Directorate of Intelligence

25X1

USSR Review

25X1

January-February 1985

LOGGED SYPA

Project number "037"

I W M J K

Page number 41

Total number of copies 880

Dissem date 850221

Extra Copies 554-613

Record Ctr 614-854

~~Secret~~

SOV UR 85-001X
February 1985

Copy 555

Page Denied

Intelligence [redacted] 25X1

USSR Review [redacted] 25X1

January-February 1985

The *USSR Review* is published by the Office of Soviet Analysis. Comments and queries regarding the articles are welcome. [redacted] 25X1

Secret
SOV UR 85-001X
February 1985

Declassified in Part - Sanitized Copy Approved for Release 2012/05/10 : CIA-RDP88T00799R000200020004-5

[redacted] 25X1

Contents

Page

The Lot of the Soviet Consumer

Perspective [redacted] 1 25X1

Consumption levels in the USSR made some impressive gains during the 1960s and most of the 1970s, but have risen only about 1 percent per year since 1980. The outlook for improvement in the standard of living for the rest of the 1980s is not bright because economic growth is likely to be slow and investment and defense will continue to take precedence. Nevertheless, Soviet leaders will probably try to increase consumer spending because of its perceived link to productivity and the potential for social unrest if living standards decline. [redacted] 25X1

Living Standards in the Soviet Union and the United States [redacted] 5 25X1

Since 1960 the USSR has inched toward its oft-proclaimed goal of matching the US standard of living, but real Soviet per capita consumption is still only about one-third the US level. Life for the average Soviet citizen is drab by Western (and even some East European) standards. Soviet consumers have seen some improvements—their diet now nearly matches the US diet in daily protein and calories, and many households have manual washing machines and small refrigerators. Housing is still very tight, however, and health care problems have contributed to rising death rates and lower life expectancies. The future may see some of these problems mitigated, but, with economic growth slowing, living standards probably will improve more slowly than they did in the 1960s. [redacted] 25X1

[redacted] 25X1

Efforts To Improve the Food Supply [redacted] 11 25X1

The Soviet leadership has used a variety of economic and political approaches to manage food shortages in recent years. These measures probably have checked the potentially serious threat to social stability that food shortages presented in the late 1970s and early 1980s. [redacted] 25X1

[redacted] 25X1

Secret

25X1

The Consumer and the Automobile—What Future? 15 25X1

Because the USSR is not producing enough automobiles to meet consumer demand, owners are keeping vehicles beyond their planned service lives. This may become more difficult, however, because Moscow has apparently decided not to reallocate resources to increase substantially the production of spare parts and has taken steps to tighten its control of gasoline consumption. The Soviets appear to be readying plants to increase automobile production later in this decade, but increments to production and consequently to the domestic supply will probably be small. 25X1

25X1

Personal Care and Repair Services—The Stepchild Sector 19 25X1

The Soviet leadership has voiced concern that the shortage of personal care and repair services is reducing worker productivity but has made only token efforts to solve the problem. The service sector continues in the doldrums, reflecting leadership stinginess in allocating resources to it and a lack of the incentives that would really produce services for individual consumers. 25X1

25X1

Impact of Resource Allocation Policies on the Consumer 23 25X1

If Soviet GNP growth during the rest of the 1980s is as slow as we expect, 1.5 to 2.5 percent per year, consumers will probably enjoy only moderate gains in the standard of living. Moreover, if the growth rate of investment or defense spending increases, per capita consumption could stagnate or even decline over the rest of the decade. 25X1

25X1

25X1

Other Topics

The Soviet-Cuban Relationship: Serving Mutual Interests 27 25X1

The Soviet-Cuban relationship remains strong because each country serves the other's interests. Cuba helps the Soviets advance their influence in the Third World and challenge the United States in the Caribbean Basin, while Cuba is dependent upon the Soviets for economic and military aid. But the relationship is not immune to strains, which occur when one side attempts to advance its foreign policy goals at the expense of the other. The two countries have just come through such a period of strained relations. The recent problems have been set aside for now, but their root causes have not disappeared. 25X1

25X1

Proposed Soviet Gas Pipeline to Eastern Europe 31 25X1

The USSR has proposed building a gas export pipeline to Eastern Europe during 1986-90 with the help of its allies. The pipeline reportedly would deliver 20-22 billion cubic meters of Soviet gas annually to Eastern Europe. Whether the East European economies could absorb this amount is not certain; the Soviets might use the pipeline as a readymade vehicle to export additional gas to Western Europe, should demand for this gas by the OECD countries materialize during the late 1980s and early 1990s. 25X1

25X1

The Changing Role of Soviet-Owned Banks in the West 35 25X1

The Soviets have maintained a small but important string of banks in the West since the Russian revolution. Less active international financial markets, the downturn in Bloc financial fortunes, and the generally cooler East-West climate have impinged on bank operations in recent years, forcing Moscow to assume a greater role in managing the day-to-day operations of these banks. 25X1

25X1

 25X1

The Lot of the Soviet Consumer

Perspective 25X1

Consumption levels in the USSR made some impressive gains during the 1960s and most of the 1970s, but have risen only slowly in the 1980s. Since 1980, per capita consumption has increased at an annual average rate of about 1 percent. Moreover, the outlook for improvements in the standard of living for the rest of the 1980s is not bright, for several reasons: the prospect that general economic growth will be slow, a desire in the leadership to increase spending on investment, and a continuing high priority for defense. 25X1

In terms of the most basic measure of consumer welfare—food and diet—the lot of the consumer is mixed. The Soviets have nearly matched the Americans in terms of daily caloric and protein levels. In recent years, however, Moscow's substantial efforts to improve the supply of quality foods have achieved only marginal increases in per capita consumption of meat, leaving much unsatisfied demand. An expansion of the special system that makes priority foods available to workers at their places of employment has further limited the quantity of these items available to pensioners and others without special access (see "Living Standards in the Soviet Union and United States" and "Efforts To Improve the Food Supply"). 25X1

Health and housing present more serious problems. Per capita health expenditures have grown by only 1 or 2 percent a year since the 1970s—too slowly to keep pace with a growing need for health care stemming from such increasing problems as alcoholism and hypertension. Partly as a result, the Soviet Union is the only major industrial nation in the world to have a lower life expectancy now than it had 20 years ago. Housing has similar problems: although the Soviets have built more than 2 million new units per year since 1975, an estimated 20 percent of the urban population still shares its living quarters with unrelated families or singles. Finding an apartment is a major challenge for newlyweds—personal want ads for apartments can frequently be found posted near collective markets and public parks. 25X1

The Soviet consumer is somewhat better provided with durable goods than in the past. Overall purchases of durables have doubled since 1960. Some two-thirds of all Soviet families now own refrigerators and washing machines, and three-fourths own TV sets; but the quality and design of these goods are vastly inferior to those in the United States. The automobile is still out of reach for seven out of eight families, and those who own a car face chronic shortages of spare parts and gasoline, inadequate repair services, and poor roads (see "The Consumer and the Automobile—What Future?"). [redacted] 25X1

In a similar vein, the consumer has made measurable progress in consumption of soft goods over the past two decades, but domestic production—especially in recent years—has not kept up with rising expectations. Soviet consumers have become much more discriminating and now refuse to purchase unwanted or poorly made domestic products. They are much more willing to pay premium prices for imported goods, and inventories of domestic goods have risen sharply as a result. [redacted] 25X1

Deficient repair and personal services are perhaps the sectors of the Soviet economy most difficult for the consumer. Although the Politburo has decreed longer service hours and higher quality repairs, it retains an incentive system that actually discourages managers from providing the most sought-after personal services. State-run service establishments find it easier to fulfill their planning goals by mass-producing goods and providing "bulk" services to large enterprises than by meeting the needs of individuals (see "Personal Care and Repair Services—the Stepchild Sector"). [redacted] 25X1

The lot of the Soviet consumer has been a sensitive issue for Soviet leaders since the economic slowdown of the late 1970s and early 1980s. After more than a decade of growth in food supplies and consumer goods, they have recently had to deal with growing gaps between demand and supply. A collision between the steady growth of expectations and the slowing growth in consumption has been at least partly responsible for declining worker morale and productivity since the late 1970s; it provoked strikes and food riots during the difficult winters and poor agricultural years of 1979-81. Civil unrest due to inadequate food supplies has greatly diminished since then, though at least one food riot reportedly occurred last summer. [redacted] 25X1

General Secretary Chernenko's response, like Andropov's, has been to reaffirm the farm policies begun under Brezhnev (notably the Food Program) and to try to dampen expectations by telling the consumer that increases in income must be linked to increases in productivity. He also has continued Andropov's discipline and anticorruption program. Indeed, this program appears to be receiving widespread support from a public that seems to hope it will eventually lead to greater availability of goods. [redacted] 25X1

Improvements in industrial growth in 1983 and 1984 have given the Soviet leaders some slack that they can use now to reduce the imbalance between demand and supply of consumer goods, but their ability to satisfy the consumer over the longer term will be severely limited by the likelihood that economic growth will continue to be slow. If GNP growth is in the range we are projecting for the late 1980s—1.5 to 2.5 percent per year—the leadership will have to make choices among its ambitious goals, or reduce them all somewhat. At these growth rates, the USSR cannot, simultaneously, increase consumption substantially to stimulate labor productivity, modernize the economy rapidly to incorporate more efficient plant and advanced technology, and increase defense spending significantly in response to US defense initiatives. There will have to be tradeoffs (see "Impact of Resource Allocation Policies on the Consumer"). 25X1

Soviet leaders will probably try, as they did in the 1960s and 1970s, to balance growth in investment and defense with at least some improvement in living standards. As Chernenko acknowledged in his November 1984 speech, they feel pressed to increase consumer spending because of its perceived link to productivity. The leaders are no doubt keenly aware that social unrest could occur if living standards actually declined. Their commitment to the consumer will limit their ability to maintain high rates of investment while accelerating the growth in defense spending. 25X1

25X1

Living Standards in the Soviet Union and the United States

25X1

The USSR has made only a little progress toward its oft-proclaimed goal of catching up with the United States in standard of living. Over the last two decades, real Soviet per capita consumption improved slightly, relative to that in the United States, but it is still only about one-third the US level.[1] Soviet living standards remain low by Western standards and also compare unfavorably with those in much of Eastern Europe. Nevertheless, from the viewpoint of the Soviet consumer, some improvements have occurred since the 1960s. The Soviet diet now nearly matches that in the United States in terms of daily protein and calories, and many households have manual washing machines and small refrigerators. There is still a severe shortage of housing, however, and there are problems in health care that have contributed to rising death rates and lower life expectancies. At best, future improvements in living standards may mitigate some of these problems, but slower economic growth will make progress harder to achieve, and it probably will occur at a slower rate than Soviet consumers experienced in the 1960s.

Trends in Per Capita Consumption

Soviet per capita consumption has been growing more and more slowly since the mid-1960s, and it decelerated markedly in the early 1980s.[2] The rate of growth stagnated or fell in all major categories of consumption, falling particularly sharply in consumer durables. In total retail sales, the estimated share of imports of final consumer goods nearly doubled during the 1970s, but this was not enough to offset the growing demand for goods and services. As average income increased, widespread gaps between the demand for consumer goods and their availability became more evident. The year 1982 was a particularly bad year—per capita expenditures on food, soft goods, and durables showed an actual decline from their 1981 levels. All major categories of per capita consumption rebounded somewhat in 1983, however.

25X1

Diet

Perhaps the brightest area in the comparative living standards picture has been that of food. The Soviets gained a little on the Americans in terms of per capita expenditures for food, rising from about 40 percent of the US level in 1960 to about 55 percent in 1983.

25X1

The quality of the Soviet food supply has also improved. The daily caloric level of the Soviet diet nearly matched that of the United States in 1981 (figure 1). Soviets still consumed more starches than Americans did, but the gap has narrowed somewhat, largely because more livestock products are now available. Nonetheless, the Soviets have met their recommended daily per capita caloric levels—more calories than the current US recommended allowances for adults.

25X1

25X1

Soviet per capita protein levels nearly match US levels. The share of protein in the Soviet food supply has increased from one-third to one-half since the mid-1960s—a marked improvement, though still low by US standards. (The share of protein from livestock products in the US food supply is 70 percent.)

25X1

The United States does much more food processing—canning, freezing, and drying, as well as specialized processing and packaging. The universal use of refrigeration and a flexible distribution system make fresh foods widely available throughout the year and give US consumers a wider choice than their Soviet counterparts. The Soviet food industry is heavily oriented toward processing food into more storable forms—canning vegetables and making sausage, cheese, and similar products. Freezing and packaging are at an embryonic stage in the Soviet Union; in 1976, for

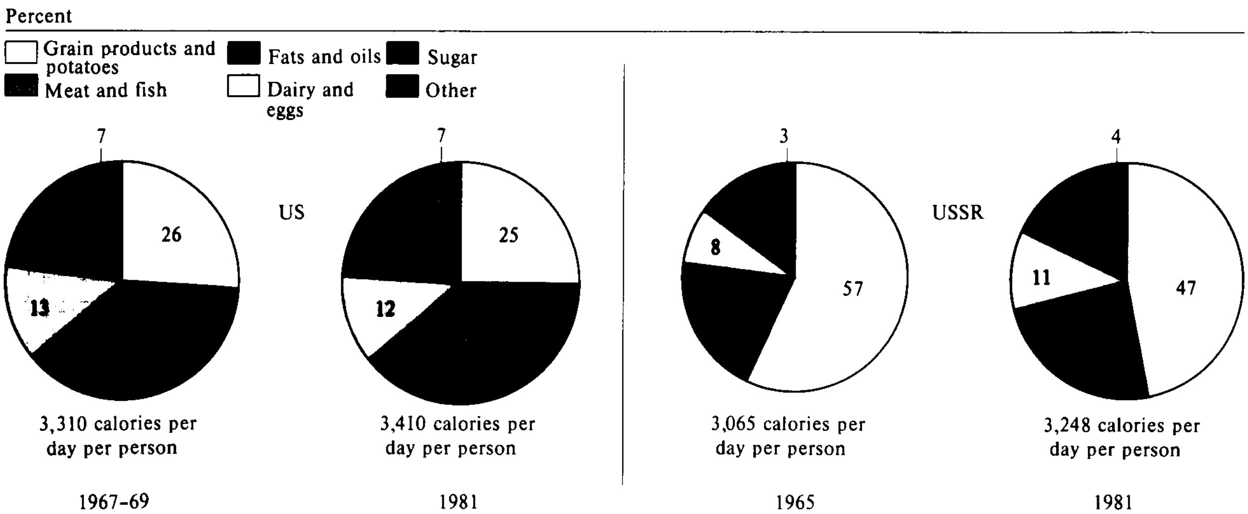
25X1

[1] Comparisons with the United States are made by pricing each country's goods and services in the other's currency, adjusted for inflation. An "average" is obtained by calculating the geometric mean of the comparisons in dollars and rubles.

