



**THE COMMUNIST FOREIGN ECONOMIC OFFENSIVE**

Mr. Leon M. Herman

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Reviewed by Col R. W. Bergamy, USAF on 9 July 1964

**INDUSTRIAL COLLEGE OF THE ARMED FORCES  
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19 March 1964

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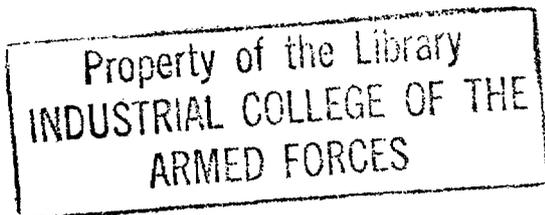
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Report prepared by: Col R. W. Bergmyer, USAF Date: 9 July 1964



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Washington 25, D. C.

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DR. POPPE: Admiral Rose, Gentlemen: To discuss the Communist foreign economic offensive, we have with us today the speaker whose youth was spent at the ringside of the Bolshevik revolution. He was born in Poland and presently he is a specialist and a distinguished scholar in Soviet economics who has devoted more than 30 years of his life studying Soviet economic objectives and methods.

Mr. Herman, it is a pleasure to welcome you back to the College and to present you to the Class of 1964.

Mr. Herman.

MR. HERMAN: Thank you, Dr. Poppe. Admiral Rose, General Stoughton, General Steele, Gentlemen of the College: It's always a pleasure to be here, especially when you have the habit of inviting me in the spring of the year. Somehow the spring always comes a little earlier at Fort McNair and it looks a little more attractive.

After all this introduction, to give a man 45 minutes is something of a comedown. I'll try to fit myself in and, if there are any ragged edges left, we can take them up in the question period.

I thought that we might begin briefly by introducing to some of the language you might run into if you read Soviet literature on the subject of the competition. There is a story told about a manager of a Soviet radio who suddenly, toward the end of the day, discovered that he had not read the bulletins that had come in for the day. He got his share of political bulletins. He looked them up and there

were only two, and this was the very end of the program, so he read the two of them, one after the other, and they came out reading like this: Bulletin No. 1: "The United States is drifting helplessly toward the edge of the final economic precipice." Bulletin No. 2: "The Soviet Union is moving resolutely behind the United States, maintaining a higher rate of speed and destined to overtake it within the immediate future."

I think this sums up a lot of Soviet economic analysis, but we won't have time to comment on this. The topic, of course, is familiar to you. It's "The Communist Foreign Economic Offensive." Every observer, of course, defines the offensive in his own way, and in defining<sup>it</sup> it, of course, he makes sure to omit the things he doesn't want to talk about.

My definition is also full of omissions. I would like to think of the heart of this offensive as being related to the determination of the Soviet leadership to practice what we might call international economic interposition or the determination to interpose the economic weight of the Soviet bloc between the developing countries, the newly emerged, national, independent countries and the advanced Western nations. Somehow this promises to them to perform important services on behalf of the Communist cause.

This is what I will focus on, and for that reason not much will be said in my presentation about trade, which is also part of this offensive. I feel that this is the strategic component of the offensive. The trade you might call the tactical component. I hope I've got it properly distinguished.

Now, my first topic would be the economy behind the offensive. Then I will go to the theory behind the offensive, then to the forces working in support of the Soviet economic offensive, and, last will be the forces working against it. All I have to do is manage to fit it all in.

On the economy I don't think we have to go into great detail. In fact, we can't. I'll just say that the Soviet Union is both large and isolated as an economy. I think this is important to bear in mind, namely, that it is large by almost any standards you apply. When you measure the total value of industrial production, it's the second largest industry. It has the second largest economy in the world. Or if you measure it by principal economic indicators, such as key industrial commodities--electric power, steel, cement--it always comes out second, also in petroleum. In some, of course, we know they have already pulled out ahead, such as coal. If you measure them by the size of the industrial labor force, you find that they are already No. 1 in the world, because, after all, they are the most populous industrial nation. This means that they have the largest potential labor force, and in industry, of course, they have been pressing very hard to expand the industrial labor forces as fast as possible. They passed us up in 1955 and they have been growing rather rapidly since. The Soviet industrial labor force is now 40 percent larger than that of the United States, to measure the outside dimensions.

If you look at it historically, you find that, say, over the last

50 years, they moved from being No. 5 as an industrial power to No. 2. This, too, is a measure of accomplishment. The point is--and this is what I want to stress--that this is economic growth that took place in isolation, by their own choice and as a matter of conscious policy. From the beginning Soviet leaders decided that they had to look to their economic development without too much involvement in the outside world economy. There has been some moderation to this extent since the death of Stalin, largely because they have absorbed an empire, and with an empire you cannot practice the amount of self-sufficiency that they practiced before. But the basic adherence to these two principles, such as internal economic planning and effective self-sufficiency, continues to be operative. That has not changed.

So that, when you look at how much of the Soviet economic power winds up beyond the frontiers, you find that it's quite small. The Soviet Union as a world trader accounts for about 5.7 percent of total world trade. As a producer she accounts for 15 percent. This is a measure of the relative isolation. In rank as a trading nation, say, as an exporter, Russia comes out No. 5, after France, and you must remember that Russia has three times as large an economy as France. This, too, is a measure of a relative, modest participation in world trade. But, after having said that, you still have to add that these measures I just gave you refer to their total trade, global trade, but that 70 percent of this global trade is concentrated within the Communist bloc of 12 nations. For the rest of the 101 nations they leave 30 percent

of this rather small total.

The commodity composition of trade is also striking. Somehow they have never taken trade too seriously. As a result they haven't developed new lines of specialization. When you look at the Soviet composition in exports, you find that the exports are approximately what the exports were under the Tsars. They simply have taken over the old commodity composition and have institutionalized it.

