

FEB 15 1956

CONFIDENTIAL
NOFORN

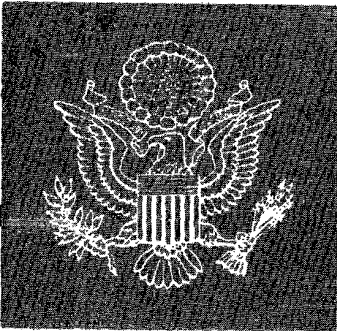
D410014

Intelligence Report

No. 7106

COMMUNISTS CAPITALIZE ON FREE WORLD'S COTTON PROBLEMS

DEPARTMENT OF STATE



Office of Intelligence Research

Prepared by
Division of Functional Intelligence
January 26, 1956

State Dept. declassification & release instructions on file

THIS IS AN INTELLIGENCE REPORT AND NOT A STATEMENT OF DEPARTMENTAL POLICY

CONFIDENTIAL
NOFORN

This report is based on information available through January 20, 1956.

TABLE OF CONTENTS

	<u>Page</u>
Abstract	iii
I. Introduction	1
II. World Cotton Situation and Outlook	2
A. General Summary	2
B. United States	3
C. Volume and Pattern of Free World Export Trade	5
D. Importance of Cotton Trade to Countries of the Free World	7
E. The Cotton Position of the Communist Bloc	7
III. East-West Trade in Cotton	10
A. Free World Exports to the Bloc	10
B. Bloc Operations in Free World Cotton Markets	11
1. Egypt	11
2. Pakistan	13
3. India	14
C. Soviet Exports to the Free World	14

APPENDIX

A. Cotton: Exports from the Free World to Sino-Soviet Bloc Countries 1949-50 - 1954-55	17
---	----

TABLE OF CONTENTS, Continued

Page

LIST OF TABLES

1. Cotton: Distribution of Free World Exports, by Country of Origin, Selected Periods, 1934-38 - 1954/55	6
2. Cotton: Exports as a Percentage of Total Export Values in Certain Countries, 1937 and 1952-54	8
3. Cotton: Estimated Exports from the USSR to the Free World, 1951/52 - 1954/55	16

CONFIDENTIAL /NOFORN

Abstract

The Sino-Soviet bloc is exploiting the mounting world cotton surplus situation to further its stepped up economic and political offensive in the Middle East and South Asia. The most dramatic example was the recent exchange of Czech arms for surplus Egyptian cotton. Another instance was the shifting of Communist China's cotton purchases from Pakistan to India and Egypt in retaliation for the breakdown of the Sino-Pakistan trade agreement negotiations. Such maneuvers have yielded the bloc political gains at no economic cost and may in fact have brought positive economic advantages. With the prospect that cotton will be in oversupply for some years, further bloc manipulations in the Free World cotton markets seem likely.

Although the overall cotton position of the Soviet bloc is one of approximate self-sufficiency at present consumption levels, it can move in and out of the world market on a considerable scale at will. The USSR has been the principal supplier for the bloc's major raw cotton deficit region -- Eastern Europe. However, the satellites can and have been switching their purchases to Free World sources releasing Soviet supplies for sale to Western Europe. Thus, as a result of its recent increased sales to the bloc, Egypt may in effect be displacing its own sales in its traditional markets. Exports of USSR cotton to the Free World in the past season expanded by almost 100 percent. There is reason to believe that the bloc will continue to push such sales both because of expanding domestic output and the opportunities to derive economic and political advantages for purchases in Free World markets. Such sales can help to relieve bloc difficulties in balancing its trade accounts with Western Europe. It is much easier for the bloc to sell cotton in Western Europe, possibly by shaving prices slightly, than to sell manufactures. On the other hand Soviet manufactures, especially capital equipment, should find a fairly ready market in the less developed areas where the bloc is prepared to take surplus cotton in exchange.

Expansion of Soviet cotton exports outside the bloc will intensify the Free World's cotton surplus disposal problems. It has the added advantage from the Communist viewpoint of increasing competition among Free World suppliers for cotton markets behind the iron curtain. This in turn increases the political and economic leverage the bloc can exert in coming to the aid of distressed cotton exporters.

CONFIDENTIAL /NOFORN

I. INTRODUCTION

The Communist bloc is adept in making the most of the Free World's commodity problems. The techniques employed are tailored to fit the particular situation. For example, early in the Korean War, when there was great pressure on world wool supplies and prices, and the US Government had a large military procurement program for wool manufactures, it is believed that the USSR timed its purchases in the Australian wool market so as to increase US procurement problems and costs. The increased purchases by two major importers prompted other countries to engage in scare buying, and generated friction among Free World governments. Since then the irregularity of Soviet purchases and their concentration in a short period of time have often accentuated price fluctuations in the very sensitive Australian wool market.

Another technique which has been used, and at times with serious repercussions in the West, is that of playing off a short supply commodity against a strategic material. The classic example of this technique was the agreement under which Communist China offered rice in exchange for Ceylonese rubber at a time when rice was in very short supply. The details of this agreement, and the trouble it has caused the Free World, are so widely known that there is no need to review them here.

