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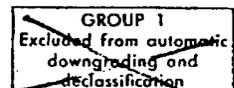
CIA HISTORICAL REVIEW PROGRAM
RELEASE IN FULL

POSSIBLE SOURCES
OF DEFENSE EXPENDITURES
IN THE SOVIET BUDGET

DIRECTORATE OF INTELLIGENCE

Office of Research and Reports

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WARNING

This material contains information affecting the National Defense of the United States within the meaning of the espionage laws, Title 18, USC, Secs. 793 and 794, the transmission or revelation of which in any manner to an unauthorized person is prohibited by law.

FOREWORD

Few analysts of Soviet economic affairs accept the explicitly announced defense allotment in the budget as an accurate representation of the total expenditures for military and space activities in the USSR. Other allocations in the Soviet budget are probed systematically in this report -- particularly certain large unexplained residual items -- in order to arrive at an estimate of the total budget funds available for military and space activities during 1955-63. These estimates are compared with the defense series announced by the USSR and with the most recent ORR estimates of total Soviet defense expenditures.

The explicit section of the Soviet budget that deals with defense is held to represent actual accounting and statistical "flows" within the economy, even though presented to the outside world only as a single number. However, additional large defense expenditures are believed to be concealed within other categories of the budget, and the ratio of these expenditures to total defense expenditures can and does vary widely. Concealment of data rather than outright falsification is believed to be the method employed by the Soviet leadership for disguising the size and trend of defense expenditures. Concealment is simpler, less time-consuming, and, if uncovered, potentially less embarrassing. There are not two sets of books, one for private and one for public use -- just one set of books kept under lock and key.

Previous attempts have been made within and outside the intelligence community to estimate the concealed funds intended for defense by examining budget residuals. This attempt benefits from additional budgetary material published by the USSR and described in the text of the report.

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POSSIBLE SOURCES OF DEFENSE EXPENDITURES
IN THE SOVIET BUDGET*

Summary and Conclusions

Total Soviet expenditures for defense during 1955-63, as independently estimated by ORR, have been consistently larger than expenditures reported in the Soviet State Budget** under Defense, a fact that would indicate that some defense outlays are concealed under other categories of the State Budget.*** Moreover, the trend of ORR estimates of defense expenditures differs from the trend of these expenditures reported by the USSR. When certain unexplained residual allocations in the Soviet budget are added to the Explicit Defense allocations,† the series obtained, although exceeding the range of the ORR estimates in every year, matches these ORR estimates much more closely than does the Explicit Defense series that has been announced by the Soviet government.

The selection of these unexplained residuals rests on a hypothesis concerning the location of defense expenditures in the Soviet budget. The consolidated Soviet State Budget is composed of the All-Union Budget and the budgets of the individual republics, including the local budgets. The financing through the All-Union Budget of works of "national" (obshchegosudarstvennoye) significance suggests that those expenditures for defense not financed through the Explicit Defense budget would be included in certain unexplained allocations of the All-Union Budget. These suspected appropriations appear as residuals within four major categories of expenditures: General Expenditures, Financing the National Economy, Industry and Construction, and Science. The residuals are found by subtracting from the total expenditures in each category (1) specified nondefense items and (2) unspecified nondefense items identified from other information. Although the residuals still include other nondefense elements, it is impossible with the available data to estimate a net series that embraces only expenditures for defense. For 1961-62 and the Plan for 1963, two separate series, Variant I and Variant II, which are based on alternative assumptions, are presented as estimates of these residuals.

* The estimates and conclusions in this report represent the best judgment of this Office as of 15 November 1964.

** Also referred to as the Soviet budget.

*** In addition to the conventional military outlays (for example, personnel and procurement of armaments), defense outlays (or expenditures) as used in this report also include outlays on the militarized security forces, on research and development activities related to military programs, and on all space programs.

† The consolidated State Budget allocation to Defense will be referred to as the Explicit Defense allocation or the Explicit Defense budget.

A total budget availability series -- the Explicit Defense allocations plus the unexplained residuals -- which is derived from present information, can provide only a hypothetical upper limit of possible defense expenditures, whereas the Explicit Defense budget alone presumably furnishes a lower limit. Throughout the period reviewed, 1955-63, the independent ORR range of estimated annual defense outlays has been within these two limits, as shown in Figure 1 and Table 1.* From 1955 through 1957, all three series went down. The budget availability series began to climb in 1958 and the ORR series in 1959, but the Explicit Defense budget series flattened out during 1958-60. After 1960, although all three series were rising, both the Explicit Defense budget and the budget availability series increased more rapidly than the ORR range of estimated expenditures on defense. Over-all, the trend of the ORR defense estimates does not agree with the trend of the budget availability series any more closely than it does with the trend of the Explicit Defense budget series. However, the high ORR series agrees more closely in trend with both budget series than does the low ORR series and, in this respect at least, is more plausible than the low series.

The sudden rise by 25 percent in 1961 in the Explicit Defense budget was accompanied by a decline of 23 percent in the allocation to another All-Union Budget category, Financing the National Economy, and probably was the result of surfacing expenditures from this and possibly other budget categories. Such a procedure would represent a reversal of the Soviet government's policy before 1961 of reducing that part of expenditures for defense presented in the publicly announced Explicit Defense budget.

Annual changes in Explicit Defense expenditures may well be viewed as more indicative of trends in Soviet political policy rather than as indicators of change in absolute or relative levels of Soviet defense spending. The official effort to portray a certain image of its defense posture to foreign and internal audiences probably is the major consideration in deciding the absolute and relative annual changes to be announced publicly through the Explicit Defense budget. On the other hand, the ever-present possibility of shifts in the content of the budget residuals makes the budget availability series a risky alternative guide to short-run changes in the level of defense spending.

The categories of expenditure believed to be excluded from the Explicit Defense budget include allocations for research and development, for militarized internal security forces, and for some major procurement. Although the allocation to Science probably covers almost all military research and development and although the security

