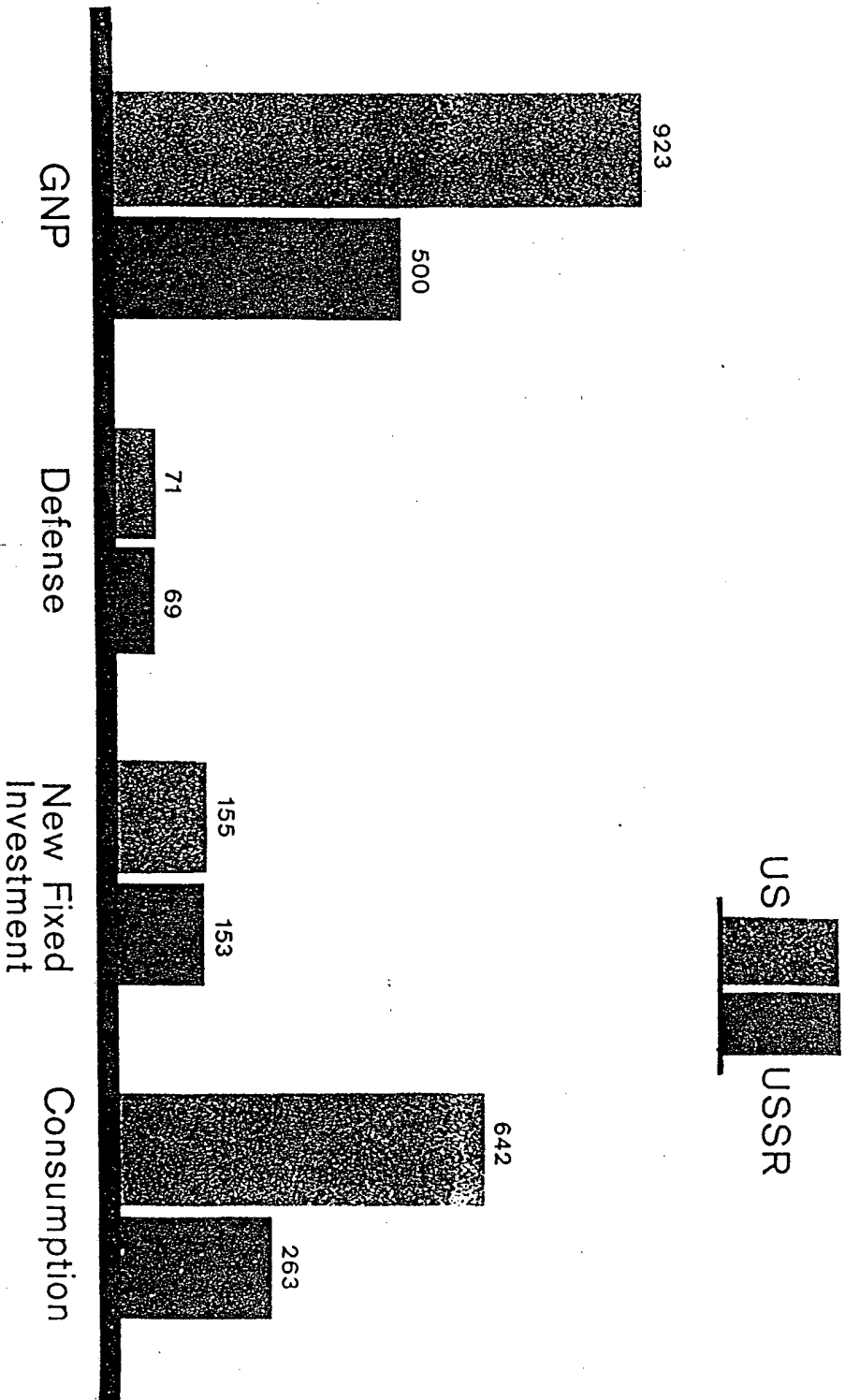
~~The USSR allocates its total output much differently than does the US. Their allocations stress the elements of national power, US allocations stress consumer welfare. Our chart shows:~~

1. Their outlays for new fixed capital are now about 90 percent of the US figure in absolute terms. This concentration reflects the continued growth orientation of the Communist leaders.
2. As for consumption, or what the man in the street receives, a Soviet population one-fifth larger than the American population gets perhaps 40 percent of what is spent in the US.

US and USSR: Gross National Product by End Use

(Billion 1969 US Dollars)

1970



Per capita, this means a bundle of goods and services about one-third of the US level and less than one-half of the West German level.

3. Finally, the Soviet defense and space outlays -- in dollar values -- ~~equates to over three fourths of~~ *are roughly the same as* ~~what the United States spends on~~ such programs.