[2] Growth in real per capita consumption is a good general measure of changes in a nation's standard of living because it shows the volume of goods and services acquired by households. It cannot indicate the lot of a particular citizen, however, because it cannot account for distribution disparities or regional differences that could affect changes in individual consumption levels.

25X1

Figure 1
US and Soviet Diets: Major Food Groups



Source: SOVA-USDA study and "Nutrient Content of the National Food Supply, 1981," *National Food Review, Winter, 1983.*

25X1

304387 (C00721) 12-84

example, only one-quarter of the food products marketed were packaged. Fresh fruits and vegetables (other than the storable potatoes, cabbages, carrots, beets, and onions) are scarce outside the short harvest season, July through October.

The Soviet consumer's most notable "advantage" is in alcoholic beverages. Although total Soviet per capita consumption of alcohol only exceeds that of the United States by an estimated 40 calories per day, consumption patterns differ in the two countries. Soviets drink mostly hard liquor, while Americans drink mostly beer and wine; hard liquor, mainly vodka, made up 70 percent of total consumption of alcoholic beverages in the USSR (hard liquor was 20 percent of the US total in the mid-1970s). More important, the Soviet figures do not include *samogon* (homemade hard liquor), which has been estimated to be 30 percent of alcohol consumed.

Consumer Durables

The gap between US and Soviet purchases of durable goods is still enormous, although it is closing. Overall Soviet per capita expenditures for consumer durables are less than 20 percent of the US level, but they have nearly doubled since 1960. Relative levels of expenditures on durables are generally corroborated by the data shown in table 1. 25X1

25X1

By the mid-1970s, two-thirds of all Soviet families had a refrigerator and washing machine (figure 2) and three-fourths had a TV set; in the United States, almost every family has a refrigerator and TV set and about three-fourths have washing machines. The quality and design are vastly different in the two countries, however. In the USSR, most washing machines are small hand-wringer models, refrigerators are small by Western standards and have no freezing compartment, and most TV sets are black and white models. In the United States, virtually all washing machines are fully automatic, refrigerators are large and most have freezers, and over two-thirds of the TV sets sold are color models. 25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/10 : CIA-RDP88T00799R000200020004-5

Table 1
Soviet and US Retail Sales of Major Consumer Durables, 1982

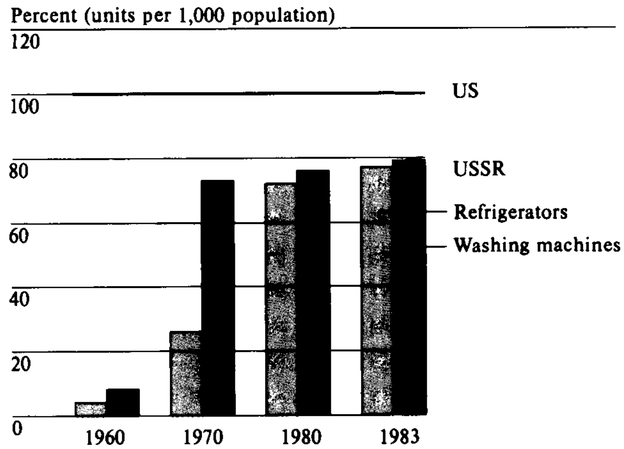
Million units

	USSR	US
Automobiles	1.4 [a]	8.0 [b]
Television	7.0	16.4 [c]
Radios	6.0	44.1 [c]
Refrigerators	4.6	4.4 [d]
Washing machines	3.7	6.4 [d]
Vacuum cleaners	2.9	7.6 [d]
Tape recorders	3.2	28.9 [d]

[a] New and used cars; about 80 percent were new.
[b] New cars only.
[c] Production.
[d] Manufacturer's shipments.

Note: In 1982 the Soviet population was 16 percent larger than the US population (270 million persons in the USSR compared with 232 million persons in the United States).

Figure 2
Appliances in Use in the USSR and the United States



Note: Soviet major appliances are frequently of poor quality by Western standards. For example, Soviet washing machines are usually small hand-wringer models, while virtually all US washing machines are fully automatic. Most Soviet refrigerators are small and have no freezing compartments; US refrigerators are large, and most have freezers. 25X1

25X1

25X1

304806 2-85

Health Care

Annual US growth rates of per capita health expenditures have consistently outstripped those in the Soviet Union since 1960. Soviet per capita expenditures, which were 60 percent of the US level in 1960, were only 35 percent in 1983. This change was a function of rapidly escalating US health costs and low Soviet growth rates, which were on the order of 1 or 2 percent a year during the 1970s.

Although the USSR has made significant improvements in its health care system, there now are signs of serious trouble because growth in expenditures has not kept up with the increasing demands for health care services—demands that stem in part from growing problems associated with alcoholism, hypertension, and aging of the population. The Soviet Union is the only major industrial nation in the world where life expectancy is lower now than it was 20 years ago. Moscow stopped publishing these statistics in the early 1970s, but Western estimates indicate that the average life expectancy for Soviet males fell from 66 years in 1960 to 62 years in 1980 (figure 3). This was 11.6 years less than the life expectancy for Soviet females—a gap unprecedented in developed countries.

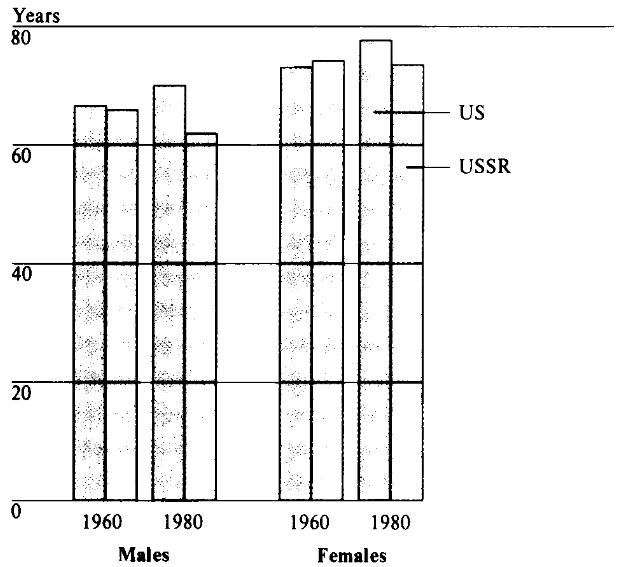
In contrast, life expectancy for both sexes in the United States has increased nearly every year since the end of the Second World War. US females in 1980 had on average a life expectancy of 7.6 more years than US males. 25X1

Soviet health care problems are also reflected in the death rates, which increased by about 50 percent from their low point of 6.9 per 1,000 people in 1964 to 10.3 per 1,000 in 1980. The increase was significant for every age group. In contrast, the US death rate declined from 9.4 per 1,000 in 1965 to 8.7 per 1,000 in 1981. Soviet infant mortality declined substantially between 1950 and 1970 but may now be on the rise. 25X1

25X1

As in the United States, the major cause of death in the Soviet Union is heart-related disease. It accounts for over half of all deaths in the Soviet Union. US rates are high, but they declined 15 percent during

Figure 3
Life Expectancy in the USSR and the United States



304807 2-85

1960-79; Soviet heart-disease-related deaths doubled over the same period and in 1979 were 50 percent higher than the US rate. Cancer was the second leading cause of death in both countries. Both saw an increase over the last two decades, but the US cancer death rate was one-third higher than the Soviet rate in the late 1970s.

The Soviets have made advances in combating infectious diseases, but still lag well behind the United States. The Soviet typhoid fever rate per 100,000 population in 1979 was about 30 times that in the United States, for example, and the measles rate was over 20 times as high. There is evidence that rickets, caused by a vitamin D nutritional deficiency, still exists among Soviet children, particularly in rural areas. The United States no longer keeps statistics on rickets because it is so rare.

Housing

The shortage of housing in the Soviet Union is severe. Although there has been some progress during the past 25 years, an estimated 20 percent of city dwellers still share their living space with unrelated families or singles.

Determining the magnitude of the shortage is difficult because the Soviets do not publish statistics on the number of households. The housing deficit has been estimated from a comparison of the number of housing units constructed with the number of marriages. In 1982, marriages outnumbered housing units built by 766,000 (on the other hand, deaths would have reduced this total demand for new units). The Soviets, seeking to control this demand, have limited the creation of new households by refusing to let singles get on lists for available housing. At the same time, however, the state keeps rents down through large subsidies, spurring demand by making rents easily affordable. 25X1

On the supply side, the primary reason Moscow has not built more houses is the low priority given to their construction in investment decisions. In addition, the rising cost of new construction—reflecting an increase in the average size of new dwellings, the provision of more utilities, and the increased costs of materials—has limited the number of units built. 25X1

Soviet per capita housing expenditures, which were under 20 percent of the US level in 1960, were only about 10 percent in the early 1980s; this is because US growth rates in per capita expenditures for housing (3 to 4 percent a year) exceeded Soviet rates (1 to 2 percent a year). Not surprisingly, Soviet consumers face a much more limited choice of housing. The government owns three-quarters of all urban housing (primarily apartments) and controls its construction and distribution. The wait for an apartment can take as long as 10 years, although the average is substantially less. Priority is often determined by a worker's position or the importance of his place of employment. In contrast to the United States, where the poorest housing is often concentrated in the core of urban areas, Soviet housing policy has scattered substandard housing throughout the cities, as well as in a band on their periphery. 25X1

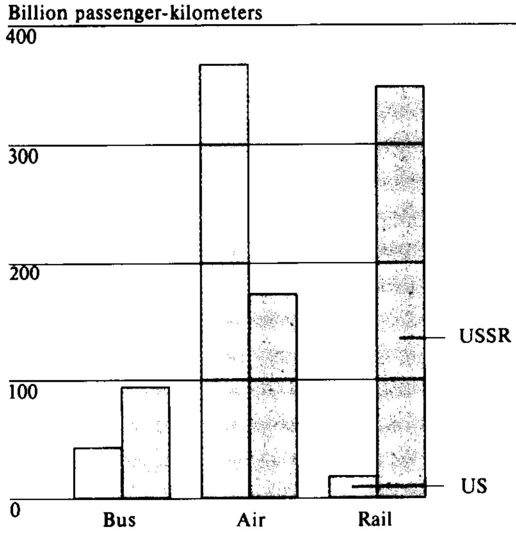
Living quarters are less spacious than in the West. In the 1920s the Soviets set a national standard of 9 square meters of "living space" per urban person; this is equivalent to 13.5 square meters of "general space"—about the size of a room 12 feet by 12 feet.

25X1 25X1 25X1 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/10 : CIA-RDP88T00799R000200020004-5

Figure 4
US and Soviet Passenger Travel Between Cities by Common Carriers, 1982

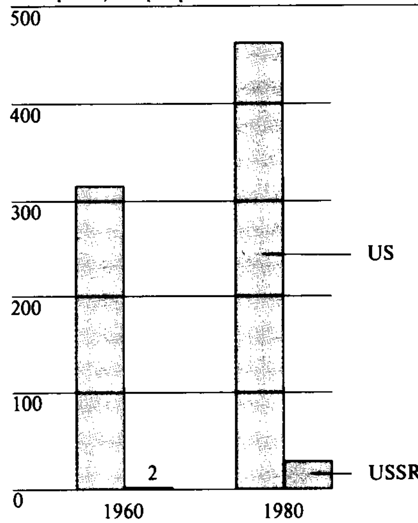
Billion passenger-kilometers



304808 2-85

Figure 5
US and Soviet Private Ownership of Automobiles

Cars per 1,000 people



304809 2-85

25X1

The Soviet Union as a whole has exceeded this by averaging 14 square meters of general space per capita in 1980, although in half of the Soviet republics the figures are still below the average. The 14 square meters represent progress, but are still well below the average US figure of 49 square meters of general space per capita.

Transportation
The typical Soviet citizen depends much more heavily on common carriers than his American counterpart—in part because of Moscow's greater emphasis on public transportation, but also because of the undeveloped nature of the Soviet auto industry, road system, and support services. In 1982, for example, the volume of *intercity* passenger traffic by common carriers was more than twice as large in the USSR as in the United States; 85 percent of all US intercity travel was by private automobile, even though the United States is trying to encourage greater use of common carriers. Soviet travelers used railroad transportation almost 20 times as often as US travelers did; air was the most used US form of common carrier intercity transportation (figure 4). The patterns are similar in *intracity* transportation: Soviet streetcars, trolleys, subways, and local buses carried more than six times as many passengers as US local systems. 25X1

The Soviet Union has entered the age of the automobile, but has a long way to go before driving approaches the ease and convenience enjoyed in the West. In terms of level of development, the Soviet inventory of cars in 1980 was roughly where the US inventory was in 1920. This represents considerable progress, however (figure 5). 25X1

25X1

Prospects for Improvements in Living Standards
Moscow has traditionally given the consumer lower priority than investment or defense. While this priority structure has enabled Soviet GNP to grow from 49 to 55 percent of US GNP since 1960 and Soviet levels of investment and defense to rise above US levels, it has held Soviet per capita consumption to only about 33 percent of that in the United States. In the future, rising expectations and a new generation of citizens not hardened by the sacrifices endured during the

Second World War and the postwar rebuilding years may increase pressure for continued growth in consumption. Soviet leaders have apparently recognized that some improvement in living standards is necessary to maintain worker productivity and satisfaction, as shown by their continued support for the food programs. Projected slower economic growth, however, will make continued progress more difficult. 25X1

25X1

Efforts To Improve the Food Supply

25X1

The Soviet leadership has used a variety of economic and political approaches to manage food shortages in recent years. Besides fostering steady—albeit slow—growth in food production and modifying food allocation and distribution systems, it has attempted to dampen popular expectations. These measures—coupled with the regime's demonstrated willingness to import large quantities of foodstuffs and its commitment to a long-term Food Program—probably have checked the potentially serious threat to social stability that food shortages presented in the late 1970s and early 1980s.

