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## Soviet Perceptions of Economic Prospects

An Intelligence Assessment

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## Soviet Perceptions of Economic Prospects

### Key Judgments

The Soviet leadership recognizes it faces a convergence of economic constraints in the 1980s that defies easy solution. Relatively new constraints, such as raw material scarcities, a manpower shortage, a slowdown in capital formation, and a decline in the growth of consumer welfare, have combined with such traditional problems as lagging agriculture and transportation and poor planning and management. Defense spending is acknowledged to be an added burden. Moreover, the leaders realize that gains in productivity have not offset the decline in the rate of growth of resources committed. The result is a continuing slide in economic growth.

The leadership also has a clear idea of what needs to be done. The focus must now be on "intensive" development—that is, rapid productivity gains through the introduction of new technology, improved incentives that encourage the conservation of scarce factors of production, and better planning and management. Soviet leaders seem increasingly concerned that the transition to such development is not being made successfully. Their public statements indicate particular anxiety over the energy crunch, the slow pace of economic reform, and the effect of lowered expectations on worker productivity. Soviet leaders apparently do not expect a quick turnabout in fortunes. They apparently believe that there are no panaceas, only palliatives, for the continuing economic problems.

*Consumer welfare.* They see a continued decline in consumption growth, evidenced by their search for ways to restrict demand and to modify rising expectations. They hope that there will be some growth in priority consumer areas and that exhortations for greater worker efforts will be an adequate stimulus to productivity.

*Capital formation.* They realize that a return to high rates of investment growth is neither possible nor practical and hope that smaller investment allocations will encourage more efficient use of plant and equipment. In the short run, they probably do not view the slowdown in capacity expansion as the major constraint on growth.

*Energy production.* They do not appear sufficiently concerned by energy prospects to take any radical steps, such as the transfer of investment resources from other priority areas. They have turned instead to more urgent energy conservation and are stepping up the rate of investment in oil production and other energy sectors.

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**Manpower.** They seem convinced that modest measures to save and redistribute labor will compensate to some extent for the slowdown in new entries into the labor force.

**Planning and management.** They are disappointed by the slow pace of economic reform but are still confident that tinkering can make the system work.

**Agriculture.** They see little hope for significant breakthrough in acceleration of the growth of farm output or for reducing its instability. They realize that they must continue to invest heavily in this sector and spend sizable amounts of foreign exchange on imports to counter in part the large fluctuations in domestic farm output and to satisfy the rapid rise in consumer demand.

**Technological progress.** They see the slow pace of economic reform and the decline in growth of plant and equipment threatening the introduction of new technology and hence productivity goals. They will continue to rely on imported foreign technology, to concentrate investment funds in sectors considered key to technological progress, and to encourage the military research and development sector to share its skills with the civilian sector.

The leadership's apparent belief that the decline in Soviet economic performance can be held within manageable bounds without major policy change diverges from the perception of most Western observers, who foresee more severe consequences stemming from this business-as-usual attitude. The measured response is typical of Moscow's aged leaders, who have a vested interest in and close identification with the system as it is. They have a penchant for piecemeal measures and count on continued docility by the consumer, who must absorb the major impact of the economic decline. In the end, the leadership looks ahead to the 1990s, which promise some relief from this decade's toughest problems.

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## Soviet Perceptions of Economic Prospects

### Introduction

The study of Soviet leadership perceptions of economic prospects is important because Soviet actions in many areas—foreign policy, military programs, and trade—are motivated to varying degrees by internal economic developments. If our perceptions of Soviet economic prospects differ markedly from theirs, we could misinterpret their reactions to internal and external stimuli.

An assessment of leadership perceptions is of particular current interest because of the unique challenges that the Soviet economy faces in the 1980s. The simple growth formula used for more than half a century—large infusions of labor and capital—will work no longer because these inputs are becoming more scarce and costly. As a result, large productivity gains are essential for future growth. To understand and perhaps predict Soviet economic policies it is useful to know how the leadership views this changing situation.

The leadership does not specifically address overall economic prospects in public. Bits and pieces of evidence from a wide variety of sources need to be assembled, therefore, to construct a reasonable facsimile of the leadership's perceptions. This paper arranges the evidence in answer to the following questions—deemed to be the most relevant to an assessment of prospects:

- What does the leadership identify as the key economic problems?
- According to Soviet measures, how serious is the decline in growth?
- Do Soviet leaders display a rising concern about specific problems or economic growth in general?
- What do they believe are the prospects for solving specific major problems?

The collected speeches of Brezhnev and Kosygin were used as a major source. Although voluminous, their public pronouncements are highly general in nature, and rhetoric often obscures substance. Moreover, it is legitimate to question how representative they are of the leadership's true perceptions. Nevertheless, they are the only primary source. Another major source was

statements by leading Soviet economists. At the least, their views must have some impact on the leadership's thought processes and, at most, they can be said to share the leadership perspective. An analysis of official Soviet statistics was used to determine Soviet perceptions of past trends in economic growth. Western estimates of Soviet growth performance were introduced to compare the configuration of trends between the two sets of measures. Finally, Soviet policy responses were a source of clues to the degree of concern with which the leadership views specific economic problems

In the last section of the paper the evidence outlined above is weighed to obtain a general assessment of leadership perceptions. The task is then to explain the apparent divergence in their views of economic prospects from those of most Western observers. Some tentative hypotheses are offered, but a thorough examination of the leadership's rationale is beyond the scope of this paper

### Identification of the Key Economic Problems

The first clue to leadership perceptions of economic prospects lies in its identification of key economic problems. If the weak spots are identified correctly, then a realistic assessment of prospects is more likely. A list of key economic problems was compiled—based on the frequency and intensity of citation—from the speeches of Brezhnev and Kosygin for 1970 to 1980. Despite some differences in approach on specific issues, a consensus on the major problems readily emerged and was remarkably stable over time. The liberal use of quotations in this section allows a close look at the peculiar Soviet perspective on each subject.

Throughout the past decade the leadership was absorbed with the problem of declining economic growth. It acknowledged that a new growth strategy was required, one that emphasized "intensive" and not "extensive" development. Brezhnev put it most simply

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in a speech to workers at the Kharkov tractor plant in April 1970.

Many problems are essentially connected with . . . the fact that we have entered a stage of development that no longer allows us to work in the old way but calls for new methods and new solutions

More specifically, the new growth strategy was recognized as necessary because the basic inputs that were available in such relative abundance in the past—manpower, capital, and raw materials—were becoming more scarce and expensive.