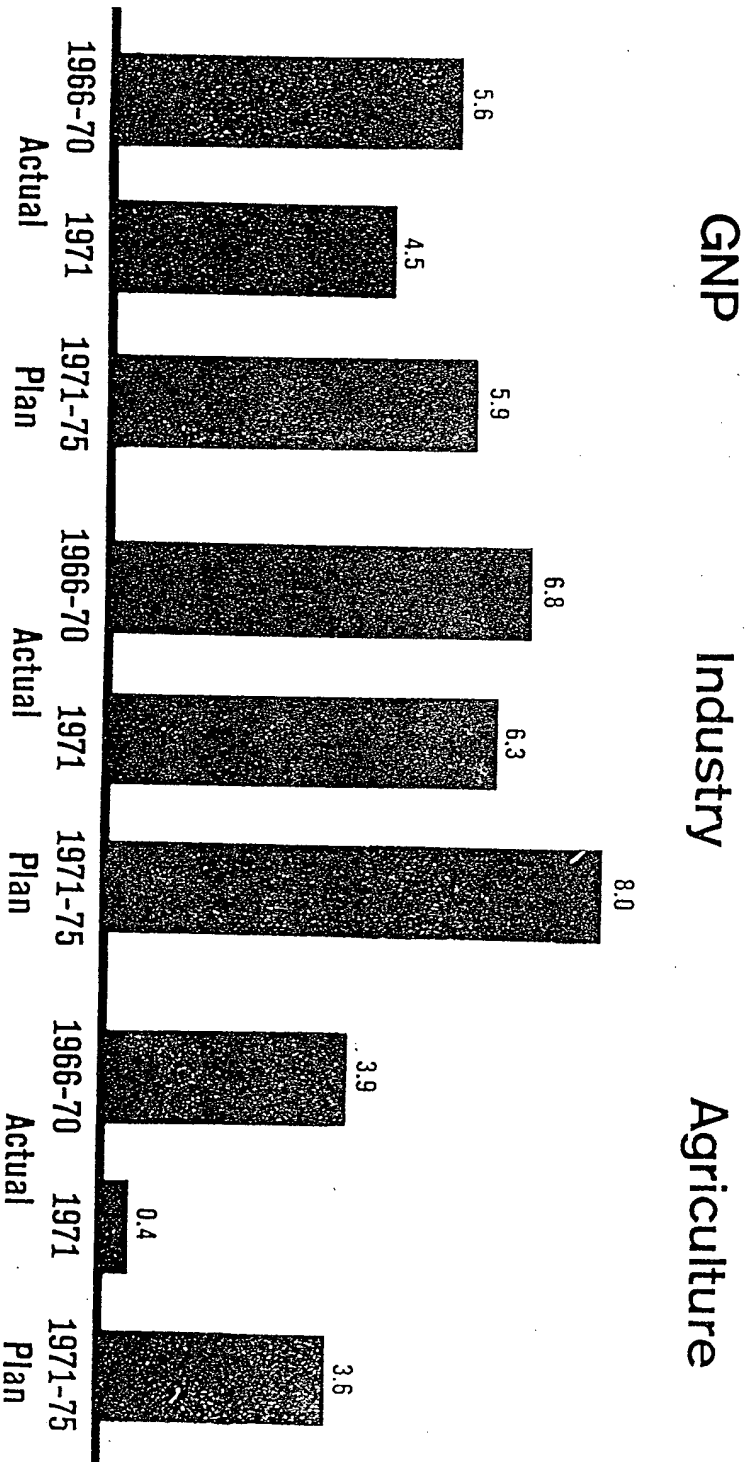
Moreover, The economic blueprint of the new five-year plan (1971-75) does not call for a radical shift either in production or allocational policies. The average annual rates of increased planned for GNP and industry are somewhat above the average annual growth achieved in 1966-70, as shown in the chart.

Chart #6

Although the new output targets for 1975 are relatively modest, the prospects for fulfillment are not auspicious. ~~The projected rates of growth of manhours after the stock of plant and equipment are somewhat less than during the last half of the 1960's.~~ Indeed, as indicated in the chart, in 1971, the first year of the

USSR: Average Annual Rates of Growth

Figures in Percent



plan period the economy got off to a slow start.

