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The Soviet Economy And the Summit

An Intelligence Assessment

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June 1979

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The Soviet Economy And the Summit (U)

An Intelligence Assessment

Research for this report was completed on 8 June 1979.

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This paper is a joint effort of the Office of Economic Research and the Office of Political Analysis. Comments and queries are welcome and should be directed to [redacted] Office of Economic Research, [redacted] or [redacted] Office of Political Analysis. [redacted]

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The Soviet Economy And the Summit (U)

Summary

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In mid-1979 the Soviet leadership is concerned about the economic dilemmas that confront the USSR and about finding measures that would alleviate economic pressures without weakening political control at home or generating unrest in Eastern Europe. At the same time, however, the leadership remains dedicated to projecting Soviet power abroad—from which it sees economic as well as other benefits. Unhappy with impediments to trade with the United States, President Brezhnev probably comes to Vienna with expectations of economic gain that are more modest than those he harbored at the 1972 and 1973 summits. Nevertheless, he might have hopes of a major breakthrough in trade between the superpowers based on credits and compensation deals. [redacted]

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As the Summit approaches, the outlook for Soviet economic growth is bleak. In the short run, poor industrial performance will impede the investment programs that underlie Moscow's efforts to turn the economy around. In addition, the large drop in grain production expected this year means that the gap between production and domestic requirements for grain will be roughly 43 million tons. Longer term prospects are even worse. Our forecasts on energy production seem to be holding. The USSR's oil industry is likely to enter a no-growth stage by 1980, followed by steady production declines in the early 1980s. This, together with manpower stringencies, slower growth of new plant and equipment, and little or no gain in productivity will push economic growth down to about 2 percent per year in the mid-1980s. [redacted]

Faced with these prospects, President Brezhnev and his colleagues must soon make some hard choices regarding resource allocation. Fundamental policy decisions must be made over the next year as the economic plan for 1981-85 is being formulated and as measures looking toward 1990 are approved. These decisions are further complicated by the necessity to consider the needs and potential of the East European client states, whose dependence on the USSR for energy and other raw materials is likely to increase in the 1980s. The leaders must also take account of the future

trade-offs in allocating smaller GNP increments among consumption, investment, and defense:

- Because of resource constraints on both Eastern Europe and the USSR, Moscow cannot do more to help Eastern Europe without seriously hurting its own economic interests, while to do less might well endanger political stability there.

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- From the standpoint of economic trade-offs, the importance of arms limitation agreements such as SALT II is not in immediate savings, which are small relative to total military spending, but in future cost avoidance. [redacted]

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Given the present state of the economy, Soviet leaders may see their economic and military aspirations best served by a policy of increasing commercial relations with the West and encouraging an influx of Western machinery and technology. Because of the prospective decline in Soviet oil production, the impetus to obtain assistance in energy exploration and development will be especially strong. [redacted]

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In approaching the Summit, the Soviet leadership would undoubtedly like to encourage a US-Soviet dialogue leading to a predictable, sustained, and growing economic relationship. Although the USSR can find most of the equipment, technology, and credits it needs in Western Europe and Japan, Soviet policymakers still have high regard for US technology and believe that the US market has the potential to absorb substantial amounts of Soviet exports. [redacted]

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Soviet leaders would like to be able to count on the participation of the US private sector as they formulate economic plans for 1981-85 and beyond; they believe such participation could make a difference in how the USSR copes with its economic problems in the 1980s. At a minimum, the USSR would like assurances that it can count on substantial US Government-backed financing over the next few years. This means repeal (or waiver) of the Jackson-Vanik and Stevenson Amendments. In addition, the Soviets might possibly ask the United States to raise the 8-million-ton ceiling on the amount of US grain they can purchase under the Long Term Agreement without further US Government approval. [redacted]

We do not believe, however, that economic difficulties will force Soviet leaders to make significant concessions in areas they consider central to the USSR's economic, political, and military security interests, or to its global

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aspirations. They probably feel that they have substantial capacity to resist US leverage in the economic sphere and that this capacity will permit them to minimize any noneconomic concessions they might have to make in return for greater access to US technology, goods, and credit. They think, not without reason, that they can count on considerable pressure from US business circles for a relaxation of trade restraints. And they observe that Congress and the administration now appear actively interested in resolving the issues of most-favored-nation status and credits. [redacted]

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The Soviet Economy And the Summit (U)

Introduction

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At Vienna the Soviet Union's economic problems will probably loom larger than they have at previous summit meetings. This memorandum reviews the USSR's economic situation and discusses the impact that deteriorating economic prospects have had—and might have—on Soviet defense spending, Soviet economic relations with the West, and Soviet foreign policy. Finally, the memorandum suggests how economic issues might figure in this month's Summit discussions. [redacted]

The Soviet Economy on the Eve of the Summit

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The long-term outlook for the Soviet economy remains bleak, and the disappointing performance over the last six months has further driven home to the leadership the fact that rising resource costs, impending energy and labor shortages, and sluggish productivity cannot be overcome easily or soon. The winter of 1978-79 nearly brought economic growth to a standstill, raising demand for energy while at the same time making energy and other raw materials more difficult to produce and distribute. The resulting disruptions to industrial production and high-priority investment projects will be felt throughout the rest of this year. [redacted]

Short Run Prospects

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Industry Stagnates. Coming on the heels of a very poor performance during October-December 1978, industrial production during January-March 1979 increased by less than 1 percent over the first quarter of 1978. Production of key commodities—including steel, cement, nonferrous metals, mineral fertilizers, and pesticides—dropped well below last year's first quarter levels. Average daily oil production during January-March fell below that of the preceding quarter for the first time in the 1970s. [redacted]

These first-quarter shortfalls were caused in large part by the unusual severity of the past winter. Bad weather west of the Urals increased the demand for fuel and hindered transportation of raw materials. Reduced fuel supplies interrupted industrial production; residential and commercial heat and power were cut back in some areas. The Soviet economy apparently began the winter with low fuel stocks as a result of production shortfalls in the oil and coal ministries. Fuel shortages will not be eliminated with the advent of warmer weather, however. Rationing and conservation will have to continue to rebuild stocks for next winter. [redacted]

Poor industrial performance in 1979 will impede the investment programs that underlie Moscow's efforts to turn the economy around. Investment growth may fall below plan in 1979 because of shortfalls in construction materials, machinery, and ferrous metals. This, in turn, will hinder efforts to accelerate additions of new industrial capacity, setting back Moscow's program to modernize the economy's stock of plant and equipment. [redacted]

Agriculture Looks Bad. Weather has also taken its toll on the farm sector. After fall-sown grain suffered above average winter kill, a recent drought accompanied by high winds in the southern part of European Russia has reduced the potential Soviet grain harvest to below 200 million tons. If average weather conditions prevail for the balance of the season, the crop could fall to 185 million tons. Even a crop of 200 million tons would leave the Soviets roughly 43 million tons short of domestic requirements for grain in the coming marketing year (1 July 1979–30 June 1980). Although part of such a shortfall could be offset by drawing down stocks, a large increase in grain imports from the 15-million-ton average of the past three years would be necessary to fill the gap. [redacted]

Longer Term Outlook

While the short-term outlook for the economy is gloomy, longer term prospects are worse. Our forecasts on *energy production* seem to be holding true. The USSR's oil industry is likely to enter a no-growth stage by 1980, followed by steady production declines in the early 1980s (chart 1). West Siberia, which accounted for more than two-fifths of Soviet oil production in 1978, is the key to oil prospects for the foreseeable future because rising output in this region is currently offsetting progressively steep declines in the remainder of the USSR. We believe that even a moderate decline in West Siberian production would lead to a sharp drop in national production [redacted]

West Siberia, however, faces serious difficulties and a probable decline in output in the early 1980s. Production has come primarily from 18 large oilfields, but the Soviets predict that by 1980 half of these fields will be in decline, the rest producing at their maximum level. Growth from many smaller, less productive, and more remote fields will be required to offset these declines and provide any growth after 1980. Yet, the exploitation of these fields is lagging behind plan because of acute transportation bottlenecks, soaring drilling requirements, and failure to provide the necessary equipment and infrastructure (roads, pipeline, electric power, and housing). Growth from these smaller fields probably will be insufficient to offset declines in the larger fields. Especially significant is the anticipated drop in oil production at the supergiant Samotlor oilfield by 1980-81. This field currently accounts for more than half of West Siberian oil production and one-fourth of total Soviet output. [redacted]

