Estimated Impact of Western Economic Sanctions Against the Sino-Soviet Bloc

The Problem

The problem is to estimate the likely impact of a total embargo imposed, alternatively, by the United States, or the Western Allies (NATO plus Japan), against:

a. The Sino-Soviet Bloc countries as a whole, or
b. The USSR and its European Satellites, or
c. East Germany

Strategic Aspects of the Bloc Economics

The Sino-Soviet Bloc countries as a whole comprise a formidable and largely self-sufficient economic unit. Their combined population is nearly one billion and gross annual output is now over $350 billion. The primary objectives of economic activity are the development and maintenance of military strength, and rapid industrial growth, which has been averaging about 10 per cent a year.

The countries of the Bloc have consistently pursued a policy of attaining maximum economic independence from the West. This policy has been tempered by the desire to draw on the Western nations for advanced technology embodied in industrial equipment, and on the raw material resources of the Free World for those few commodities which either are not present in the Bloc at all or else are in insufficient quantities -- natural rubber, copper and certain agricultural products.

Total Sino-Soviet Bloc imports in 1960 amounted to nearly $15 billions, of which less than $5 billions or one-third was from the Free World, reflecting the policy of avoiding dependence on non-Communist powers. Of Free World trade, 50 percent was with the NATO countries and Japan. Since the death of Stalin, there has been a trend of increasing imports from the West, particularly in the case of the USSR, which is now importing roughly up to the limit of its ability to pay.

Because of the highly diversified resource base of the Sino-Soviet Bloc economies, considered in the aggregate, and their generally advanced state of industrialization, the economic effects of a trade and transport embargo would be minimal in the long run. However, the short-run disruption would be significant, particularly to the attainment of some key industry goals of the USSR's current Seven-Year Plan (1959-65). Additionally, the chronic food deficit of the European Satellites is currently compounded by the food shortage of Communist China, so that the loss of planned imports of Free World grain would have some additional disruptive effects within the Bloc.

Estimated Impact of a Unilateral Embargo by the United States

The United States already maintains a complete embargo on trade with Communist China, and also a higher level of restrictions on exports to the European Bloc than do the Western European countries. Other U.S. measures which restrict trade with the USSR are the denial of Most-Favored-Nation tariff treatment and the provisions of the Johnson and Battle Acts which prohibit governmental and private loans. For these reasons, the volume of U.S. trade with the Communist world is small and non-strategic in nature.

Total exports of the United States to the Communist Bloc amounted to only $193.4 millions in 1960. Of this total, $143.1 millions, consisting primarily of grain and raw cotton, went to Poland. The comparatively large volume of shipments to Poland is a reflection of our policy to assist that nation in maintaining the measures of freedom and independence from Soviet domination thus far achieved. An embargo on either the Sino-Soviet Bloc or the USSR and its European Satellites would, of course, cut off these agricultural products to Poland. This would decrease Poland's freedom of negotiation with the USSR, but would not impose any serious problems on the Bloc as a whole as long as other Free World suppliers remain available.

U.S. exports to East Germany amounted to $3.9 millions in 1960, of which almost two thirds were steel, largely sheet. This is less than one per cent of East Germany's steel consumption, and apart from some administrative inconvenience in adjusting suppliers, no economic effects could be expected from embargo.

U.S. exports to the USSR amounted to about $39 millions in 1960, and were composed largely of textile machinery and steel products. The denial of textile and other civilian machinery in such limited quantities would have little economic effect on the USSR because virtually identical equipment is available in Western Europe. The steel products going to the USSR are, it is believed, not for strategic purposes but for the production of civilian goods. U.S. steel accounts for about 5 per cent of such Soviet imports from NATO countries, and is not a significant addition to total USSR availabilities.

