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CURRENT ECONOMIC WEAKNESSES
IN THE SOVIET BLOC AND COMMUNIST ASIA

January 1964

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FOREWORD

This report sets forth the current economic weaknesses of the Soviet Bloc and Communist Asia. It does not present a balance sheet of strengths and weaknesses. The report concentrates on economic factors and does not analyze the interplay among economic, political, and military factors. Although a large number of examples are used to illustrate specific points, the report cannot supply detail for the wide range of problems considered, and other reports must be consulted for further information.

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CURRENT ECONOMIC WEAKNESSES
IN THE SOVIET BLOC AND COMMUNIST ASIA

Summary and Conclusions

The countries of the Soviet Bloc and Communist Asia have certain economic weaknesses in common: (1) the failure of agriculture to prosper under a doctrinaire system of collectivization, coupled with inept policy guidance from above; (2) the failure of industry to adapt flexibly to new technology and to a wider variety of final product; and (3) the general failure to provide the populace with adequate housing, consumer goods of reasonable quality, and, in some instances, even a sufficient amount of food.

In the USSR the attempt by Khrushchev to improve performance in hitherto neglected areas of the economy, coupled with rising demands of military and space programs, has led to an overcommitment of resources and additional waste and confusion. Agricultural output has failed to advance above the level of 1958, and the rates of growth in industrial production and investment have been appreciably lower in the last 4 years than in the 1950's. The Soviet planning and administrative system has not proved to be adaptable in meeting the expanded demands for a wide variety of high-quality goods in all sectors of the economy. The weaknesses in the economy came dramatically to the fore in the second half of 1963, when the USSR contracted for imports of roughly 10 million tons of Western grain and announced a crash program to quadruple production of chemical fertilizer by 1970.

In the Soviet Bloc countries of Eastern Europe, agriculture continues in the doldrums while the rates of growth of industrial production have slumped off. Continued annoyance with difficulties in everyday living and with the lack of competence of the economic administrators has left the populace sullen if not mutinous. The Soviet-style system of central planning and control has proved to be unsuitable in many areas, the more so because of the great dependence on foreign trade of many of the countries of Eastern Europe. Movement toward economic integration within the Bloc has been slow.

In Communist China the gravest economic weaknesses are the precarious food-population balance and the lack of technical support once furnished by the USSR. Production of grain in 1963 is about the same as in 1957, when there were 75 million fewer people. Imports of about 5 million tons of grain a year from the West are continuing. The abrupt withdrawal of Soviet technical aid in mid-1960 -- together with the wastes of the overambitious "leap forward" of 1958-60 -- has left China marking time with little immediate prospect for a resumption of rapid economic growth.

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These economic weaknesses are of considerable importance to the world image of the Communist system. In the case of the USSR the leadership has loudly proclaimed the superiority of the system in providing extremely rapid economic growth, in building up a mighty military establishment, and in providing a euphoric level of consumer well-being. Today these boasts sound hollow. Catching up with the US in industrial production, let alone in living standards, seems out of the question for at least this generation. The ante in the military-space race has been raised substantially, and the Soviet leaders now propose a game with smaller stakes. Finally, efforts to placate the Soviet consumer continue, but the response of the Soviet economy to the rising consumer standards of the modern industrial age has been notoriously sluggish. Khrushchev himself emphasizes the importance of consumer welfare as a symbol of economic success and makes sneering references, for example, to the Chinese Communists as apostles of a "pantsless Communism."

Weaknesses in the countries of Eastern Europe contrast with the buoyance of the major economies of Western Europe. As for Communist China, its economic energies for the time being are concentrated on feeding and clothing the population, and ambitious industrial and technological programs have been postponed indefinitely.

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I. Current Economic Weaknesses in the USSR

A. General Weaknesses

The Soviet leaders have accomplished certain things at an impressive rate of speed. They have built up the second largest industry in the world; they have developed a very large machine building industry, capable of turning out many types of technically advanced machinery for military and industrial use; they have greatly expanded production of basic industrial items, such as steel, coal, petroleum, electric power, and cement. As an engine of national power, the Soviet economy is a big, tough establishment.

In large measure these achievements are the result of concentrating on a narrow range of economic tasks and the corresponding neglect of other things. The "other things" can no longer be postponed without serious economic or political results. Khrushchev, beginning in 1956, has been forced to deal with some of the neglected areas. These efforts, together with his challenges to the West, have resulted in adding commitments to an economy that already was heavily burdened with ambitious military and investment programs.

Khrushchev's efforts to deal with these general economic issues have laid bare -- most spectacularly in 1963 -- the cost of concentration (and achievement). The growing dispersion of effort among many major economic problems has led to problems in management and control -- the simple emphasis of the past on sheer quantity of output no longer suffices, and new methods must be sought for forcing or inducing managers to readjust efficiently to the new economic situation. Included in the problems of management is the question of flexibility; the new emphasis on responding to the needs of various users, instead of concentrating on producing more and more of basic materials and machines for the restricted purposes of a centralized leadership, requires a much finer detail in central planning or, better yet, a system for relieving central planners of dealing with detail.

The current general weaknesses in the Soviet economy are thus an overcommitment of resources and the ineffectiveness of a system of economic management that worked well enough for the objectives of the leadership in the past but now is hard-pressed to direct an economy of increasing diversity of product and of purpose.

1. Overcommitment of Resources

The Soviet economy is then an economy under strain, an economy trying to do a lot of things all at once. The economy in the past, of course, has typically been run full throttle, with men, machines, and materials pressed hard to achieve ever-increasing output goals.

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What distinguishes the situation in 1963-64 is that the pressures on the economy are tied up with frustrated global political and military ambitions and with disappointed hopes on the part of an increasingly articulate citizenry.

The term overcommitment is too often used promiscuously in describing an economy's problems. In the USSR, overcommitment shows up graphically in Khrushchev's attempt to boost production of meat by greatly increasing the number of cattle; the limited amount of fodder has been distributed among the larger number of cattle, and the result has been that inputs of fodder go to keeping larger numbers alive -- that is, to growing bones rather than to producing more meat. An analogous situation exists in construction: because of the great increase in construction projects, coupled with a limited supply of management energy and construction materials, a great number of projects are kept alive but are not being expeditiously completed -- that is, meat is not being added to the bones efficiently.

The strains and weaknesses in the economy suddenly burst into the open in August 1963 when the USSR contracted for about 10 million tons of Western* wheat and announced a large crash program for expanding capacity and output in the chemical industry. In his report of 9 December to the Central Committee of the Communist Party of the Soviet Union,** Khrushchev put the best face possible on these embarrassing revelations of weaknesses by pointing out that when grain was scarce in 1947, Stalin and Molotov simply continued to export grain and let people starve.

In large part, then, Soviet economic weaknesses stem from the attempt of the Soviet leadership to do too much too soon. Specifically the Soviet leadership has somewhat less than half of the gross national product (GNP) of the US to allocate among the following purposes: (a) the investment in new plant and equipment of amounts roughly comparable to investment in the US, as a vital part of the program to "catch up" with the US in economic power; (b) the maintenance of a tremendous military-space establishment, the annual upkeep of which approaches in real terms the upkeep of the US armed forces; (c) the feeding, clothing, and housing of a population 18 percent greater than that of the US; and, a relatively small item, (d) the supply of arms, military specialists, machinery, and engineers and other technical people to Cuba, the United Arab Republic, Indonesia, and other partly developed countries.

* "Western" as used in this report refers generally to non-Communist industrial nations and in some contexts includes Australia and/or Japan.

** This report will be referred to hereafter as "Khrushchev's report."

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The top Soviet leadership has overcommitted its economic resources in its impatience to achieve all its goals, and its attempts to repair deficiencies in one sector have led to difficulties in other sectors. In late 1963, for example, the need to import up to \$1 billion worth of wheat from the West and the apparent need to import perhaps \$2 billion worth of Western chemical equipment over the next 7 years worsened an already troublesome foreign exchange problem. The reactions to this problem -- drawing down of gold reserves, stepping up of exports, trimming of imports of other goods, and seeking out of large long-term credits from the West -- all create problems of displacement and rearrangement of economic plans and resources elsewhere in the economy. The economic plans sketched out for 1963-64 have the theme "chemicals ueber alles." Just as "electrification" was the magic word for the legendary Lenin, so "chemicalization" is the incantation of Khrushchev -- chemicals to make the fields yield richer harvests of grain and cotton; chemicals to supply light industry with greater quantities of synthetic textile fibers; and chemicals to furnish plastics that will serve a wide variety of uses and release great quantities of metals, wood products, and leather for other uses. Billions of rubles worth of construction materials are part of the chemical program -- well, then, comrades, construction of housing, hospitals, and schools won't advance quite as fast as we'd like! Thousands of engineers and other skilled people will be needed to build and operate the new chemical plants -- well, then, comrades, we'll train them on a crash basis, and we may even cut back some of our less essential military programs to show that we are a peace-loving people! Thousands of tons of fertilizer are wasted now -- well, then, comrades, we'll have to develop teaching activists who will train several hundred thousands of the peasants in fertilizer application!

Given the overcommitment of resources, under various plans and programs, the actual allocation of resources is determined by a system of arbitrary priorities, priorities that can change overnight in bewildering fashion. For example, one year the planting of corn can be in fashion, the next year the plowing up of grassland, and in 1963 it was chemicals that were pulled out of the hat. Accordingly, weaknesses are most pronounced in those sectors of the Soviet economy that have been time after time shortchanged when the priority system got down to actual physical placement of resources. Major weaknesses are to be found in agriculture, in light industry, in certain branches of construction, in housing, and in consumer services.

2. An Inefficient Guidance-and-Control Mechanism

Besides the overcommitment of resources, a continuing weakness in the Soviet economy is the doctrinaire and heavy-handed system of economic control, a system that breeds large-scale waste of resources and that is peculiarly inefficient in making the fine adjustments required of a modern economy. This guidance-and-control mechanism -- an

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elaborate hierarchy of economic policymakers, planners, administrators, and managers -- all fortified with a correct "Party line" -- certainly does not suffer from an underallocation of resources. Rather it lies as a dead weight on all enterprises of pith and moment.

The Soviet economy is a "command economy." General economic policies are set by the handful of top-level Communist oligarchs, among whom Nikita Sergeyeovich Khrushchev casts the biggest vote. These policies are colored by the quasi-religious doctrines attributed -- sometimes accurately -- to Saint Karl and Saint Vladimir. (Saint Joseph has been decanonized.) In general, these policies call for rapid expansion of the heavy industrial base, collectivization of all economic activity including small-scale industry and agriculture, central planning of economic affairs, and maintenance of a large military establishment to protect the revolution and to bring its benefits to oppressed peoples everywhere. Later on, a controlled abundance of consumer goods based on scientific norms will become available to everyone "free of extra charge," but in the meantime a minimum amount of consumption goods, distributed according to a person's productive output or political position, is the rule of the game. More detailed information on weaknesses in the planning and administrative system is given at various points in the sections below.

