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OCI No. 3217/63

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
19 November 1963

MEMORANDUM FOR: Director of Central Intelligence
SUBJECT: Khrushchev's Recent Optimistic Remarks

SUMMARY

On several recent occasions, but particularly in talks with visiting US businessmen, Khrushchev attempted to put the best possible face on the present condition of the Soviet economy. What he actually said

25X1 [redacted] certainly had little relationship to fact but was neither particularly new nor as striking as indicated by the treatment in the Western press. 25X1

His statements concerning competition with the US and extravagant claims of economic progress and prospects are shopworn shibboleths which he has used in nearly every major speech or extensive conversation with Western dignitaries in the last several years. They reflect a formal part of the Twenty-Year program adopted for the years 1961-80 at the 22nd Party Congress in 1961.

There is no doubt, however, that during the past few weeks Khrushchev has exhibited more than normal concern to promote the image of a powerful Soviet economy in the West in order to buttress his position in wheat negotiations and in the search for better credit arrangements for much-needed industrial equipment.

If Khrushchev is also in trouble at home either with the party or the people on economic issues, we get no clues to this from these extravagant claims which are designed primarily for Western consumption.

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1. Khrushchev's claim that the Soviet Union will overtake the US economy--apparently he said by 1970--is based on an unrealistically high growth rate for the USSR, a very low growth rate for the US, and a statistical judgment that the Soviet economy is considerably closer to the US level than is considered reasonable by most Western economists. According to CIA estimates, the Soviet gross national product in 1962 was 48 percent of US. If we apply an average annual rate of increase of 6.3 percent for the USSR and 3.4 percent for the US--these rates are the average performances of the last twelve years--then Soviet GNP will be about 70 percent of US by 1970 and about 85 percent by 1980.

2. If we were to apply only the growth rates of the last two years--when the US economy was growing more rapidly and the Soviet economy was slowing down under the simultaneous burdens of the armaments race, industrial expansion, and rising consumer demands--then the picture would be even more favorable to the US. By 1970 Soviet GNP would be only a little over half of US; by 1980 it would be about 60 percent of US.

3. Khrushchev's statement that the "economic situation within our country is excellent today and tomorrow and in the future it will be still better" is belied by the stagnate position of Soviet agricultural output and the fact that the rate of growth of industry has slowed from an annual average increase of about 10 percent in the 1956-59 period to about 7 percent for the last three years. The volume of housing construction leveled off in 1959 and has declined since then. Industrial investment which formerly increased 10 percent or more annually has grown at 4 or 5 percent per year since 1960.

4. As a part of the bullish image Khrushchev was striving to create, he claimed that the Seven-Year Plan (1959-65) would be overfulfilled by 40 billion rubles (one ruble nominally equals \$1.11). This is virtually a meaningless statistic and certainly is no support for his argument that "we have all the strength we need to go on competing in the economic field and in science and research and even in the armament field." The figure represents gross production--as opposed to net--and double counts production in various stages of

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manufacture. In addition, "overfulfillment" as such means nothing if the products involved are not of an assortment and quality needed. It is clear from the present Soviet efforts to revise the production plans for 1964-65 and from Khrushchev's continuing barrage of criticism of economic disproportions that simple "overfulfillment" is no answer to Soviet economic problems.

5. Khrushchev's statement that productivity of Soviet agriculture would be raised to the US level is so vague and unrealistic that it defies any very serious comment. Suffice it to note that in 1958 the US employed about 7.5 million workers in agriculture compared to about 52 million for the USSR. Our sown acreage was roughly 60 percent of USSR. In spite of this huge labor force and larger acreage, Soviet agricultural output was about two thirds of US. Since 1958, Soviet agricultural output has virtually stagnated and the labor force has changed but little--hence, productivity has increased only slightly, if at all.

6. Khrushchev explicitly linked hoped-for successes in agricultural productivity with a crash program for chemical fertilizers and herbicides which is now being given the final touches before presentation at the central committee plenum on 9 December. In assigning chemicals the singular role of promoting agricultural productivity, Khrushchev, in a typical fashion, oversimplifies the problem. But in doing so he took a curious position--namely that farm output does not depend on the capitalist or socialist system but upon investment. While it is clear from the context that he is not advocating an abandonment of collectivized agriculture, it is equally clear that he has repudiated--for the time being at least--the organizational gimmickery which has characterized his approach to the farm problem for several years.

