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WITHDRAWAL SHEET

Ronald Reagan Library

Collection Name MATLOCK, JACK: FILES

Withdrawer

JET 5/6/2005

File Folder USSR-ECONOMY 8/10

FOIA

F06-114/7

Box Number 25

YARHI-MILO

2509

ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
9700	PAPER	USSR: HARD CURRENCY POSITION REMAINED STRONG IN 1983	1	4/25/1984	B1
9712	MEMO	BALDRIGE MEETING WITH SOVIET DEPUTY FOREIGN TRADE MINISTER SUSHKOV	4	5/25/1984	B1
9713	PAPER	DISCUSSION OF NEED FOR NEW ECONOMIC POLICIES INTENSIFIES <i>R 5/7/2013 F2006-114/7</i>	4	5/31/1984	B1
9701	PAPER	USSR: MIXED ECONOMIC RESULTS AT MIDYEAR	1	8/5/1984	B1
9702	MEMO	ROBINSON TO MCFARLANE RE PROPOSED STRATEGY FOR EAST-WEST ECONOMIC WORKING GROUP MEETINGS IN MOSCOW, DECEMBER 17-18 <i>R 6/25/2009 F2006-114/7</i>	1	10/10/1984	B1
9703	MEMO	SOVIET ENERGY DEVELOPMENT AND ITS STRATEGIC IMPLICATIONS FOR EAST-WEST RELATIONS TO SHULTZ; BALDRIGE; BROCK <i>R 5/7/2013 F2006-114/7</i>	2	ND	B1
9704	MEMO	ROBINSON TO MCFARLANE RE PROPOSED STRATEGY FOR EAST-WEST ECONOMIC WORKING GROUP MEETINGS IN MOSCOW, DECEMBER 17-18 <i>R 6/25/2009 F2006-114/7</i>	4	10/4/1984	B1

Freedom of Information Act - [5 U.S.C. 552(b)]

- B-1 National security classified information [(b)(1) of the FOIA]
- B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
- B-3 Release would violate a Federal statute [(b)(3) of the FOIA]
- B-4 Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
- B-6 Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
- B-7 Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- B-8 Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- B-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

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9705	MEMO	SOVIET ENERGY DEVELOPMENT AND ITS STRATEGIC IMPLICATIONS FOR EAST-WEST RELATIONS TO SHULTZ; BALDRIGE R 5/7/2013 F2006-114/7	2	ND	B1
9714	LETTER	SHULTZ TO MCFARLANE RE SOVIET ENERGY POLICY R 7/7/2008 NLRRF06-114/7	1	9/28/1984	B1
9706	LETTER	BALDRIGE TO MCFARLANE RE USSR	1	9/17/1984	B1
9707	MEMO	CASEY TO MCFARLANE RE REQUESTED STUDY ON SOVIET ENERGY DEVELOPMENT AND ITS STRATEGIC IMPLICATIONS FOR EAST-WEST RELATIONS PAR 5/7/2013 F2006-114/7	1	9/19/1984	B3
9708	MEMO	MCFARLANE TO PRESIDENT REAGAN RE PROPOSED RENEWAL OF U.S.-USSR AGREEMENT ON ECONOMIC, INDUSTRIAL, AND TECHNICAL COOPERATION R 6/25/2009 F2006-114/7	2	ND	B1
9715	LETTER	BROCK TO MCFARLANE RE SOVIET ENERGY POLICY	1	10/5/1984	B1

Freedom of Information Act - [5 U.S.C. 552(b)]

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FOIA

F06-114/7

YARHI-MILO

2509

ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
9711	PAPER	RECENT SOVIET ECONOMIC PERFORMANCE AND LONGER TERM GROWTH PROSPECTS: SOME PRELIMINARY CONSIDERATIONS PAR 5/7/2013 F2006-114/7	13	10/29/1984	B3

Freedom of Information Act - [5 U.S.C. 552(b)]

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MEMORANDUM

NATIONAL SECURITY COUNCIL

ACTION

April 19, 1984

MEMORANDUM FOR ROBERT C. MCFARLANE

FROM: JACK F. MATLOCK SUBJECT: Presidential Message to Plenary Session of
U.S.-USSR Trade and Economic Council, May 22-24,
New York

As you recall, Bill Verity wrote you asking for a number of actions in connection with the meeting of the U.S.-USSR Trade and Economic Council in New York May 22-24. In your reply you indicated that you would support sending a message from the President to the meeting. Attached at Tab A is a draft message which has been prepared by State and reviewed by the Speechwriters.

RECOMMENDATION:

That you approve sending the memorandum from Kimmitt to Livingston (Tab I) for appropriate transmission of the Presidential message.

Approve _____ Disapprove _____

Attachments:

Tab I Kimmitt/Livingston Memo

Tab A Proposed Presidential Message

MEMORANDUM

NATIONAL SECURITY COUNCIL

April 19, 1984

MEMORANDUM FOR DODIE LIVINGSTON

FROM: ROBERT M. KIMMITT

SUBJECT: Presidential Message to Plenary Session of
U.S.-USSR Trade and Economic Council, May 22-24,
New York

Attached for appropriate transmission is a proposed Presidential message to the Plenary Session of U.S.-USSR Trade and Economic Council, May 22-24 in New York. The message was drafted by the Department of State and reviewed by the Speechwriters.

Attachment

3

DRAFT PRESIDENTIAL MESSAGE TO PLENARY SESSION,
US-USSR TRADE AND ECONOMIC COUNCIL,
NEW YORK, MAY 22-24

I would like to take this opportunity to welcome the Soviet ~~attendees~~ ^{participants in} the plenary session of the US-USSR Trade and Economic Council to the United States. It is ~~well~~ ^{encouraging} that leading representatives of American industry and their Soviet counterparts can meet to discuss trade and economic issues of mutual interest at a time when US-Soviet relations are not what we might wish. The U.S. government supports mutually beneficial, non-strategic trade between our two countries. Your meetings and the activities of the Council, including the Agribusiness '83 trade show in Moscow last October, demonstrate that a key element of the structure for trade between our two countries remains in place to build upon if an improvement in international conditions permits. I look forward to hearing the results of your meetings.

Ronald Reagan

REFERRAL

DATE: 09 APR 84

MEMORANDUM FOR: DEPT OF STATE

8410602

DOCUMENT DESCRIPTION

TO. MCFARLANE

SOURCE: VERITY, C WILLIAM

DATE. 27 MAR 84

KEYWORDS: USSR

AP

SUSHKOV, VLASIMIR

INTL TRADE

MP

BAIBAKOV, NICHOLAI

SUBJ: LTR TO MCFARLANE FM ARMCO REQUESTING PRES MSG RE US - USSR TRADE COUNC

REQUIRED ACTION: RECOMMENDATIONS & DRAFT MSG

DUE DATE: 16 APR 84

COMMENTS

Loretta Swanson
44614
FOR ROBERT M. KIMMITT
EXECUTIVE SECRETARY

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United States Department of State

Washington, D.C. 20520

~~CONFIDENTIAL~~

April 18, 1984

MEMORANDUM FOR MR. ROBERT C. McFARLANE
THE WHITE HOUSE

SUBJECT: Draft Presidential Message to Plenary Session of
US-USSR Trade and Economic Council, May 22-24, New York

In response to your request (Tab A), we have prepared a draft Presidential message to the Trade and Economic Council meeting (Tab B) which U.S. Co-Chairman C. William Verity had requested in his letter to you of March 27. We understand that your staff has already replied to that letter.

Verity also wrote to Secretaries Shultz, Baldrige and Block, inviting them to speak at the meeting. After coordinating with Commerce and Agriculture, we have determined that the USG speakers should be at the sub-Cabinet level. Tentative plans call for Deputy Secretary Lyng to represent Agriculture, Deputy Secretary Brown to speak on behalf of Commerce, and Deputy Assistant Secretary Mark Palmer to represent State.

We will keep you informed of any additional requests on behalf of the Trade and Economic Council will would involve senior-level USG officials.