The so-called extensive factors of growth in the national economy are also becoming more limited; in 1971-75 opportunities for enlisting additional manpower will decline in comparison with the past five-year plan. The growth rates of capital investments also have their limits. [Brezhnev speech to 24th Party Congress—March 1971]

Requirements are growing faster than resources. For this reason we are compelled to introduce rigid consumption coefficients . . . for the production of petroleum, gas, coal, steel, rolled metal, and nonferrous metals. [Brezhnev speech to party plenum—October 1976]

The leadership realized that this decline in resource growth could be offset by a rise in productivity gains and believed the best way to effect this transition to "intensive" development was to "accelerate scientific-technical progress" and improve labor organization and discipline. Various obstacles stood in the way of accomplishing these goals, however. The list below represents an attempt to distill into "first causes" the major obstacles cited in the 10-year file of leadership speeches:<sup>1</sup>

- A chronic lag in the completion of investment projects.

We have still not been able to halt the process of scattering capital investments among numerous construction projects. The amount of unfinished construction is increasing. Uninstalled equipment worth several billion rubles lies around unused in warehouses. This has been discussed more than once. But there are no signs that Gosplan, the

<sup>1</sup> These problems are abundantly delineated in the speeches of both Brezhnev and Kosygin. Illustrations here are mostly drawn from Brezhnev because his statements are more clear and germane.

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clients, or the builders feel any responsibility for immobilizing capital investment equipment and materials.

[Brezhnev speech to Central Committee plenum—November 1978]

- Weak incentives and poor management structure for the introduction of new technology.

Cardinal changes [are needed] in the style and methods of economic activity, improvement of planning and economic incentives to make possible the swiftest possible transmission of new ideas along the entire chain from invention to mass production. [Brezhnev speech to 25th Party Congress—February 1976]

- Weak incentives and poor management structure for the conservation of scarce resources, including manpower and materials.

Thrift . . . requires new approaches in capital investment policy and in many spheres of technical policy, maneuvering with existing capacities and manpower resources, and the overcoming of departmental and parochial tendencies. It also requires a certain restructuring in planning, in the methods of economic management, in the system of indices, and in material incentives. No matter how complicated this restructuring may be, we cannot get along without it. [Brezhnev election speech—March 1979]

- Consumer goods shortages, particularly food, that frustrate worker incentives:

The entire course of economic development confirms again and again that a Group B [consumer] industry that meets today's demands is an important condition for the effective work of the economy, as a whole and for the improvement of material incentives. [Brezhnev speech to Central Committee plenum—November 1978]

Two additional problem areas that cannot be directly related to the emphasis on "intensive" development are agriculture and transportation. The leadership identifies two parts to the agricultural problem—how to reduce the wide fluctuations in farm output caused by weather and climate variations and how to accelerate long-term growth. The obstacles encountered in the pursuit of these twin goals resemble those in the rest of the economy—lagging technology and poor organization and management.



Comrades, there are no easy paths here ... it has become all the more obvious that a further steep upswing in agriculture depends on the creation of a material and technical base that will correspond to present-day requirements. [Brezhnev election speech—June 1970]

The organization and management of agriculture should be improved ... there are no ready-made recipes here. [Brezhnev speech to 25th Party Congress—February 1976]

The transportation problem is seen as a serious growth constraint and the result of a lag in investment allocations that allowed this sector to fall behind the development of the rest of the economy.

A permanent, comprehensive development program for transport must be worked out which would absorb the best achievements of scientific and technical thought. This program is called upon to cover the questions of the development of all types of transport. It should be focused on modernizing the railroads ... [Brezhnev speech to party plenum—November 1979]

Although not an economic problem per se, the size of defense expenditures is a frequent background theme to the leadership discussion of economic growth. It expresses continued concern about the high levels of spending and the consequent burden on the economy.

Socialism is sufficiently powerful to ensure both a reliable defense and the development of its economy, although of course, without large defense expenditures we and our economy would move ahead far more quickly. [Brezhnev pre-election speech—June 197

In addition to the themes reflected in leadership speeches, recently published lists of economic goals for the medium and long term reveal the emphasis on intensive development. Virtually all targets emphasize conserving resources, promoting sectors key to "technical progress," or improving incentives to promote efficiency. The first list was compiled by a commission set up to prepare the "Complex Program of Scientific-Technical Progress and its Social-Economic Consequences to the Year 2000"—the joint task of Gosplan, the State Committee for Science and Technology and the Academy of Sciences (*Voprosy Ekonomiki* No. 7, July 1979). The Commission believed that their efforts should concentrate on seven

"urgent problems for the country's social-economic development":

- Improved structure of capital investment, that is, a substantial increase in the equipment component.
- Improved "capital construction," that is, higher quality and more timely completion of new plant and equipment.
- Development of the machine-building sector.
- Improved management and organization of the "agro-industrial complex."
- Provision of the "solvent demand of the population," that is, reduction of the backlog of unsatisfied consumer demand.
- Solution of the "housing problem."
- The problem of labor resources.

The major plan themes for 1981-85 were first enunciated by Gosplan Chairman Baibakov in *Vestnik akademii nauk SSSR* (May 1980). He said that "priority has been given to five programs":

- The conservation of metal.
- Conservation of fuel.
- The construction of the Baikal-to-Amur Railroad (BAM) and development of the newly accessible Siberian areas.
- Reduction of manual labor.
- Increased production of new types of consumer goods.

Later in the year Gosplan's house organ *Planovoye khozyaystvo* (No. 8, 1980) modified these points somewhat and gave more detail:

- Reduce transport "difficulties," particularly in the railroads.
- Improve the fuel-energy balance through the greater use of natural gas and atomic energy, and implement a nationwide energy conservation program.
- Improve the work of metallurgy and machine building through such means as reducing the metal content of machinery and developing metal substitutes.
- Complete unfinished construction and reduce new construction starts in favor of the reconstruction of existing facilities.
- Improve the supply of food, especially meat

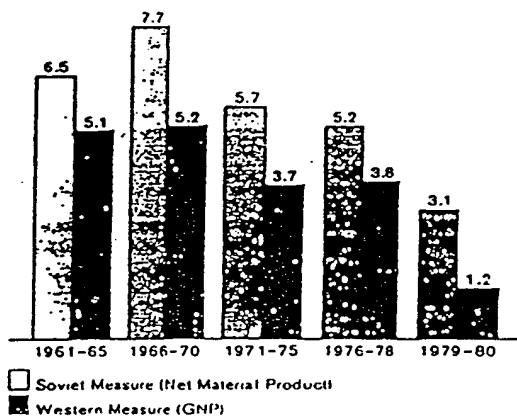
In summary, the problems identified are recognized as the result of both resource and systemic deficiencies that are interrelated. The ultimate problem is how to