Now that there are burdensome surpluses of most of the major agricultural commodities that enter world trade, the opportunities for the bloc to make economic and political capital out of commodity transactions is greater than ever before. First, there is an unusually wide range of commodities from which to select, including some which are traditionally imported by the bloc in substantial quantities. Second, the list contains commodities of key importance to a number of underdeveloped countries, including some countries that are on the outer fringe of the anti-Communist community. Still another facet of the problem, and one that lends itself to bloc propaganda uses, is the fact the US is engaged in agricultural disposal operations which are the source of much concern among competing exporting countries. Despite the care the US is exercising to avoid disruption of world markets and prices, it has not been able to allay the fears of other countries that their exports will suffer sooner or later as a result of US disposal operations.

Cotton and rice offer outstanding current examples of how the bloc is making economic and political capital of commodity transactions. It is the purpose of this report to examine the cotton situation in the context of East-West trade relations.

CONFIDENTIAL/NOFORN

- 2 -

II. WORLD COTTON SITUATION AND OUTLOOK

A. General Summary

World production and consumption of raw cotton have increased significantly since 1950/51,¹ but production has consistently outstripped consumption by a wide margin. As a result stocks have been accumulating rapidly. By July 31, 1955, the closing date of the 1954/55 season, world stocks of the fiber had risen to approximately 21.7 million bales,² or nearly twice the total quantity exported in 1954/55.³ The US alone had 11.1 million bales on hand, or more than its total exports in the three preceding years. In terms of the rate of domestic consumption and exports in 1954/55 US stocks were equivalent to nearly a year's supply. Stocks in other major exporting countries were of much smaller proportions in relation to 1954/55 offtake. Most importing countries were carrying unusually small stocks because of the expectation of lower prices. As a group they held only a little more than three months' supply at the 1954/55 consumption rate, or minimum working stocks based on current consumption levels.

COTTON: ESTIMATED WORLD PRODUCTION AND CONSUMPTION, 1951-55

(In millions of bales)

Year beginning August 1	Production	Consumption	Excess of production over consumption
1951	36.4	33.1	3.3
1952	36.9	34.6	2.3
1953	39.3	36.0	3.3
1954	38.3	36.6	1.7
1955	40.5	36.8	3.7

Source: International Cotton Advisory Committee, Cotton, Quarterly Statistical Bulletin, Vol. 9, No. 1, October 1955, and FAS op. cit.

The 1955/56 world cotton crop is estimated at the all-time peak of 40.5 million bales, or 6 percent more than the previous near record of 38.3 million bales attained in 1954/55.⁴ Since no substantial gain in consumption

1. Season beginning August 1.
2. Unless otherwise noted, figures given in bales are in terms of equivalent bales of 478 pounds net weight, except for the US. Those for the US are reported in terms of running bales, the net weight of which has averaged approximately 490 pounds in recent years.
3. USDA, Foreign Agricultural Service, Foreign Agriculture Circular, FC 10-55, 11/16/55.
4. FAS, op. cit.

CONFIDENTIAL /NOFORN

CONFIDENTIAL/NOFORN

- 3 -

is anticipated for this season, a further rise in world stocks of over 3.5 million bales by July 31, 1956 seems likely, with the US holding the bulk of the increase. In short, the world not only is not reducing its cotton surplus this season, but is actually adding more to its stocks than in any season since the surplus began to develop.

The longer run outlook indicates that cotton is likely to be a problem commodity for some years to come. The production potential is so far in excess of the current relatively high rate of consumption that the readjustment of supply to demand is bound to be a painful process for producing countries. This outlook presents serious domestic and foreign political and economic problems for the US. Domestic interests are clamoring for government action to make US cotton competitive in world markets. Foreign cotton producers have expressed apprehension over the possibility that the US may "dump" its surpluses on world markets, and some have made representations to the US Government concerning its special export program for disposing of 1.0 million bales of short staple cotton on a competitive bid basis. They take the position that since a considerable number of financially weak underdeveloped countries in the Free World are dependent on cotton exports to a much greater degree than the US, this country should not pit its financial strength against them in the competition for world cotton markets.

B. United States

From an acreage 14 percent smaller than a year earlier, the US has produced a crop of 14.5 million bales in 1955/56, or about 7 percent more than in 1954/55 and 4.5 million bales more than the official goal.¹ Acreage restrictions in the past two seasons and the continuation of price supports at 90 percent of parity have encouraged the utilization of the most suitable lands and production techniques. Yields have established astonishingly high records. For the 1955/56 crop the average yield per harvested acre is estimated at about 416 pounds compared with the previous record of 341 pounds for 1954, and the 1950-54 average of 292 pounds.

It is estimated that less than 12 million bales will be absorbed by domestic consumption and exports in 1955/56 as against 12.3 million bales last season. Domestic consumption is expected to reach 9.2 million bales, an increase of 0.4 million, and exports of about 2.5 million bales are anticipated, or about one million bales less than in 1954/55. On the basis of these estimates, stocks will show a net increase of about 3.0 million bales by July 31, 1956 leaving an all-time peak carryover of about 14.0 million bales.