Chart 7

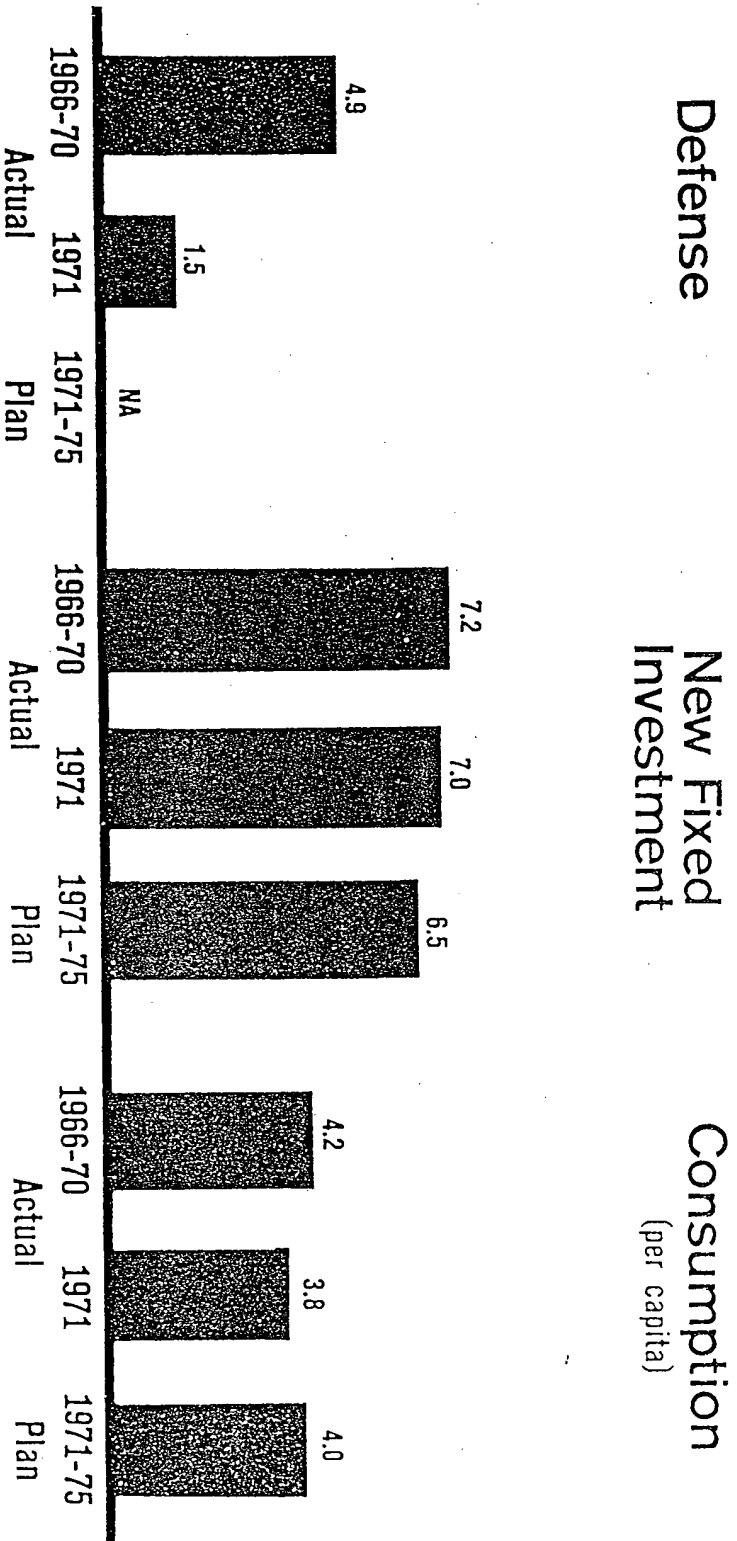
There is no evidence of major changes in priorities in the interplay of the demands for increases in all major sectors -- military and space, growth and consumption. As before, investment is to grow at a slightly higher annual rate (6½%) than GNP and consumption at a lower rate (5%). The data do not permit precise estimates of defense outlays, but it appears that the plan allows for a rise in expenditures for military and space programs at least as rapidly as that for national income.

I would like to ^{a few} ~~say an~~ additional word concerning priorities for the consumer. ~~We do not believe the long run outlook for the Soviet economy has improved fundamentally. There are signs that from here on in, every percentage point of future growth will be harder to achieve~~ There has been a good deal of debate as to whether the new five year plan signals a shift of priorities toward the consumers. Arguments both pro and con miss the message carried by past performance. There has been a steady effort to

7288

USSR: Average Annual Rates of Growth

Figures in Percent



raise the standard of living over the last decade or more. Investment in agriculture and consumers goods in industry in general have received an increasing share of investment.

