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CENTRAL INTELLIGENCE AGENCY
Office of the Chief, Economic Research
Office of Research and Reports

Project Action Memorandum

Project No. 42.1080
Date: 10 April 1956

TITLE: Trends and Prospects in East-West Trade

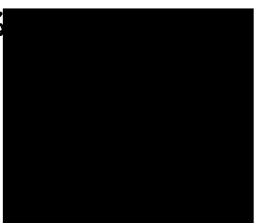

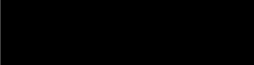
REQUESTER: DD/I

STATEMENT OF THE PROBLEM AND TERMS OF REFERENCE:

Problem: To prepare a paper to be used in briefing the President on the above subject.

- Terms of Reference:
1. Terms of reference as given (see outline attached).
 2. To be coordinated with D/E, State, Commerce, and Defense.

RESPONSIBILITY:

		<u>Man-hours</u>	<u>Due Date</u>	<u>Concurrence (Initials)</u>
<u>Action Division:</u>	D/S		16 Apr 56	
<u>Branch:</u>	S/TF	50		
<u>Consulting Branch:</u>	M/NF			
<u>Staff:</u>	St/PR			
<u>Principal Analyst:</u>		x 3098		
<u>Project Monitor:</u>		25X1A 2803		

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This project will not delay completion of currently scheduled projects. The classification of this project will be no higher than SECRET.

APPROVED  Ch/E

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Trends and Prospects in East-West Trade

1. East-West Trade in Relation to World Trade

World trade was at an all-time high of nearly \$92 billion in 1955 exceeding the previous peak (1954) by more than 7 percent. Trade of Free World nations with each other accounted for some \$80 billion of this or more than 86 percent of the total. In contrast the trade among Bloc nations amounted to \$7.8 billion or less than 9 percent of total world trade. Trade between Free World and Bloc countries was \$1.4 billion in 1955, less than 5 percent of total world trade. The major change in the distribution of world trade since 1948 has been the six-fold increase in intra-Bloc trade, \$1.2 billion in 1948 to \$7.8 billion in 1955. This increase has derived primarily from a more rapid increase in trade between Bloc countries than between Free World countries, and from the diversion of much of mainland China's trade to the Soviet Bloc. Although the total value of East-West trade has risen by about half a billion dollars in this same period, the proportion of East-West trade to total trade has actually declined from 7 percent in 1948 to less than 5 percent in 1955.

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2. Bloc Foreign Economic Policy and the Pattern of East-West Trade

The outstanding features in the recent East-West trade pattern has been: a rapid expansion of trade after 1953 accompanied by increased trade ties with underdeveloped countries, and important shifts in the commodity composition of trade.

The value of East-West trade declined from \$4 billion in 1948 to \$3 billion in 1953 and then rose to an estimated \$4.4 billion in 1955. Since 1953, although Western Europe has remained the Bloc's major trading partner, the action of the Sino-Soviet Bloc to increase trade ties with underdeveloped areas has become increasingly apparent. This trend has been evidenced both in terms of actual trade and trade overtures.

The commodity composition of Bloc trade with the Free World has also changed. In the immediate postwar years the Bloc was a large net importer of capital goods (machinery and equipment) and a large net exporter of food products. By 1954 the Soviet Bloc, including both the USSR and the European Satellites, for the first time became net importers of food products from the Free World. At the same time the value of Bloc capital goods exports ^{doubled} ~~increased~~ some ten times from 1952 to 1954. The European Satellites by 1954 had become net exporters of capital goods to the Free World, although the USSR and the Bloc as a whole remained a net importer.

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Although the Bloc as a whole remains a net importer of capital goods, it had, by 1954, become a net exporter of such commodities as machine tools, agricultural machinery, office machinery, and transport equipment except ships and boats. While complete commodity data are not yet available for 1955, evidence suggests that the Bloc is continuing to move toward a position of a net exporter of capital goods.

The above changes in the pattern of East-West trade suggest that Bloc foreign economic policies are in process of adjustment to internal developments.