1. The statistics cited in this subsection are from the USDA Agricultural Marketing Service, The Cotton Situation, 1956 Outlook Issue, November 25, 1955, and The Demand and Price Situation, December 20, 1955

CONFIDENTIAL/NOFORN

- 4 -

During the past two seasons domestic prices for cotton generally have been above world market prices. As a result US exports have contracted sharply despite substantial government financing of cotton sales under foreign aid programs, Export-Import Bank loans, and sales for local currency under Public Laws 480 and 665. In 1954/55, the US share of Free World exports was only 32 percent, as compared with about 40 percent in 1949/50-1953/54 and in 1934-38. The US ratio has dropped precipitously in the first five months of the current season. It may recover somewhat in the next few months under the stimulus of the special program under which the government is offering 1.0 million bales of 15/16 inch and shorter cotton for export on an open competitive bid basis, beginning January 1, 1956. Even so, it appears doubtful that the US will supply more than one-quarter of Free World cotton exports for the current season.

COTTON: US SHARE IN FREE WORLD PRODUCTION, CONSUMPTION,
AND EXPORTS, SELECTED PERIODS, 1934-38 - 1955/56

	(Percent)			
	1934-38	1949/50- 1953/54	1954/55	1955/56 (Preliminary)
Production	51	53	46	46
Consumption	29	36	32	33
Exports	40	40	32	25

Cotton plantings will be subject to acreage restrictions again in 1956, for the third successive year. On the other hand, for the first time since World War II, cotton prices may be supported at less than 90 percent of parity. The exact price-support ratio has not yet been announced. If it were to be set at the legal minimum of 75 percent of parity, and if the present basic formula were continued, this would imply a basic minimum support price of about 5 cents a pound less than the current rate. Legislation is pending that proposes changes in the basis of the support price which would reduce it by an additional three cents a pound. In December 1955, some foreign cottons were quoted in European markets at nearly eight cents a pound less than comparable US grades. Therefore, unless changes are made in US price-support legislation, or surplus disposal legislation, prices of cotton in the domestic market may continue to be higher than those in world markets in 1956/57.

The Council on Foreign Economic Policy has been seeking solutions to US cotton problems, particularly to the problem of stimulating US exports of the fiber without causing undue hardship to other Free World exporting countries. The policy determination has not yet been made. The probabilities are, however, that some type of executive action may be taken in the near future in an effort to rehabilitate US cotton export trade, although such a program might not become effective until the cotton season beginning August 1, 1956. Moreover, a number of bills with this objective are expected to receive

CONFIDENTIAL / NOFORN

- 5 -

congressional consideration early in 1956. While no prediction can be made at this time as to the government's future cotton export policy, the indications are that some steps will be taken soon to make US cotton competitive in world markets. Thus, the outlook is for increased competition for world export markets, and increased pressure in other Free World exporting countries to take advantage of all possible markets for their surpluses. In the context of East-West trade relations, the outlook clearly holds prospects of increased opportunities for the bloc to capitalize on Free World's difficulties in cotton.

C. Volume and Pattern of Free World Export Trade

The long-term downward trend in raw cotton exports, which has been in evidence since the 1920's, has continued in recent years. This has occurred despite a moderate upward trend in world cotton consumption. It has been associated with the development of the synthetic fiber industry and the expansion of cotton cultivation and textile processing facilities in underdeveloped countries which formerly obtained a significant share of their cotton supplies in the form of imported textiles.

Free World exports of cotton declined to about 10.7 million bales in 1954/55, thus showing a reduction of 5 percent from the annual average for the five preceding years and of 14 percent from that of 1934-38. (Table 1.) The decline from the levels reached in the period immediately preceding was strongly influenced by the drawing down of inventories in importing countries in expectation of a downward trend in prices. The decline from prewar levels, in addition to being influenced by the factors noted above, also reflects to some extent the reduction of Free World exports to Eastern Europe following their incorporation into the Soviet orbit.

The shift in the country composition of Free World cotton exports has been much more pronounced than the decline in the volume of the trade. Reductions in shipments by traditional major exporting countries like the US, Brazil, and Egypt have been sharper than the contraction in the world total because of large-scale expansion of cotton production and trade in areas like Mexico, the Middle East, and dependent territories in Africa. Reductions in exports from the Indian subcontinent have been due mainly to increased domestic consumption, notably in Pakistan. The traditional exporters of secondary importance in world trade, such as Sudan, Peru, and Uganda, are exporting roughly the same quantities as before World War II; hence, their share of total Free World exports is higher than before the war. Iran, Syria, and Turkey have expanded their exports of cotton so rapidly in recent years that they have become important cotton trading nations. More striking still is the meteoric rise of Mexico's cotton trade. In 1954/55 Mexico exported approximately 1.3 million bales, as compared with an annual average of 105,000 bales in 1934-38, and it ranked second only to the US among Free World exporters.