Charles Hill

Charles Hill
Executive Secretary

Attachments: Tab A - NSC Tasker and letter from C. William Verity to Robert C. McFarlane
Tab B - Draft Presidential Message

DECLASSIFIED

Department of State Guidelines, July 21, 1997

By CU NARA, Date 7/16/12~~CONFIDENTIAL~~

DECL: OADR



ARMCO CORPORATE OFFICES

C. WILLIAM VERITY, JR.
Chairman, Executive Committee
Board of Directors

8410604
MAR 29 1984

March 27, 1984

The Honorable Robert C. McFarlane
National Security Advisor to the President
The White House
Pennsylvania Avenue
Washington, D.C. 20050

Dear Mr. McFarlane:

I thoroughly enjoyed our visit last Thursday and appreciate so much you taking the time to visit with me and to bring me up-to-date on our present positions vis-a-vis the Soviet Union.

I talked to Tom Green and Terry Pearce over the weekend and we are making arrangements to see Ambassador Dobrynin during the first week of April. We shall keep you advised of the results of that meeting.

I am also happy that I had a chance to share with you some of the high points of my meeting in Moscow with Prime Minister Tikhonov, as well as meetings with Deputy Prime Minister Nicholai Baibakov and Foreign Trade Minister Patolichev. There is no question in my mind that the Soviets are anxious to move forward in the normalization of relationships, but they want President Reagan to provide some signals that he is desirous of moving forward and that he does understand the Soviets' reluctance to make the first move.

I do believe that the U.S.-U.S.S.R. Trade and Economic Council meeting in New York on May 22-24 might provide a good vehicle for communication with the Soviets.

As I explained to you, the Trade Council is considered by high Soviet officials to be a very important organization. At the meeting in May, we will have not only a meeting of members but, also, the Directors and the Executive Committee, which is composed of Soviet Ministers, including Alkhimov, Chairman of Gosbank.

As agreed, I will check with you early this week on specific questions I asked of you -- namely, would the President send a message of support for the work of the Council and a message for our May meeting which would indicate that he hopes progress is made in ways to facilitate trade between our two countries?



The Honorable Robert C. McFarlane
Page 2
March 27, 1984

Also, would the President receive Vladimir Sushkov, Chairman of the Soviet side of the Council? Mr. Sushkov and I are Co-Chairmen -- one from the American side and one from the Soviet side. Mr. Sushkov would be available on May 21, 22, 23 or 24.

Is it possible for us to invite Nicholai Baibakov, Deputy Prime Minister of the Soviet Union and Chairman of Gosplan, to the United States? We would make all the necessary arrangements for his visit, but it would not be appropriate to invite him unless we knew that he would be received at the White House.

Nicholai Baibakov is one of the most revered men in the Soviet Union because of the important position he has held for many years as Chairman of Gosplan.

And, lastly, if it is possible to reestablish the Aeroflot flights between New York and Moscow by May 22, this would be most helpful in making a significant signal to the Soviet Union.

If you were to let me know that this might be possible, I would communicate with Vladimir Sushkov and tell him that this is being done because of his request and, as a means of facilitating attendance by the Soviets at the meeting May 22-24. I can assure you this would be a most significant signal to the Soviets.

I am most anxious to be of help to you and to the President in any matter regarding our relationships with the Soviet Union. I do believe our Council might be helpful in creating a dialogue.

Also, I am hopeful that I will have a chance to spend about ten minutes with the President at which time I could give him my feelings about the current situation with the Soviet Union, and some other suggestions on possible signals to them.

Sincerely,

A handwritten signature in cursive script, appearing to read 'Aice'.

CWV:cee

MEMORANDUM

NATIONAL SECURITY COUNCIL

ACTION

April 19, 1984

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FROM: JACK F. MATLOCK SUBJECT: Presidential Message to Plenary Session of
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MEMORANDUM

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Ronald Reagan



United States Department of State

Washington, D.C. 20520

April 18, 1984

~~CONFIDENTIAL~~

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Attachments: Tab A - NSC Tasker and letter from C. William Verity to Robert C. McFarlane
Tab B - Draft Presidential Message

DECLASSIFIED
Department of State Guidelines, July 21, 1997
By *CWS* NARA, Date *7/16/02*

~~CONFIDENTIAL~~

DECL: OADR

REFERRAL

DATE: 09 APR 84

MEMORANDUM FOR: DEPT OF STATE

8410602

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COMMENTS

Loretta Drastoo
44614
FOR ROBERT M. KIMMITT
EXECUTIVE SECRETARY

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DISPATCH _____ W/ATTCH FILE _____ (C)



ARMCO CORPORATE OFFICES

C. WILLIAM VERITY, JR.
Chairman, Executive Committee
Board of Directors

March 27, 1984

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Sincerely,

RECEIVED 04 JUN 84 11

TO MCFARLANE FROM VARGO, F

DOCDATE 25 MAY 84 ¹⁶

DECLASSIFIED
White House Guidelines, August 28, 1997
By CJS NARA, Date 7/16/02

KEYWORDS USSR INTL TRADE BALDRICE, M

SUBJECT: SEC OF COMMERCE BALDRICE MTG W/ SOVIET DEPUTY FORN TRADE MIN SUSHKOV

ACTION: FOR RECORD PURPOSES DUE: STATUS C FILES PA

FOR ACTION

FOR CONCURRENCE

FOR INFO

File US-USSR Econ

- MATLOCK
- LENCZOWSKI
- SESTANOVICH
- MCMINN
- ROBINSON
- FORTIER
- POINDEXTER

COMMENTS

REF# LOG 8404395 8404280 NSCIFID (EF EF)

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National Security Council
The White House

System # _____

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Dep. Exec. Sec'y	_____	_____	_____
Bob Kimmitt	1	K	_____
John Poindexter	_____	_____	_____
Tom Shull	_____	_____	_____
Wilma Hall	_____	_____	_____
Bud McFarlane	_____	_____	_____
Bob Kimmitt	_____	_____	_____
NSC Secretariat	2	_____	Staff
Situation Room	_____	_____	_____

I = Information	A = Action	R = Retain	D = Dispatch	N = No further Action
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cc: VP Meese Baker Deaver Other _____

COMMENTS

Should be seen by: _____
(Date/Time)

4250-7
4395

Info only
Matlock
Lengowski
McMinn
Fortier
Poindexter

File - 22
USSR -
Economy

Discussion of Need for New Economic Policies Intensifies

A bold article by a leading advocate of reform argues that the Soviet Union and other communist countries must undertake basic reforms in order to avert explosions of public discontent. Citing Lenin's sharp reversal of economic policy in 1921 as a precedent, the article recommends shifting resources to the consumer sector, expanding private enterprise, and streamlining the bureaucracy. The article appeared in the same issue of Voprosy Istorii (Questions of History) as an extraordinary editorial praising the populist policies pursued under Khrushchev, suggesting that those favoring a basic reassessment of regime policies are now able to argue their position more openly.

The article, by Yevgeniy Ambartsumov, implicitly argues that Lenin's decision to reject outmoded and unpopular policies and pursue bold new initiatives should serve as an example to current leaders. Writing in the April issue of *Voprosy Istorii*, he points out that Lenin, rather than trying to hush up the serious problems that existed in 1921—most notably the Kronshtadt rebellion—or blame them on the hostile international situation, took them as a warning that the government had itself created a dangerous situation by neglecting public needs. Ambartsumov says that Lenin acted decisively to remedy this situation by introducing the New Economic Policy (NEP), in which additional resources were shifted to the consumer sector and the role of private enterprise was expanded. He contrasts the "lesson" of 1921 with the failure of East European leaders decades later to undertake basic reforms before crises erupted, pointing to the major outbreaks of unrest that took place in 1953 in the GDR, in 1956 in Hungary, in 1968 in Czechoslovakia, and most recently in Poland.