Chart ~~7A~~ 8

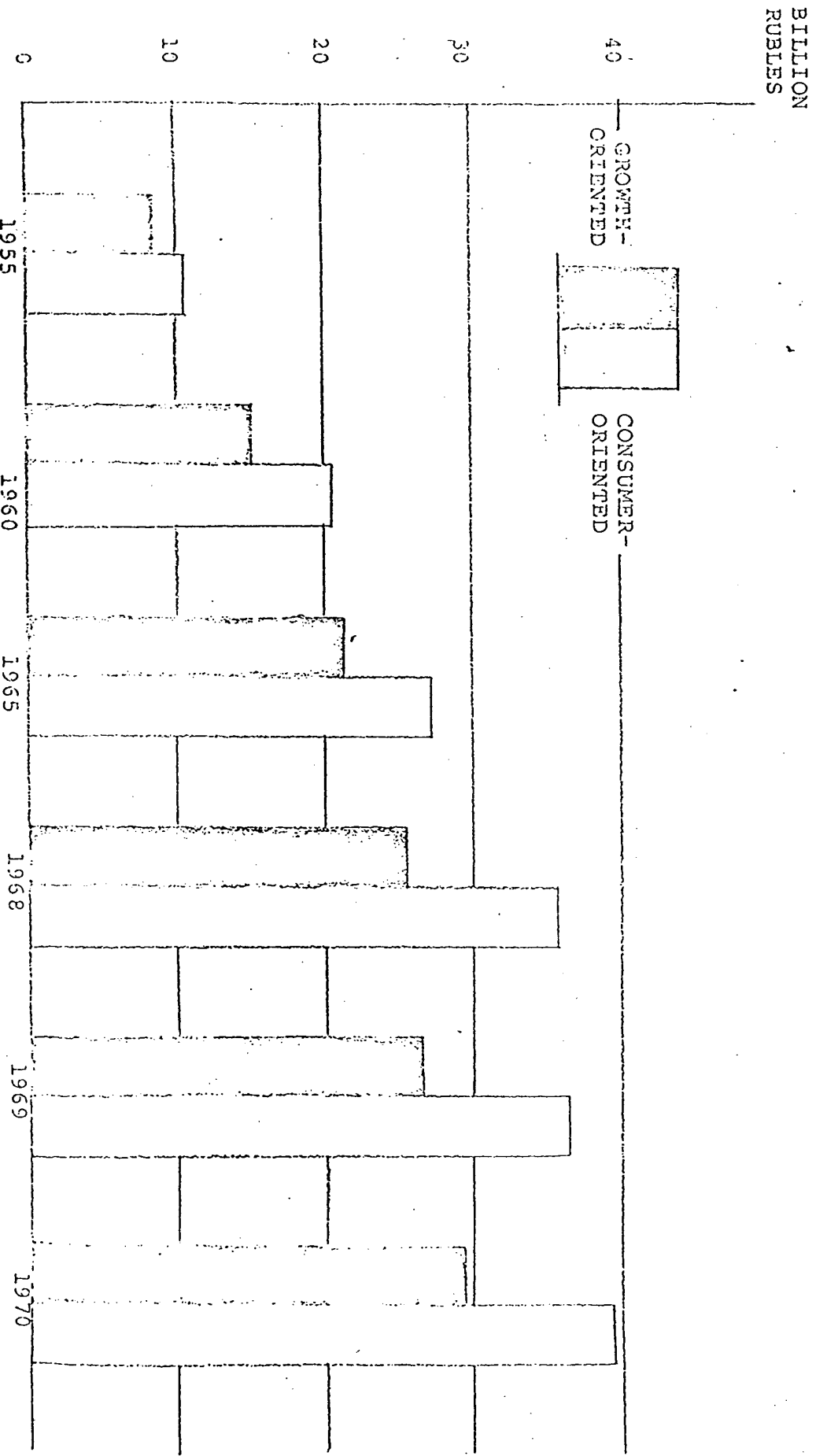
Consumer durables have grown more rapidly than producer durables. The difficulty springs not so much from lack of priority or effort, but from the extraordinary resistance to improvement under the Soviet system of meat production, housing construction, retail trade, repair services, and variety and quality of goods in general. These are all areas in which decentralized ownership and management have worked far better in all countries. We expect consumption to continue to get rising allocations and the problems to yield slowly and grudgingly.

We do not believe the long-run outlook for the Soviet economy has improved fundamentally. There are signs that from here on in, every percentage point of future growth will be harder to achieve.

And what about Soviet growth over last 75 period

9
FC

USSR: GROWTH-ORIENTED AND CONSUMER-ORIENTED INVESTMENT



NOTE: Growth-Oriented investment includes investment in heavy industry, the construction industry, and transport and communications. Consumer-oriented investment includes investment in consumer goods industry, agriculture, housing, and services.

1. The Soviets are experiencing a sharp decline in the return on investment in new plant and equipment, and we expect this trend to continue.
2. A tight labor situation has developed, and most of the excess rural workers have already been drawn to the cities.
3. The easiest technological gains have been made. Technological progress as measured by the estimated annual increase in productivity has been slowing in recent years.