B. Weaknesses in Agriculture

Agriculture has been a chronically weak sector in the Soviet economy. Estimates of net agricultural output can be only approximate, but it is believed that no discernible increase has been achieved above the good year of 1958. Estimated percentage increases in net agricultural output for each year since 1958, above the previous year, are as follows:

| <u>Year</u> | <u>Percent</u> |
|-------------|----------------|
| 1959 | -4 |
| 1960 | +3 |
| 1961 | +8 |
| 1962 | -4 |
| 1963 | -4 |

In this 5-year period, while agricultural production was faltering, the population of the USSR grew 8 percent, and net production per capita in 1963 is estimated to have been 10 percent below the level of 1958. The weaknesses in Soviet agriculture described below are man-made; these man-made problems, however, have been made worse by the generally mediocre weather since 1958, a year of unusually good weather. During

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this recent period the pressures on the leadership from the failures and inadequacies in agriculture have led to a progressive inflation of the official statistics on agriculture.

1. Inadequate and Misused Investment

Usually outside observers have explained past and present weaknesses in Soviet agriculture by the low priority given to agriculture in the allocation of men, machinery, and materials and by the neglect of agriculture on the part of the central government leadership. Actually a little salutary neglect on the part of the regime might have left agriculture in much better shape than the policy actually followed, which has been marked by (a) the insistence on collectivization as the ultimate long-term answer to all agricultural problems; (b) the principle, especially dear to Khrushchev, that there is no trouble down on the farm that cannot be solved by a vigorous Party member taking hold and shaking things up; (c) the abrupt twists and turns in official directives as to what crops should be planted by what methods under what organizational rules; and (d) the general inadequacies of incentives for increased effort and improved techniques of production.

Since Khrushchev came into power, resources in considerable quantity have gone to agriculture, but not enough to make up for years of neglect or enough to meet the greatly expanded needs of a more intensive agriculture. In addition, some of the investment has been misapplied and misused -- for example: (a) a considerable part of farm machinery is known to be inoperative at any one time because of grave shortages of spare parts, skilled repairmen, and trained operators, and (b) according to Soviet studies, 15 to 25 percent of fertilizer is lost between factory and farm because of poor transport and storage, and an additional significant part is applied ineffectively to the fields.

2. Erratic Planning and Administration

Central planning of the Soviet kind is supposed to supply central initiative and technological leadership for the improvement of agricultural techniques and yields. As it has turned out, however, erratic and shortsighted planning has hampered Soviet agriculture, and administrative reorganizations and crash programs to end the stagnation in agricultural production have resulted only in a compounding of confusion and a further waste in resources.

In the past decade the Soviet leadership has made several important reorganizations of the systems by which agriculture is administered. These reorganization patterns have varied in the degree of decentralization from one in which even minute details of agriculture are determined in Moscow to one in which agriculture is allowed considerable local autonomy, provided that planned deliveries to state

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collection agencies are made. Another way in which these various systems differ is the degree to which Party organizations play a direct role in making agricultural decisions. One of the few amusing aspects of the vacillations in the organization of Soviet agriculture is the public scourging of the administrative apparatus for operating in an uninspired bureaucratic fashion, and, later, when the Party activists have been thrown into the fray, the denouncing of the apparatus for operating in an unsystematic disorderly fashion.

Although a great deal may appear to have been accomplished in the short run, the crash programs for changing the face of agriculture are often shortsighted. For example, in the middle 1950's a great acreage of semiarid lands was plowed up in Kazakhstan and adjoining regions, and a considerable immediate increase in production of grain was achieved. The land was not rested to restore moisture and nutrient content, however, and in 1963 the drought came, and the winds blew the soil, and yields fell nearly to zero in much of the area. Khrushchev, in his report, alluded to "enemies of the Soviet Union" who "have been spreading all sorts of fabrications of late about the virgin lands, trying to prove that the policy of the reclamation of the new lands had allegedly not given the results expected." On this occasion, Khrushchev, although sensitive about Western gibes, went blandly ahead with a completely different approach -- a program for the intensive use of existing acreage through more fertilizer, with not a kopek more for the program of extensive development -- that is, the cultivation of additional acreage.

The corn program illustrates the erratic nature of planning in agriculture. In 1955, Khrushchev said "corn," and shortly the whole countryside was up to its ears in plans for corn. Late in 1963, however, Khrushchev chided comrades who had grown corn in unsuitable climatic zones on unsuitable land, and he said that the new agricultural policies, although deemphasizing corn, were not a retreat from the corn program. The trumpet that blows in Moscow is no uncertain trumpet, but agricultural officials can expect contradictory blasts within a short period of time and must pretend that the previous blasts do not exist. In summary, the waste of investment in agriculture and the erratic and frequently short-sighted guidance from above are part and parcel of the same problem of inefficient use of the economy's resources.

3. Doctrinaire Insistence on Collective and State Farms

The dominant units in Soviet agriculture are the 39,700 collective farms (kolkhozy) and the 8,570 state farms (sovkhozy). There are practically no individual peasants left. Under the collective farm system, net income is paid out, either in cash or kind, according to the number of workdays (adjusted for level of skill) of the individual.

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Under the state farm system the individual is paid a set wage. The state farm is considered "superior" in an ideological sense because it is closer to the "factory farm," an idealized production unit patterned as closely as possible to the industrial plant.

State and collective farmers typically are permitted to cultivate private plots of one-half to 1 acre in size. These private plots account for only 3 percent of the sown acreage but for almost 30 percent of the estimated man-years applied to Soviet agriculture, as follows:

Distribution of Soviet Farm Workers
by Type of Activity, 1963

| | Thousand Man-Years |
|---|--------------------|
| Total civilian employment in agriculture | 38,900 |
| State farms | 8,400 |
| Collective farms | 19,600 |
| Private plots of collective and state farm workers | 10,900 |

Rural incomes are low and, especially in the case of collective farmers, highly uncertain. Thus the small private plot plays an important role by supplying the rural population with fresh fruits and vegetables, with meat and dairy products, and with supplementary income. The importance of the private plot is shown in the following tabulation of the distribution of production of selected products, by type of farm, in 1962 (data are taken from the official Soviet handbook):

| Product | Total | Collective Farms | State Farms | Private Plots* |
|-------------|-------|---------------------|----------------|-------------------|
| Grain | 100 | 58 | 40 | 2 |
| Cotton | 100 | 82 | 18 | 0 |
| Sugar beets | 100 | 93 | 7 | 0 |
| Potatoes | 100 | 20 | 10 | 70 |
| Vegetables | 100 | 28 | 30 | 42 |
| Meat | 100 | 30 | 26 | 44 |
| Milk | 100 | 34 | 21 | 45 |
| Eggs | 100 | 11 | 13 | 76 |
| Wool | 100 | 46 | 32 | 22 |

* Including production on the private plots of state and collective farmers and of state workers and employees in rural nonfarm occupations.

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Higher yields and a large share of production of many important products are obtained on the private plots in spite of the absence of state help in the form of equipment and facilities, chemical fertilizer, and extensive pieces of land. The private plot has the advantage because of personal incentives and the careful attention of the peasants. The kinds of agricultural activity that are most dependent on individual responsibility and incentive -- such as livestock-raising -- are often the kinds that must be expanded if the Soviet consumer is to be provided with a more varied diet; these new activities sometimes require new investment in specialized facilities and equipment. But, for doctrinal reasons, the Soviet leadership is hamstringing individual incentive by consolidating collective farms into larger units, by transforming collective farms into state farms, and by chipping away at the freedoms of the private plot. Thus a fundamental weakness in Soviet agriculture today is that political doctrine runs counter to economic requirements. Khrushchev, in his report, shows extreme sensitivity on this point, referring to the "slanders" of Western opponents of socialism and to the "absolute victory" of collective and state farming. Presumably, when Khrushchev in this same speech launches a vast fertilizer program and urges great increases in agricultural output and productivity, he is merely mopping up after the absolute victory.

4. Unsatisfactory State of Farm Mechanization Program and of Farm Technology

Another continuing weakness in the Soviet agricultural picture is the state of farm mechanization. Problems in this area are tied to problems previously described -- the inadequacy and misdirection of investment, the cumbersome nature of Soviet planning, and the failure of collective institutions to provide incentives for more diligent care and better maintenance of livestock and machinery. Flexibility of design in farm equipment, the achievement of high quality in equipment, and the provision of a ready supply of spare parts are some necessary aspects of the farm mechanization program, but none of these has been a noticeable attribute of the farm equipment industry. Furthermore, the operators of equipment and, especially, skilled mechanics are the first to be lured to the less rigorous life of the city. The social and political institutions of the rural areas cannot handle the problems that arise under a high-pressure program of mechanization.

The training of agricultural research people and the operation of agricultural research stations look good on the reports submitted to Moscow. Yet, in December 1963, Chairman Voronov of the RSFSR Council of Ministers stated that in the RSFSR most of the 561 agrochemical laboratories in operation were not worthy of the name. Voronov went on --

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As a rule, there are only two men in each lab. They work in cramped, unsuitable quarters, without the proper equipment. They do not act in concert; their work is not coordinated by anybody; the ob- last and kray experimental stations do not give methodological guidance to their labs; and the majority of them do not fulfill their allotted tasks.

Typically, this leader urged that more, presumably better staffed labo- ratories be set up.

5. Chemical Fertilizer Program as a Case Example

The current weaknesses in Soviet agriculture, together with weaknesses in adjoining sectors of the economy, may be illustrated by Khrushchev's current proposal to raise the annual production of chemical fertilizer from 20 million tons in 1963 to 70 million to 80 million tons in 1970. Many steps must be taken to translate the proposal into greatly increased production of grain -- production and import of chemical equip- ment, training of engineers and skilled workers in the chemical field, construction and equipping of fertilizer plants, production of fertilizer, storage and distribution of fertilizer to regional centers, blending and bagging, storage and distribution to state and collective farms, produc- tion of fertilizer-spreading machines, application of fertilizer to the fields, and reaping and storing the resulting grain. Each step in each of these operations, with a few exceptions, is a relatively simple oper- ation. The application of fertilizer to a field, for example, is not a particularly complicated job, but it does require over-all enlightened management and a responsible attitude. The key word here is incentive. Does anyone care whether the fertilizer is distributed in bags or in bulk? Does anyone care if a certain acreage is not suitable for ferti- lizer of a certain composition? Khrushchev remarked drily that the bureaucratic solution is to "give everyone a little fertilizer."

C. Weaknesses in Industry

Official Soviet announcements of industrial production in the USSR, although they must be examined cautiously, are more reliable than statistics on agricultural production. A large part of industrial pro- duction is concentrated in a few hundred large factories, and industry is not subject to the vagaries of weather. Consequently, industrial production has advanced at a relatively steady pace, and results have corresponded fairly closely to annual and to 5-year plans. Exaggera- tion of achievements by Soviet industry is less than in the case of

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agriculture. Annual rates of growth in industrial production, as announced by the government, overstate the actual rate, usually by one or two percentage points:

Average Annual Rate of Growth
in Soviet Industrial Production

| <u>Year</u> | <u>Plan</u> | <u>Percent</u> | |
|-------------|-------------|-----------------------------|------------------------------------|
| | | <u>Announced Result</u> | <u>Estimated Actual Result</u> |
| 1951-55* | 11.2 | 13.1 | 10 |
| 1956-60** | 10.5 | 10.4 | 9 |
| 1961-63*** | 8.3 | 9.0 | 7 |
| 1956 | 10.5 | 11.0 | 9 |
| 1957 | 7.1 | 10.0 | 8 |
| 1958 | 7.6 | 10.0 | 8 |
| 1959 | 7.7 | 11.4 | 10 |
| 1960 | 8.1 | 9.6 | 7 |
| 1961 | 8.8 | 9.3 | 7 |
| 1962 | 8.1 | 9.5 | 7 |
| 1963 | 8.0 | 8.5 | 7 |

1. Decline in Industrial Rates of Growth

In the early 1950's Soviet industrial production grew at an average annual rate of 10 percent and in the late 1950's at 9 percent. In the last few years the rate has been 7 percent. This slowing down in the rate of growth of industrial production has sorely complicated the task of the Soviet leadership in adjusting to the greatly increased burdens placed on the economy. Furthermore, this slowing down in industrial growth -- coupled with the stagnant performance in agriculture -- has dimmed if not extinguished their hope of catching up with the US in this generation.