The most outstanding point about Soviet foreign trade, from a point of view of its composition, is the lack of machinery or the low part played by machinery in this export. In fact, six nations, most of them smaller than the U.S.S.R., export more machinery than the Soviet Union. This is relevant to our discussion, because a nation which wants an impact on a developing nation has to have machinery to export. This is the wherewithal of economic development. The Soviet Union exports just about a billion dollars' worth of machinery, whereas the major exporters, the three largest--Britain, Germany, and the United States--export about six or eight times as much. So that in a year like 1962, for example, all of Russia's exports of machinery to the underdeveloped countries amounted to less than \$300 million. This is by way of identifying the limited resources for export in this critical category.

This isolation, you will probably not be surprised to learn, has been extended to the entire bloc. The bloc has been so oriented in its own trade that 70 percent within and 30 percent without is roughly the ratio for the bloc as a whole. A few countries have a somewhat different

ratio, but not very different. So that this large part of the world, which includes 35 percent of the population, exports to the rest of the world about \$5 billion worth a year. This is the measure of their impact, and this \$5 billion represents 4 percent of the trade of the non-Communist countries, either on the export side or on the import side. Should the Communist world disappear overnight, the non-Communist countries would lose 4 percent of their exports and imports.

All right. This takes me to my second topic. Here I might begin by calling attention to a basic paradox. Here you have the Communist world, very determined to isolate itself from the outside world and to avoid being influenced by the outside world, and at the same time they are interested in exerting influence on the outside world, even with this minimal amount of trade resources. The ordinary non-Marxist mortal might look at this and say, "This is kind of an impossible assignment." Of course he hasn't reckoned with Marxism. Marxist theory makes all things possible and this is why we have to look briefly at the theory behind the economic offensive.

When the Marxist--and of course the chief Marxist today as far as the Soviet world is concerned is Nikita Khrushchev--looks at the outside world, he finds that the prospects are quite good if he is determined to play the game of economic pressure, that the phase through which the outside world is now passing is a phase fraught with opportunity for communism, and that not only is it good but it is precisely as Lenin had predicted. Lenin had predicted, you remember, among his very many other predictions, that when the underdeveloped countries

began to move and when they struck out for their independence, that would be the death knell for the Western world, because the colonies were the source of their strength and the colonies gave them everything they had to make them rich, gave them cheap labor, gave them cheap commodities, and gave them capital markets. So that once they lost this part of their possessions, a trend would set in, a cycle of retrenchment would set in which the West would not be able to stop. And this would be, of course, a time favorable for the Communist world. Not only would they lose their wealth but the West would be confronted by a new area full of hostile independent governments who would have bitter memories against the West, and this, too, would be working on the side of communism. They somehow also saw in their Marxist crystal ball that the newly developing countries would be anti-capitalist, not only anti-imperialist and anti-colonialist but anti-capitalist, that they would not want to have anything to do with the economic system which their masters, their oppressors, practiced.

Khrushchev calls this bypassing capitalism, devising some kind of system which step by step will lead to a state economy, and ultimately to a totalitarian economy. This, of course, is what Stalin had missed. Remember they are very critical of Stalin in that, when the decolonization period got under way, he was too obtuse, or they say too insensitive, to realize the opportunities. Khrushchev, of course, is not one to be accused of being indifferent to an important, bypassing opportunity, and he would enlist himself in the service of an ongoing revolution.

So that here you have a trend which is very strong, moving in the right direction from the point of view of the Communists, and therefore even a small contribution in terms of economic power could strengthen the trend and accelerate it, if possible.

Foreign aid, of course, was conceived as the direct instrument which would perform this function, get in between the newly developing nations and the advanced nations and work its magic. The objective conditions, he felt, as he described them, the natural economic conditions under which these countries work, were entirely favorable to the cause of communism. In fact, when Khrushchev looks at the underdeveloped nations as a group, he is very heavily encouraged. He finds that almost anything they do tends to move in the direction of state enterprise and ultimately, therefore, in the direction of totalitarian communism. If they are expanding their industrial output, for example, this is good, too, because this increases the size of the proletariat. Remember, the proletariat would become the leader of the peasantry in each country. We know what happens when the proletariat leads the peasantry. The results, in Marxist theory, of course, are inevitable. When they develop the state sector of the economy, that, too, is good, because it is moving away from private enterprise in the right direction. When they regulate their domestic economic activities--mining activities, size of enterprises--this, too, moves in the right direction. When they control participation by outside investors and put limits on that, this, too, is favorable to the cause of state enterprise. And, of course,

when they engage in internal, economic planning, this, too, gives them a link with the Soviet world.

In fact, when he puts some of these things together he argues that the whole thrust of development in the new countries seems to work against the West and in favor of communism. Even expansion in the private sector, which is one of the most difficult things for them to explain, their internal critics argue is the way you surely accomplish one thing, and one thing only, namely, you are strengthening private capitalism in these countries, but the experts who advise the Soviet leaders say that even this is nothing to worry about, that the private sector is growing, that's true, but when it grows it increases the capacity of the underdeveloped country to produce for itself, and therefore it reduces its requirements for imports, and therefore it reduces the power of the monopolist, the West, and anything which reduces the monopolist, says Soviet theory, strengthens socialism, which of course we read as communism.

In the Soviet mythology, the whole thing becomes very simple. There are only three important, *dramatis personae*: The Communist countries represent the workers; the underdeveloped countries represent the peasantry at large, the world peasantry; and the worker gives leadership to the world peasantry for the purpose of moving against the oppressor class, which of course is the West.

Without going into the details of the Soviet aid program, I think on this there is a large amount of literature, and I might briefly dwell on the fact that the economic aid program is so oriented as to deliver

a political message to the underdeveloped countries . By its very composition, which, of course, is very carefully planned, the kind of economic project that they support reveals a design, a fairly conscious design. It's intended to support the Soviet assertions against the West.