Estimated Impact of a NATO (plus Japan) Embargo on the Sino-Soviet Bloc Countries

The Bloc Wide Case

Under generous assumptions of impact, the economic loss which the NATO countries (including Japan) could impose on the Sino-Soviet Bloc through embargo would be about $4 billions. The denial of the $700 million of imports currently moving to the USSR, the $1.2 billion flowing into the European Satellites and the $500 million currently being imported by China would cause an immediate decline in output in the Bloc as a whole and most of the loss of $4 billions, or about 2 months growth, would be felt in the first six months following the imposition of the embargo. Recognizing the alternatives which actually would be open to the Bloc, the fact that, in part, denied imports of steel, machinery, etc., could be obtained in non-NATO countries such as Sweden, Austria, and Switzerland, and recognizing the possibilities for substitutions from Bloc sources, the actual loss expected would be smaller than this. The major burden would be felt by the European Bloc.

At present levels the seaborne foreign trade of the Sino-Soviet Bloc is nearly 100 million tons annually, of which almost 65 percent moves on Western, primarily NATO shipping. The imposition of economic sanctions would reduce this volume nearly by half allowing the Bloc to carry, on its own vessels, over 60 percent of the reduced total. To carry the remainder would require about 2 million deadweight tons of shipping which the Bloc would have to charter from non-NATO sources. The most readily available non-NATO shipping is represented by the tramp fleets of Panama, Liberia, Honduras, Sweden, Finland, and Yugoslavia. These fleets total over 20 million DWT and the Bloc should have little trouble chartering the 2 million DWT which it would need.

The Chinese Case

There are no strategic or vital industrial imports from NATO countries into Communist China that cannot be replaced by imports from the Soviet Bloc or other Free World countries. Two Chinese imports, grain and chemical fertilizers, would be seriously affected by an embargo by the NATO powers participated in by Australia and Japan. In order partially to overcome the effects of two successive bad harvests, China has contracted to buy more than 5.5 million tons of grain (primarily wheat) from Canada and Australia during 1961. In recent years, Chinese import of chemical fertilizer from NATO countries has been nearly one million tons annually, or about one-fourth of total domestic supplies.

If Chinese trade with NATO, Australia, and Japan were terminated, it is unlikely that either the grain or chemical fertilizer imports could be replaced by imports from the Soviet Bloc. It would not be possible for China to replace the bulk of these grain and fertilizer imports directly from other countries in the Free World, and any attempts to obtain these imports through an intermediary would be extremely difficult. The only major wheat exporter not participating in the embargo would be Argentina. Exports of wheat from Argentina have declined sharply in recent years, and on 1 June 1961 the total supply of wheat in Argentina available for export and carryover was only one million tons. China could substitute rice imports from Burma and other countries for perhaps a quarter of the planned imports of wheat from Canada and Australia, although it would be more difficult for China to obtain the same favorable credit terms for rice that now apply to its purchase of wheat.

The loss of grain imports and fertilizers would compound already critical food shortages, although probably the regime would impose severe rationing which would provide adequately for the party, the military establishment and the industrial labor force.

The Soviet Bloc Case

If economic sanctions are levied only against the USSR and the European Satellites leaving China free to carry on foreign commerce, the aggregate impact estimated above is obviously lessened by the amount of damage estimated for the Chinese economy. As for the impact of the sanctions against the USSR and the European Satellites, it would remain about the same as in the case of sanctions against the entire Bloc. It is not likely that the availability of Western markets to the Chinese alone would be any more than a fairly long-run advantage to the USSR and the European Satellites.

The impact of an embargo would fall unevenly on individual sectors of the Soviet economy. In spite of the general validity of Khrushchev's repeated assertions that "in our economic development we rely wholly on the internal forces of our country, on our resources and possibilities . . . Irrespective of whether or not we shall trade with western countries . . . the implementation of our economic plans . . . will not in the least be impeded," it is clear that it will be difficult for the Soviet economy to fulfill certain key investment plans without recourse to imports from NATO countries.

