

C-O-N-F-I-D-E-N-T-I-A-L

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CONTINUING STRAINS IN THE CZECHOSLOVAK ECONOMY



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CONTINUING STRAINS IN THE CZECHOSLOVAK ECONOMY

The strains that had appeared in the Czechoslovak economy in 1961 (See CIA/RR CB 62-33, The Czechoslovak Economy in 1961: Indications of Increased Strain, 17 Apr 62, CONFIDENTIAL) continued unabated in the first half of 1962. Output in Czechoslovakia's main growth-oriented industries -- steel, cement, and machine building -- continued to be well short of plan, agricultural production stagnated, and construction activity declined. The strain in the balance of payments was alleviated by holding down imports of foods and materials and by raising exports of manufactured consumer goods, but at the cost of unbalancing the consumer market. The cumulative effects of economic difficulties in the past 18 months have led the regime to recommend the abandonment of the Third Five Year Plan (1961-65) and the drafting of an interim plan for 1963 to be followed by a Seven Year Plan for 1964-70. The new plans, which probably will be revealed in December at the Twelfth Congress of the Czechoslovak Communist Party, apparently will retain or increase the high priority of the steel and machine building industries but presumably will schedule less ambitious rates of economic growth.

Industry and Investment

Industrial production in Czechoslovakia increased by 6.8 percent in the first half of 1962 in comparison with the first half of 1961 -- a rate considerably lower than that planned for 1962 or for the entire period of the Five Year Plan. The rates of growth of both industrial output and labor productivity have followed a definite downward trend since 1960, as shown in the following tabulation.

	<u>Industrial Output</u>	<u>Labor Productivity</u>
1960	11.7	7.0
1961	8.9	5.1
1962 January-June*	6.8	3.2
1962 plan	9+	6.0
1961-65 plan (annual average)	9.3	7.4

\* Data for the first 6 months of 1962 are compared with the same period for 1961.

More serious than the lag in total industrial output, however, is the fact that shortfalls in industry were concentrated mainly in branches which play a key role in economic growth -- steel, cement, and heavy machine building -- and that the grades and assortment of the finished steel and machinery produced did not meet the technological requirements of the consuming sectors. These shortfalls undermine the Third Five Year Plan, which was predicated on a massive investment program and large exports of machinery. Moreover, the phasing of the plan required more rapid rates of growth in the output of these key industries in the early years of the plan period than in the later years. In planning for 1962, the regime had sought to make up the deficits of 1961, but this goal has proved to be unrealistic. During the first half of 1962, the output of steel grew by 5 percent and the output of cement by 9.5 percent in comparison with the levels of January-June 1961. To fulfill the 1962 plan, however, production of steel and cement in the second half of 1962 would have to grow by 22 and 43 percent, respectively, in comparison with production in the latter half of 1961. Although some improvement in performance in these branches may occur, especially in steel (the output of which declined in the second half of last year) the plan for 1962 cannot be fulfilled, and the regime clearly has abandoned it. As in 1961, lags in the introduction of new technology were mainly responsible for the difficulties in the steel industry, and this same problem, as well as a shortfall in steel supplies, had an unfavorable effect on machine building.

Industrial growth was hampered also by some new circumstances -- a flu epidemic, which caused a high rate of absenteeism in January and February, and difficulties in transportation. Although the volume of goods carried by rail normally increases more than half as fast as industrial production, this volume barely increased in the first 6 months of 1962 compared with the same period for 1961, as shown in the following tabulation.

	<u>Industrial Output</u>	<u>Tons Carried by Rail</u>
1961	8.9	5.9
1962 January-June	6.8	0.7
1961-65 plan (annual average)	9.3	6.2

Construction activity declined in the first half of 1962 in comparison with the same period for 1961 (see the Table). Many of the difficulties that held back industrial growth -- particularly bottlenecks in transportation -- were felt more acutely in construction because of the low priority assigned to that sector in the allocation of resources. This low priority reflected a general uncertainty concerning investment plans, which were being revised.

Difficulties in steel, machine building, and construction, in turn, led to a slight decline in capital investments, which had been planned to increase by about 7 percent in 1962. Investments in machinery and equipment rose, even though less than planned, and the regime continued to complain about the large volume of unfinished investments. Investment in industry increased by 5.1 percent.