CONFIDENTIAL/NOFORN

Table 1. COTTON: DISTRIBUTION OF FREE WORLD EXPORTS, BY COUNTRY OF ORIGIN, SELECTED PERIODS, 1934-38 - 1954/55

Country	1934-38 Average	1949/50- 1953/54 Average	1954/55
	(Thousand bales ^a)		
United States	5,018	4,441	3,446
Brazil	1,065	641	900
Mexico	105	863	1,300
Peru	337	338	375
Sudan	257	356	299
Egypt	1,744	1,465	1,086
Iran	85	89	200
India	(2,746	172	220
Pakistan		997	650
Syria	11	137	325
Turkey	77	326	250
Uganda	277	307	265
Others	715	1,085	1,379
Total	12,437	11,217	10,695

a. Bales of 478 lb, (216.8 kg) net weight except for the US. Figures for the US are in terms of running bales, of a net weight averaging approximately 490 lb. (222.3 kg).

SOURCE: International Cotton Advisory Committee, Cotton Quarterly Statistical Bulletin, Vol. 9, No. 1, October 1955.

CONFIDENTIAL/NOFORN

- 7 -

D. Importance of Cotton Trade to Countries of the Free World

Cotton is one of the principal commodities in Free World trade. Until recently the value of raw cotton exports was exceeded only by that of petroleum. Moreover, this commodity plays a key role in the export earnings of a number of countries in Latin America, the Near East, South Asia, and Africa. (Table 2.) Cotton plays a significant role in the export trade of a dozen countries, and in half of these it outranks all other export commodities.¹ Cotton alone accounts for over three-fifths of the total exports of Sudan and Uganda. In Egypt the ratio of cotton exports to total exports has been over four-fifths in recent years, as compared with three-fourths before World War II. Egypt's increased dependence on cotton makes it especially vulnerable to Communist offers to take surplus cotton off its hands in exchange for other goods and services.

E. The Cotton Position of the Communist Bloc

Sino-Soviet bloc production of cotton has been rising almost steadily in recent years. The FAS estimates the bloc crop for 1954/55 at approximately 9.0 million bales, and anticipates that output in the current season will increase to about 9.2 million bales. This would mean that the bloc's share of the 1955/56 world crop would be nearly 25 percent. This compares with an average of only about one-fifth of the world crop in 1934-38.

The bloc's cotton resources are concentrated almost entirely in the USSR and China. The USSR is the world's second largest cotton producer. The rise in its output is mainly responsible for the increase in the bloc's share of world cotton production. The Soviet Union is a newcomer in the ranks of major cotton exporters; it exported only minor quantities before World War II. The USSR usually channels most of its cotton exports to Eastern Europe, but it has stepped up the volume of shipments to the Free World significantly in the past two seasons.

Communist China ranks fourth among world cotton producers, although its production has shown a very slow postwar rate of recovery. Except in 1953/54 output has not exceeded the 1934-38 average by as much as 10 percent. Thus, per capita output is still much below the prewar level. Cotton has been in especially short supply in the past year because of adverse weather conditions in 1954. However, the Peiping regime declared that it would cut cotton yarn output in 1955 rather than allocate more foreign exchange for the

1. Cotton ranks first in the export trade of Egypt, Mexico, Paraguay, Peru, Sudan, and Uganda.

CONFIDENTIAL/NOFORN

Table 2. COTTON: EXPORTS AS A PERCENTAGE OF TOTAL EXPORT
 VALUES IN CERTAIN COUNTRIES, 1937 AND 1952-54

Country	1937	1952	1953	1954
<u>United States</u>	11	6	3	5
<u>Latin America</u>				
Brazil	19	2	7	15
Mexico	1	23	24	27
Nicaragua	9	16	18	31
Paraguay	37	34	35	<u>n a</u>
Peru	25	34	30	26
<u>Near East, South Asia and Africa</u>				
Sudan	67	68	62	56
Egypt	74	87	85	82
Iran ^a	4	16	23	24 ^b
Pakistan	...	49	43	29
Turkey	4	19	20	16
Uganda	<u>n a</u>	63	50	64

a. Figures are for the year beginning March 21.

b. Preliminary.

n a Not available.

SOURCE: International Monetary Fund, International Financial Statistics,
 December 1955, and country trade returns.

CONFIDENTIAL/NOFORN

- 9 -

purpose of additional imports of raw cotton.¹ Communist officials recently have announced that a record crop of 1.4 million metric tons, or 6.5 million bales, of cotton was harvested in 1955.² Independent estimates indicate a considerably lower level of output. Under Peiping's new drive to complete the 1953-57 economic plan ahead of schedule, 1957 goals have been advanced to 1956; the official production target for cotton has been increased from 1,637,500 tons (7.6 million bales) to 1,775,000 tons (8.2 million bales). This goal is generally considered to be unrealistic. Nevertheless, there is little doubt that the Communist regime places great stress on expansion of cotton production and is vigorously pursuing the objective of self-sufficiency in cotton.

Before World War II, China was both an exporter and importer of cotton, and on balance a net importer. Communist China apparently has ceased to export cotton. It has continued to import moderate quantities of medium and long staple cotton. Such imports are obtained from Free World sources. In 1954/55 they totaled about 140,000 bales. So far as is known, Red China is not getting cotton from the USSR, but the available information on this subject is inconclusive.