Pursuant to the requirements of the Seven-Year Plan, Soviet imports during 1961-65 will continue to focus on machinery and equipment particularly for the chemical industry, for rail and water transport, and for light and food processing industries. Other Soviet import priorities include metallurgical equipment, metalcutting machine tools, equipment for the

electronics industries, and oil field equipment, particularly large diameter pipe for oil and gas transmission. The priority expansion of the chemical and petrochemical industries postulates substantial imports of chemical equipment, particularly for plastics and synthetic fiber production, to compensate for lagging technology and inadequate manufacturing capacity in the domestic machine building industry.

Plans for modernizing and improving Soviet transport capabilities -- an essential element of the over-all Plan -- call for sizeable imports of merchant shipping and railway equipment to effect a saving in domestic plant expenditures. Similarly, the more rapid growth in consumer goods production, only recently reiterated by Khrushchev as a priority objective of the current Plan, is based in part on substantial imports of textile and food processing equipment to obviate the need for extensive domestic investments in research and development by providing up-to-date plants and installations.

Most of the import requirements generated by the Seven-Year Plan will be satisfied, as in the past, in trade with the Sino-Soviet Bloc. For the fulfillment of plans for certain industrial sectors, however, imports from NATO countries are significant. For example, without imports of chemical equipment and technology from NATO countries (such imports have increased more than tenfold between 1956 and 1959) prospects for fulfillment of planned output in fertilizers, plastics, synthetic fibers and synthetic rubber, are doubtful. Khrushchev himself has admitted that imports from capitalist countries, primarily from the U.S., the U.K. and West Germany, would provide the USSR with "quicker fulfillment of its program for the construction of new chemical enterprises without wasting time on creation of plans and mastering of the production of new types of equipment." In sum, NATO denial of certain kinds of chemical equipment to the Soviet Bloc (and in spite of the diversion of such imports to other sources of supply) would impede production of the required product mix of equipment for the Bloc chemical industry, principally because of the technical problems involved in developing new chemical equipment, plant and technology.

Similarly, while imports of rolled steel from NATO countries have supplemented domestic production, such imports in 1960 have accounted for little more than 2 per cent of total Soviet supply (a larger share of Satellite supply) and overall Soviet plan goals for crude and rolled steel are not contingent on imports from NATO. For specific steel shapes, however, imports are a considerably larger share of Soviet supply. Completion of the ambitious Soviet pipeline program with its requirements for large diameter pipe have imposed a heavy burden on Soviet Bloc steel producers. It is likely that the Bloc will face deficits in the production of large diameter pipe at least through 1963 and possibly through 1965 and beyond -- shortfalls for which the Bloc will have to compensate by imports of pipe from NATO countries if it is not to suffer delay in its pipeline program.

The disruptive effects of a NATO embargo on food exports to the Soviet Bloc could be minimal, were it not for the large requirements of Communist China. The USSR continues to be a large overall net exporter of grain, with the chronically food-deficit Satellites accounting for about three-quarters of the principal agricultural commodities exported by the USSR. With the exclusion of China, a NATO denial of grain exports to Eastern Europe (NATO exports of grain to the USSR, almost exclusively from Canada, are relatively small and destined largely for its more remote far-east regions) could be compensated by a diversion of Soviet grain shipments from NATO countries to Eastern Europe. In the two-year period 1959-60, the Soviet net export position in grain to the NATO area was approximately equal to the Satellite net deficit position with the same area. Again excluding Chinese requirements, the diversion of Soviet grain shipments to Eastern Europe, and Satellite food exports from Western to Bloc recipients, coupled with increased purchases of sugar, rice, tropical fruits and vegetables and other foodstuffs from underdeveloped areas, could do much to mitigate the disruptive effects of NATO sanctions.

The impact of the denial of NATO shipping to the USSR and the European Satellites in similar to that estimated for the entire Sino-Soviet Bloc except that the amount of shipping which the Bloc would have to charger from non-NATO countries would only be about 1.5 million DWT. This amount would be readily available among the tramp fleets of non-NATO countries.