For example, I think our figures show that about 60 percent of all the projects supported are in the field of industry and a high proportion of that in heavy industry. Oil plays a large part. We'll talk about it a little more, briefly. Also there is steel and electric power. This supports the Soviet message that only the Communist countries will give them their own heavy industry, and only heavy industry can serve as a sound basis for economic independence.

I could mention several other things which move in the same direction and bring this message: "You must turn to us, because <sup>we</sup> alone have the interest of your economic interest at heart." Whether they support geological prospecting or exploration for minerals, or whether they provide them with technological institutes, or irrigation and electric power, they all point in the same direction: "We will train your national canneries, we will give you support for increasing your mineral deposits. You no longer have to worry about your old oppressors."

Khrushchev has summarized this new doctrine in his 20th Party Congress Report, when he says that the world has changed, a new age is now dawning, the new, emerging nations no longer have to go their former oppressors to obtain modern equipment. They will come to their socialist brothers and they will get everything that they want.

Now as far as the forces working to support the economic offensive are concerned, I'll give you a little, brief discussion on them.

The theory, of course, we have reviewed briefly, and now we'll try to see how it is expressed in political terms. In political terms, of course, it would say that the Soviet bloc has a good opportunity here. The theory, of course, is correct. Nobody has ever questioned that, not in the Marxist world, and the opportunities are good enough for an investment, an economic investment from the Communist countries, and even their own modest surplus, such as they are, are sufficient if properly applied--as just briefly described--applied in the right direction, and they will help to accelerate this inevitable outcome--the inevitable outcome meaning, of course, the rapid evolution of the new countries in the direction of state enterprise and communism.

The strange reaction of a conscious Marxist is always this, that he is on the side of history, that history is working in the direction in which he is examining, because he and only he possesses the science that gives them the laws of historical development. He also tells you that you cannot leave it all to self-development, that you must exercise control over the objective laws of history. It doesn't come by itself. It doesn't come automatically. You have to be an activist. You must get mixed up in it and help things move in the right direction.

So, with this entry into the area of economic development the Soviet Union, of course, has altered the situation somewhat, and this is a large economic fact which we cannot ignore. Let's first try to see how it has made its impact on this new world environment. It is true that world reality hasn't changed much. It is pretty much as it

was, but it has made several serious impacts. First, I think any observer would acknowledge that the Soviet bloc has established an economic presence in the underdeveloped world. They have demonstrated the fact that they are a mature industrial society, that they are capable of providing equipment for basic industries, they are capable of supplying the technicians who can help them make these installations work. In short, the U. S.S.R., if nobody else in this group, has joined the ranks of industrial exporters, even though, as I indicated, not on a large scale. As we sometimes say it in the West, they have broken the monopoly of the West in both industrial equipment and arms. In arms, as you well know, they especially have some impressive capacity to work with. In fact, arms are sometimes described as the only genuine export surplus the Russians really have.

This has proven, of course, useful. What they have done, if nothing more, is to provide a haven for defectors from the Western world. Sometimes, I suspect they must wish for some more self-supporting defectors, somebody a little better than Cuba, but that they probably continue to hope for. But so far they have shown that they have sufficient resources to give support to a country whether it is having a mild quarrel like Ceylon, or sometimes a regional quarrel, like Iceland with Great Britain, to show that they are there to keep the pot stirred up, and if it is necessary to keep the fight alive they will throw in what they can into it.

Now, we must also admit that the Soviet offensive has some rather powerful allies on its side. I think that, being non-Marxist, we will

probably have to admit that perhaps history is not on the side of the Communists, but there are some very prominent phenomena in our world of today which do act as allies to the Communist cause. I would like to cite a few of them. I am sure you are familiar with most of them. I think it is fair to say that economic nationalism in the world today is a powerful ally of communism. There is a man in Brazil. I think he is now a Congressman and before that he had been the Governor of a province. His name is Brizzola. When he was in power every other month he was nationalizing some private property, and the Brazilians always came back with an explanation. "He," they say, "is not a Communist. He just happens to be a very powerful nationalist." But the companies that were nationalized somehow could not appreciate the difference.

There are areas in which these two trends come very close together. There is also income disparity around the world, which you and I know about. This is a powerful ally on the side of the Communist offensive. There are the unfavorable terms of trade on the part of the underdeveloped countries, in which, somehow, the things they sell have a tendency to drop in price and the things they buy have a tendency to go up in price. This produces unfavorable terms of trade. A unit of their export buys fewer units of their imports. The problem of unstable demand in the world market for, say, primary materials, and the problem of unstable prices and therefore unstable earnings, are important. In general, the slow pace of economic progress is, I think, an important source of support to the Communist drive, because it does make people restless,

impatient, and it does make them interested in shortcuts.

Now, we can briefly identify one of these allies, and that is economic nationalism, and I think we can identify it by speaking briefly of a particular industry that I would like you to bear in mind as an important industry that illustrates this important phenomenon. The Soviet Union has within the last 5 or 6 years offered and received acceptance of technical, financial support in petroleum. They have launched a slogan: "We will help you build your own, national oil industry," and it apparently has struck a responsive cord, not just among the least developed but all along the spectrum of underdeveloped countries, ranging from Ethiopia to Chile and Argentina. Apparently the idea of having their own national oil industry has powerful emotional attraction. In Latin America I think there is a slogan which says, "Petroleum is Ours." Once you keep it, presumably you then have a great source of wealth that will give you enough capital for investment, and will give you enough capital for education, for development, and for economic progress. Of course the Soviets exploit a situation of this sort, because they point to the fact that the West is giving them nothing more than a current good deal. Of course they have something to say about the good deal, too, about the rate of profit. But at least they will say, "It doesn't go beyond that. We will offer you more than that."