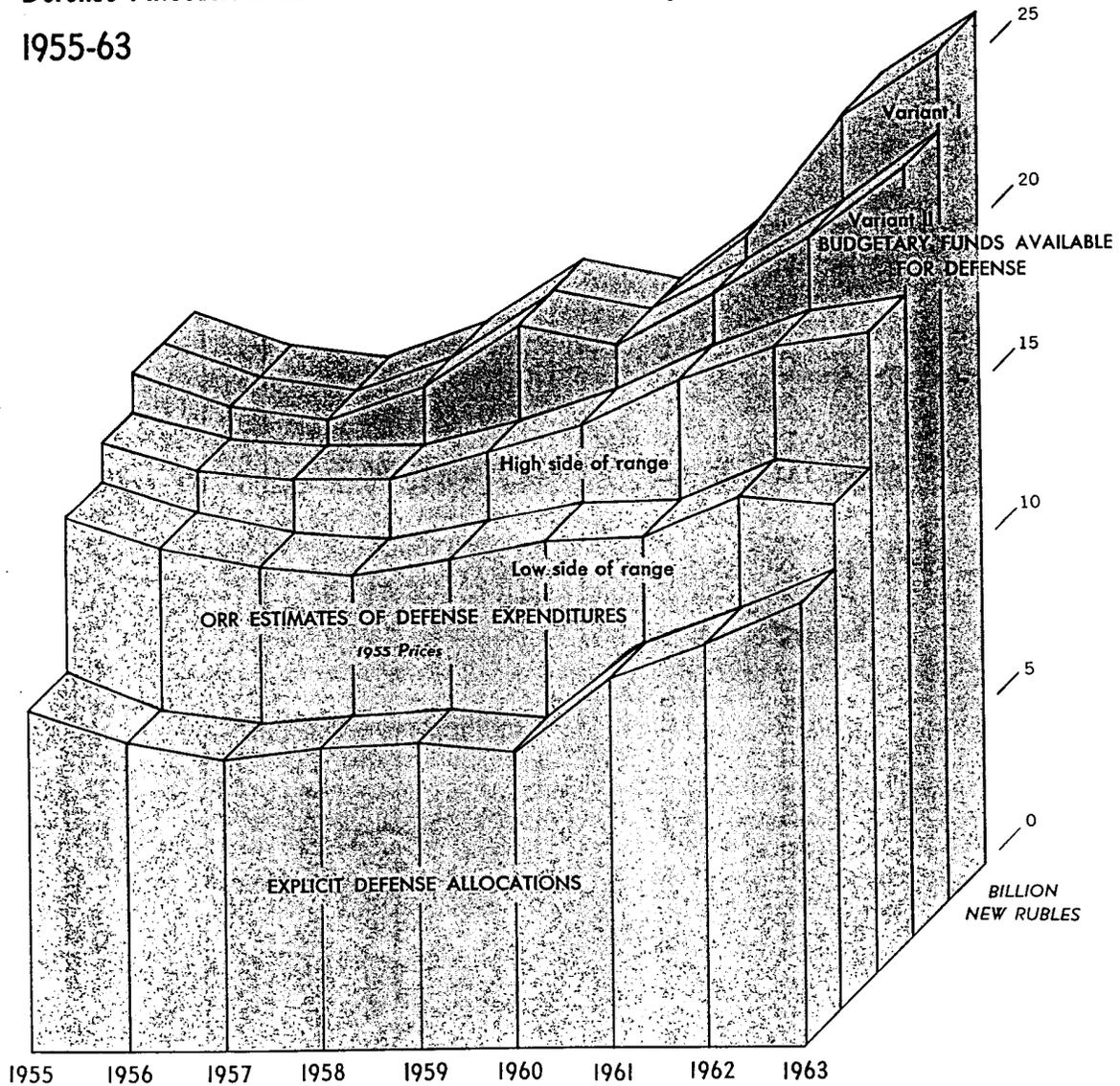
* P. 3, below.

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Figure 1

USSR

Comparison of Budgetary Funds Available for Defense
ORR Estimates of Defense Expenditures, and Explicit
Defense Allocations in the Consolidated State Budget
1955-63



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Table 1

USSR: Budgetary Funds Available for Defense, ORR Estimates of Defense Expenditures,
and Explicit Defense Allocations in the Consolidated State Budget
1955-63

	1955	1956	1957	1958	1959	1960	1961	1962	1963
Budgetary funds available for defense									
Variant I (billion new rubles)	17.61	16.37	15.91	16.99	18.69	17.91	20.2	23.8	26.4
Variant II (billion new rubles)							19.5	21.4	23.8
Index 1955 = 100									
Variant I	100	93	90	97	106	102	115	135	150
Variant II							111	122	135
ORR estimates of defense expenditures									
Low side of the range (billion new rubles) a/	15.6	14.7	14.0	13.8	14.2	14.8	14.9	16.0	15.9
Index 1955 = 100	100	94	89	88	91	94	96	103	102
High side of the range (billion new rubles) a/	16.5	15.7	15.2	15.2	16.0	16.8	18.2	19.2	19.8
Index 1955 = 100	100	96	92	93	97	102	110	116	120
Explicit Defense allocations (billion new rubles)	10.74	9.73	9.12	9.36	9.37	9.30	11.6	12.7	13.9 b/
Index 1955 = 100	100	91	85	87	87	87	108	118	129 b/

a. Expressed in 1955 prices. See III, p. 23, below, for a discussion of the effect of this use of constant prices on the comparison with the budgetary series, which is in current prices.

b. Plan data.

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forces are financed by the residual under General Expenditures, no single residual appears large enough to accommodate all of the procurement thought to be financed outside the announced allocation for defense. The residual under General Expenditures, the all-union allocation to Industry and Construction, and perhaps some grants from union-republic budgets for increasing state material reserves probably all conceal some items of military procurement.

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I. Introduction

According to the Soviet interpretation of Marxist principles, the state appropriates the surplus value produced in the economy (the excess of labor's output above its wages as reflected chiefly in profit and turnover taxes) and applies it to investment, defense, social welfare, and government administration. The State Budget, administered by the Ministry of Finance, is the principal instrument for carrying out this redistribution of funds. Other major instruments for accomplishing this redistribution are accumulations by state enterprises, collective farms, and the banking system.*

Expenditures in the principal categories of the consolidated State Budget are summarized in Table 2.** The category Financing the National Economy provides funds for investment, additions to working capital, and current operational costs to enterprises in all branches of the economy. Under the category Social-Cultural Measures, funds are allocated for education, science, art, press and radio, health and physical culture, social insurance, and welfare. The budget category Defense represents the officially announced defense allocations of the Soviet government for support of military programs and is referred to in this report as the Explicit Defense budget. Expenditures on Administration support the national and local organs of state power; planning, financial, and economic organs; ministries, departments, and perhaps state committees; councils of the national economy; and judicial organs. Expenditures on Loan Service cover the retirement of principal and interest payments on the public debt. The Reserve Funds of the Council of Ministers of the USSR and of the republics are contingency funds that are spent on the other categories as the need arises during the year. In recent years, almost all of these reserve funds have supported the category Financing the National Economy.

The Soviet State Budget is a consolidated budget, including all-union, republic, and local government budgets. The Republic Budgets finance activities under the control of the sovnarkhozes and the republic ministries, including almost all industry, state farms, internal trade, municipal economy and housing, some transportation and communications, and various social-cultural measures. The Republic Budgets also encompass local budget expenditures on these same activities. The All-Union Budget finances activities of national importance or "works of all-union significance" such as defense, foreign trade, almost all

* State enterprises accumulate almost all of their own funds from retained profits; collective farms accumulate theirs from annual deductions of a fixed share of gross receipts. The banking system is a mechanism for redistributing funds through financing bank loans to state enterprises. For additional details on the role of the State Budget in the Soviet financial system, see source 1/. (For serially numbered source references, see the Appendix.)