Of course, an increase of 7 percent per year in industrial production under ordinary circumstances is quite respectable, but measured against Soviet aspirations it is not. Then, too, it should

* Base year 1950.
** Base year 1955.
*** Base year 1960.

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be noted that industry -- especially that part of industry that turns out capital equipment -- is the apple of the Soviet eye. The USSR has concentrated on industrial growth, and even in the field of their own choosing they are not doing too well.

One major cause of the decline in the Soviet industrial rate of growth is the failure of investment to increase further as a percent of GNP. In the 1950's, Soviet investment in new plant and equipment increased from 15 to 23 percent of GNP but subsequently has remained fixed as a percent of GNP. The high rate of industrial growth in the 1950's depended on investment's being an ever-increasing share of GNP, and when the share became stabilized, the pace of industrial expansion slowed. The sharp upturn in military expenditures starting about 1958 is part of the explanation for the failure of investment to maintain the pace, particularly because production of military goods draws on the same high-quality men and materials that spark industrial growth. And industrial growth also was retarded by the apparent decline in the ability of Soviet management to get increased gains in the efficiency with which capital and labor inputs are combined. Finally, the transition from a 46-hour to a 41-hour workweek in industry had the result that there was little if any increase in the input of man-hours into industry between 1958 and 1961.

Restoration of the old level of rates of growth is not likely in the near future unless a substantial reduction in allocations to the armed forces takes place. In this connection the appeals by Khrushchev in 1963 and at the start of 1964 for a lessening of the tempo of the "cold war" could be important from the economic point of view if they proved to mark, as current economic plans suggest, the beginning of a reallocation of resources toward growth.

2. Emphasis on Sheer Quantity -- at a Cost

The traditional emphasis on quantitative growth in Soviet industry has entailed considerable costs in the form of wasted output, poor quality of product, poor assortment and variety, uneven technology, and considerable wear-and-tear on workers and managers. Because heavy industry, especially those branches serving the military, has always had priority in getting the best manpower, machinery, and materials, these costs have been especially important in the industries affecting the consumer.

An example of wasted output -- the factories producing trucks and tractors turn out as many units as they can, but at the same time the tire industry runs into trouble, producing an insufficient volume of tires of notoriously low quality. Result -- trucks and tractors stand around waiting for tires.

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Examples of poor quality and variety -- producers of clothing strive to fulfill and exceed production goals. To get sheer quantity of output, they skimp on quality, and the inspectors become accustomed to passing shoddy goods. Sheer quantity means, in the extreme case, one style, one color, and very few sizes. The retail distribution system in effect is dealing with a monopoly supplier, and remonstrances would be futile. And, until recently, consumers had to take what was supplied. Now, however, consumers are in a position to reject poor-quality goods; they are not able, as in a market economy, to signal the producer effectively as to how much quality and diversity they are willing to pay for, but they are able to take the first step -- of letting unsold goods pile up on the shelf. In the case of clothing, cigarettes, and consumer durables -- for example, radios -- the Soviet citizen -- now free to criticize the "bureaucracy" if not the leading individual culprits -- equates "Western" goods with quality. Visitors from the West discover an open or furtive admiration for their possessions, from automobiles to footwear, from luggage to Kleenex tissues. Khrushchev was uncharacteristically reserved in the following statement: "Some of our fibers are considerably inferior to imported ones in their physico-mechanical properties and finish."

As for uneven technology, Soviet industry is an interesting blend of the latest wrinkle in automated plants side-by-side with exceedingly primitive factories. In some cases the unevenness of technology merely reflects the high priority of military and heavy industry. In other instances, technology suffers from the unwillingness of industrial managers to experiment with new techniques or to replace old equipment at the expense of current output.

3. Difficulties in Planning and Administration

The past emphasis on fulfillment or overfulfillment of physical output quotas might have been logical in the early phase of Soviet industrialization when the Soviet leadership concentrated on the rapid expansion of production of a narrow range of basic industrial materials and machinery. Under these circumstances a "command" system in which orders are imposed downward through an administrative hierarchy works fairly well. Now, however, managers of industrial enterprises and trusts are supposed not only to meet physical quotas but also to lower costs of production, to adopt the latest technology, and to improve quality and assortment of goods in response to the needs of a more sophisticated and varied group of users. At the same time, the central leaders enjoin the managers to keep in mind national goals and to avoid "provincialism" -- that is, making decisions on the basis of local interests. The general weakness in the industrial administrative system is that the manager does not get clear signals as to what is really wanted (how much physical output, for example, may be sacrificed in order to get a higher quality of product), nor, even if the signals

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are clear, is the manager necessarily motivated by the system to re-order his activities. Because complexity of product and complexity of user demand are increasing inevitably, this weakness becomes more and more serious. For example, Khrushchev himself recently castigated two sovnarkhozy (economic administrative areas) for failure to get into production of new raw materials required for the expanded synthetic fiber program.

Three lines of attack on the weakness have appeared: (a) a proposal, by Professor Liberman of Khar'kov, for a limited decentralization of decision-making by setting up one criterion of success -- profitability* (ratio of profits to capital plant used in the enterprise); (b) proposals by various economists to increase the power of the central planning apparatus to handle the new complexities by development of new mathematical techniques coupled with the use of giant computers; (c) proposals, usually favored by Khrushchev, to send dedicated Party men in as troubleshooters when the bureaucrats have failed. These kinds of proposals may all be tried, thus still further tangling the situation. Up to now the most important changes have been in reorganizing lines of authority, especially at the top levels, and in introducing Party elements as overseers of the production process. Proposals to liberalize the scope of authority of managers of individual enterprises run contrary to political doctrines of central planning, forced-draft growth, and preeminence of the authority of the Communist Party.

The inflexibility of the industrial administrative system in dealing with variety and with change is reflected in the existence of many informal arrangements that fill in the interstices in the economy. Managers of enterprises employ fixers and expeditors, who arrange special dispensations (for example, arrangements with local authorities to wink at unlawful overtime work) or turn up nonofficial sources of raw materials. Small-scale enterprises in basements supply services or handicraft goods, filling needs that fall in between the lines of the economic plan. The central authorities -- as in the case of the private plot in agriculture -- wisely tolerate many of these activities because it helps the system work. Of course, individual enterprise in currency speculation or the use of state raw materials for private gain is proscribed, and several score of enterprisers have been shot in the last couple of years to underscore the point.

D. Weaknesses in Construction

In his speech of 24 April to the RSFSR conference of industrial and construction workers, Khrushchev expressed his exasperation at the

* Physical output quotas, price, and major investments would still be determined by central authority; individual enterprises would have control over inputs of labor and raw materials and methods of production.

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persistence of shortcomings in construction programing in the USSR. "The increase in unfinished construction is a swamp," he complained, "and we are dragged into this swamp by certain comrades who begin more and more new construction sites indiscriminately The more construction sites there are in the process of construction, the less materials and equipment every construction site will receive. The advantage lies not in the fact that we have a large number of construction sites where work has started but in an accelerated pace of completion of projects." He criticized both Novikov (Chairman of the State Construction Committee, Gosstroy, USSR) and Lomako (Chairman of Gosplan, USSR) for "deficiencies in their work [and] the disorder in construction" and called on Ustinov (Chairman of the Supreme National Economic Council) to occupy himself with the problem.

Construction programing is one of the most intricate and difficult problems faced by Soviet economic planners. There are more than 100,000 state construction projects underway in the USSR, and the supply of construction resources (building materials, manpower, and equipment) is insufficient to meet the requirements of all projects simultaneously. Without adequate control measures the supply of construction resources tends to be allocated among the many projects in accord with a Russian proverb: "Each sister gets one earring." Construction projects in the USSR, therefore, generally take considerably longer to complete than would otherwise be necessary, and the inefficiency is reflected in higher costs. As the construction effort has increased rapidly in size and complexity in recent years, the Soviet system of construction programing has become more and more inadequate to the task. The cost of such inefficient programing thus has reached impressive proportions in terms of additional production forfeited. Khrushchev, in a series of statements, has shown that he has long understood this problem. He has not yet developed a solution, however, that satisfies both the requirements of the situation and the tenets of the Communist system.

With the supply of resources insufficient relative to the number of construction projects underway, Khrushchev has centered his attention largely on two kinds of corrective policies: (a) increasing the supply of construction resources and (b) concentrating the available supply of resources by reducing the total number of projects on which construction is continued. The first policy would permit an increase in the total volume of construction performed, acceleration in completion of projects, and reduction of the cost of construction without reduction in the number of projects underway. The second policy would permit accelerated completions and lower cost of construction without requiring an increase in the supply of construction resources or in the total volume of construction performed. The two policies are not mutually exclusive, but Khrushchev from time to time has shifted his attention from one to the other.

However, warnings and admonitions from the center to make construction more efficient do not mean that things actually change

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at the construction site. Khrushchev, for example, complained in April 1963 that Gosstroy and Gosplan had failed to review proposals to eliminate 2,500 projects, with the result that financing of these projects was undertaken after all. In reviewing the lists of approved projects, province and district Party leaders cut back only a small number of the total projects subject to their review. As of April 1963, more than 100 of the most important projects that were to have been completed in 1962 still had not been supplied with all their equipment. Ustinov, reporting on December 11 to the Plenum of the Central Committee of the Communist Party, said that too much time is lost between the various stages of a project: planning the project, the actual construction, training the production workers who will man the new plant, starting production, and reaching the planned quantity and quality of output. He cited a characteristic example: a sulphuric acid workshop commissioned in 1962 at the Sumgait phosphate fertilizer works has still not reached its planned capacity. The cost of producing 1 ton of sulphuric acid there is twice that of other enterprises throughout the country.

E. Weakness in Foreign Trade

The weakness in the Soviet foreign exchange position with the industrial West is another major weakness brought to the surface in late 1963. This weakness is closely tied to the domestic problems described in the earlier sections.

Over the past few years, Soviet exports to the industrial West, which have consisted mainly of basic commodities such as petroleum, wood and wood products, grain, and ferrous and nonferrous metals and ores, have been insufficient to pay for Soviet imports of Western machinery and manufactured goods. The difference has been made up largely by sales of gold and more recently by medium-term credits. Gold sales since 1955 probably have been greater than domestic production of gold. New medium-term credits from the industrial West amounted to about \$300 million annually in 1962-63. Repayments of principal plus interest came to \$240 million in 1963, leaving net credits of only \$60 million. Total outstanding medium-term credits at the end of 1963 were about \$575 million.

The scheduled import of 10 million tons of grain in 1963-64 at a cost of roughly three-fourths of a billion dollars has greatly accelerated the drain on Soviet gold reserves. Moreover, Khrushchev's program for a tremendous increase in chemical production appears to require the import of a minimum of several hundred million dollars of additional chemical and related equipment from the industrial West. The import of this equipment, now that gold reserves have been heavily drained, depends on securing large additional credits from the West -- perhaps up to \$500 million annually from the current level of \$300 million -- with payments extended over a long period of time. These credits

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could furnish the Soviet leadership with an important respite and room for maneuver in the face of its growing economic difficulties.

