

CONFIDENTIAL

Soviet Union

CONFIDENTIAL

FM MOSCOW 181515Z NOV

TO PRIORITY FCO

TELEGRAM NUMBER 697 OF 18 NOVEMBER.

SAVING TO UKDEL NATO.

MY TELNO 696: THE SOVIET ECONOMY.

1. THE SOVIET ECONOMY HAS MADE A POOR START TO THE CURRENT FIVE YEAR PLAN. IN HIS SPEECH TO THE PARTY PLENUM ON 16 NOVEMBER BREZHNEV DELIVERED A GLOOMY CATALOGUE OF ECONOMIC SHORT-COMINGS. ALTHOUGH HE REFERRED TO THE INTERNATIONAL SITUATION AS COMPLICATING THE PROBLEMS OF THE SOVIET ECONOMY HE DID NOT ELABORATE. INSTEAD HE CONCENTRATED ON DOMESTIC ECONOMIC QUESTIONS, PARTICULARLY AGRICULTURE AND THE WAY THE ECONOMY IS RUN. THE NOT OF ANXIETY IN HIS SPEECH ABOUT FOOD PRODUCTION WAS PARTICULARLY STRIKING. HE GAVE NO FIGURES FOR THE HARVEST BUT IT WAS OBVIOUS FROM WHAT HE SAID THAT HIS HAD BEEN VERY DISAPPOINTING. (MOST PEOPLE ASSUME THAT IT WILL BE ABOUT 175 MILLION TONNES AGAINST A PLANNED TOTAL OF 236 MILLION TONNES.) HE IMPLIED THAT THE TARGETS HAD NOT TAKEN PROPER ACCOUNT OF THE RECURRING PATTERN OF BAD WEATHER.

2. THERE WAS NO SIGN THAT THE SOVIET LEADERSHIP HAS A NEW ECONOMIC APPROACH IN MIND. THE THRUST OF BREZHNEV'S SPEECH WAS THAT WHAT WAS MAINLY NEEDED WAS TO IMPLEMENT AGREED POLICIES, TO COMPLETE EXISTING TASKS AND TO AVOID DIFFUSION OF EFFORT. INEFFICIENCY AND WASTE LAY AT THE ROOT OF CURRENT DIFFICULTIES AND HAD TO BE REMOVED. HE EMPHASISED THE NEED FOR IMPROVEMENTS IN MANAGEMENT, CRITICISED THE WASTEFUL EFFECTS OF EXISTING METHODS OF CALCULATING PLAN FULFILMENT BY CRUDE MEASUREMENT OF GROSS PRODUCTION, AND COMPLAINED OF THE FAILURE SO FAR TO IMPLEMENT FULLY THE 1979 REFORMS.

3. BAIBAKOV'S ECONOMIC REPORT TO THE SUPREME SOVIET ON 17 NOVEMBER CONFIRMED THAT THE SOVIET ECONOMY IS WELL BELOW PLAN THIS YEAR. HE DID NOT GIVE NUMERICALLY EXPRESSED TARGETS FOR THE MAIN SECTORS FOR 1982 BUT HIS OUTLINE FOR 1985 RETAINED MOST OF THE OPTIMISTIC TARGETS PUBLISHED AT THE BEGINNING OF THE YEAR, ALBEIT WITH SOME SCALING DOWN. SOME OF THESE TARGETS ARE ALREADY OUT OF REACH. TO MEET ITS FIVE YEAR TARGET FIGURE OF 239 MILLION TONNE AVERAGE THE GRAIN HARVEST WILL HAVE TO AVERAGE OVER 250 MILLION TONNES A YEAR OVER THE NEXT FOUR YEARS - 15 MILLION HIGHER THAN THE 1978 RECORD. IT IS ALSO UNLIKELY THAT COAL PRODUCTION, WHICH HAS BEEN FALLING FOR THREE YEARS (TO 705-710 MILLION TONNES THIS YEAR) WILL REACH ITS 1985 TARGET OF 775 MILLION TONNES. OIL PRODUCTION MAY BE SUSTAINED AT ITS CURRENT LEVEL OF 600-610 MILLION TONNES, BUT IS UNLIKELY TO REACH 630 MILLION TONNES BY 1985.

CONFIDENTIAL

/4

CONFIDENTIAL

4. THAT SO MUCH OF THE 1981-5 FIVE YEAR PLAN SHOULD BE OUT OF REACH SO EARLY IN THE PLAN PERIOD MUST BE PROFOUNDLY DEPRESSING TO THE SOVIET LEADERSHIP. THE CONTINUING DISCREPANCY BETWEEN HOPE AND REALITY IN SETTING AND MEETING TARGETS IS A VIVID ILLUSTRATION OF WEAKNESS IN ECONOMIC MANAGEMENT, ON WHICH BREZHNEV COMMENTED. LITTLE IS APPARENTLY BEING DONE TO CORRECT IT BEYOND EXHORTATION TO APPLY MORE EFFECTIVELY THE PRESENT LARGELY DISCREDITED METHODS.

5. THE FAILURES HAVE DIRECT IMPLICATIONS FOR THE SOVIET EXTERNAL FINANCIAL POSITION. THERE IS NO REASON TO SUPPOSE THAT THE COUNTRY IS IN SERIOUS DIFFICULTY, BUT A CERTAIN STRINGENCY MAY LEAD THEM TO LOOK TWICE AT THE COST OF EXISTING AND - EVEN MORE - POTENTIAL EXTERNAL COMMITMENTS.