** P. 6, below.

Table 2

USSR: Expenditures of the Consolidated State Budget, by Category a/
1955 and 1960 and Plans for 1962-65

Expenditures	Billion New Rubles					
	1955 Actual	1960 Actual	1962 Plan b/	1963 Plan b/	1964 Plan	1965 Plan
Financing the National Economy	<u>23.31</u>	<u>34.12</u>	<u>32.5</u>	<u>34.5</u>	<u>38.7</u>	<u>41.2</u>
Industry and Construction	10.95	15.59	14.8	15.5	N.A.	N.A.
Other specified categories	9.77	(14.54) c/	13.1	13.5	N.A.	N.A.
Residual	2.60	(4.00)	4.6	(5.5)	N.A.	N.A.
Social-Cultural Measures	<u>14.72</u>	<u>24.94</u>	<u>28.7</u>	<u>31.0</u>	<u>32.8</u>	<u>34.5</u>
Of which:						
Science	0.82	2.34	N.A.	N.A.	N.A.	N.A.
Defense	<u>10.74</u>	<u>9.30</u>	<u>13.4</u>	<u>13.9</u>	<u>13.3</u>	<u>N.A.</u>
Administration and Loan Service	<u>2.68</u>	<u>1.79</u>	<u>1.9</u>	<u>1.6</u>	<u>(1.6)</u>	<u>(1.6)</u>
Reserve Funds of the Council of Ministers	<u>0</u>	<u>0</u>	<u>3.93</u>	<u>2.6</u>	<u>2.3</u>	<u>3.3</u>
General Expenditures residual	<u>2.51</u>	<u>2.97</u>		<u>2.6</u>	<u>2.6</u>	<u>N.A.</u>
Total	<u>53.95</u>	<u>73.13</u>	<u>80.4</u>	<u>86.2</u>	<u>91.4</u>	<u>100.4</u>

a. Because of rounding, the components may not add to the totals shown.

b. Data for actual expenditures (estimated or official) are available for most major categories but not for several important elements of those categories. Since the primary purpose of the above table is to illustrate the comparative size of expenditures by category and trends over time, the plan data were included.

c. Data in parentheses are OPR estimates.

transport and communications, the Academy of Sciences, major scientific research institutes, and some social-cultural measures. Expenditures of the consolidated State Budget, the All-Union Budget, and the Republic Budgets are shown in Table 3.

Table 3

USSR: Expenditures of the Consolidated State Budget
by Type of Budget
1955-62 and Plan for 1963

Billion New Rubles									
Expenditures	1955	1956	1957	1958	1959	1960	1961	1962	1963 Plan
Consolidated State Budget a/	53.95	56.35	60.73	64.28	70.40	73.13	76.3	82.2	86.2
All-Union Budget	39.85	38.76	32.19	30.23	31.56	30.09	30.7	34.2	38.9
Republic Budgets	14.11	17.59	28.55	34.05	38.84	43.03	45.6	48.0	47.3

a. Because of rounding, components may not add to the totals shown.

The announced allocation for defense, the Explicit Defense budget, is believed to understate consistently the absolute size of ruble expenditures* for military and space programs. Some major reasons for rejecting the series of officially announced allocations for defense as embracing total defense expenditures are (1) Soviet texts in the field of finance have intimated that certain defense expenditures are financed in budget categories other than Explicit Defense 2/; (2) the persistence from year to year of large unexplained residuals in the state budget is ground for suspicion that some "sensitive" activities are being financed by these unspecified allocations; and, finally, (3) a costing in rubles of Soviet military programs by Western intelligence agencies produces estimates greatly in excess of the Explicit Defense budget.

* In this report, budgetary expenditures are given in new rubles at current prices. A nominal rate of exchange based on the gold content of the respective currencies is 0.90 ruble to US \$1. This rate, however, should not be interpreted as an estimate of the equivalent dollar value of similar US goods or services. ORR estimates of defense expenditures are given in new rubles at 1955 prices. For a discussion of the impact of this difference on the comparison between budgetary numbers and the ORR estimates, see III, A, p. 23, below.

The search for the sources of this additional financing of defense has drawn the attention of Western analysts to several unexplained categories of expenditures in the announced annual budgets. These sizable, unexplained allocations -- hereafter referred to as residuals -- are not explicitly separated in Soviet reporting from the categories shown in Table 2 but are derived by (1) deducting from the highly aggregated major categories known ruble expenditures for nondefense elements and then (2) deducting from these derived residuals those allocations for some of the nondefense elements included therein, insofar as they can be estimated from nonbudgetary sources.

Previous attempts to refine the budgetary expenditure residuals have been confined to the residuals in the over-all consolidated State Budget.* In 1962, however, the Soviet government published a statistical handbook ^{4/} that provided more detail on expenditures within the several categories of the consolidated State Budget and also provided a detailed breakdown of the consolidated State Budget into its component budgets: the All-Union Budget and the Republic Budgets (including the local budgets). From this information it was possible to construct separately the all-union and republic components of the expenditure residuals in the consolidated State Budget from 1955 to 1960.

As the All-Union Budget finances "works of national or all-union significance," it is believed that almost all defense expenditures not financed from the Explicit Defense budget are contained within the All-Union expenditure residuals of the consolidated State Budget.** In other words, expenditures made through the budgets of the republics are not believed to be related to defense, with two exceptions: (1) appropriations for the militarized security forces of the republic "ministries for the preservation of public order" and (2) additions to state material reserves for defense purposes, which possibly could be financed at the republic level.

The consolidated State Budget of the USSR is divided into its two major components, and the budgetary categories that either are known to contain or are believed to contain defense expenditures are indicated in Figure 2. After known nondefense outlays are deducted, these categories yield the principal residuals under the All-Union Budget with which this report is concerned -- (1) the residual under General Expenditures, (2) the residual under Financing the National Economy, (3) the allocation to Industry and Construction, and (4) the residual under the allocation to Science.

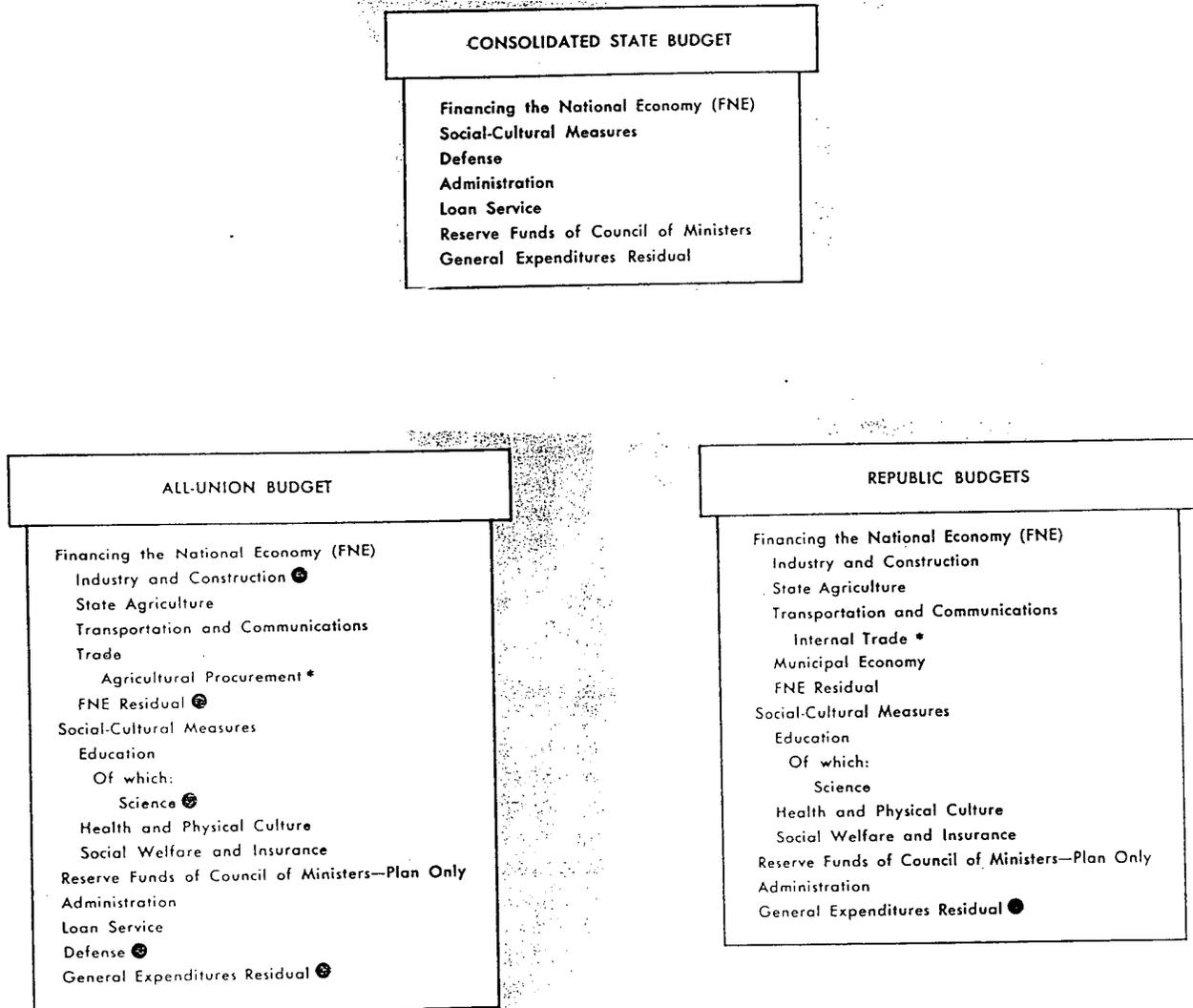
This report presents estimates of and defines the scope of these residuals in terms of the known or suspected but not quantifiable

