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CFEP DRAFTING GROUP
ECONOMIC DEFENSE POLICY REVIEW

Staff Study No. 20 (Revised)
Draft of June 27, 1955

Political Impact of Free World Controls on
Trade with the Sino-Soviet Bloc

This draft of Staff Study No. 20 (Revised), "Political Impact of Free World Controls on Trade with the Sino-Soviet Bloc", is transmitted for your use in connection with the work of the CFEP Drafting Group on Economic Defense Policy Review.

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ECONOMIC DEFENSE POLICY REVIEW

Staff Study No. 20
Draft of June 27, 1955
Contributed by Defense

Political Impact of Free World Controls on
Trade with the Sino-Soviet Bloc

A. CONCLUSIONS

1. Examination of the indications from available intelligence provides strong support for the view that Free World controls on trade with the Sino-Soviet Bloc --

effect
in addition of an economic impact has an impact upon the foreign policy
(a) have a ~~major~~ political impact upon the foreign relations of the

of the Sov Bloc;

(b) represent a lesser threat to the internal political stability of the Bloc regimes, which however could be considerably increased by total embargo;

(c) at their present level or at a higher level controls constitute major Free World bargaining points in negotiations with the Bloc;^{1/} and

(d) at a lower level, particularly of CHINCOM controls, would be a sign of Western weakness and might hamper future political discussions and negotiations.

B. UNDERLYING CONSIDERATIONS

2. In an examination at this time of the effects of Western trade

^{1/} Trade controls as a diplomatic device contain sanctions which can be applied entirely at the discretion of Free World governments both as to timing and extent.

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controls on countries of the Sino-Soviet Bloc, it is assumed that despite apparent concessions recently made by the Soviet rulers, (a) there is no convincing evidence that the ideological force of Communism is abating, (b) the fundamental hostility of the Communist leaders toward the Free World remains unchanged, and (c) the basic objective of the Communist leaders is a continued expansion of their own sphere of power at the expense of the Free World.

3. The political structure of the Sino-Soviet Bloc is vulnerable to the impact of Free World economic measures because Marxist political thinking is conditioned by economic considerations.

4. The total political impact of Free World denial of goods and services to the Sino-Soviet Bloc involves effects of economic and military measures which are not here assessed. Although the political significance of this impact may be greater or less at any given time, the Free World controls constitute an effective overall bargaining instrument in negotiations with the Sino-Soviet Bloc and produce disruptive intra-Bloc political effects of an ideological and psychological character from which tactical advantages can be derived. For these reasons the correct assessment of the political impact of trade controls is a vital factor in the formulation or revision of an economic defense program aimed at the preservation of Free World security.

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*Omit
strategic*

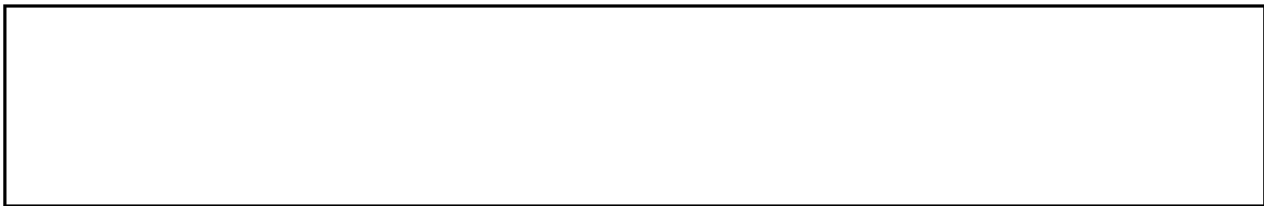
5. It is a premise of the Free World controls that they impose a greater strategic cost on the Sino-Soviet Bloc than on the Free World.^{2/} By parity of reasoning, any increase of the level of controls would increase the relative strategic cost to the Sino-Soviet Bloc, and the maximum possible strategic cost would be imposed by a total embargo.

6. Although the system of Free World controls has been based primarily on the idea of selectivity, the trend in the recent past in the main has been toward selecting items for decontrol rather than toward selecting items which would have a major strategic impact if denied to the Bloc. For example, in the context of current Soviet Bloc economic conditions, it might be that agricultural commodities should be near the top of the list from the point of view of strategic impact. Another important area of direct vulnerability is the provision of shipping and shipping services to the Bloc (shipbuilding and repairs for Bloc accounts in Western yards), chartering of ships in trade with the Bloc, etc.^{3/}

C. POLITICAL STABILITY OF THE SINO-SOVIET BLOC

7. The system of Free World controls on trade with the Sino-Soviet Bloc represents a continuing challenge to the political stability of the Bloc regimes. The controls —

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(a) compel the Bloc to try to compensate by autarchic measures in those particular areas where Free World denial of goods and services is effective; 4/

(b) disrupt Soviet state planning; 5/

(c) contribute to the failure of the Bloc to benefit from Free World advances in broad fields of science and technology; 6/

(d) restrict the flexibility and possibly influence the basic pattern of the development of the Bloc's mobilization base 7/ and even influence major strategic military decisions as in the case of Communist China. 8/

8. As regards relationships between the various member states of the Bloc, Free World controls tend to --

(a) maximize strains, stresses and consequent chances for disunity by compelling the institution of priorities for the allocation of scarce goods and services on the basis of Bloc-wide strategic requirements decided by Moscow; 9/

(b) cause the European satellites to be turned by Moscow from traditional Free World markets in order to satisfy overriding internal

4/ See Annex II
5/ See Annex III
6/ See Annex IV
7/ See Annex V
8/ See Annex VI
9/ See Annex VII

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requirements of the Bloc as a whole or of specific Bloc partners; 10/

(c) require policing efforts among Bloc partners to insure compliance with intra-Bloc priority allocation systems made necessary by Free World controls; 11/

(d) encourage satellite countries to reestablish normal relations with the Free World. 12/

8. INTERNATIONAL RELATIONS BETWEEN SINO-SOVIET BLOC AND FREE WORLD COUNTRIES

9. In international relations between Sino-Soviet Bloc countries and the Free World, strategic trade controls:

(a) limit the Sino-Soviet Bloc's freedom of action under peacetime conditions and in preparation for war; 13/

(b) constitute a major bargaining point for Free World negotiators, particularly for negotiations involving economic requirements or the political prestige of Communist China; 14/

(c) call attention to the advantages of a free exchange of goods and persons enjoyed by non-Communist countries (see 8.(d) above); 15/

(d) emphasize the decreasing dependence of Free World economies upon trade with the Bloc. 16/

- 10/ See Annex VIII
- 11/ See Annex IX
- 12/ See Annex X
- 13/ See Annex XI
- 14/ See Annex XII
- 15/ See Annex XIII
- 16/ See Annex XIV

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ANNEXES

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Annex II

Comments on Soviet Bloc Vulnerabilities, Intentions, and
Autarchic Measures in the Electron Tube Industry.