A second chronic weakness in the Soviet foreign trade situation is the inability of this large industrial country to compete with even small industrial nations of Western Europe in quality and reliability of machinery and manufactured products. The internal conditions that push the Soviet industrial manager toward quantity rather than quality of output mean that the USSR has difficulties in selling these advanced types of products in the industrial West. But, even more important than the quality issue, the Soviet foreign trade monopoly has shown little understanding of the techniques and problems in marketing such goods in the West.

F. Weaknesses in the Consumer Sectors

Throughout the Soviet era the concentration on growth in heavy industry and on increases in military strength has been at the expense of the consumer. Since Khrushchev has been in power, he has posed as a champion of the consumer. Yet the consumer continues to chafe under a regimen that features a starchy and monotonous diet; poorly styled clothing of inferior quality; very small quantities of many consumer durables found everywhere in non-Communist industrial nations; and -- probably the biggest sore spot -- badly crowded, run-down housing. In 1963, total consumption per capita was less than one-third that of the US, but this comparison does not fully reflect the considerable advantages that the US enjoys in the quality, variety, and ready availability of consumer goods.

1. Shortages of Food

In some aspects of consumption, there have been important improvements since Stalin died, but promises and expectations have easily outdistanced performance. Perhaps the most galling aspect from Khrushchev's point of view of the agricultural failures of 1963 was the open evidence for all the world to see that after more than 40 years of Communism and a decade of his stewardship the USSR could not feed itself and had to turn to the capitalistic West for 10 million tons of grain. As domestic conservation measures, the government lowered the quality of bread, introduced informal rationing measures, and cracked down on the widespread practice of feeding bread to livestock. (This crackdown illustrates the failure of the Soviet price system to limit the employment of resources to their most valuable uses; a rise in the price of bread was called for so that it would not be profitable to use it to fatten livestock.)

Khrushchev's promises never have been presented more glowingly than when he used to talk of surpassing the US in per capita

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consumption of meat, butter, and milk. Failures in agriculture, described in a previous section, have punctured this dream. In addition to these products the provision of fresh fruits and vegetables and of quality foods in general is hampered by lack of refrigeration, by backwardness in techniques of packaging and storage, and by the general failure of the system to transmit the wishes of the final user back to the producer. In these respects the Soviet system is markedly inferior to a market system, in which the consumer is able to insist on quality and variety at a mutually agreed on price.

2. Deficiencies in Soft Goods

Humor magazines and circus clowns in the USSR appear to specialize in jokes about ill-fitting and poorly made clothing. Some of the reasons for deficiencies in this area were mentioned in the discussion about light industry above -- namely, the low priority of light industry in obtaining competent workers and managers, new equipment, and suitable raw materials.

3. Small Quantities of Consumer Durables

The average Soviet consumer, without an automobile and with little hope of ever having one, is forced to use public transportation facilities that Khrushchev refers to as approaching the best in the world. He can hope that out of the 70 million families in the USSR by 1965 his might be one of the fortunate 8 million to possess a (small) refrigerator if present production plans are adhered to, and he can even hope that the refrigerator might be one that really refrigerates! It might not occur to him to miss such luxury items as freezers, dishwashers, and clothes dryers, which are almost nonexistent in the USSR. TV sets are readily available in large cities, but the quality among different models varies from fair to atrocious, and consumers sometimes insist on a repair ticket at the time of purchase in the expectation that the set will not work until after some initial repairs.

4. Crowded, Run-Down Housing

The great majority of urban families in the USSR have a small one-room or two-room apartment and share kitchen and toilet facilities with other families. A man must rise fairly high in industry or government to rate a larger private apartment, and in some instances successful Soviet astronauts are rewarded with a private apartment. Making arrangements for an apartment is an important part of getting married, and the lack of sufficient housing space probably is a main cause of the low urban birth rate. Because of the continuing large-scale movement of people from the country to the city, the

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construction of urban housing has done little more than to keep pace with the growing population. The Soviet urban dweller must make do with only 70 square feet of living space, which is less than he had in the early 1920's and only slightly more than he had immediately following World War II. He has little prospect of ever experiencing the luxury of 300 square feet per person enjoyed currently in the US.

5. Other Weaknesses as Seen by the Consumer

Shortcomings in the quantity, quality, and availability of food, clothing, durables, and housing are not the whole story of weaknesses in the consumer sector. The interminable queuing, the bootlicking necessary in some cases to get scarce items such as apartment space, the maddening inefficiency of a distribution system that provides a surplus of Item A in one locality while acute shortages exist elsewhere, the contrast between relatively large supplies in Moscow and Leningrad and the lack of goods in the province, the export of semiluxury items in great demand domestically, the favored treatment of the ruling elite in the allocation of scarce supplies, the printing of minute editions of the works of a vers libre poet in contrast to the printing of many thousands of copies of a political tract by a Party hack, the continued absence of many of the convenient little repair and service shops taken as a matter of course in any civilized country -- all these clumsy and inefficient aspects of consumption reflect the general low priority of the sector. And on top of all this the cornucopian promises!

Money incomes in the USSR show the same general pattern of inequality of distribution as in the US. However, consumers in non-Communist countries can allocate their incomes among a wide variety of different kinds and qualities of goods. The Soviet consumer cannot spend more on Item A and less on Item B just because he would prefer 100 rubles worth of additional B to 100 rubles worth of A; to illustrate, most Soviet consumers would like more housing space and better quality housing, but they cannot increase the real satisfaction obtained from their ruble income by redirecting their expenditures toward housing.

Consequently, when it is said that the real income of the consumer in the USSR or another Communist country is a certain fraction of the income of a consumer in a non-Communist country, such a comparison overstates the proportion. Even if quality of goods has been taken fully into account, other shortcomings and annoyances in the system, together with the inability to apportion income among various kinds of consumption, mean that the real income of the Communist country has been overstated.

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6. Failure to Reduce Hours of Work

In weighing the meaning of a consumer's income, it is necessary to take into account how long and how hard he has to work for that income. Contrary to plans announced by Khrushchev in 1958, the Soviet worker will continue on a 6-day, 41-hour workweek through 1965 and will continue to pay an income tax. The USSR apparently has shelved its plans to reduce the workweek to 35 hours beginning in 1964 and to eliminate the income tax by October 1965. No mention of these goals is contained in the economic plan for 1964-65 that was announced in December 1963. The Seven Year Plan (1959-65), announced in 1958, provided for a reduction in the workweek from 46 hours to 41 hours by 1960, to 40 hours in 1962, and to 35 hours beginning in 1964. The reduction to 41 hours took place as scheduled, but no further reductions have been made. Also according to the plan the level of tax-exempt income was to be raised annually beginning in October 1960 until all income became tax-exempt -- and the income tax thus eliminated -- in October 1965. The program proceeded on schedule in 1960 and 1961, when tax-exempt income was raised from 37 rubles to 60 rubles a month. (Average monthly earnings of Soviet workers was approximately 85 rubles in 1961.) The program was halted abruptly in September 1962 and has not been resumed.

An increase in the minimum wage and in disability pensions that originally was scheduled to take effect in 1962 is now planned for 1965. The Seven Year Plan called for an increase in the minimum wage from a level of 27 to 35 rubles per month in 1958 to 40 to 45 rubles during 1959-62 and to 50 to 60 rubles during 1963-65. The plans announced in December 1963, however, call for an increase to 40 to 45 rubles during 1964-65.

The delay in wage hikes and the failure to cancel the income tax probably reflect the planners' efforts to hold the line on purchasing power because of shortfalls in production of consumer goods. The shelving of the 35-hour workweek may stem from a reassessment by the Soviet leadership of the labor supply and the labor requirements of rapidly expanding service sectors. Since 1961, high labor turnover in Soviet industry has been symptomatic of serious shortages of skilled workers -- hardly the proper climate for a drastic reduction in man-hours in that sector of the economy. In addition, a reduction in the workweek at schools, hospitals, retail stores, and other service facilities might seriously curtail the very services that Khrushchev has promised to improve.

G. Decline in Over-All Growth Compared with the US

Great difficulties are encountered in comparing the level of total output and the rates of growth of total output of countries whose

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price systems, economic institutions, and economic goals differ widely. Therefore, the following comparisons of US and Soviet growth must be regarded as approximations only:

Average Annual Rate of Growth in GNP

| | Percent | | | |
|------|-----------------|------------------|-------------------|-----------------|
| | <u>1951-55*</u> | <u>1956-59**</u> | <u>1960-63***</u> | <u>1951-63*</u> |
| US | 4.3 | 2.2 | 3.5 | 3.4 |
| USSR | 6.6 | 6.9 | 4.1 | 5.9 |

Soviet GNP grew at an average annual rate of nearly 7 percent in the 1950's, an annual rate about twice that of US GNP. The slowdown in Soviet industrial and agricultural growth has brought the Soviet rate down close to the US rate in the last few years; in fact, in 1962 and 1963 the increase in US GNP was substantially greater than in Soviet GNP, mainly because of the disastrous Soviet experience in agriculture. In spite of mild cyclical ups and downs in US business activity, the average rate of growth in the US averages -- and may continue to average -- a fairly stable 3.5 percent. In the next few years the over-all Soviet rate of growth will depend largely on (a) the success of efforts to regenerate the agricultural sector and (b) the degree to which military-space programs are held in check or, conversely, the degree to which especially scarce high-quality resources are devoted to investment. If Soviet industry continues on its new lower plateau of rates of growth and if agriculture manages to keep up with the increase in population, over-all growth of about 5 percent annually is likely. In any event, the gap between US and Soviet rates of growth has narrowed and will remain narrowed or even disappear over the next few years.

Soviet GNP in 1950 was roughly 34 percent of US GNP and in 1963 had grown to roughly 47 percent of US GNP. Because the difference in rates of growth has narrowed, little change in this proportion is expected over the next few years.

- * Base year 1950.
 ** Base year 1955.
 *** Base year 1959.

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II. Current Economic Weaknesses in Eastern Europe*A. General

Like the USSR the countries of Eastern Europe have set up an economic system operated primarily through commands from Party and state authorities and have followed economic policies stressing the rapid development of heavy industry. Consequently, these countries have encountered some of the same basic economic weaknesses as the USSR -- a high cost of industrial development; glaring inefficiency in collectivized agriculture; drabness and lack of variety in consumption; sluggishness in technology, except in a few areas; and a lack of flexibility in adapting policies and production to changes in the economic situation. In some respects these weaknesses have been felt more severely in Eastern Europe than in the USSR. Soviet-type policies and institutions often have proved poorly suited to smaller countries, which have very different histories, cultures, and economic structures and are much more dependent on foreign trade. In recent years the more industrialized countries of Eastern Europe, especially Czechoslovakia and East Germany, have experienced severe economic difficulties and have found the established policies and system to be inadequate for solution of these difficulties.