* See, for example, source ^{3/}.

** A recent Soviet source states, "Expenditures on defense are fully realized from the funds of the union budget." ^{5/}

Figure 2

USSR: Structure of Announced Expenditures in the Consolidated State Budget



categories (defense and nondefense) remaining in them and then compares the budget availability series (the sum of the unexplained sections of the various residuals in the All-Union Budget and the Explicit Defense budget) with the Explicit Defense budget and the ORR defense estimates. The first two objectives are developed in II, below, and the third in III, below.

II. Scope and Content of the Expenditures Residuals

The four unexplained categories in the All-Union Budget that could finance defense expenditures are the residuals under General Expenditures, Financing the National Economy, and Science and the allocation to Industry and Construction.* This section explains the derivation of these residuals. These allocations in the budget clearly include items of expenditure other than those related to defense, but large parts of these unexplained sums probably were allocated to defense programs.

The reliability of these estimated residuals is affected by a number of shortcomings in concept and data, and these weaknesses are discussed in the following sections. Although the budgetary residuals are presented to the nearest tenth or hundredth of a billion rubles, the sums are not that accurate. The unknown location of certain accounts in the Soviet budgetary system necessitated some arbitrary classifications, and planned data have been used to supplement the less detailed actual data that have become available since 1960. The lack of detailed definitions of budget categories in Soviet texts and the lack of knowledge of the effects on the budget categories of the frequent reorganizations of the economy since 1957 also have caused some improvisation.

A. General Expenditures Residual in the All-Union Budget

The steps followed in deriving the General Expenditures residual under the All-Union Budget are shown in Table 4.** Categories 2 through 7 of the All-Union Budget include the major groups of outlays in the Soviet budget, and these outlays are the highly aggregated elements that usually appear in the published version of the budget.

Categories 9 through 12 are the only known elements in this residual under General Expenditures. 6/ The item Refund of Tax Revenues covers refunds to enterprises and individuals for overpayment of taxes in previous years. The content of the category Accounts with Banks is not clear; it may include deposits directly allocated from

* Although the allocations to Industry and Construction are not true residuals, they have been included in the list of budget residuals of possible defense significance because they are suspiciously large in relation to that part of the Soviet economy that they are intended to support.

** P. 10, below.

Table 4

USSR: Derivation of the General Expenditures Residual
in the All-Union Budget

-
1. Total expenditures in the All-Union Budget
 - Less appropriations to
 2. Financing the National Economy
 3. Social-Cultural Measures
 4. Administration and the Courts
 5. Loan Service
 6. Defense
 7. Reserve Funds of the Council of Ministers (plan only)
 - Equals
 8. General Expenditures residual
 - Of which:
 9. Refund of Tax Revenues
 10. Accounts with Banks
 11. Ministry of Internal Affairs (MVD) and the Committee for State Security (KGB) -- for 1955-59
 12. Various Payments and Other Expenditures, including an unspecified element (possibly related to defense)

the budget for granting long-term credits.* The category Various Payments and Other Expenditures is known to include minor outlays not elsewhere classified -- expenditures for the manufacture of medals and other decorations, reimbursement of postal expenditures incurred in the transfer of tax payments, and the like. If defense expenditures are included in the General Expenditures residual, it is believed that they would be classified in this catchall category.

Although no information is available for estimating expenditures under categories 9 and 10 and the nondefense elements of category 12, the over-all ruble outlay on nondefense items is thought to be considerably less than the ruble magnitude of the General Expenditures residual in each of the years 1955-62 and the Plan for 1963 (see Table 5).

* Such allocations would be in addition to the funds available for this use from the budget surplus explicitly allocated for this purpose.

Table 5

USSR: Adjusted General Expenditures Residual in the All-Union Budget
1955-62 and Plan for 1963

	Billion New Rubles								
	1955	1956	1957	1958	1959	1960	1961	1962	1963 Plan
Derivation of the Residual									
General Expenditures residual in the All-Union Budget <u>a/</u>	2.40	2.69	(2.39) <u>b/</u>	2.62	3.38	1.97	(2.0)	(1.2)	(1.65)
Plus									
Expenditures for the Internal Security Forces (former MVD) <u>c/</u>						(0.55)	(0.55)	(0.55)	(0.55)
Adjusted General Expenditures residual in the All-Union Budget	2.40	2.69	(2.39)	2.62	3.38	(2.52)	(2.55)	(1.75)	(2.20)

a. For 1955-60, see source 1/. Data for 1957 include an estimate of 1.1 billion rubles for Loan Service. Data for 1961-62 and those of the plan for 1963 are estimated from data in the annual plans and from reports of plan fulfillment. 8/

b. Data in parentheses are ORR estimates.

c. The estimate of 550 million rubles for 1960 is suggested by the over-all changes in the residuals in the All-Union and the Republic Budgets between 1959 and 1960. The actual outlays are assumed to have been of the same magnitude in 1961 and 1962 and in the plan for 1963.

With but two minor exceptions, defense expenditures probably are not included in the budgets of the union-republics. One of these probable exceptions relates to the militarized security forces of the republic internal security organs. Until 1960, expenditures for the internal security organs were financed at the all-union level, but in that year the Ministry of Internal Affairs (MVD) was abolished, its functions were transferred to the republic "ministries for the preservation of public order," and the financing of this element of internal security was transferred to the budgets of the union republics. 9/ Expenditures for the other militarized security forces, the Committee for State Security (KGB), probably are still financed at the all-union level. Because expenditures on the former MVD organs after 1959 are believed to have been transferred from the General Expenditures residual of the All-Union Budget to the Republic Budgets, the all-union ruble series for 1960-62 and the Plan for 1963 have been adjusted to include these expenditures on internal security forces.