The following statements on "vulnerabilities" and "intentions" appear in the "Economic Intelligence Report, The Electron Tube Industry in the Soviet Bloc, CIA/RR 7-S-1 (6 Sep 1954)" page 19:

B. Vulnerabilities.

In general, there is no change in the statement concerning vulnerabilities presented in CIA/RR 7. Specifically, the electron tube industry in the Soviet Bloc has been taking steps to provide domestic capacity for a number of the specialized products formerly imported from the West. Complete interdiction of such products would probably no longer reduce tube production by as much as 50 percent. The procurement of nickel-cathode sleeves, tungsten and molybdenum metal products, and diamond dies, tube material shortages, due to a lack of exports from the West into East Germany, caused a drop in production of some types of tubes.

* * *

C. Intentions.

It appears certain that the intentions of the USSR are to expand the electron tube industry in the Soviet Bloc as rapidly as feasible, to maintain a high proportion of industrial effort devoted to military end items, and to equal or exceed in quantity the probable production of military electronics in the US. In detail, a very high priority is assigned to the production of radar counter-measures, probably followed by the production of technically adequate microwave radar, and then by one or more basic systems of missile-guidance controls.

It is also certain that it is the intention of the USSR to insure that the Soviet Bloc is completely selfsufficient in its supply of electron tubes. This goal appears to be nearly attained at this time.

It is believed that the situation described in the foregoing paragraphs would not apply today if free world export controls over electronic equipment had been more specific or tighter as a whole. Development and production of many electronic tubes and components in the Sino-Soviet Bloc has been based on Western prototypes. The effort on the part of the Bloc to copy Western prototypes has virtually always been restricted to electronic tubes and components which were capable of use in military equipment. The following types of tubes might be cited as prominent examples:

1. Oscillograph tubes. Laboratory development and pilot production from copies of US tubes.

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2. Kinescope tubes. Laboratory development and pilot production from copies of US tubes.
3. Cathode ray tubes. Laboratory development and pilot production from copies of US tubes.
4. Oscilloscope tubes:
 - a. 3-5 inch electrostatic-deflection tubes for radar. Copied from British type ACR-1 and modified.
 - b. Dark-trace projection tubes for ground radar PPI repeaters. Copied and improved version of a US tube.
 - c. Image orthicons. Patterned after U. S. design.
5. Klystrons:
 - a. 3000 mc/s reflex local oscillator. Copied and improved from US type SK 28/707B.
6. Crystal diodes:
 - a. 3000 mc/s diode for radar mixers. Copied from US type 1N21.
7. Transmitting and Modulating Tubes:
 - a. Low to medium power glass oscillators for low frequency radar.

These examples represent only a small fraction of the materials of direct military usefulness which Western countries have made available to the Bloc in the form of prototypes. The relaxation of controls following the list revisions of 1954 have made available to the Bloc a wide variety of the newest types of tubes, electronic components, and instruments which have primarily a civilian applicability in the West but which, under Bloc priorities apparently are used chiefly for military purposes. The recent control relaxation, for example, now has made available tubes and components which the Bloc could use in its early radar warning system, the most comprehensive and extensive radar system in existence.

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ANNEX III

Interference with Soviet Bloc Planning.

An example of how the denial of specific raw materials and manufactured goods may not only affect a specific branch of industry but disrupt broader planning, may be found in the following quotations from the Economic Intelligence Report, The Heavy Electrical Machinery Industry in the Soviet Bloc, CIA/RR 9 (12 Sep 1952), pages 1 and 2:

The heavy electrical machinery industry plays a vital part in the economy of the Soviet Bloc. The atomic energy program and most of the basic industries depend on this industry in two ways; first, directly, for motors, generators, and transformers for use in their own facilities; second, indirectly, because they are dependent on the general power system, one of the main users of heavy electrical machinery.

* * *

Facilities probably are not in most cases the limiting factor in over-all expansion plans. Occasionally it is not clear whether the impact of the Bloc's military production program, the lack of raw materials, or the inadequacy of the physical capacity of the plant to contain all the necessary operations causes deficient production in a given plant.

Although it probably is true that the employment of the inputs in the heavy electrical machinery industry of the Soviet Bloc results in markedly better returns to the economy than would the employment of these inputs in other industries, the number and types of inputs in this industry cause a serious drain on some of the resources of both metals and manpower in the Bloc. The real shortage in the industry exists in the supply of basic raw materials rather than in the facilities in which such raw materials are used.

Notable shortages exist in these basic raw materials, primarily copper, transformer sheet steel, and transformer oil.

* * *

The deficit of heavy electrical machinery in the Soviet Bloc would be compounded if imports were reduced. The level of current imports of heavy electrical machinery into the Bloc is estimated at a rate of 4,425,000 kilowatts a year, approximately one-quarter of the estimated production rate.

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This major deficit between domestic production and demand indicates an unusually large dependence on imports. Even with a range of error which cuts this import figure in half, the imports still would be enough to satisfy completely the requirements of the Bloc's atomic energy program for heavy electrical machinery. The strategic importance of the import program cannot be overlooked in view of its sizable contribution to the Bloc's potential for war.

Many of the Bloc's industries require heavy electrical machinery for defense or defense-supporting production. The submarine program, the steel industry, the atomic energy program, and the railroad equipment industry are examples of strategic sectors of the Soviet Bloc economy which are likely to have difficulties in fulfilling planned output if either the supply of heavy electrical machinery or the output of other basic industries which in turn depend on this supply is curtailed. Another strategic sector to be affected would be the electric power industry, which consequently would probably be unable to relieve the chronic shortage of electric power. Since all the industries of the Soviet Bloc which consume heavy electrical machinery are of varying degrees of strategic importance, the Bloc is particularly vulnerable should Western countries greatly reduce their exports to the Bloc of heavy electrical machinery or should there be a curtailment of the Bloc's imports of the basic raw materials used to produce such machinery. A continued excess of demand for heavy electrical machinery over supply would in the long run adversely affect the Bloc's economy and its war potential.

In a recent editorial comment on the Leipzig Fair, the influential Cuesseldorf INDUSTRIEKURIER referred to, "Questions frequently raised by Sovzoners [which have] reportedly included such reproaches as, 'Why do you Westerners help the Soviet Zone regime overcome its many bottlenecks and keep its shaky economic system artificially alive by deliveries of raw materials and consumer goods?'"

