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## Soviet Economic Problems and Prospects

*Central Intelligence Agency  
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### *Summary*

The Soviet economy faces serious strains in the decade ahead. The simple growth formula upon which the economy has relied for more than a generation—maximum inputs of labor and capital—will no longer yield the sizeable annual growth which has provided resources needed for competing claims.

In the past, rapid growth enabled Moscow simultaneously to pursue three key objectives:

- catching up with the US militarily;
- steadily expanding the industrial base; and
- meeting at least minimal consumer expectations for improved living conditions and welfare.

Reduced growth, as is foreshadowed over the next decade, will make pursuit of these objectives much more difficult, and pose hard choices for the leadership, which can have a major impact on Soviet relations with Eastern Europe and the West.

This study examines the causes of the slowdown in growth, its implications, the policy choices open to the Soviet leadership, and their possible impact on defense, the consumer, foreign trade, and US relations.

### **Causes of the Slowdown**

Factors tending to slow down the rate of growth have been apparent for some time.

- The drying up of rural sources of urban labor force growth;
- A slowdown in the growth of capital productivity;
- An inefficient and undependable agriculture which may be hit hard by a return of the harsher—but probably more normal—climatic patterns that prevailed in the 1960s;
- A limited capacity to earn hard currency to pay for needed technology imports and intermittent massive grain purchases.

These problems are not new. The Soviet leadership has tried to offset their effect by improvisation and palliatives, without impairing the priority development of defense production. They did not succeed, however, in preventing a steady fall-off in economic growth from its earlier high rate.

Looking toward the next five to ten years, these long-standing problems are likely to intensify, and will be joined by two new constraints which will greatly aggravate the resource strain: a sharp decline in the growth of the working age population and an energy constraint.

*Labor force.* In the 1980s the rate of growth of the labor force is expected to drop sharply (to less than 1 percent beginning in 1982) because of the depressed birth rates of the 1960s. Moreover, additions to the labor force will come mostly from ethnic minorities in Central Asia who do not readily move to the northern industrial areas.

In anticipation of this labor force constraint, the Soviet government is planning for an accelerated growth in the productivity of both labor and capital in the current 5-year plan (1976-80). But for years productivity gains have been slowing, and this trend is likely to continue given the sharply rising resource costs facing the economy. The more readily accessible fuel and mineral reserves west of the Urals are being rapidly depleted, while the abundant but more remote resources of Siberia and Central Asia require enormous investment outlays.

*Energy.* The most serious problem is a looming oil shortage. Soviet exploration and extraction policy has long favored increasing current output over developing sources of future output. As a result, new oil deposits have not been discovered rapidly enough to offset inevitable declines in older

fields. Consequently, production will begin to fall off in the late 1970s or early 1980s. The current level of oil production is close to the estimated maximum potential of 11 million to 12 million b/d. By 1985 oil output is likely to fall to between 8 million and 10 million b/d.

The decline in output may or may not be a temporary phenomenon. The USSR is counting on large new supplies of oil and alternative energy sources—coal, natural gas, and hydroelectric power—coming onstream beyond the mid-1980s. But most of these energy sources lie east of the Urals, far from major industrial and population centers: their development would take years and require massive capital investment.

In the near-term, however, even if the development of alternative energy sources is pushed to the maximum, overall energy output will grow at a sharply declining rate. Under a plausible set of assumptions, it would decline from 4 percent in 1976-80 to slightly above 1 percent in 1981-85. Since Soviet energy consumption increases in close parallel with the growth of the economy, a sharp slowdown in energy production would seriously constrain economic growth unless Moscow finds ways of conserving large amounts of energy or covers its shortfall by becoming a net oil importer. The Soviet government appears to be aware that it has an energy problem but has not yet made the difficult choices which will be needed to deal with it. The longer the delay in adoption of a top-priority energy program, the greater will be the economic impact in the 1980s.

#### Policy Choices

Measures for grappling with these varied problems must meet two tests: first, they must be designed to remedy particular elements of the problem—the labor force, productivity, and energy constraints; second, they must be shaped with the recognition that the problems are interrelated, and that measures aimed at easing one problem may aggravate another.

Even on the first level, it will not be easy to find solutions that will do more than alleviate the component problems. Powerful remedies are either not readily available or not politically feasible.

The labor force constraint could be eased somewhat by such measures as retaining older workers longer in the labor force, shortening secondary education, and reducing military manpower by cutting the term of service. But such measures would have only a one-time impact.

Moscow's options for raising the rate of growth and productivity of plant and equipment are even more constrained.