Problems With Food Supplies

Emphasis on increasing the availability of meat and other quality foods (dairy products, fruits, and vegetables) in the Soviet diet has been a major aspect of the leadership's approach to the problem of consumer welfare for three decades. Considerable progress was made in the 1960s and early 1970s, and the Soviet diet began to resemble more closely that of the United States and Western Europe. When various difficulties in agriculture blocked progress in the last half of the 1970s, consumer disappointment was keen. Although general nutritional levels in the USSR were adequate, the consumer wanted more livestock products and fruit, greater variety and higher quality products.

Consumer dissatisfaction with the food situation became more widespread during the late 1970s and early 1980s. In particular, as the gaps between the demand for and the supply of livestock products and some other highly sought-after foods appeared to widen during this period, there was a marked increase in labor strikes, demonstrations, and actual violence.

Food supplies became tighter for several reasons. The quantities of meat and milk products sold in state and cooperative stores remained essentially unchanged from 1979 to 1980, largely because of back-to-back poor harvests. Moreover, during the winter of 1979-80 and throughout 1980, procurements of meat and milk from state and collective farms were generally lower than those of the corresponding periods in the preceding year. This decline in procurements, although supplemented by large imports, led to more erratic deliveries of meat and milk products to many regions in the USSR. 25X1

In 1981 and 1982 the situation worsened. Per capita consumption of milk declined, and per capita meat consumption was slightly lower than in 1980. Queues 25X1 at retail stores became so widespread that informal rationing of meat and milk products was imposed in 1981. Formal rationing, involving coupons and other paper work, was instituted in some cities. During the 1979-82 period, the leadership was able to maintain some growth in per capita consumption of vegetables, fruit, and vegetable oil only by stepping up imports of these products. 25X1

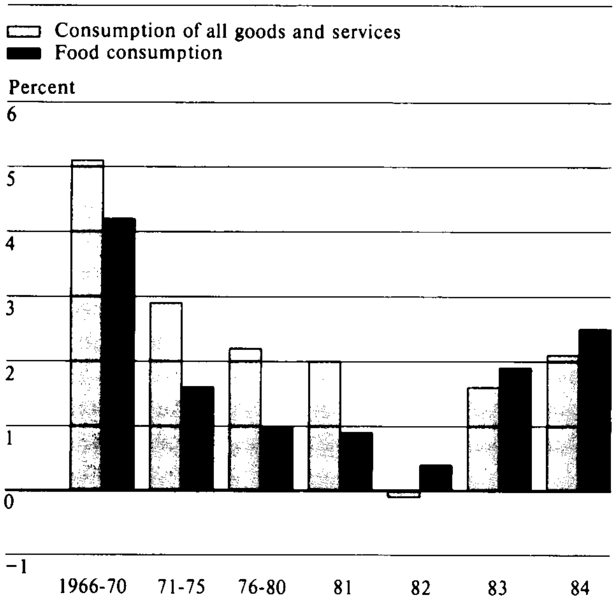
Impact on Consumption and Morale

Because food accounts for about half of the value of total consumption, the slowdown in the growth of the food supply seriously impeded the leadership's efforts to improve consumer welfare. After increasing by an average of about 3 percent per year during the first 25X1 half of the 1970s and slightly above 2 percent per year during 1976-80, per capita consumption of all goods grew about 2 percent in 1981 and actually declined slightly in 1982 (see graph). 25X1

The slowdown in consumption growth in turn eroded popular morale, leading to greater worker apathy and labor unrest. During the spring of 1981, for example, some large industrial installations went on strike, 25X1 partly because of food shortages. Coming a year after the Polish crisis, these strikes caused great concern on the part of top Soviet officials. They were also troublesome to regional party leaders, who already had to contend with social tensions generated by 25X1 ethnic and cultural factors, as well as general consumer dissatisfaction. 25X1

Secret

USSR: Average Annual Per Capita Growth in Total Consumption and Food Consumption[a]



[a] The index of consumption underlying these growth rates is constructed using 1970 expenditure weights and consumption indexes for 11 major categories of goods and services. Where possible, the indexes are based on physical quantities consumed. The food consumption index, for example, is largely based on Soviet per capita consumption data in kilograms. Where these figures are not available, physical production data and deflated retail sales are substitued.

304810 2-85

The Leadership's Response

In response to these problems, the leadership in recent years has reaffirmed farm policies initiated under Brezhnev to improve the technical underpinning of agriculture and promote a more effective use of inputs through better material incentives for farm managers and workers. It has also taken several new initiatives intended to improve distribution, increase supplies, and otherwise dampen the discontent caused by the food supply issue. These have included:

- Greater attention to the priority allocation of the most desired foods to workers in large industrial installations.
- A sharp upsurge in imports of farm products.
- A campaign to reduce expectations.
- Brezhnev's announcement in May 1982 of the decadelong Food Program to upgrade and integrate the activities involved in producing, processing, and marketing food. 25X1

Changes in Allocation and Distribution. Beginning in 1979, the deteriorating food supply situation was reflected in ever lengthening queues for various foodstuffs. As a result, the leadership in 1980 began making factory trade unions responsible for special food distribution at the workplace. Although special stores for a small elite have long been a feature of the Soviet system, the distribution of food at important factories or prestigious institutions was a phenomenon of the middle and late 1970s. The decision to enlist the trade unions in this effort was probably both an attempt to pacify workers unhappy with queuing and a device to raise the prestige of the unions. 25X1

Although the share of various foods that are being distributed through these channels is not known, the practice apparently had become so prevalent by the early 1980s that most workplaces were distributing special food packages to employees, at least on the major holidays. To the extent that these packages came from supplies targeted for state stores, however, it meant that those without access to special distribution centers—such as people on pensions or holding less important jobs—could not obtain as much food. 25X1

Increased Food Imports. The efforts to maintain the country's heavy investment in livestock herds and to mollify the consumer also have led to a sharp upsurge in imports of farm products. Although Moscow probably regards reliance on increased imports of food, along with grain and other feeds, as a temporary tactic, the continuing problems in the agricultural sector made such imports a necessity. The share of net imports in net farm product, on a per capita basis, grew from 1 percent in 1970 to 12 percent in 1981 and 1982. As a result, by the early 1980s nearly 40 percent of Soviet hard currency expenditures were going for agricultural imports. 25X1

25X1

Controlling Expectations. More recently, the Soviet leadership has started to address the problem of consumer expectations. In discussing food issues, the regime has begun to admit problems and has stopped promising quick solutions, stressed long-term improvements, and shifted some of the blame to poor worker performance. [redacted]

General Secretary Chernenko's speeches have reflected this effort to moderate consumer expectations. In his first speech after succeeding Andropov, he did not promise swift progress in consumer welfare but did say that "much is being done now" to increase the supply of quality foods. This more balanced treatment of consumer issues was also evident when he criticized the present wage and bonus system for lacking "proper fairness" but, on the other hand, repeated a statement by Brezhnev: "One should never forget one simple truth: in order to live better, it is necessary to work better." [redacted]

Adoption of the Food Program. In addition to the above measures, which the regime clearly recognizes do not address the USSR's fundamental agricultural problems, the leadership has adopted a long-term Food Program. The program was unveiled by Brezhnev at a party plenum in May 1982, and both Andropov and Chernenko subsequently embraced it. The most comprehensive attack on agriculture's problems since the Khrushchev era, it calls for shifts in investment resources to permit the building of rural infrastructure, increased production of agricultural machinery, and improvements in the processing and distribution network to reduce losses of farm products. It also calls for the establishment of agro-industrial coordinating bodies at the national and regional levels as a way of overcoming the fragmented management structure. [redacted]

Recent Performance

In 1983-84, food availability improved somewhat. Reflecting a strong rebound in agricultural output in 1983, meat and milk production climbed to new highs of 16.4 million tons and 96.4 million tons, respectively. Although growth rates of meat and milk output slowed in 1984, new records—16.7 million tons of meat and 97.6 million tons of milk—were achieved. [redacted] by the second half of 1983 the availability of food products had returned to the 1981 level; fruits and vegetables showed the largest gains. [redacted] 25X1

The degree to which these production gains have translated into gains for the consumer is unclear, however, because consumption depends on imports as well as on the amount of product channeled into inventories and end uses other than consumption. In recent years, for example, meat imports have accounted for 2 to 4 kilograms of per capita consumption. Nevertheless, assuming imports in 1984 were maintained at the 1983 levels and there were no additions to inventories, the amount of meat available to consumers per capita (after adjustment for losses between farm and consumer) would have increased slightly, by about 0.5 percent in 1984. We estimate that, overall, per capita consumption of food increased by about 2 percent in 1983 and by 2.5 percent in 1984. [redacted]

25X1

25X1

25X1

Apart from the gains in food production in 1983 and 1984, the leadership's attempts to improve distribution and dampen expectations also may have helped ease consumer unhappiness over food supplies. There has been a visible decrease in queuing at state stores during the past two years. In addition, with the exception of two reports of food-related unrest this summer, there has been an absence of reports of disturbances occasioned by food shortages during this period, suggesting that the population perceives the food situation to be less difficult. [redacted] 25X1

Outlook

The food supply issue is likely to remain a major leadership concern throughout this decade. Development of the farm sector will depend strongly on weather conditions and how the leadership implements the Food Program. Our baseline projection of average annual growth in net farm output of 2.0 to 2.5 percent in the 1980s assumes weather conditions approximating the 1960-83 average and some implementation of changes proposed in the Food Program. [redacted] 25X1

25X1

If Soviet production of various agricultural commodities rises at the average annual rates of the 1961-83 period and the pattern of food and nonfood use of

25X1
25X1

Kilograms

USSR: Per Capita Consumption in 1983 and 1990

	1983	1990 Goals [a]	1990 Projection	
			(Without Imports)	(With Imports) [b]
Meat (including slaughter fat)	58	70	63 to 64	66 to 67
Milk	309	330 to 340	338	NA
Eggs (units)	253	260 to 266	292	NA
Fish	17.6	19	18 [c]	NA
Sugar	44.2	45.5	31	47
Vegetable oil	9.6	13.2	7.0	10.0
Potatoes	110	110	110 [d]	NA
Vegetables and melons	101	126 to 135	110	112
Fruit and berries	44	66 to 70	51	56
Bread and cereal products	136	135	135 [d]	NA

[a] The total calorie intake that would result from a diet conforming to the indicated goals would be unrealistically high, because it would fail to reflect the substitution of quality foods for staples—bread and cereals, and potatoes—that would occur. The official 1990 per capita consumption goals appear to embody an effort to reassure the consumer that the supply of staple foods will be adequate.

[b] We assume for illustrative purposes that imports will be at 1982-83 levels.

[c] Based on 1990 gross fish catch targets. We could not assume continuation of the growth rates of the 1960-83 period because of unfavorable changes in ocean fishing conditions.

[d] Because significantly more grain and potatoes are now produced than required to meet 1990 targets for human consumption, we assume that the supply in 1990 would permit consumption at planned levels. We are unable to allocate the decreases in consumption of these products associated with increased consumption of quality foods. Thus the amounts shown represent an upper bound rather than a best estimate of 1990 consumption.

these commodities does not change, per capita consumption of quality foods will rise. Even without imports to supplement supplies available for consumption, more meat, dairy products, vegetables, and fruit should be available in 1990 (see the table). The projected availability will be considerably short of goals for vegetables and fruit, but still represents a marked improvement in the diet. The items which the USSR would be able to supply in planned amounts from domestic production include milk and eggs. The quality foods for which domestic production would need to be supplemented by imports to meet 1990 per capita consumption targets include meat, vegetables, fruit, sugar, vegetable oil, and fish (in small amounts). 25X1

Thus, the Soviet "food problem" is not likely to be greatly alleviated by 1990. But the experience of the past few years suggests that modest growth in production and continued imports of quality foods, leadership circumspection regarding promises in the consumption area, and a continuation of the system of distributing food at the workplace will probably prevent food shortages from becoming the volatile issue it threatened to become in the late 1970s and early 1980s. 25X1

25X1

25X1

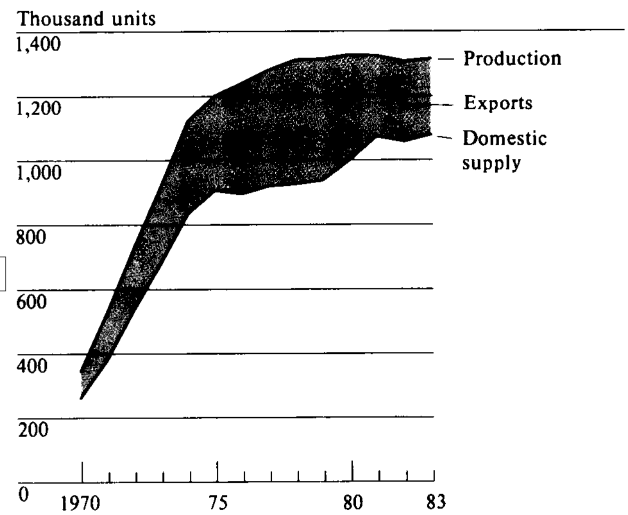
The Consumer and the Automobile—What Future?