In each of the East European crises, Ambartsumov argues, the leadership showed insensitivity to the people's needs. He specifically mentions a tendency to overinvest in industrial development and defense while shortchanging the welfare of the people and the overbureaucratization of both the party and the government. For example, he compares Gierek's overinvestment in Polish heavy industry with similar Soviet excesses in the early 1920's. Citing Lenin's attacks on "bureaucratic centralism," he states that East European studies "analyzing the causes of crises in their countries also point to bureaucratic distortions and alienation of some of the apparat and leadership from the masses."

DECLASSIFIED

Ambartsumov contrasts the negative experiences in East Europe with Lenin's decision in 1921 to lessen central control in the Soviet Union and allow private enterprise to develop in order to pragmatically increase the availability of food and services. He points out that Lenin, arguing that it was necessary to use capitalists to help develop socialism, even turned over various Soviet natural resources to foreign investors to develop. Lenin, he says, realized that this would revive "capitalist tendencies" but argued that they posed no danger as long as industry remained under state control and the party kept all political power. Ambartsumov maintains that many socialist countries in recent years have similarly helped to overcome their economic crises by encouraging private enterprise, once again confirming the correctness of Lenin's approach and "refuting the unjustified fears of those who jealously guard the purity of theoretically correct but, as Lenin said, in practice unworkable systems."

The message of Ambartsumov's article was all the stronger since the same issue of *Voprosy Istorii* carries a striking editorial also arguing for more stress on consumer welfare and democratization.¹ The editorial, which reviews the 1960's, holds up as a successful precedent Khrushchev's policy of shifting resources from heavy industry and defense to consumer goods. The favorable treatment of Khrushchev is highly unusual. *Voprosy Istorii*, whose 69-year-old chief editor, Vladimir G. Trukhanovskiy, had been appointed in 1960 under Khrushchev, has not recently been notable as a vehicle for reformist or politically controversial views, although it did take the lead in the early 1950's in calling for a reassessment of the Stalinist era.

Background

In the past Ambartsumov, the head of the sector for political problems at the Institute of Economics of the World Socialist System, has been a strong advocate of expanding the role of the private sector in the Soviet economy. In a pair of articles in *New Times* in 1980, he argued—in less sweeping terms than he uses in the current article—that the NEP remained relevant to contemporary circumstances and that it demonstrated that the private sector can respond "more promptly and flexibly" than the state to consumer needs. In subsequent articles he has held up the experience of East European countries in using the private sector to meet public needs for services. He has pointed out that even such an orthodox communist country as East Germany has improved living conditions by opening consumer services to private entrepreneurs, for example, by allowing family-owned stores and cafes.²

¹ See the *Trends* of 23 May 1984, pages 5-7.

² See the *Trends* of 29 April 1981, pages 5-6.

~~Matlock~~ 25

MEMORANDUM

NATIONAL SECURITY COUNCIL

File -
US - Soviet -
Econ Relations

~~SECRET~~

October 10, 1984

ACTION

MEMORANDUM FOR ROBERT C. MCFARLANE

FROM: ROGER W. ROBINSON *RWR*

SUBJECT: Proposed Strategy for East-West Economic Working Group Meetings in Moscow, December 17-18

Attached (Tab I) is a revised memo to Secretaries Shultz and Baldrige and Ambassador Brock which reflects your recommended changes as well as Don Fortier's helpful revisions. As you know, I did not have an opportunity last Friday to have Don read the proposed response, particularly the section dealing with arrangements similar to the China export control issue. His revisions were focused primarily on clarifying the objectives of the steering group. Also attached (Tab II) for your reference is my original memo embodying your changes so that you can get a better sense of Don's inputs.

The only other alterations to your memo were: (1) the addition of Bill Brock's name to the addressees as he just sent in a correspondence to you (Tab III) which is virtually an "instant replay" of the correspondence of Secretaries Shultz and Baldrige and (2) copies to Director Casey and Secretary Weinberger who are directly engaged in this issue and require knowledge of this latest beneficial development.

Your signing the attached response will be very helpful in putting this issue on a more sensible, stable footing that provides all interested agencies with an opportunity to participate but not at the expense of the NSC/CIA relationship.

RECOMMENDATION:

That you sign the memo at Tab I as soon as possible.

Approve _____ Disapprove _____

Don Fortier *DF* and Bill Martin *WFM* concur.

Attachments

- Tab I Revised Memo to Shultz/Baldrige/Brock
- Tab II Robinson Memo to McFarlane of October 4, 1984
- Tab III Memo from Brock

cc: Jack Matlock, Chris Lehman, Ron Lehman, Ken deGraffenreid, Dave Wigg, Diane Dornan

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DECLASSIFY ON: OADR

NLRR 606-114/7 #9702

BY CW NARA DATE 6/25/04

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THE WHITE HOUSE
WASHINGTON

DECLASSIFIED

NLRR F06-114/7 #9703

BY KML NARA DATE 5/7/13

~~SECRET~~

MEMORANDUM FOR THE HONORABLE GEORGE P. SHULTZ
The Secretary of State

THE HONORABLE MALCOLM BALDRIGE
The Secretary of Commerce

THE HONORABLE WILLIAM E. BROCK
United States Trade Representative

SUBJECT: NSC Tasker to CIA on Soviet Energy
Development and Its Strategic Implications
for East-West Relations (S)

I appreciated receiving letters from you expressing the strong interest of your agencies in our request that the CIA undertake an assessment of Soviet energy strategy and its strategic implications. I think we all agree that such an updated assessment is of value at this time, particularly in view of the upcoming meetings of the East-West economic working group tentatively scheduled for December in Moscow.
(S)

Bill Casey has assured me that the CIA assessment is already under way based on our comprehensive terms of reference. In light of this, I believe the best approach at this juncture is to invite the comments of your agencies on the TOR which will be forwarded to the CIA as deemed appropriate. I understand Commerce has already submitted to the CIA a separate list of requirements. (S)

We need though to think not only about an assessment, but also about a process to assimilate the information we receive and to transform it into clear policy recommendations. Here I think our procedure on China technology transfer policy serves as an appropriate precedent. A steering group should be created under NSC auspices. The task of this group should be to evaluate the spectrum of technology before us, to examine the strategic rationale for transfer and for denial, and to table recommendations in green lines and red lines, as well as for an amber zone for the purpose of establishing negotiating leverage. A knowledgeable pre-existing group under the direction of the steering group

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should be assigned to prepare issues for policy resolution. The State-chaired SIG on Technology Transfer would probably be most appropriate as it has heretofore been responsible for COCOM deliberations on oil and gas equipment and technology transfers.

Although it would be desirable to reach a consensus by the time of the December meetings in Moscow, priority must be given to conducting a careful evaluation of this issue and the important role of energy trade in the context of our broader agenda on East-West relations for the second term. As you know, this Administration has expended enormous efforts to forge a security-minded consensus on East-West economic relations as outlined in NSDD-66, and it is important that we take a measured approach to the beneficial expansion of U.S.-Soviet commercial relations so that our hard-fought gains in this area are preserved. (S)

cc: The Secretary of Defense
The Director of Central Intelligence

II

National Security Council
The White House

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System # I
Package # 7520
1387

	SEQUENCE TO	HAS SEEN	DISPOSITION
Paul Thompson	<u>1</u>	<input checked="" type="checkbox"/>	
Bob Kimmitt	<u>2</u>	<input checked="" type="checkbox"/>	
John Poindexter	<u>3</u>	<input checked="" type="checkbox"/>	
Tom Shull			
Wilma Hall	<u>4</u>		
Bud McFarlane	<u>5</u>	<u>AM</u>	<u>A</u>
Bob Kimmitt		<u>lead</u>	
NSC Secretariat	<u>5</u>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Situation Room	<u>5</u>	<input checked="" type="checkbox"/>	
<u>Robinson</u>	<u>6</u>	<u>AM</u>	<u>pls ask Robinson to take</u>

I = Information A = Action R = Retain D = Dispatch N = No further Action

cc: VP Meese Baker Deaver Other _____

COMMENTS Should be seen by: _____
(Date/Time)

NATIONAL SECURITY COUNCIL

October 5, 1984

Bud,

The attached package is virtually completed with the exception of Jack Matlock's concurrence (not available). Don Fortier and I have discussed this proposed approach at length, and he is fully on board "in principle." Unfortunately, he was crashing this morning and has not yet had the opportunity for a detailed reading of the memo. He asked me to mention, however, that he basically concurs. I am rushing this forward primarily for the purpose of equipping you for any discussions that might take place with Secretary Shultz over the weekend. We can always wait until Tuesday to send the attached memo to Secretaries Shultz and Baldrige (if approved). I think you share my view that this is not an easy tightrope, but I believe we are striking the appropriate middle ground.