Eastern Europe has a substantial cotton textile industry and only negligible raw cotton resources. Its annual rate of imports is currently estimated at well over 1.0 million bales. In keeping with Soviet objectives of an economically integrated, self-sufficient bloc, the USSR has been furnishing the bulk of Eastern Europe's raw cotton supplies.

The available evidence suggests that the bloc as a whole is approaching self-sufficiency in cotton. The FAS estimates that the group's gross exports totaled some 1.4 million bales in 1954/55 and its gross imports just under 1.6 million bales. All exports were made by the Soviet Union and most of the imports by Eastern Europe. In view of the difficulty of estimating intra-bloc trade, these figures may be subject to a considerable margin of error. Their main significance is they indicate that the bloc has a very substantial cotton trade and that its exports and imports are of nearly the same magnitude.

To sum up the situation, at present the bloc as a whole is virtually self-sufficient in raw cotton; it may become a net exporter in the near future. At present levels of domestic consumption, the USSR is able to meet its own needs and those of the major deficit region, Eastern Europe. However, current per capita availabilities of textiles are admittedly unsatisfactory in the USSR. It is continuing its drive to expand cotton production and is likely to continue exports even though they would slow up the upward trend of

1. IR-7021R, Potential Markets in the Sino-Soviet Bloc for US Surplus Agricultural Products, October 4, 1955, CONFIDENTIAL.
2. New York Times, December 27, 1955.

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN

- 10 -

domestic consumption. Red China is still short of cotton but is determined to become self-sufficient, and willing for the present to limit consumption rather than supplement domestic supplies through imports except to a very limited degree. With this combination of export and import possibilities, the Communists can readily manipulate cotton trade within and outside the bloc by switching Eastern Europe's imports from the USSR to Free World sources and channeling Soviet exports away from the satellites to non-Communist countries. At the same time, if it decides to do so, the bloc as a whole can reduce its net take of Free World cotton while increasing the volume of its imports from and exports to the Free World. Furthermore, any increase in cotton exports which a non-Communist country seems to derive from this trade is likely to be more apparent than real, and if real it will be at the expense of other Free World countries. The pattern of bloc purchases of Free World cotton no doubt will be influenced by political considerations. Any country which places reliance on continuity of export markets for cotton in bloc countries is likely, sooner or later, to find that no other markets are so uncertain.

III. EAST-WEST TRADE IN COTTON

A. Free World Exports to the Bloc

The annual volume of Free World exports of cotton to Communist countries has been less than 600,000 bales since 1949/50 (Appendix A). In 1949/50 the last full season of US trade with Mainland China, the Free World shipped over 800,000 bales of cotton to the bloc. The US alone exported nearly 300,000 bales to bloc countries, nearly two-thirds of which went to Mainland China. In 1950/51 when US exports of cotton were under allocation controls, shipments of US cotton to bloc countries ceased. These controls were lifted in 1951/52, but the European satellites did not reenter the US cotton market presumably because of Soviet policies since there was no legal obstacle to commercial exports of cotton from the US to destinations other than Communist China and North Korea.

In 1954/55, the Free World exported 4,60,000 bales of cotton to the bloc, including 249,000 to Eastern Europe, 71,000 to the USSR, and 140,000 to Communist China. Czechoslovakia, Poland, and Hungary were the principal Eastern European markets.

The USSR has been a fitful purchaser of Free World cotton, buying fairly substantial quantities one year and very little the next, first in one market and then in another. According to all available information, the USSR is more than able to supply all of its industry's needs at present consumption levels both as to quantities and qualities.

Communist China's purchases of Free World cotton also have been sporadic. In recent years the annual imports from the Free World have ranged from a low of 140,000 bales in 1954/55 to a high of 328,000 in 1951/52. While it has recently increased the volume of its purchases in Egypt and

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN

- 11 -

India, and reportedly is negotiating a cotton barter deal with Syria, so far as is known it has not been in the Pakistan market for some months. Previously Pakistan was the major source of imports. It is too early to estimate how Communist China's total purchases of Free World cotton this season will compare with earlier years. With the downward trend in cotton prices some increase in imports would be possible without allocating any more foreign exchange for cotton purchases than in 1954/55. However, an increase in the ratio of high quality Egyptian cotton imports to total imports would tend to reduce the volume obtainable from a given exchange allocation. On the basis of the evidence available to date, it seems likely that Communist China's imports of Free World cotton in the near future will be within the range of the past few years. Over the longer term, a downward trend and possibly eventual cessation of imports is indicated, depending on the rate of progress in expanding domestic output.

Egypt and Pakistan usually have supplied at least three-quarters of bloc imports of Free World cotton since 1949/50, the last season in which US exports to the bloc were a significant factor in this trade. Turkey, Iran, Brazil, Mexico, and Sudan, and at times Burma, have been suppliers, but on a relatively small scale. There has been an appreciable increase in Sudan's exports to the bloc in the current season. In addition, India recently has announced that sizeable sales have been made to Communist China. Syria reportedly is negotiating for the export of 40,000 tons (184,000 bales) of cotton to the USSR, and in addition will sell cotton to Poland under a newly executed commercial treaty. Syria also is said to have received proposals from Communist China for a trade agreement involving Syrian exports of cotton.¹

B. Bloc Operations in Free World Cotton Markets

This burst of activity by the bloc in Free World cotton markets at a time when bloc cotton production is higher than ever before, together with the concentration in Middle Eastern sources of supply, can only mean that cotton importing policy is dictated by political motives and economic considerations other than a need to import cotton. The fact is that cotton trade is being used as one of the prongs of the Soviet political and economic offensive in the Middle East and South Asia. This can be seen most readily in the bloc's recent operations in the cotton markets of Egypt and India on the one hand, and in Pakistan on the other.