25X1

Despite an estimated sevenfold increase in the personal auto stock since 1970, consumer demand for cars in the Soviet Union, even at the relatively high prices, continues to far exceed supply. The aggravations of auto ownership caused by inadequate development of fuel supply, maintenance, and repair have not stopped consumers from buying the available supply and keeping cars past their planned service lives. In the future, however, consumers may find it even more difficult to maintain and use their automobiles. Moscow is taking actions to limit the gasoline supply and has decided not to reduce the widening gap between the supply of and the demand for spare parts.

25X1

USSR: Trends in Production, Export, and Domestic Supply of Passenger Cars



25X1

304811 2-85

25X1

Consumers Enter the Auto Age

The Soviet consumer entered the automotive age in the early 1970s with a bang. Annual car production in the USSR increased almost 250 percent, from 344,000 to 1.2 million vehicles, between 1970 and 1975 (see graph). Although exports also rose rapidly and the stock of vehicles for official use was largely replaced, supplies to the public were increased dramatically. The chance of buying a car—formerly reserved for various elites—was brought within the grasp of a much larger share of the population.

Long queues developed for new automobiles, even though the costs were high. Soviet citizens waited four years or longer to spend the equivalent of 40 months' salary on a bottom-of-the-line Zhiguli.[1] Moreover, consumers were forced to pay for cars on a cash-and-carry basis rather than on installment credit. Moscow probably hoped that cash purchases would help to draw down consumer savings. Workers with an exceptional performance record and those who had accepted work on priority projects in undesirable locations were rewarded with a higher priority on waiting lists. The length of these lists created a ready demand for used official cars. New car sales plus resales of official cars nearly tripled the stock of private automobiles between 1970 and 1975, from 1.3 million to 3.4 million units.

25X1

The rapid growth in the stock of personal cars taxed the government's ability to provide the necessary support. Owners were confronted with gas lines, traffic jams, shortages of spare parts, and poor highway systems. The number of auto service stations was inadequate and the service sometimes incompetent. To solve at least some of these problems, Soviet consumers turned to burgeoning black markets, particularly in spare parts and gasoline. The planners

[1] The car models produced by the Fiat-designed Volga Motor Vehicle Plant are marketed domestically as Zhigulis and externally as Ladas. Responsible for most of the increase in production since 1970, Zhigulis are more widely available and more popular than their major competitors, the lower quality Zaporozhets and comparably priced Moskviches. The Volga and Chaika cars produced in Gor'kiy and the ZIL limousines in Moscow either are priced only for the elite or are not available to the public.

25X1

tried to attack other problems. For example, programs were begun to expand and improve the road system and construct larger and improved service facilities, but in general the measures were too little and too late. [redacted]

Production Levels Off but Consumer Stock Grows

Growth in car output in the USSR ended as abruptly as it began when Moscow abandoned plans to expand production capacity during 1976-80. Production increased by only 10 percent during this period and reached a plateau of just over 1.3 million cars per year in 1978. Output has hovered within 2 percent of this mark ever since. [redacted]

Soviet consumers were nevertheless allowed to buy increasing numbers of cars each year—although the rate of increase was slower than in the past. Holdings of personal cars increased to 8 million in 1980 and by 1983 reportedly reached 10 million. [redacted]

Growth in the domestic supply in the 1980s was made possible by a cutback in exports, although Moscow carefully avoided losses in hard currency earnings. The Soviet Union exported 238,000 cars in 1983, 28 percent less than in 1980. Exports to Communist countries—mostly East European neighbors—were slashed by 60 percent, however, while deliveries to the developed West rose by more than 40 percent during the period. [redacted]

Pressure on Support Services Builds

Car ownership, now at about one car for every eight families, still has not reached the level of the Soviets' East European neighbors in the early 1970s or that of the West in the 1950s. Consumers continue to line up for the new models they prefer and hold onto them longer than Moscow planned. We estimate that at least 65 percent of the cars on the road in 1975 were still in service in 1983. As with other consumer durables, however, quality counts. The Soviets recently have reduced prices of lower quality Zaporozhets by 25 percent, reportedly to clear backlogs of cars gathering dust in showrooms [redacted]

The aggravations of car ownership have not lessened over the years. Consumers now compete for service at a rate of 580 cars per service bay, up from 400 per bay in 1970. Although new service stations undoubtedly are more productive than those in 1970, anecdotal material in the Soviet press suggests that consumer demands are far from being satisfied. Consumers complain constantly about shortages of spare parts and, according to Soviet officials, contribute to the problem by hoarding parts. [redacted]

The Soviet consumer's insistence on keeping his long-awaited and expensive automobile past the planned service life of nine to 10 years is aggravating his problems with spare parts and auto servicing. Because retirements are low, the car inventory is growing in excess of plan, causing the inventory of service stations and production of spare parts to fall even further behind demand. If, as planners fear, consumers continue to keep older cars, these problems will become more acute over the next five years when the 4.6 million cars added to the auto inventory in the late 1970s reach the end of their planned service lives. [redacted]

Soviet statistics confirm that the gap between the supply of and the demand for spare parts is widening. Production of spare parts increased by an average of 8.5 percent per year between 1976 and 1981, but the inventory of personal cars grew by an average of 18.6 percent during the same period. Plans called for the supply of spare parts to increase by about 5.5 percent per year in 1982-85, but the car inventory probably will rise by 8 percent annually. [redacted]

An emerging problem is the reduced availability of gasoline. The leveling off of oil production—combined with delays in introducing diesel trucks, lagging expansion of secondary oil-refining capacity, and growing demand from the high-priority agricultural sector—has increased the need to control gasoline supplies. Consumers, who are using their cars more for suburban and long-distance trips than for commuting, are racking up greater mileage and consuming more gasoline than Moscow probably expected. We estimate Soviet auto consumption of gasoline at more than 300,000 barrels per day—about 20 percent of the available supply [redacted]

Moscow has long tried to restrict gasoline consumption by private autos through the use of coupon rationing, but with little success. By 1981 Soviet consumers were pirating nearly 100,000 barrels per day of official gasoline through black-market sales from truckers, according to one Soviet estimate. Over the last few years, Moscow has increased the price of gasoline to restrict fuel demand, with some success. [redacted] gasoline prices have increased fourfold in recent years, which has in turn dampened demand for autos. Nevertheless, higher pump prices intended to restrict auto use may instead encourage further illegal sales of gasoline. [redacted]

Policies To Control Personal Autos

Moscow has shown increasing concern over the growth of the fleet of privately owned automobiles but seems to be avoiding a direct confrontation with consumers. Steps such as production cutbacks or further price hikes still appear to be off limits. Nevertheless, planners' policies toward spare parts supply and gasoline allocation could be as effective in controlling both the growth and the use of the private auto fleet. [redacted]

Recent Soviet journal articles suggest that Moscow will not reallocate resources to increase substantially the production of spare parts. Furthermore, one report indicates that production of specialized spare parts for older cars no longer will be supported. Consumers will have to rely more heavily on recycled used parts, and this could make it more difficult to keep older models in running condition. Unless the Kremlin also controls the pilfering of spare parts from distributors and limits consumer hoarding of spare parts, however, the new policies will merely encourage further activity in the black market. [redacted]

More important, the Soviets intend to restrict the use of all vehicles through policies to further control gasoline consumption. They have moved beyond price increases and have instituted policies to regulate fuel consumption by truckers which—if effective—will also bring fuel consumption by private autos under greater control. Trucks now are being checked for faulty odometers, which drivers tamper with to overstate mileage in order to resell state-supplied gasoline to consumers. Moscow is also establishing a credit card system that will allow allocation of fuel for specific trucking assignments and record use in a central data bank. This procedure is intended to remedy the sloppy or nonexistent bookkeeping at enterprises that also has promoted fuel abuse in the past. Although the Soviet consumer has become expert at circumventing Moscow's consumer restrictions, the new policies, combined with high prices for gasoline, will make it more difficult and less attractive for consumers to tap official gasoline supplies. [redacted]

Plant Modernization Continues

Despite Moscow's concerns over the maintenance of an aging personal auto fleet, it appears to be preparing to increase car production again later in the 1980s—perhaps as early as 1987—although a return to rapid growth rates of the past is not foreseen.[2] It is not clear, however, that the Soviet consumer is the intended beneficiary. [redacted]

The Soviets continue to acquire Western motor vehicle equipment to modernize plants and expand output. We expect them to buy motor vehicle production equipment, technology, and technical support worth at least $500 million from the West in 1981-85. Some $400 million already appears to have been allocated for upgrading and expanding the auto industry. [redacted] the USSR plans to modernize the Moscow Motor Vehicle Plant and install a flexible manufacturing system there, to rebuild the Gor'kiy plant beginning in 1985, and to install a fourth assembly line to manufacture a new front-wheel-drive car at the Volga plant. A turnkey plant in Moscow, to be supplied by Liebherr of West Germany, will make transmissions for the new car. The Soviets also are increasing their capacity to produce galvanized steel at the Novolipetsk Steel Plant. [redacted]

Although this program could be intended to increase the consumer's auto supply, it offers other options.

[2] Because the Soviets lack an appropriate system for providing adequate maintenance services, they may believe that boosting new car production is more efficient than trying to provide more repair services and spare parts to maintain older cars. [redacted]

First, the productivity gains from plant modernization could allow the Soviets to produce the same number of cars—and improve their quality—using less skilled labor and material resources. As a bonus, Moscow would gain experience with Western technologies such as industrial robots and numerically controlled machine tools, which it regards as a prime means of improving productivity in industry as a whole. Second, the modernization program may allow Moscow to increase production for export at a lower resource cost and without reducing sales to consumers [redacted] 25X1

Outlook

Consumers are unlikely to gain much ground in auto use over the next several years. They probably will continue receiving close to 1 million new cars per year, but the chances of increasing sales look dim. The probable increased production later in the decade may improve the domestic supply, but the additions will probably be small. Growth of the personal car inventory itself will be sharply reduced—despite record sales—if Moscow's plans to discourage the maintenance of older vehicles, and thereby spur retirements, are effective. Even if owners of older cars resist, they may not be better off. With Moscow holding the line on spare parts production, black-market prices will increase and add to the owners' overall costs. Finally, car owners may find it difficult to use their cars at past rates if Moscow's policies to limit black-market gasoline sales are effective. [redacted] 25X1

[redacted] 25X1

Personal Care and Repair Services— The Stepchild Sector

25X1

Soviet authorities have become increasingly dissatisfied in recent years with the state of personal care and repair services.[1] They are particularly concerned about rural areas, where per capita consumption of services—despite some narrowing of the gap—still lags far behind that in urban areas.

The leadership recognizes that the lack of services lowers the general quality of life, which presumably lowers popular morale and, thus, productivity in general. More specifically, workers must spend considerable time and energy generating for themselves the services that the state (as well as private individuals operating on a commercial basis [2]) fails to furnish. Because they must do this during working hours, productivity suffers. Furthermore, the acute shortage of services in rural areas spurs the flow of workers to the cities, despite official efforts to stem or reverse that flow.

Growth in Consumption of Services

The services sector has grown more rapidly than overall personal consumption (of housing, food, clothing, and so on, as well as of services). Per capita availability of personal and repair services almost doubled between 1970 and 1983 (table 1), while total per capita consumption grew by about one-third.

[1] The services we look into in this article are included in the Soviet category "everyday services of the population"—hereafter, "everyday services." In the US national income accounts, most of these services are classified as "personal services," "automotive repair services and garages," and "miscellaneous repair services." The Soviet category everyday services goes beyond personal care and repairs, however. It includes some private housing construction and repairs that we omit—partly for the sake of manageability and partly because housing construction is not a service. In addition, about 40 percent of the total Soviet everyday services category is made up of the production of goods—which we have likewise excluded. For example, almost three-quarters of total sales of state shoemaking and repair establishments are accounted for by sales of new shoes they produce. Repair services comprise only a little over a quarter of their sales.

[2] Private individuals may legally provide several personal care and repair services. As is true of all activity in the so-called second economy, estimates of the value of privately provided services are necessarily imprecise. But recent comments by a Soviet author, coupled with previous estimates by the CIA, suggest that the private sector currently provides about a fifth of all personal care and repair services

Table 1
Growth in Real Per Capita Consumption

Average annual growth in percent

25X1

	1971-75	1976-80	1981	1982	1983
Personal care and repair service					
Total (includes private sector) [a]	6.0	5.3	4.2	2.4	4.3
State sector only	6.9	5.8	4.6	2.5	4.7
Total personal consumption [b]	2.9	2.1	2.0	−0.1	1.6

[a] The private sector currently provides about a fifth of the total.
[b] Total personal consumption includes food, soft goods, durable and miscellaneous goods, and the following services: personal care and repair, housing, utilities, communications, transportation, and recreation.

Note: Figures are computed for the most part according to the methodology in "An Index of Consumption in the USSR" in *USSR: Measures of Economic Growth and Development, 1950-80: Studies Prepared for the Use of the Joint Economic Committee, Congress of the United States, December 8, 1982.* Adjustments to official figures made in the data presented above include removal of services sold to enterprises.

25X1

25X1

Growth in per capita consumption of these services has been faster in rural than in urban areas. The ratio—on a per capita basis—of state-provided services in the countryside to such services in cities rose from about a third in 1970 to about two-thirds in 1982.

25X1

The relatively speedy growth in the consumption of personal and repair services should not obscure the fact, however, that they remain a Cinderella sector. Personal care and repair services—including those provided by the private sector—constitute only about 2.5 percent of total personal consumption in the USSR. In the United States, the proportion is about 7 percent.