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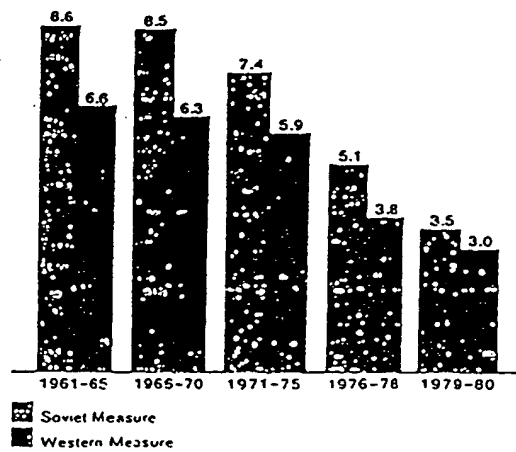
Figure 1

Selected Economic Indicators

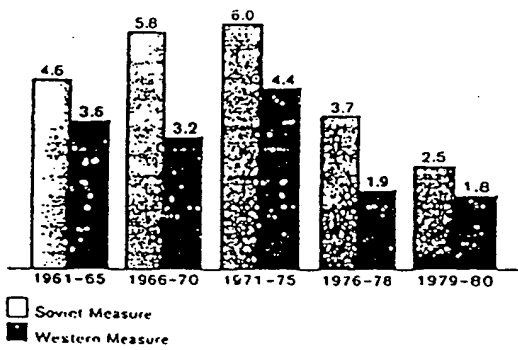
Average Annual Percent Rate of Growth  
Overall Economic Growth



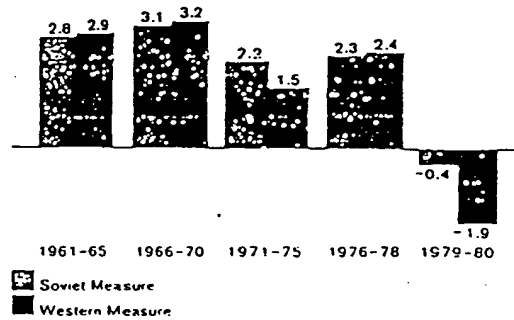
Industrial Production



Industrial Labor Productivity



Agricultural Production\*



\*Three-year average. The average for 1980 includes an estimate for 1981 based on normal weather conditions.

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promote intensive development—that is, rapid productivity gains. The leadership's picture of the challenges confronting the Soviet economy in the 1980s, then, is not unlike that drawn by Western observers.<sup>2</sup>

**Measurement of the Decline in Growth.** Because declining growth is the nexus of the economy's problems, it should be examined quantitatively from the Soviet viewpoint, that is, by using official Soviet measures of economic growth. In this way we can determine the magnitude of the problem from their perspective and at the same time compare it with Western estimates of Soviet growth.

Since the inception of the Brezhnev-Kosygin leadership, economic growth has trended downward, particularly since 1970 (see the figures). Although Soviet aggregative statistics show generally higher rates of progress than Western measures, the trends have been remarkably similar. The decline is apparent in both the industrial and agricultural sectors. The pace of the rise in consumer welfare has suffered accordingly. Productivity data clearly show a secular decline, revealing this to be a major reason for the general economic slowdown

It seems unlikely that the Soviets could take comfort in these statistics, even considering the 1 to 2 percentage point spread above Western estimates of GNP and industrial output growth. The relevant aspect is the downward trend in growth that requires hard-policy choices and increases tensions among competing power groups. A continued rise in resource allocations at past rates for one resource claimant, the military for example, would create a serious squeeze on resources for growth and consumption

Although official Soviet measures reflect a decline in overall growth similar to that revealed by Western measures, conceptual differences may affect the level of Soviet leaders' concern. The exclusion of most services from Soviet national income, for example, predisposes them to give greater weight to the material-producing sectors. The precipitous decline in industrial

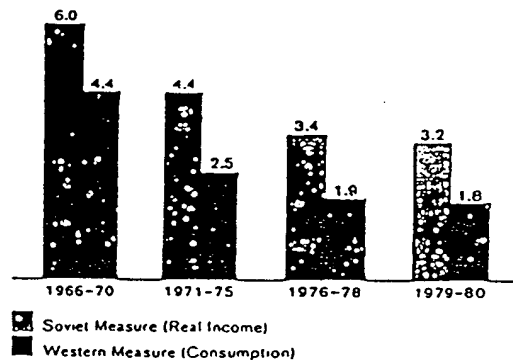
<sup>2</sup> See "Soviet Economic Problems and Prospects," ER 77-10436U, July 1977

<sup>3</sup> For a short discussion of the different concepts underlying Soviet and Western measures, see Appendix

Figure 2

## Growth in Per Capita Consumer Welfare

Average Annual Percent Rate of Growth



production growth during the 1970s, therefore, could look more ominous to the Soviet leadership than to Western observers, who measure growth more comprehensively. On the other hand, Soviet biases in the measurement of industrial output could result in a more sanguine view of their prospects because their upward bias is greatest in those sectors that are most important for technological progress—machinery and chemical:

It is difficult to assess the relative impact on leadership thinking of its use of different economic concepts. In any event, there is some evidence that the leadership has a relatively unsophisticated view of economic data that would tend to minimize the effect of the most serious Soviet statistical biases. A recent study of the type of economic data cited by 25 members of the

\* The possible bias from increased double counting, for example, is greatest in industries with a high ratio of material inputs to gross output such as machinery, chemicals, and construction materials. The bias caused by disguised inflation is most common in industries with a heterogeneous assortment of products and in technically dynamic industries, featuring a high percentage of capital goods characteristic of the machinery and chemicals branches

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Soviet leadership<sup>3</sup> suggests that value data—the most biased—are used infrequently, and that the emphasis is on physical production series.

**Signs of Increasing Concern.** The evidence leads to the presumption that the leadership believes that the major economic problems are serious and have had a deleterious effect on economic growth. Now, the relevant questions are whether the leadership believes that the economy's problems are getting worse, and, if so, which ones are becoming particularly intractable? Answers to these questions have obvious repercussions on the perception of the future.

The leadership speeches during 1970-80 were examined again, but this time to reveal relevant changes. There was evidence of a substantial rise in concern in three major areas—energy, planning and management, and consumer welfare. The level of concern expressed for the remaining problem<sup>4</sup> was relatively steady throughout the period.