This I would say is probably an area that should be recognized as an area in which we are perhaps indifferent to the aspirations of the

newly developing nations, namely, we have not been alive to the fact that they want a little more than an adequate commercial deal, that they would like some way of being able to look to the future in the sense that they can some day be self-reliant, that their own people will be learning the skills. When the Soviets see this kind of discontent they have not only the incentive but they also have the resources to exploit this sort of situation. I consider that to be the really dangerous element in the Soviet oil offensive, and not the part that deals with the price-cutting operation. I hope nobody here from the oil industry will talk back to me, and I hope nobody will report me to the oil industry, because we might have some disagreement.

I tell them directly that this is something they have to worry about, the fact that the Soviets are building a fire under them within the underdeveloped countries.

This sums up, then, my list of forces working in support. Now I should like briefly to dwell on the forces that work against the Soviet economic offensive. There are some substantial elements in that direction. I think it is reasonable to say that the facts of international economic life as a whole are working against the Soviet economic offensive, namely, that the lack of surpluses is a very serious deterrent. Let's see how we can demonstrate that.

The main Soviet message, as I indicated, to the underdeveloped countries is to go it alone as far as possible and not to get too involved with the Western nations, not to remain with these one or two crops

but to diversify their economy and to keep out private investment, because this is the way to neocolonialism through the back door. So, in general, when they give them this kind of advice, they don't need the West. This is not a very convincing message to these countries, because these countries, although underdeveloped, and although weak economically, are precisely the kind of countries that cannot go it alone. They are very heavily involved in the world market. They have something to export, and they've got so much that they have to import that they cannot afford to even think about losing their export markets. They must continue to cultivate them and to expand them. And when they are involved invariably they are involved with the Western nations. The statistics we have on the subject show that about 72 to 75 percent of everything this whole group of <sup>newly</sup> developing countries export out of their economies and import into their economies is with Western nations. These are the countries that buy their surpluses, buy their cotton, their rubber, their wool, their various tropical products. So that it is very difficult for them to consider this as an area that they can treat as expendable, because it is anything but.

They are involved with them on both sides. Here I would say that the Communist record, the Communist basic commitment to economic self-sufficiency is a weakness, because, had they by now been less committed to internal trade and internal planning, I think they would have had more to offer to the newly developing nations as an alternative to the West. This, you remember, is the crux of Khrushchev's message: "Don't go to

to your former oppressors; come to your socialist brethren. That's me and all the other chickens here. We are the alternatives." And yet, when it comes to the actual problem of selling and buying as an alternative they look rather pitifully small. Compared to the 72-75 percent, by the way, the Soviet bloc as a whole, the whole one million people buy and sell about 5 to 6 percent of all the exports and imports of all the underdeveloped countries. This kind of partner does not really recommend itself as a plausible alternative.

When you look at it from the point of view of machinery imports into the underdeveloped countries, you find that there the West plays even a larger part. The West supplies 92 percent of all their imports of machinery and equipment, and the bloc supplies 6 percent. When you look at one more indicator, namely, credits obtained by the developing nations in the course of a year, there you find the ratio is 95 to 5--95 percent of all their credits, investments, and grants they get from the West, and 5 percent from the Communist bloc, so that in a year like 1963 all the Communist bloc actually delivered to the developing countries in the form of equipment covered by credits amounted to \$400 million, and of course the West supplied something over \$8 billion.

So this is what I call the fact of international economic life. You must also bear in mind that within the last two years the Soviets seem to have lost their interest a little bit in making new commitments to the underdeveloped countries, whereas in a year like 1959, for example, they opened new credits to the extent of \$800 million. In a year like

1963 new credits measured only \$200 million throughout the whole year. In fact, the satellites contributed \$200 million as well. This has never been quite that way. The satellites always contributed about one-fourth or one-fifth. So something apparently is not pulling the Russians very hard in the direction of making new commitments.

Now, another force I would identify here as being against the offensive is the forces working for national stabilization in these newly developing countries. Contrary to Russian expectations, these countries are not shopping for an ideology. Somehow they don't consider it as critical as the Russians do to have a blueprint, an ideology, first and then to go about the job of economic development. They seem to be more pragmatic. They seem to be determined to work out their own economic formula of some kind of mixed economy rather than a pure theoretically, ideologically based economy. When the Russians continue to hammer away to them, telling them that there is no middle ground and they will have to make up their minds sooner or later whether they want to be capitalist societies or Communist societies, that there is no other way they can stabilize, they somehow are not impressed by it because they see that at the same time the Russians are contributing toward their stabilization and the West is contributing toward their stabilization, and that perhaps the Russian deed of making available resources is more meaningful than the Russian word of warning them that theoretically they must get themselves a good theory first, an ideology, before they go to work. So they seem to be, not with great ease but

in one way or another, continuing to try their own experimental way, feeling that they perhaps are on the right track, and that perhaps the only way to get economic development is to work at it as hard as possible and that perhaps state enterprise is not the answer to all questions in Russia.

I am sure that a year like 1963 was perhaps not a good year in which to try to impress the rest of the world that the best way to organize its agriculture was on a collectivized basis. In fact, they tell a story in Russia currently which they also hang on the Armenian radio. The question comes, "What would you call a hairdo of the kind that our leader sports, Nikita Khrushchev?" And the answer is, "This year we call it Harvest 1963."

So there is evidence that in the underdeveloped countries experimentation seems to be the general trend and there are some second thoughts about total state enterprise and that perhaps the Russians have not found the magic formula. They also probably accept the findings of some of our research workers to the effect that it takes about 40 years to produce a cadre for a modern society, to produce the professors who will teach mathematics to students who will become engineers, and that you don't produce these miracles overnight.