NIE-22 (19 Feb 1951) assessed the likely impact of an economic warfare program upon Soviet Bloc economic development as follows:

A program of economic warfare would add to the internal economic problems of the USSR and its Satellites and would make it virtually impossible to carry out the planned balanced development of their economies. Such prospects as they now have for narrowing the present great gap between their combined productive capacities and those of the West would be decidedly reduced.

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ANNEX IV

Science

Science and Technology.

An example of technological advance in Western nations, and particularly the U. S., over the Soviet Bloc, which has recently been under scrutiny, is in the field of rolling mill design and construction:

The ability to coordinate and bring together all factors, including design and production skills, necessary in the production of rolling mills is not as advanced as in the West. The degree of the technological advances in the West over the level of Bloc technology varies somewhat with types of rolling mills. The USSR has designed and constructed since 1946 several blooming mills and rail-structural mills, and other types. They have not produced continuous strip and sheet mills of high quality steel sheet and strip although several of these types are under construction. It is in this particular field of flat rolled products that the West holds the greatest advantage in advanced technology. Because the Bloc's machine building plants capable of producing rolling mills probably have not acquired all the production techniques available in the US, UK, and several of the other Western countries, they have more difficulty in producing rolling mills, components, and auxiliary equipment.*

The general organizational, technical, and political problems which face the Bloc in any effort to advance scientific achievement or improved technology have recently been discussed in public statements by prominent Soviet functionaries. In a speech to the All-Union Conference of Workers in Industry, N. A. Bulganin, Chairman of the USSR Council of Ministers, on 16 May 1955, emphasized the importance of "measures to effect a further advance of industry by an extensive introduction into production of achievements of science, technology, and advanced experience." Bulganin's emphasis of the importance of science and technology, if read against the background of Soviet Bloc efforts to



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procure prototype goods and achieve autarchy, are significant:

Bulganin said the question under discussion at the conference was of great State importance. Only the introduction into production of the latest achievement of science and technology, which constitute the basis of technical progress, can insure the rapid growth of labor productivity, which, according to Lenin, is ultimately the most important and the main factor for the victory of the new social order.

During the past 26 years, labor productivity in industry has increased in our country by more than 6 times. To insure the further development of the national economy of the country it is essential to raise labor productivity to a new high. This task can be solved only as a result of an inexorable and decisive introduction into production of new technique and modern technology, by modernizing existing machines and equipment, and by radical improvement in production management.

Machine builders have a particularly important role in introducing new technique and in increasing labor productivity in the national economy. The influence of machine builders on technical progress is felt in two ways: the introduction of new technology and increased labor productivity in the machine building works themselves, and the designing and delivery of machines to insure technical progress in the whole of the national economy.

Although during and immediately after the war, progressive methods such as production lines, automatic and semiautomatic welding, high-speed metal-cutting, heating by high frequency currents, and so forth were widely introduced, we now hear little about new vast technological measures in machine building. Our machine builders restrict themselves mainly to the technological processes already mastered, whereas there are new progressive technical processes capable of increasing labor productivity several times over, sharply reducing costs of metal and material, and producing more from the same production space.

The engineering situation cannot be considered normal when, because of inadequate output of special equipment, the proportion of highly productive machine tools is falling off in the machine-tool reserves. The production of forging and pressing equipment is lagging sharply. Processes rendering production automatic are being incorporated too slowly. Poor use is made of existing equipment at many engineering works. We have works which still make machines inferior to those made by some works abroad.

Comrade Bulganin pointed out that metal workers and chemists should play an important role in the matter of insuring technical progress of the country and of raising labor productivity. In spite of certain metallurgical and chemical achievements in introducing new technical equipment, both fields are lagging behind the level of world technology in certain types of production. In ferrous metallurgy not enough is being done to improve

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the quality of special steels and alloys, especially of heat-resisting types. The introduction of highly productive processes of blast furnace is slow. The introduction of steel smelting production based on the use of oxygen high top-gas pressure, neutralization (usrednenie) of iron ores, the use of new highly refractory materials, and the complex automatization of the control of metallurgical processes is also slow.

The Ministry of Ferrous Metallurgy is not paying due attention to the production of more economic rolled steel parts, which are in particularly short supply, which results in difficulties in the industry and excessive use of metal.

There are many unexploited reserves in our metallurgical industry. Substantiating this, Comrade Bulganin lists a number of examples.

The Ministry of the Chemical Industry is not mastering with sufficient speed the production of concentrated fertilizers, new organic materials, plastic masses, non-ferrous metals substitutes, and dyes, and is lagging in the organization of the chemical refining of oil and natural gases.

In speaking about the oil industry, Comrade Bulganin pointed out that individual drilling brigades had reached high speeds in drilling. For example, the drilling brigade of foreman Mugalim Minyazevich Gimazov--Tatneft-- had drilled about 16,000 meters, or more than 1,300 meters per machine tool a month in 1954. In individual drilling, this brigade reached a drilling speed of approximately 2,500 to 3,000 meters per machine tool per month.

However, the oil industry as a whole is lagging in the speed of drilling and in oil-refining.*

*FBIS, Daily Report: Foreign Radio Broadcasts, No. 96 (1955), USSR and Eastern Europe, pp. CC2 - CC4.

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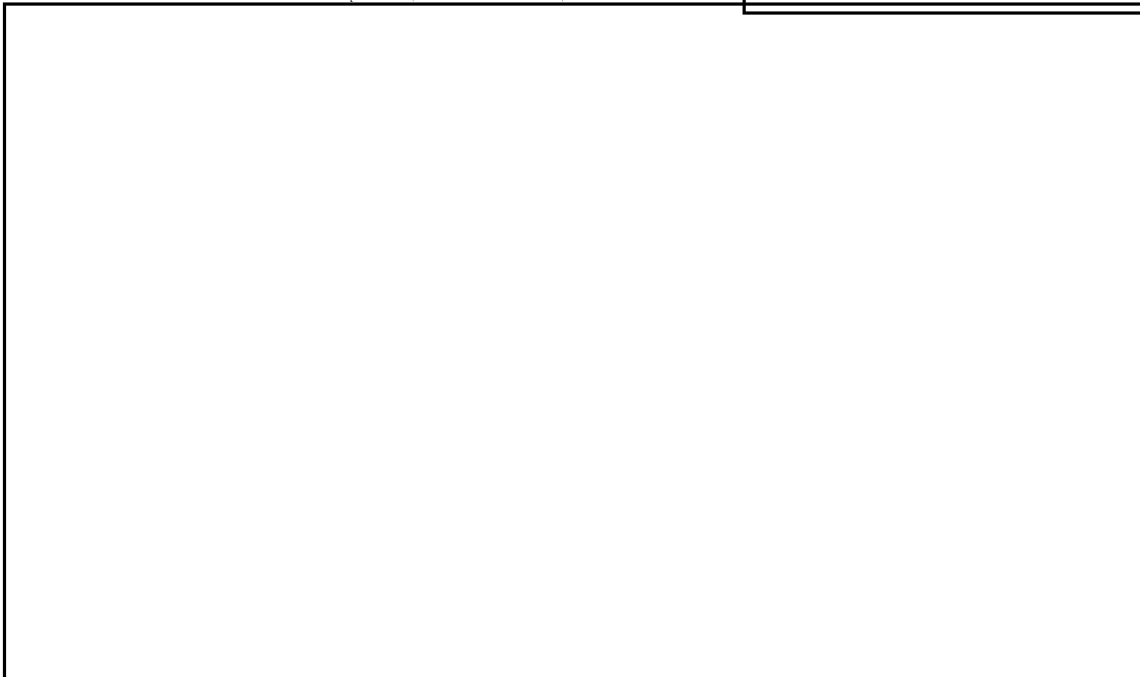
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ANNEX VII

