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26 JUL 1963

POST MORTEM ON

"TRENDS IN THE SOVIET ECONOMY (1950-63)"

1. Introduction

This memorandum is intended primarily as an elaboration and fuller explanation of the main ideas that were contained in NIE 11-5-63, Soviet Economic Problems, 20 March 1963, and in our contribution to this NIE, published as CIA/RR ER 63-2, Trends in the Soviet Economy, 1950-63, February 1963. Time has passed and new information has appeared. Hence the memorandum also reflects to some degree the re-assessment of the Soviet economy as of mid-1963 that was summarized in the CIA Memorandum of 3 July 1963, Soviet Policies and Problems on the Eve of the Moscow Negotiations.

2. Recent Strain on Resources and Difficulty of Allocation Decision

A basic theme of ER 63-2 is that the recent slowdown of growth combined with growing commitments in defense, space, and investment programs has resulted in a state of "strain" in the Soviet economy and that in the words of the ER: "This suggests that some very difficult allocation choices have yet to be made or are being made now. Choices must be made on the one hand between current consumption, investment, and defense (including space) and on the other hand between investment in consumer sectors and investment in basic industry." (p. 51)

The difficulty referred to is not the chronic problem of the allocation of scarce resources in a "taut economy", but rather the political problems arising from frustrated hopes and unfulfilled promises. Khrushchev and his colleagues have the same difficulties as other political leaders in postponing ambitions and renegeing on promises. The demands which are competing with defense and space were described in ER 63-2, as follows:

(a) Demand for rapid economic growth: "Rapid economic growth aimed at catching up with the US is a fundamental long-run Soviet policy, which the leadership will be reluctant to sacrifice to an inconclusive military buildup for very long." (p. 3)

(b) Demand for better supply of consumer goods: "The Soviet people are chafing increasingly under the inability of their government to provide better quality food, decent housing, and more consumer durables." (p. 3)

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No attempt was made in the ER to document these two demands in detail. However, they can be extensively documented. Consumer chafing, the incidence of riots, and rising prices are discussed in the recently published paper, Evaluation of Inflationary Pressures in the USSR (CIA F April 1963).

The goal of catching up with the US is a long established communist goal. It has not diminished with time. On the contrary, it has flourished and has taken on more body and precision as the gap between Soviet and US output has apparently been narrowed. Stalin was emphatic as to the importance of catching up with capitalist countries but vague as to timing. In 1939 he said;

Only if we surpass the principal capitalist countries economically can we count on our country being fully supplied with consumer goods, will we have an abundance of products, and will we be able to make the transition from the first to the second stage of communism .... But it should take time, and not just a little time, to surpass economically the principal capitalist countries.

Khrushchev, on the contrary, has set precise dates to the goal of catching up. In 1957 he said;

Comrades, the estimates of our planning staff show that the Soviet country can in the next 15 years not only catch up with the present United States production volume of essential products, but outstrip it.

In 1961, louder and clearer:

...I am asked, "Mr. Khrushchev, what do you think? In what year will you catch up with America?" - - - My reply is; "you can write down in your little notebook that we will overtake you in per capita industrial production by 1970".

There are numerous other Soviet statements to the same effect, going back to Lenin in 1919. Nearly all students of the USSR have recognized the importance of this goal. Professor Abram Bergson said in Challenge (March 1963), "But in the economic field he has pursued steadfastly the imperative that he inherited from Stalin; by outpacing the USA economically, the USSR must eventually supplant us as the World's first industrial power."

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### 3. Effect of Defense on Growth

The slowdown in growth continued into 1962 and, so far as we can judge from economic intelligence information, continues in 1963. GNP, for example, grew 3 percent in 1962, compared to an average of 5.5 percent from 1959 to 1961 and an average of 7 percent from 1955 to 1959. In the slowdown was attributed to (1) the defense buildup in 1958-62 after a lull in 1955-57, (2) the shortened work week, and (3) less favorable weather and a slowing down in the rate of increase of resources in agriculture. The experience of 1962 underlines the importance of (1) and (3) since the effect of the short work week was largely over by 1961. In 1962, total manhours worked in industry rose 3 percent after staying constant during 1958-61.