Now I would say that another force in the same direction, meaning against the drive, would be the rising pressures of unresolved domestic economic problems. This, of course, has been very serious in the last few years. Somehow all of the statistics that we have been poring over--

and I referred to your instructors a new publication put out by the Joint Economic Committee, called "Annual Economic Indicators for the U.S.S.R."-- this collection of data and almost any other, seem to point to the fact that the Soviet economy was enjoying a kind of unusual momentum up until 1958, when all the indicators were moving upward, but since 1958 apparently everything is pointing downward, whether it is the return on new capital investment, whether it is labor productivity, or industrial production, agricultural production, or GNP; all the important indicators point rather downward. This, of course, is a critical signal to the Soviet leadership. They know roughly what it means, and they know that the economy has to be adjusted in some of its basic mechanisms and some rather major economic reforms have to be introduced, because something hasn't been paying off on all the input.

A recent article in the Pravda for February 24, by the No. 1 economist in the country--although basically he<sup>is</sup> the economist who specializes on the outside world, on world materialism, he seems to have been invited to write two articles in the Pravda--expressing himself on domestic issues gives as the main burden of his recommendation that under present conditions the all-around improvement of the structure of the national economy assumes particular importance. It's a particularly obtuse Soviet statement, but I think if you translate it it means that things have become bigger without becoming better. This is a serious problem, because, when they look around, they really don't know what has

hit them, because they continue to feed people into the labor force, they continue to introduce modern technology to the extent that they can import it and copy it, and they apply all kinds of devices of measurement and calculation, and yet, somehow, it gets more and more difficult with every passing year to invest enough to add to the capital stock and to continue to obtain the former rate of growth, which was roughly 6.8, which we got for an average for 1950 to 1958. Now apparently it is down to 4.4, in the last two years, 1962 and 1963, which were just plain, oldfashioned years of recession. They simply ran into something that hit them, without quite knowing what. This has been happening to capitalist countries in the past, but it hurts, apparently, when it happens to a scientifically founded, Soviet type of economy.

There is no doubt that the harvest of 1963 has dramatized some of their problems and has dramatized them in a rather unpleasant way. It has dramatized the fact that the West has an enormous abundance in agriculture and that somehow the West no longer worries about food. I don't think there is a country in the West where people wonder whether they will have food to eat or whether the country will have its own requirements/<sup>met.</sup> Only in the Communist bloc do they have to continue to worry about the food supply.

This contrast of abundance in the West and a rather drastic short supply within the Communist bloc and the fact that they have to swallow their political pride and go precisely to the West and buy this ~~wheat~~ is very embarrassing. This is not, I suppose, a good year for generating

great boasts. Perhaps this is a good year to think about problems, and they are thinking about their problems.

The expectations of the Soviet consumer are also rising constantly. He has been enjoying a little rise. There, too, our indicators show that private consumption was going up at the rate of about 4.5 percent until 1958 and now it has dipped to about 1.9 to .1. Now, that, in the Soviet setting, where there is so much lacking, is not a very impressive rate of growth.

This hurts. In fact, they had to raise prices in the middle of 1962 on critical commodities like meat and milk products. This, of course, set the consumer back, because this was a retreat from the rise in real wages, and the whole system of central planning for consumer goods is under trial, under question, today. In fact, in Poland they have already given it up. They have admitted it is a bad job, that it cannot be done, namely, <sup>that</sup> you cannot sit in an office somewhere and write out directives saying, "Produce so many bolts of cotton cloth and wool and so many dresses," and that the determination has to be made at the other end, that the consumer decides what he wants and then he goes to the stores and they find out what they want, instead of the planners ordering the factories to produce and the factories unloading it on the stores and having the consumers turn it down. Soviet warehouses are now reported to be bulging with unsold goods.

This is a signal of something that has to be taken seriously.

They have to worry about what to do next, about how they can retreat from this absurd system of planning this whole variety of colors and styles from some central office. Then I suppose they will have to come up with a decision on that.

The whole system of production by centralized directive is under question, too, and they have a great need for one solution, namely, they must find some way to decentralize decision-making in the economy. Too many decisions are made at the top and, of course, the result is that they are not really made; they remain unmade. For example, it turned out that in recent discussions about fertilizer suddenly they discovered that fertilizer fertilizes, and this, of course, is a great discovery.

Khrushchev discusses from the rostrum of the Party Plenum as to whether the fertilizer should be packed in plastic bags or in old-fashioned jute bags. This has to be decided on his level. It's no wonder that a lot of decisions simply are not made.

So that, when we touch our last point, namely, about the present state of Soviet economic aid, I think I can sum it up in one minute, which I will have to borrow from the next lecture, namely, that there is no doubt that the whole operation of foreign aid has been downgraded in Soviet policy today. It is no longer considered the ultimate weapon it was considered, say, some 10 years ago, which will change the balance of power in the world. This is not the weapon for the final assault against capitalism. It has been declassified or downgraded as just another weapon, perhaps, for exerting pressure, again, in favor of the

progressive forces. You can still get spot victories, you can still pick up some piecemeal victims, and you might call it a form of penetration on a piecemeal basis, rather than the original hope that somehow there would be a wholesale penetration and there would be a large breakthrough and a mass defection.

At the same time I would say it is not abandoned because it does serve some useful purposes. I would like to mention one purpose, for example. It is terribly useful for the Soviet leadership in each of these client countries to have, instead of one channel of communication, two channels, one to the leadership and one to the Communist minority. They feel that they are paying a small premium on a very important kind of reassurance, so that if things go well with the country the Soviets can take credit for having contributed to their slow economic betterment, and, on the other hand, if chaos is the turn of events, then the Soviet Union will probably know what to do with their channels of communication to the Communist minority.

I think in a time of chaos it is good to have a militant minority on your side.

I think at this point we can call it finished.

DR. POPPE: Mr. Herman is ready for your questions.

QUESTION: Mr. Herman, I wonder if you will address yourself, please, sir, to whether or not we should trade with the Russian government.