Allocation of Supply Priorities in the Sino-Soviet Bloc.

In the Sino-Soviet Bloc, Communist China continues to retain important priorities for supply of materials either produced in other parts of the Bloc or procured by European Bloc countries from the Free World under relaxed controls.



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ANNEX VIII

REORIENTATION OF SATELLITE

FOREIGN TRADE

The reorientation of satellite foreign trade within the Sino-Soviet Bloc has taken both the form of specific bilateral arrangements (East German reparations, trade arrangements with the USSR, China-trade commitments - see also Annex X) and multilateral arrangements. A prominent example of the latter is the Council of Mutual Economic Assistance (KOMEKON), which was established by the USSR and the European satellites in Moscow on 18 January 1949. A few pertinent articles from the protocol establishing the organization, are quoted below.

Article 2. The purposes of this organization are:

- (a) To coordinate the economies of the signatory countries within a general economic plan developed by the Council.
- (b) To supervise the consolidation and development in each country of the industries and resources of each of the respective countries in such a manner that the industries of all the signatory countries will no longer be competitive but will compose a homogeneous whole, complementing one another.
- (c) To add in the economic reconstruction of each country individually, bearing in mind for this purpose the possibilities of providing each country with raw materials.
- (d) To increase the capacity of each country for the production of raw, processed or semi-processed materials by establishing mixed companies or associations for exploration and exploitation of surface and sub-soil resources.
- (e) To arrange for exchanges of experience.
- (f) To standardize and increase the quantity as well as the quality of industrial products of the signatory countries.
- (g) To assure the sale of the products of member countries.
- (h) To accord assistance by loans or arranging investments for the purpose of strengthening the economy of each signatory country.

Article 4. The Council will be convened whenever it may be necessary, each time in a different country under the presidency of the delegate of the host country but not less frequently than

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once every three months.

At these meetings the economic situation of each country individually will be discussed and analyzed.

Article 5. Beginning with the year 1950 the economic plans of all member countries will be drawn up in conformity with the advice of the Council, but for the present year each signatory country will endeavor to adapt its own economic plan to the provisions of the present protocol and the advice of the Secretariat General in so far as any investment of funds in the execution of predetermined parts of the economic plans of each member country has taken place up to the signing of the present protocol.

Article 6. The present protocol neither excludes, annuls, or alters in any way commercial agreements already signed by any of the parties to this agreement and which are communicated to the Secretariat General within a period of thirty days.

Article 8. Each signatory country is obligated to make available to the Council all information and documentary material necessary to permit and facilitate the task of the observers which the Council may find necessary to send into any of the signatory countries upon the proposal of the Secretariat General, which has authority to make any decisions, subject to their ratification by the Council at its first meeting.

Each signatory country is also obligated to accept and follow the advice of any counselors and technicians which the Council may find necessary to send, directly or upon request, to any of the signatory countries.

Article 9. The Governments of the signatory countries obligate themselves to send to the Secretariat General within the first five days of each month a detailed statistical situation report concerning production and any other documentary material pertinent to the economic and financial situation of the country concerned for the next month.*

*EIC-P-1, Appendix A.

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The significance of KOMEKON activities for the free world was re-emphasized by a Western European observer who visited Poland in 1954:

* * * All the new commercial agreements reached by Warsaw with Western countries are part of a vast plan of Soviet commercial expansion-worked out by the KOMEKON, and they must fit into it. A careful study of the agreements shows clearly that this offensive of expansion is chiefly aimed at France, Great Britain, Italy and South America and East-Asiatic countries. Apart from financial gains the aim is clear---it is to foster on that basis difficulties between these countries and the USA. It is needless to say that the part played in these proceedings by the Poles is practically nil, the right of decision resting in the hands of Walentin Jozefowicz SOLOWIOW -- the official representative of the KOMEKON in Warsaw.*

The Communist view of "trade as a political weapon" was elaborated in one of the papers reportedly presented at the Sochi economic conference (5-9 July 1954). At this meeting, attended by representatives of all Sino-Soviet Bloc countries, North Korea, Viet Minh and observers from Japan, Indonesia, and France.

The strongest possible emphasis was placed on the concept that trade with the western democracies was a weapon in the political fight, rather than a means to obtain scarce goods or commodities except in certain cases of materials not produced within the Soviet Bloc.**

In relations with Latin America, the Bloc has used trade as an economic weapon with a strong political tinge:

*Radio Free Europe report, 13 February 1954, quoted in AMCONGEN MUNICH Dispatch 329, 25 March 1954.