B. Over-All Economic Growth

By concentrating on investment rather than on consumption, the countries of Eastern Europe have achieved high rates of economic growth. However, these rates, if they are calculated in a comparable manner, are no higher than in continental Western Europe. In recent years, moreover, economic growth has slowed considerably in the more industrialized countries, as is seen in the following tabulation of official data** for national income:

| | <u>Percentage Increase Above the Previous Year</u> | | | |
|----------------|--|-------------|-------------|-------------|
| | <u>1960</u> | <u>1961</u> | <u>1962</u> | <u>1963</u> |
| East Germany | 4.5 | 3.9 | 1.2 | 3.0 |
| Czechoslovakia | 8.2 | 6.8 | 1.5 | Negl. |
| Poland | 4.5 | 8.1 | 1.5 | 4.7 |
| Hungary | 10.1 | 5.8 | 5.0 | N.A. |

* In this report, "Eastern Europe" or "countries of Eastern Europe" includes Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Rumania.

** Official data for the countries of Eastern Europe generally are employed in this section of the report, but, as in the case of other Communist countries, these data either grossly or subtly exaggerate economic achievements.

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The decline is due to stagnation or reduction in agricultural production and a drop in the rate of industrial production. It has been accompanied by a lack of growth in consumption and by slower growth or even a reduction in the level of investment.

As a result of its slower growth, Eastern Europe has lost ground to continental Western Europe in each of the past 4 years, 1960-63.

C. Agriculture1. Stagnation in Production

Agriculture is the weakest part of the Eastern European economies. Agricultural production has stagnated since 1959 or 1960 in almost all of Eastern Europe. Production of key crops, such as grains and potatoes, has tended to decline in several countries, with unfavorable effects on the raising of livestock. The stagnation of agricultural production is apparent even from official statistics, as shown below, and even these unfavorable statistics probably are biased upward:

| | Annual Percentage Changes | | | | | | | |
|----------------|-------------------------------|------|------|------|------------------|------|------|------|
| | Gross Agricultural Production | | | | Grain Production | | | |
| | 1959 | 1960 | 1961 | 1962 | 1959 | 1960 | 1961 | 1962 |
| Bulgaria | 18 | 3 | -3 | 4 | 23 | -1 | -10 | 4 |
| Czechoslovakia | -1 | 5 | 0 | -8 | 15 | 3 | 1 | 0 |
| East Germany | 3 | 6 | -1 | 1 | -5 | 6 | -26 | 21 |
| Hungary | 6 | -5 | 1 | 1 | 29 | -6 | -11 | 10 |
| Poland | -1 | 5 | 10 | -8 | 4 | 1 | 8 | -13 |
| Rumania | 21 | 2 | 8 | -9 | 46 | -8 | 8 | -9 |

Official statistics on net production (total agricultural production less the cost of such things as feed, seed, fertilizer, insecticides, spare parts, and fuel) show an even more unfavorable picture. In Czechoslovakia, net production in 1962 was 17 percent below the level of 1961, as shown below:

| | Annual Percentage Changes in Net Agricultural Production | | | |
|----------------|---|------|------|------|
| | 1959 | 1960 | 1961 | 1962 |
| East Germany | 1 | 2 | -1 | -5 |
| Czechoslovakia | -12 | 4 | -2 | -17 |
| Hungary | 4 | -11 | -4 | 2 |
| Poland | -4 | 4 | 13 | -17 |
| Rumania | 34 | 0 | 4 | -6 |

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Moreover, it is not true as commonly believed that investment in agriculture has been negligible. On the contrary, these poor results in recent years have been achieved in spite of fairly high investments in agriculture. As is shown below, the Eastern European countries have used much larger shares of their total capital investments for agriculture than the selected countries of Western Europe, if countries at similar stages of economic development are compared:

Percentage Share of Agriculture in Total Capital Investment, 1958-61

| | | | |
|--------------|----|----------------|----|
| West Germany | 6 | East Germany | 12 |
| France | 7 | Czechoslovakia | 17 |
| Austria | 13 | Hungary | 17 |
| Italy | 12 | Poland | 12 |
| Greece | 13 | Rumania | 20 |
| | | Bulgaria | 31 |

2. Inefficiencies in Management

Maladministration in general and collectivization in particular have been the main causes of the poor performance in agriculture. Collectivization was pushed in the late 1950's in Czechoslovakia, East Germany, Hungary, and Rumania and had been practically completed by 1961. Its effects were to reduce the care given to cultivation of crops and the raising of livestock, to reduce the amount of family labor available, to cause a poor distribution of labor on collective farms (with too little time being spent on the collective and too much on the small private plots), and to raise the need for mechanized equipment and livestock shelters without correspondingly raising production possibilities. These adverse effects of collectivization in turn are the result of the strong preference of most peasants for private ownership, of premature formation of large farms, and of a system of payment for collective work that discourages initiative and care.

Inefficiency has been caused not only by collectivization but also by the direct interference of ignorant Party officials in agricultural matters. For example, Party officials in East Germany have forced collective farms to sow an uneconomically large acreage to corn because promoting the cultivation of corn was current Party policy.

Poland, the only country where agriculture remains predominantly private, also has had difficulties in agriculture -- production dropped sharply in 1962 following an excellent year in 1961 and did not increase much in 1963. On the whole, however,

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agricultural performance has been better in Poland than in the countries that have collectivized. In particular the investment requirements have been proportionately smaller.

3. Results of Agricultural Failures

The weakness of agriculture has resulted in a stagnation or decline in supplies of quality foods, such as meat and dairy products; in increased imports of grains; in decreased exports of foods; and in some countries in a shift in investments to agriculture at the expense of pressing needs elsewhere. The resulting increase in the strain on the balance of foreign payments, especially with the West, has been severe in some countries of Eastern Europe notably, Czechoslovakia, East Germany, and Poland, and has led to cuts in imports of goods supporting industrial growth. In 1962-63, East Germany, for example, reduced its imports from West Germany of industrial machinery in order to increase imports of food, although West German machinery plays a key part in East German investment plans.

D. Industry

1. Decline in Rates of Growth

The countries of Eastern Europe have been able to achieve rates of industrial growth comparable to those in countries of Western Europe such as West Germany, France, Italy, Austria, and Greece that also suffered heavy damage during World War II as a result of defeat or occupation. This growth in Eastern Europe, however, has been more costly than in Western Europe. It has been achieved with larger increases in the number of workers and by devoting larger shares of the national income to industrial investments. Since around 1960, moreover, growth has slowed considerably, as is shown in the following tabulation of official data:

| | Annual Percentage Increases in Gross Industrial Production | | | | |
|----------------|---|-------------|-------------|-------------|--------------------------------------|
| | <u>1959</u> | <u>1960</u> | <u>1961</u> | <u>1962</u> | <u>1963</u> (Officially Expected) |
| Bulgaria | 20 | 13 | 12 | 11 | 10 |
| Czechoslovakia | 11 | 12 | 9 | 6 | Negl. |
| East Germany | 11 | 8 | 6 | 6 | 4 |
| Hungary | 9 | 12 | 10 | 8 | 7 |
| Poland | 9 | 11 | 10 | 8 | 5 |
| Rumania | 11 | 17 | 16 | 15 | 13 |

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To a large extent the causes of the decline are fundamental. The more industrialized countries, and especially Czechoslovakia and East Germany, have run out of easy ways of increasing production -- such as shifting labor from agriculture to industry, increasing rapidly the employment of women, and putting spare productive capacity to work. Consequently, maintenance of high rates of growth now depends to a greater extent on increased investment and on technological innovations. However, the rapidly growing needs for investments in other sectors, especially agriculture and the growing replacement needs within industry, limit the possibilities for increasing new industrial investments. The Eastern European regimes have placed great hopes on development of new technology, but they have had difficulty obtaining and mastering this technology. For example, Czechoslovakia produced and installed several generators of 100-megawatt capacity for electric power stations but had to rebuild several of these partly and, after many months, still because of technical flaws, is unable to use them efficiently.

2. Obsolescence and Inefficiency of Equipment

In spite of very large investments in industry, the industrial plant of Eastern Europe is not particularly modern. This condition is partly the result of having installed Soviet equipment that was below world standards and frequently also below the best Soviet standards. In the industrialized countries a large part of the equipment in basic industries such as steel and power is of post-war vintage because investments were concentrated in these industries. Equipment in a large part of the machine building industry and in practically all of light industries, such as textiles and leather processing, however, is obsolete and frequently also is in a poor state of repair. Well above one-third of the machine tools in use in East Germany, for example, date from before World War II, and more than two-thirds of the machines used in the Polish wool textiles industry were built before 1900.

Although the plant in basic industries is relatively modern in most countries of Eastern Europe, some of these industries, as well as many industries producing finished goods, nevertheless are highly inefficient. In many instances -- for example, in the case of steel in Hungary -- it probably would have been cheaper to import materials than to produce them, but domestic production was pushed partly as a matter of prestige and partly because the USSR could not supply the imports and because the countries in Eastern Europe could not pay for such imports from the West. High costs also were caused by dependence on Soviet ores, which had to be transported long distances, and by poor planning of the location and organization of new plants, such as the large Hungarian iron and steel combine at Dunaujvaros. Finally, it has taken many years for some of the new

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plants to produce at their scheduled efficiency because of delays in delivery of and flaws in domestic and foreign equipment and because of shortages of skilled engineers, managers, and workers. Another cause of high costs was the construction of plants for the specific purpose of supplying the USSR without an adequate economic basis. Uranium mining in East Germany is a well-known illustration of an activity serving Soviet needs but highly unprofitable to East Germany. The East German shipbuilding industry, which sells almost exclusively to the Soviet Union, also is unprofitable.

3. Unsatisfactory Quality of Goods

The dominant role of the USSR in the foreign trade of Eastern Europe not only has held back the growth of technology and the development of an efficient pattern of investment but also has led to production of manufactured goods of a type and quality that are difficult to sell on Western markets. Even the most advanced countries, such as East Germany and Czechoslovakia, have great difficulty selling significant amounts of machinery to Western Europe. The quality and variety of consumer goods available for exports reflects the lack of attention to consumer industries and the lack of knowledge of Western markets. The noncompetitiveness of Eastern European exports of manufactures in the West has become an especially serious problem for East Germany and Czechoslovakia and an important problem for Hungary and Poland because of their increased needs for imports of agricultural products, key industrial materials, and specialized machinery.

A general weakness in Eastern Europe is the inability of industry to produce the assortment of goods most suited to the needs of consumers. Because the system of economic management and incentives is designed to achieve maximum increases in the sheer quantity of production, customers often have had to accept products of inferior quality or of inappropriate characteristics. Recently, however, requirements have become more complex as a result of technical advance, and consumers can afford to be more demanding as a result of improvement in the over-all balance between supply and demand in the market. Consequently, as in the USSR, large inventories of goods that could not be sold have accumulated. The regimes have been concerned increasingly with this waste of chronically scarce resources and have exhorted managers and workers to improve design, assortment, and quality of consumer goods.

E. Transportation

Transportation is one of the least advanced branches of economic activity in Eastern Europe. In order to be able to concentrate investments in industry, the Eastern European regimes have tried

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to minimize investments in transportation by using existing facilities to the utmost. This policy was successful for a number of years. In 1961-63, however, the strain on the transportation system, especially on the railroads, became severe. In Czechoslovakia in particular the railroads were unable to carry the goods available, and, consequently, transportation became a bottleneck. For example, in August 1963, two large steel plants in the Ostrava area of Czechoslovakia (the Trinec Iron Works and the Klement Gottwald Works in Vitkovice) could not meet planned production goals, because of shortages of raw materials caused by a shortage of freight cars. Most of the other countries also experienced serious shortages of freight cars and other transportation facilities during the unusually cold winter of 1962-63. These problems have dramatized the lack of flexibility in the transportation system and the progressive deterioration in the condition of equipment as a result of inadequate maintenance. In intra-urban transportation the conditions are even worse.