Soviet officials also acknowledge the challenge to policy implicit in the *adverse demographic trends* expected in the 1980s. The natural increase in the working-age population will drop off to about 300,000 per year by the mid-1980s (chart 2). Moreover, from now until the late 1980s, increments to the labor force will come almost exclusively from the less-skilled and less-mobile Turkic populations of Central Asia and the Transcaucus republics. [redacted]

Forced migration of labor from the Turkic republics of Central Asia to the labor-short areas of Siberia and the western USSR is not a practical option. For a number of reasons, the Turkic population is probably unwilling to move in sufficient numbers, and the "host" Slavic population would not welcome such migration. First, the orientation of these people toward irrigation agriculture, warm climates, and large families make it unlikely that they could adapt readily to the living conditions and vocational demands in either the European or Siberian regions of the country. Second, accommodations for immigrants are badly lacking—particularly in Siberia but also in the western USSR. Housing would be particularly troublesome and a potential source of friction between the Slavic population and the newcomers, since it is already in short supply and generally not suited to large families. Finally, differences in language, culture, and education would be an impediment to migration. [redacted]

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Thus, the critical policy issue will be the competition for investment resources among (1) Central Asia, where most of the growth in labor will occur, (2) Siberia, where the infrastructure and industrial facilities needed to exploit energy and other raw materials are sorely lacking, and (3) the European USSR, which is short of labor, raw materials, and energy, but where investment can be carried out more cheaply by modernizing and expanding existing facilities rather than building new plants. In any case, Central Asian and Siberian development will preempt an increasing share of total investment, while the growth of total investment continues to decline. [redacted]

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The immediate development of Siberian energy and raw material sources is essential. But extracting and processing Siberian resources, as well as transporting them to urban-industrial regions in the European USSR, is extremely costly, and—in some instances—still not technically feasible. For example, the technology for long-distance transmission of large amounts of *coal-based* electric power from Siberia is still at least a decade away. [redacted]

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Meanwhile *agriculture* remains a major economic headache for the Soviet leadership. Although Soviet farm production has climbed well above the level of a decade ago, severe shortages of meat and quality food persist. Some of the rise in farm output reflects a massive infusion of investment, but relatively good weather has been responsible for roughly half of the increase in grain production between the early 1960s and the mid-1970s. This situation could change in the 1980s if weather conditions become more normal—that is, harsher. While the outlook for agricultural production is uncertain at best, *consumer incomes and expectations* will continue to rise and with them the demand for more and better quality food. Soviet leaders will probably have to continue buying large quantities of grain and other agricultural products. [redacted]

The impact of impending resource constraints on the USSR's economic growth cannot be softened unless the Soviets are more successful in using labor, capital, and natural resources more efficiently than in the past. Soviet development is distinguished from that of other modern industrial nations in its failure to obtain a major share of its economic growth through increased efficiency. Now, however, the policy of (extensive) growth based on abundant resources must give way to one of (intensive) growth based largely on technological progress. [redacted]

Although the leadership recognizes the need for change, the Soviet system is not designed to make this transition easily. The foundations of the system—directive planning, central allocation of resources, administratively set prices, and incentives oriented toward quantitative production goals—discourage innovation and encourage redundancy and waste in the use of resources. Thus, the productivity gains from additional labor and capital are low and have slumped in the 1970s (table 1). And planned improvements have not occurred. Rising costs of extracting, processing, and delivering raw materials, together with slower growth of fixed capital make a rebound in productivity unlikely under the present system. [redacted]

As for reforming the existing managerial and organizational arrangements, Soviet leaders have been unwilling to make radical changes in an organizational structure which centralizes decisionmaking at the highest levels and stifles the initiative and managerial flexibility required by enterprise managers in a modern complex economy. Instead, the leadership believes it can alleviate the system-based barriers to innovation

Table 1 — Percent

USSR: Average Annual Rates Of Growth in Inputs, GNP, and Factor Productivity

	1961-70	1971-74	1975-78
Total Inputs	4.3	4.3	3.6
Man-hours worked	1.8	1.8	1.2
Capital	8.1	8.0	7.3
Land	0.1	0.9	0.1
GNP	5.2	4.3	3.2
Factor Productivity	0.8	0	−0.4

[redacted]

and managerial efficacy without jeopardizing strong central control. We do not think half-hearted reforms will be any more successful in generating technical progress and production efficiency than they have in the past. On balance, we expect growth in gross national product (GNP) to continue to slow—averaging about 3 percent per year for the next few years and then dropping to little more than 2 percent in the mid-1980s because of increasing energy and manpower constraints. [redacted]

Economic Policy Choices

Faced with these prospects, President Brezhnev and his colleagues must come to grips with hard choices over resource allocation in the very near future. Fundamental policy decisions must be taken over the next year as the economic plan for 1981-85 is being formulated and as measures looking forward to 1990 are approved. These decisions are further complicated by the necessity to consider the future needs and potential of the East European client states, whose dependence on the USSR for energy and other raw materials is likely to increase in the 1980s. [redacted]

In reaching decisions about the 1980s, Soviet leaders will be under greater pressure than ever before to reconcile national objectives and economic constraints. President Brezhnev has publicly hinted that a substantial improvement in consumer welfare is not only a precondition for raising labor productivity but is also related to the maintenance of political stability. This view is implicitly challenged by other leaders who urge that less emphasis be placed on material rewards and more on discipline and self-sacrifice. [redacted]

Here, the debate carries over into the issue of maintaining the high rate of investment in agriculture long championed by President Brezhnev (20 percent of total investment in the current five-year plan). Demands for greater investment in heavy industry, which in previous years could be viewed as an expression of the parochial interest of dominant elements of the party-economic bureaucracy, are now justified by the real need to speed capital renewal in such lagging key sectors as the steel and machine-tool industries. [redacted]

A new factor that is likely to intensify political conflict is the rapidly escalating cost of extraction and transportation of fuel and raw materials. In 1979, of the planned *increment* of 3.5 billion rubles to total capital investment, some 3 billion rubles have been allocated to energy, while almost all the rest is going to agriculture. This remarkable retardation of investment growth in other—even high priority—sectors of the economy probably foreshadows painful adjustments in the overall pattern of resource allocation (chart 3). [redacted]

So far there is no evidence that the Soviet leadership has settled on a long-term strategy for coping with its economic dilemmas. Instead, it has been temporizing on policy decisions; reacting rather than redressing. Arguments over allocation decisions and management of the economy reveal conflicting claims and divided advice at the middle levels of government, and caution verging on immobility in the Politburo. [redacted]

Impact of Economic Problems on Arms Limitation and Soviet Defense Spending

The Soviet Attitude Toward Defense Spending

President Brezhnev and Premier Kosygin have frequently alluded to the weight of the arms burden on the economy, and the Soviets obviously recognize that high levels of defense spending impose serious *economic* costs—notably in investment, but also in consumption. Although Brezhnev is likely to deplore these costs at the Summit, the perceived benefits derived from military spending have made Soviet leaders less resentful than we are of high defense budgets and more willing so far to make the economic tradeoff. They accept the economic sacrifice because they believe it does in fact enhance Soviet military security [redacted]

They also accept it because making substantial military gains against the United States provides a foundation for demanding acceptance of all the other claims of superpower status and for projecting Soviet influence across the globe. They realize that the Soviet Union's role as a great power has its origin far more in military might than in economic efficiency or in the attractiveness of the Soviet political model. Nonetheless, the deteriorating economic situation could well lead the Politburo to strike a new balance between the economic costs and political benefits of continuing growth in military spending. [redacted]

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Momentum of the Soviet Arms Buildup

If the Soviets follow through fully on programs now in train, overall defense outlays—which presently constitute 11 to 12 percent of GNP—would continue to rise at a rate of 4 to 5 percent annually through the early 1980s—even if SALT II enters into force. As a result, growth in defense spending would exceed growth in GNP (chart 4). Qualitative factors alone will tend to push up Soviet defense spending in the 1980s, especially the requirement for high-technology solutions to current force deficiencies and future US threats. High-technology weapons systems projected for the 1980s will be particularly costly. Advanced aerodynamic weapons, high-technology electronics—especially sophisticated radars, submarine detection and communications systems—and advanced nuclear weapons designs will account for a large share of procurement expenditures. These expenditures—together with continued rapid growth in research, development, testing, and evaluation—will shape the trend of total defense expenditures. [redacted]