25X1

25X1

25X1

Table 2
Services Provided by the State

Average annual growth in real consumption of selected state services, in percent

	1971-75	1976-80	1981	1982	1983
Repair of:					
Shoes	0.3	5.1	4.8	4.7	NA
Clothing, excluding knitwear	2.6	3.4	11.0	7.1	NA
Knitwear	NA	11.4	5.3	14.7	NA
Durable goods (household appliances, motor vehicles, tools, radios, television sets)	NA	15.7	11.7	10.5	12.0
Furniture	NA	13.0	2.9	6.9	NA
Drycleaning	9.3	5.3	3.2	3.4	2.5
Laundry	10.5	6.3	2.4	2.1	2.8
Photography	NA	10.3	3.7	5.0	7.1
Public baths	NA	2.6	1.6	3.2	3.6
Beauticians and barbers	5.0	5.6	6.1	5.5	5.7
Rental of durable goods	NA	14.3	13.0	10.3	12.5

Note: Adjustments of Soviet figures referred to in the footnote to table 1 have not been made here. The repair and rental of durable goods account for about 15 percent of the total everyday services provided by the state. Laundry, photography, and beauty and hair care are the next largest category, jointly accounting for about one-third.

The repair and rental of durable goods (including automobiles) is the largest and fastest growing sector in everyday services provided by the state, accounting for about 15 percent of the total (table 2). Their swift increase complements the rapid rise in Soviet production of durable goods. It also is in keeping with the official policy (originated by Khrushchev) of trying to limit the overall demand for durables by encouraging the public to rent rather than buy them.

Why This Sorry State of Affairs?

The unsatisfactory state of the services sector, despite the rapid growth, is in large measure a consequence of the regime's stinginess toward it. Investment in everyday service facilities accounted for less than half of 1 percent of total investment in the period 1966-80. (The share was slightly lower in 1976-80 than in 1966-70.) In keeping with this traditionally low priority, investment in services often is actually less in the annual plans than was scheduled for them in the five-year plan. In 1976-80, for example, capital spending on the services sector totaled 2 billion rubles, although the plan had scheduled 2.3 billion for that period. 25X1

The machinery and equipment used to provide consumer services comes from more than 20 different ministries. Dry cleaning and laundry equipment, for example, is produced by factories under the Ministries of Aviation, Road and Construction Machinery, and Machinery for the Light and Food Industries. That equipment is a sideline for those factories, whose managers (and the parent ministries) give priority to their primary product line—on which everyone's plan fulfillment and bonuses depend. Some of the machinery and equipment used in the services sector comes secondhand from other branches of the economy. 25X1

Despite its labor-intensive nature, the services sector has also been a stepchild with respect to manpower. Only 2.7 million people—2.3 percent of those employed in the state sector—are employed in furnishing everyday services. This share is up only slightly from 2.1 percent in 1970. The quality of personnel is also reportedly low. About three-quarters of the workers in everyday services begin work with no prior training, and too few of them ever acquire skills. There are serious shortages of trained workers, particularly of 25X1 repairmen of consumer durables. The sector has a high labor turnover—workers leave for jobs with higher pay, more prestige, better working conditions, and the fringe benefits (like access to housing) that are often available in more prestigious sectors. 25X1

The quality and variety of personal care and repair services also leave much to be desired. This reflects not only the general high-level indifference but also the perversity of Soviet success indicators, which judge performance mainly by fulfillment of output 25X1 targets imposed from above rather than by satisfaction of consumer demand. The distortions created by this bias are evident throughout the economy but tend to be particularly severe in consumer services, where the gap between what is advantageous for the producer and what is satisfying for the consumer is especially wide. Producer interests are best served by large-scale output of identical objects, whereas responding to individual needs tends to require small-scale output of individually tailored "products."

As a result of the biases of the Soviet incentive system, personal care and repair outlets tend to:

- Provide high-cost services, often in disregard of consumer demand, because the greater value of such output facilitates plan fulfillment.

- Produce for bulk buyers rather than individual consumers.[3] (Service outlets are authorized to sell services and a limited amount of goods to enterprises. But the share of their output sold to enterprises has been rising, even though official policy has decreed its decline.)

- Produce goods rather than services. (They find it easier to meet gross output targets through the material-intensive route of manufacturing products than by the generally more labor-intensive route of providing services.)

- Mass-produce goods rather than turn out custom-made items for individuals, although the latter are supposed to account for most of what the outlets produce.

Measures for Improving Services

Although the regime sees that by starving consumer services it is limiting economic efficiency, the leadership has been unwilling to transfer resources into services on a large scale. For example, we believe that the 11th Five-Year Plan (1981-85), at least initially, called for no increase in capital investment in services. However, the language of the Food Program unveiled by Brezhnev in 1982 implied that investment in rural services would rise substantially. (It is not clear whether this increase was an addition to the originally planned investment total or had been cut from the investment earlier earmarked for urban service facilities.) 25X1

25X1

Instead of providing some investment priority, the Soviets have seemed intent on improving services primarily by tapping unused labor, using existing facilities more intensively, and organizing the production and distribution of services more efficiently. In the mid-1970s, for instance, the authorities began to emphasize expansion of specialized service enterprises to replace consumer service combines. At the same time, a network of local "receiving points," where people could bring items in need of servicing and repair for delivery to the specialized service enterprises, was to be set up. The hoped-for efficiency never materialized, however, because nobody provided the resources. Most receiving points were woefully small and understaffed, and the authorities generally provided too little transport to ship the goods back and forth. 25X1

The Andropov regime, during its short tenure, likewise sought to give consumer services a shot in the arm—again, with minimal resources. Noting that because service enterprises were only open during working hours, workers had to leave their jobs to acquire a service, a January 1983 resolution ordered the enterprises to be open longer, to use more part- 25X1
time labor, and to provide more services at places of employment. A joint resolution of the Central Committee and Council of Ministers in March 1983 again called for increased use of part-time labor and instructed industrial enterprises to establish service outlets "on the basis of their own funds." In July 1983 the Council of Ministers approved these measures:

- Collective farm members and pensioners who work at consumer service enterprises are to receive their full pensions. (Previously, pensioners could not retain their full pensions if they earned more than 120 to 150 rubles a month.)

- Individuals may work at a second job in a service enterprise for as much as half their normal work 25X1
time, if the primary place of employment and its trade union approve.

25X1

[3] As one service enterprise employee said in a letter to a Soviet newspaper in 1983, "Our repair brigades are all too eager to service various organizations, but they don't want to serve the public, because it is easier for them that way. Why replace a broken belt in a washing machine or do minor repairs on an electric razor? It's bothersome and it only yields a few kopecks, while working in a hospital or a kindergarten you can fix all the appliances in a block order and there's your plan fulfilled. You receive bonuses . . . and then many of the figures for service organizations are switched to the consumer services account."

Since he became General Secretary, Chernenko has likewise shown concern, initiating the consumer services "experiment." This calls for intensified recruitment of part-time workers in the services sector and creates some additional incentives. The most promising part of the experiment (so far limited to enterprises in a few areas of the Russian Republic) is the emphasis on rewarding service establishments for selling directly to individual consumers. [redacted]

These recent initiatives seem to have had little impact, however. After some initial extensions, the establishments seem to have gone back to their earlier hours of operation. A February 1984 article declared that some managers had advertised new hours but continued work on the old schedules. The major drag probably is the lack of incentive; a manager who can fulfill his sales plans and earn the regular bonuses during the shorter hours has little reason to change. [redacted]

Nor does it appear that employment of part-timers or pensioners has increased much. This is largely because the managers of service establishments are reluctant to hire them. Pensioners are viewed as inefficient, and the employment of part-time labor is said to complicate the computation of wages and bonus funds. [redacted]

Last, though it is too early to make a fair judgment, the Chernenko consumer experiment is likely to be disappointing. It does not offer enterprises significant incentives for improving the quality (as apart from the volume) of services. [redacted]

The Outlook

The prospects for markedly better or more available personal care and repair services in the next five-year plan (1986-90) are not good:

- So far, the leadership seems unwilling to undertake the expense. Instead, it apparently is still hoping for the efficiency gains that have eluded it in the past.
- The labor shortage, which will continue through the 1980s, will be particularly hard on such labor-intensive sectors as services.
- Finally, the outlook for expansion of private enterprise in services—the most promising avenue for improvement in this sector—is poor. [redacted]

Even though Andropov urged economic experimentation and receptivity to innovative ideas in some situations (the New Economic Mechanism in Hungary, for example), he rejected a broader role for private enterprise activity in the consumer sphere. That rejection probably reflected both general ideological qualms and anxiety that it might conflict with his anticorruption campaign. [redacted]

Chernenko has likewise opposed the enlargement of private enterprise activity in the consumer sphere. In early 1984 a noted Soviet academic, writing in a prestigious journal, in effect suggested that the best way to improve satisfaction of consumer demand would be to revive the New Economic Policy (NEP), which turned many activities over to the private sector in the 1920s. Recently the journal retracted this article, however, after a scathing critique of it appeared in the party's theoretical journal *Kommunist*—a signal that the leadership will not tolerate a significantly enhanced officially sponsored role for private entrepeneurs. [redacted]

[redacted]

25X1
25X1
25X1
25X1
25X1
25X1
25X1
25X1

Impact of Resource Allocation Policies on the Consumer [redacted] 25X1

Longstanding Soviet priorities, dating from the First Five-Year Plan, have favored heavy industry and defense at the expense of the consumer sector of the economy. A relatively greater emphasis on consumption emerged in the post-Stalin period and has continued, in varying degree, through the Khrushchev, Brezhnev, and Andropov years to the present. The Soviet leadership's concern for the welfare of the population has been reflected in investment allocations, program proposals, and import decisions. But in public statements the leadership has been careful not to raise consumer expectations too much, preferring to play down the material aspects of consumption while still stressing the link between increases in income and labor productivity. Consumption levels have risen only slowly in the 1980s. Per capita consumption, for instance, showed no growth in 1982 and increased by only about 1.5 percent in 1983. Our preliminary estimate is that gains in 1984 were perhaps slightly higher than in 1983. [redacted]

The prospects for advances in living standards in the USSR during the rest of the 1980s depend on overall economic growth and on the policies adopted by the Soviet leadership in allocating resources. Despite some recent improvement in performance, we expect GNP growth over the second half of the 1980s to average only about 1.5 to 2.5 percent per year. Such growth is too low to permit real rates of growth in living standards, investment, and defense as high as those of the 1970s. The leadership will have to make choices among some of its ambitious goals or reduce them all somewhat. [redacted]

Because evidence now suggests a renewed emphasis on investment and perhaps defense as well, the outlook for a substantial improvement in the lot of the consumer over the rest of the 1980s is not bright. To assess the prospects for consumers, we examined several policy options in which we varied our assumptions about resource allocation policies the Soviet leaders might adopt and compared the results.[1] [redacted]

[1] Our mechanism for trade-off analysis is SOVSIM, a large econometric model of the Soviet economy. [redacted]

The Balanced Policy Option

We believe one possible policy for the Soviets would be a middle course. Such a policy would attempt to make some simultaneous progress in consumption, military production, and industrial modernization but would avoid a marked swing in any one direction by maintaining a balance in meeting the demands of the competing claimants. The relatively good results of 1983 may provide additional impetus to choosing such a strategy [redacted] 25X1

In more specific terms, we would see this policy as one in which achievable GNP growth would be in the lower half of our 1.5- to 2.5-percent range over the rest of the decade, investment growth might average around 2.5 percent, and defense spending growth would average about 2 percent per year. Under these conditions, per capita consumption growth would average just under 1 percent per year. The advantage of this balanced strategy would be to provide growth 25X1 sufficient to support a range of policy initiatives, especially in the areas of defense and investment, and still keep living standards from declining. It would provide little hope, however, of a substantial improvement in the standard of living over the rest of the decade [redacted] 25X1

Alternative Investment and Defense Policies

Other policy options available to the leadership could have a more severe impact on the consumer. For example, instead of averaging about 2.5 percent through the remainder of the decade, investment growth might continue at the higher 4-percent rate 25X1 experienced in 1982 and 1983. The leadership would regard this as important for achieving industrial modernization—a key long-term goal. In fact, there are some indicators that point to the probability of the Soviets' maintaining a relatively high rate of investment during the 1980s: 25X1

- Although the Soviets have not announced an official target for total investment during the 12th Five- 25X1 Year (1986-90) Plan, [redacted] 25X1 investment will increase at about 4 percent per year. 25X1

- The Soviet leaders have already adopted two expensive programs as part of the 12th Five-Year Plan—the Food Program and the long-term Energy Program—which are likely to be a very heavy drain on investment. Consequently, any significant reduction from the present rate of investment growth would put a severe crimp in the amount of investment resources available for other essential areas such as machine building.

We also considered the impact of more rapid growth of defense spending. This might involve:

- An increase in total defense spending growth from 2 percent to 5 percent—a rate approximating that observed during the military buildup of 1966-76.
- An increase in military procurement spending growth from 2 percent to 6 percent.
- Larger shares of the investment pie for energy, industrial materials, and the investment goods sectors to support these military programs.

The focus of these trade-offs in the Soviet economy is the machine-building sector—the main source of investment goods, military equipment, and consumer durables. It is here that broad Kremlin pronouncements concerning Soviet goals must be translated into specific types of output. If investment and defense growth continues late into the decade at the relatively low rates of the balanced policy, production of consumer goods will grow more slowly because of the increasing constraint imposed by available resources and productivity levels.

If investment and defense are to grow more rapidly, Soviet leaders will probably encourage machinery output to grow faster, but production of consumer durables is likely to suffer even more. The results of our analysis suggest that continuation of the higher investment growth rate alone could be enough to change the growth of per capita consumption from positive to negative during the latter half of the 1980s. If, in addition, the economy were geared up for major defense increases, per capita consumption would be driven down at a rate of about 1 percent annually during the last half of the decade. Both cases suggest a bleak outlook for the consumer as the decade draws to a close.