In prewar years the USSR, in support of its industrialization program, exported raw materials in return for capital goods but at the same time strived to attain an increasing measure of independence from Western markets. As a result of years of high investment in heavy industry, assisted by imported capital goods, the USSR has achieved a position of industrial power second only to the United States, although it should be noted that the value of its industrial production is only about ^{one-third} ~~40 percent~~ of that of the United States.

In the postwar period, the Soviet economy, augmented by the resources of the European Satellites has not only become a highly developed industrial nation but has achieved a higher degree of self-sufficiency than any other major country in the World.

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The USSR's present economic advantage tends to be in the export of capital goods and the import of food and certain raw materials. The costs of manufactured goods have declined as production has expanded, as skills have developed, and as additional capital goods have made other economies possible. During the same time, however, the costs of food and raw materials have risen with increasing demands and the exhaustion of low-cost production opportunities.

The steady transition of the USSR from a relatively undeveloped to a highly industrialized economy, provides the economic basis for the foreign economic policy toward underdeveloped countries being evolved by the present Soviet leadership. This policy may also have the dual purpose of using the current needs and capabilities of the Soviet economy to promote the broader and longer range political and strategic aims of the USSR in world affairs.

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3. Free World Trade Controls

a. Controls Against the USSR and European Satellites

The Free World has restricted multilaterally the import of selected strategic goods into the European Bloc for almost six years; the United States for over eight years. During this period the Bloc economy continued to expand rapidly, particularly in the heavy industry sector. While controls undoubtedly had some retarding effect on the economy, nevertheless the Bloc internal supply position for many of the items on the original control lists has improved markedly. Currently Free World embargo lists do not impose a significant deterrent on the economic nor on the military growth potential of the European Bloc, although in a few selected sectors controls continue to have an important impact.

This impact derives primarily from embargo of advanced electronic materials and equipment, selected non-ferrous and ferrous metals and alloys, and a small range of advanced equipment in other fields. While the impact may be quantitative in some sectors, the primary effect of controls is a qualitative one in restricting the transmission of advanced technology.

Among the items which the Bloc relies on external sources for a large part of its requirements are copper, ships, and natural resources.

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(1) Copper

Even before the downgrading of copper wire to List III in August 1954, the Bloc imported from the Free World some 20-30 percent of its total new supply. Because of the embargo most of this procurement was by clandestine means. Imports of copper and copper wire were in excess of 120,000 tons in both 1953 and 1954. In 1955, it is estimated that the Bloc imported approximately 100,000 tons. Because of the downgrading of bare copper wire to List III, most of these imports consisted in 1955 of legal procurement of copper wire.

Although almost no copper is produced in Western Europe, most of the shipments to the Bloc are from this area. For example in 1955, the United Kingdom supplied almost 40 percent of total exports, Western European countries accounted for another 40 percent and most of the remainder came from Japan.

Although the Bloc is currently procuring a significant part of its copper supply from the Free World, imports in 1955 decreased by as much as 20 percent from the 1954 level. If current Bloc plans for increased copper production are realized Bloc dependence on Free World supply may have lessened by 1960.

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(2) Ships

Trade controls have been effective in restricting the sale to the Soviet Bloc of certain types of vessels, such as tankers and higher speed freighters but other types of vessels, not subject to embargo have been sold in considerable quantity to the Bloc. In 1955, approximately 120,000 tons of new shipping was purchased by the Bloc from the Free World and in 1956 it is expected that at least 250,000 tons will be purchased. Since vessels of the Bloc merchant fleets are generally over age and slow, new acquisitions are of considerable importance in improving the overall characteristics of the fleets. Trade controls have been most effective in restricting the acquisition of ocean going tanker tonnage from the West and, in fact, have forced the USSR to undertake a very sizable tanker construction program in its own yards. However, there is no conclusive evidence that the tanker construction program has adversely affected the construction of naval combat vessels.

Thus, the primary importance of the embargo has been to delay the overall modernization of the Bloc merchant fleets, to prevent the acquisition of certain strategic types of vessels, and require the expansion of Bloc merchant shipbuilding capacity.

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(3) Natural Rubber

Natural Rubber is embargoed to Communist China but can be freely imported by the European Bloc. However, Ceylon has been supplying Communist China since the beginning of 1953 with quantities of rubber more than sufficient to meet China's domestic requirements and China has re-exported significant quantities of its rubber purchases to other members of the Bloc.