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Economic Problems and Defense Spending

Decisions regarding military programs now in train were reached some time ago and probably would be altered only at the margin—perhaps by stretching out and some selective pruning if mounting economic pressures forced action on this front. However, decisions made from now on, which will affect resource allocations for defense in the mid-to-late 1980s, may

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reflect greater concern for the military drain on the economy:

- We expect the leadership to recognize increasingly that the slowdown in economic growth cannot be reversed by administrative measures or superficial reforms; resource reallocation will thus become more tempting.
- The manpower and energy shortages are likely to worsen during the 1980s, so restraints on military spending that take hold after 1984-85 would be especially attractive.
- The Soviets have a strong interest in avoiding an acceleration in military spending—especially in new and sophisticated weapon systems where they may have difficulty competing and where the costs to them are probably significantly higher than to us.
- At the same time, a reduction in the growth of defense spending would not mean a corresponding reduction in the growth of military power. The present level of investment in military hardware is so high that with a reduced growth—or, indeed, with no growth at all—force modernization would continue at an impressive pace [redacted]

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From the economic standpoint, the importance of SALT II to the Soviets therefore lies not in immediate savings, which are small in relation to the total level of military spending, but in the avoidance of future costs, which SALT II makes politically conceivable. Ratification of the SALT II Treaty by the US Senate would make it easier for those Soviet leaders inclined to do so to argue that the danger from the West has slackened and that more resources can be directed to meet civilian economic needs. Such an argument would also come into play in justifying further arms limitation initiatives—for example SALT III or Mutual and Balanced Force Reduction (MBFR). [redacted]

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SALT II and followup arms talks would also provide a political basis for advocating—and obtaining—an expansion of trade ties with the West. Given the present state of the economy, Soviet leaders may see their economic and military aspirations best served by a policy of increasing commercial relations with the West and encouraging an influx of Western machinery and technology. Advanced Western equipment and technology imported by the USSR often has both civilian and military-related applications, so a greater flow of such technology inevitably helps military-related production; it already touches sensitive areas in computer technology and electronics. [redacted]

Warmer relations, especially with the US, would also encourage the West to grant more credits on better terms to the USSR in the 1980s, when we expect an economic crunch. For a time, such credits would support a welcome inflow of resources, which, however, would have to be repaid by an excess of Soviet exports over imports—probably in the 1990s. [redacted]

Impact of Economic Problems on Trade with the West

In the mid-1970s, the Soviet leadership—confronted with rising hard currency debt, difficulties in assimilating Western technology, and perhaps some domestic opposition to squandering the national patrimony—seems to have taken a more cautious attitude toward commercial relations with the West. It has learned that, even under detente, Western governments cannot commit the private sectors of their economies to increased trade with the USSR. In addition, the cyclical behavior of Western markets has made export planning difficult, and Soviet manufactured goods have made little headway in these markets. The conservative stance on trade taken during 1977-78 will, however, probably yield in the 1980s to a policy of exploiting East-West trade for all possible help in surmounting domestic economic problems. [redacted]

Soviet International Financial Position

After running large trade and current account deficits in 1975 and 1976, the Soviet Government took steps to restrain the growth of its hard currency debt. The USSR substantially improved its current account position in 1977 and 1978 by expanding exports and gold sales and limiting import growth. Its strong payments position should be maintained in 1979. Due to the turnaround in the current account balance, net debt has grown by slightly less than $1 billion in the last two years after increasing from $1.2 billion to $10.1 billion between 1973 and 1976 (chart 5). [redacted]

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Over the next few years, the USSR should have little difficulty borrowing in the West if it chooses to do so. Bankers and governments consider the Soviet Union a good credit risk, and bank liquidity is high. As domestic oil production tails off, however, oil exports for hard currency are likely to fall as Moscow balances the requirements of Eastern Europe against the growing needs of the Soviet economy. We believe that the USSR may have to import Western oil on a net basis by the mid-1980s, a shift that will limit Moscow's capacity to buy grain and import Western machinery and technology. Maintenance and expansion of Soviet trade with the developed West will depend increasingly on (1) its success in negotiating compensation agreements with Western firms so as to assure an expansion of exports and (2) its willingness and ability to increase markedly Soviet medium- and long-term debt to the West. [redacted]

Importance of Trade and Credits in the 1980s

The expected economic slowdown and the energy situation make commercial and scientific relations with the West all the more valuable to the USSR. First of all, the USSR will need imports from the West to deal with particular domestic shortfalls:

- The leadership's policy of improving the consumer diet is expected to require between 15 million and 25 million tons of imported grain annually for the next several years.
- We do not expect the Soviets to overcome rapidly the difficulties in steel production that have led to large purchases of Western steel products in recent years. In particular, planned Soviet natural gas and oil pipeline construction will require substantial imports of Western large-diameter pipe.
- During the 1980s, the USSR probably will have to spend hard currency to import oil. [redacted]

Because of the prospective decline in Soviet oil production, the impetus to obtain assistance in energy exploration and development will be especially strong. The Soviet petroleum equipment industry has serious technological shortcomings. Moscow consequently has turned to the West, ordering $2.8 billion worth of oil and gas equipment and technology in 1976-78. The largest order—$427 million—went to West Germany in May 1976 for compressor stations for the Orenburg pipeline; the largest order from the US was a $158 million contract awarded to Dresser Industries in March 1978 for modernization and expansion of the Kuybyshev rock bit plant. The remaining orders ranged from submersible pumps and equipment for lifting and delivering natural gas to modern equipment for exploratory drilling, enhanced recovery, and offshore operations. [redacted]

If the USSR is to reverse its oil fortunes by the late 1980s, however, it must broaden the scope of its technology purchases and do so quickly. As a rule, oil discovered today will not be produced until five to eight years hence. The technology transfers that the Soviet petroleum industry now needs involve large-scale, capital-intensive projects with long leadtimes. For example, the USSR must begin to convert its rig park from turbo to rotary drilling since it must drill deeper and begin exploring more difficult geologic formations in the hostile environment of East Siberia, and it must begin to explore and develop deep basins in the Caspian and Black Seas and in offshore Arctic waters. For the next few years at least, the USSR will not have the know-how or equipment to carry out these activities without Western help and technology. [redacted]

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While energy-related technology probably will be given priority in Soviet foreign trade plans, the declining growth of GNP will underline to the leadership the importance of boosting productivity throughout the economy. Modernization of the economy in turn depends in part on obtaining Western technology and equipment for a broad range of sectors. But Soviet imports will be held down by the competition with oil and grain for available hard currency. [redacted]

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Role of the United States

Although the USSR can find most of the equipment, technology and credits that it needs in Western Europe and Japan, Soviet policymakers still have a high regard for US technology and believe that the US market has the potential to absorb substantial amounts of Soviet exports. Moscow seeks, above all, to obtain a sustained and secure trading relationship with the US complemented by unhampered access to long-term government-backed credits [redacted]

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Table 2

Million US $

USSR: Distribution of Orders for Western Machinery and Equipment

	1972-74		1975-76		1977-78	
	Value	Percent of Total	Value	Percent of Total	Value	Percent of Total
Total Contracts	**7,908.9**	**100.0**	**10,625.0**	**100.0**	**6,457.9**	**100.0**
United States	1,684.2	21.3	1,426.9	13.4	886.1	13.7
West Germany	2,111.4	26.7	1,838.0	17.3	1,517.2	23.5
Japan	745.8	9.4	2,289.0	21.5	1,083.0	16.8
France	1,459.1	18.4	2,117.4	19.9	899.7	14.0
Italy	717.7	9.1	1,680.3	15.8	678.6	10.5
United Kingdom	467.2	5.9	562.6	5.3	807.5	12.5
Other Western	723.5	9.2	710.8	6.8	585.8	9.0

[redacted]