#### Foreign Trade

As in 1961, internal economic difficulties were reflected in foreign trade. In 1961, Czechoslovakia did not earn a sufficiently large surplus on commodity trade to cover its deficit on invisibles and its credit commitments to other countries. Preliminary figures show that during the first half of 1962 the regime apparently was able to increase the export surplus on commodity trade by almost 25 percent in comparison with the same period of the previous year -- the surplus was \$105 million in January-June 1962 and \$85 million in January-June 1961 -- but in so doing added to its domestic difficulties. The lag in production of machinery led to an increase of only 8 percent in exports of machinery (the same rate of growth as that in 1961), in sharp contrast with the 26.5-percent increase planned for the year. Imports of machinery, on the other hand, grew by 27 percent -- in value terms, by more than exports of machinery. To generate a larger surplus, exports of manufactured consumer goods were increased, and imports of goods other than machinery (that is, raw materials, foods, and manufactured consumer goods) were curtailed, as shown in the following tabulation.

	<u>Million US Dollars</u>		
	<u>1961 January- June</u>	<u>1962 January- June</u>	<u>Percentage Increase</u>
Exports*	1,034	1,102	6.6
Of which			
Machinery	467	505	8
Consumer goods	N.A.	N.A.	7
Imports*	949	997	5.1
Of which			
Machinery	195	248	27
Other	754	749	

\* Preliminary data based on invoice prices.

The restrictive import policy apparently had a greater impact on Czechoslovakia's trade with the Free World, which declined by  $2\frac{1}{2}$  percent, than on its trade with the Sino-Soviet Bloc, which increased by 10 percent.

#### Consumption

Foreign trade policy and difficulties in agriculture created a severe imbalance on the consumer market -- an imbalance that mainly took the form of a shortage of meat and other foods. Because most of the increase in the production of manufactured consumer goods was exported, retail sales of these goods increased very little if at all, and consumers directed the bulk of the increase in money incomes (about 4 percent for the nonagricultural population) to purchases of foods, especially meat.

The total supply of foods, however, did not increase. The total output of meat remained about stable, and the output of milk and eggs declined. The regime was able to raise retail sales of foods but only by collecting a larger share of farm produce, thus restricting the free market and reducing payments in kind to collective farmers. The reduction in the

supply of foods obtainable outside the retail network entailed a corresponding increase in the demand for foods in retail stores. Moreover, panic buying of meat aggravated the shortages, for housewives feared that the regime would raise prices of meat, as it had done for prices of some wood and paper products early in May and of potatoes in June. Shortages of foods were reflected in the need for consumers to queue for hours before food stores -- a situation that caused mounting resentment against the regime.

### Economic Plans

Failure to reach key targets in the first 18 months of the Third Five Year Plan has already dashed the hopes of Novotny's regime that this plan can be fulfilled. The Central Committee of the Party recently has recommended that the plan be abandoned in favor of an interim plan for 1963 to be followed by a Seven Year Plan for 1964-70. The high priority of key industries -- steel and machinery -- will be retained or even increased in the new plans. An improved performance in these industries is essential to the fulfillment of both the regime's long-term objectives for modernizing the economy and the country's export commitments to the Bloc and the underdeveloped countries of the Free World. Planned rates of growth in total industrial output, however, probably will be reduced in recognition of the fact that all the regime's original goals cannot be achieved simultaneously. It is also likely that the regime will tighten central controls over the economy and the population, curtail the authority of enterprises and local governments over investments and some aspects of production, and hold down personal consumption.

The Novotny program has proved overambitious, and the attempt to pursue it for 18 months has subjected the economy to increasing strain. Once again, however, the regime has reacted to emerging difficulties by revising its plans fairly promptly and should be able to correct most of these difficulties less painfully than if it had held on longer to its program. Prospects for agricultural production remain poor, partly because the regime still appears unwilling to provide adequate incentives to collective farmers. Industrial growth, however, will probably continue to be rapid, by the standards of either Eastern or Western Europe, although less rapid than in the past few years.

13 September 1962

CIA/RR CB 62-58

Page 5

C-O-N-F-I-D-E-N-T-I-A-L

Table  
 Economic Indicators in Czechoslovakia  
 1961-62

	Percentage Increases*			
	1961		1962	1962
	Actual	Plan	January- June Actual**	Plan
National income	6.7	8.3	N.A.	6.5
Capital investment	7	N.A.	-.5	7***
Of which:				
Construction by state enterprises	7	N.A.	-4.1	7 +
Gross industrial output	8.9	9.3	6.8	9 +
Heavy machine building	11.4	14.1	8.4	15
Steel	4.1	10.2	5	14
Cement	5.8	10	9.5	22
Gross agricultural output	1	7.1	N.A.	5.1
Retail trade	3.8	4.2	4.3	5.6
Foreign trade	9	9.8	5.9	10***

\* Official definitions and data are used.  
 \*\* Data for the first 6 months of 1962 are compared with the same period for 1961.  
 \*\*\* Approximate.



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Coord:

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13 September 1962

CIA/RR CB 62-58

Page 7

C-O-N-F-I-D-E-N-T-I-A-L

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