**EDAC, "A Soviet Trade Warfare Conference, K"EDAC D-36/59, 29 October 1954

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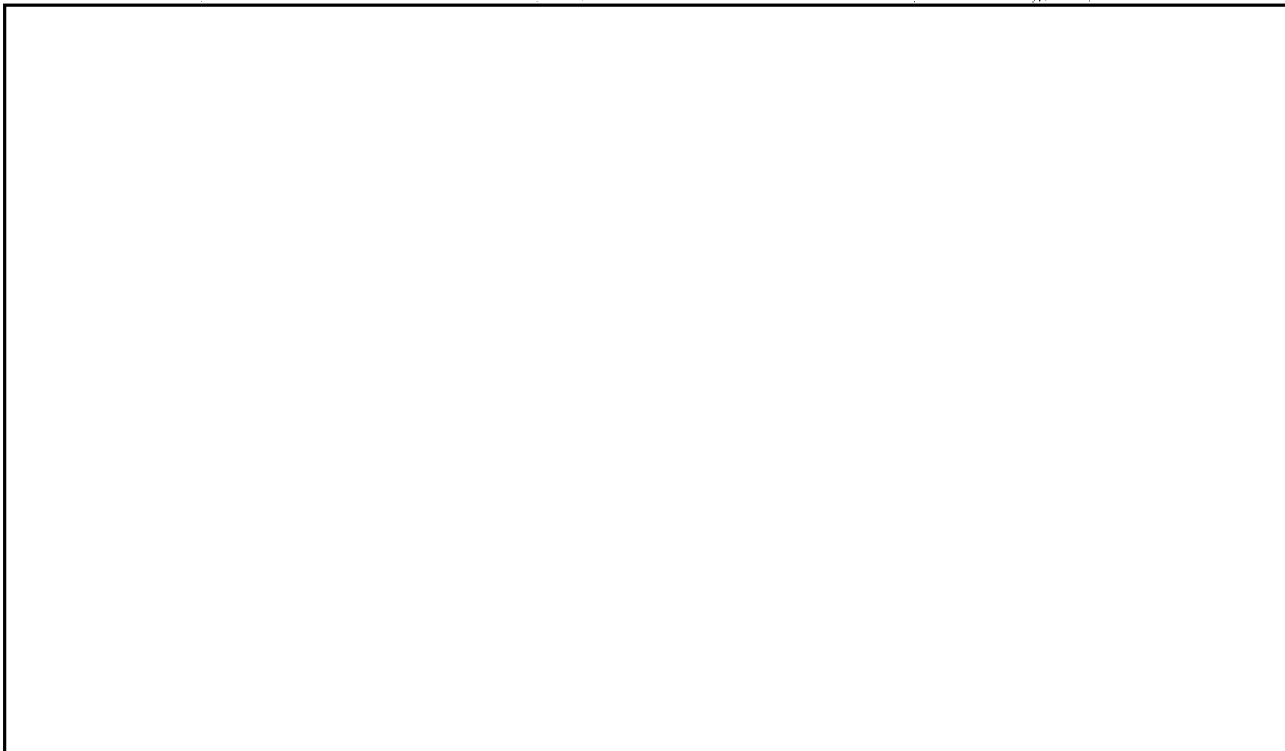
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* * * The USSR and its satellites have shown a growing interest in trade with Latin America since early 1953. Past Latin American trade with the Soviet bloc has been on a small scale, and until recently was declining. Currently some Latin American countries are vulnerable to bloc approaches. As a result of unsold export surpluses, Argentine, Uruguay, Chile, and Brazil have been having balance-of-payments problems. Some countries may welcome these approaches as a means of increasing bargaining power or demonstrating political independence or neutralism.

* * * Communist propaganda in Latin America has stressed the role of trade with the bloc in aiding economic development and ending "domination" by US "monopolies." On occasion bloc trade moves have been directed toward aggravation of US semi-strategic goods -- e.g., Brazilian iron ore, Chilean and Mexican copper, and Bolivian tin and lead -- represents, with varying degrees of seriousness, a mixture of political and economic motives.*

Traditional Hungarian, Polish and Czech trade connections have been subverted to serve the political as well as economic aims of the bloc.

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ANNEX X

Promotion of "Titoism" in Satellites.

Staff Study No. 4 in this Economic Defense Policy Review series deals with the "Promotion of Soviet Bloc Disunity through Flexible Application of Strategic Trade Controls." In addition to considerations presented in the draft of that study, however, the most recent results of Titoism should be examined.

In the "Declaration of the Governments of the Free Peoples' Republic of Yugoslavia and the USSR," summarizing the Belgrade and Brioni discussions of 27 May to 2 June 1955, the following paragraph appears:

The furtherance of mutual and international economic cooperation, and the removal of all those factors in economic relations which impede the exchange of goods and hamper the development of productive forces both in the world and within the national economies.*

Subsequent official Yugoslav comment, furnished to the U. S. ambassador on the foregoing passage, contained the following interesting observations:

When questioned about the reference to "the removal of all those factors in economic relations which impede the exchange of goods" (reference telegram paragraph 11), he replied main purpose this paragraph was to break down controls on shipments of strategic materials (Embassy telegram 1066, paragraph 5) but implied agreement might have this result. He said they had in mind the more general purpose of increasing East-West trade and remarked that even the US was seeking new solutions of this problem. He added that insofar as Yugoslav exports to certain countries concerned, question of COCOM controls

* State Incoming Telegram, Belgrade, No. 1058, June 2, 1955, Unclassified.

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had scarcely arisen in the past since Yugoslavs have not had enough exports but he implied that if Yugoslav exports to certain countries should become a factor of economic importance, Yugoslavs would not be bound by controls.

He said that Yugoslavs had not expected to be able force Soviets to agree acknowledge separate roads to socialism (Embassy telegram 1058 paragraph 10) and they considered this passage one of most important in communique for its possible long-term results. They doubted it would have immediate effects of importance in satellites, though it was sure to be painful to Rakosi et al, but they had hopes that it would eventually help to weaken Soviet control over satellites and contribute to retraction area Soviet domination.*

The U. S. ambassador's evaluation of the general results of the Russo-Yugoslav talks also is of interest:

In spite of unsatisfactory character of declaration, there is good reason to believe atmosphere of conference widened rather than narrowed gap between Soviets and Yugoslavs. Tito who was optimistic about visit is reported from good sources to have been clearly disillusioned re real Soviet attitude and is not so convinced as formerly of Soviet peaceful intentions. Tito also reportedly shocked at some of conversations at Brioni where Soviet boasted World War I had brought communism to Russia, World War II had added Eastern Europe and China and World War III would see it spread throughout world. This shocked Tito who above all wants avoid World War III. Tito also reported as shaken by frank statements of continuation of Stalinist line inside USSR. Other high Yugoslav leaders regard Soviet leaders as second-rate and have doubts about their capacity to conduct negotiations with West. From one excellent source I learn Tito apparently defended West most vigorously at Brioni. Another high Yugoslav official told me

* State Incoming Telegram, Belgrade, No. 1070, June 4, 1955, Secret.

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Yugoslavs resisted until last their mention of Formosa but finally gave in because it consistent with their general position on China. Another source said Yugoslav Government had no desire to see NATO dislocated.*

Free-World controls on trade with the Bloc and related ancillary control measures can have considerable political impact when promptly and specifically applied in emergency situations. The Berlin Blockade of 1948 is a case in point, and a somewhat similar situation arose last year in connection with increased road tolls for Western use of autobahn roads leading to Berlin. For the latter case, the effectiveness of imposing free-world restrictions on (German) interzonal trade was evaluated by HICOG in the attached cable.