Thus the adjusted General Expenditures residual shown in Table 5 includes ruble outlays for at least one element of defense -- militarized security forces -- and probably other defense expenditures as well. Some procurement of major military equipment very likely is financed from funds in this residual.*

B. Residual Under the Allocation to Financing the National Economy

This budget residual under the allocation to Financing the National Economy is obtained from the All-Union Budget by the procedure shown in Table 6.

Of the four unexplained residual categories considered, the residual under Financing the National Economy is the smallest, and in allowing for the probable inclusion of at least some nondefense programs, it is quite likely that this residual does not contain defense expenditures. Soviet sources indicate that additions to "state reserves"*** are partly financed from funds included in Financing the National Economy. 10/ On the other hand, because the total magnitude of these annual increments to reserves greatly exceeds the size of the residual under Financing the National Economy, it is clear that this source of financing plays a minor role. The greater part of allocations financing additions to state reserves probably is divided among the several categories, for example, Industry and Agriculture, according to the type of commodity stockpiled.***

* See III, B, p. 25, below.

** State reserves refer to stockpiling of goods not normally available as working capital. Thus they are special inventories set aside for emergency use in times of mobilization or of crop failure.

*** Several Soviet sources have stated that one of the components of state reserves is armaments -- "reserves of means of defense which have a special nature." It is possible that [footnote continued on p. 13]

Table 6

USSR: Derivation of the Unexplained Residual Under the Allocation
to Financing the National Economy in the All-Union Budget

-
1. Total expenditures for Financing the National Economy
in the All-Union Budget

Less appropriations to
 2. Industry and Construction
 3. State Agriculture
 4. Agricultural Procurement
 5. Trade
 6. Transport and Communications
 7. Municipal Economy and Housing
Equals
 8. Gross residual under Financing the National Economy

Less
 9. Premium payments for agricultural procurements (1955-58)
 10. Allocations to Ministry of Culture enterprises (1955-57)
Equals
 11. Net residual under Financing the National Economy

Of which:
 12. Additions to state reserves (nonmilitary)
 13. Unspecified (possibly related to defense)

To achieve comparability in coverage of this residual within the All-Union Budget for all years between 1955 and 1963, minor adjustments must be made for appropriations that were included in the All-Union Budget only in the early years. Rough estimates are possible for these elements, categories 9 and 10, in Table 6. Direct grants from the All-Union Budget were made in 1955-58 to agricultural procurement organizations for the premium payments that they made to farms for technical crops. Since 1958 these budgetary

defense-related accumulations to state reserves are financed directly from explicit budgetary appropriations to defense. 11/

allocations are believed to have been transferred to the Republic Budgets. Before 1958 the entertainment and publishing industries operated by the Ministry of Culture* received a small allocation from the All-Union Budget. Since 1957 these budget grants also are believed to have been financed by the Republic Budgets.

The adjustments outlined above result in the net estimate of the residual under Financing the National Economy for 1955-60 as shown in Table 7. Because the USSR has not revealed actual budgetary expenditures within this category during 1961-63, there is no basis for obtaining a reasonably accurate estimate of the residual after 1960. Rather this residual is lumped together with another category under Financing the National Economy -- the all-union appropriations to Industry and Construction -- which is suspected of containing expenditures related to defense. The derivation of this latter series is described in the following section.

C. Allocations to Industry and Construction in the All-Union Budget

The main reason for including allocations to Industry and Construction in the category of budget residuals is the unaccountably large size of these allocations during 1957-60, the years for which firm data are available. During those years, budgetary appropriations through the All-Union Budget to Industry and Construction were about 25 percent of the total budgetary (consolidated) appropriations to all Industry and Construction (see Table 8**). Yet, in the same period, industrial and construction enterprises of all-union subordination produced annually only 6 percent of the gross value of industrial output in the USSR. 12/

This small part of total industrial output seems to have originated in enterprises controlled by three state production committees subordinated to the Council of Ministers of the USSR -- medium machine building, construction of electric power stations, and the gas industry -- and the state production committees that are engaged in defense. Because of the high capital intensity required in producing electric power and nuclear materials (medium machine building), these all-union enterprises may well require larger budgetary allocations in relation to the value of their output. It is unlikely, however, that the character of all-union enterprises explains why the ratio of budgetary allocations to gross value of output for all-union Industry and Construction should be 5.2 times as large as the ratio for Industry and Construction that is financed from the Republic Budgets.

* This ministry controls the movie producers, ballet and opera companies, and the like. Only a small number of printing and publishing enterprises in the USSR are under the Ministry of Culture.

** P. 16, below. The balance of the budgetary appropriations -- 75 percent -- to Industry and Construction were channeled through the Republic Budgets.

Table 7

USSR: Unexplained Residual Under the Allocation
to Financing the National Economy in the All-Union Budget
1955-60

	Billion New Rubles				
	1955	1956	1957	1958	1960
Derivation of the Residual					
Gross residual under Financing the National Economy in the All-Union Budget a/	2.26	1.13	(1.26) b/	(1.56)	(0.64)
Less					
Premium payments for agricultural procurements c/	(0.90)	(0.90)	(0.90)	(0.90)	
Allocations to Ministry of Culture enterprises d/	(0.07)	(0.07)	(0.07)		
Equals					
Net residual under Financing the National Economy in the All-Union Budget	(1.29)	(0.16)	(0.29)	(0.66)	(0.64)

a. In obtaining the series for the residual under Financing the National Economy, as shown above for 1957-60, the series shown in source 13/ was adjusted further. Estimated outlays of 500 million rubles were added to the other specified categories under Financing the National Economy to cover the normal expenditures of the agricultural procurement organizations.

b. Data in parentheses are ORR estimates.

c. These grants, which arose because procurement organizations paid premium markups to farms for technical crops, were planned at 860 million rubles in 1958 and are assumed to have been realized at this level from 1955 to 1958. 14/ If these payments have continued since 1958 (they could have been eliminated by the price adjustments of 1959 and 1960), the assumption is that they have been included in the residuals under Financing the National Economy in the Republic Budgets. The increase of 1 billion rubles in these residuals and the decrease of 800 million rubles in the residual under Financing the National Economy in the All-Union Budget between 1958 and 1959 suggest a transfer of about 900 million rubles.

d. 15/. The assumption is that these allocations were made from the All-Union Budget before 1958 and from the Republic Budgets thereafter.

Table 8

USSR: Adjusted Allocations to Industry and Construction in the All-Union Budget 1955-60

	Billion New Rubles					
Derivation of the Residual	1955	1956	1957	1958	1959	1960
Allocations to Industry and Construction in the consolidated State Budget a/	10.95	12.75	13.08	13.67	14.88	15.59
Less						
Allocations in the Republic Budgets b/	2.13	3.46	9.78	10.34	10.96	11.61
Equals						
Adjusted allocations to Industry and Construction in the All-Union Budget	(2.74) c/	(3.19) c/	3.30	3.33	3.92	3.98

a. 16/

b. 17/

c. The industrial reorganization of 1957 is reflected in the budget by a transfer of funds from the All-Union Budget in 1956 to the Republic Budgets in 1957. Between 1957 and 1960, allocations to industry and construction in the All-Union Budget varied between 24 and 26 percent of allocations to industry and construction in the consolidated State Budget. Thus, to obtain estimates for 1955 and 1956, 25 percent of appropriations in the consolidated State Budget in those years were allocated to the All-Union Budget.