The USSR purchased no rubber directly from the Free World between July 1953 and July 1955 and then resumed purchases at a rate below its estimated requirements. It is estimated that the USSR had a stockpile of 300,000 tons of rubber at the end of 1952, or sufficient for 3-4 years normal requirements. After 1952 the USSR apparently liquidated part of its stockpile and in addition received part of China's rubber imports from Southeast Asia.

The elimination of trade controls would probably lead to some increase in total Bloc imports, particularly of certain metals, ships, electronics and other complex industrial equipment. Increased Bloc purchases of such complex industrial equipment, however, would probably be concentrated in a relatively small number of categories since most of it is not included in the relatively narrow range of items now effectively embargoed by the West.

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b. Controls Against Communist China

Free World trade controls on Communist China being much more inclusive have a more significant economic effect on Communist China than the controls applied against the European Bloc. The difference in effect is due principally to the ancillary transportation controls (which increase Bloc transportation handling and other costs), to US unilateral financial and import controls. A relaxation of trade and ancillary controls including those of the US to the level maintained with the European Bloc would not greatly increase Communist China's access to strategic imports (most commodities are presently available through transshipment from European Bloc ports) but would permit less costly procurement and an expansion of exports. It is believed that in this way a relaxation of controls would enable an increase in Communist China's annual import capabilities by about \$125 million, of which two-thirds would be due to the relaxation of US controls. To that extent, the buildup of Communist China's economic and military potential could be accelerated. There would also be a reduction in internal Bloc transport costs amounting to approximately \$100 million annually.

An expansion in Communist China's imports from the Free World of \$150 million, though amounting to about 8 percent of the present level

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of Free World exports to the Soviet Bloc, would have little effect upon total Free World trade. For particular business in a few countries, however, especially Japan, this increase would be regarded as important.

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4. The Current Bloc Trade Drive in Underdeveloped Free World Areas

The Sino-Soviet Bloc is currently participating to a much greater degree than in the past, in the international economic affairs of the Free World, especially the underdeveloped countries of Asia, Africa, and Latin America. This program in underdeveloped areas is marked by an expansion of trade, the extension of liberal credits, offers of technical assistance, and wider participation in trade fairs.

Although the Bloc trade drive in underdeveloped areas is not limited to the extension of credits, this feature is one of the more important ones. It is estimated that from January 1954 through February 1956, the Bloc countries has extended long-term credits of almost \$900 million to non-Bloc countries. Sixty percent originated with the USSR and the remainder with the European Satellites.

Yugoslavia has been the principal recipient of the new Bloc trade drive followed by Egypt, Afghanistan and India. The Bloc has also been active in other countries of the Near East as well as Southeast Asia and Latin America.

The bulk of this credit (65 percent) arises from four large agreements; Yugoslavia, \$204 million; Indian steel mill, \$115 million; Afghanistan, \$100 million; Egyptian arms, \$140 million. With the exception of the credit arrangement on arms shipments to Egypt, these are longer term (10-30 years) credits. The remaining credit

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allocations are of smaller size (usually less than \$5 million each) and with shorter terms. Virtually all of the credit extension bear a rate of interest approximately half that of normal Western commercial rates.

In addition to obtaining needed capital equipment with payment terms more attractive than usual in the West, the underdeveloped countries are able to repay the USSR through the barter of their exportable surpluses. Many of these surpluses do not at present bring satisfactory prices in Free World markets. Outstanding examples are Egypt and Burma where the Bloc has arranged to take exportable surpluses of cotton and rice for Bloc equipment and for the services of Bloc technicians.

a. Cotton

Cotton is a major export of a number of countries in the Near East, Africa, South Asia, and Latin America. It outranks all other commodities in the export trade of Egypt, Mexico, Paraguay, Peru, Sudan, and Uganda. It accounts for four-fifths of Egypt's exports and over three-fifths of the exports of Sudan and Uganda.

Although world consumption of raw cotton has increased significantly in the last five years, production has consistently been greater than the demand. By 1955 accumulated stocks totalled almost 22 million bales, half of them held by the United States. In addition the world is presently faced with another bumper crop

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and many consumer countries are holding off large purchases in anticipation of lower prices. Thus certain of the underdeveloped countries welcome the opportunity to sell cotton to the Bloc.