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The USSR views US participation in Soviet projects as highly desirable for several reasons. US firms are often uniquely suited to provide the technology, equipment and services needed for the large projects envisioned by the USSR. This is particularly true in energy exploration and development. At the moment only the US has a completely integrated petroleum industry that can provide the necessary engineering know-how, experience, equipment, services, and, perhaps most importantly, capital to put together a complete technology package on a scale beneficial the Soviet petroleum industry. [redacted]

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Given current Soviet economic and energy problems, Moscow may well view this as an opportune time for a broad technical assistance program between the US and the USSR in which US firms would become more actively involved in Soviet oil exploration and production and other large-scale energy development projects. US firms for their part are likely to become increasingly interested in such participation as the world oil supplies tighten. [redacted]

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In recent years trade with the US has been restricted by the lack of Exim Bank financing and the reluctance of the USSR to seek a broad trade expansion in what it considers to be an unfavorable political climate. The August 1978 decision to control exports of petroleum equipment probably added to this reluctance. [redacted]

Because of technological superiorty, US firms have, nonetheless, enjoyed some success in winning Soviet contracts and will continue to do so, even in the absence of a government-to-government framework for US-Soviet trade (table 2). Soviet buyers have sought US bids on technology and equipment knowing that Exim Bank credits would not be available. Western Europe and Japan will probably continue to capture the lion's share of Soviet contracts, but US firms will still get a respectable portion of (1) contracts for oil and gas equipment and (2) the technology portion of contracts for many other sectors. [redacted]

Impact of Economic Problems on Soviet Foreign Policy

Eastern Europe

Soviet foreign policy toward Eastern Europe must maintain a careful balance between helping political and military allies and reaping the economic benefits of trade. Because of resource constraints within both Eastern Europe and the USSR, Moscow cannot do more to help Eastern Europe without seriously hurting its own economic interests. But to do less for Eastern Europe might well endanger political stability in these countries. [redacted]

Under Soviet direction, CEMA (the Council for Mutual Economic Assistance) is now elaborating five long-term multilateral target programs in the fields of energy and raw materials, agriculture, machine building, consumer goods, and transportation that will maintain East European investment in and dependency upon the Soviet Union, but will at the same time limit Soviet leeway in satisfying or not satisfying East European requirements. The long-term target program for energy and raw materials does not deal, however, with Soviet oil deliveries, which are negotiated on a strictly bilateral basis. [redacted]

EO 12958 6.1(c)>10<25Yrs (U)

The Soviet Union is meeting its commitments for delivery of energy to Eastern Europe under 1976-80 protocols. The Soviet-supplied share of total East European energy consumption has continued to rise, although at a slower pace than in 1971-75, mainly because of a slowdown in the growth of Soviet oil deliveries—4.9 percent annually in 1976-78 compared with 9.6 percent a year in 1971-75. East European countries have been under pressure to increase their imports of OPEC oil in recent years, but because of the sharp rise in oil prices and East European lack of hard currency they have not been able to buy enough to reduce the drain on Soviet supplies [redacted]

EO 12958 6.1(c)>10<25Yrs (U)

Responding to the increases in world oil prices, the Soviets have raised oil prices to Eastern Europe annually since 1975 and by 1978 were charging $12 a barrel—about 88 percent of the price for benchmark crude landed in Rotterdam. These deliveries were paid for with East European exports. For supplies greater than those specified in their trade agreements, East European countries either pay in hard currency, invest further in Soviet resource development, or supply goods that the USSR would have to buy in the West for hard currency. Limited East European availability of exportable goods and hard currency severely restricts these options, however. To help ease the financial burden of the higher prices, Moscow has permitted the East Europeans to run huge deficits in their bilateral trade—a practice the USSR is trying to bring to an end (chart 6). [redacted]

EO 12958 6.1(c)>10<25Yrs (U)

East European countries are already experiencing varying degrees of consumer dissatisfaction, however, and it is a delicate question how hard the Soviets can squeeze economic growth in this region without provoking serious internal unrest. To avoid political instability in the region, Moscow may have to revise its plan to put a lid on energy deliveries during 1981-85. But any likely increase in Soviet deliveries above projected levels will still leave the East Europeans in the position of having to buy more OPEC oil. Under the circumstances, Moscow cannot easily counsel a cutback in East European economic relations with the West. In fact, the USSR might welcome an expansion of these ties as a means of increasing East European hard currency exports and access to Western credits to pay for OPEC oil. [redacted]

The Soviet objective here would be to facilitate East-West ties that (1) do not jeopardize the solvency or credit-worthiness of CEMA or individual member countries and (2) do not significantly weaken Soviet control over the bloc. In this respect, having their cake and eating it too has been an objective of the Soviets in the CEMA negotiations with the Common Market and in the discussion of Brezhnev's proposals for conferences on energy, pollution, and transportation in the UN Economic Commission for Europe. Conceivably, the Soviets might use the Summit as an occasion to prod the US on these proposals. [redacted]

The Third World

Economic problems at home have not dampened Soviet enthusiasm for involvement in the Middle East, Africa, and elsewhere in the Third World. Since Lenin's time, the less developed countries have been considered to be the soft underbelly of the capitalist West, and this traditional perspective has probably been strengthened by events since 1973. Moreover, as a great power, the USSR considers that it has a right to extend its influence worldwide and especially in contiguous areas such as the Middle East. [redacted]

Although the Soviets have multiple interests in the Middle East, one of them unquestionably is access for themselves and their East European clients to Middle Eastern oil. They have pursued this objective on the economic plane by providing development assistance (hoping, in part, to barter Soviet manufactures and technology for oil), but their key oil-earning export to the region has been armaments. As Soviet oil production peaks in the near future, maintaining Soviet and East European arms sales in the Middle East will increasingly be directly linked with satisfying critical CEMA oil needs. [redacted]

The West

The USSR has—as noted above—historically regarded the West as a source of advanced technology and a source of commodities to make up for shortfalls in domestic production. Despite recent disappointment with the benefits achieved, the Soviets continue to believe that Western technology and equipment help to raise productivity, the *sine qua non* for boosting currently lagging economic growth. [redacted]

Always ready to make a virtue out of necessity, the USSR has capitalized on the desire of developed Western countries to obtain Soviet business. The USSR has demanded and obtained Western government-supported long-term credits. Also in response to Soviet requests, a number of Western governments have agreed to conclude or renew long-term trade and cooperation agreements. Kosygin said at the 25th Party Congress that "our trade and economic ties will develop faster with countries that show a sincere willingness for cooperation and concern for ensuring normal and equitable conditions for its development." [redacted]

The USSR likes these agreements because they provide governmental support for Soviet efforts to obtain Western technology and equipment. The Soviets feel that formal government-to-government agreements reassure and thereby encourage private firms in their negotiations with the Soviets. [redacted]

[redacted] the Soviet party [redacted] because of the bad state of the Soviet economy, more attention must be paid to the economy in the future and Soviet foreign policy must be used in support of internal economic development. The USSR, of course, has frequently sought to manipulate foreign interest groups to support Soviet commercial goals. Their recent easing of emigration policy is intended to obtain relief from Jackson-Vanik as well as to promote SALT II. They have used the export orientation of American farmers to fend off the use of leverage by the US in supplying grain to the Soviets. They have also been effective in generating US business support for the granting of most-favored-nation status, removal of restrictions on Exim Bank credits to the USSR, and relaxation of export controls. [redacted]

The Economy and the Summit

The Soviet leadership is concerned about the economic dilemmas that confront the USSR, worried about the potential for economically generated political unrest in Eastern Europe, and interested in measures that would help alleviate economic pressures without jeopardizing the tenure of office of the present gerontocracy or weakening political controls. At the same time, however, the leadership is interested in actively projecting Soviet power abroad—from which it sees possible economic as well as other gains. Unhappy with Jackson-Vanik and irritated by impediments to trade with the US, Brezhnev probably comes to Vienna with expectations of likely economic gains that are more modest than those he harbored at the 1972 and 1973 summits, although he conceivably might conjure up vistas of a major breakthrough in trade between the world's two industrial superpowers based on credits and compensation deals. [redacted]

What the Soviets Want

General Objective. In approaching the Summit, the leadership would undoubtedly like to encourage a positive dialogue with the US Government that over time would lead to a predictable, sustained, and growing economic relationship. It would like to be able to count on the participation of the US private sector as it formulates its economic plans for 1981-85 and beyond; it believes such participation could make a difference in how the USSR copes with its economic problems in the 1980s. [redacted]