F. Construction

Construction in the countries of Eastern Europe has suffered from low labor productivity, backward technology, and frequent shortages of materials. These problems have been caused partly by the fact that the demands placed on the construction industry have been too great and partly by poor administration of the industry. As a result of these weaknesses and of unrealistic planning of investments, construction time of projects and construction costs have almost always been much greater than planned. In turn, lags in construction schedules have led to an increasing backlog of unfinished buildings and structures. In East Germany, for example, these lags have greatly delayed the completion of large new industrial plants, including the oil refineries at Schwedt and Luetzkendorf, the second major chemical works at Leuna, and the synthetic fiber plant at Guben. In the past 2 or 3 years, the backlog has grown considerably in several countries, and the regimes have greatly curtailed the number of new starts in the hope of reducing it.

G. Living Conditions

Personal consumption has increased much more slowly than national income in Eastern Europe. In East Germany and the western part of Czechoslovakia, the standard of living, which before World War II ranked with the highest in Europe, has increased very little from the prewar level and is now far behind that of the advanced countries of Western Europe. Improvements have been greater in the less developed countries of Eastern Europe, but they have been unevenly distributed. Established urban workers, as well as the prewar middle class, often have suffered a decline in their standard of living. Ex-farmers who found jobs in the cities are better off

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materially but face a severe shortage of housing and many difficulties of adjustment. Farmers also are better fed and clothed but have to cope with frequent interference in their affairs by Party and government officials. In the past 2 years, there has been practically no increase in personal consumption in most of the countries of Eastern Europe. Moreover, a series of annoyances and frustrations (described below) attributable to the Communist way of doing things has meant that the consumer now gets less satisfaction out of the same income compared with the pre-Communist period.

1. Inadequacies in the Supply of Consumer Goods

The people of Eastern Europe generally have enough food to eat and enough clothes to keep warm, but the quality and variety of the consumer goods available are poor, and a general drabness is evident. Supplies of such goods as good-quality clothes, imported foods (like coffee and citrus fruit), consumer durables, and, in some countries, basic items such as meat and dairy products are limited. The drabness of life also is due, however, to the lack of attention to consumer satisfaction in production and trade. Producers generally do not care about style, color, or variety, because they get their bonuses for the quantities produced. Retailers have little or no authority to influence assortment or prices. The large accumulation of inventories of cheap textiles in Poland during recent years is a direct result of poor quality and assortment combined with inflexible prices. Moreover, inefficiency in distribution is frequently responsible for gluts of perishable products like cherries in some rural areas and their complete absence in large cities.

2. Inadequacies in the Supply of Housing and Other Consumer Services

Supplies of services are even worse than supplies of goods. Housing is very cheap but also very hard to get. For most of the postwar period, construction of new housing in the cities has not kept pace with the growth of the urban population, causing overcrowding and exacerbating social frictions. Political favoritism, for example, is sometimes an important factor in the allocation of housing.

Very often the housing repair services taken for granted in Western Europe -- plumbing, roofing, glazing, carpentry, and the like -- are completely lacking or are available only after long delay. The suppression of private handicraft and service trades during the early 1950's in nearly all the countries of Eastern Europe left a large void in the supply of these and other consumer services. It is very difficult to have goods repaired, all the more so because the factories often cannot supply the needed spare parts.

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3. Other Deficiencies in Living Conditions

In addition to having little choice of goods to buy, the Eastern European housewife also may have to spend hours queuing up in front of stores. Shortages of quality foods, especially meat and dairy products, have been common in recent years. In Czechoslovakia and East Germany they have been constant since 1961.

Another negative factor in the Eastern European standard of living is the necessity for several members of most families to find salaried work and of the principal wage earner to do odd jobs to supplement his wage to make ends meet.

H. Economic Planning and Management

Many of the problems that have developed in the various parts of the economy have their roots in the system of economic planning and management. Modeled after that of the USSR, this system in the countries of Eastern Europe has shown itself to be too inflexible to cope successfully with the rapidly changing problems of a modern economy. As long as it was possible to tap unused national resources, sizable progress could be made. But now that progress can continue to be rapid in countries such as East Germany and Czechoslovakia only through increased efficiency, the shortcomings of the system have become apparent. Serious mistakes have been made in economic planning because of inadequate economic knowledge and criteria or a doctrinaire approach. Because the system does not stimulate imagination leading to the correction of such mistakes, erroneous policies continue to be pushed with great damage to the economy. Another weakness is in the implementation of economic plans and policies. The formal lines of economic management tend to be bureaucratic and conservative, and attempts to energize the system through Party cadres with little technical competence often do more harm than good. Perhaps the most serious weakness is in the system of incentives for producers, which is built around fulfillment of plan indexes rather than designed to satisfy the needs of customers and of society. In such matters as the determination of the precise technology most appropriate for a product, and the final assortment of items to be produced, the planners and administrators have little knowledge, and the producers have an inadequate basis for decision. It is in making fine distinctions that the system usually is most inefficient, but the ability to make such distinctions is becoming increasingly important as the demands on the economies gradually become more complex.

I. Intra-Bloc Economic Cooperation

Intra-Bloc relations under Stalin consisted of rather crude exploitation of Eastern Europe by the USSR, although little reliable data are available as to its exact magnitude. It may be assumed

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that this crude exploitation is a matter of the past, but memories of that period still rankle and bedevil intra-Bloc relations. Moreover, the weakness of Soviet-type policies and institutions has been even more apparent in intra-Bloc economic relations than in the domestic problems of the individual countries of Eastern Europe. There has been very little systematic progress toward the economic integration of the Soviet Bloc beyond the increased interdependence that was the inevitable result of the division of Europe into two camps and systems. Trade continues as the most prominent intra-Bloc tie. Bloc leaders admit that there has been very little conscious specialization of production and that the coordination of economic plans through the Council for Mutual Economic Assistance (CEMA) still occurs after national plans have been formulated and entails few changes in these plans. In most instances, CEMA merely ratifies the specialization of production that already exists. Moreover, capital movements within the Bloc are small, and movements of labor across national boundaries are practically inexistent. Recent Soviet attempts to move toward supranational planning were unsuccessful because of nationalist sentiment in Eastern Europe, and, in spite of some progress in technical cooperation and in formation of a freight car pool and a CEMA bank, intra-Bloc cooperation still takes the form mainly of bilateral agreements.

The poor performance of CEMA in promoting cooperation among its members, by comparison with the Common Market and even with Western Europe as a whole, is due partly to the greater differences in the level of economic development, partly to stronger economic nationalism, and partly to some inherent characteristics of the Bloc economic system. In contrast to the countries of Western Europe, the countries of Eastern Europe vary greatly in level of economic development, from highly industrialized East Germany and Czechoslovakia to still partly underdeveloped Bulgaria and Rumania. Consequently, the national interests of these countries are different, the most advanced being interested in specialization as a means of increasing efficiency in existing industries, and the least advanced being more concerned with building new industries. Because of nationalistic interests, they still keep labor and capital at home, and foreign trade still seems to be viewed as a necessary evil. The defects of the Bloc economic system, especially its lack of flexibility, are compounded in foreign trade. In the absence of a central economic authority for the Bloc, the lack of flexibility of the system greatly impedes multilateral clearing, and there is no reliable way to enforce implementation of agreements and contracts.

J. Conclusions

The countries of Eastern Europe, like the USSR, have seen themselves in an economic "race" with the advanced Western countries. Over the long run they have not achieved a faster growth of production

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than the countries of continental Western Europe. The increase in production has been more costly than in Western Europe, and, consequently, consumption has increased less. The unmeasurable elements in consumer welfare have been even less favorable to the countries of Eastern Europe than the measurable elements, even if no account is taken of the lack of political freedom. The Soviet Bloc has shown less ability than Western Europe to move toward economic integration. In recent years the rate of economic growth has declined substantially in the more developed countries of Eastern Europe; economic problems have multiplied; and the regimes, at least temporarily, appear to have given up the "race." The inadequacy of the Soviet-type economic system to cope with modern economic problems has been an important cause of the poor performance of the developed countries of Eastern Europe in recent years.

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III. Current Economic Weaknesses in Communist China

A. Background

The fundamental fact faced by economic policymakers in Communist China is the existence of a huge and growing population in combination with a relatively small amount of arable land, a low level of technology, and a small amount of capital plant. After seizing power in October 1949 the Communist leaders began a determined drive to industrialize China by putting an increasing share of the nation's income into investment and by importing modern industrial plants and technicians from the Soviet Union and Eastern Europe. The First Five Year Plan (1953-57) followed the Soviet model of development and resulted in a growth of industrial output that averaged 15 percent annually. Because the regime brought peace and order to war-torn China, agricultural output kept up with the growth in population through 1957, although the margin between production of food and the minimum needs of the population remained perilously thin. Most important of all, China had made a moderate but hopeful start toward sustained economic development.

In 1958 the regime became impatient with the tempo of its industrial program and launched the "leap forward," a Chinese-style economic program designed to take advantage of China's huge underemployed rural population. Mao Tse-tung said that China was to "walk on two legs": at the same time that the modern industrial program was to be speeded up, the peasants were to be mobilized into huge supercollectives -- the so-called "communes" -- and the economy was to be carried forward by sheer weight of numbers. The leadership, however, permitted its economic policies to become divorced from reality. Overnight, untrained cadres were placed in charge of construction of a huge number of irrigation and flood control projects, and political fanatics rather than competent technicians took over the planning and administration of industry. Abnormal numbers of machines broke down, many irrigation projects were ineffective, products of little economic use piled up in warehouses, and people became exhausted and apathetic from overwork. By mid-1960 a pullback from the "leap forward" was overdue. What might have been an organized retreat turned into a rout, however, when the USSR unexpectedly withdrew its technicians from China and the regime encountered the worst agricultural crisis in its history.

The failure of the "leap forward" is now abundantly clear, and Peiping's hopes of achieving world power status in this decade have vanished. The economy is still painfully underdeveloped, and much of the capital plant built up at great cost is standing idle or has deteriorated because of abuse and poor maintenance. The regime boasts about economic self-sufficiency when it should be seeking gains from international division of labor. Since 1959, output of grain in China has

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been no higher than it was in 1957 before the "leap forward," although the population has increased from 1957 to 1963 by 75 million. Industrial production is now about half the level that it achieved in the peak period of 1959-60. After 4 years of hardship not only do the Chinese people remain more poorly clothed and fed than they were during the 1950's, but there is no prospect for significant improvement within the next year or two. The margin that had been built up by 1957 between total production and minimum consumption needs has disappeared because of the "leap forward" and the withdrawal of Soviet support. And the inexorable growth of population means that the margin is getting harder and harder to reestablish.

B. Difficulties in Agriculture

1. Deficits in the Food Supply

Agricultural output in Communist China in 1957 was sufficient to provide adequate food for the farm population and the urban labor force and to permit the regime to export small amounts of grain* and other agricultural products in order to help finance imports of machinery. Although an exceptionally good harvest was obtained in 1958 (about 200 million tons of grain), output of grain fell sharply in 1959 (to about 165 million tons) and dropped again in 1960 (to about 160 million tons). During these years, output of cotton also declined, and production of subsidiary foods such as vegetables and fruit was considerably below normal. The grain harvest improved slightly in 1961 and increased to about 180 million tons in 1962. Output of grain in 1963 was no higher than in 1962 and may have been slightly less, although supplies of vegetables and fruit were moderately greater. Production of cotton and other industrial crops since 1960 has been below the levels achieved in 1957.