MR. HERMAN: It's a very difficult question. I used to feel very

free to talk about East-West trade, so long as the Congress was indifferent to the issue. Now it's a very lively issue on the Hill, and Capitol Hill, I think, is pretty well split. There are some/arguments strong one way or the other. I think we are now in a phase where several committees will be taking it up. One committee, the Committee on Foreign Relations of the Senate, has already begun hearings. Several members of the Cabinet have already testified. The Committee on Commerce will begin hearings in a week or two. So we'll have a prolonged debate and we'll have what the members of the Senate like to think is an educational campaign on this subject--what about trade.

Without taking sides on the issue, I will sum up two conflicting views. You might call these the American view and the West European view. Of course your question has somewhat of an oversimplification in it, namely, that it isn't a question of whether to trade or not to trade, because we are trading. The question, I suppose, is whether to trade as the Western Europeans are trading or whether to continue to trade as we are trading now. Our trade is rather minimal.

As a typical example now, we export to the whole European bloc about \$100 million worth of commodities a year. Western Europe exports about \$2 billion. That's a ratio of 20 to 1. If you look at machinery you find that we export about \$7.5 million of machinery to all of Eastern Europe, including Russia and the satellites. Western Europe exports \$750 million. That's a ratio of 100 to 1. It's that kind of disparity.

We are simply coasting along on a policy that we elaborated, say,

back in the early postwar years and finally hardened during the Korean affair, which was a good time for things to harden. They couldn't go in any other direction. In 1954, when the new leadership came to power and staged an overture in our direction, the Western Europeans apparently accepted the overture. We did not. This is the way it has been proceeding now for about 10 years.

I would say this, as far as giving an opinion is concerned. I would say that the worst of our fears at that time, say, 1954, when we were advising the Western Europeans to go easy and not to respond to the Communist overtures, have not been justified. We warned them that they would strengthen the Soviets militarily and that they would find themselves supporting the Communist military establishment. I think that has not been borne out, because, if the Russians are self-sufficient anywhere they are self-sufficient in the military, and when they lack something in the military they don't use overt channels of trade to get it. We know how they go about getting it.

I think we also worried then that they might develop a dependence on the part of Western Europe. I would say, by way of giving an opinion on that--that this you might read as an implication for our own action, because I don't want to recommend action--that even this warning that they would become economically dependent did not materialize. In fact, I would say it worked out just the reverse. The Western European countries are in no sense dependent on Eastern Europe, either qualitatively or quantitatively. Quantitatively, for example, all of the Communist

world to Western Europe represents 4.5 percent of their trade. They could lose it tomorrow without missing it. Qualitatively, everything they buy from them is junk; it's cats and dogs. It's the kind of raw material that you can buy anywhere else. It's timber, flax, manganese ore, and petroleum coal. Petroleum, too, is generally available. What the East Europeans get from the West is very high in quality, and I think we have here some kind of deterrent built in. I don't know how much to base on it. I would not advise anybody to scrap our military establishment, but we have a deterrent here to the extent of making the Russians think twice before they engage in any kind of a cheap quest for victory, because, if they do lose that Western European trade--and there could be a political action which would make them lose it--they would lose a lot more than the Western Europeans would lose.

I think that is about as much as I would want to say.

QUESTION: What can you tell us about the comparative output per man hour, first, for the American and the Soviet worker, and, secondly, how do their trends compare to ours by output per man hour?

MR. HERMAN: Our best information is in industry. That's the sector where it is easy to measure, you know. You know the value of your product. You can also piece it together by looking at individual branches and then working out an average. Our information is pretty good. I would recommend to you an earlier publication of the Joint Economic Committee, which came out in late 1962, called "Dimensions of Soviet Economic Power." In a sense it is the forerunner to this annual

indicator. We think of the indicators as being the statistical supplements to "Dimensions." In "Dimensions" we have a very elaborate article by one of our top specialists on labor productivity. The story from the Soviet point of view is a most unimpressive story. Almost any time you look at the picture and take a measurement based on their own statistics you find that in 1913 average labor productivity was about 40 percent of that of the U. S. If you look at it in 1937 you find that the average labor productivity was about 40 percent of that of the U.S. If you look at it in 1960 to 1962, roughly then, you find that in fact if anything it has gone down. I think this particular article comes up with a calculation which is, I think, so far the best we have. It points to a ratio of 32 percent, namely, it takes three Russian workers, on an average, to produce what the American worker puts out in industry as a whole, which means that in some branches it is 4 workers to 1 or 5 to 1. In some it's 2 or  $2\frac{1}{2}$  to 1. The average comes out about 3 to 1.

This is one of their greatest weaknesses. I remember we interviewed a minister who was here some three years ago and we put the question to him. He was then minister of general machine building. We asked: "What do you consider your biggest problem?" He said, "Labor productivity." There is no doubt about it. Especially now that numbers have stabilized, they have pumped about as many people as they could into industry, and still, with a labor force 40 percent larger than ours, right in industry, and a labor productivity of about 32 percent of ours--although they claim 38 and there will never be an identical figure from the two sides--

they are still foundering somewhere in the neighborhood of producing about 52 percent in industry of what we are producing.

This seems to be a chronic problem. I see no easy solution. There is something in their system which, even when they use the best known technology--incentives being what they are, organization being what it is, and management being what it is--makes them wind up with this tremendous lag in output per worker. There seems to be no easy solution.

QUESTION: Sir, the Soviets seem to be building a merchant marine which is greatly in excess of what they need for their normal international trade. Do you have any information or opinion as to what their objective or goal is in this?

MR. HERMAN: In fact this is a problem on which I was asked to concentrate for a few weeks by one of the committees interested in this area. I have made a little preliminary survey of the material. There is no doubt that your main point is correct, namely, that they are working very hard to make accelerated progress. It would not do for them just to expand as rapidly as the merchant marine of the world is expanding. They must accelerate at a special rate to improve their relative position. This is what they have been doing.