The objection to the analysis, namely, that investment did not fall significantly as a percentage of GNP can best be answered by a quote from Bergson's Challenge article.

"...But it should be borne in mind that the Soviet stock of fixed capital already is growing at an extraordinary rate: in the fifties by some 11 percent per year. Even maintaining this high tempo, to say nothing of increasing it will be a difficult task. This could not be accomplished merely by maintaining the present share of national income devoted to the new capital investment. Rather the government would have continually to raise this share.

"While this important fact is still not always understood, it becomes obvious when one considers that capital stock has been growing much more rapidly than output and that this is the chief reason that it has been possible to increase output at a rapid pace to begin with. As we saw, the growth in the employment of labor has only been modest".\*

Finally, there is a question of time lag. Investment is an increment to capital stock, and time must pass before a slowdown in the rate of growth in the increment seriously slows the growth of capital stock. Although investment has not grown as a share of GNP for three years, this factor could not have slowed up the growth of capital stock much yet. The quantitative measures, therefore, do not fully explain the slowdown in growth of output.

\* Ben Bergson and Kuznets, Economic Trends in the Soviet Union, Harvard University Press, 1963, pp. 4-6, for the historical rates of growth of capital stock and output.

\*\* For example, if capital stock and net investment had been growing at 11 percent annually, and if net investment slowed to a growth of 5 percent annually, then the growth of capital stock in the third year would be 10 percent.

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The other factors in the slowdown which are discussed in are qualitative changes and lack of flexibility of the system. Thus the diversion of resources to military and space uses has been as important in quality as in quantity. Military and space have provided increasing competition for specialized high-grade resources -- complex machinery, new alloys, and highly skilled labor and management.

The second factor -- difficulty of the Soviet system in adjusting to sudden change -- is elaborated in the discussion of problems in investment, in industry, and in planning and organization

Speeches by Soviet leaders paint a picture of resistance to change and inability of the economy to adjust smoothly to changes. Khrushchev, for instance, in his speech before the Central Committee Plenum last month, once again berated the planners and managers for starting new investment projects instead of finishing old ones. Our assumption is that the rather small percentage stringency imposed by added consumption of materials and equipment in the defense and space programs quickly resulted in bottlenecks which the Soviet investment system was unable to solve expeditiously and economically.

The current revision of the plan for 1964 and 1965 is support for the above arguments. In order to get the adjustments wanted by Khrushchev -- notably the rapid expansion of production of fertilizers and plastics and the concentration on a limited number of investment projects of the highest priority -- it has proved necessary to completely rework the last two years of the seven-year plan.

#### 4. Comparative Effects of the Arms Race on the US and the USSR

ER 63-2 asserts that "The Soviet leaders must be acutely aware, however, that the arms and space races are penalizing Soviet economic growth more than these races penalize US growth." (p. 3). Nothing particularly subtle was meant by this statement. The US today has idle capacity in the economy as a whole and in almost every major branch of heavy industry in particular, in contrast to the strained condition of the Soviet economy. Further arms and space expenditures in the US almost certainly would lead to substantial increases in GNP, investment, and consumption, whereas in the USSR further expenditures would lead to additional shuffling of economic plans and resources and would cause further delays in finishing non-military construction projects and in improving the lot of the consumer. Furthermore, the arms and space race, which has been stepped up a notch or two, in the past two years, has caused almost no problems of adjustment or friction in the market economy of the US, whereas in the USSR the transitional costs of getting from one product mix to another appear to have been high.

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5. Facing the Problem

The general economic picture presented in \_\_\_\_\_ remains a valid appraisal of the situation in the Soviet economy today. However, the response of the leadership to its problems may have changed. At the time \_\_\_\_\_ was written the Soviet leaders appeared undecided about which commitments, if any, should be reduced. In February of this year, they seemed to be leaning toward a continued emphasis on defense at the expense of consumption (See NIE 11-5-63). Now, however, Khrushchev appears to have given the green light to the production of fertilizers, synthetic fibers, and plastics, in apparent support of consumption. What other decisions (for example, the trend in defense expenditures) may have been made we do not yet know, but the current process of revising the plans for 1964 and 1965 suggests that the general outline of these decisions has been laid down by the leadership.

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