Repeal of Jackson-Vanik and Granting of Most-Favored-Nation Status. Repeal of Jackson-Vanik is, in the first instance, a political issue from President Brezhnev's standpoint: what is at stake is the elimination of a demeaning intrusion that challenges a particularly sensitive instrument of Soviet political control. There is also, now, the issue of the relative status of the USSR as most-favored-nation vis-a-vis China. [redacted]

In economic terms, the most immediate hoped-for gain from a repeal (or waiver) of Jackson-Vanik would be access to government-backed credits. Passage of the Stevenson Amendment to Exim-Bank legislation limiting credits to the USSR to $75 million a year and $300 million over four years (without Congressional approval) was probably even more important than the Jackson-Vanik Amendment in leading the Soviets in January 1975 to disavow the trade agreement reached with the Nixon administration. Moscow could hope for large-scale credits only if restrictions of the Stevenson Amendment are eased substantially. [redacted]

Although the Soviets realize most-favored-nation status is unlikely to lead to any short-term direct economic gain, Moscow undoubtedly hopes it would improve the long-term prospects for manufactured goods exports to the United States. It would, however, take a decade at least for the USSR to develop a significant US demand for Soviet products currently affected by the higher duties. In the end, Soviet inability to produce competitive manufactured goods and the likelihood of dumping charges cloud its ultimate ability to take real advantage of most-favored-nation status. Indirectly, the receipt of most-favored-nation status would be valuable to the extent that it signifies an improved economic climate and encourages US firms to enter into negotiations with the USSR. [redacted]

Credits. At a minimum, the USSR would like asssurances that it can count on substantial US government-backed financing over the next five years. Currently, Western credit lines which have been made available to the USSR are underutilized; the availability of US credits would thus not necessarily lead to a rise in overall Soviet purchases under credits but would enable the USSR to divert some of its purchases to the United States. Moscow would like to include more US corporations among the firms it selects to bid on Soviet projects [redacted]

A Trade Agreement. According to the Trade Act of 1974, a trade agreement must be signed before most-favored-nation status may be extended to any given country. Consequently the Soviets would almost certainly like to conclude an updated version of the 1972 trade pact, which would—at a minimum—address the most-favored-nation and credit issues. [redacted]

A Long-Term Cooperation Agreement. The Soviets would probably like to set the groundwork for a more comprehensive US Government involvement in trade issues. Aside from obtaining credits and most-favored-nation status, Moscow would probably like to conclude an overall cooperation agreement similar to the trade and cooperation pacts it has signed elsewhere in the West. Such a pact would demonstrate the positive intent of the US Government to encourage trade with the USSR and might lead to more positive expectations within the US private sector, increasing its willingness to bid on Soviet deals and enter long-term agreements with Moscow, with or without equity participation. [redacted]

Renewed Grain Agreement. If grain issues are not resolved in the bilateral talks on this subject scheduled at the end of May in Moscow, the topic might arise at the Summit. The Soviets possibly might ask the US to raise the 8-million-ton ceiling on the amount of US grain they can purchase under the Long Term Agreement without further US Government approval, although they realize that such a move would probably elicit renewed demands from the US side for more adequate crop data. [redacted]

Technology Transfer. President Brezhnev might stress the importance for detente of continuation of the bilateral exchanges on science and technology. The major issue outstanding at the moment is renewal of the energy agreement, which comes up for resolution at a Joint Commission meeting in June. The US has proposed a three-year renewal, while the Soviets want a full five-year term. The access to US work in the energy field provided by the agreement is highly valued by Soviet scientific leaders and energy administrators, although the Soviet side has persistently avoided living up to its commitment under the original agreement to provide the projections of Soviet energy production that would represent a real payoff from our standpoint. [redacted]

Restraint in Military Spending. President Brezhnev is likely to take an upbeat position on future arms limitation measures because of concern over US advances in military technology and a desire to restrain NATO modernization. Economic constraints will provide added impetus for expediting ongoing arms negotiations or speeding up SALT III [redacted]

What the Soviets Will Pay

At the present, economic difficulties will not force the Soviet leaders to make significant concessions to the United States in areas considered by them to be central to the USSR's economic, political, and military security interests, or to its global great-power aspirations. The debate on the Soviet side is likely to be over concessions *at the margin.* Here it is probable that the leadership is divided on how far to go. [redacted]

EO 12958 1.6(d)(1)>10<25Yrs (C)

Perceptions of Leverage. The Soviets probably feel that they have a substantial capacity to resist US leverage in the economic sphere and that this capacity will permit them to minimize any noneconomic concessions we might seek at Vienna in return for greater access to US technology, goods, and credits. They think, with justification, that their import needs—with the exception of grain and to some extent petroleum equipment—can, if necessary, be largely satisfied outside the United States. In this respect they see themselves having gained ground since 1972-73, when, in all probability, they felt US participation was crucial to their foreign trade aspirations. Their strategy of playing one Western country against the other in the trade sphere has been quite successful, and they will continue it. [redacted]

EO 12958 6.1(c)>10<25Yrs (U)

The Soviets also see certain political forces within the US working in their favor. They are fully aware of the obstacles that constrain US manipulation of grain exports for political ends. They think, not without reason, that they can count on considerable pressure from US business circles for a relaxation of trade restraints. And in Washington they observe that Congress and the administration now appear actively interested in resolving the issues of most favored nation and credits. [redacted]

EO 12958 6.1(c)>10<25Yrs (U)

"Good Behavior" in the Third World. On the basis of experience to date, the Soviets have no good reason to believe that what they do in Africa, the Middle East, or elsewhere in the Third World significantly affects their economic relations with Western industrialized nations other than the US, and they must seriously doubt whether it even has any lasting impact on economic ties with the US. The Soviets count upon the need of Western countries for their business, and competition among these countries, to counter any tendency toward collective Western attempts to use trade to inhibit an aggressive Soviet foreign policy in Third World countries. What inhibitions there may be in promoting Soviet objectives in these regions arise more from political and military than economic considerations. [redacted]

EO 12958 6.1(c)>10<25Yrs (U)

Human Rights. The USSR's behavior since the early 1970s indicates that the Soviet leadership will make certain concessions with regard to emigration in the hope of promoting trade. Soviet willingness to make meaningful concessions in other human rights areas, which impinge even more seriously on domestic political controls, has been minimal. The hope of improving the atmosphere for SALT II passage is one factor explaining the Soviet policy decision in recent months to permit a significantly larger number of Jews to emigrate; but the desire to smooth the way for improved trade relations is also important. [redacted]

President Brezhnev doubtless expects the US to regard the present high rates of Jewish emigration as a gesture designed to open the way for improved trade and commercial relations. However, the Soviets, in a variety of ways, have strongly indicated their unwillingness to link explicitly trade and emigration. State Bank Chairman Alkhimov and Deputy Minister of Foreign Trade Vladimir Sushkov have recently suggested, however, that President Brezhnev might be agreeable to an approach that discussed emigration and trade in separate parts of the agenda. [redacted]

They seemed to suggest that President Carter could raise the emigration issue in the context of a question about Soviet views on implementation of the Helsinki accords, which would give President Brezhnev an opening to observe that Soviet emigration policy was in line with Helsinki, that large numbers of people were currently emigrating, and that this level of emigration would be maintained in the future provided that there were sufficient applicants to maintain the flow. This Soviet formula would seem designed to provide the assurance President Carter needed, without a politically unacceptable explicit obligation on the Soviet side. Following such an exchange, the trade issue could be treated completely on its own, with no reference to emigration [redacted]

EO 12958 6.1(c)>10<25Yrs (U)

The Soviets probably would not denounce a Presidential finding that they are in compliance with Jackson-Vanik, if this finding and Congressional action on it are presented in temperate terms and as discretely as possible—perhaps in tandem with authorization of most-favored-nation status for China. If a waiver or repeal of Jackson-Vanik were not forthcoming or were not followed by guaranteed large and continuing credits, then the incentive to permit continued large-scale emigration would be reduced. Granting most-favored-nation status to China but not the USSR would reinforce the Soviet's worst suspicions of the United States and possibly evoke a forceful denunciation and demonstrate cutbacks of contracts wherever possible. [redacted]