In fact, our statistics show--and we have fairly good statistics; they're not Soviet statistics; they report very little, except fragmentary information--outside statistics, that they have within the last five years, I would say, just about, from 1958, moved from No. 12 to No. 11, to No. 10, to No. 9, and at the end of 1963 they were No. 8

among merchant powers, maritime powers, in the world. There is no doubt that a lot of resources go into it and a lot of investment. They would have liked, I am sure, to expand their merchant marine with their own resources--internal Soviet shipyard and satellite shipyards--but all their shipyards are working full time and it still isn't enough. They are ordering ships from all over the world.

In this report of ours we have a tremendous list of Western nations producing types of ships. Tankers, of course, are very heavy in the operation.

They are very serious about it. One cause of this strong compulsion to expand I would say was the fact that they were caught shorthanded, say, at the time of Cuba. Suddenly they were trying to supply Cuba with all the petroleum it needed and all the other industrial equipment, and they did not have enough Communist tonnage. They had to go to the outside world. It so happened that they were lucky. It hit them at a time when there was a surplus of tonnage, but it could have been the other way around. The Western leaders were not successful in organizing a boycott of their request for ship tonnage, simply because the atmosphere was not too fraught with immediate danger.

When this happened I think it must have given them cause to think, and they must have realized that it could be a period of more intensive tension, in which the Western leaders might be able to succeed in withholding tonnage from them. Therefore they must have made a decision not to be caught shorthanded again. As long as they have the ambition to be all

around the world at all times, and to be able to support their satellites in Zanzibar or in the Caribbean, or around the Horn somewhere, they know that they must have this capacity and I suppose they are the second largest economy in the world. My guess is that in the Kremlin the decision must have been made that "We must develop our maritime capacity commensurate with our economic ability, commensurate with our political ambitions," and this is what they are pushing toward.

In the outside world there is great consternation. I don't know what can be done about it. They apparently <sup>are</sup> determined at least to move up closer to No. 2 than they are today. This is very embarrassing and this is very threatening. But I haven't really identified the specifics of this threat, which I hope to identify through closer study. But there is no doubt that it does serve as a supply fleet all around the world to actual defector nations and to potential defector nations. This is obvious, and I am sure there are other hidden potential threats which will come to the surface.

QUESTION: Mr. Herman, I wonder if you can give us more information with regard to the 1962-63 recession in the U.S.S.R. and the causes for it. Where they primarily agricultural? Just how did this occur, when there was such a high demand for consumer and industrial products? Is the Russian economy subject to the same cyclical economic factors as we are?

MR. HERMAN: To begin with, the last part of your question is a critical question, but everybody gives a different answer. The Russians, of course, would say no, that cyclical fluctuations are endemic to

capitalist forms of production, because the capitalist form of production is oriented toward demand. When there is demand you produce. When somehow the consumer stops buying automobiles or something equally important, then this all backs up, and you cut back production, the level of activity declines all along the line, and demands for investment capital **are** down, so you have a downward cycle.

They would argue that this could not happen to them, because that economy is not oriented toward demand, it is not propelled by demand but is rather propelled by directives from their planners. They produce as much steel as they<sup>do</sup>/not because they have heard from the machine-building factories or they have heard from the people who make baby carriages and they know approximately how much. They produce so many tons of steel because the planners have looked at their books and their plans and they have decided that they must increase production by 10 more percent or 8 more percent.

We think of our economy as being demand constrained. If there is demand we go ahead, and fine. If not we feel the constraint. They, on the other hand, are resource constrained, and they produce to the limit in every area possible, every area<sup>being</sup>, of course, areas except the consumer goods area.

So it's not a cycle due to the slackening of demand, because, as you have suggested, the consumer in Russia has tremendous unfilled demands that he can make you a long list of. But that's not what worries the planners and the producers. They are not running the economy for his benefit.

The reason they are not growing because of consumer demand is because they are not responsive to consumer demand, and they don't care.

The reason they run into difficulties and we have called these last two years a recession period is a combination of reasons: Agriculture, of course, is very important. This is an economy in which some 37 percent of the labor force is still engaged in agricultural production. So this is a very heavy weight in the index of total gross national product, and when there is a slump in this important weight there is a slump in the overall index. Agriculture tends to drag down the index of gross national production. Agriculture is, of course, the basic factor, but it is not the only factor.

In 1962, you remember, agriculture had a middling year. It was not a disastrous year such as they had in 1963. In 1963 it was disastrous, and in 1962 agriculture had a **poor** to middling performance. They have run into a kind of decline which the Western analysts have suggested right along. In a sense it is part of the price they pay for their relative maturity. They no longer have this frontier in technology. Every time they imported a machine from the outside they jumped 20 years in the technological level. Therefore they jumped in productivity. This gave them a boost in growth.

I think perhaps one of the strongest reasons is--and this turns up in our calculations--that their capital output ratio has worsened. They have to put in more investment capital per unit of increase in output, simply because the economy has gotten larger and also because the gap

between the old technology and the new technology is not as great. All the empty spaces have been largely filled and the original magic has evaporated. This is one of the reasons why they were so angry.

I mentioned to a small group earlier that they have attacked this latest report of ours because in this report all the indicators since 1958 are pointing downward, and we have in a sense tampered with an image they have been building up all over the world, especially in the underdeveloped countries, as an economy which is scientifically ordered, scientifically planned, and guided along a steady line of progressive growth year by year, so that they can get all the growth they want. Suddenly they found that they could not get all the growth they want.

It's a combination of forces, partly the result of capital. Technology is probably the main reason, and the continuing lag in labor productivity. Had productivity moved more rapidly growth would have moved more rapidly.

QUESTION: Sir, assuming that the U.S.S.R. has never been noted for philanthropic tendencies or for pouring money down a rat hole, how do you assess the status of their Cuban meddling?