* State Incoming Telegram, Belgrade, No. 1066, June 3, 1955,
Secret.

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**State Incoming Telegram, Bonn, No. 2915,
April 6, 1955, Confidential.**

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A recent New York Times article stated that, as regards Communist China,

* * * it is possible to envisage compromise interim settlements and it is to be hoped that the Eisenhower Administration will use this lull to work out a coordinated program in association with our Allies on these points:

(1) Trade. The relaxation of the United Nations embargo on exports of strategic materials, together with a modification of the complete embargo on trade between the United States and Communist China, is the least difficult concession that the United States would offer.

Embargo List

The General Assembly could not repeal or modify the embargo before its autumn session: but individual members could take practically everything except guns and gasoline off the embargo list without waiting until then.

Although the details are still top secret [sic] the Marshall Plan countries of Europe, in fact, relaxed the application of the strategic embargo more than a year ago. This was worked out in the secret London Committee [COCOM] that draws up the lists of strategic equipment and materials barred to the Soviet bloc.

There is a wide-spread demand for increased trade with China, Communist or otherwise, not only in Britain, Japan and West Germany, but also among certain business groups in the United States. The State Department has gone so far as to concede that trade concessions might be a useful bargaining card.*

* Thomas J. Hamilton, "'Summit' Talks Awaited for Light on Far East," New York Times, 12 June 1955, Sec. IV, p. 3.

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Senator Walter F. George has expressed similar thoughts recently when he called for a change in the US stand against Japan's trading with Communist China:

"Japan ought to be allowed and should not be discouraged from reopening her markets in the great trading area of China," Senator George said, adding that only goods with a strict military application should be withheld from Red China by the Japanese.*

That the USSR and the Bloc as a whole are receptive to the idea of restoring normal trade relations, is evident from recent speeches and comments by Soviet leaders. The following remarks were made by Krushchev:

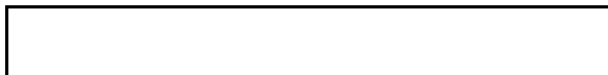
"First, the prerequisite for improvement of relations is to establish normal trade relations."

Concerning non-interference in the affairs of other countries/ "This and normal trade which is mutually profitable are essential."

"What we need is trade. Butter for manganese is blackmail. We need real normal trade; that's the way to begin."

"Well, our heavy industry is sufficient but our economy is developing and therefore our requirements are developing. Our requirements in metals are developing. That branch of heavy industry should develop in advance of others. Our requirements are greater, particularly for metals. Of course, this is for defense but mainly it is for peaceful industry."**

* Charles E. Egan, "East-West Trade Bid Rises; George Asks Japan Outlet," New York Times, 12 June 1955, p. 1.



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ANNEX XIII

Free World Trade Based on Mutual Advantage.

In his Message to the Congress in January, 1954, President Eisenhower stated:

The national interest in the field of foreign economic policy is clear. It is to obtain, in a manner that is consistent with our national security and profitable and equitable for all, the highest possible level of trade and the most efficient use of capital and resources. That this would also strengthen our military allies adds urgency. Their strength is of critical importance to the security of our country.

Great mutual advantages to buyer and seller, to producer and consumer, to investor and to the community where investment is made, accrue from high levels of trade and investment. They accrue no less in trade from nation to nation than in trade from community to community within a single country. The internal strength of the American economy has evolved from such a system of mutual advantage.*

* Clarence B. Randall, A Foreign Economic Policy for the United States, Chicago: University of Chicago Press, 1954, page 54.

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ANNEX XIV

Decreasing Free-World Dependence on East-West Trade

Part 1

Statement of Kenneth R. Hansen, Assistant Deputy Director for Mutual Defense Assistance Control, Foreign Operations Administration, in "East-West Trade", Hearing, Subcommittee on Foreign Economic Policy, Committee on Foreign Affairs, House of Representatives, 83rd Cong., 2d Session on East-West Trade, 16 February 1954, pp. 8-12, Charts Nos. 2-5, copy attached.

Charts to be added & addition

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Part 2

Excerpt from "Conclusions" of Economic Intelligence Report, Long-Run Soviet Economic Growth, CIA/RR 53, 23 December 1954. pp. 56-58:

A basic assumption of this report is that international trade will increase only slightly and will not contribute to the growth of the USSR any more than it currently does. If, however, the Soviet policy makers decide to supplement the agricultural output of the USSR by imports to a significant extent, it is possible that the rate of growth of the Soviet gross national product could be considerably higher. The level to which it would grow depends on the extent of the imports and on the terms of trade involved. It is, however, important that the intelligence community be alert to significant increases in Soviet imports, especially of agricultural commodities.

Another basic assumption of this report (that the cold war will continue at about the present level of intensity) is translated into the proposition that expenditures for defense will increase during this period at the rate of 2.75 percent per year. These expenditures would be primarily for the maintenance of the current military strength in an up-to-date condition. If, however, defense expenditures are kept at the current level or reduced, it is possible that total production in 1975 would be higher than estimated. How much higher would depend on the extent of the cut in defense expenditures.

It should also be pointed out that the contributions to the growth of the USSR made by the Satellites have not been explicitly considered. These effects have, however, been considered implicitly to the extent that they have affected Soviet growth in the past.

Finally, it should be noted that the projections of Soviet output in 1975 are limited to the extent that all economic projections over a long period of time are limited. They are based on what is known about the past developments and present conditions and what can be deduced from this information and reasonable assumptions about the future. They are limited to the extent that currently unknown future events affect the quantities which this study attempts to estimate.

A rough comparison of the projected gross national product of the USSR with that of the US is helpful in assessing the meaning of estimates developed in this study. This comparison cannot be precise, because it involves not only all the inaccuracies of projecting both the Soviet and the US data but also the inaccuracies of international comparison. The factor inputs projections of Soviet gross national product and an estimate of US gross national product are compared in Table 16* and

* Table 16 follows on p. 58 [p.47]

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Figure 7.* While the US estimate grows from \$350 billion in 1953 to \$735 billion (3.4 percent per year), the best estimate for Soviet gross national product grows from \$103 billion in 1953 to \$290 billion (4.2 percent per year), assuming low consumption, and \$250 billion (4.2 percent per year), assuming high consumption, for 1975. The difference between the two gross national products grows from \$247 billion in 1953 to \$422 billion (low consumption) and to \$482 billion (high consumption), while the Soviet gross national product expressed as a percentage of the US increases from 29 percent in 1953 to 39 percent, assuming low consumption, and 34 percent, assuming high consumption, in 1975. It is also interesting to note that during this period the average annual increase in the difference between the US and Soviet gross national products is growing much faster (between 2.7 percent and 3.1 percent) than the percentage relationship between the two (between 0.7 percent and 1.3 percent). In summary, the gap (in absolute terms) between the US and Soviet gross national products is expected to increase, even though the Soviet gross national product is expected to become a larger percentage of the corresponding US value by 1975.