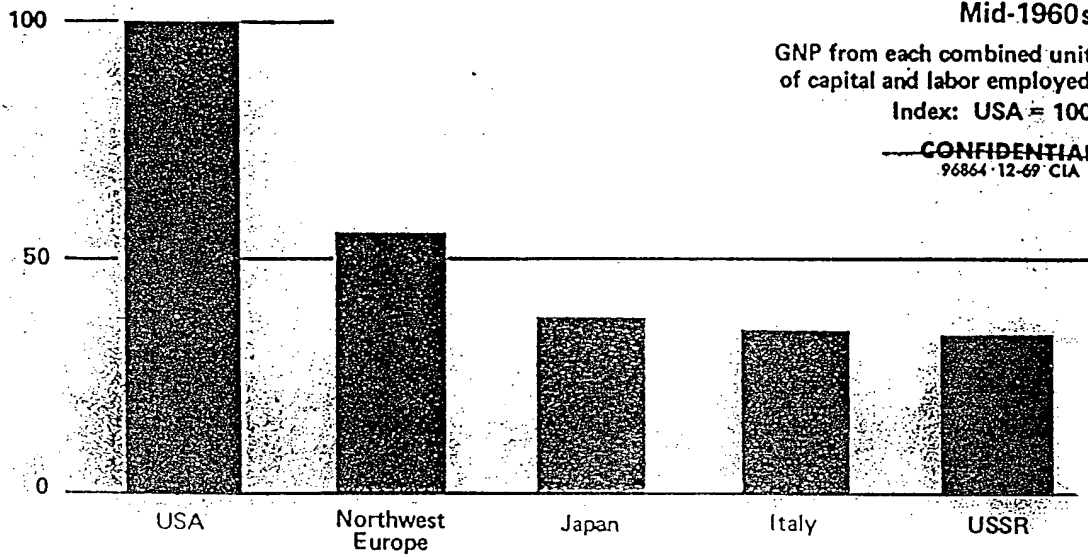
Chart 8

Moreover, closing the technological gap -- of which the Soviet leadership is well aware -- is not an easy task. An appreciation of the size of that gap can be obtained by comparing the relative levels of technological development in the USSR with other industrialized nations. The chart shows that, for a given input of capital and labor, output in the USSR is about one-third that of the United States. It is about equal to that of Italy, but significantly behind that of Western Europe. The Soviet Union's relative

Relative Levels of Technological Development --
Mid-1960s

GNP from each combined unit
of capital and labor employed
Index: USA = 100

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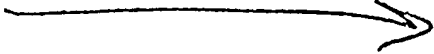


position does not change very much if the comparison is made on the basis of the amount of GNP generated per worker.

It is clear that an improvement in productivity performance requires not only a change in priorities, but some kind of drastic shake-up of the moss-covered bureaucracies responsible for initiating, designing, and executing new investment projects. In other words, it is a task of altering the institutional means whereby new technology moves from the research stage through development and test to fruition in the form of completed plant.

Many articles have been written in Soviet journals on the kinds of organizational changes that could be made which would supposedly speed up the introduction of new technology. To date, however, the results of exhortation and suggestion have not been visible.

Moreover, economic reforms introduced in 1965, designed to halt a rapid decline in the growth of productivity, have been effectively eroded by bureaucratic



opposition and half-hearted implementation. In fact, developments in the field of management have been retrogressive rather than progressive. I use these terms in two senses. First, the Reform of 1965 has not moved forward and in actual practice has moved back toward the pre-1965 methods. Thus, much like Krushchev, Brezhnev is now emphasizing close supervision of enterprises, more detailed planning, socialist competition, and more participation in economic matters by the Party. Secondly, from the point of view of liberal hopes, there has been no progress toward decentralization or use of markets or even adaptation of Western economic theory.

The Role of R&D Imports

One way to help overcome the technology problem is to increase imports of Western technology -- not only plant and equipment but also process licenses and patents. The Soviets have been expanding their imports from the West for the past decade. This helps in particular areas, but not across the board.

For example, as you know, the Soviets are

-92 ✓

now finishing construction of a modern automobile plant, a FIAT-equipped facility, which will raise the technological level of the Soviet automobile industry sharply for a few years. They are starting to build a very large truck plant on the Kama River, a facility that will embody Western, including US, technology. They are trying to acquire computer technology. These are not inexpensive moves. The FIAT plant will cost roughly \$1.5 billion, and the Kama truck plant, a follow-up project, will cost even more. But ~~as indicated above~~ the ability to acquire technology from the West, in the form of complete plants on a turn-key basis, is limited by the availability of foreign exchange.

Moreover, there is a hard-currency deficit of several hundred million dollars a year in trade with the West, because of chronic difficulty in providing anything the West wants to buy. Since 1966, Russia has used credit to cover this deficit, rather than selling gold. The Soviet debt to Western countries now exceeds one and a half billion dollars.

Chart 810

Krushchev sold gold to buy emergency wheat and complete plants and technology from the West. As a result, gold reserves dropped from three billion dollars in 1955 to one billion in 1965. They are now back up to about \$2 billion.