Have a good weekend!


 Roger Robinson

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MEMORANDUM

NATIONAL SECURITY COUNCIL

~~SECRET~~

October 4, 1984

DECLASSIFIED

ACTION

NLRR FD6-114/7 #9704

MEMORANDUM FOR ROBERT C. MCFARLANE

FROM: ROGER W. ROBINSON *RWR*

BY CN NARA DATE 6/25/09

SUBJECT: Proposed Strategy for East-West Economic Working Group Meetings in Moscow, December 17-18

Attached (Tab II) are letters to you from Secretaries Shultz and Baldrige in response to our terms of reference on Soviet energy development and its strategic implications for East-West relations. Also attached (Tab III) is Director Casey's confirmation note stating that the Agency "anticipates no difficulty in meeting your requirements" and that the assessment is under way. The letters from Secretaries Shultz and Baldrige are very similar and basically make the following points:

- o Both State and Commerce firmly state their interest in being full participants in this assessment.
- o Both claim that the existing NSC terms of reference should be changed to take account of their views and requirements.
- o State goes further and calls for an interagency meeting to generate an entirely new TOR.
- o State and Commerce make clear that we should arrive at a clear policy understanding of what U.S. oil and gas equipment and technology we are prepared to sell to the Soviets for the Moscow meetings December 17-18.

As you know, State and Commerce were both made aware that we planned to develop terms of reference for a study prior to our preparation of the TOR and had already taken steps to address this NSC effort. We can also safely assume that our effort is not entirely agreeable. We now have two orders of business: (1) your response to the two Secretaries in a manner which preserves the integrity of the NSC/CIA relationship and (2) to develop a coherent approach for arriving at NSC guidelines for the U.S. delegation to Moscow. It may be useful, however, to review the issue involved prior to addressing these action items.

Issue

What is at stake in the USG actively promoting the sale of oil and gas equipment and technology to the USSR at the Moscow meetings?

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DECLASSIFY ON: OADR

o First, we should remember that the President did not approve a high visibility trade negotiation with the USSR. He approved the resurrection, under Article III of the ten year agreement, of meetings of a benign, traditionally low-level working group of economic experts for the sole purpose of providing "the U.S. with access to some unpublished economic and technical data." This was the verbatim State explanation used in the memo to the President (Tab IV).

o By promoting oil and gas equipment sales to the USSR, we would likely undermine our on-going effort in COCOM to achieve multilateral controls on sophisticated "dual-use" oil and gas equipment called for in NSDD-66. The language in NSDD-66 states that the President requires "a quick agreement that allied security interests require controls on advanced technology and equipment beyond the expanded COCOM list, including equipment in the oil and gas sector, development of a list of equipment in this category and an effective procedure to control its transfer to the Soviet Union." Bill Schneider and Dick McCormack are currently considering the resubmission of several items not retained in the initial round of COCOM talks.

o USG promotion of U.S. oil and gas equipment and technology sales primarily to facilitate the extraction, processing and transmission of exportable Soviet surpluses is inconsistent with our firm stand against further Soviet energy incursions into Western markets, including the first provision of NSDD-66 which calls for "an agreement that countries participating in the agreement will not commit to any incremental deliveries of Soviet gas beyond the amounts contracted for the first strand of the Siberian pipeline; not commit themselves to significant incremental deliveries through already existing pipeline capacity; and participate in the accelerated development of alternative Western energy resources, principally Norwegian gas reserves."

o By permitting the issue of oil and gas equipment sales to be placed on the Moscow agenda, we would reinforce a Soviet disinformation effort centered on the argument that our East-West economic policy initiatives, the pipeline dispute, and efforts in COCOM on select oil and gas equipment controls are merely cynical devices to secure a preferred position for U.S. suppliers of oil and gas equipment at the direct expense of European and Japanese suppliers.

o For the benefit of a few U.S. oil and gas equipment suppliers and a modest level of sales (\$50-100 million?), we would incur European ridicule concerning this perceived flip-flop in the President's hard fought East-West economic policy ("when it suits U.S. commercial interests"). It would also almost surely provide the pretext for the allies to ignore the IEA May 1983 agreement on the second strand (already contemplated in the next Soviet five year plan) that when completed would provide between \$10-15 billion in annual Soviet hard currency earnings (25% of the total projected Soviet earnings structure). These earnings would, in turn, be used to expand further Soviet adventurism against U.S.

interests and ultimately further add to our defense expenditures (in effect an added "tax" on the American people).

o Such a U.S. initiative in Moscow would likely stimulate media attention to a perceived renewal of U.S.-initiated "economic detente" similar to the pattern established in 1972-73 when expanded economic cooperation and concessions were ostensibly used to leverage greater Soviet geopolitical cooperation. The President has acknowledged publicly that a decade of this policy failed and he would, in turn, be vulnerable to significant bipartisan criticism. It could also greatly complicate the task of renewing the EAA next year as Senator Garn is known as an ardent foe of U.S.-Soviet energy cooperation.

o Finally, we should not forego our opportunity to fully evaluate and integrate the crucial U.S. leverage embodied in the key elements of East-West economic relations for the second term by taking unilateral economic initiatives in the December meetings in Moscow. After all, these working group meetings do not represent an action-forcing event. We should instead take the time required to carefully evaluate the optimal use of U.S. economic and financial leverage in advancing our broader U.S. Soviet agenda. In our view, there is probably no way this can be accomplished by year-end. It would also reserve these policy options for the President rather than having the potentially positive relationship benefits diluted at the sub-Cabinet or even Cabinet level.

The TOR and Your Response to State and Commerce

Consistent with NSDD-66, we tasked an updated assessment of Soviet energy strategy, its strategic implications, and the role of U.S. and Western oil and gas equipment and technology in order to develop "an effective procedure to control its transfer to the Soviet Union." We are satisfied with the present formulation of our TOR. More importantly, it is inappropriate for State and Commerce to attempt to intervene in an NSC tasking to the CIA in matters of interest to our organization. Indeed, allowing this to happen would create a damaging precedent that could affect a broad range of NSC issues in the future. We, therefore, have proposed a response from you to Secretaries Shultz and Baldrige (Tab I) which acknowledges their strong interest in this issue and invites their comments concerning our TOR that would be passed on to CIA as deemed appropriate. This way the substance of the NSC tasker to CIA would be preserved.

Approach to Guidelines for U.S. Delegation

In addition, your memo to the Secretaries outlines an approach to interagency consideration of the CIA assessment when completed. Because there exist stark differences in the positions of the agencies on this issue, it is recommended that we take an approach similar to the China export control issue -- namely, a steering group chaired by you and a working group chaired by State. Our principal objective in this exercise should be to develop a "red line" on a few select U.S. oil and gas equipment and technology

items most likely selected from the proposals we have submitted to COCOM (e.g. semi-submersible pumps and seismic exploration equipment).

Again, if such an agreement cannot be reached by December, instructions should be issued to the delegation not to address or promote U.S. oil and gas equipment sales. The Soviets already know our present licensing policy, and we would simply reserve judgment on those "dual-use" items which have to be submitted to COCOM until further notice.