* Following p. 58 ∟ Omitted ∟

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Table 16

Comparison of the Gross National Products
of the USSR and the US
1953 and 1975

<u>Year</u>	<u>USSR (Billion 1951 Dollars) a/</u>	<u>US (Billion 1951 Dollars)</u>	<u>Difference USSR as (Billion Proportion 1951 of US Dollars) (Percent)</u>
1953	103	350	247 29
1975 b/ USSR, low consumption	313	735	422 43
USSR, high consumption	253	735	482 34
USSR, low consumption, most probable	290	735	445 39
USSR, high consumption, most probable	250	735	485 34

- a. Dollar values for the gross national product of the USSR are derived on the basis of 10 rubles equal one dollar.
- b. USSR estimates for 1975 are factor inputs estimates. US estimate for 1975 is based on discussion in Appendix E.

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Part 3

Excerpt from "Economic Developments in the European Soviet Bloc-1953-1955," Revised Abstract of EDAC Document ED/EC D-85, published as ED/EC D-85/1b, 12 May 1955, pp. iv-v:

Foreign Trade of the European Soviet Bloc

The economic system of the Soviet bloc countries, and still more the policies of their rulers, have been such as to restrict the expansion of trade relations with the Free World. Soviet foreign trade has always been guided by the Kremlin's desire to reduce dependence on "capitalist" markets. But this policy does not require the U.S.S.R. to avoid trading with the countries over which it exercises various degrees of control, nor does it require the U.S.S.R. or the satellites to deny themselves priority needs for rapid industrialization and economic development which can be met by procurement from Free World countries. In general, commodities are exported chiefly in order to buy such imports as are considered essential. Imports consist predominantly of capital goods and raw materials; relatively few consumer goods are purchased abroad. This policy -- while not permitting any large general expansion in trade with the Free World -- fosters modest expansions from time to time in trade with certain countries and in selected commodities.

1953 and 1954 fell into one of the periods of heightened Soviet attention to foreign trade. Soviet bloc spokesmen, particularly since late 1951, have been stressing their desire to increase trade with the Free World. In 1953 there was also a shift in some of the Soviet trading tactics, and in late 1953, actual trade began to rise modestly.

Recorded trade with countries outside the Soviet bloc, which was at a low point in 1952 and 1953, increased in 1954. Imports and exports totaled roughly \$2.4 billion annually in 1952 and 1953 and rose to about \$2.8 billion in 1954. Trade of the satellites was roughly in balance, while the U.S.S.R. had a large deficit in 1954 which was made possible by the gold sales of 1953 and 1954. The bloc countries had generally used all of the "swing credits" made available to them by Free World trading partners.

The trade has continued to be largely an exchange of Free World raw materials and manufactures for Soviet bloc food and raw materials. Bloc demand for shipping and for commodities still classified as

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strategic remains high, and attempts to frustrate or evade existing controls continue. In the past two years, however, associated with the Soviet bloc consumer goods emphasis and the poor harvests of 1953 and 1954, there has been a significant increase in bloc imports of food, and raw materials for light industries -- textile fibers, hides and tobacco. In 1954, the U.S.S.R. became the third largest meat importer in the world, exceeded only by the U.K. and the U.S. It also became the world's second largest butter purchaser in 1953 and 1954. Nevertheless, trade with the Free World still is quite small in relation to prewar trade, total international trade of each bloc country, bloc consumption or national income.

During this period, the attempt of the Soviet bloc to use foreign trade as an economic and political lever in Free World countries has continued and may have been increased. The usual propaganda about the necessity for expanding East-West trade was plentiful. There was a marked increase in the number of trade agreements between the Soviet bloc and Free World countries. Soviet bloc missions were active in establishing new contacts in various parts of the Free World, and numerous missions from the outside were admitted into Soviet bloc countries. The U.S.S.R. participation at trade fairs increased sharply in 1954, although participation of the satellites decreased slightly. The trade fair activity seemed to have been aimed less at increasing sales than at enhancing the prestige of the Soviet bloc in Free World countries.

To a greater extent than previously, Soviet bloc nations appear to be increasing their efforts to develop economic relations with underdeveloped Free World countries in Asia -- and to a lesser degree, in Latin America and Africa. The trade of the Soviet bloc is still predominantly with Western Europe, and will probably continue to be in the future, but these developments in areas outside Europe are significant. In addition to expanding its trade with these areas, the Soviet bloc has been making numerous offers of technical aid. Of course, many of these countries are sources of food and raw materials, but the increased attention shown them is probably due as much to political as to economic considerations.

The recent Soviet reemphasis of the primacy of heavy industry has been coupled with reports of some cutbacks in U.S.S.R. import orders in Western countries, primarily in the consumer goods field. The reported cuts could well be attributed to the payments problem which the U.S.S.R. has, having expanded its imports much more rapidly than its exports, and not necessarily to any change in Soviet foreign trade policy or internal economic policy.

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Part 4

"The Implications of East-West Trade Controls," from Staff Papers,
Presented to the Commission on Foreign Economic Policy, February 1954,
pages 447-450:

I. Effects in Various Areas

EFFECTS IN THE EUROPEAN SOVIET BLOC. In trying to measure what effects our existing security trade controls have had upon the European Soviet bloc, a few general facts must be taken into account. Foreign trade plays a relatively minor role in the build-up of Soviet bloc strength. Foreign trade accounts for about one percent of the bloc's gross national product. Moreover, as long as the Soviet bloc maintains its present political orientation and totalitarian organization it will not allow itself to become very dependent on trade with the free world. The Soviet bloc's objective is to achieve invulnerability to outside pressure. Accordingly, by and large, its military and industrial machine will be built and maintained on its own resources. It can achieve this aim without great cost because it has abundant natural resources, and it is able to shift its productive facilities and manpower without the inhibitions which exist in a private enterprise economy.

On the other hand, the low total level of the Soviet bloc's imports from the West tends to understate the relative importance of the products which the bloc has obtained. The ingredient for industrial growth which the Soviet bloc seems most to have lacked in the past has been mechanical and engineering skills. These skills are embodied in the goods the Soviet bloc has been most anxious to obtain -- machinery, machine tools and the like. The Soviet bloc also has lacked copper, natural rubber and industrial diamonds. Limitations on the export of these tools and materials probably have slowed up the industrial growth of the Soviet bloc to a modest extent during the past few years. But it would be too much to say that these measures have, or ever could, really hurt the over-all Soviet bloc economy in any vital way.