The embargo would be expected to have no impact on the Soviet military program. Some redirection of investment activity would be expected in order to compensate for the loss of capital goods imports from the NATO countries. The effect would probably be focused mainly in the Soviet consumer goods industries, and perhaps housing as resources were diverted to maintain the Soviet military program and to supply the industrial material needs of the Satellites. Depending upon the degree of dislocation that stems from the readjustment process and the extent to which the USSR fills Satellite needs, the overall impact upon Soviet economic growth would range from negligible to a very small decline. It is probable that the Soviet consumer would bear the brunt of any such decline.

The East German Case

Despite East German official announcements suggesting the contrary, only a very marginal reduction in current dependence on imports from NATO countries as a whole has been affected by means of changes in East German economic plans and foreign trade arrangements since the latter part of 1960. The East German regime apparently has been forced to adopt a policy of only gradual reduction in the range of commodities for which the East German economy is entirely or mainly

dependent on NATO countries. In order to reduce greatly its current dependence on imports of key commodities -- particularly steel -- East Germany and other Soviet Bloc countries would have had to make economic adjustments, incurring costs equivalent to a substantial portion of the loss from an embargo.

Shipments from NATO countries continue to represent approximately one-sixth of total East German imports. As before, a significant portion of these imports consists of commodities which are of special importance to the East German economy and are in short supply within the Soviet Bloc. East German dependence on NATO also remains significant for imports of new technology. Although West Germany continues to provide by far the major portion of East German imports from Western Europe, the relative importance of trade with other NATO countries has increased significantly. These countries currently are providing a substantially larger share of the most important commodities imported by East Germany from NATO -- steel, particularly high quality steels, chemicals, and machinery (including equipment for whole chemical and metallurgical plants).

It is doubtful that other industrialized Western countries (Austria, Sweden, and Switzerland) would be able to provide these goods in the amounts and types adequate to the fulfillment of East German needs now covered by supplies from NATO countries. The necessity to concentrate purchases in a few markets would add significantly to East Germany's marketing problems.

East Germany, therefore, would probably suffer significant economic losses in the event of a NATO embargo. In December 1960 it was estimated that the total loss to the East German economy during the first six months following a general NATO embargo would perhaps approximate $250 million or, at an annual rate of $500 million, approximately two-thirds of one year's increment to total industrial output (or one-half of one year's increase in gross national product). Failure to receive current imports from NATO of metallurgical products and materials could result in a decline of approximately 10 percent in East German supplies of finished steel. A cut of 10 percent in steel supplies could result in a proportionate cut in the output of the engineering industries, a cost of about $250 million on an annual basis. The cost resulting from the loss of other bottleneck items might increase this amount to $400 million. The denial of the remainder of East German imports might create an additional loss in the value of output on the order of $100 million.

These estimates represent only a general order of magnitude and, as such, are a reasonable measure of current East German vulnerability. However, as a result of improved contingency planning, which is presumed to be more comprehensive and specific than before, and assuming broad support from the rest of the Bloc, the duration of the period of substantial economic disruption has probably been reduced somewhat from 6 months to perhaps 4 or 5 months. Economic losses would then decline steadily until a new structure of priorities, permitting supplies of commodities once again to be in balance with requirements for them, had been achieved.

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THE USE OF ECONOMIC COUNTER-MEASURES IN THE BERLIN CRISIS

Summary

1. The Soviet Union and its Eastern European satellites are relatively self-sufficient. Essentially trade and shipping embargoes would only somewhat slow down current rates of growth particularly as relates to the chemical and petro-chemical industry and to the installation of pipelines. The principal vulnerabilities in the bloc are in the GDR on one edge and Communist China on the other. In the case of the East German regime, marked economic dislocation would result from a trade embargo requiring revamping of current economic plans and readjustments which would seriously injure East German production for a period of some months. In the case of Communist China the main vulnerability is in food, particularly supplies of wheat contracted with Canada and Australia. Embargoes on these two might indirectly create some serious problems for Moscow.