FCO PSE PASS SAVING UKDEL NATO

KEEBLE

REPEATED AS REQUESTED

FCO / WH
EESD

THIS TELEGRAM
WAS NOT
ADVANCED

2
CONFIDENTIAL

SOVIET ECONOMIC PROBLEMS

Summary

Soviet economic difficulties, already severe, will have been somewhat increased by Western measures introduced following the invasion of Afghanistan. Meat and milk production have been adversely affected and there have been hold-ups in projects relying on Western technology.

1. Western imposition of certain economic measures following the Soviet invasion of Afghanistan came at a time when the Soviet economy was already in difficulties. In 1979 Soviet industrial output grew by only 3.4 per cent against a plan target of 5.7 per cent. National income increased by less than 2 per cent, well below the planned growth rate and the lowest since the Second World War. A major factor in these poor results was the severe winter of 1978-79 which disrupted industry and transport. The steel, chemical, pulp and paper industries fell behind their production plans. Coal and electricity supplies were also affected. Agriculture suffered from the severe frosts and a drought in the spring growing season, resulting in a poor grain harvest of 179m tons, (following a record harvest of 237m tons in 1978).

2. While denying Western forecasts that oil production is about to peak and then decline, Soviet officials have admitted that the efforts required to maintain future output of fuel and energy will make major demands on capital investment and scarce labour supplies, and require advanced technology. Oil, gas and coal deposits will need to be developed as fast as possible in an attempt to meet Soviet domestic needs and the commitment to supply all of Eastern Europe's natural gas and the bulk of its oil requirements up to 1985. Over the next few years, however, oil exports to the West (which at present provide about half of hard currency earnings) will decline sharply and the shortfall cannot be made good by expanding gas exports.

3. The Soviet Union is entering a period of tight labour supplies; the working age population will grow at only 0.3% a year in the 1980s compared with 1.6% a year in the 1970s. At present the highest birth-rate is in the Central Asian and Transcaucasian republics, where relatively little heavy industry is sited, few raw materials are located, and the population is generally immobile. The costs of bringing industry to these areas would be enormous. Meanwhile the labour pool in Western Russia will actually dwindle in the 1980s. These factors mean that industry needs to become more efficient, and automated. A number of measures to improve labour productivity and economic performance announced last summer are to be introduced gradually during the next few years. They include new and generally higher wholesale prices (intended to discourage waste) for energy and raw materials, and subsequently for manufactured products, to be introduced from 1 January 1982.

4. For many years the Soviet consumer has been promised better living standards, and in general conditions slowly improved during the 1970s. In the 1980s, however, the consumer will be squeezed between the increasing needs for investment in energy, heavy industry and agriculture, and the growing allocation of resources to defence. On paper, living conditions may improve, but in practice Soviet industry and agriculture will still fail to provide the public with the goods it wants in the right place and at the right time. Soviet commentators acknowledge that persistent shortages of consumer goods reduce incentives and cause low morale among the work-force. High among the causes of the decline in the urban birth-rate is the reduced but persistent housing shortage: 24 per cent of Muscovites still live in shared communal flats and the proportion is higher still in many provincial cities. Many of the population take refuge in drink; alcoholism is a major problem, contributing to increased infant mortality and rising death-rates among working males.

5. Plan results for the first half of 1980 show an improvement on the equivalent period last year, when output was hit by the severe winter of 1978/79. Industrial production increased by 4.2 per cent, compared with an annual target of 4.5 per cent. Labour productivity growth of 3.2 per cent was a considerable improvement over last year's figure, although still falling short of the annual plan. Oil production at 297 million tonnes is on target, suggesting that the reduced 1980 plan target of 606 million tonnes is a realistic one. Gas continues to do well but coal output has fallen below last year's level. In agriculture, partly as a result of US grain restrictions, meat output in the first half of this year was below that for the same period last year, with particularly sharp falls recorded in the RSFSR, Lithuania, Byelorussia and the Ukraine. Livestock figures indicate that cattle and pig herd levels are being maintained at the expense of sheep and goats. Meat output continues to increase but at a slower rate than planned and output in 1980 is likely to be below last year's - and well below the original 1980 target of 17.3 million tons. Much will depend on this year's grain harvest. Prospects so far are for a reasonable crop.

6. The US ban on high technology exports to the USSR, and the suspension of high technology exports by other countries as exceptions to the COCOM embargo, have undoubtedly affected certain sectors of the economy, but the extent is difficult to gauge. Kosygin admitted at the 34th Session of the CMEA in June that the Western restrictions had caused hold-ups in a number of projects, and made adjustments to economic plans necessary. He also said that future policies concerning the orientation of foreign trade would need to be reviewed, suggesting that the Soviet Union had found itself vulnerable to interruptions in technology imports. At the Central Committee meeting in June Brezhnev announced that he had sent a number of memoranda to the Central Committee, including one dealing with the import of equipment which also suggests that policy is under review.

CONFIDENTIAL

7. Even without Western economic measures against the Soviet Union, the 1980s promised to be a hard decade for the Soviet Union, with great problems of resource allocation and extra strains on the planning and management system. The 11th Five Year Plan is due to be presented by Brezhnev next February; the planners' task will have been made harder by uncertainty over the degree to which they can rely on future Western supplies of goods and technology.

CONFIDENTIAL