In conclusion, we understand and are supportive of the President's interest in expanding trade with the USSR as a means to facilitate greater U.S.-Soviet contact and incentives for a more peaceful world. However, it is important to note that our policy on oil and gas equipment sales to the USSR has a rather complicated history which requires careful management. Our willingness to sell this particular equipment has traditionally been linked to progress on human rights issues in the USSR (1978 Shchiransky; 1981 reconciliation in Poland). The Administration will therefore probably not escape thorough cross-examination from human rights groups and Capitol Hill on which specific human rights conditions in the USSR and/or Poland have improved to justify a visible U.S. initiative in this area.

in principle see note
NOT AVAILABLE
UFA *CI* *not available*
Don Fortier, Jack Matlock, Bill Martin, Chris Lehman, Ron Lehman, Ken deGraffenreid, Dave Wigg and Diane Dornan concur.

RECOMMENDATION:

That you sign the memo to Secretaries Shultz and Baldrige at Tab I.

Approve _____ Disapprove _____

Attachment

- Tab I Memo to Shultz/Baldrige
- Tab II Memo from Shultz/Baldrige
- Tab III Memo from Casey
- Tab IV Memo to President

36

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THE WHITE HOUSE
WASHINGTON

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NLRR F06-114/7 #9705

BY KML NARA DATE 5/7/13

~~SECRET~~

MEMORANDUM FOR THE HONORABLE GEORGE P. SHULTZ
The Secretary of State

THE HONORABLE MALCOLM BALDRIGE
The Secretary of Commerce

SUBJECT: NSC Tasker to CIA on Soviet Energy
Development and Its Strategic Implications
for East-West Relations (S)

view

I appreciated receiving letters from both of you expressing the strong interest of your agencies in our request that the CIA undertake an assessment of Soviet energy strategy and its strategic implications. I think we all agree that such an updated assessment is of value at this time, particularly in lieu of the upcoming meetings of the East-West economic working group tentatively scheduled for December in Moscow.

As Bill Casey has assured me that the CIA assessment is already under way based on our comprehensive terms of reference, we believe the best approach at this juncture is to invite your agencies' comments on the TOR which we can then forward to the Agency as deemed appropriate. I understand Commerce has already submitted to the CIA a separate list of requirements. (S)

arrangements

while being
Once the assessment is completed, I propose that we establish a procedure for interagency consideration of the findings similar to our handling of the China export control issue. A steering group would be created under NSC auspices with a working group formed and chaired by State with a view toward outlining the issues and the positions of the key agencies for decision by the steering group or the President. This process should facilitate the development of a consensus on what sophisticated U.S. oil and gas equipment and technology can be made available to the USSR and what we do not wish to sell. Although it would be desirable to reach such a consensus by the time of the December meetings in Moscow, priority must be given to conducting a careful evaluation of this issue and the role of energy trade in the context of our broader agenda on East-West relations for the second term. As you both know,

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DECLASSIFY ON: OADR

this Administration has expended enormous efforts to forge a security-minded consensus on East-West economic relations as outlined in NSDD-66, and it is important that we take a measured approach to the beneficial expansion of U.S.-Soviet commercial relations so that our hard-fought gains in this area are preserved. (S)

~~FOR THE PRESIDENT:~~

THE SECRETARY OF STATE
WASHINGTON

~~SECRET~~

September 28, 1984

Dear Bud,

I have seen your memorandum of September 10 requesting that the CIA undertake an assessment of Soviet energy policy. I agree with you that Soviet energy policy has very significant implications for us and our allies and believe that particular attention should be given to questions such as Soviet production capabilities, the degree of potential Western dependence on Soviet sources, the extent to which the Soviets may be able to use their role as supplier to obtain political leverage, and the possibility for developing alternatives to Soviet energy. Since these issues bear upon critical U.S. foreign policy concerns, the Department of State must actively participate in drawing up the terms of reference for this study and in reviewing the study.

The preparation of such a study in connection with the upcoming meeting of the US-USSR economic and technical experts' group makes good sense. Given the capabilities of U.S. manufacturers in the field of energy exploration, production, transmission and refining, and the need the Soviets have for such equipment, it is desirable that we come to these meetings with a clear idea of what we would be prepared to make available as well as what we do not wish to sell. In this connection the proposed study should take a special look at the question of specifically how and whether Soviet energy development would be inhibited by a denial of U.S. origin equipment and know-how as well as the question of foreign availability. Of course, the military relevance of any such equipment should also be examined.

I suggest that a meeting be convened of agencies involved in this area, along with CIA, so that a single, clear statement of the terms of reference can be developed. We have already proposed meeting dates to the Soviets -- December 17-18 -- and we expect these to be confirmed soon. Thus I believe that work on the study must begin promptly.

Sincerely,



George P. Shultz

The Honorable Robert C. McFarlane,
Assistant to the President for National
Security Affairs
The White House

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NLRR FOI 7-14/7 #9714

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DECL: OADR

BY CW NARA DATE 7/7/08

~~SECRET~~

90921 Add-on 40
III

Central Intelligence Agency

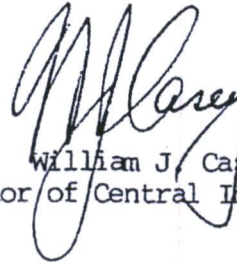
Washington, D. C. 20505

19 September 1984

MEMORANDUM FOR: The Honorable Robert C. McFarlane
Assistant to the President for
National Security Affairs

SUBJECT: Requested Study on Soviet Energy Development and
Its Strategic Implications for East-West Relations (S)

The Agency stands ready to contribute analysis of Soviet energy developments and their implications for East-West relations as background for discussions on U.S. policy formulation in this area. Based on the guidelines established in your tasking memorandum dated 10 September 1984 we anticipate no difficulty in meeting your requirements. Per your suggestion, I intend to have members of my staff contact Bill Martin, Roger Robinson and David Wigg to discuss further the nature of the study and establish a timetable for its completion.



William J. Casey
Director of Central Intelligence

cc: The Secretary of State
The Secretary of Commerce

DECLASSIFIED IN PART

NLRR F06-114/7 # 9707

BY KML NARA DATE 5/7/13

FOIA(b)(3)

~~SECRET~~



THE WHITE HOUSE
WASHINGTON

~~SECRET~~ACTION

DECLASSIFIED

NLRR F010-114/7 #9708

BY CIV NARA DATE 6/25/09

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT C. MCFARLANE

SUBJECT: Proposed Renewal of U.S.-USSR Agreement on Economic, Industrial and Technical Cooperation

Issue

Should you approve renewal of the ten-year U.S.-USSR Agreement on Economic, Industrial, and Technical Cooperation?

Facts

Attached (Tab A), is a memo to you from Secretary Regan as Chairman of the Senior Interdepartmental Group-International Economic Policy (SIG-IEP) forwarding a majority SIG recommendation that you approve renewal of the ten-year U.S.-USSR Agreement on Economic, Industrial, and Technical Cooperation (Tab C). The Agreement was originally signed by President Nixon and General Secretary Brezhnev during the 1974 Moscow Summit and is due to expire on June 28.

Discussion

A majority of agencies represented on the SIG-IEP including State, Commerce, and USTR, support renewal of the Agreement on the basis of the following arguments:

- Agreement is very general and does not constrain U.S. foreign policy actions.
- Contains a provision which obliges the Soviets to assure acceptable operating conditions for American firms domiciled in the USSR.
- Renewal would be consistent with your January 16 speech in which you stated that we should not further disassemble the U.S.-USSR bilateral framework.
- The business community strongly supports renewal.

Prepared by:
Roger W. Robinson

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DECLASSIFY ON: OADR

-- According to USTR, a decision not to renew could have an adverse affect on our grain trade.

The only dissenting agency was Defense. Secretary Weinberger sent a memo to me summarizing DOD's objections (Tab B). He argues:

-- Against sending a "business-as-usual" message to the USSR when relations are poor.

-- The language of the Agreement reflects the euphoric, detente era period rather than the post-Afghanistan-Poland-KAL period.

-- This issue should be deferred until we are prepared to negotiate a tougher, more limited agreement in exchange for a substantive concession from the Soviet Union.

-- Could complicate renewal of the Export Administration Act.