Expenditures on other economic activities that may be included under this category possibly provide for organizations whose functions cross territorial and sovmarkhoz lines and therefore logically would be financed through the All-Union Budget. For example, operational outlays on geological surveying, clearing land for nonagricultural activities, fish-breeding, and the like may be financed under the allocation to Industry and Construction. The State Geological Committee of the USSR is a budget organization, and all of its activities are fully financed by the State Budget. ^{18/} In addition, there is the possibility that the allocation to Industry and Construction in the All-Union Budget could finance accumulations of state reserves of an industrial nature. If this is the case, then it is conceivable that accumulations of reserves of some military hardware could be procured under this allocation. The lack of available data prevents estimating appropriations for geological surveys and for additions to state reserves of a nonmilitary nature from the allocation to Industry and Construction in the All-Union Budget.

In the absence of a reliable method of estimating the share of either the all-union enterprises or these other nondefense activities in the allocation to Industry and Construction in the All-Union Budget, the entire allocation is treated as a residual, with the understanding that a sizable part of it is clearly of a nondefense nature.

For 1961-63 the residual under Financing the National Economy and the allocation to Industry and Construction in the All-Union Budget have been estimated jointly in two different ways. One method assumes that the trends in the consolidated State Budget (all-union and republic) for components of Financing the National Economy are identical with those for the same components in the All-Union Budget (Variant I in Table 9*); the other method assumes that the joint residual moves over time as does the index of total expenditures for Financing the National Economy in the All-Union Budget (Variant II in Table 9*).

Under Variant I the All-Union Budget is assumed to have retained the same relative share of the total allocations to nonindustrial components under Financing the National Economy. Allocations assigned annually since 1960 from the consolidated State Budget to State Agriculture, Transport and Communications, and Trade have remained fairly steady. Variant II extrapolates the combined total of the allocation to Industry and Construction and the residual under Financing the National Economy in the All-Union Budget on the basis of the percentage change in expenditures for Financing the National Economy in the All-Union Budget. Of the two variants, Variant I produced the high boundary of the range because it assumes near constancy in outlays on State Agriculture, Transport and Communications, and Trade, whereas Variant II assumes that the expenditures in these categories increase in direct proportion to the expenditures for Financing the National Economy in the All-Union Budget.**

* P. 18, below.

** Text continued on p. 20.

Table 9

USSR: Sum of the Unexplained Residuals Under the Allocation to Financing the National Economy and the Allocations to Industry and Construction in the All-Union Budget 1960-63

	Billion New Rubles		
	1960	1961	1962
Derivation of the Residual			
Variant I			
Expenditures for Financing the National Economy in the All-Union Budget <u>a</u> /*	10.3	7.9	10.7 <u>b</u> /
Less			11.8 <u>b</u> /
State Agriculture <u>c</u> /	0.1	(0.1) <u>d</u> /	(0.2)
Transport and Communications <u>e</u> /	1.5	(1.5)	(1.5)
Trade <u>f</u> /	3.6	(1.6)	(1.2)
Agricultural Procurements <u>g</u> /	(0.5)	(0.5)	(0.5)
Equals			
Allocation to Industry and Construction and the Residual under Financing the National Economy	(4.6)	(4.2)	(7.3)
Variant II			
Expenditures for Financing the National Economy in the All-Union Budget <u>h</u> /	10.3	7.9	(11.0)
Allocation to Industry and Construction and the Residual under Financing the National Economy <u>i</u> /	(4.6)	(3.5)	(4.9)
			11.8 <u>b</u> /
			(5.3)

* Footnotes follow on p. 19.

Table 9
(Continued)

- a. For 1960, see source 19; for 1961, 20; for the plan for 1962, 21; and for the plan for 1963, 22.
b. Plan data.
c. For 1960, see source 23. The extrapolation for 1961-63 is based on assumed biennial increments of 100 million rubles.
d. Data in parentheses are ORR estimates.
e. For 1960, see source 24. The extrapolation for 1961-63 is based on a relatively constant trend at the level of the consolidated State Budget.
f. For 1960, see source 25. The estimates for 1961-63 are based on annual plan reports.
g. The estimates are based on the annual plan reports of data for State Agriculture, Agricultural Procurements, and Trade.
h. For 1960, see source 26; for 1961, 27. The estimates for 1962 and 1963 are based on annual reports of plan fulfillment.
i. The estimate for 1960 is the same as in Variant I, above. The extrapolation for 1961-63 is based on the percentage change in the expenditures for Financing the National Economy in the All-Union Budget.

D. Residual in the Science Budget

A statistical handbook on Social-Cultural measures that was published in 1958 provided a table showing total expenditures for Science that were made from the consolidated State Budget and a breakdown of these expenditures by "stat'ya," or "article" (such as wages, equipment, and repair expenses). 28/ The sum of these "article" expenditures did not exhaust the reported total. Furthermore, for the years before 1958 the excess of disclosed expenditures (by article) above the expenditures for Science in the budgets of the republics roughly corresponded with the budgets of the Academy of Sciences and the research institutes of the Ministry of Health. Therefore, it has been suggested that those expenditures detailed by type of outlay in the 1958 handbook covered outlays for nonmilitary purposes -- expenditures on science by the union-republics, the Academy of Sciences, and the health institutes -- but did not cover expenditures for science related to defense. The undistributed part in this sense is here taken as a Science residual that probably includes expenditures on research and development related to defense (see Table 10).

This breakdown by article (or function) was not repeated in the recently published budget handbook; therefore, the method cannot be repeated for the years following 1957. In estimating those expenditures for science not related to defense for the years following 1957, expenses of the Academy of Sciences and the health institutes were estimated and then subtracted from the reported allocation to Science in the All-Union Budget in order to obtain the Science residual.

The residual so obtained looms large as a share of the total Science budget and probably should be viewed as the upper limit of that part of the allocations to Science that are related to defense. The boundary between military and civilian research and development is vague. For example, it would be difficult to prorate between civilian and military purposes research on the development of a nuclear reactor that could be used to power a submarine or an icebreaker.

E. Sum of the Unexplained Residuals and the Explicit Defense Budget

A total of budget funds available for defense -- the sum of the unexplained residuals and the announced or Explicit Defense budget -- is presented in Table 11.* It must be emphasized that several categories of nondefense spending are included within this series. In addition to those categories already discussed, nondefense expenditures included in the budget availability series provided for (1) drawings against foreign aid grants; (2) expenditures on special industrial programs such as those for raising wages during 1957-61; (3) special expenditures for regional development, such as the virgin lands program;

* P. 22, below.