1. Egypt. Egypt is the only country besides the US which has restricted cotton acreage in recent years. The Egyptian restrictions, unlike those of the US, have been due in part to government efforts to encourage cereal production. Except in 1952/53, Egypt's cotton crops have been consistently

1. Middle East Economist and Financial Service, December 1955, as reported by the International Monetary Fund in International Financial News Survey, Vol. VIII, No. 26, December 23, 1955.

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN

- 12 -

below the 1934-38 average. Domestic consumption has risen to nearly 400,000 bales, or more than five times the prewar average while exports generally have been much lower than the 1934-38 annual average of 1.7 million bales.

The value of Egyptian cot on exports reached an all-time peak of over \$470 million in the calendar year 1951. It has declined steadily since then and dropped to about \$325 million in 1954. Cotton export values for January-July 1955 were at an annual rate of approximately \$290 million; about a quarter of the total was accounted for by shipments to the bloc. Preliminary statistics indicate that the ratio taken by the bloc increased considerably in the third quarter of 1955.

Communist bloc countries are traditional markets for moderate quantities of Egyptian cotton. The share of the country's total exports taken by the bloc did not exceed 15 percent until the past season, when it rose to 22 percent. However, the increase in the bloc's share of the total was due only partly to increased shipments to Communist countries. It was also strongly influenced by the contraction in Egypt's sales to its major markets -- Western Europe, India, and Japan. Despite an increase of 90,000 bales in exports to the bloc, total cotton exports declined by about 400,000 bales, or 27 percent, to less than 1.1 million bales.

The market outlook for Egyptian cotton outside the bloc is generally unfavorable. At present, there is no indication that the Free World will take any more of its fiber this season than last (i.e., 842,000 bales). The country's total cotton supply is estimated at 2.4 million bales or some 300,000 bales more than in the past season. With a larger supply to move and little prospect of expanding sales to the Free World, Egypt's receptivity to Communist proposals for barter deals involving cotton is not surprising.

Bloc activities in the Egyptian cotton market have attracted world-wide attention since September 1955 when it was announced that Czechoslovakia was selling Egypt arms in exchange for Egyptian cotton. The value of Czech arms which Egypt is to receive reportedly amounts to LE 36 million (\$103.4 million), which presumably is to be paid for mainly in cotton.¹ In a resume of recent agreements between Egypt and Sino-Soviet bloc countries, Embassy Cairo pointed out that reference to specific Soviet bloc cotton purchases may be found only in the Egyptian Ministry of Finance announcement of August 8, 1955, which stated that Communist China had agreed to buy 290,000 kantars (one kantar = 99.05 pounds) of cotton to be paid for in sterling. The Embassy noted further that in the case of all other commitments, sales to, or purchases by, bloc countries are not limited to cotton, although cotton is, of course, Egypt's principal commodity export. However, on the assumption that all Egyptian exports under the 1955 agreements with Communist China and Hungary would be cotton, the Embassy has calculated the maximum value of Egypt's cotton sales under these agreements at LE 17,440,000 (\$50.1 million).²

1. D-612, Cairo, December 5, 1955, CONFIDENTIAL.

2. Ibid.

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN

- 13 -

Egypt has additional agreements involving cotton with Czechoslovakia, East Germany, Poland, Rumania, and the USSR, but the cotton component of most of these agreements is not determined by quotas, and no precise value estimates are possible. It has been estimated, however, that Egypt's exports of cotton to the bloc in the year beginning September 1, 1955 will be about a third larger than in the preceding year. An increase of this size would not be enough to solve Egypt's cotton disposal problem, especially since no appreciable gain in sales to other markets is anticipated.¹ However, it means a further and significant increase in cotton exports to the bloc that will tend to strengthen the Soviet's economic foothold in Egypt.

2. Pakistan. Following loss of access to US supplies, Communist China turned to Pakistan as its major source of imported cotton. Pakistan was the logical choice both from the standpoint of location and ability to supply types similar to US cotton. Initially this change was very costly to the Peiping regime since soft currency cotton was in short supply at that time and Pakistan cotton commanded a high premium over comparable US cotton prices. By 1951/52, a buyer's market developed in cotton which narrowed the spreads between soft currency and dollar cottons; and within two years soft currency cottons were selling at discounts from US cottons.