**Energy.** During the early 1970s the energy-related portion of the leadership speeches was limited to general statements about the need for "raising the efficiency of the fuel and power complex, increasing the share of petroleum and gas in the fuel balance, and expanding the construction of atomic power stations." (Brezhnev speech to the 24th Party Congress—March 1971.) There was no sense of urgency concerning attainment of output and requirements targets. By early 1976 it was apparently felt necessary to assure the public that fuel shortages "as a rule" were not expected.

As a rule, our plans will provide for faster growth rates for proven reserves of minerals than for their extraction, so that the levels of their supply to production will always be adequate. This will enable us to continue to guarantee the national economy against shortages of energy and raw materials. [Kosygin speech to 25th Party Congress—March 1976]<sup>5</sup>

<sup>3</sup> William J. Kelly and Hugh L. Shaffer, "Compilations of Economic Statistics Cited by Soviet Leaders," Battelle Columbus Laboratories, November 1979.

<sup>4</sup> Surprisingly, no increase in concern was found for the manpower or transportation problem.

Later that year it was admitted, however, that "requirements are growing faster than resources. . . . Rigid consumption coefficients [and] great efforts to improve the efficiency of all branches of heavy industry" were needed if there was to be "uninterrupted satisfaction of the economy's growing requirements for . . . energy." (Brezhnev speech to Party plenum—October 1976.) By 1978 Brezhnev indicated an impatience with the conservation effort and for the first time admitted that energy shortages were causing problems in other sectors.

Fuel continues to limit us. . . . There has been virtually no reduction in wastes and losses. . . . This creates difficulties in a number of branches of the national economy. [Brezhnev speech to Central Committee plenum—November 1978]

This line is now *de rigueur*

**Planning and Management.** On the subject of planning and management, the interesting aspect is not the growing urgency of the rhetoric, as with the energy problem, but the continued plea for improvement despite the introduction of countless "reforms" throughout the period. These years included the ostensible completion of the 1965 reforms,<sup>6</sup> the creation of "production associations,"<sup>7</sup> the introduction of labor-saving experiments such as Shechekino,<sup>8</sup> and the initiation of the most recent "comprehensive" reform of mid-1979.<sup>9</sup> Yet the leadership continually noted that (a) the current reforms were not being successfully implemented, and/or (b) further reforms were necessary.

Frequently the economic-accountability rights of enterprises are infringed and economic methods are supplanted by administrative fiat. . . . at the same time. . . . aspects of the economic reform are in need of further clarification.

<sup>6</sup> The major reform of the Brezhnev-Kosygin regime that stressed profit and economic "levers" as a way to improve efficiency.

<sup>7</sup> The merger of industrial enterprises to reap gains from specialization, obtain economies of scale, and save on administrative costs.

<sup>8</sup> Introduced in 1967 at the Shechekino Chemical Combine to allow enterprises to keep wage fund savings obtained through labor force reductions.

<sup>9</sup> Reform of planning and incentives that includes an attempt to replace the gross value of output indicator with a net output concept.

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and development. [Kosygin speech to 24th Party Congress—April 1971]

[We] need to improve the planning and management of the national economy which must orient economic organizations toward the use primarily of intensive factors of economic growth and toward the acceleration of scientific and technical progress. [Kosygin on the occasion of the 50th anniversary of the formation of the USSR in *Kommunist*, November 1972]

By the end of the decade, Brezhnev was still making vociferous attacks on the failure to adequately "restructure the economic mechanism."

It [raising efficiency and quality] is being impeded not only by objective circumstances but also by the force of inertia. Inertia in planning, in methods of economic management, and, perhaps most important, in economic thinking. . . . A certain restructuring in planning, in the methods of economic management, in the system of indices and in material incentives (is needed). . . no matter how complicated this restructuring may be, we cannot get along without it. [Brezhnev election speech—March 1979]

*Consumer Welfare.* Consumer frustrations as a damper to work incentives have been a recurrent theme in the speeches. As early as 1971 Brezhnev made the vital tie between the "well-being of the worker" and "rapid production growth." In the last several years, however, as growth in labor productivity has declined steadily, this linkage has been made more frequently and elaborately. In 1978, for example, Kosygin promoted the importance of fulfilling consumer service goals—while Brezhnev emphasized the output of consumer goods.

The task of improving efficiency and quality should be persistently tackled not only in the sphere of production but also in the sphere of services to the population. . . . The service sphere is a sphere that is used by all citizens all the time, one that does a great deal to determine their mood and to influence their attitude toward their jobs and toward those around them. [Kosygin speech on the occasion of the 61st anniversary of the October Revolution—November 1978]

A Group B [consumer goods industries] that meets today's demands is an important condition for the effective work of the economy as a whole and for the improvement of material incentives. [Brezhnev speech to Central Committee plenum—November 1978]

The use of the word "mood" became more common in both leaders' vocabulary. In effect, it suggests heightened concern over solving the consumer question since "mood" could be a euphemism for the threat of civil discontent.

*The Economy in General.* More generally the leadership evidently believes that current economic problems are unprecedented in complexity and scope. Evidence of this is the pessimism that has been allowed to creep into statements by major economic spokesmen. Gosplan Chairman Baibakov's bleak picture of the economy in a recent *Vestnik akademii nauk SSSR* (No. 5, May 1980) serves as a good example, particularly since his style is usually reportorial if not upbeat.

The rates and absolute size of the growth of the national income and the output of industry and agriculture for four years of the present five-year period will be less than we intended. To a considerable extent this situation is explained by the fact that we have been unable to achieve an abrupt change in direction in raising the efficiency of social production . . . without a radical improvement of affairs in the field of scientific-technical progress, it will not be possible to perform these large tasks which the party and government are setting.

The leadership's increasing sensitivity to the economy's failings probably is a major reason for the decline in the publication of economic data, noted since the mid-1970s. The missing data, such as regional production of fuels and details on the 1976-80 plan, are embarrassing evidence that the leadership would prefer to conceal from the Soviet and foreign public alike.

"The guidelines for the 1981-85 plan contain less statistical data—some 40 to 50 percent overall—than the guidelines for the previous two five-year plans. While partially motivated by the desire to conceal embarrassing data, the absence of concrete figures for several key goals and conventional categories also probably reflects delays, uncertainties, and possible conflicts in Soviet decisionmaking. See *USSR: Goals of the 11th Five-Year Plan Unattainable*, ER 81-10023, January 1981

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More evidence of the leadership's rising concern is its recent attempt to impress the elite with the serious nature of the economy's problems. In late 1979 and early 1980, senior government officials revealed to a group of leading academicians of the Soviet Academy of Sciences that the economy was suffering "very serious problems" and asked for suggestions and advice.