The Chinese consumer today is eating slightly more grain and considerably more vegetables than he was in the worst year of food shortage, 1961, but his total caloric intake remains substantially below the level to which he was accustomed during the First Five Year Plan (1953-57). After the poor harvests of 1959 and 1960, Communist China's grain deficits were 22 million and 30 million tons on the basis of the per capita level of 1957, and during those 2 bad years China probably used all of its grain reserves that had been accumulated in 1958 and earlier. Although output of grain increased in 1961 and 1962, the intervening growth in population kept per capita output of grain well below the level of 1957. The poor harvest of 1963 will result in a grain deficit of nearly 20 million tons compared with the level of per capita production in 1957.

2. Causes of Agricultural Failures

The major causes of agricultural failures in Communist China during the past few years have been adverse weather and the mismanagement

* Including tubers on a grain equivalent basis.

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and relative neglect of agriculture. Peiping has claimed that unfavorable weather, including prolonged droughts in some areas and floods and excess moisture in other areas, was responsible for the sharp drop in the grain harvest during 1959 and 1960. Although weather conditions improved slightly in 1961 and again in 1962, the year 1963 proved on balance to be unfavorable.

Many of the agricultural difficulties of the last few years in Communist China have resulted from the policies of the "leap forward" and the communes -- such as the disruptive effects of commune organization, the vacillating policy with respect to private plots and private livestock holdings, and agricultural innovations that often ignored practical experience and that could not be assimilated quickly under varying local conditions. Examples of the latter are (a) plowing the land to a depth of 2 feet, (b) indiscriminately dredging mud and refuse from old ponds for use as fertilizer, and (c) planting seeds abnormally close together without providing sufficient water and fertilizer. Finally, the fundamental long-term economic policy of giving priority to industry necessarily has resulted in relative neglect of agriculture.

3. Difficulty of Righting Agricultural Sector

The most important agricultural task, and perhaps the greatest economic need, of Communist China is to modernize agriculture. China's arable land, only 11 percent of the total area, is worked relentlessly, but cultivation methods are primitive, and most of the farm work is done by human labor. The leadership in Peiping now believes that increases in agricultural output large enough to raise consumption levels, build up stocks, and restore exports cannot be expected for some time to come. The economic spokesmen for the regime acknowledge that agricultural growth will require increased capital investment in the form of technical improvements, expanded water conservation and irrigation projects, selected mechanization, and greatly increased use of chemical fertilizer. Some technical advances, such as improvement of soil and seed, may be relatively inexpensive but will require complicated organization and years of development. Construction of chemical fertilizer plants, both from domestic resources and from imports, will be expensive and time-consuming. Contrary to the apparent hopes of the regime in 1959-60, it now seems clear that more than a bumper harvest or two will be required to get the surplus from agriculture that will again permit Peiping to push ahead in industry. It is more probable that only at the end of a decade of high priority to agriculture and prudent administrative policy could the agricultural sector be in a relatively favorable position to contribute to resumption of sustained industrial growth.

The best hope for short-run improvements in agriculture is the return of average weather -- a factor beyond the regime's control --

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and a moderate approach to institutional arrangements in agriculture. Communist China's attitude toward private farming is summed up in its concept of "small freedoms within the large collective," which is essentially a flexible strategy subject to tactical change as the need arises. During the "leap forward," private farming was abandoned altogether. In the recent years of food shortage, however, the regime encouraged private plots and free markets in order to provide incentives to farmers to increase the supplies of vegetables, fruit, meat, and eggs. If the outlook for agriculture in a given year improves substantially, the "small freedoms" almost certainly will be circumscribed. The ideologues in Peiping are compelled in both propaganda and practice to uphold the collective farm and to denigrate the private farm, but in doing so they rob the peasant of the incentives that will encourage him to give his best to the land. The morale of both peasants and cadres in many areas of China has been shaken badly in recent years by the failure of the communes, by the inability of the regime to develop a successful model for collective farming, and by the off-again-on-again attitude toward private farming.

Although Communist China was a net exporter of grain until 1960, the agricultural reverses of the past few years have made it necessary for Peiping to import about 5 million tons of grain annually during 1961-63, mostly from Canada and Australia. Contracts have been signed for continued imports of grain in 1964, and it seems likely that substantial imports will be required for the next several years. China has spent about \$350 million annually in scarce foreign exchange to finance imports of grain; as a result, Peiping has had to postpone orders for badly needed machinery, industrial equipment, and raw materials.

4. Pressure of Population

Official propaganda from Peiping has admitted recently for the first time that the economic welfare of the state is threatened by unrestrained growth of population. The total population of Communist China at the end of 1963 was about 720 million, and the rate of growth is now about 2 percent annually. Although new methods of birth control -- including abortion and sterilization -- are now being discussed, China's shortage of qualified medical specialists and adequate medical facilities precludes the widespread use of these techniques. The contraceptive methods advocated by the government and the campaign for late marriages have found some acceptance in urban areas, but the rural population has shown little interest in such methods. The regime is experimenting on a small scale with economic pressures aimed at reducing births, such as cutting out various benefits for children beyond the third child.

The peasants, comprising 80 percent of the population, remain the key element in any birth control campaign that seeks to reduce substantially the national rate of growth of the Chinese population.

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It is hard to imagine that institutions governing family life and relations between the sexes could be smashed so thoroughly as to permit effective birth control within a generation. However, the Communist leadership can be utterly ruthless, and a "leap forward" in compulsory sterilization is not wholly out of the question.

C. Difficulties in Industry

1. Severe Decline in Output

Total industrial production in Communist China today is little more than half the peak levels of production attained in late 1959 and early 1960 during the ill-fated "leap forward," when steel was made in many thousands of little backyard furnaces. Current output is only slightly higher than in 1957. Capacity, however, is much larger now in nearly all industries than in 1957, even though much of it is idle or in miserable operating condition. Industrial output dropped sharply in late 1960 as the result of the withdrawal of Soviet technical aid and the accumulated problems of mismanagement during the "leap forward." The decline in production continued into 1961, industry failed to achieve an upturn during 1962, and only a moderate recovery in industrial output occurred in 1963.

The slight improvements that were obtained in industrial production in Communist China in 1963 were overshadowed by the major difficulties that still confront Chinese industry. The most difficult problems in light industry are related to agricultural production; two-thirds of the output in this sector is dependent on agricultural raw materials, and no substantial increases can occur until agriculture recovers. For example, textile mills are operating well below capacity because the cotton harvest for several years has been below the level of 1957. Most of the heavy industries have the capability to increase output, but the need for many products of heavy industry such as cement and crude steel is relatively low because the regime's present economic priorities do not require large amounts of new construction and because insufficient finishing capacity exists in the steel industry.

The deterioration in Sino-Soviet economic relations has affected production in technologically advanced industries, has contributed to failures to meet goals in construction, and has been a prime factor in the delays and revisions in industrial planning for Communist China. The deterioration in Sino-Soviet economic relations was highlighted by the abrupt withdrawal, late in July and August 1960, of all the 1,390 Soviet technical experts who were in China assisting in the building and operation of large new industrial plants and working on other technical assignments. These modern industrial plants -- steel mills, machine building factories, aircraft plants, oil refineries -- represented the cutting edge of China's whole economic development program.

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About one-half of the scheduled Soviet aid projects had been completed by mid-1960, when the industrial technicians were pulled out, but many projects were in varying stages of construction. The suddenness of the Soviet withdrawal -- the Chinese claim the Soviet personnel simply dropped their tools and went back home with the blueprints -- caused a suspension of activity on a number of large-scale projects and brought production to a halt in some new plants still being operated under Soviet supervision. The Chinese leadership apparently has been unable to settle on remedies for this setback in construction activity, and decisions as to the scope and magnitude of industrial expansion in the future have been delayed for several years.

2. Dim Prospects for Resumption of Industrial Growth

Communist China does not have the capability to restore the rapid industrial growth rates of the First Five Year Plan (1953-57) -- an average annual rate of about 15 percent -- unless substantial outside help is received for both technology and capital equipment. China has mastered the basic technology of many basic industries, such as aluminum, steel, and electric power, but needs to import modern capital equipment in order to develop them rapidly. Other industries have substantial production capacity but continue to require technical assistance from abroad in order to keep up with advances in product designs and new devices. There are a few highly complex industries in China, such as shipbuilding and aircraft, that depend for their rapid development on both imported knowledge and equipment, including spare parts.

During the "leap forward" in Communist China, some raw material industries, such as coal and pig iron, developed at a phenomenal pace if quantity alone is counted, but these industries turned out products that were notoriously high in cost and low in quality. Many of the small and medium-size facilities that sprang up during 1958-60 have now been closed, and China is short of high-quality, low-cost industrial raw materials such as timber, coal, and iron ore. Large additional investment in extracting and cleaning facilities will be required to assure a steady and uniform supply of these essential industrial raw materials.

Current attempts by Peiping to expand output in those industries receiving priority are encountering technological problems of varying degrees. The chemical and petroleum industries, for example, are having difficulties in obtaining and operating complex equipment. Within a few years the Chinese may be capable of building small plants to produce chemical fertilizer, but in the meantime the most that they can hope for is completion of the plants already started, which will produce only a fraction of the fertilizer that China's farms could usefully absorb. Although production of crude oil and most petroleum products probably will meet minimum Chinese needs for the next few years, modern refinery equipment will be required soon and probably will have to be imported.

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In the basic industries lower on the priority list, where some expansion may be required within a few years, technological problems also present a barrier to rapid growth. The metallurgical industries will have trouble in obtaining the precision rolling and finishing facilities that they require unless large quantities of equipment are obtained through imports. The electrical equipment industry will not be able to produce the large generating units that will be needed by the electric power industry if output greatly expands.

The major problem in the research and development field as it applies to industry concerns the acquisition of both personnel and equipment. At present the prospects for undertaking a research program that will cover the wide range of Chinese industrial problems are poor. Although the laboratories at higher levels, such as the Academy of Sciences, are well equipped, laboratories at lower levels are short of quality equipment. Communist China is still faced with the perennial problem of a shortage of skilled personnel such as engineers, scientists, technicians, and managers. In addition, the education system up to a short time ago was still suffering a hangover from "leap forward" education methods, through which engineers and physicists were created in a semester.

The decline in industrial production and the slowdown in technological developments in Communist China have had adverse effects on the technically advanced parts of the Chinese military establishment. A large part of weapons systems and the industrial plants to produce weapons that were imported from the USSR before 1960 are deteriorated and obsolete. Communist China probably does not now have the technological capabilities to design and produce new weapons. Chinese spokesmen have finally admitted that the effort to produce atomic weapons may not bear fruit for at least several years. In 1963 these spokesmen bitterly denounced the perfidy of the Soviet leadership that had started to help the Chinese in nuclear research in 1957 but that had abruptly ended its support in this field in 1959.