Exports to Communist China accounted for 17 percent of Pakistan's total cotton exports in 1953/54 and 16 percent in 1954/55. As the Free World's cotton surplus has mounted, the Communists have placed their purchases so as to create the maximum difficulties for Pakistan. Last season most of their purchases were made in large chunks very late in the season. In the current season, Communist China apparently is striking back at Pakistan for its failure to renegotiate the Sino-Pakistani trade agreement. Accordingly, it has shifted cotton purchases from Pakistan to India and Egypt. These actions adversely affected the Karachi cotton market early this season. However, because of recent floods the Pakistan 1955/56 cotton crop may be less than it was last year, and the lack of sales to Communist China may not create a disposal problem. In fact, Pakistan's immediate concern is that with expanded textile capacity and decreased domestic supply its current export availability is much less than anticipated. This, together with the downward trend in world cotton prices, indicates a considerable drop in the country's cotton export earnings for this season.

Over the longer term, a surplus problem is likely to reappear if Pakistan's plans for expanding raw cotton production are successful. Raw cotton is one of the mainstays of the country's foreign trade. Hence, Pakistan is exceedingly anxious to hold on to its cotton export markets and eventually to expand them.

1. Confidential estimates reported in the Cairo despatch referred to previously.

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN

- 14 -

3. India. India is both an importer and an exporter of raw cotton, and on balance a large net importer. It has a deficit in medium and long staple cotton and a surplus in short staple varieties. The Government of India (GOI) prohibits the importation of cotton having a staple length of less than 1-1/16 inches, and limits raw cotton exports to specific quotas of short harsh staple varieties in excess of domestic requirements. Until recently there have been practically no exports of Indian cotton to bloc countries.

Because of a bumper crop in 1954/55, GOI increased the cotton export quotas and late in the season raised the limit on the staple length of exportable cotton. This action prompted early inquiries by Communist China. In June 1955, New Delhi reported that Communist China was negotiating for the purchase of Indian cotton. In September, it was announced that negotiations had been completed for the exportation of 40,000 bales of Indian cotton to Mainland China, the price to be settled by traders. In return, India was said to be considering offers of caustic soda and soda ash by Communist China.¹

These negotiations have been grist to the Sino-Soviet propaganda mills, and at the same time an effective means of retaliation against Pakistan. Thus, by shifting the source of cotton purchases from Pakistan to India, Communist China has, without any extra cost (and possibly with some saving) contributed to Indo-Pakistani friction. The effect of these sales on the total Indian cotton economy is slight, whereas sales of similar quantities would be of considerable significance to Pakistan.

Another aspect of the cotton situation which is the source of concern to Free World exporting countries is the recent Soviet move to market some of its cotton in India. A representative of a Soviet export organization has been attempting to promote business with Bombay mills. Trial shipments have arrived, and the qualities included are said to compare favorably with American cottons. Invasion of the Indian market by Soviet cotton would intensify the Free World's cotton marketing problems.

C. Soviet Exports to the Free World

The Soviet Union has been actively promoting export markets for its cotton in the Free World during the past two seasons. This development apparently is a part of the drive to balance their trade with Western Europe. Previously, practically all Soviet cotton exports were channeled to bloc countries, except for some shipments to Finland. In 1953/54, small quantities were exported to several Western European countries (see Table 3). By 1954/55 the USSR was actively promoting cotton sales to Free Europe. Exports to that area rose to 284,000 bales or nearly twice the 1953/54 volume. Shipments to the UK alone totaled over 100,000 bales. There is some evidence that the quality of cotton offered in the UK was high grade and that prices were shaded slightly in order to effect the sales.

1. Ticker service, September 15, 1955.

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN

- 15 -

The USSR has been experiencing difficulties in balancing its trade with the Free World even at the recent low levels of imports. Grain exports, the traditional mainstay of Soviet export trade with the UK and Western Europe, have contracted sharply since 1952. Compensatory increases in other exports have been hard to achieve, especially since there is little demand for Soviet manufactures at competitive prices. Sales of cotton have been of some help in reducing the trade deficit with this region. The USSR is unable to compete at world market prices for export sales of many types of manufactures to underdeveloped countries. In an effort to stimulate trade with underdeveloped countries, the USSR has been making offers to supply capital equipment, mainly in countries where trade would be most useful politically. If need be, cotton can be accepted in payment for the equipment since it can be used within the bloc, thus increasing Soviet availabilities for export to the Free World, or it can be reexported, as circumstances warrant. Moreover, this can be done without prejudice to the bloc's basic goal of autarky. Finally, it should be recognized that there is a possibility that the USSR may soon be exporting more cotton to the Free World than all the bloc countries combined are importing from the Free World.

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN

- 16 -

Table 3. COTTON: ESTIMATED EXPORTS FROM THE USSR TO THE
FREE WORLD, 1951/52 - 1954/55^a

(Season beginning August 1)

Country of destination	1951/52	1952/53	1953/54	1954/55
(Thousand bales ^b)				
<u>Europe</u>				
Austria	0	0	1	5
Belgium	0	0	29	9
Denmark	0	0	3	2
Finland	0	20	41	45
France	0	0	25	39
Germany, Federal Republic	0	0	*	7
Italy	0	0	16	44 ^c
Netherlands	0	0	6	8
Norway	0	0	0	1
Sweden	0	0	0	14
Switzerland	0	*	1	1
United Kingdom	0	0	23	103
Yugoslavia	0	0	0	5
Other	0	0	0	1
Subtotal		20	145	284
<u>United States</u>	*	0	1	1
Total Free World	*	20	146	285

- a. Figures based on reported imports.
b. Bales of 478 lb. (216.8 kg.) net weight.
c. Estimated.