Currently the Bloc is virtually self-sufficient in cotton. Nevertheless, it can purchase from the world market in considerable volume if it so chooses. These purchases enable the USSR to expand exports of Soviet cotton to the Free World.

The Bloc has been exploiting the mounting cotton surplus problem in its trade drive in underdeveloped Free World areas. In addition to the exchange of arms for Egyptian cotton, the Bloc has shifted some of its cotton purchases from Pakistan to India and Egypt. Since such purchases yield political gains at little or no economic cost, further Bloc manipulations in the Free World cotton market seem likely.

b. Rice

Rice, like cotton, is a major export of a number of countries, particularly in South Asia. It yields 70 to 80 percent of Burma's export earnings and about 50 percent of Thailand's.

Since 1953, the Asian rice situation has shifted from a condition of relative shortage to one of oversupply. Prices have slipped substantially from their postwar peaks and major exporters are plagued by surpluses and difficulties in finding satisfactory export markets.

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A number of factors have contributed to this situation, including a shift to other cereals and an expansion of cereal production in traditional Asian deficit areas, for example, India and Indonesia. The burden of rice surpluses was most severe in Burma when the government marketing agencies strongly resisted the downward trend in rice prices.

Prior to 1955 no significant amounts of rice were imported by the Bloc. On the contrary, Communist China had been exporting about 250,000 tons of rice a year to Ceylon as part of a five-year rice-rubber agreement. Since 1955, however, there have been a number of rice purchases by Bloc countries, principally from Burma. In 1955, Communist China, the USSR, Czechoslovakia, Hungary, East Germany, Poland, and Rumania all negotiated agreements for the purchase of Burmese rice. These agreements covered from 250,000 to 300,000 tons of rice. Much of this rice was destined for North Vietnam as part of the Bloc aid agreements.

Under a new 1956 agreement, the USSR has signed a contract to purchase from Burma 400,000 tons of rice annually for the next four years. This represents over one-fourth of Burma's expected rice export for the period.

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c. Prospects for Bloc Fulfillment of Credit Agreements

Present Bloc commitments for the sale of capital goods to the underdeveloped Free World areas amount to less than one percent of industrial production. Thus it is likely that the countries of the Bloc could expand credit and export programs with underdeveloped countries substantially without impairment to their own economies.

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5. Future Bloc Prospects for East-West Trade

As the Bloc develops its industrial capacity further, resulting in increased industrial demands for basic resources and the gradual depletion of these resources, it will become increasingly advantageous for the Bloc to export capital goods and to import industrial raw materials. In addition, as population continues to grow, it will also become more advantageous for the Bloc to import food products. The bulk of the exports of capital goods, however, will probably be confined to the simpler types which are relatively easy to manufacture. Such exports are the items which the underdeveloped countries have especially desired to import - transportation equipment, prime movers, machinery for extractive industries, and basic and standard manufacturing facilities. In addition, the Bloc is able and willing to direct the export of technical assistance. Thus the basis exists for an expansion of East-West trade particularly between the Bloc and Free World underdeveloped countries.

The future level of East-West trade depends not only on economic considerations but also on political considerations. Nonetheless, there is reason to believe that the motivations behind Soviet trade -- including the relatively high-cost mineral and agricultural resource base, the desire to extend Soviet influence among other nations, and the rapidly expanding industrial plant -- point to an increasing trade

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between the Bloc and the Free World. It is estimated that Bloc exports to the Free World could double within the next five years and exceed \$4 billion by 1960.

Soviet exports to the Free World in 1960 could exceed \$2 billion. Years of priority expansion in the machinery and equipment sector of the economy has brought the USSR to a point where it has export potential for many basic types of machine tools, industrial products, and industrial installations. Without regard to difficulties in assessing comparable quality and production, it is important to note that in 1955, Soviet production of machine tools (excluding metal forming equipment) exceeded that of the US in terms of units. A program oriented toward export of such machinery, however, would to some extent compete with the Soviet program of modernization and re-equipment which has been put forth as a part of the Sixth Five-Year Plan.