The chastening experiences of Communist China in industrial development underscore a major weakness -- namely, the scarcity of technical resources in relation to China's military and economic ambitions. This weakness could have been largely overcome with time if Soviet aid had continued, but the sudden withdrawal of Soviet support not only killed projects scheduled for the future but also undid the benefits from many of the projects already completed. For instance, there were dams with no generating equipment, weapons factories with no spare parts or trouble-shooters, and output with no market.

D. Foreign Trade Difficulties

The economic and political difficulties of Communist China of the past few years have had a profound effect on its foreign economic

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relations. The reduction in agricultural products available for export, the deterioration in Sino-Soviet relations, and the policy of retrenchment in industry have combined to lower the total volume of trade and to alter sharply its direction and composition. Total imports and exports in 1962 amounted to only \$2.5 billion compared with \$4.2 billion in 1959. The regime is now concentrating on imports of foodstuffs and raw materials that account for about 80 percent of total imports. Imports of machinery and other needed investment goods have plummeted from one-half of total imports in 1959 to less than one-sixth in 1962. Trade with the USSR and the countries of Eastern Europe represented about 45 percent of total trade in 1962 compared with nearly 70 percent in 1959.

Communist China's reserves of gold and foreign exchange are at a minimum necessary to conduct normal trade and other economic relations abroad. A large part of the convertible foreign currency that China currently earns through exports must be used to pay for the imports of grain. The prospects for increasing exports during the next few years are not bright. The products that China can sell abroad most easily -- foodstuffs -- will likely be least available for export, whereas those hardest to sell -- textiles and minerals -- will be relatively more plentiful. Exports of manufactured consumer goods other than textiles could be expanded if the Chinese would develop quality and varieties in these products and would engage in intensive sales efforts. Large increases in Chinese exports, however, must await a revival and expansion of agriculture.

E. Difficulties in Planning

In the more comradely days of the early 1950's, Mao espoused the policy of "lean to one side," which committed Peiping to follow the Soviet model of industrialization and provided China with Soviet machines and technicians. This policy, which proved successful during the First Five Year Plan (1953-57), became a casualty of the bitter Sino-Soviet dispute. Peiping has fallen back on a theme of economic construction by self-reliance -- a program that implies a very slow and painful recovery in industry and agriculture.

Communist China's Third Five Year Plan, scheduled to begin in 1963, apparently did not get off the ground. No goals have been announced for an annual plan since 1960, much less for a new 5-year plan. The economic indecision that has prevailed in Peiping during the past few years has compounded the economic difficulties that arose from poor weather, isolation from the USSR, and the aftermath of the "leap forward." Only general guidelines for the economy have been announced from Peiping, and these imply that the major claimants on scarce developmental resources in China today are (1) the advanced weapons program and probably armaments in general, (2) agriculture and industries supporting agriculture, (3) consumer goods industries, and (4) foreign

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trade requirements (particularly the continued expenditure of foreign exchange for imports of grain).

If Communist China is to regain its economic momentum over the long run without substantial help from abroad, Peiping must solve its food-population problem before a sustained drive in industry is feasible. Premier Chou En-lai stated in November 1963 that agriculture will remain the basis of the Chinese economy throughout the period of "building socialism." If this priority for agriculture is maintained, the rate of economic growth in China for the next 5 or 10 years probably will be well below that of the First Five Year Plan (1953-57), when GNP increased at an average annual rate of about 6 percent.

Should the Chinese leaders become impatient with a postponement of rapid industrialization, however, they might divert foreign exchange earnings and domestic resources from agriculture to industry. If a marked switch to industry should occur within the next year or two and if agriculture should fail to receive the physical resources that it requires, agricultural output would continue to stagnate. If, in addition, Peiping should harden its position on private plots and incentives to the peasants, it would be only a matter of time -- perhaps 2 or 3 years at most -- before a food shortage more serious than the recent one would develop. A decision by the regime to accelerate industrialization would probably entail the acceptance of considerable starvation and an increased resort to police controls to maintain political stability.

During the First Five Year Plan (1953-57) the Chinese Communists built up the rudiments of a good central statistical system along Soviet lines. This system was badly damaged during the "leap forward," when "politics led economics", and a lack of good statistical data currently hampers economic planning. It is true, however, that some of the ground lost during the "leap forward" has been regained, and the absence of published statistical data may be more the result of embarrassment at the low figures rather than the lack of figures.

F. Consumer Welfare and Morale

Two major weaknesses in the area of welfare and morale should be noted here. First, the thinness of the margin between production and consumption of food for the country as a whole means that a small setback in production, in imports, or in distribution of foodstuffs can rapidly push the situation across the danger line as in 1960-61. Second, the morale of the population gets lower and lower as the food stringencies persist because tolerance of the stringencies depends on hope that the situation will improve; thus the leadership can no longer count on the esprit that united the nation in support of economic development in the First Five Year Plan (1953-57) and that made possible the

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burst of energy in the insanely feverish "leap forward" era (1958-60). From the point of view of the Chinese Communist leaders, these morale aspects constitute a weakness because they limit the range of options open to the leadership. For instance, if morale were given heavy weight, a sustained program to increase agricultural production at the same time that the little concessions to the peasant were continued would have much better prospect of success than a program that called for an immediate resumption of industrial growth under the banner of autarky and anti-imperialism.

Because of the vacillations in Chinese Communist economic policy and because of widespread shocks in the economy -- for example, the withdrawal of Soviet aid -- a phenomenon allegedly confined to capitalistic countries has appeared -- unemployment! No official government data are announced, of course, on unemployment, but refugees in Hong Kong report large-scale dismissals from factories and report also the measures, such as relocation, taken by the authorities to deal with this capitalistic problem. Persons sent back from the cities to rural areas are hardly welcome, because feeding them means a dilution of an already inadequate food supply.

Young people no longer can go to higher-level schools in the vast numbers publicized by the regime under previous plans. Their aspirations for technical and managerial jobs cannot be fulfilled. They no longer are carried along by the momentum of a rapidly growing national economy that is "catching up" to Japan or Britain. Their loss of enthusiasm for the new order is a problem to the regime because of the question not only of "political purity" but also of productive efficiency.

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IV. Current Economic Weaknesses in North Korea and North Vietnam

A. North Korea

The North Korean economy is in the midst of a reorientation of its national economic development plan that supposedly will shift major emphasis from expansion in heavy industry to production of consumer goods and support of agriculture. This change in priorities diminishes the possibility that the regime will fulfill the over-all goals of its ambitious Seven Year Plan (1961-67). Industrial growth slackened in 1963 because of poor planning and economic organization in industry and perhaps because of a decline of imports of machinery and equipment from the Soviet Bloc. The regime has attempted to increase output of consumer goods (such as clothing, footwear, sewing machines, and bicycles), but the impact of these increased supplies on the prevailing low levels of living of North Korea's 11.6 million people will be negligible.

Imports of machinery and equipment from the Soviet Bloc have been essential to the industrial buildup of North Korea, but the regime is now trying to reduce this dependence. (North Korea is siding with Communist China in the Sino-Soviet dispute.) North Korean trade delegations have visited many countries since June 1963, from Holland and Egypt to Indonesia and Cambodia, in an attempt to find new sources of raw materials and industrial goods traditionally imported from the Soviet Bloc. Few trade contracts have been concluded. In any case, the poor quality of goods that North Korea can offer for export will not be able to compete favorably in world markets. The regime probably will have difficulty in replacing the USSR as a source of machinery and technology.

Industrial development in North Korea has been retarded by poor performance in coal and steel, which achieved only about 85 percent of their planned levels in 1962 and probably did no better in 1963. In spite of increased investment in the mining industry in 1963, amounting to 21 percent above the previous year, it is unlikely that output of coal in 1963 reached the goal of 15 million tons that was originally set for 1962. Important construction projects such as the P'yongyang Thermal Powerplant and the rolling mill of the Nampo Smeltery continue to lag far behind schedule. A lack of standardized plans, blueprints, and construction materials has retarded progress on many construction sites.

Although the North Koreans claim that their grain harvest has increased from 3.8 million tons in 1960 to 5 million tons in 1962, the grain ration has remained unchanged at about 1.5 pounds daily for the average industrial worker, with smaller amounts given to farm workers, housewives, and children. Good growing weather and increased investment should have provided some stimulus to agriculture during 1963, but

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it is believed that poor administration and inefficient use of the labor force held output to only a small gain above 1962. Living conditions in the agricultural cooperatives are so primitive that most able-bodied young men have migrated to the cities, leaving the arduous work of agricultural production to the elderly and to the very young.

The North Korean regime has been in power for almost 16 years and has received massive economic and technical assistance from Communist China and the USSR, but the North Korean peasant and worker remain relatively poor. The average North Korean worker must work more than 9 hours to earn enough to pay for 1 meter of cotton cloth compared with less than 2 hours of worktime for a worker in South Korea. Similarly the average North Korean industrial worker must spend up to 950 hours on the job to earn a bicycle, considerably longer than a worker in South Korea. A police-state system of distribution reserves the best consumer goods for Communist Party members and government officials.

B. North Vietnam

Current economic problems in North Vietnam indicate that the regime will have great difficulty in fulfilling its First Five Year Plan (1961-65), the goals of which have already been reduced from the original plan. The key economic weakness is agriculture. The poor harvest of 1963 -- affected by drought, typhoon, insects, and disease, as well as by poor management, peasant apathy, and a lack of fertilizer -- has aggravated further an already tight food situation in North Vietnam. Four consecutive years of mediocre harvests have caused the regime to become seriously worried about its food-population balance, and recent official statements have referred to low food reserves and the possibility of insufficient food supplies in the event of a continuation of natural calamities.

Since March 1960, when a census revealed that the population of North Vietnam numbered nearly 16 million persons and was growing rapidly, the regime has been particularly concerned about its ability to feed the population. The regime launched a low-keyed birth control campaign in mid-1961, which was considerably stepped up in 1962 and was pushed unevenly during 1963. The population of North Vietnam, which numbered 17 million at the end of 1963, is growing at an annual rate of about 2 percent. North Vietnam does not have the medical facilities necessary for a successful birth control campaign in the short run, and the prospects of reducing the rate of growth of population substantially are not bright for several decades.

Although the effect of the Sino-Soviet dispute on the economic development of North Vietnam is still uncertain, some recent reports have indicated that Hanoi's support of Peiping has resulted in reduction in aid from the USSR. A curtailment of Soviet aid would result in a slower rate of economic growth and particularly in the rate of industrial

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growth. Communist China, hampered by its own economic difficulties, cannot replace all of the technical aid and equipment being supplied to North Vietnam by the USSR.

North Vietnam has a serious shortage of trained managerial and technical personnel, particularly for the construction and operation of modern industry and transportation. The influx of several thousand advisors and technicians, primarily from the USSR and Communist China, has been the major feature of the technical assistance programs to North Vietnam. The major new industrial plants are the iron and steel mill at Thai Nguyen, the superphosphate plant at Lam Thao, and the machine tool plant at Hanoi. In addition, the Communist countries have supplied technical data, advised in planning, and trained Vietnamese in their universities. In spite of increased efforts by Hanoi to close the gap between requirements and supply of skilled manpower, inadequate schools preclude the training of sufficient engineers, technicians, foremen, and other supervisory personnel required for North Vietnam's ambitious industrial plans, and Hanoi remains highly dependent on technical assistance from abroad. Furthermore, the support by North Vietnam of the large-scale Communist insurrection in South Vietnam is a drain on its slender economic resources and is maintained at the expense of the rank-and-file citizen.

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