One more effect which our restrictions have had deserves a brief comment. With self-sufficiency as their goal, the Soviet bloc has needed no encouragement to try to detect the points of vulnerability in its own industrial machine. However, it must be presumed that our controls have assisted the bloc somewhat in the process and have led to its placing even higher priorities on

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repairing vulnerable points in its economy. This is an unavoidable adverse by-product of any control system.

Effects on Communist China. Communist China is a more primitive society than the rest of the Soviet bloc. At this stage in its development, it is more impervious to outside economic pressure; its demands for industrial goods are lower and its reliance on foreign trade to maintain its existing economy is less. Nevertheless, our trade controls have forced Communist China to draw more heavily on the Soviet Union for its industrial needs, and have probably immobilized some Western industrial equipment useful to the Chinese.

Communist China's projected industrial growth will steadily increase its demand for products available in the West. Accordingly, this growth probably would be retarded somewhat by the retention of existing controls over trade with that area. If the present high level of restrictions on exports to Communist China were changed to a total embargo, this of course would affect Communist China slightly more than the existing level of controls and would increase further her dependence on the European Soviet bloc.

Effects on Western Europe. The place of East-West trade in Western Europe's economic life has gone through a number of stages since the end of the war. Immediately after the war, there were absolute shortages in the free world for some critically important commodities, such as wheat and coarse grains. As far as Western Europe was concerned, this absolute shortage was aggravated by the fact that, even when the goods were available in dollar areas, Western Europe's lack of dollars prevented their buying the products in sufficient quantities. In this early postwar period, therefore, the wheat, coarse grains, coal, timber, and other necessities which came from the Soviet bloc -- marginal amounts in some cases -- assumed great importance in the eyes of Western Europe's governments.

For some countries, the critical commodities supplied by the Soviet bloc were especially important. Norway, for example, imported and still imports from the Soviet bloc about one-fifth of the bread grains consumed in the country. Sweden imported and still imports about one-third of its coal from Poland. The United Kingdom still imports about one-tenth of its timber from the bloc.

However, the problem now has changed. Coal, wheat, timber and other basic commodities are now physically available in ample supply in the free world and at prices which are equal to or lower than Soviet bloc offers. But other aspects of the problem remain, or have been intensified.

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One of the remaining problems has to do with the balance-of-payments position of the Western European countries. East-West trade controls have somewhat aggravated the balance-of-payments problem of Western Europe by discouraging larger exports from the Soviet bloc and forcing Western Europe to buy more from dollar sources. But this impact can be exaggerated. In the first place, it is not clear how much more Eastern Europe would have been willing to ship even under the most favorable circumstances. In the second place, as long as the production facilities of Western Europe are operating at full capacity, Western Europe would have paid for what it bought, in effect, largely with machinery and industrial materials, that is, with products and resources which earned or saved dollars for them when they remained in Western Europe. The net dollar cost to Western Europe of East-West trade controls, therefore, must be calculated modestly, probably representing on the order of one hundred or two hundred millions a year. As idle capacity develops in Western Europe, the adverse balance-of-payments effect may be greater. In any case, until the balance-of-payments position of Western Europe is reasonably secure, this factor will have to be taken into account.

Another factor in the minds of Western European countries has been their dependence upon the markets supplied by the Soviet bloc. To be sure, no Western European nation has a very heavy over-all reliance on Soviet bloc markets. The highest relative dependence is registered by Finland and Austria which in 1952 sold 20 and 11 percent respectively of their total exports to the bloc. But the importance of the problem is much more acute in individual industries. Norway relies heavily on the Soviet bloc to dispose of the product of two major interdependent industries, fishing and fats and oils; Finland, Austria, Sweden and Italy would have a difficult problem in finding alternative markets for their machinery, since in 1952 they marketed 78, 35, 18, and 10 percent respectively of their exports of that product in the Soviet bloc. A number of countries outside Western Europe are in the same position.

The present dependence of Western European countries on the Soviet bloc markets is aggravated by two fears -- the fear that trade barriers will rise among the nations of the Western world, particularly the United States, and the fear of a depression in the Western world. Each country, while recognizing the essential undependability of the Soviet bloc as a future buyer, also takes into consideration the risk that the markets of its Western trading partners may shrink.

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Closely related to this problem is that of the political security of the governments in power in Western Europe. Each nation of Western Europe has a pro-Communist -- or at any rate a neutralist -- group within its borders. Each government must take into account the possibility that if unemployment develops within its boundaries while East-West trade controls are being imposed, the opposition may threaten its position. The threat varies from country to country but is present in some degree in virtually all of them.

The political aspect of East-West trade controls has become especially important in a number of countries as pressures from the United States have become more evident. With the passage of the Kem Amendment, forerunner of the Battle Act, Western Europe felt that the United States was attempting to substitute coercion for cooperative agreement among sovereign nations. This issue tended to submerge the real merits of the East-West trade question. Virtually every foreign government, no matter how predisposed to the maintenance of controls over East-West trade, tends to resist any United States pressures which seem unduly coercive, even when they agree with, and are cooperating in the achievement of, the objective which the United States is seeking.

Effects on non-Communist Far Eastern Countries. The effects of East-West trade controls in the Far East have fallen largely on Hong Kong and Japan. Hong Kong's entrepot trade has fallen substantially with the application of strict export controls. Unemployment has become something of a problem in the colony and its foreign exchange earnings have declined.

The impact of the controls on Japan is more problematical. Japan's trade with the Chinese mainland before the war -- at a time when Japan controlled Manchuria -- had been about one-fifth of its total trade, and had provided it with cheap sources of raw materials and a ready market for manufactured goods. These advantages would have been greatly reduced in any case on the initiative of the Chinese Communist government; it is likely, however, that Japan's severe controls somewhat heightened the degree of the trade decline and somewhat aggravated Japan's acute payments problem.

The net effects -- free world vs. bloc. To provide a judgment as to the net effect of existing East-West trade controls is largely to compare noncomparable factors. In military and industrial terms, both sides are slightly hurt by the controls and the Soviet bloc is probably hurt more than the free world.

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However, the cost of maintaining these controls in the free world must also be measured in other terms as well. The controls clearly strain somewhat the political ties among free-world countries and contribute slightly to balance-of-payments and employment difficulties on our side. Our problem is to ensure that this strain does not, in the end, affect the strength of the free world's military and economic position.

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