The USSR sold about \$20 million in gold early in 1971, but no sales have been noted since March. In view of the Soviet's persistent hard-currency deficit and recent large grain purchases, additional sales are possible, although probably not in excess of Soviet annual output. Thus, sales of up to \$200 million are possible without drawing down Soviet reserves.

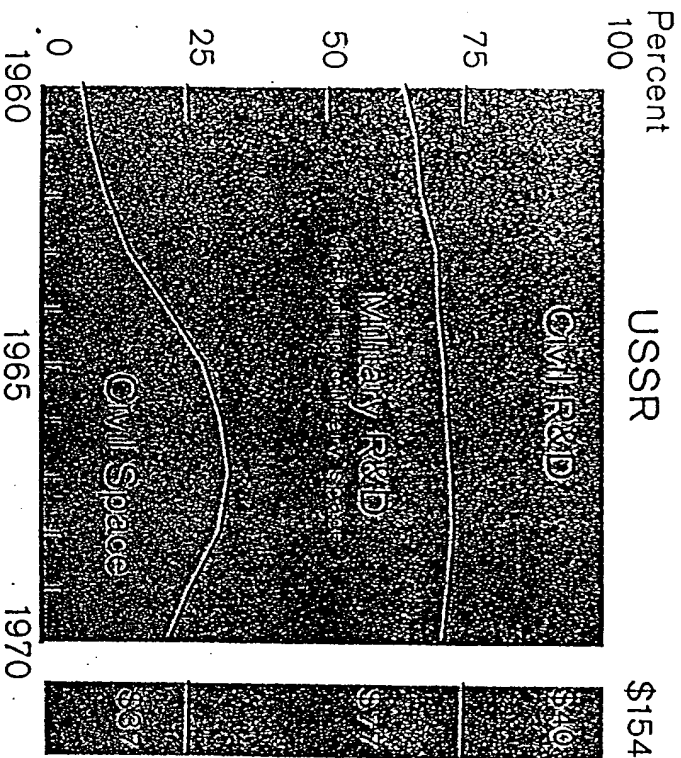
Let me close by reiterating that slower economic growth clearly can provide the resources for an increasing military effort, a rising level of living, and "an expanding industrial base. The Soviet economy is now so large that a very small rate of increase in GNP -- say 2% -- results in about \$9 billion more of product.

Additional Charts
Distributed During the Briefing

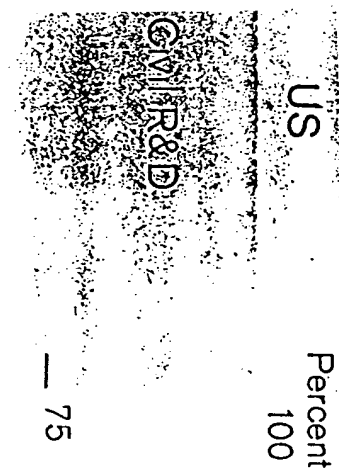
US and USSR:

Expenditures for Research and Development and Space

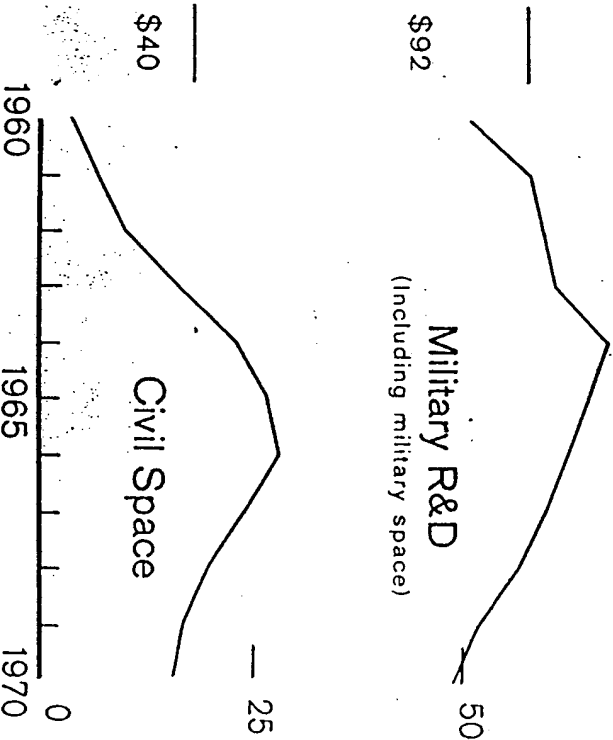
1960-70



\$226

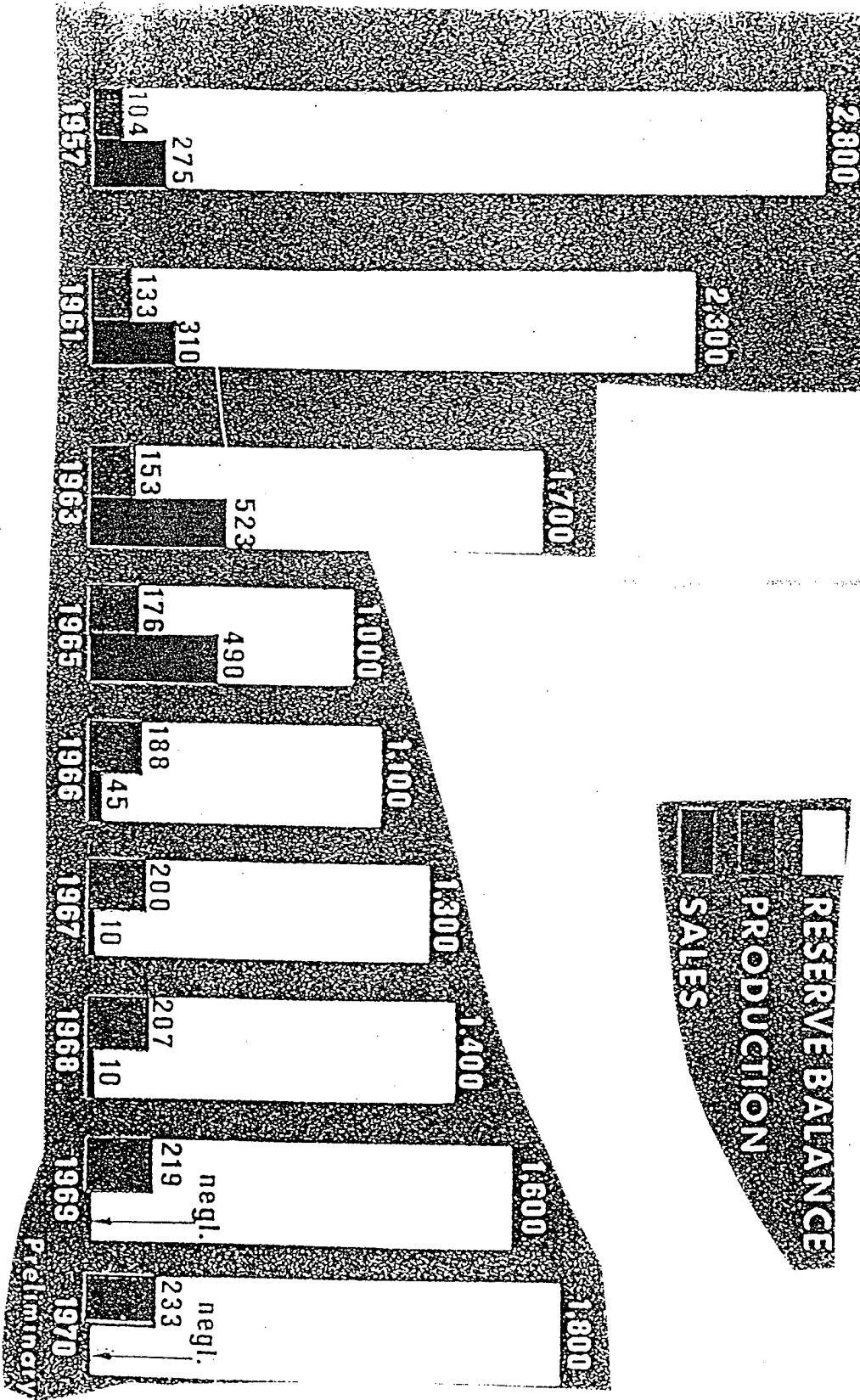


Cumulative Expenditures
1960-1970
(Billion US Dollars).