#### Prospects for Solving the Major Problems

The leadership is adept at pinpointing shortcomings but rarely articulates the chances of finding timely solutions or their likely effect on general economic growth. For this we must turn to statements by high-level officials and economists, who probably share the leadership perspective. Also, actions already implemented or in the proposal stage are good clues to leadership views of prospects. For example, the adoption of draconian measures presumably would be a logical response to a problem viewed by the leadership as particularly threatening to growth prospects. In this section these sources will be used to explore the leadership perspective on specific major problems including the consumer, investment, energy, manpower, planning and management, agriculture, and technological progress.

**Consumer Welfare.** The leadership seems aware that the consumer has already borne much of the burden of declining growth, especially in poor harvest years. But do the Soviet leaders believe that consumption growth will continue to decline and, more importantly, are they confident that they can make this palatable to the populace? The evidence presented below suggests that the leadership believes that the decline will continue and will be serious enough to require some revision in policies and attitudes in order to restrict demand.

Nonetheless, Soviet leaders probably believe that they can deliver some growth in priority consumer areas such as quality foods to workers in key industrial sectors. Moreover, they appear convinced that exhortation and a more differentiated wage structure will provide an adequate spur to productivity.

The most tangible evidence that only a minimal improvement in consumer welfare is expected is the recent emphasis on finding ways to restrict consumer demand rather than on expanding the output of con-

sumer goods.<sup>2</sup> In a *Kommunist* article (No. 8, 1979), Gosbank Chairman Alkhimov recommended several ways to increase the output of consumer goods but devoted the major portion to methods of dampening demand. These included the limitation of "unjustified," that is, not tied to labor productivity, increases in wages and strengthened control by central administrative organs and banks over wage payments resulting from above-plan construction and repair work. A professor of economics writing in *Pravda* (24 May 1980) also concentrated on ways to reduce growth in demand. He advocated a greater differentiation in prices to reflect levels of quality, such as train fares and hotel rates. He suggested that better workers be given special access to paid social services including education and medical care in addition to the free services provided by the state.

While these are still in the early proposal stage, it appears that the leadership might be more ready to move on two fronts that would immediately restrict demand—monetary reform and a rise in retail prices. Rumors have circulated for over a year that a currency exchange is imminent, designed largely to reduce the large lump of liquid holdings embodied in savings deposits and cash hoards. The exchange reportedly would allow savings deposits up to an established ceiling to retain their former value while amounts above the ceiling and money outside the banking system would be exchanged at a severe loss to the holder. Gosbank Chairman Alkhimov and the Deputy Minister of Foreign Trade Sushkov recently expressed extreme apprehension over the continued buildup in savings. Alkhimov said, "What the savings figure was much too high for Soviet purposes while Sushkov interjected that "it was positively dangerous."

A price hike for a broad range of consumer goods may be implemented during the early 1980s." During a discussion of the wholesale price reform scheduled to begin in 1981, the Chairman of the State Committee on Prices promised only that retail prices would not be

<sup>2</sup> The recent plenum speech by Brezhnev (21 October 1980) does not run counter to this thesis. Although expressing a deep concern for the consumer, particularly in light of another poor harvest, he indicated no reordering of priorities in investment to benefit the consumer. It is "The recent events in Poland" that have postponed this action until the latter part of the period.

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raised during the current five-year period (1976-80) but hinted that a continued freeze would be unreasonable.

The leadership apparently realizes that consumer expectations must be lowered. A recent article in *Questions of Philosophy* (No. 2, 1980) urges that more attention be given to the problem of persuading individuals to tailor their demands closer to the economy's potential. The author, economist P. N. Fedoseev, argues the need for "truly reasonable demands."

We must examine the socioeconomic processes as they change and develop, and determine their interaction as completely as possible. This also concerns the problem of correlating production with demand and educating the public about truly reasonable demands. There has been an increasing stream of literature on this subject in recent years, but the existing works provide no convincing answer to the most pressing question for the theory and practice of social management: What are the criteria for reasonable demands and what are the ways of forming them in a socialist society?

The necessary restrictions on demand may not appear as severe to the Soviets as to us because they expect a modest growth in per capita consumption during the 1980s compared with our scenarios that project little or no growth in per capita consumption. Soviet emigres over the last several years have emphasized that the consumer's perception of some forward movement is essential for holding the lid on consumer discontent."

If the leadership expectations for continued positive overall growth in consumer welfare appear untenable, it could concentrate its limited resources on projects with high visibility that would create the image of a concerned leadership fighting for consumer rights. The continued pledge to improve the diet backed by massive imports of grain and meat falls in this category. Also, the new Soviet Constitution of 1977 contains more permissive language that indicates an intent to

"Several Western observers of the recent Soviet domestic scene have written about the new pessimism of the Soviet consumer regarding future improvements in the living standard. See John Bushnell, "The New Soviet Man Turns Pessimist," *Survey*, Spring 1979, Volume 24, No. 2; and George Feifer, "Russian Disorders," *Harper's*, February 1981.

loosen restrictions on the private sector. An expansion of private consumer services and farm output in particular could make a difference at the margin with only a minimum expenditure of state resources. No action has as yet been taken in the private service area but a recent party and government decree (*Selskaya Zhizn*—17 December 1980) makes it more economically attractive for state and collective farms to give support to the private plots

Finally, the leadership probably believes that it still has the power to motivate the worker despite the failure to provide a substantial boost in living standards. First, wages will be tied more closely to individual productivity, reversing the more egalitarian policy favored in the past. Secondly, recent pronouncements make it clear that the worker will be continually reminded that a rise in consumer welfare depends directly on his own efforts. Typical of this approach is a *Pravda* editorial (25 October 1980) following the recent party plenum that raises self-interest to a new high.

Soviet people know well that the party and state have no concern higher than that for the people's welfare. Soviet people also know that their welfare is created by their own labor and by nothing and by no one else and that only what man has produced and created can be distributed and consumed. That is why they are fully determined to work selflessly for the benefit of the motherland and that means for their own benefit

**Capital Formation.** The leadership seems under no illusions that a return to high rates of investment growth will accelerate overall output growth to previous levels. It understands that the growing scarcity of easily exploitable raw materials is a major reason for the rising investment cost per unit of additional production. At a general meeting of the Soviet Academy of Sciences in December 1979, as reported by our Embassy, the prominent economist Abel Aganbegyan provided graphic proof of this phenomenon.

The capital investment required in the 1980s to yield 1 rubic of increased output of fuel and raw materials will be at least two and a half times the 1965 figure

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Instead of stepping up the annual growth in investment to compensate for the decline in capital productivity, investment has grown slowly. Investment growth in the 1976-80 plan was set at the historically low rate of 3.5 percent per year, and the five-year plan directives for 1981-85 project an even lower rate—about 2.6 percent each year. In an article in *Planovoye khozyaystvo* (No. 7, 1979) Kosygin discussed this slowdown and implied that it would continue indefinitely.