Productivity Improvements

Would the consumer's prospects be less gloomy if Soviet attempts at carrying out an intensive growth strategy turned out to be more successful than we think is likely? To answer this question, we assumed that Soviet labor and capital could somehow be made as productive as they were in the early 1970s. Such conditions would improve overall growth of the economy, and, even with high investment growth and increased orientation toward defense, per capita consumption growth could be maintained at the balanced-policy rate of just under 1 percent, allowing modest improvements in living standards. The problem, however, is that the longer term productivity improvement required in this scenario does not seem to be in the offing, particularly in view of the increasing cost of introducing new plant and equipment into more remote areas of the country, the severe conditions of climate under which that equipment must operate, and the cost of compensating for the deteriorating quality of raw material reserves.

25X1

25X1

25X1

Soviet leaders, however, do recognize the importance of productivity improvements to economic growth in general and to their investment and defense goals in particular. They also seem to believe that healthy per capita consumption growth contributes to labor productivity. This explains the efforts now being made to improve the lot of the consumer through emphasis on the Food Program, continuing grain and meat imports, and attempts to foster growth of consumer durables. Therefore, even though prospects for per capita consumption growth are not bright, the Kremlin is not willing to dismiss entirely the consumer claim to an improved standard of living.

25X1

25X1

A More Radical Consumer Policy

Although we do not consider it a likely eventuality, the Soviets could undertake a more radical tilt toward the consumer by altering the distribution of investment in favor of the consumer sectors of the economy and reducing the commitment to defense spending. Politically, this policy would have to be justified as a move to preempt likely popular unrest under international conditions benign enough to permit such a step.

25X1

This consumerist policy would involve relatively greater shares of investment for housing, consumer goods, trade and services, and agriculture than would the balanced policy. Total defense spending could be held constant through the rest of the 1980s to maintain investment growth, and the volume of food and other consumer goods imports from the West would increase. 25X1

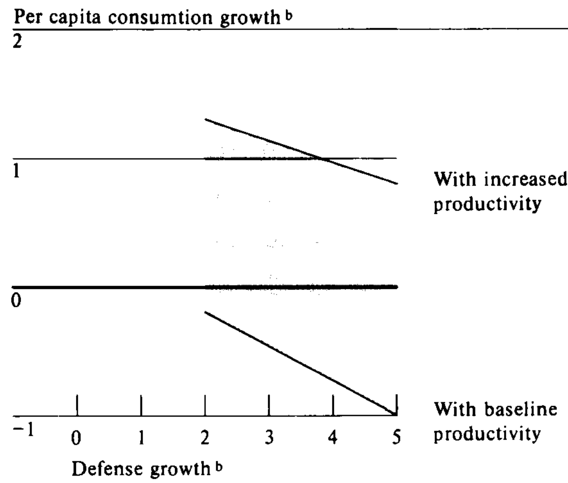
The Soviets might also alter the mix of their imports to support consumer goals. For example, they might eliminate imports of less essential machinery in favor of additional feed grains. This would reduce the rate of capital formation and the long-run growth of output but facilitate more immediate growth of meat output. Such a policy would be limited by the capacity of Soviet ports to accept grain imports. Even so, it could raise per capita meat availability perceptibly. The impact on capital stock at the end of the decade would be slight. Initially, the net effect on GNP would be favorable. Eventually, but not until the 1990s, the reduced output brought about by the forgone investment would nullify the greater production of meat. 25X1

Such policies would alter the distribution of national product in the consumer's favor. Growth in per capita consumption within the 1986-90 period would be boosted back toward the more favorable rates of the early-to-middle 1970s. In addition, these outcomes might inspire improved worker productivity that could lead to higher rates of growth throughout the system. We do not believe, however, that the Soviets would adopt such a policy unless they were forced to do so by some internal crisis such as a severe worsening of public morale. Soviet leaders perceive the costs, in terms of the lost opportunities to accelerate technological modernization, to be too high, and we think they would be unlikely to allow overall defense spending to stagnate for such a prolonged period.

Prospects for the Consumer

In making decisions about resource allocations, the Soviet leadership must deal with the issues that are illustrated in our policy alternatives. The accompanying figure summarizes the trade-off dilemma that we believe the Soviets will face if they continue to emphasize investment and defense. Whether we use moderate or bullish assumptions about productivity

USSR: Impact of Increased Defense Growth on Per Capita Consumption Growth, 1986-90[a]



[a] Investment growth is 4 percent per year in all cases.

[b] Average annual percentage.

Our baseline assumptions about factor productivity are derived from the estimated historical relationship that has existed among capital, labor, and output in the branches of industry in the USSR since the mid-1970s. Under the policy options associated with baseline productivity, GNP growth approaches the lower side of the 1.5-2.5-percent range we forecast for the 1986-90 period; under conditions of increased productivity, it is near the upper side. 25X1

25X1

304812 2-85

and growth prospects, living standards, as measured by per capita consumption, are not likely to grow substantially during the last half of the decade. Further, if the Soviets were to accelerate defense spending from today's 2-percent growth rate while maintaining investment growth at 4 percent a year, they would jeopardize even the faint hopes for slow improvements and, in some cases, incur a decline in living standards. Slower growth in investment would 25X1 allow a bit more room for improving the Soviet consumer's lot in the shorter run, but such a policy would be counter to the need to modernize much old industrial plant and stimulate energy conservation and substitution and could even undermine longer range programs undertaken on behalf of the consumer, such as the Food Program. 25X1

The average Soviet citizen doubtless gauges his standard of living not in terms of per capita consumption growth but by the reality he sees around him. The Soviets do have some flexibility to adjust the structure of consumption to react to problems most urgently felt by the population in areas such as food, medical services, and housing. Nevertheless, the forecast of per capita consumption growth in the balanced policy option represents a fairly confined envelope within which to deal with consumer demands. [redacted] 25X1

In the future, Moscow's ability to satisfy claimants on resources will be limited by the likelihood of slow economic growth. Growth in the range we are projecting does not suggest that the Soviet economy is in desperate straits. Rather it indicates that the leadership will have to make choices among ambitious goals or reduce them all somewhat. The lower the rate of overall growth in the economy, the harder the choices become. At projected growth rates, the USSR cannot simultaneously increase consumption substantially to stimulate labor productivity, rapidly modernize the economy to incorporate more efficient plant and advanced technology, and make a sharp response to a US military buildup. [redacted] 25X1

Overall, the leadership will probably try, as it has in the last two decades, to balance growth with at least some improvement in living standards and slow increases in resources for defense. Certainly, as acknowledged in General Secretary Chernenko's November 1984 speech and as hinted in the announced 1985 defense budget, the pressure to raise defense spending substantially is strong. Also, official policy now seems to recognize the desirability of maintaining a relatively high rate of investment growth. However, a decision to actually increase the rate of growth for defense while maintaining high investment growth is almost sure to have adverse consequences for the consumer that would probably be unacceptable for the leadership. [redacted] 25X1

[redacted] 25X1

The Soviet-Cuban Relationship: Serving Mutual Interests

25X1

Despite recent strains in the Soviet-Cuban relationship, the ties binding Moscow and Havana remain strong. Cuba continues to advance Soviet efforts to establish influence in the Third World and challenge US domination in the Western Hemisphere, while Cuba's economic and military development depends substantially on Soviet aid. CEMA's willingness last year to reschedule Cuba's debt, guarantee future Soviet oil supplies, and assist Cuba's development of energy resources illustrate the special treatment being accorded Havana. As long as mutual interests are served, the Soviet-Cuban relationship is likely to remain the strongest of Soviet-client links in the Third World.

As in most bilateral relationships, however, strains emerge when each side seeks to advance its foreign policy objectives at the other's expense. A classic example of discord in the Soviet-Cuban relationship is that which results from Moscow's giving a higher priority to East-West security issues than to the North-South economic development issues that are of paramount concern to Cuba. Castro has frequently resorted to diplomatic and political pressure to extract economic and military concessions from Moscow, and the Soviets have used pressure and propaganda to influence the Cubans. Strains in the relationship also developed during the period between the US intervention in Grenada in October 1983 and the CEMA conference of October 1984.

Nature of the Relationship

As a Marxist-Leninist regime located in the Caribbean Basin—directly in the US "strategic rear"—and deeply committed to support of national liberation movements in the Third World, Cuba's attraction to the Soviets is understandably strong. The Soviets benefit from Cuba's anti-US foreign policy, its political skill in courting Third World radical nationalism, and its pro-Soviet leadership in the Third World "Nonaligned Movement." Cuba, in turn, enjoys $4-5 billion in annual Soviet economic support through trade subsidies, development aid, and balance-of-payments assistance—by far the highest amount Moscow extends to any Third World client. Cuba receives low-priced, Soviet-subsidized oil transfers, higher-than-world-market prices for its sugar, and military supplies virtually free of charge. Since 1960 the cost of Soviet economic support to Cuba has amounted to nearly $33 billion. 25X1

25X1

In pursuing his own foreign policy interests in the Third World, Castro usually advances Soviet interests by: 25X1

- Reinforcing the connections between Cuba's revolution and Third World revolutionary movements to enhance Cuba's international role.

- Developing a personal relationship with such leftist revolutionary leaders as the former leader of Grenada, Maurice Bishop, and the current Sandinista leader, Daniel Ortega.

- Strengthening Third World socialism and radical national movements as a way to legitimize Cuba's own revolutionary legacy. In quest of these interests, Castro has sent troops and technicians to Africa, the Caribbean Basin, and the Middle East. We estimate that as of 1983 this commitment amounted to over 40,000 military personnel and 21,000 civilian advisers, technicians, and construction workers. 25X1 25X1

Havana's Soviet-backed policies in the Caribbean Basin and Africa help portray the Soviet Union as the Third World's "natural ally." In the case of the Caribbean Basin, especially Central America, the Soviets benefit from Cuba's geographic proximity and linguistic ties as well as its cultural affinity with local Third World leaders. Moreover, Moscow benefits from Third World receptivity to Cuba's presence as a small "anti-imperialist" revolutionary state in defiance of the United States—a posture that appeals to leftist anti-imperialist movements. [redacted]

Cuba also advances Soviet interests by:

- Attempting to heal the rifts within the Caribbean leftist movement caused by the Grenada debacle, as in the first Consultative Meeting of Anti-Imperialist Organizations of the Caribbean, held in Havana in June.
- Continuing its general propaganda effort condemning US policies in Central America and stressing the US military threat to small Caribbean Basin countries.
- Maintaining traditional contacts with insurgent movements throughout the Third World in terms of training, financial aid, and policy guidance. [redacted]

By joining with the USSR, Cuba has been able to draw upon Soviet economic and military support to survive economically, protect its physical security, project its own brand of power abroad in support of national liberation movements, and raise its prestige as a small-state actor in international politics. From Havana's perspective, Moscow's economic support and virtually free military aid:

- Make possible Cuban economic gains in public health, housing, education, and other social services.
- Transfer technical know-how and managerial techniques to Cuba's economy.
- Support Cuba's oversized and modern (by Third World standards) armed forces.
- Improve Castro's capabilities to support revolutionary movements abroad through Soviet logistic backing, in addition to economic and military assistance.
- Enhance the survivability of Castro's regime through the militarization of Cuban society.

[redacted]

Soviet economic and military aid to Cuba is the largest Moscow extends to Third World clients. Soviet economic support—development aid, trade subsidies, and balance-of-payments assistance—reached an estimated $4.2 billion in 1983. Cuba has received the equivalent of about $33 billion since the early 1960s. In addition to serving as Cuba's chief trading partner, the Soviet Union provides Havana with substantial amounts of imported food, oil, and capital goods. [redacted] 25X1 25X1

The Soviets have modernized Cuba's armed forces as a result of Havana's interventions in Angola and Ethiopia, and shipments of Soviet miltiary weapons over the last four years have been the largest since the missile crisis of 1962. These military supplies entail a heavy economic burden for Moscow, amounting to $2.5 billion worth of deliveries from 1981 to 1983, equal to the dollar value of the total deliveries in the preceding 20 years.

[redacted] 25X1

Cuban and Soviet Influence-Seeking During 1983-84

Cuba used its privileged position to try to pry concessions from the Soviets between the June 1984 CEMA summit conference held in Moscow and the October meetings in Havana. The June summit reflected Soviet and Cuban discord over the essential development strategy assigned to Cuba within CEMA's long-term goals. According to the US Interests Section in Havana, information from East European diplomats has indicated that Cuba, in planning talks for the CEMA summit, emphasized accelerated industrial development rather than a continuation of its role as a supplier of agricultural commodities. These proposals were rejected by the USSR. In response to this rebuff, Castro did not attend the June meetings in Moscow. 25X1

[redacted] 25X1

Other indicators of discord between Moscow and Havana were evident during much of 1984. These strains, which have not completely disappeared, include:

- Cuba's frustration with Moscow's weak response to the US intervention in Grenada in 1983.
- Havana's discontent with Moscow's focus on East-West issues and relative lack of attention to Third World development issues and the Central American crisis. 25X1
- Moscow's unhappiness with Cuban economic inefficiency and mismanagement, notably in the sugar industry.

- Soviet irritation over Cuba's large purchases of machinery from Western Europe rather than from CEMA countries.
- Castro's displeasure with Soviet equipment, particularly navigation equipment, and with the expenses associated with purchasing Soviet spare parts and meeting maintenance costs.

Castro's absence from the CEMA summit in June 1984, coupled with a letter to Chernenko on the eve of the summit which underscored Castro's unhappiness over economic assistance to Cuba, was probably meant to direct Soviet attention to Cuba's need for increased economic aid and to Cuba's mounting sense of insecurity for itself and Nicaragua in the face of US actions. In an effort to exert added pressure in these directions, Castro's 26 July speech made little mention of the Soviets' contribution to the Cuban Revolution or to Moscow's role in the economic development of Cuba.

Following the CEMA meetings in Moscow and Castro's public irritation with the Soviets, Moscow responded with its own signs of displeasure with Havana.

As a further signal of its displeasure with the Castro government, Moscow did not acknowledge Castro's June letter to Chernenko in the Soviet media and sent a low-level delegation to cover the 26th of July celebration in Cuba. The Soviet congratulatory message to Havana also did not mention the US threat to Cuba or the revolutionary developments in Central America, both of which deeply concern Castro.