Substantial increases in Soviet production of agricultural machinery, tractors, and trucks planned for the period 1955 to 1960 also provide a considerable export potential. The 1960 output of agricultural machinery is to be 62 percent greater than the 1955 level, while the 1960 output of tractors is to be almost double that for 1955. While much of this equipment is obviously earmarked for the accelerated mechanization of agriculture it must also be viewed as a potential export.

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Such equipment is sorely needed by the less well-developed and agriculturally-oriented economies and the USSR could probably exploit this requirement for political as well as economic advantage.

European Satellite exports to the Free World might also exceed \$2 billion in 1960. The primary export potential of the European Satellites lies in an expansion of exports of industrial products. Indeed because their own natural resources, with the exception of Polish coal, Rumanian oil, and Hungarian bauxite, are not sufficient to supply their own current needs, the successful fulfillment of their plans for industrial development depends on an expansion of such exports. In the past the USSR has provided the bulk of Satellite food and raw material import requirements, but it is likely that the share of these imports from the USSR will decline in the future. The USSR can retard the inexorable rise in its own raw material costs by encouraging its Satellites to seek other sources of supply.

In the pattern of Sino-Soviet Bloc trade with the Free World, Communist China will play only a secondary role for the next five years. China, faced with the problems of developing its own economic structure, will not be in a position to make large direct contributions to Bloc exports to the Free World. Moreover, a large share of the Chinese export potential, primarily raw materials and food, will be directed to the Bloc in return for industrial products.

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Of the three major areas within the Sino-Soviet Bloc the European Satellites face the most pressing agricultural problem. In food production the Satellites are deficient and will require, by 1960, about 1.5 million tons of wheat annually in order to maintain their present living standards. In the past the USSR has provided their food imports, but during the next five years the USSR, even barring unfavorable weather, will only be able to increase living standards slightly at home. In nearly all instances the Satellites can obtain the needed food products from underdeveloped areas, who will also provide a market for their machinery industries.

For raw materials the European Satellites are also the most hard-pressed of any area in the Sino-Soviet Bloc. The USSR has been supplying them with considerable quantities of raw materials, but as Soviet domestic demand has risen there has been evidence of reluctance to ship to the Satellites. In iron ore the Satellites must import more than two-thirds of their requirements, much of which has been supplied by the rest of the Bloc. The Satellites will require about 10 million tons of iron ore imports by 1960. East Germany's requirements for crude oil will be doubled: one million tons are now being obtained from Austria. Satellite natural rubber requirements will nearly double in the next five years. All of the Satellites have trade agreements with underdeveloped countries

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specifying rubber shipments. The European Satellites, even at current output levels, are also deficient in non-ferrous metals and other minerals and will have increasing demands for imports of copper, bauxite, rutile (for titanium), tin, columbium, tantalum, mercury, sulfur, mica, and industrial diamonds. In nearly all cases, South and Southeast Asia has the capability for exporting these materials.

The USSR has less a problem of deficiency in raw materials than a problem of high and increasing costs. In coal, petroleum products, and timber the USSR is relatively well-situated, but in ferrous metals, as well as non-ferrous metals, costs of additional supplies have risen in recent years. Many of the ores are very lean and extraction costs high. Since the USSR has no natural rubber, her requirements of nearly 200,000 tons in 1960 must be imported. The USSR will also continue to be an increasingly large market for wool and possibly cotton.

The Sino-Soviet Bloc will continue to have high demands for machinery and equipment from the Free World. In the past these have comprised nearly half of total imports and while this percentage may decline somewhat, they will probably continue to be the major import. It is likely that Bloc orders in the Free World will emphasize the more complex capital equipment, prototypes, and products which if produced internally would interfere with military priorities, such as merchant ships and equipment of relatively low priority domestically.

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6. Summary

It can be seen from the above discussion that both the direction of East-West trade and its commodity composition should change between now and 1960. Exports will become increasingly weighted in favor of manufactures and capital goods as food and raw materials decline in relative importance. The share of food and raw materials in imports will probably increase significantly. Many of the imports which the Bloc will need must come increasingly from Asia, the Near East, Africa, and even Latin America, where the capital and manufactured goods which the Bloc is increasingly prepared to export can be absorbed. Consequently, it is likely that during the next five years the proportion of imports originating from and exports shipped to the relatively underdeveloped nations of Asia, the Near East, Africa, and Latin America will increase.

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