For many years we rapidly increased the amount of capital investments—their growth rate markedly surpassed the growth in national income. According to the results of the first three years of the current five-year plan, the growth rate of the national income produced was higher than the growth of capital investments. This is a positive trend. . . . It must be enshrined in plans for the future

In an editorial of his Academy's journal (*Ekonomika i organizatsiya promyshlennogo proizvodstva*, October 1979), Aganbegyan discussed why a return to high investment rates is not only undesirable but not easily obtainable. He acknowledged that the resources currently available cannot support investment at past rates, and moreover, the consumer will not be sacrificed to do so.

Growth in capital investment has slowed considerably. This stems from the need to increase the share of the consumption fund in the national income and to balance the growth in capital investments with the country's ability to produce rolled metal, building materials, and equipment

Despite the obvious implications for economic growth, the leadership may not view the planned decline in investment growth with great alarm, at least in the short run. They apparently believe that a cutback in investment will force a more efficient use of plant and equipment. This has been one of the purported motivations behind restraining investment growth during 1976-80 and during the current plan. The hope is that restrictions on new construction starts and concentration on unfinished construction will bring new plant and equipment on stream faster, thereby raising capital productivity somewhat

*Energy Production.* "Soviet leaders have been aware since well before the Western oil crisis of 1973-74 that they had a far more serious energy problem than they were prepared to acknowledge in public. But in 1977 their actions indicated a new depth of appreciation for just how serious the problem really was. At the December Plenum of the Central Committee the Soviet leadership significantly altered the energy policy of the 10th Five-Year Plan (1976-80). Instead of following what had been a "balanced" policy of stabilizing and then gradually decreasing the share of hydrocarbons while simultaneously increasing the share of coal and nuclear power, the emphasis was to be given to a narrower, all-out campaign simply to develop oil and gas production in Tyumen Oblast over the next decade. It is likely that some in the leadership were unhappy with this shift; they realized that there were few options but at the same time feared that the current campaign would undermine the pursuit of crucial longer range goals

Uncertainty is probably the central feature of Soviet leadership judgments about future oil prospects. This uncertainty probably is bounded on the high side by hopes among some leaders for at least a slight increase in oil production and on the low side by fears that public CIA projections might prove to be not far off the mark. The leadership is intensely worried about the current oil situation, and individual leaders are almost certainly aware that the productivity gains on which future increases in the oil extraction level depend are unlikely to be met

Despite their concern, there has never existed what could properly be called a comprehensive and operative Soviet energy program. Energy production decision-making has not been seriously influenced by any carefully elaborated and stable "master plan." The process of decisionmaking in this crucial area is far more ad hoc than is customarily assumed by either Soviet propagandists or many Western analysts. At present

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leadership policy is to urge energy conservation and step up the rate of investment in oil production and other energy sectors. Apparently the leaders are unwilling thus far to make any radical or really innovative domestic policy adjustments to meet the energy situation such as the transfer of investment resources from other priority areas or the initiation of a rationing system for fuels.

**Manpower.** The regime has been slow to implement measures in response to the impending manpower shortage—a shortage that Soviet specialists have warned about for the past decade. Moreover, actions taken have been piecemeal and largely unimaginative retreads of those taken in the past. Apparently the leadership believes that the problem can be substantially alleviated without resort to radical action through large increases in productivity. An awareness of the profligate use of manpower and a consequent belief in the presence of enormous “hidden reserves” may also be a factor in the formation of this attitude.

The following list includes the major manpower-related measures already taken:

- Centralization of decisionmaking under the State Committee for Labor and Social Questions.
- Changes in managerial incentives to encourage the release of surplus workers such as the Shchekino experiment.
- Compulsory two-year job assignment for vocational-technical school graduates.
- Expansion of labor-placement bureaus, resettlement committees and Orgnabor (Organized Recruitment).
- Increased material incentives to workers for continuous service to reduce labor turnover and retain pensioners.
- Ceilings on number of workers at industrial enterprises.
- Increased material incentives for students who enroll in certain specialties or agree to study and work in specific locales.
- Push for mechanization of manual labor.

A recent *Pravda* article (19 September 1980) that provides a good comprehensive review of the reasons for the manpower shortage is typical for its lack of urgency. Most of the suggested measures—such as the release of surplus labor hoarded as a hedge against

unplanned changes in output targets or to provide manpower for the harvest—could be implemented on the authority of enterprise managers alone. Even the suggestions offered for tapping the rich supply of surplus labor in the Central Asia republics were equivocal.

The leadership's policy on the use of the Central Asian labor supply is illustrative of its reluctance to initiate labor-related measures that could prove disruptive such as forced out-migration. Instead, the leaders favor a mixed policy of incentives to encourage the redistribution of young workers and increased investment in Central Asia. A middle-level Gosplan official recently indicated that such a reorientation of investment resources would take place in 1981-85. Referring to the preparation of the current five-year plan, he reported intensive regional infighting because “the older industrial areas are not happy with their diminished role in favor of Central Asia where the excess manpower is.”

**Planning and Management.** Leadership statements adequately attest to its disappointment with past reforms in the area of planning and management. But do the leaders conclude that a more fundamental reform—one that would truly change the system's basic operating procedures—is necessary? An examination of past reforms indicates that Moscow remains eternally optimistic that a perfection of the current “economic mechanism” is not only possible but desirable. Although impatient with the slow progress of the reform movement, they continue to expect that the next reform will be the one that makes all the others fall into place.

The reforms of the last 15 years reveal that the leadership's basic beliefs—ones most relevant to future changes in planning and management—are:

- Central planning must be the basis of the economic mechanism.
- The use of poorly designed success indicators has been a major reason for incorrect decisions by the enterprise manager.

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- There is a limit to decentralized decisionmaking as long as the ministries are held ultimately responsible for results.
- Prices in general should not serve as the major allocative device but should play a more neutral role in decisionmaking; the objective is a price structure in which profit serves as a success indicator without serving as an allocative device by influencing production choices.
- A major objective of new reforms should be the promotion of "technological progress."
- The general philosophy seems to be that the less the discretion that needs to be given to management, the better. The hope is that eventually management will consist solely of carrying out preplanned instructions."

With such a mindset, it seems unlikely that the leadership would introduce radical economic reforms involving the introduction of market arrangements—ones that might have some chance of boosting productivity.