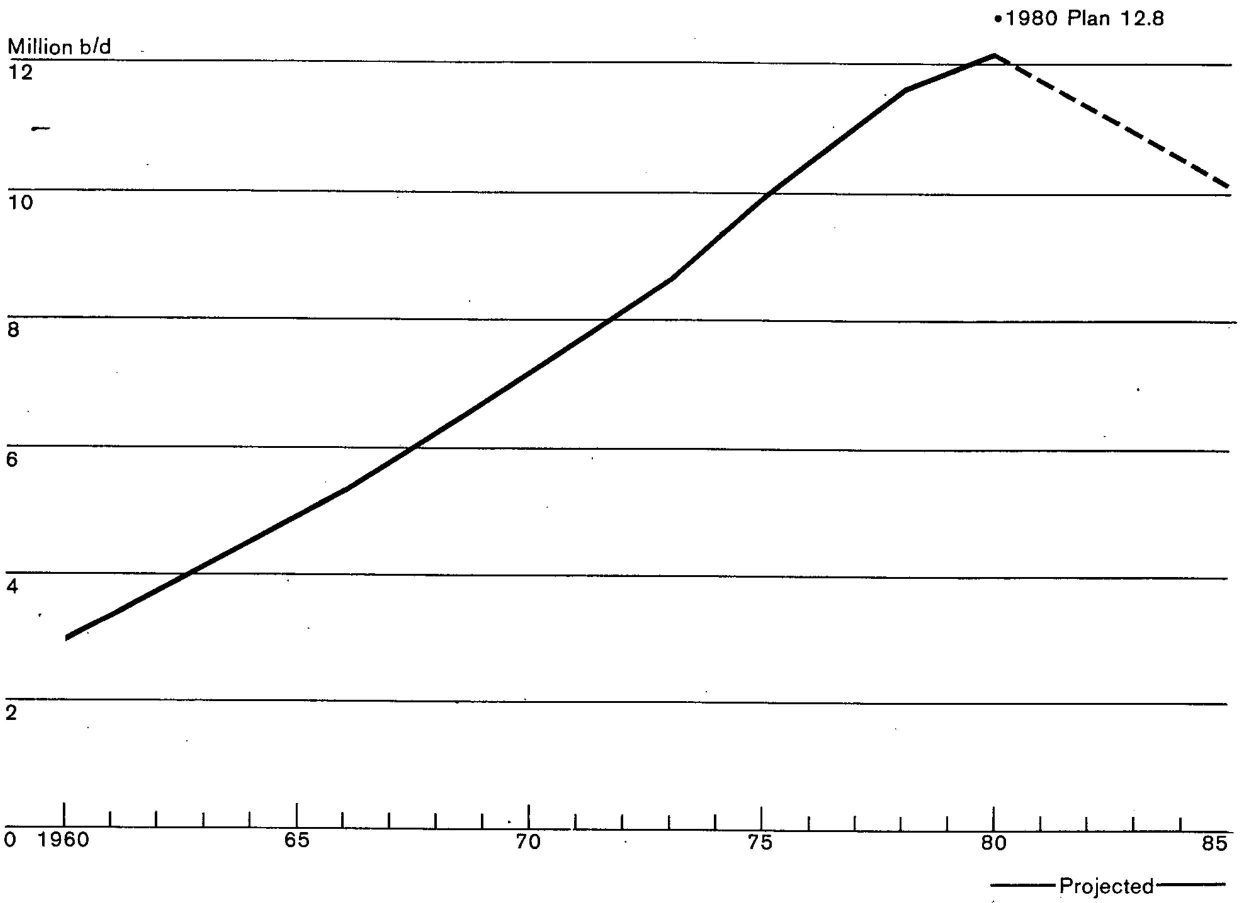
EO 12958 6.1(c)>10<25Yrs (U)

Economic Concessions. President Brezhnev will almost certainly dwell upon the bright prospects for compensation deals and is unlikely to raise the question of forms of US participation inside the USSR that involve equity, production sharing, or even quality control. However, what he would say if pressed on these issues is uncertain. Lenin himself encouraged concessionary deals when the young Soviet economy was in serious trouble, and there were many of them in the 1920s. Poland and Hungary (not to mention Romania and Yugoslavia) today permit equity participation in their economies by Western firms, such as Volvo in Hungary—presumably with Soviet acquiescence. More flexibility in this matter could be very beneficial to the Soviets, especially in offshore oil exploration and development and in the energy field in general. There is strong evidence that some Soviet officials would approve a softer line here, although the issue is controversial. [redacted]

EO 12958 6.1(c)>10<25Yrs (U)

USSR: Oil Production[1]

Chart 1



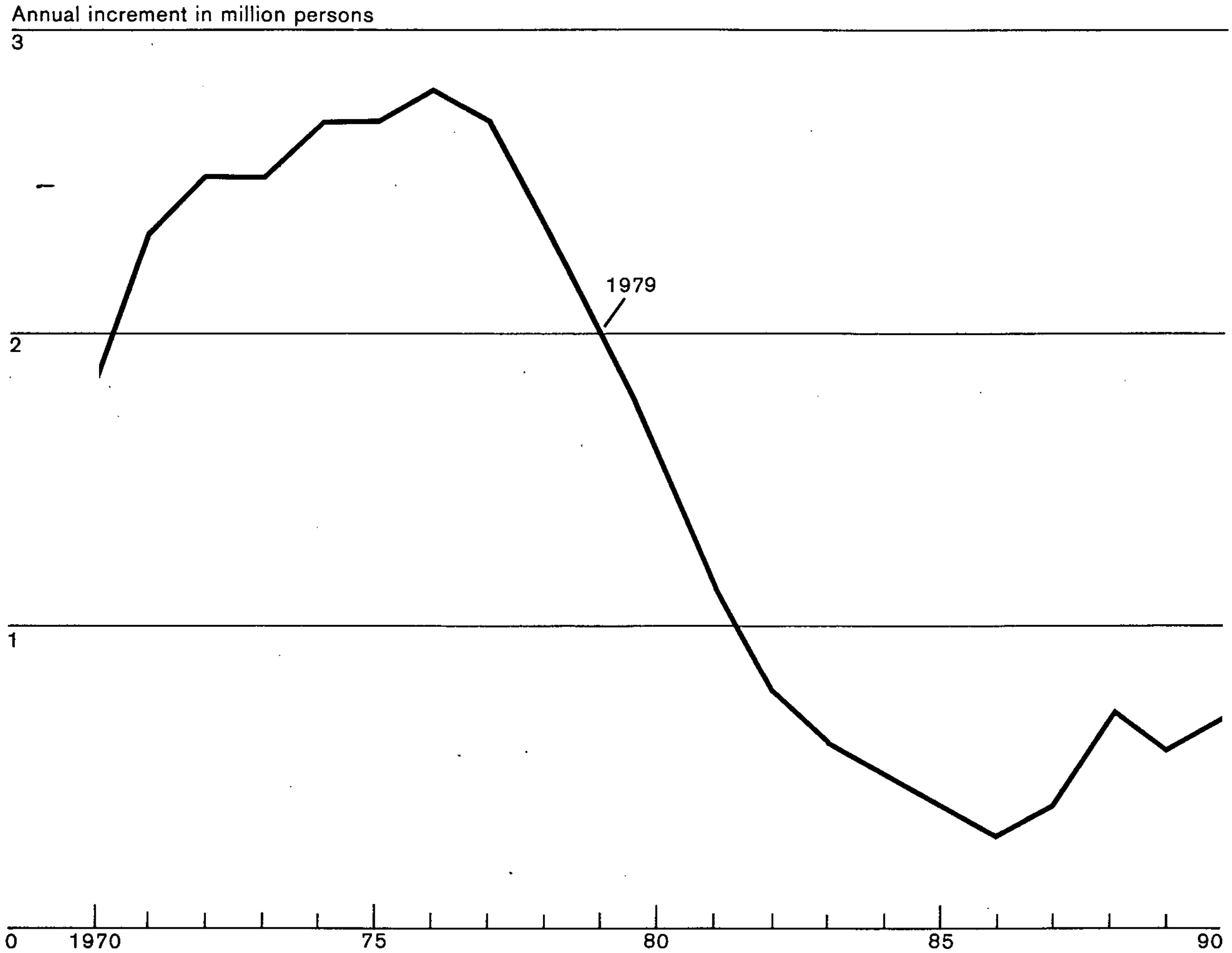
[1] Including a small amount of natural gas liquids (20,000 b/d in 1960 to some 300,000 b/d in the 1980s).