- They could convert industrial capacity from defense to the production of investment goods. They would be reluctant, however, to impair their defense production capability. Moreover, specialized defense resources are not easily transferred on short notice.
- They could stretch out R&D programs and production schedules and slow the rate of expansion of defense-oriented industrial capacity, but this would have limited effect in the short run.
- They could institute incentive-enhancing reforms of economic management. Such reforms, however, will be resisted by powerful vested political and bureaucratic interests.

Even a combination of these measures—such as a leveling off of defense production, coupled with measures to obtain additional manpower—would probably raise economic growth only slightly.

Options for dealing with the energy problem are similarly constrained. Opportunities for conservation are less obvious in the USSR than in the West—for example, there are few automobiles and most are for commercial or industrial use. Consequently, conservation measures alone are unlikely to yield large oil savings. The leadership thus will probably have to rely on some combination of the following measures:

- importing substantial amounts of oil from non-Communist countries;
- cutting oil exports to Eastern Europe; and
- severely rationing oil to domestic users.

Moving from a position of major oil exporter to that of a net importer would be particularly painful. Last year Soviet oil exports of \$4.5 billion accounted for almost one-half of its hard currency earnings. If current trends are projected with no change in present policies, Soviet oil import requirements by 1985 could cost \$10 billion at today's prices. Even with high priority measures to boost other exports, including gold sales, oil imports at

that level would absorb most of the Soviet hard currency earnings in the 1980s, and largely foreclose the import of other goods from the West, including badly needed Western technology.

Cutting oil exports to Eastern Europe would ease this problem by forcing Eastern Europe to share the burden of the oil shortage. Any substantial cut in the Soviet oil supply commitment to Eastern Europe, however, would worsen that area's already difficult economic situation.

Placing the burden of the oil shortage on the domestic economy would mean curtailing oil rations to producing enterprises. Such cuts would almost certainly impede production, though the impact would be less severe if reductions were more gradual as part of a long-term energy-saving program.

Implementing the foregoing solutions is complicated by the fact that the problems are interrelated and the solutions impinge upon each other. For example, pressure on enterprises to save labor will be much less effective if they must also save energy. If the energy shortage is eased by allocating foreign exchange to import oil, the resulting decline of imports of foreign machinery and technology would adversely affect productivity and economic growth within a few years. Failure to import large amounts of energy equipment and technology from the West would substantially worsen the USSR's prospects for raising oil and gas production in the longer-term.

We conclude that a marked reduction in the rate of economic growth in the 1980s seems almost inevitable. At best, Soviet GNP may be able to continue growing at a rate of about 4 percent a year through 1980, declining to 3 - 3 1/2 percent in the early and mid-1980s. These rates, however, assume prompt, strong action in energy policy, without which the rate of growth could decline to about 3 1/2 percent in the near-term and to 2 - 2 1/2 percent in the 1980s.

These are average figures; in some years performance could be better, but in others, worse, with zero growth or even declines in GNP a possibility if oil shortages and a bad crop year coincide.

*Potential Impact on Defense* The slowdown in economic growth could trigger intense debate in Moscow over the future levels and pattern of military expenditures. Military programs enjoy great momentum and powerful political and bureaucratic support. We expect defense spending to continue to increase in the next few years at something like recent annual rates

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of 4 to 5 percent because of programs in train. As the economy slows, however, ways to reduce the growth of defense expenditures could become increasingly pressing for some elements of the Soviet leadership.

*On Consumers* The reduced growth potential means that the Soviet consumer will fare poorly during the next five to 10 years compared to recent gains. Under the projected growth rates, per capita consumption could grow no more than 2 percent a year in contrast to about 3.5 percent since 1965. As a result, there will be no progress in closing the gap in living standards with the West or, for that matter, with most of Eastern Europe. Moreover, rises in wages over the next ten years combined with a slower growth in the availability of consumer goods would result in higher prices, more widespread shortages, and increasing consumer frustration.

*On Relations with the US* Moscow's economic problems in the 1980s will affect its relations with the West, especially the United States. Since the USSR's ability to pay for imports from the industrial West in the early and mid-1980s will be strained, Moscow may seek long-term credits (10-15 years), especially to develop oil and gas resources. Much of the needed energy technology would have to come from the US.

#### **Stresses upon the Leadership**

These serious problems ahead seem most likely to prompt Soviet leaders to consider policies rejected in the past as too contentious or lacking in urgency. Some leaders might be persuaded that basic organization and management reforms in industry are necessary. But that will raise the spectre that such reform would threaten political control. Consideration of other options—such as accelerating investment at the expense of defense or consumption, or reducing the armed forces to enhance the civilian labor force—could also result in strong leadership disagreements. Soviet responses to these problems could be further complicated by the fact that leadership changes will almost surely take place during the coming period. Even a confident new leadership would have difficulties in coming to grips with the problems ahead