Another factor arguing for the retention of highly centralized planning is the belief in some quarters that more sophisticated planning techniques backed by computers will eventually make the system work. Some Western specialists believe that the use of more technical equipment has already contributed to the production of more solidly based plans than in the past and that the plan-making process will continue to improve in the future. The touting of automated systems of management reportedly is a central theme in the curriculum of the Economic Management Institute in Moscow. This Institute was created in the 1970s to introduce progressive (including Western) business techniques to senior Soviet managers. According to a former Soviet official who attended this school, V. M. Glushkov, Chairman of the Scientific Council for Computer Technology and Control Systems, was a key lecturer who claimed that computers would rationalize the Soviet economy in the "near future" and eliminate the human or "subjective" element.

\* These points are a summary of the ideas of Joseph S. Berliner in *Planning and Management: Conference on the Soviet Economy Toward the Year 2000*, September 1981.

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*Agriculture.* The leadership admits the intractable nature of the agricultural problem. Of the seven party plenums devoted to specialized economic topics since 1965, five dealt with agriculture. The leaders seem resigned to pouring huge amounts of resources into this sector with no guarantees of a real breakthrough in stability or size of output. Proof of the limited progress anticipated toward the ultimate goal of self-sufficiency is their continued interest in trade and particularly long-term commodity agreements as a way to supplement domestic production.

The leadership consensus seems to be that the share of resources allocated to agriculture cannot be reduced without risking the gains already achieved although it acknowledges the heavy burden on the rest of the economy. In his plenum speech of October 1976 outlining the new 1976-80 plan, Brezhnev called the investments in agriculture "a huge sum" and said that "frankly it was not easy to find it . . . we had to somewhat curtail the demands of other branches of the economy." But this was necessary "because now there is no more pressing task" than increasing agricultural production. In a special plenum on agriculture in July 1978 Brezhnev attempted to stake an early claim for agriculture in the 1981-85 plan. He specifically ordered Gosplan to follow this principle in working out the new five-year plan. At the most recent plenum in October 1980, Brezhnev again pressed for "big capital investments and material resources for agriculture."

A growing exasperation with the small return on agricultural investment indicates that the leadership is not banking on much improvement in efficiency, especially in the livestock area. At the November 1979 plenum Brezhnev complained that "the return is still clearly small" and "with the present scale of expenditures," livestock raisers should be able to cope with the problem "much faster."

While continuing to remain pessimistic about substantial breakthroughs in output and efficiency in the farm sector, the Soviet leadership probably believes that it

can muddle through by adopting piecemeal measures such as:

- Reallocation of resources from production to transportation, storage and processing to reduce high rates of losses. The 1981-85 plan directives emphasize the development of the "agro-industrial complex" and pledge "almost one-third" of total capital investment to this combined effort.
- Tinkering with planning and management. A December party-government decree reduces the number of obligatory planning indicators given to both state and collective farms, raises prices for above-plan sale of products, and increases individual incentives for such things as raising labor productivity and preventing cuts in livestock herds.
- Expansion of the private sector. In mid-January, Moscow published a decree stressing the importance of private plots and encouraging greater support of this sector by state and collective farms. Brezhnev, in his 26th Party Congress speech in February, described the private sector as a prime source of additional meat supplies and promised additional assistance including forage and equipment.

Foreseeing the likely prospect of another decade of unreliability from the farm sector, the regime is strengthening its position in world agricultural commodity markets in order to stabilize consumption. The US embargo was a temporary setback to this effort. While posturing that the embargo was of no consequence, the Soviets have lobbied zealously for its elimination while concluding a five-year grain agreement with Argentina.

**Technological Progress.** Leadership perceptions of prospects for "the acceleration of scientific-technical progress" (that is, productivity) are inextricably linked with its perceptions of prospects for reform and capital formation. Disappointed with the pace of the reforms and resigned to a substantial decline in investment growth, the leaders realize that this goal will be even harder to achieve during the 1980s. In order to limit the damage of a slowdown in investment, they are concentrating resources on those sectors that are most important to technical progress: machine building, the chemical and petrochemical industries, and energy. As

compensation for the poor performance of reforms in the civilian R&D sector, there is continued interest in importing foreign technology and a newfound willingness to encourage spinoffs from the military R&D sector.

The Soviets' current hard currency position is favorable enough to allow them to import foreign technology in the form of equipment or know-how, providing that the West is also willing. The priority they assign to this effort is high, illustrated by the scramble to substitute other foreign technologies for those embargoed by the United States last year.

The Soviets continue efforts to improve the performance of their domestic R&D sector. In July 1979 the Central Committee Council of Ministries decree on planning and management included specific measures for raising the incentives of R&D organizations and strengthening ties with their customers. More recently, Brezhnev encouraged the military R&D sector to share its talents and know-how with the civilian sector. Referring to the importance of developing the machine-building sector, Brezhnev said,

To this we should orient our strongest scientific collectives. I have in mind, besides the Academy of Sciences, scientists and designers working in the defense branches. I believe that their contribution to the development of the economy of the country can be wider and more varied. The Council of Ministers, jointly with specialists should be instructed to determine precisely what scientific and design collectives of the defense industry could assist some or other types of civil machine building, could give assistance in the development of highly effective and high-quality types of machinery, in drawing up concrete programs and assignments. [Speech to party plenum—October 1980]

#### Perception of Prospects—A Wrap-Up

The leadership admits that the Soviet economy is being challenged by a convergence of unusually serious problems. Moreover, the transition to intensive growth, the required response, is not perceived as going smoothly. As a result, a sober appraisal of economic prospects has been made, reflected in the moderate goals of the 11th Five-Year Plan. The planned target for national income growth (average annual) during 1976-80 was 4.7

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percent, the lowest rate since World War II; plan directives for 1981-85 show a further drop in expectations—a range of 3.4 to 3.7 percent.

Despite the serious nature of this assessment, the leadership has given no indication that it is ready to respond with radical action such as a real systemic reform. Its business-as-usual attitude is apparent in the new plan directives for 1981-85—a familiar litany of problems and proffered solutions that contain no detectable attempt to rethink their plan of action. This is the most telling evidence available that they believe the general decline in growth can be held within manageable bounds and that it will not damage vital interests such as the ability to maintain a formidable defense posture or to retain the allegiance of the consumer/worker. Some tentative hypotheses can be offered to help explain their measured response:

First, the leadership is unlikely to make radical changes because it has an obvious vested interest in retaining the present system. More than that, however, the leaders' speeches and articles, even considering their rhetorical nature, indicate a firm belief in the system. They so closely identify with the system that a lack of confidence in it would be an admission of personal failing. Bolstering the Soviets' belief that the economy can effectively deal with current problems is the fact that they personally witnessed and participated in past triumphs over substantial internal and external obstacles.