USSR: Gold Reserves

Million US Dollars



RESERVE BALANCE

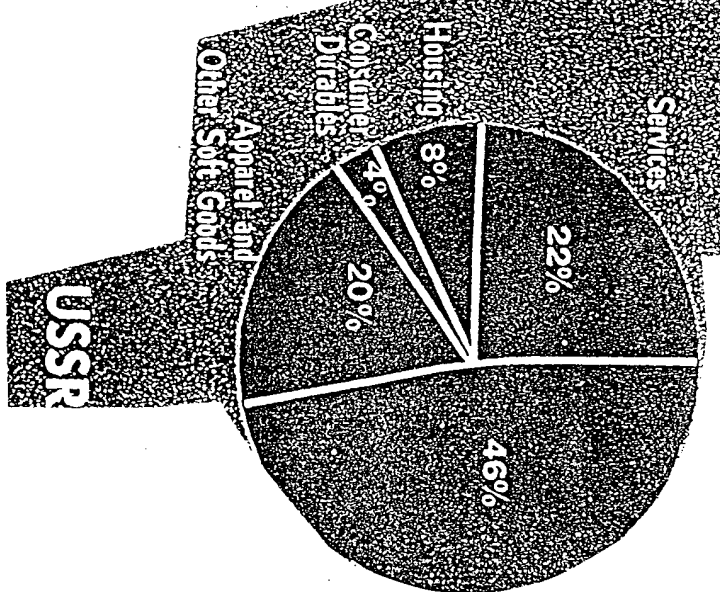
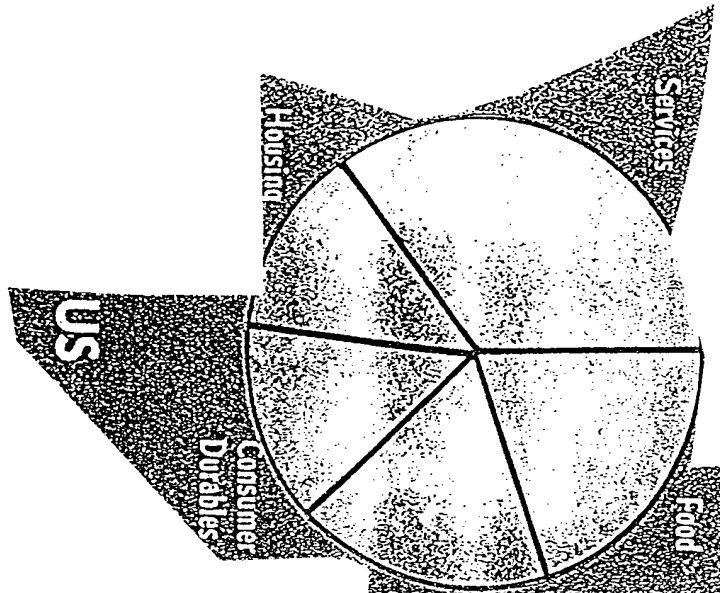
PRODUCTION

SALES

Preliminary

Food and clothing take the major share of Soviet consumption expenditures

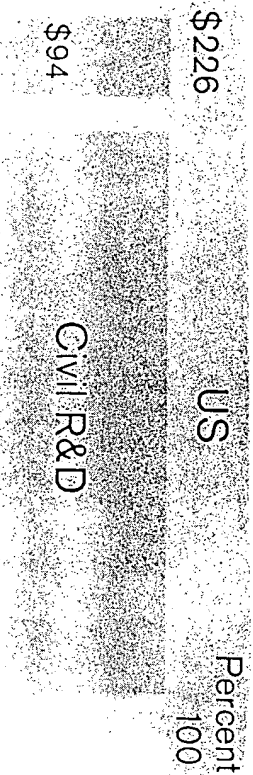
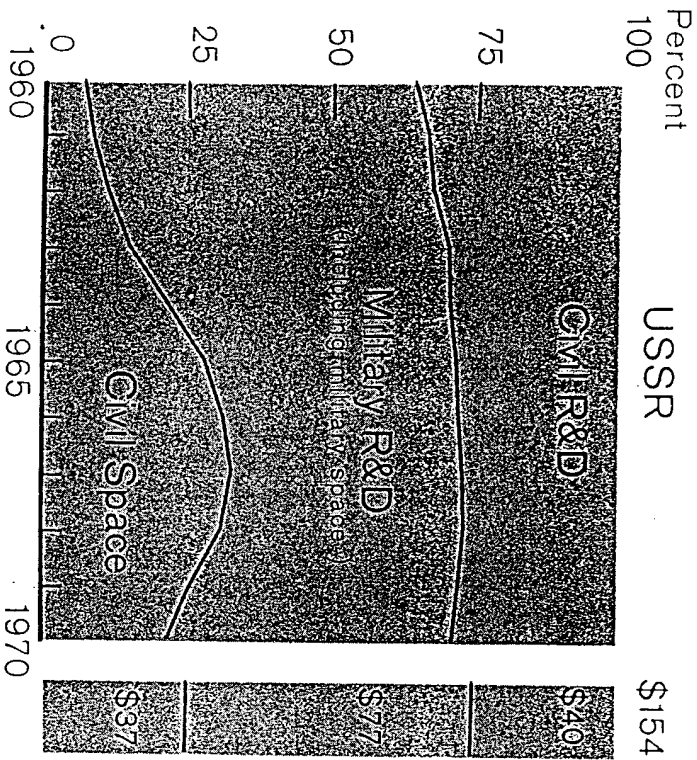
1970
(Percent of Total Consumption Expenditures)



US and USSR:

Expenditures for Research and Development and Space

1960-70



Cumulative Expenditures

1960-1970

(Billion US Dollars).