In the context of considering renewal of the agreement, State also requests that you approve resurrecting U.S. participation in a working group of experts called for in Article III of the agreement that would meet periodically to exchange information concerning basic economic, industrial and commercial trends. This working group met only three times prior to being suspended due to the Afghanistan invasion. State feels this forum could be useful as it reportedly provides the U.S. with access to some unpublished economic and technical data.

On balance, we believe that renewal of the ten-year agreement would advance our broader objectives concerning relations with the USSR. The general terms of the agreement also protect us from any foreseeable downside risks such as the USSR attempting to use the agreement to constrain our actions. In addition, we see no difficulty with approving the reconvening of a working group of experts which would probably be represented at the Assistant Secretary level.

Recommendation

OK No

- | | | |
|-------|-------|--|
| _____ | _____ | 1. That you approve renewal of the U.S.-USSR Agreement on Economic, Industrial and Technical Cooperation. |
| _____ | _____ | 2. That you approve U.S. participation in a working group of experts called for in Article III of the Agreement. |

Attachments

- | | |
|-------|-------------------|
| Tab A | Regan Memo |
| Tab B | Weinberger Memo |
| Tab C | Text of Agreement |

III

~~CONFIDENTIAL~~
Central Intelligence Agency



Washington, D. C. 20505

*File:
USSR -
Economy*

DECLASSIFIED IN PART

NLRRF06-114/7*9711

BY KML NARA DATE 5/7/13

DIRECTORATE FOR INTELLIGENCE

29 October 1984

FOIA(b)(3)

Recent Soviet Economic Performance and
Longer Term Growth Prospects:
Some Preliminary Considerations

Summary

On the basis of the improvement noted in Soviet economic performance in 1982 and 1983 and the results so far in 1984, we believe that average annual GNP growth for the 1980s will probably be closer to 2½ percent than to the 2 percent we had forecast earlier this year. Our analysis suggests, however, that even if the recovery is linked primarily to factors operating over the longer term rather than to one-time gains, the average annual rate of increase over the decade is not likely to exceed 2½ to 3 percent. Only a fundamental improvement in productivity appears to offer the potential for moving longer term growth above 3 percent. Such improvement seems unlikely, particularly in view of the increasing cost of introducing new plant and equipment into more remote areas of the country.

Without some progress toward improved productivity, however, an effort by the leadership to maintain investment growth at the present above-plan rate could imperil the recent gradual improvement in living standards. The dilemma would be much more acute if Soviet leaders attempted to accelerate growth in defense spending. Slower investment growth would allow a better opportunity to regain earlier rates of growth in living standards, but such a policy would not address the economy's urgent need for industrial modernization.

This memorandum was prepared in the
Office of Soviet Analysis. Comments and queries may be addressed to

SOV M. - 84-10178



~~CONFIDENTIAL~~

Recent Soviet Economic Performance and
Longer Term Growth Prospects:
Some Preliminary Considerations

Introduction

1. In early 1984 we estimated that Soviet economic growth would average about 2 percent per year over the 1980s.¹ Now, recent revisions of estimates of economic growth for 1982 and 1983 and preliminary estimates for 1984² indicate that average growth during the first half of the decade is almost certain to be higher than had been anticipated. This turn of events raises the question of a possible change in the longer range outlook.

2. Research directed toward an understanding of the causes of the apparent recovery has suggested specific factors affecting the current trends.³ In this memorandum, we have limited ourselves to considering two aspects of the relationship between recent growth trends and our long-term forecast. First, we have made some simple calculations to suggest why average growth in the 1980s is now likely to exceed the 2 percent a year that we estimated earlier. Second, we take a preliminary look at the more significant considerations which the new estimates raise. To do this, we have tried to gauge the shift in long term growth prospects by revisiting some of our

¹For a description of this estimate, see Research Paper SOV 84-10017S (Confidential), April 1984, USSR: Economic Projections Through 1990--A New Look.

³See Typescript Memorandum Soviet Economic Growth: On the Road to Recovery?, (Confidential), October 1984.

judgments about several key factors affecting growth--investment, energy constraints, and production relationships. The strategy we have adopted is to assume that certain longer term changes have taken place and then compare simulations of the economy's performance under the altered conditions with our earlier analysis.

3. In this memorandum, we do not try to present a new baseline projection of the outlook for the Soviet economy, a step which we believe would be premature at present. We have simply tried to suggest some of the bounds within which growth might fall and some of the possibilities for distributing national output available to the leadership.

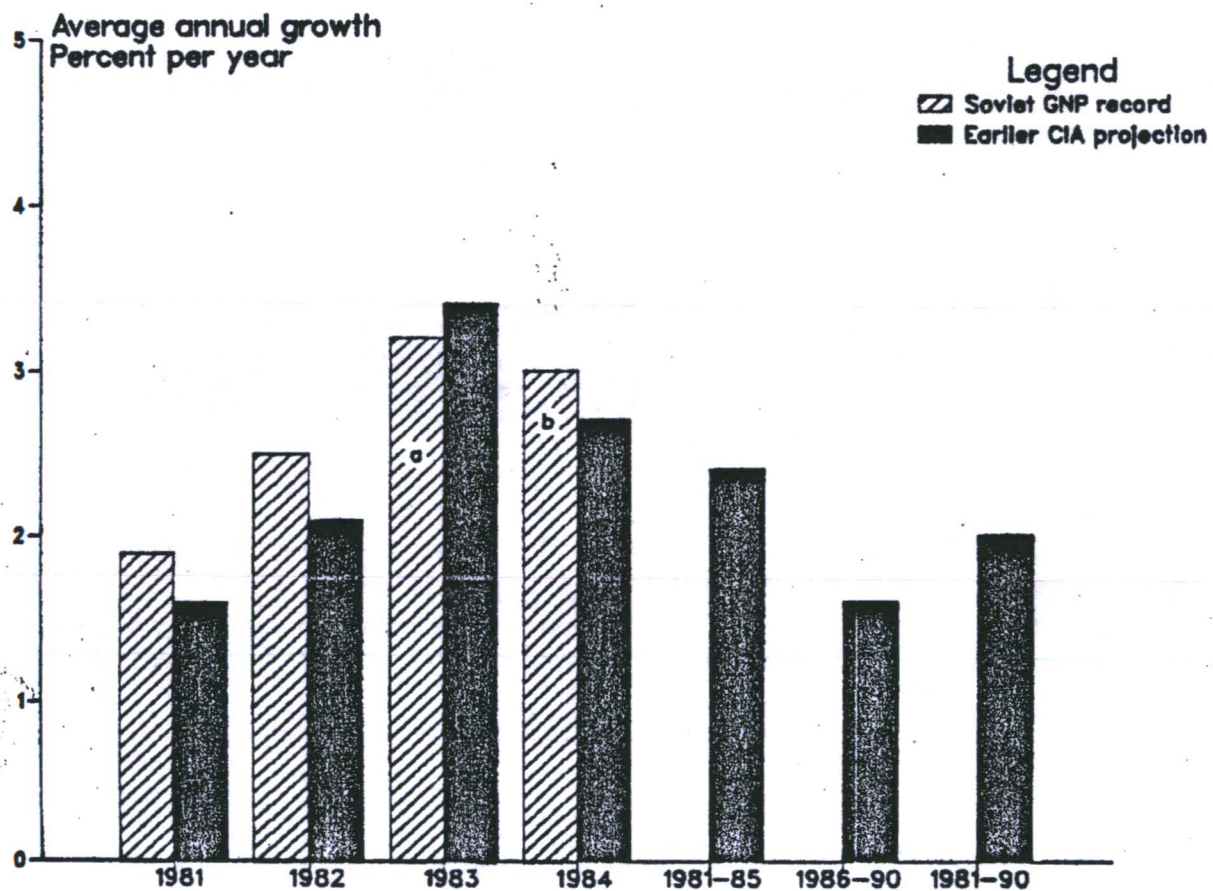
Current Growth Trends and Recent Projections

4. Recently, new data prompted revision of our estimates of economic growth in 1982 and 1983. Growth is now estimated to have been about 2 percent in 1981, 2½ percent in 1982 and roughly 3 percent in 1983. We judge that growth could continue at about 3 percent for another year or two, provided that short-term swings in agricultural output are not large.