[redacted]

EO 12958 6.1(c)>10<25Yrs (U)

PG 14 BLANK

USSR: Growth of Working Age Population Chart 2



[redacted]

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(U)

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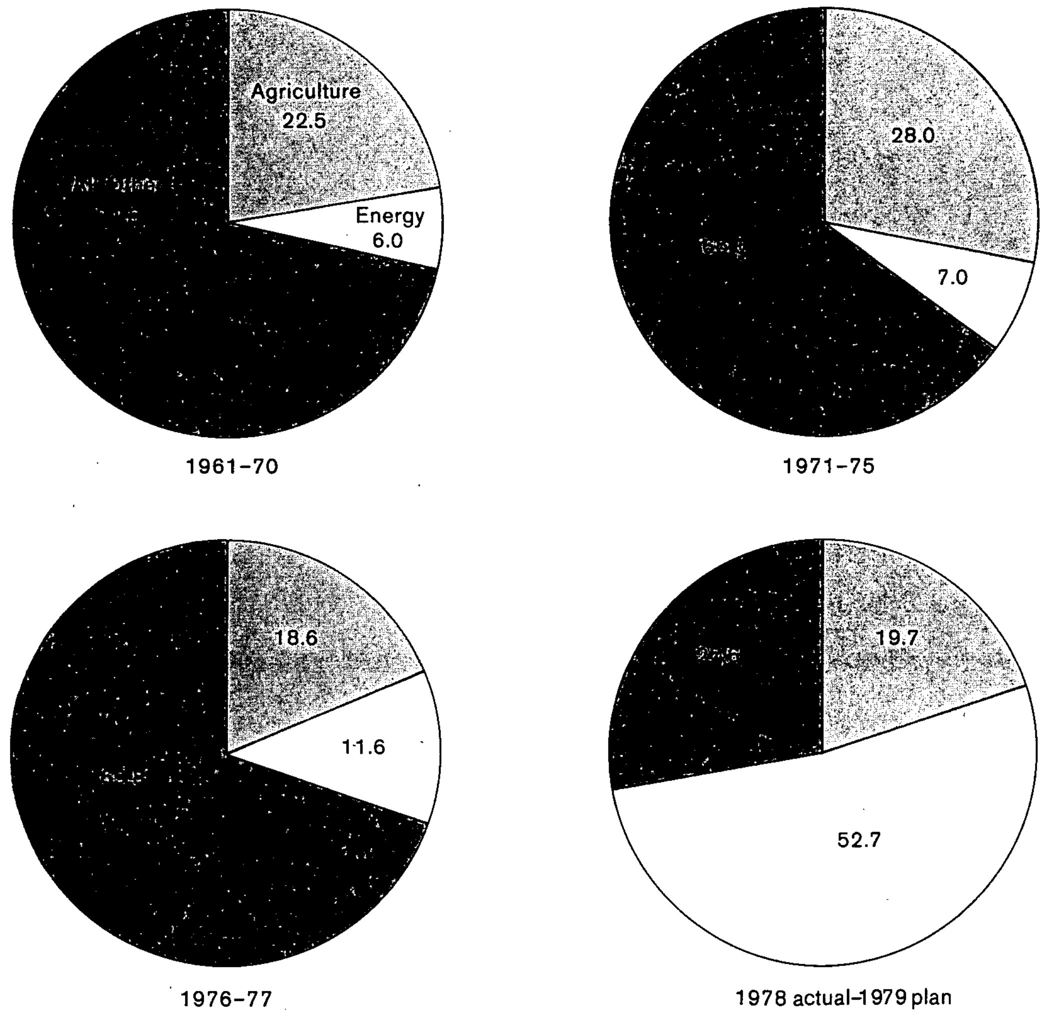
USSR: Distribution of Annual Average Increment to Investment Chart 3
(Percent)



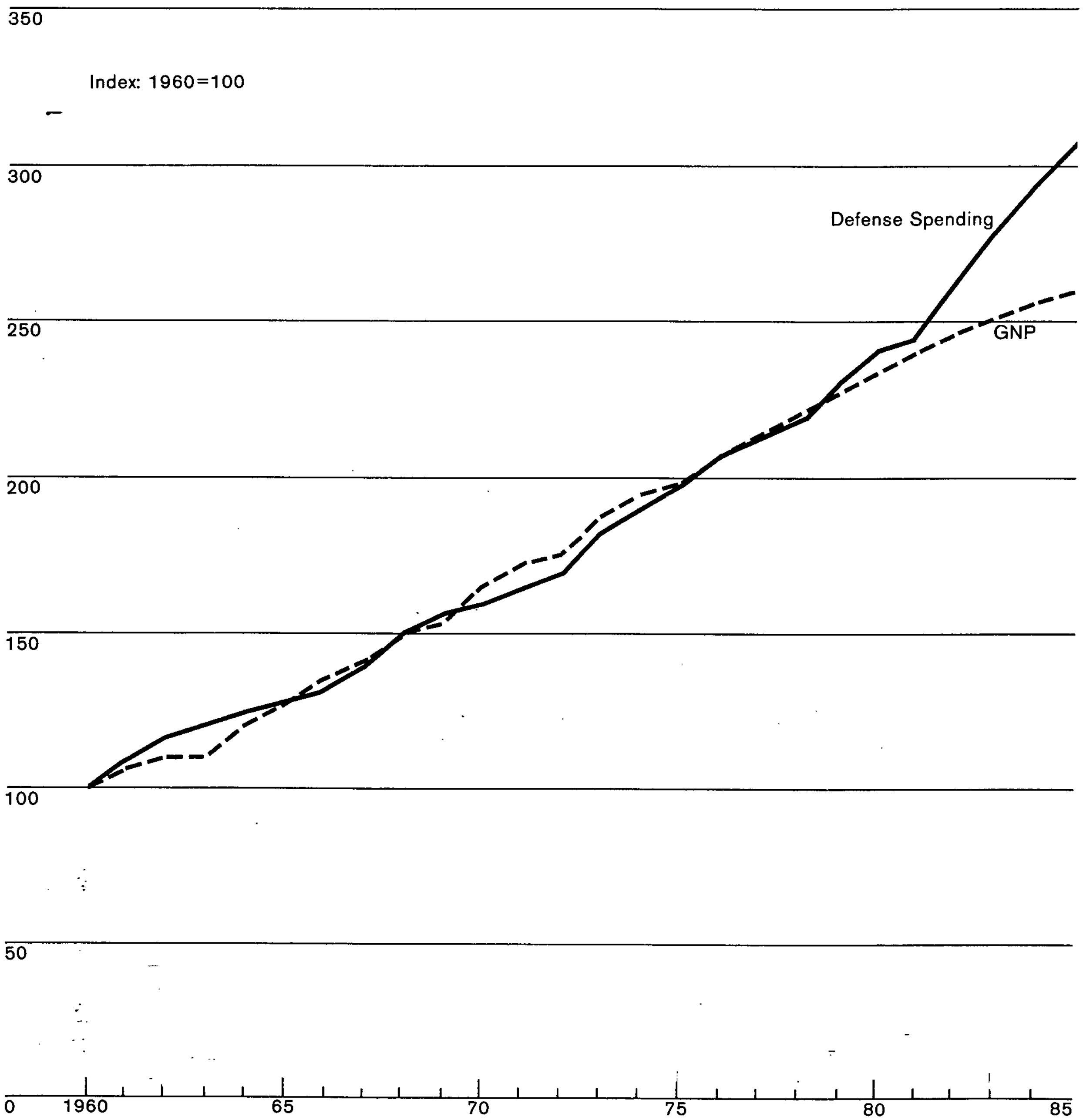
[redacted]

EO 12958 6.1(c)>10<25Yrs
(U)

PG 18 BLANK

USSR: Increase in GNP and Defense Spending

Chart 4



[redacted]