The Soviets normally use these Cuban celebrations to underscore and reinforce Soviet bilateral ties with the Castro regime. The low-level Soviet treatment, therefore, was probably a part of the larger effort to influence Castro in the direction of:

- Abandoning his short-term goal of switching to a more rapid course of industrialization.
- Remaining a team player within CEMA by playing the traditional role of supplying agricultural goods.
- Concentrating on higher Cuban economic efficiency as a quid pro quo for continued high levels of economic and military aid. 25X1

The October 1984 CEMA Meetings in Havana and Future Prospects 25X1

A compromise on Soviet and Cuban priorities regarding Cuba's economic directions may have been advanced at the October CEMA meetings in Havana. While Cuba did not gain backing in its industrialization aims, a large, high-level Soviet representation at the Havana meetings stressed the North-South dimension of the conference and noted that the conference was the first major CEMA meeting held outside the Soviet Bloc. The Havana venue acknowledged the role of less developed countries as members and observers in CEMA, as well as CEMA's commitment to equalizing the levels of development between the 25X1 European and non-European (Cuba, Mongolia, and Vietnam) members of the organization. 25X1

After a year of Soviet-Cuban discord dating back to the Grenada crisis, the Soviets used the October 25X1 CEMA meetings in Havana to restate their continuing commitment to Cuba. Vice President Carlos Rafael Rodriguez told foreign diplomats in November that Cuba's CEMA partners had agreed to reschedule Cuba's debt with them, postponing repayment of principal five years, from 1986 to 1990. Rodriguez also stated that the Soviet Union had committed itself to supplying Cuba with the same quantity of petroleum now provided during the next five-year period (1986-90), and that Cuba would be allowed to sell for hard currency any Soviet oil it did not need. 25X1

The 15-year accord also emphasized development of Cuba's domestic energy resources and nuclear power stations, almost certainly to reduce Cuban dependence on Soviet energy supplies. The accord provides for further modernization of Cuban sugar production and industrial plants, with special attention to the 25X1 chemical industry. The Soviets also tried to persuade their already hard-pressed CEMA allies to share the burden of support for CEMA's less developed members, but only Bulgaria seems to be moving in that direction. 25X1

In response to the new economic arrangements with the USSR and CEMA, Castro hailed the Soviet Union in November. In an interview with *Pravda*, he stated that "the USSR is giving Cuba all it needs for the defense of its revolutionary gains and the accelerated development of its national economy." Castro also lavished praise on the Soviets in his December speeches. [redacted] 25X1

Outlook

Problems in the Soviet-Cuban relationship have been set aside for now, but future problems are likely to emerge over conflicting priorities pursued by the Soviet patron—with its own economic difficulties and East-West security concerns—and the Cuban client, with its economic development problems and regional security priorities vis-a-vis the United States. The Soviets have made a commitment to continue their support of the Cuban economy [redacted] 25X1 Some potential causes of strains in the future include:

- The level of Soviet oil deliveries to Cuba, especially as Nicaraguan demands on Soviet oil supplies increase.
- Cuba's ineffectively managed economy and growing Soviet pressures for increased austerity and consumption cutbacks.
- Moscow's inattention to Third World economic development problems.
- Levels of Soviet military commitments to clients in the Caribbean Basin.
- Cuba's continued desire for industrialization programs in mechanics, electronics, and other fields.
- Imposition of austerity measures in Cuba to the extent they are perceived as a consequence of Soviet pressure. [redacted] 25X1

[redacted] 25X1

Proposed Soviet Gas Pipeline to Eastern Europe 25X1

The Soviets are pushing for East European agreement on the joint construction of a new gas export pipeline. Moscow wants to get more East European participation in Soviet investment projects in return for increased Soviet deliveries of energy and other raw materials. It is not certain, however, that the East European nations could absorb the additional 20-22 billion cubic meters a year of gas that the pipeline reportedly would deliver to them. If not, the Soviets might attempt to sell some gas to Western Europe. The outlook for such sales would, of course, depend on market conditions and the willingness of prospective Western buyers to become more dependent on Soviet gas.

Background

Moscow has for many years been trying to rectify what it considers to be inequities in its trade with Eastern Europe. Soviet assistance to Eastern Europe has taken the form of price subsidies, trade credits (as represented by chronic surpluses in trade), and the provision of goods readily salable for hard currency (such as oil and other raw materials) in exchange for goods not as salable. The Kremlin seems more determined than ever to reduce the assistance to Eastern Europe during the next five-year period. The Soviet approach is epitomized in the October 1984 cooperation agreement with East Germany:

> For a continuation of the supplies of the most important raw materials and fuels from the USSR, the GDR will take the necessary measures in the fields of investment and the reconstruction and modernization of its industry to guarantee the production and supply of the products needed in the Soviet Union and will *continue its participation in establishing a capacity in the oil and natural gas industry and other branches of the extraction industry.* (Italics added.)

Western engineers working in the Soviet Union in 1983 were the first to report that the USSR was planning to build a new export pipeline to the East European countries during 1986-90. A Soviet announcement in *Pravda* in July 1984, after the June summit meeting of the Council for Mutual Economic Assistance (CEMA), indicated that the USSR—with the assistance of the East Europeans—would build a gas export pipeline to deliver 20-22 billion cubic meters a year to Eastern Europe. According to East European diplomatic sources, the project will cost between 10 and 13 billion rubles. CEMA's total investment projects in the 1986-90 period reportedly will come to about 45 to 55 billion rubles, of which the USSR will provide about half. 25X1

Previously, the CEMA countries were extensively involved in the construction of the Druzhba (Friendship) oil pipeline in 1960-64 and the Soyuz (Union) gas pipeline in 1977-79. Each of the signatory nations 25X1 to the Soyuz gas pipeline agreement was charged with complete construction of a large segment of the line (including compressor stations), using its own resources and manpower. Western equipment and pipe purchased for the Soyuz pipeline were financed by \$2.5 billion in syndicated loans raised by CEMA's International Investment Bank. These funds were then lent to East European countries, which, in turn, made them available to the Soviet Union. In addition, Eastern Europe provided substantial ruble assistance. East European contributions were to be repaid with deliveries of resources and natural gas through 1990. 25X1

Requirements for Pipe and Equipment

The new export line is to be about 4,600 km in length—two-thirds longer than the Soyuz line—and 1,420 mm in diameter. It reportedly is to have 40 compressor stations and run from the Yamburg gasfield, about 150 km north of the Urengoy gasfield, to the export terminal at Uzhgorod on the Czechoslovak border. The route will parallel the recently completed Siberia–to–Western Europe gas export pipeline (see 25X1 map). Construction reportedly is to begin in 1985 and be completed in 1988. 25X1

We do not believe that the new CEMA gas export pipeline will be a major source of equipment contracts with West European firms, as was the recently completed gas export pipeline. 25X1

Soviet Oil Deliveries to Eastern Europe

The new gas pipeline may be intended to compensate for possible reductions in Soviet oil deliveries to Eastern Europe. With oil output from the key West Siberian production region showing signs of slower growth and that from other production regions declining by about 10-12 million tons per year, Soviet oil output during 1986-90 will at best remain constant. Output in 1984 was 613 million tons—3 million tons below the 1983 level and 11 million tons below plan. At the annual CEMA meeting in October 1984, Soviet Premier Tikhonov announced that the USSR would continue "to guarantee oil supplies" to CEMA member nations and "increase future shipments" of electricity and gas. The wording of the Soviet announcement suggests that, while the USSR will continue delivering oil to the CEMA countries, the volume of future oil shipments may be reduced. [redacted]

[redacted] the USSR plans to equip the pipeline with Soviet gas turbines. Output of Soviet turbines suitable for use on 1,420-mm gas pipelines has in fact increased in recent years. Since the purchase of the 125 Western gas turbines for the Siberia–to–Western Europe gas export pipeline, the USSR has contracted to buy only 21 additional Western 25-megawatt turbines—enough to meet about 10 percent of estimated demand during 1984-85. A substantial amount of pipe probably will have to be imported from the West, however; the project will require about 2.8 million tons of high-grade large-diameter pipe. [redacted]

East European Participation

Moscow apparently sees the gas pipeline as a high-priority project and is pressing to complete bilateral agreements with the individual East European countries. [redacted]

[redacted] 25X1

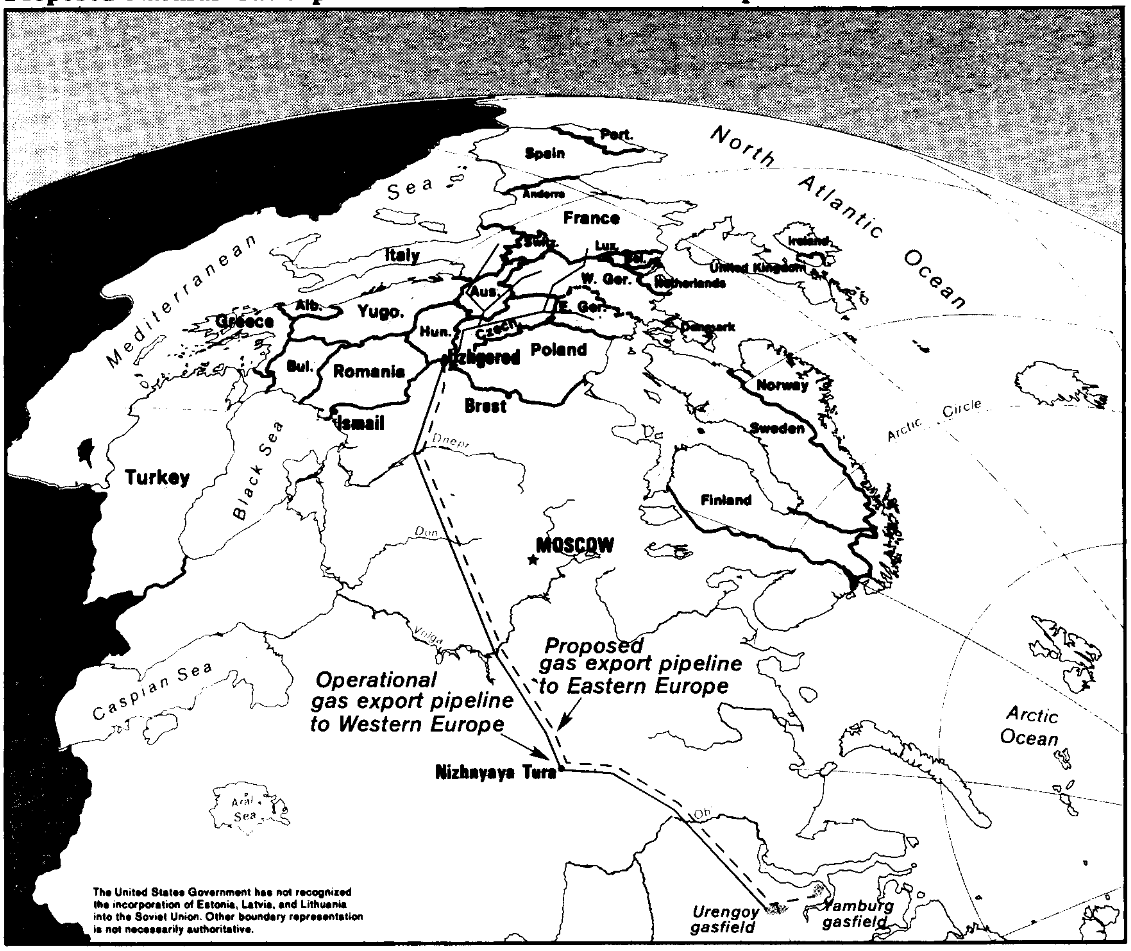
There appears to be considerable foot-dragging by the East Europeans in regard to the pipeline and other projects. [redacted] In 1983, Soviet gas exports to these countries totaled about 31-34 billion cubic meters or about three-fifths of total gas consumption in Eastern Europe excluding Romania.[1] [redacted] 25X1 25X1

Western Europe: An Alternative Market?