Secondly, a reliance on piecemeal measures is standard operating procedure for the Soviet leadership. This may be ascribed in large degree to a lack of imagination but also to an apparent optimism that half measures will indeed be effective. Typical of this reasoning is a formulation common throughout the speeches that details impressive gains in rubles, manhours, metal, and so forth, that will result with only a little extra effort. The leadership's advanced age ensures that this type of response will continue: modest measures with some hope of immediate impact will be favored over grandiose schemes that promise long-run benefits but would be disruptive to the regime's final year.

Thirdly, they apparently are gambling that the stoicism of the long-suffering consumer, who will bear the brunt of the economic decline, will remain unchanged. In any event, they probably believe that a strict police crackdown would be sufficient to control any civil discontent over consumer problems—although some productivity would surely be lost. A return to Stalin-like command tactics is likely viewed not as a final solution but a temporary measure to get over the hump of the late 1980s—which introduces the final point.

The most probable cause for the leadership's relaxed response to the current economic situation is its ability to look ahead to better times in the next decade and to see the 1980s as only part of a continuum. The decade of the 1990s promises some relief from at least two of the major problems—manpower and fuels. Although major increments to the labor force will not appear even in the next decade, the decline will have at least bottomed out. In the energy area, the Soviet leaders probably are counting on large new discoveries of oil as well as alternative energy sources coming on stream. The Soviet ability to take the long view is reflected in a recent statement by a middle-level Gosplan official. He acknowledged that this decade would bring a decline in growth from the rates achieved in the 1960s and early 1970s but confidently predicted an upturn in the 1990s.

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## Appendix

### A Comparison of Soviet and Western Measures of Economic Growth

#### National Income

In market economies, the relevant measure of overall economic growth is *gross national product* (GNP). It is the total value of the final sales of goods and services at market prices produced by the labor and property of a given nation in a given time period. The Soviets compile a measure of aggregate economic activity labeled *net material product* (NMP). It is the net value added in the production of material goods and in providing the limited number of services that are directly required to bring the material goods to their final sales point.

There are three principal reasons for compiling an independent index of Soviet economic activity rather than accepting the Soviet measure: (1) there are important differences in coverage between NMP and GNP, (2) there is insufficient knowledge of the methodological base of the NMP data, and (3) there is evidence that the Soviet data in purported constant prices are actually subject to major price inflation and cannot be used directly for growth analysis expressed in deflated real terms.

The principal differences in coverage between NMP and GNP are that NMP does not include the value added in the service sectors or the depreciation in any sector.<sup>1</sup> In order to build an estimate of GNP from the Soviet data, these two quantities, which represent about 25 percent of GNP in 1970, must be estimated in the desired detail.

Perhaps the most important reason for making independent GNP estimates is that the Soviet data on the real growth of NMP and its various sectors involve considerable upward bias. One Western expert<sup>2</sup> has examined this overstatement problem by allocating the

difference in the growth rates of Western estimates of Soviet GNP and Soviet NMP among three sources: the differences in coverage, in the weights assigned to each sector, and in the sectoral growth rates. He found the latter to be the most important. The principal cause of the growth rate overstatement is believed to be the Soviet method of accounting for the production of new products. It is thought that the Soviets include new products in the value of a sector's constant price output at their introductory prices. These prices relative to the prices for the close substitutes that the product is replacing are too high in the sense that the qualitative differences between the "old" and "new" cannot explain the large price gap.

#### Industrial Production

Similarly, there is a Western methodology for estimating Soviet industrial output.<sup>3</sup> The official Soviet rates of growth are not used because they are believed to be biased upward for two reasons: (1) the use of gross output indexes result in double-counting that overstates growth; and (2) the official data allow disguised inflation to enter the indexes under the guise of new-product pricing. This is a particularly severe problem in the machinery industry where products are complex and heterogeneous.

Synthetic indexes are constructed, therefore, to circumvent these problems. They are based on a sample of three types of Soviet reporting: physical output series, value series, and official indexes of gross output. The products included in the index sample are classified by input-output sector and aggregated using 1 July 1967 price weights.

#### Agricultural Production

The Western measure of Soviet agricultural production is a net concept based on the output of 28 individ-

<sup>1</sup> See *USSR: Toward a Reconciliation of Marxist and West—Measures of National Income*, ER 78-10505, October 1971.

<sup>2</sup> Stanley H. Cohn, "National Income Growth Statistics," in *Soviet Economic Statistics*, eds. Vladimir G. Treml and John P. Hardy (Durham, N. C.: Duke University Press, 1972), pp. 136-37.

<sup>3</sup> See *Comparing Planned and Actual Growth of Industrial Output in Centrally Planned Economies*, ER 80-10461, August 1980, (Unclassified).

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ual crops, 10 livestock products, and four items of livestock inventory change. The physical production data are then aggregated using average 1970 prices received by all producers.

The comparable Soviet measure—gross agricultural production—cannot be used for two major reasons. First, the use of a net concept is necessary to conform to the GNP accounting procedure. Estimates of intra-agricultural use of farm output—seed and feed—are deducted from gross output to yield net agricultural production. Secondly, some of the Soviet data must be adjusted to eliminate a large element of waste that is included as output. The most significant adjustment is made to the Soviet grain statistics. A net usable measure of grain output is substituted for the Soviet "bunker weight" concept that has exaggerated Soviet grain statistics since about 1956.<sup>3</sup>

#### Consumption

The Western index of total Soviet consumption is a weighted aggregate of separately constructed indexes for three broad categories of goods—food, soft goods, durables and miscellaneous goods, six categories of personal services, and two communal services. The separate time series, most of them in physical units based on Soviet data, are weighted by expenditures in rubles in the base year (1970).

A Western-type measure of per capita consumption in the USSR is required for several important reasons. The measures published by the Soviet Government are conceptually unsuitable for comparison with those published in the West and also are believed to have a large upward bias. The official Soviet measures—real per capita income, for example—exclude the labor inputs into personal and communal services, and they include depreciation and some other elements not considered to be final consumption expenditures in the West. The Soviets publish neither a cost-of-living index nor a suitable deflator for net material product by end use. The official Soviet index of retail prices has serious methodological and conceptual faults.

<sup>3</sup> For further details, see Douglas Whitehouse and Joseph F. Havelka, "Comparison of Farm Output in the US and USSR—1950-71," in *Soviet Economic Perspectives for the Seventies*, Joint Economic Committee, June 1973.

<sup>4</sup> See Morris Bornstein, "Soviet Farm Statistics," *Soviet Economic Statistics*, *op. cit.*, pp. 370-371.

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