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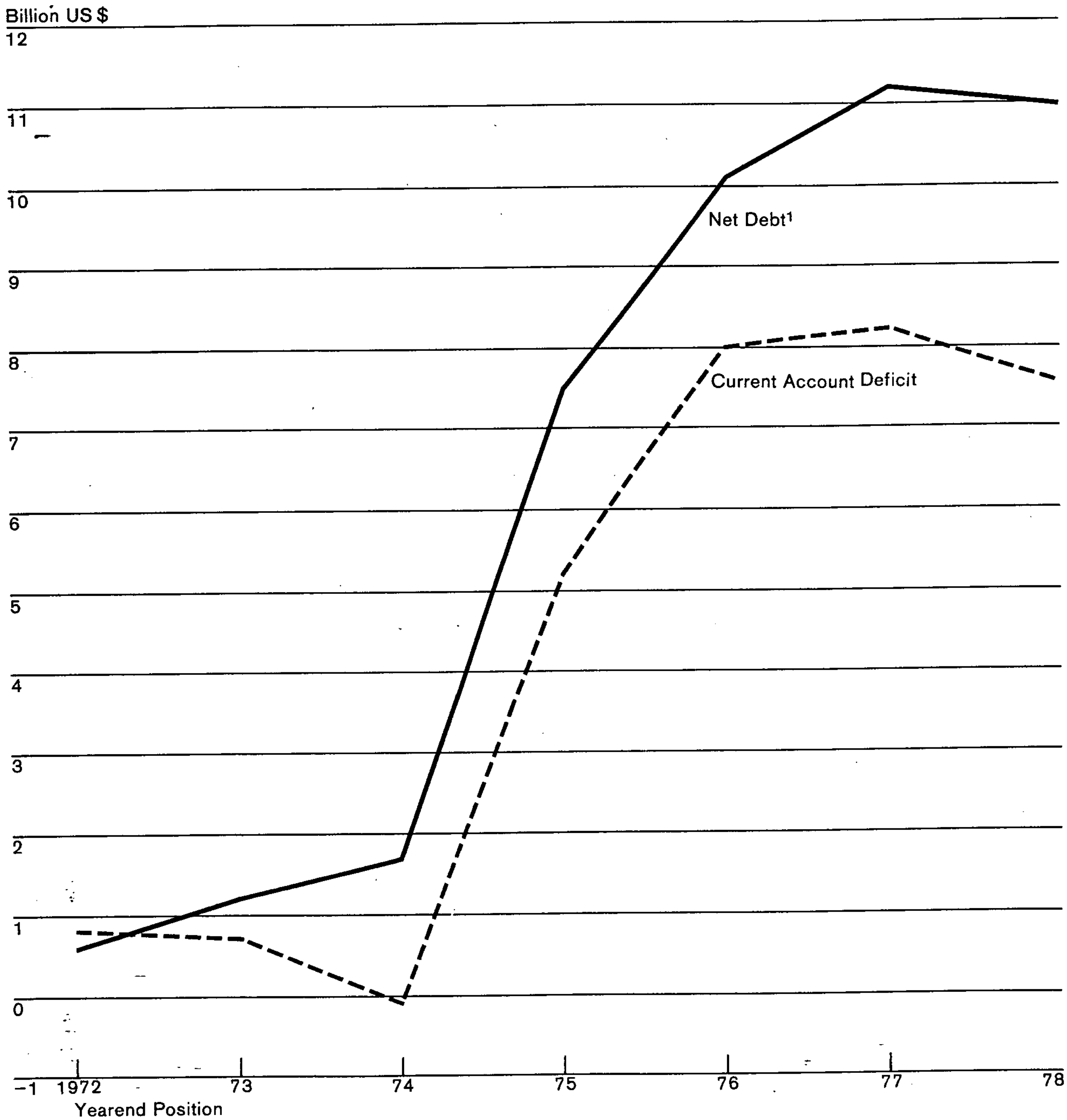
USSR: Cumulative 1972–78 Hard Currency Current Account Deficit and Debt to the West

Chart 5



[1] Net debt estimates exclude (a) yearend 1971 debt of $581 million; (b) East European investment in the USSR for construction of the Orenburg pipeline, and (c) Soviet assets with regard to less developed countries.

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(U)

[redacted]

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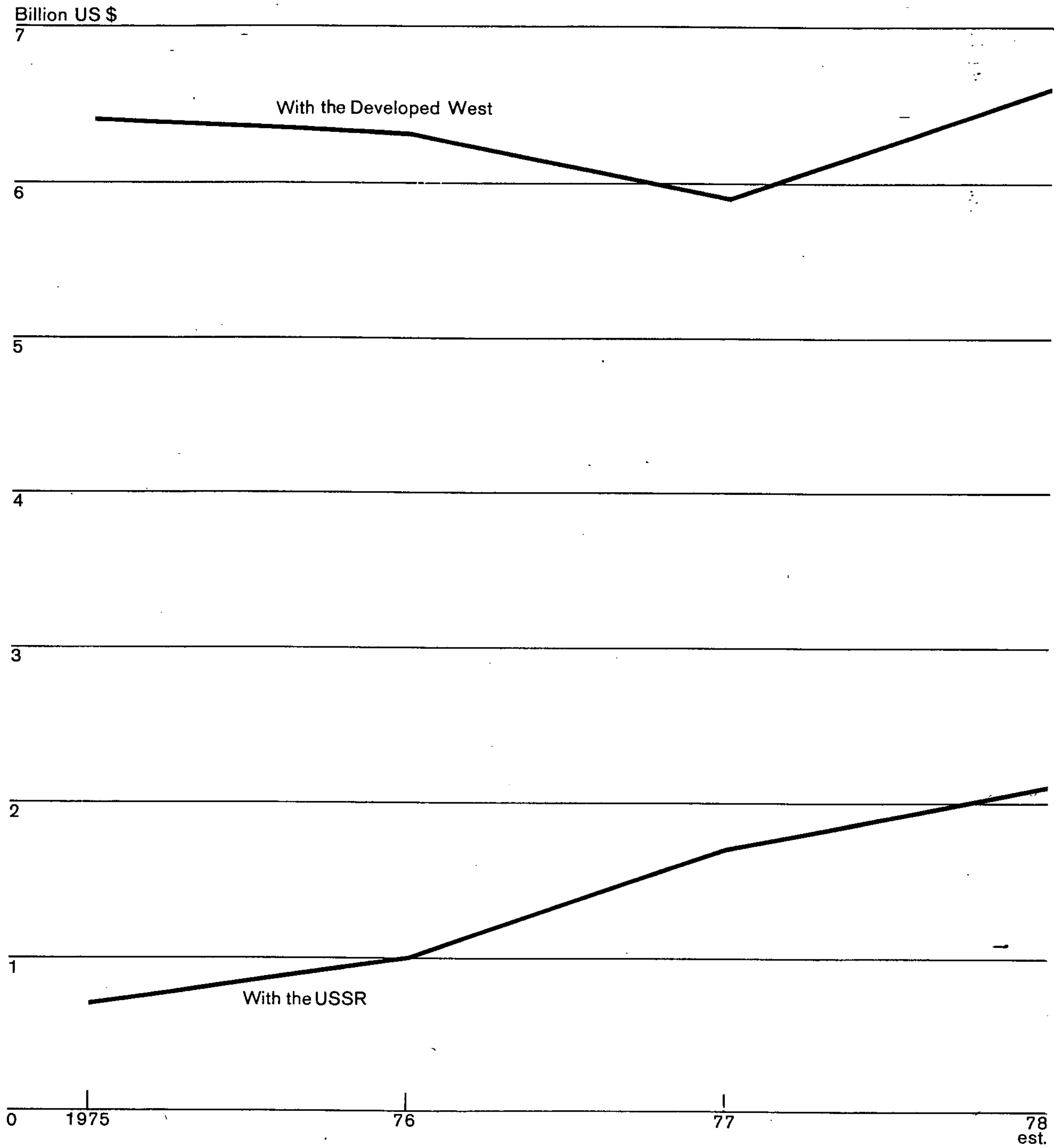
Eastern Europe: Merchandise Trade Deficits[1]

Chart 6



1. All exports and imports are on an f.o.b. basis except for Hungary, which reports its imports on a c.i.f. basis.

[redacted]

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