

**NATO Study on East-West Economic Relations:
Possible Conclusions**

1. The USSR uses its economic relations with the West to build its military power and international influence in the following ways:

- o To ease the burden of defense by helping to cope with economic problems and to stimulate productivity.
- o To help build the industrial base for military production.
- o To obtain specific technologies essential to the modernization of weapons systems.
- o To help finance foreign assistance activities.

2. Although the Soviet economy has achieved a high degree of self-sufficiency, East-West trade has a much greater importance to the USSR than its market value alone would suggest:

- o Soviet imports from the West consist mainly of goods and technologies which the USSR cannot currently produce, are in very short supply (e.g., grain, steel), or are far more advanced technologically than available domestic substitutes.
- o These characteristics of Soviet imports from the West are reflected in the fact that imports are about three times larger relative to Soviet GNP in rubles than in dollars (over 5 percent of Soviet GNP).

- o Soviet imports of machinery and equipment from the West in recent years have constituted about 10 percent of the ruble value of investment in machinery and equipment.
 - o Imports of Western steel have partly compensated for major shortfalls in domestic steel production, and imports of steel pipe have been of critical importance to the development of the massive West Siberian gas reserves.
 - o Massive imports of Western grain and other foods have made it possible to sustain food supplies without large slaughtering of livestock.
3. Soviet economic growth has slowed to the point that Moscow can no longer simultaneously achieve its military and civilian objectives to a reasonable degree.
- o The economic slowdown is due primarily to fundamental demographic and productivity trends, which are unlikely to improve and may worsen.
 - o Among the principal factors in declining productivity growth are: rapidly rising energy costs; severe transportation bottlenecks; shortages of steel and other major products; and low worker morale. The new Soviet leadership may be able to temporarily boost productivity, but is unlikely to make a lasting change.
 - o With GNP growth about 2 percent or less, the burden of defense is rising and Moscow has been forced to greatly slow the growth of investment. In turn, slow investment growth is contributing to slower modernization and capacity bottlenecks.

- o The slowdown in the economy, including key industries such as steel and machinery, which strongly contribute to military production, has made it more difficult to insulate military programs from economic difficulties. In recent years, military hardware procurement apparently has leveled off. Although we do not know all the reasons, these clearly include problems with supply of key industrial inputs. It would indeed be surprising if economic difficulties were not having an impact on military programs, given the complexity of the economy and the close dependence of industries on each others' performance.
- o Although no major change in Soviet priorities is likely in the near term, the Soviet leadership is likely to consider in the future the possibilities for improving economic performance by lowering military expenditures. Unless productivity can be substantially improved, which is unlikely, a continuation of the rapid military build up of the 1970s will mean little or no improvement in living standards in the 1980s. It is uncertain whether either the leadership or the population would accept such an outcome.
- 4. An expansion of imports from the West would be of considerable benefit to the Soviet economy by helping to stimulate productivity.
 - o Prospects for an expansion of Soviet hard currency earnings depend primarily on how much gas exports can be increased. If alternative energy sources are not developed, there is a potential market in Western Europe in the 1990s for a substantial increase in Soviet gas exports to that area.

*W. S. ... dev. of ...
alter...*

- o In the next few years Soviet hard currency earnings are unlikely to increase because of stagnating or falling oil production and soft energy markets. Rapid growth could resume in the 1990s, depending on gas sales and energy markets.
 - o Moscow has followed conservative hard currency payments and debt policies and will probably continue to do so at least through 1985. The new Soviet leadership will be considering whether or not to seek increased Western credit as a means of stimulating imports in the next (1986-90) five year plan. Whether or not Moscow exercises this option will depend in part on how accommodating Western credit policies are.
5. Hard currency constraints have some direct and indirect effects on Soviet military and foreign policy programs.
- o When foreign exchange is in particularly short supply, as it was in 1981, Soviet programs which are of relatively low priority, or are unpopular in some domestic political circles, have received cuts (for example, some programs involving hard currency aid for LDCs or client states).
 - o The bureaucratic process of allocating shortfalls in foreign exchange, as for other key inputs, typically entails broad across-the-board cuts, which adversely affect some high priority military and foreign policy programs that have not been explicitly exempted.
 - o The tendency to give priority to imports of consumables in allocating scarce foreign exchange, in order to avoid major

shortages, results in imports of machinery and equipment being squeezed. A result can be an unintended slowdown in the development of industries important to military production.

6. Soviet military hardware, which was at one time distinguished for its rugged simplicity, has been qualitatively improved until it is in some instances the technological equal of--if not superior to--military hardware produced in the West. Without Western technology, modernization and qualitative improvement of Soviet military equipment would have proceeded at a slower pace. The Soviets have turned to legal and illegal acquisitions of Western technologies to make up for domestic shortcomings. They have thereby been able to satisfy certain R&D and production objectives:

- o The reduction of engineering risk by following or copying proven Western designs.
- o The reduction of R&D time by several years through the use of Western designs and technology and equipment.
- o The incorporation of countermeasures early in the Soviet weapon development process.
- o In addition, the Soviets have been able to upgrade critical industrial sectors such as computers, microelectronics, and metallurgy.

7. Although the dependence of the Western economies on economic relations with the USSR is small, opportunities for Soviet political and economic leverage do exist.

~~SECRET~~

- o The Soviet market is important for a few Western industries, such as steel and certain types of equipment which are experiencing depressed world demand and basic structural problems.
- o The expansion of Soviet gas exports may create local vulnerabilities in Western Europe even though alternative sources were available in most of the area.
- o Should large additional gas projects be developed, West European dependence on Soviet gas could become dangerously large in the 1990s and beyond.
- o Moscow's monopoly of foreign trade gives it opportunities to manipulate Western firms, governments, and political and economic interests in order to gain economic concessions, and to weaken the Alliance. This is particularly true in the case of large projects.

~~SECRET~~