5. Because our forecast of 2 percent annual growth for 1981-90 included a near-term recovery through 1983 with growth rates close to the observed rates,⁴ the record would not necessarily suggest a revision of our longer term forecast. However, if 3 percent growth should persist through 1985, actual growth would diverge modestly from our earlier estimate. Growth would have to average a little more than one percent a year for the last half of the decade

⁴Our earlier analysis showed significant but short-lived recovery for the early 1980s with improvements in agriculture, industry, and some non-industrial sectors. GNP growth rates for 1983 and 1984 were the highest of the decade, and the forecast average of those two years was very close to 3 percent (See figure 1).

Figure 1
Estimated and Projected Soviet GNP Growth



a Preliminary. Should be cited as "about 3 percent."
 b Rough estimate based on plan data and performance through mid-year.
 Shading indicates approximate range of uncertainty.

for our baseline forecast for the decade to hold. This now looks improbably low. It is more likely that average 1986-90 growth would be a bit higher--not lower--than our baseline forecast.

6. From this picture of the recent and current growth records we conclude that:

- Average growth for 1981-85 is more likely to be between $2\frac{1}{2}$ and 3 percent per year than the $2\frac{1}{2}$ percent in our last baseline projection.
- Average growth for 1981-90 is likely to exceed somewhat the figure of roughly 2 percent a year in our projections.
- An average of about $2\frac{1}{2}$ percent for 1981-90 now looks reasonable since it would require an average for 1986-90 of slightly greater than 2 percent.

Some Alternative Possibilities

7. Is it possible that the improvement in growth noted since 1981 points to changes--new conditions or Soviet breakthroughs--that would alter our longer range forecasts in a more fundamental way? To explore this aspect of the question, we reviewed the judgments we had made with respect to the outlook for investment, energy, and industrial productivity and adopted some alternative views about the behavior of these factors during the 1980s.

8. We looked at three cases to test the effect of increasingly favorable growth conditions:

- In Case 1, instead of using low investment growth rates such as those implied by the 1981-85 Plan, we fix growth at 4 percent per year, approximately the rate currently observed.

- In Case 2, we use the bullish investment assumption of Case 1 and remove any constraint on performance caused by a possible energy shortfall. In this case, the economy is able to employ all of its capital--no capital is assumed to be idle because of energy or material shortages.

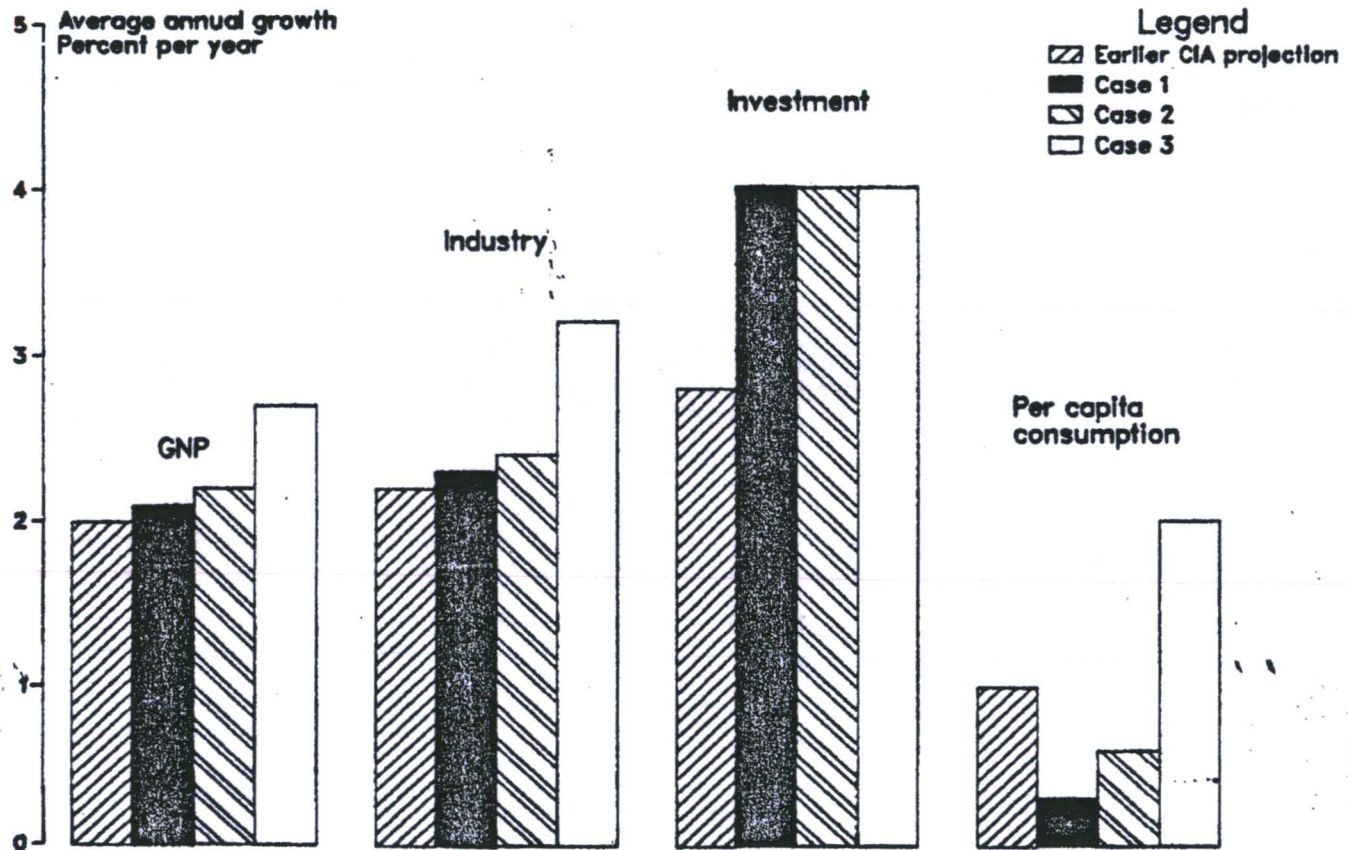
- In Case 3, we assume all of the favorable conditions of Case 2 as well as success in returning to the higher productivity levels in industry which the Soviets had enjoyed in the late 1960s and early 1970s.⁵

Implications for Growth

9. Results from these cases suggest that even under more favorable circumstances Soviet economic growth is not likely to average more than 3 percent per year during the 1980s (See figure 2). Since our most favorable case (Case 3) assumes an optimistic view of industrial productivity compared

⁵Econometric analysis of the various sectors of the industrial economy reveals that the impact of additional investment on labor productivity dropped after 1975. A return to pre-1975 productivity growth trends would help the Soviet economy grow faster by increasing the gain in labor productivity derived from increases in the stock of machinery and equipment.

Figure 2
Projected Growth of Selected Soviet Economic Aggregates, 1981-90



Case 1: Investment growth at 4 percent.
 Case 2: Investment growth at 4 percent. No energy constraint.
 Case 3: Investment growth at 4 percent. No energy constraint. Pre-1975 productivity.

to that which has been observed since the mid-1970s, growth seems more likely to average closer to 2½ than 3 percent.

10. Things would have to go well in the economy for even the 2½ percent average growth to be maintained through the decade. Our analysis suggests that requirements for long-term growth at this rate would include the following:

- Maintenance of annual investment growth at its present 4 percent rate.
- Success in implementing plans for energy conservation and fuel substitution, a key element of which would be the faster replacement of older capital with new energy-saving plant and equipment.
- Average weather and associated agricultural performance.
- Some improvement in industrial productivity.