Table 10

USSR: Unexplained Residual Under the Allocation to Science in the All-Union Budget
1955-62 and Plan for 1963

	Billion New Rubles						1963 Plan	
	1955	1956	1957	1958	1959	1960		1961
Derivation of the Residual								
Allocation to Science <u>a/</u>	0.66	0.84	1.09	1.33	1.55	1.87	(2.14) <u>b/</u>	(2.40)
Less								N.A.
Distributed part of the Science budget <u>c/</u>	0.22	0.24	0.28	(0.31)	(0.37)	(0.40)	(0.39)	(0.38)
Equals								N.A.
Science residual	<u>0.44</u>	<u>0.60</u>	<u>0.81</u>	<u>(1.02)</u>	<u>(1.18)</u>	<u>(1.47)</u>	<u>(1.75)</u>	<u>(2.02)</u>

a. For 1955-60, see source 29/. The data for 1961-62 have been extrapolated and represent 80 percent of the funds for Science in the consolidated State Budget. Between 1955 and 1960 the funds for Science in the All-Union Budget ranged between 77 and 82 percent of the funds for Science in the consolidated State Budget; the percentage figure in 1960 was 80 percent.

b. Data in parentheses are ORR estimates.

c. For 1955-57, see source 30/. These sums are the difference between the sum of the reported distribution of funds in the consolidated State Budget by type of outlay and the total of the Science budgets of the union republics. For 1958-62 the estimates of the activities of the Academy of Sciences and the research institutes of the Ministry of Health made by ORR suggest that the distributed part of the Science budget equals the allocations to these sectors.

Table 11

USSR: Explicit Defense Budget and the Unexplained Residuals
in the All-Union Budget That May Be Available for Defense
1955-63

Sources of Funds Available for Defense	Billion New Rubles								
	1955	1956	1957	1958	1959	1960	1961	1962	1963
Explicit Defense budget <u>a/</u>	10.74	9.73	9.12	9.36	9.37	9.30	11.6	12.7	13.9 <u>b/</u>
General Expenditures residual <u>c/</u>	2.40	2.69	(2.39) <u>d/</u>	2.62	3.38	(2.52)	(2.6)	(1.8)	(2.2)
Net residual under Financing the National Economy <u>e/</u>	(1.29)	(0.16)	(0.29)	(0.66)	(0.84)	(0.64)	(3.5 to 4.2)	(4.9 to 7.3)	(5.3 to 7.9)
Allocation to Industry and Construction <u>f/</u>	(2.74)	(3.19)	3.30	3.33	3.92	3.98	(1.47)	(2.0)	(2.4)
Science residual <u>g/</u>	0.44	0.60	0.81	(1.02)	(1.18)	(1.47)	(1.8)	(2.0)	(2.4)
Total	(17.61)	(16.37)	(15.91)	(16.99)	(18.69)	(17.91)	(19.5 to 20.2)	(21.4 to 23.8)	(23.8 to 26.4) <u>h/</u>

a. 31/

b. Plan data.

c. From Table 5, p. 11, above.

d. Data in parentheses are ORR estimates.

e. From Table 7, p. 15, above.

f. From Tables 8 and 9, pp. 16 and 18, respectively, above.

g. From Table 10, p. 21, above.

h. No estimate is made for funds that may have been allocated from the Reserve Funds of the Council of Ministers for defense purposes as defined in this report. Most of the Reserve Funds are allocated to Financing the National Economy, and the estimates are understated to the extent that part of these funds were used to finance defense procurements.

and (4) some scientific research programs of a nondefense character that might be included in the residuals under Financing the National Economy and under General Expenditures.

III. Comparison of Budgetary Funds Available for Defense with Expenditures for Defense as Announced by the USSR and as Estimated by ORR

A. Over-All Comparison

Given the implausibility of the announced expenditures for defense and the unknown range of error attached to ORR estimates of Soviet defense outlays, it is impossible to appraise with any confidence the defense content of the budget availability series by comparing it with the announced or estimated series. Because of the scarcity of budgetary data and the inadequacy of available information on the scope and content of the relevant budget categories, the budget availability series at best can provide only an upper limit of possible Soviet defense expenditures. The Explicit Defense budget presumably is a lower limit.

Another distortion in the comparison arises from the fact that both the budget availability series and the Explicit Defense series reflect current prices, whereas the ORR estimates of defense expenditures are expressed in 1955 prices. Although an index of prices paid by the Soviet military establishment does not exist, one can be approximated if it is assumed that the course of prices of military goods produced by industry was the same as the indexes of prices in the branches of industry that produce military goods. This price index dips 5 percent between 1955 and 1958 and levels off thereafter. The whole of this decline is the result of a decrease of 15 percent in the level of prices in machine building and metalworking, the source of almost all military hardware. Nevertheless, it is unlikely that the official index accounts adequately for the introduction of new products at inflated prices. As the military hardware mix changed drastically during 1955-63, it is quite possible that the defense industry seized the opportunities offered, and allowed by Soviet practice, to charge the high temporary prices for new products. Instead of declining, a price index of military expenditures that covered these new products correctly might have even increased somewhat after 1955. The best judgment possible, however, is that the ORR estimates (1955 prices) can be considered quite comparable to the budget series (current prices) through 1958 but that ORR estimates in current prices probably would rise somewhat more rapidly after 1958 than those presented in Table 1* and Figure 1.**

Although imprecise, the comparison presented in Table 1 discloses some interesting facets. For each year of the period reviewed,

* P. 3, above.

** Following p. 2, above.

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1955-63, the range of the ORR estimates of expenditures for defense has been within these two limits. During 1956-57, all three series went down. In 1958 the budget availability series and the high side of the ORR range rose. In 1959 the low side of the ORR range rose also; the upward trend in both series continued through 1962. In contrast, the Explicit Defense budget series leveled off during 1958-60, increased sharply in 1961, and continued upward in 1962-63.

In almost all years the range of ORR estimates for defense lies much closer to the budget availability series than to the Explicit Defense budget series announced by the USSR. The exception is 1962-63, when both variants of the budget availability series climbed steeply.

If the ORR estimates describe the trend in defense expenditures correctly, there is little reason to prefer the budget availability series to the Explicit Defense budget series as an indicator of annual changes in the level of Soviet military spending. In 1956-57, both series move in the same manner as the ORR range; in 1958 the change in the Explicit Defense budget is the better match for changes in the ORR estimates; but in 1959 the budget availability series and the ORR estimates rose, whereas the Explicit Defense budget series remained about the same. After 1960, both the budget availability series and the Explicit Defense series increased much more sharply than did the ORR estimates. However, the high ORR series agrees more closely in trend with both budget series than does the low ORR series and, in this respect at least, is more plausible than the low series. Part of the difference in trend after 1960 between the budget availability series and the ORR estimates may be explained (as discussed above) by the understatement of the rise in expenditures in the ORR series caused by the use of constant rather than current prices. Another part of the deviation could result from the procedure used to estimate jointly the residual under Financing the National Economy and the allocation to Industry and Construction in the All-Union Budget during 1961-63. The numerical basis for this estimate is clearly not as good after 1960 as it is in earlier years.

The pronounced hump in the budget availability series in 1959 points up the difficulty of using it as a herald of defense trends. Unusual increases in the General Expenditures residual and in the allocation to Industry and Construction in the All-Union Budget were followed in 1960 by a precipitous decline in the General Expenditures residual. In view of the generally accepted estimate of the trend of Soviet defense spending in 1959-60, the decline in the budget availability series in 1960 may indicate sudden shifts in the treatment of nondefense expenditures that remain in the residuals. For example, the large increase in the General Expenditures residual in 1959 perhaps might reflect an increase in funds made available to one of its components, "accounts with banks." Because these funds, as noted in II, A,* are believed to include deposits allocated directly from the budget for the purpose of granting long-term credits, an increase in these

* P. 9, above.