* Less than 500 bales.

SOURCE: International Cotton Advisory Committee.

CONFIDENTIAL/NOFORN

State-FD, Wash., D.C.

COTTON: EXPORTS FROM THE FREE WORLD TO SINO-SOVIET BLOC COUNTRIES
1949-50 - 1954-55
(Season beginning August 1)

Exporting country	Czecho-slovakia	Poland	Hungary	Rumania	Bulgaria	East Germany	USSR	Communist China	Total
(Thousand bales ^a)									
<u>Egypt</u>									
1949-50	47	17	13	23	2	0	165	1	268
1950-51	58	14	14	2	*	*	0	13	101
1951-52	37	8	23	35	2	1	39	17	162
1952-53	59	27	27	5	11	2	105	61	297
1953-54 ^b	53	5	25	8	1	10	*	52	154
1954-55 ^c	54	37	34	12	*	10	61	36	244
<u>Pakistan</u>									
1949-50	18	27	0	0	0	0	89	39	173
1950-51	7	34	4	0	0	0	0	109	154
1951-52	11	41	0	0	0	0	0	299	351
1952-53	0	0	2	0	0	0	63	93	158
1953-54 ^b	0	0	0	0	5	0	0	154	159
1954-55 ^c	0	0	0	0	0	0	0	104	104
<u>Turkey</u>									
1949-50	25	0	2	0	0	0	0	0	27
1950-51	29	3	11	0	0	0	0	*	43
1951-52	20	2	16	2	0	0	0	*	40
1952-53	25	7	31	0	0	0	0	0	63
1953-54 ^b	30	31	19	0	0	0	0	0	80
1954-55 ^c	25	10	20	2	0	0	0	0	57

CONFIDENTIAL / NOFORN

Appendix A

CONFIDENTIAL / NOFORN
- 17 -

COTTON: EXPORTS FROM THE FREE WORLD TO SINO-SOVIET BLOC COUNTRIES; (Continued)
 1949-50 - 1954-55
 (Season beginning August 1)

Exporting country	Czecho- slovakia	Poland	Hungary	Rumania	Bulgaria	East Germany	USSR	Communist China	Total
(Thousand bales) ^a									
<u>Iran</u>									
1949-50	0	0	0	0	0	0	0	2	2
1950-51	0	0	0	0	0	0	2	0	2
1951-52	0	0	*	0	0	0	18	0	18
1952-53	3	0	8	0	0	0	6	0	17
1953-54 ^b	3	2	3	0	0	0	12	0	20
1954-55	5	0	5	0	0	0	10	0	20
<u>Brazil</u>									
1949-50	3	10	0	0	0	0	0	*	13
1950-51	20	1	*	0	0	0	0	0	21
1951-52	0	3	0	0	0	0	0	0	3
1952-53	0	0	0	0	0	0	0	0	0
1953-54 ^b	3	2	0	0	0	0	0	0	5
1954-55 ^b	1	19	2	0	0	0	0	0	22
<u>United States</u>									
1949-50	55	45	23	5	*	0	0	167	295
1950-51	5	1	0	0	0	0	0	69	75
1951-52	0	0	0	0	0	0	0	0	0
1952-53	0	0	0	0	0	0	0	0	0
1953-54 ^b	0	0	0	0	0	0	00	0	0
1954-55 ^b	0	0	0	0	0	0	0	0	0

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN

COTTON: EXPORTS FROM THE FREE WORLD TO SINO-SOVIET BLOC COUNTRIES, (Continued)
 1949-50 - 1954-55
 (Season beginning August 1)

Exporting country	Czecho-slovakia	Poland	Hungary	Rumania	Bulgaria	East Germany	USSR	Communist China	Total
(Thousand bales) ^a									
<u>Others^c</u>									
1949-50	1	23	6	0	0	0	0	16 _d	46
1950-51	4	3	0	0	0	0	0	34 _d	41
1951-52	3	2	0	0	0	*	*	12	17
1952-53	0	0	*	*	0	*	0	*	*
1953-54 _b	0	0	1	0	0	0	0	0	1
1954-55 ^b	6	3	4	0	0	0	0	0	13
<u>Total</u>									
1949-50	149	122	44	28	2	0	254	225	824
1950-51	123	56	29	2	*	*	2	225	437
1951-52	71	56	39	37	2	1	57	328	591
1952-53	87	34	68	5	11	2	174	154	535
1953-54 _b	89	40	48	8	6	10	12	206	419
1954-55 ^b	91	69	65	14	0	10	71	140	460

a. Bales of 478 lb. (216.8 kg.) net weight.

b. Preliminary.

c. Principally Mexico and Sudan.

d. Principally from Burma.

* Less than 500 bales.

SOURCE: International Cotton Advisory Committee, Washington

CONFIDENTIAL/NOFORN

CONFIDENTIAL/NOFORN