MR. HERMAN: I think I will go along with your major proposition. I would certainly say about the whole economic aid program that this is not philanthropy. This is not a contribution toward the stabilization of the client countries. This they make quite clear. They tell them that things will get worse before they can get better. They say, "You will probably enter into a period of all kinds of strains and stresses and class struggles, and you'll have to resolve your class struggles

the recommended way." This is a contribution they are making toward revolutionizing the economic relations of the underdeveloped countries.

To take this from the general to the specific, it so happened that in Cuba the change in economic relations came first and their support had to come after. Cuba is not the result of Soviet economic penetration and Soviet economic diplomacy. Cuba, you remember, fell into their lap. Once it fell into their lap and Castro had antagonized their major trading partner, he broke the relations with his normal suppliers and he had to have a new set of relations. Since he proclaimed himself a Marxist-Leninist, there is nothing else that Khrushchev can do but to come in and fill the breach.

If you ask me what is the payoff, I would say the payoff is of a double kind. In the first place it keeps him alive, at home, in the present political/<sup>position</sup> he is in, as a dedicated Marxist-Leninist. Otherwise, without Soviet aid, he would be subject to pressures that he couldn't meet and perhaps there would be another movement of guerrillas. This is one payoff. Right?

They are also expecting that this island, which, as you know, is known as the island of freedom in the Soviet press, the island of the future in Latin America--there is no report about how many informers work on every block in the cities of Cuba; it's an island of freedom because Khrushchev has declared it so-- will become the base for promoting Communist revolutions to other countries of Latin America. This is a very important objective. From Khrushchev's point of view,

this is worth a good deal of resources, except sometimes in a sleepless night he must wonder wonder whether it is.

QUESTION: In Soviet aid to underdeveloped countries it would appear that the propaganda magic would be greater if the Soviets were able to give <sup>aid</sup> without the requirement for repayment. What proportion of this aid to underdeveloped countries has been in the form of grants?

MR. HERMAN: That's a good point. It is a carefully thought out approach on the part of the Soviets. Grants play a very minor role in the whole Soviet foreign aid program. I would say probably no more than 7 or 8 percent are grants. They play a larger part in China's economic aid program, for some reason or other. China gives aid to just a few nearby countries, and gives it very often in the form of consumer goods, which they spread about through local, provincial leaders, in a way which they seem to know best how to get the right influence. We don't know, for example, how much of that has paid off in Cambodia.

The U.S.S.R. proper, which is, after all, the king piece of this operation accounting for, say, 70 percent of all foreign-aid contributions, deliberately stays away from grants and works largely, almost exclusively, with credits. The Soviets have an explanation for that. It may be an explanation which makes a virtue of necessity, but it is as follows: The new, emerging nations are proud nations. They are self-respecting nations. They have dignity, and they have a future. They

want  
don't/to be treated as charity cases. They don't want any rich uncle to express his philanthropy at their expense. They want to be treated as self-supporting, promising, liquid borrowers, and this is the best way to arrange it with them.

We also suspect that they would try to get the benefit at both ends, you know, namely, that, in offering it to them they say, "We give this to you as a promising prospect, an ambitious, young nation who will go to town, and therefore there is no problem." But chances are that, if they ever run into a client who cannot meet the payments on time, they will probably forego it and write it off, you know, and maybe postpone it for 40 years, or something, so that they can collect prestige and gratitude at the other end, too.

But it is carefully calculated. They watched our performance, first, you remember. They were standing on the sidelines for about five years, roughly. If ours began in 1949, our Point IV, they would begin in 1954. Or, if you go back to 1947, they took a little longer than that. But they watched ours and they thought there was a little political capital to be gained by using the approach of credits rather than grants.

QUESTION: Mr. Herman, will you give us your evaluation of this neutral gamemanship of playing the Russian aid off against our aid? Should the U. S. enter into this popular aid game? What interests of ours does the situation concern?

MR. HERMAN: It's a ticklish problem. I'll have to grant that it

is a ticklish problem. We are really not committed to topping anybody else's offer. I don't think that's our conscious policy. I know that the policy statement in the Department of State, which is, after all, responsible for this delicate operation is that we are not in this game to match the Soviets project by project or dollar by dollar.

We simply respond to requests by these countries and we try to do what we can within our limited budget. You remember, the Congress is not very liberal with the amount requested, and a little bit of it always gets pinched off. So that our aid people have to maneuver.

You are calling attention to a very real fact, namely, that there are a number of countries in the neutral world which receive aid from both the United States and the Soviet bloc. This is a fact of life. The two major exponents of this operation would be, say, India in Asia and Egypt in the Middle East. All right.

Now, the question is: Is this good for us or bad for us? I would say that it is probably unpredictable. There is nothing inevitable about the outcome, but we feel that the underdeveloped country that has maneuvered itself into a position of receiving from both ends is probably an underdeveloped country that has learned to stabilize its operation. It's a country which will not be desperate in searching for some quick, easy solution. If, on the other hand, they were not getting any aid from anybody or getting it from only the Soviet side and enjoying only one kind of influence, the Soviet kind of influence, perhaps this would be an encouragement to subversive forces within the country, and this

could be an encouragement, also, to the top leadership, which somehow might reach a point where they would see nothing but blind alleys ahead, and no solution except to convert themselves into an authoritarian state and go the Soviet way.

I would think that it requires a little patience to work with this sort of operation. We may be suspicious of an evidence of cynicism but we think that in a real world which tends not to be very tidy most of the time this is about the best you can do. It's an investment in an alternative, in a second choice. Somehow, we are so confident that our way out is the better way out that we feel that when they have enough time to **look** at the two alternatives and work out their own program the chances are in the long run they will go our way.

DR. POPPE: Mr. Herman, on behalf of the College I thank you for giving us your time and for your excellent presentation.

MR. HERMAN: Thank you very much.