~~S-E-C-R-E-T~~

allocations can be suspected on the basis of the fact that, in 1959, kolkhozes purchased on credit large stocks of equipment from the dissolved Machine Tractor Stations (MTS's) and the fact that 1959 was the beginning of a long-term plan, the initiation of which usually places great demands on bank credit.

Another kind of shift may have occurred in 1961. When announced defense expenditures rose suddenly by 25 percent, there was a decline of about 23 percent in the allocation to Financing the National Economy in the All-Union Budget. Thus part of the increase in Explicit Defense expenditures probably represented a surfacing of expenditures from Financing the National Economy or from other budget categories. Any accounting changes that made the Explicit Defense budget more or less inclusive of total defense expenditures probably reflect an official effort to project a certain image of its defense posture for external and internal consumption.

B. Content of the Explicit Defense Budget

That the announced Explicit Defense budget does not include all defense expenditures has been intimated by Soviet sources ^{32/} and corroborated by ORR estimates of the costs of Soviet defense programs. Total defense expenditures may be divided among seven major categories:

1. Pay and allowances for personnel
2. Expenditures on the operation and maintenance of forces
3. Procurement of organizational equipment and housekeeping supplies
4. Construction of facilities
5. Procurement of major military equipment
6. Expenditures for research and development, including nuclear energy programs, that are not covered by the price of the final product
7. Expenditures on "internal security forces" -- the forces of the republic "ministries for the preservation of public order" (formerly known as the Ministry of Internal Affairs).

This concept of defense expenditures excludes investment in fixed and working capital for defense production and subsidies possibly required for production of weapons. It also excludes research expenditures related to defense that are financed from nonbudget sources.

Soviet texts appear to include expenditures on personnel, operations and maintenance, and facilities in the Explicit Defense budget but are vague on the inclusion or exclusion of procurement expenditures. ^{33/} The Explicit Defense budget is believed to include items (1) through (4) and an undetermined part of (5) up to 1961. ^{34/}

Between 1955 and 1957 the general trends in Explicit Defense expenditures, ORR defense estimates, and the budget availability series were somewhat similar, as shown in Figure 1.* Between 1958 and 1960, however, Explicit Defense expenditures leveled off, while both the ORR defense estimates and the budget availability series showed substantial increases. It may be that the increased number of categories of procurement that are financed outside the Explicit Defense budget and the growing importance of military research and development in these years had the effect of making the Explicit Defense budget less inclusive of total defense outlays.

This trend evidently was planned to continue into 1961, as planned expenditures under the Explicit Defense category were set at 9.3 billion rubles. But in July 1961, Khrushchev announced an increase to 12.3 billion rubles in Explicit Defense spending. Actual expenditures in 1961 were given as 11.6 billion rubles, 700 million rubles less than the revised plan but still 2.3 billion rubles above the original plan. In contrast, the estimated actual defense expenditures increased only 0.1 billion rubles (the low side of the ORR range) to 1.4 billion rubles (the high side of the ORR range). If it is assumed that all of this estimated increase in defense spending was included in the increase of 2.3 billion rubles in the Explicit Defense budget, then 0.9 billion to 2.2 billion rubles of the increment may have represented a transfer to the Explicit Defense budget from other budgetary categories.

The plan in 1961 for Financing the National Economy at the all-union level, as shown in Table 12, originally was 12.7 billion rubles, up 2.4 billion from the actual expenditures in 1960. By the end of 1961, however, only 7.9 billion rubles actually had been spent, a 4.8-billion-ruble underspending of the original plan. This sum of 4.8 billion rubles can be divided roughly into (1) 0.9 billion to 2.2 billion rubles representing categories that may have been transferred to the Explicit Defense budget, (2) 1.3 billion rubles representing underspending of the total expenditures plan of the consolidated State Budget, and (3) 1.3 billion to 2.6 billion rubles remaining as a sum transferred to the Republic Budgets.

On the assumption that the content of the Explicit Defense budget is that described above, the budgetary residuals would supply funds for research and development and some parts of major military procurement. It is also possible, however, that some outlays for facilities, particularly those for advanced weapons systems, would be financed outside of the Explicit Defense budget. Little can be said about the

* Following p. 2, above.

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Table 12

USSR: Planned and Actual
All-Union and Republic Budgetary Expenditures a/
1960-62

Expenditures	Billion New Rubles					
	1960		1961		1962	
	Plan	Actual	Plan	Actual	Plan	Actual
All-Union Budget						
Total	<u>35.8</u>	<u>30.1</u>	<u>34.8</u>	<u>30.7</u>	<u>35.7</u>	<u>34.2</u>
Financing the National Economy	13.1	10.3	12.7	7.9	10.7	(11.0) b/
Social-Cultural Measures	(7.4)	7.5	8.1	(8.1)	8.1	(8.2)
Administration	(0.2)	0.2	(0.3)	(0.3)	0.3	(0.3)
Loan Service	(0.7)	0.7	0.8	0.8	0.8	0.8
Explicit Defense	9.6	9.3	9.3	11.6	13.4	12.7
Reserve Funds of the Council of Ministers	2.0	0	(1.8)	0	(1.8)	0
Residual	(2.6)	2.0	(1.8)	(2.0)	(0.6)	(1.2)
Republic Budgets						
Total	<u>38.8</u>	<u>43.0</u>	<u>42.8</u>	<u>45.6</u>	<u>44.7</u>	<u>48.0</u>
Financing the National Economy	19.8	23.8	21.2	24.7	21.7	(25.2)
Social-Cultural Measures	(17.4)	17.4	19.0	(19.1)	20.6	(20.7)
Administration	(0.9)	0.9	(0.8)	(0.8)	0.8	(0.8)
Reserve Funds of the Council of Ministers	0.8	0	(0.9)	0	0.9	0
Residual	(0.1)	0.9	(0.9)	(1.0)	0.7	(1.3)

a. Source 35/ unless otherwise indicated.

b. Data in parentheses are ORR estimates.

defense content of individual residuals other than that the internal security forces probably are financed from the General Expenditures residual and that most military research and development is likely to be financed from the Science budget under the allocation for Social-Cultural Measures in the All-Union Budget.

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There are two reasons for doubting that all of the procurement outlays not financed from the Explicit Defense budget would be financed from any one residual: first, of the four residual categories discussed previously,* only the allocation to all-union Industry and Construction** is large enough to embrace the total residual for such procurement, and, second, there probably are in each of these residuals substantial nondefense expenditures that cannot be estimated with present information.

A more likely, although conjectural, hypothesis is that total military procurements are divided among the Explicit Defense category, the General Expenditures residual, and the allocation to Industry and Construction in the All-Union Budget. The Science residual logically would not include procurements of major armaments, and the residual under Financing the National Economy would be too small to hold a large procurement category even if suspected nondefense components are not included. Again, it is necessary to add that some military armaments could be procured through the Republic Budgets under the accumulation of state material reserves.

* See II, p. 9, above.

** That is, the total including the allocations to the three industrial and construction elements financed under the Industry and Construction category of the all-union Financing the National Economy -- medium machine building, construction of electric power stations, and the gas industry.

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