Implication for Defense and the Consumer

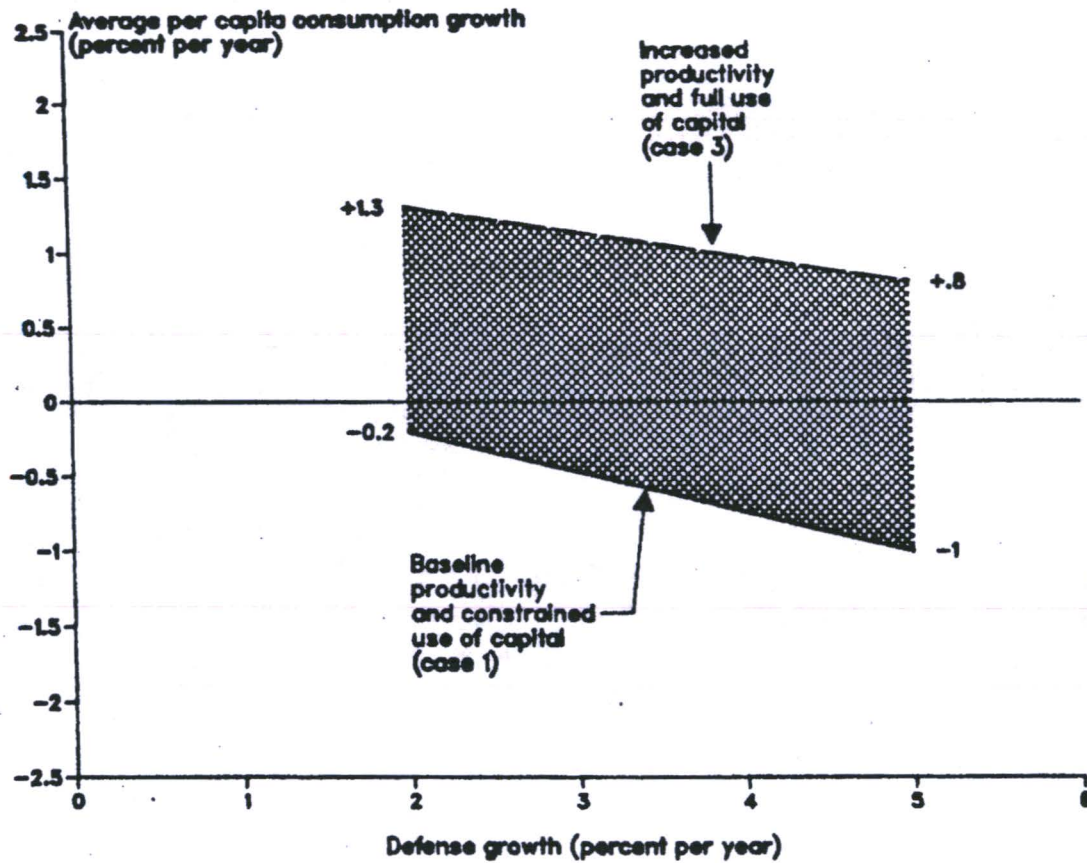
11. Since the issue of future defense growth involves considerable uncertainty at this point, we also explored the impact on economic performance of varying rates of growth in defense. Our basic assumption has total defense expenditures continuing to grow at 2 percent per year (the average rate of the recent past) through 1990 and growth in procurement of military hardware

rising to 2 percent a year later in the decade as growth of military research, development, testing, and evaluation (RDT&E) is assumed to fall somewhat. As an alternative view, we assumed a set of conditions that we believe would be likely to accompany a policy decision to increase military spending growth to a rate of 5 percent a year--a rate approximating the 4 to 5 percent observed during the military buildup of 1966-76. For example, military procurement growth was increased to 6 percent and shares of the investment pie were stepped up for energy, industrial materials, and the investment goods sectors. We then estimated in each of the previous cases what the performance of the economy might be under a return to these higher growth rates of defense and procurement.

12. Figure 3 summarizes the tradeoff dilemma facing the Soviets. Whether we use moderate (Case 1) or bullish (Case 3) assumptions about growth prospects, living standards as measured by per capita consumption are likely to grow little if at all 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 four percent a year, they would clearly jeopardize even the faint hopes for slow improvements and, in some cases, incur a decline in living standards. Slower growth in investment would allow a bit more room for improving the Soviet consumer's lot, but such a policy would be counter to the need to modernize much old industrial plant and stimulate energy conservation and substitution.

13. Under our moderate assumptions about growth prospects (Case 1), the tradeoff is particularly acute in the machine-building sector, which is the source of durable goods for investment, defense, and for the consumer. In the most adverse case for the consumer, which combines our Case 1 assumptions--high investment, baseline productivity, constrained use of capital--with

Figure 3
Impact of Increased Defense Growth on Per Capita Consumption Growth, 1986-90
(Investment growth at 4 percent per year in all cases)



Note: Case 2 is a less extreme set of conditions that gives a tradeoff inside of the band defined by Cases 1 and 3.

accelerated defense growth, machinery output grows rapidly but not fast enough to maintain a balanced distribution of output to these major claimants. Production of consumer durables declines rapidly and almost stops by the end of the decade as machinery output is increasingly directed to investment and defense. The economy becomes more and more oriented toward heavy industry and the military, and plants which now produce consumer durables must be converted to manufacture defense or investment goods.

14. In this memorandum, growth of per capita consumption is used as a measure of improvement or decline in living standards. The conventional assumption is that healthy growth of per capita consumption (signifying improvement in living standards) will have a beneficial effect on the economy as people are encouraged by material gains to work harder. It follows from this line of thinking that planners will seek to avoid meager or declining growth of per capita consumption because of a resulting adverse effect on labor productivity. Documentary evidence indicates that the Soviets believe such a link between worker benefits and productivity exists, although little substantive evidence has been accumulated by which to gauge actual response in the workplace to shifts in living standards. A less conventional view holds that in a period of decreasing living standards workers would be motivated to strive harder to obtain the benefits available, and that this reaction might mitigate or prevent a decline in worker productivity. Whichever view is closer to the mark, Soviet planners are clearly concerned with the issue of living standards and consumer satisfaction and recognize that the claims for consumption are in direct competition with those for defense and investment.



Outlook for Growth Prospects

15. As indicated above, our analysis indicates that average GNP growth over the 1980s is not likely to exceed 3 percent even under a highly favorable set of circumstances. These include maintaining the current rate of investment growth, overcoming energy constraints, experiencing average weather conditions in agriculture, and--perhaps the least likely--achieving significant improvement in industrial productivity. While distribution of the economy's output among major uses--consumption, investment, defense--can be affected by changes in the factors we considered, only the least likely change, a fundamental improvement in productivity, appears to offer the potential for moving longer term growth above 3 percent.

16. With this assessment of growth prospects, a dilemma involving conflicting claims appears likely to confront the leadership for the rest of the decade. It will be difficult to maintain investment growth at the present 4 percent level without jeopardizing the slow improvement in living standards of the last few years, especially if some upward movement is desired from the present flat level of military procurement. Substantial improvement in productivity would offer a solution to the problem. Our analysis suggests that under productivity conditions comparable to those enjoyed in the early 1970s, a higher-than-planned investment could be sustained along with slow improvements in the standard of living even if defense growth approximated the historically high rates of 1966-76.

17. At present, the required sustained improvement in productivity does not seem to be in the offing. In particular, the shift of the natural resource base into Siberia is an irreversible process that raises the investment costs of supporting industrial production. The incremental capital costs--new rail lines into more remote areas, more expensive technologies to

deal with extreme climatic conditions and lower quality raw material reserves, high cost of housing and services for large new settlements--will continue to move upwards, and gains in capital productivity will be hard to come by. Further, the recent surge in labor productivity--at least part of which was actually an increase in hours worked during the discipline campaign--probably cannot be sustained over the long term. Rather, we expect it will move up slowly over the rest of the decade, primarily as a result of the spread of new technologies in support of production and the provision of services and possibly also by requiring greater effort from each worker. Nothing, however, approaching a broad productivity breakthrough seems imminent.