7. As for the Soviet needs for chemical fertilizer equipment, Khrushchev is clearly not to be believed when he claims that capital (equipment) is presently available: "We have enough of our own." Although it is not yet clear just how much equipment the USSR will want from the industrial West--or indeed, how much they will be able to buy under present credit arrangements--it is obvious that serious shopping is under way and has been for several months. In fact, later in his conversation, Khrushchev

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undermined his earlier statement by boasting that offers (of equipment and plant) have been made by the UK, Italy, France, Japan, and Germany and are being given consideration.

The Status of the Soviet Search for Western Credits

8. The USSR must have considerable additional credits if it is to carry out purchases of Western equipment for Khrushchev's expansive program to support Soviet agricultural development. In the absence of additional Western credits, the accelerated fertilizer program would be at the expense of other Soviet programs and result in general retrenchment, the acceptance of a lower rate of growth for the time being, or a somewhat reduced arms expenditure.

9. In [redacted] negotiation of trade pacts with governments, Moscow has emphasized that it intends to place orders where credit terms are most favorable. The USSR has made it clear that it seeks not only more credits but also credits of longer duration.

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10. The USSR finances over \$1 billion of its imports annually from free world countries by exports. However, since its drive for expanded imports of Western equipment began in 1959-60, it has depended on gold sales and medium-term credits to balance its hard currency trade. For the past few years its gold sales have averaged just over \$200 million annually, while Western credits have financed about \$300 million worth of imports per year. The need to repay credits extended earlier has now reduced the relief afforded to the Soviet balance of payments. It is estimated that in 1963 payments due on medium-term credits amount to over \$200 million while new credits used this year total about \$300 million.

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11. The extraordinary Soviet purchases of about 11 million tons of grain (assuming US sale goes through) worth about \$800 million complicate the long-run picture. While payment arrangements for all the grain are not yet clear, thus far it appears that extra gold sales will be used to finance the major part of these purchases. If in fact the USSR does finance the grain purchases in 1963-64 mostly with gold, it will cause a significant reduction of a reserve whose most important function has been to provide a means to make up for production deficiencies at home by financing imports. The loss of this "cushion" presumably will cause the USSR to bargain harder and increasingly to pit Western traders against one another on prices and credit terms.

12. There are signs that the USSR may shift the composition of its imports to permit growing purchases of technologically advanced chemical plants--the major type of equipment envisioned in the Khrushchev program. However, it will be difficult for the USSR to cut back adequately on other types of imports and thereby to reduce significantly its needs for credit. Raw materials, chemicals, and manufactured goods which frequently are input items for Soviet industry account for nearly one half of current imports from the industrial countries, while machinery which could be reoriented more toward the chemical industry accounts for most of the other half. The importance of imports from the West lies in the high quality and the advanced technology which is embodied in Western equipment. The dependence on the West for chemical equipment is larger than for other types of equipment.

13. At the same time, Moscow must put forth a major effort if it is to expand appreciably in the near future its export earnings in the industrial countries. Soviet wheat sales which accounted for \$40 million in hard currency earnings in 1962 will be absent in 1964. Gains in 1963 in Soviet oil exports--the major earner of hard currency for the USSR--will barely cover the losses from failure to maintain wheat exports, and a significant increase in the rate of growth in oil exports can come only at the expense of domestic consumption. Other exports may grow slightly, but to increase importantly the magnitude of exports, price reductions might be

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necessary, eliminating to some extent the earning power not only of the additional exports, but also earnings on exports of that commodity to established markets.

14. The Khrushchev program clearly calls for purchases of Western plants in multiples. During the 1959-60 import drive for plants, the USSR appears to have experimented with the prospect of purchasing pilot plants to be copied. However, the most advanced plants--and these are the object of the import drive--were developed by economies where the wide variety of support industries required to produce ultramodern equipment had all reached a certain stage of sophistication. The USSR found that while it could skip many research stages by the purchase of pilot plants, lags in the development of Soviet support industries prevented rapid duplication of Western plants. Normally the USSR now requires that the West not only supply the equipment, but also technical data and specialists for installation.

15. The most important current sources of credit to the USSR are Japan, the UK, France, Italy, and West Germany. Of this list, only the West German Federal Government does not guarantee credits. In most cases, the governments guarantee a high percentage of credits extended by sellers for periods up to five years. The above listing represents those countries producing on a large scale the types of chemical equipment which the USSR is seeking, and are the most likely sources for additional credits. Currently NATO is considering a common policy on credits to the bloc--a policy standardizing credit terms (substantial down payments with repayments up to five years), but without limiting the magnitude of credits offered. The UK is opposed to this program and feels it is not a NATO problem, a position shared by Canada and Norway.

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