It is uncertain whether the East European countries will have the pipeline network and industrial facilities to distribute and absorb annually the additional 20-22 billion cubic meters of gas to be delivered by the Yamburg-Uzhgorod pipeline by 1990. Even if the East European economies can absorb the planned amount, the pipeline would still have some capacity for additional gas exports to Western Europe. Soviet technical journals indicate that the net throughput of a pipeline of this length and diameter operating at a pressure of 75 atmospheres is about 27 billion cubic meters per year—5-7 billion cubic meters more than the amount of gas that the Soviet press reports is earmarked for Eastern Europe. Eastern Europe's ability to absorb Yamburg gas depends also on the amount of Soviet gas received through other pipelines. Press reports indicate plans to build a gas pipeline from the Soviet border at Brest to Warsaw in 1985. 25X1 25X1 25X1

[1] We are unable to determine precisely how much Soviet gas was delivered to Eastern Europe in 1983. Soviet trade data indicate a 23-percent increase in the ruble value of gas deliveries, which would suggest total deliveries to Eastern Europe of 34-35 billion cubic meters at constant prices, excluding Romania. [redacted] the price of Soviet gas sold to Eastern Europe may have increased in 1983. [redacted] the amount of gas delivered to individual countries indicates an increase in volume but a lesser amount than suggested by the ruble values reported in Soviet trade journals. [redacted] 25X1 25X1 25X1 25X1 25X1

Proposed Natural Gas Pipeline From Siberia to Eastern Europe



The Pipeline at a Glance

Length:	**4,600 kilometers (Yamburg-Uzhgorod)**
Capacity:	**32 billion cubic meters per year (gross); 26-28 billion cubic meters per year (net)**
Pipe:	**2.8 million tons, 1,420-mm (56-inch) diameter**
Operating pressure:	**75 atmospheres**
Total cost:	**10-13 billion rubles**
Completion:	**1988**

704336 2-85

25X1

Another gas pipeline will reportedly be laid from the Soviet export terminal at Izmail to Bulgaria. (Some of the gas transported through this pipeline, however, is probably earmarked for Turkey.) 25X1

If West European gas demand rises more than is currently expected during the late 1980s and early 1990s, the Soviets could use the excess capacity of the proposed line to Eastern Europe as a readymade vehicle to transport gas to Western Europe. This could be of substantial help in maintaining total Soviet hard currency exports at a time when the ability to export oil may be diminished. The outlook for such sales to the West would, of course, depend on energy market conditions and the willingness of prospective Western buyers to become more dependent on Soviet gas. CIA believes that current industry and government forecasts for West European gas demand may be understated and do not take into account an apparent return to improved economic growth. 25X1

25X1

The Changing Role of Soviet-Owned Banks in the West [redacted] 25X1

The Soviets have maintained a small but important string of banks in the West since the Russian revolution. Despite Soviet ownership and a high degree of control, the banks—which are located in major international financial centers and possess assets of more than $10 billion—operate as independent profit-seeking Western corporations. Less active international financial markets, the downturn in Bloc financial fortunes, and the generally cooler East-West climate have impinged on bank operations in recent years, forcing Moscow to assume a greater role in managing the day-to-day operations of these banks. An emerging scandal at the Soviet-owned Zurich bank is likely to reinforce this trend. Because the political fallout from a major retrenchment would be so large, however, and the cost of keeping the banks afloat is relatively so small, Moscow would be reluctant to set any of its banks adrift. [redacted]

The Soviet Banking Network

The Soviet Union currently operates six banks (one of which has two branches) in the West. This foreign-based banking network, which formally began with the chartering of Moscow Narodny Bank (MNB) in London in 1919, has played a major role in Soviet commercial relations with the West, both as a conduit of hard currency into the USSR and as a promoter of East-West trade. [redacted]

The Soviet-owned banks in the West vary widely with respect to size, asset structure, and scope of activity (see table). All of the banks are chartered by the countries in which they are located and operate subject to the laws and regulations of those countries. Thus, Moscow Narodny Bank is legally a British bank rather than a Soviet one. In fact, MNB and Wozchod Handelsbank (Zurich) maintain business representative offices in Moscow just as any other Western corporation might. [redacted]

In practice, however, the Soviet-owned banks in the West remain just that—Soviet owned. Stock ownership is retained solely by various organizations within the Soviet foreign trade infrastructure. The scope and magnitude of bank operations is set in Moscow by the State Bank (Gosbank) and the Foreign Trade Bank (VTB), sometimes working through the Banking Supervisory Council (see figure) and sometimes directly. [redacted] 25X1

Upper-level bank management, like bank ownership, is almost exclusively a Soviet domain. All of MNB's directors and assistant directors are Soviets, as are the general managers of its branches. The banks are, however, largely staffed by local nationals. The staffs generally consist of well-trained professionals who are versed in local as well as international banking laws and customs. Moscow hires local personnel for their expertise in banking and local commercial practices, but it clearly has no intention of allowing them to take a major hand in running the banks. [redacted] 25X1

Bank Activities 25X1

The primary role of the Soviet-owned banks in the West has always been to foster and finance East-West trade. In addition to carrying on the normal business activities of all banks—accepting commercial deposits, making loans, and providing financial analysis and advice—they make special efforts to encourage trade with the USSR and Eastern Europe. To this end, Soviet bankers overseas advise Westerners about Soviet import needs and export offerings, assist businesses in the intricacies of trade-related documentation, 25X1 provide short- and medium-term financing for specific East-West commodity trade deals, and manage and generate broad-based participation in East-West commercial loan syndications. [redacted] 25X1

The banks, however, also fulfill important nonfinancial roles. They provide Moscow with:

- *Economic intelligence.* Wozchod and MNB in London are especially involved in analyzing the international gold markets; Ost-West Handelsbank and 25X1 MNB in Singapore do the same for diamonds; MNB's new subsidiary in the Netherlands is well positioned to monitor the world spot oil market in Rotterdam; and all the banks monitor Eurocurrency markets.

USSR: Soviet-Owned Banks in the West

Bank	Location	Date Established	Assets [a] (*million US $*)	Employees	
				Total	Soviet
Moscow Narodny Bank (MNB)	London	1919	3,187.0	271	12
	Beirut (branch)	1963		NA	NA
	Singapore (branch)	1971		NA	NA
Banque Commerciale pour l'Europe du Nord (BCEN)—Eurobank	Paris	1921	4,728.8	354	11
Wozchod Handelsbank (WHB)	Zurich	1966	500.2	55	5
Ost-West Handelsbank (OWHB)	Frankfurt	1971	687.7	95	6
Donaubank	Vienna	1974	482.1	62	6
East-West United Bank (EWUB)	Luxembourg	1974	487.1	30	3

[a] Values are for yearend 1983 except for WHB and Donaubank (1982). Value for MNB represents combined assets.

[redacted]

25X1

- *Trade intelligence.* All the banks observe and report on import and export needs of potential trading partners and analyze conditions in various local or international commodity markets (for example, petroleum products or agricultural machinery).

- *Political intelligence.* Knowing how major banks evaluate the USSR's credit risk and country risk gives the Soviet-owned banks and their supervisors in Moscow insight into Western expectations for East-West relations.

[redacted]

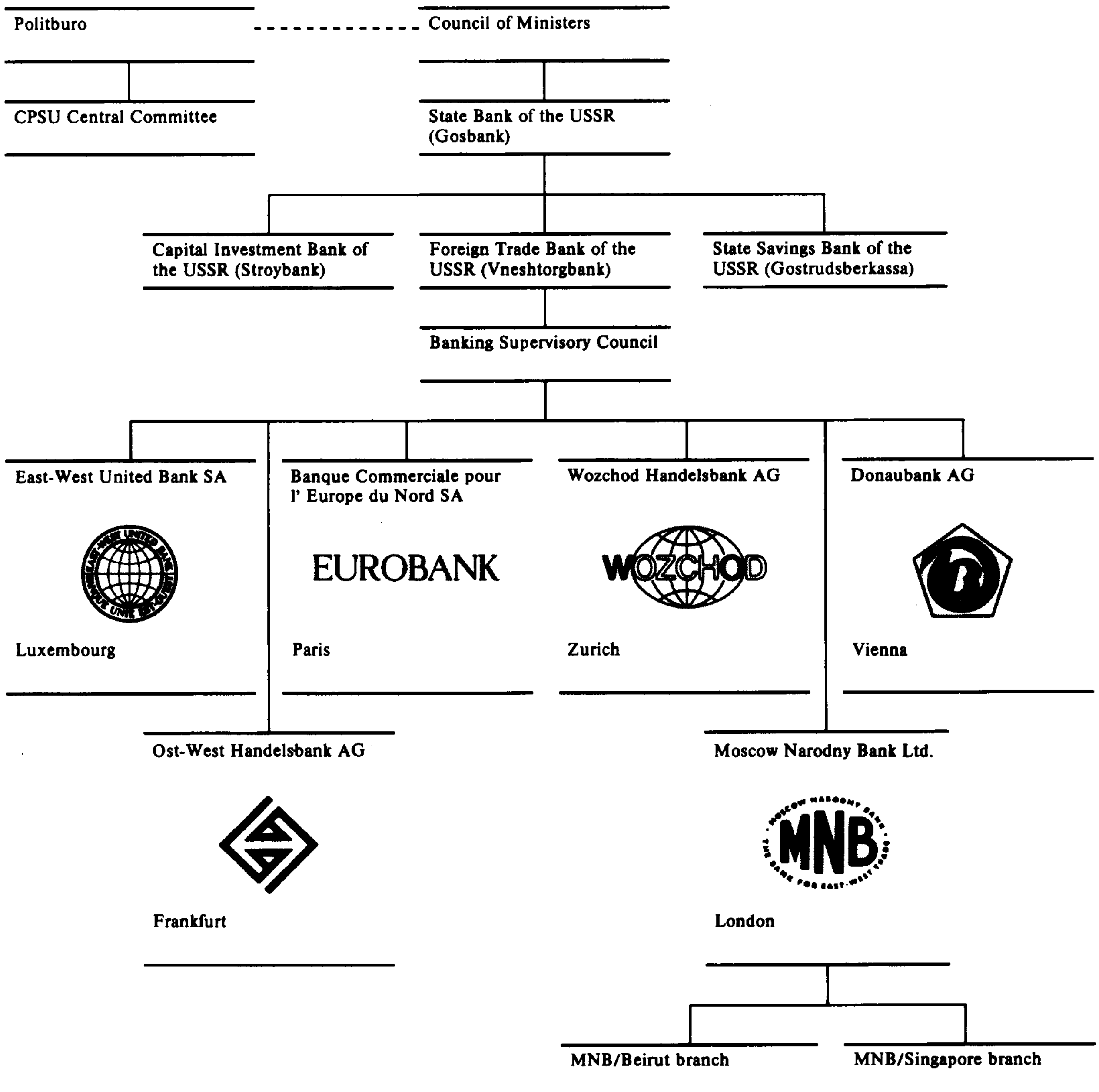
Recent Trends

Through the mid-1970s Moscow basically remained aloof from the day-to-day operation of its overseas banks. However, the banks' fundamental role, and their relationships with each other and with Moscow, began to change in the late 1970s under the guidance of new State Bank Chairman Vladimir Alkhimov and as the Soviet apparatus sustained a series of financial setbacks:

- The repercussions of poor investments—totaling nearly $500 million—by the foreign-based banks depressed profits and impeded lending.
- The Polish financial crisis forced Moscow to reevaluate its financial relationships with its West European allies.
- A corresponding skepticism grew in the West over Bloc creditworthiness in general.
- Moscow's demand for hard currency surged in 1981 and 1982 as the USSR had to pay for stepped-up purchases of agricultural imports at the same time that world oil market prices began to soften. [redacted] 25X1

25X1

USSR: Foreign Financial Apparatus[a]



[a] This figure represents the chain of command for actual banking operations. Several of the Soviet-owned banks in the West maintain representative offices in Moscow or elsewhere, or are part or full owners of other businesses.

25X1

304194 11-84

Moscow reacted to these crises by ordering an across-the-board retrenchment that has led to a fundamental restructuring of its relationship with its foreign banks. The Soviets have always kept a close eye on their banks, but Gosbank and VTB now do a great deal more than just set policy for the overseas banks. Moscow now sets country lending limits, reserves the right to approve or disapprove specific deposit operations, and is handling gold sales and purchases directly. The biggest change, however, probably has been VTB's repeated and continuing demands to all Soviet overseas banks to raise and forward cash—in fact, all surplus money—to Moscow, at the expense of other banking operations. This is impinging on the banks' original charter—to finance East-West trade.

Overall, the Soviet foreign-based banks are undercapitalized, less liquid than their peers, and only marginally profitable. Deposits in the four largest banks have fallen, probably because of East-West tensions, while capital also declined at three of them because of unprofitable operations. Total assets of the network have also been declining—from a peak of $12.2 billion in 1980 to about $10 billion at yearend 1983. Yearend data for 1984 is not yet available, but early indications are that this trend has continued. Nevertheless, while closely monitoring its overseas banks, VTB has been careful to keep sufficient funds on deposit with them to allow the banks to carry out their basic East-West trade charter and service Moscow's other monetary needs.

Prospects

Moscow's continued micromanagement of its banks in the West could threaten their long-term viability. The banking network is fundamentally sound, but the individual banks' financial status—as well as their stature among other international banks—has been eroded by three years of cash drain. East-West United Bank, which has been left without funds that it used to place into syndication, has been largely dormant since 1980 and had a profit of only 0.5 percent in 1982. This downward trend in liquidity and profitability leaves the Soviet-owned banks in the West vulnerable to further deterioration of their capital base—and eventual insolvency.

The USSR's Swiss bank, Wozchod Handelsbank, is reeling from the recently disclosed unauthorized gold trading by its former head gold dealer. Although the final accounting is not yet in, press sources speculate that Wozchod's losses could be as high as $400 million—nearly 75 percent of the banks assets at yearend 1983—and have a massive impact in terms of lost credibility in the marketplace. We believe it likely that, to forestall legal action against the bank, VTB has told Swiss banking authorities that it will back Wozchod no matter the cost. To what extent Wozchod's sister banks will be tasked to assist in keeping it afloat is unclear. 25X1

25X1

If VTB continues its pressure on the banks to raise large sums of hard currency quickly—or to help in a major salvage operation for the Swiss bank—it may force them to sell some profitable longer term investments. Several of the banks, in fact, already have had to reduce investments to accede to Moscow's guidelines, an action that has led to corresponding drops in interest income. 25X1

25X1

Soviet bank operations are also being hampered by perceptions among Western bankers that:

- The banks are not independent financial entities but rather political extensions of Moscow.
- Soviet managerial personnel sent to the banks in the West are generally not selected on the basis of professionalism and quality of training.
- The professional local bank management increasingly is being prevented from making business decisions on the basis of rational financial criteria. 25X1

25X1

In purely financial terms, the USSR could sustain the loss of the smaller and newer banks with little effect on its own activities in world markets. If necessary, Moscow could support the full range of Soviet trade activities in the West with just the two largest banks—Moscow Narodny Bank (MNB) and Eurobank—although with diminished credibility and flexibility. All of the important markets—gold, diamonds, other precious metals and gems, Eurocurrencies, bonds and other securities, and commercial paper—are now truly international in scope and operate

25X1

around the clock. MNB and Eurobank could easily be Moscow's eyes and ears in these markets as well. But the nonfinancial effects of such a retrenchment would be substantial. As noted earlier, the foreign-based Soviet-owned banks provide Moscow with windows to the West through which knowledge, as well as money, passes—in both directions. 25X1

On balance, we believe Moscow is likely to view the cost of keeping the banks afloat as relatively small compared with the nonfinancial effects of a massive retrenchment and will be reluctant to set any of its banks adrift. 25X1

25X1

Page Denied

Secret

Declassified in Part - Sanitized Copy Approved for Release 2012/05/10 : CIA-RDP88T00799R000200020004-5