2. To be effective economic counter-measures will require closely coordinated action by all members of NATO, and probably agreement to parallel action by certain others such as Sweden, Austria, Switzerland and Japan.

3. If used as a primary weapon, economic counter-measures will be regarded by the USSR not as a convincing expression of will to resist Soviet designs with respect to Germany and Berlin, but as evasive action, indicating unwillingness to face the prospect of defending our interests by force; Khrushchev has made this clear to FRG Ambassador Kroll. It is accordingly essential that planning for the use of economic counter-measures be developed in close and appropriate relationship with measures in the military, diplomatic and psychological fields.

Economic Sanctions which should be applied if access to Berlin is blocked.

Blockage of access would create a situation in which the outbreak of hostilities would be imminent and the economic embargo to be imposed would be total, including among other things:

(a) The prohibition of the use of all financial facilities of the NATO countries to carry on current transactions with the USSR, East Germany, the other Sino-Soviet Bloc members and their Nationals.

(b) The expulsion of all Sino-Soviet Bloc technical experts and foreign trade officials without diplomatic immunity from the NATO countries.

(c) The freezing of all assets of the members of the Sino-Soviet Bloc under jurisdiction of the NATO powers.

(d) Termination of trade agreements involving Sino-Soviet Bloc countries.

(e) The denials of all exports to Sino-Soviet countries.

(f) The stoppage of all imports from Sino-Soviet countries to NATO countries.

(g) The closure of NATO ports to Sino-Soviet shipping and planes and Bloc chartership.

(h) The prohibition of calling at Sino-Soviet Bloc ports of vessels and planes of the NATO countries.

Other Economic Countermeasures which may be warranted.

In the event of situations which in varying degree fall short of blockage of access, we and our allies should be prepared to apply appropriate countermeasures, e.g.:

1. Harassment of or interference with military traffic to Berlin.

(a) Close Soviet bloc trade missions, including Amtorg offices.

(b) Refuse to enter into new contracts to charter shipping to Soviet bloc countries and suspend existing contracts.

(c) Expand export control measures against the Soviet bloc, including selective embargo.

(d) Refuse ship's servicing (bunkering, lightering, provisioning, naval stores) to Soviet bloc shipping.

(e) Initiate measures to prevent Soviet bloc aircraft from landing or exercising commercial rights at Western airports and from making transit overflights and technical stops.

2. Harassment of or interference with civilian traffic to Berlin.

(a) Regulate movement of Soviet bloc vessels in Allied ports.

(b) Initiate harassments concerning documentation, inspections, delay, or technical requirements of Soviet bloc shipping at Allied ports.

(c) Delay ship's servicing (bunkering, lightering, provisioning, naval stores) to Soviet bloc shipping.

3. Signing of a Soviet-GDR Treaty.

(a) Cut off selected types of industrial and technical exchanges in which Soviets are most interested and ban export of published and unpublished technical and scientific information.

(b) Arrange for slowdown in issuance of export licenses for shipments to Soviet bloc.

(c) Cancel arrangements for Soviet participation in exhibitions, trade fairs, scientific conferences, and other international meetings scheduled in Western countries (NATO).

(d) Cancel arrangements for Western (NATO) participation in exhibitions, trade fairs, scientific conferences, and other international meetings scheduled in Soviet bloc countries.

4. Prior to signing of a Soviet-GDR Treaty.

(a) Prepare and implement countermeasures against USSR and "GDR" in form of tripartite controls over transport on basis equivalent to any Soviet or GDR harassments.

(b) Restrict economic negotiations with USSR to essential matters.

Allied Countermeasure Studies Underway.

Quadripartite studies (UK, France, Fed. Rep. and US) in Bonn on possible countermeasures against the East German regime have been in process for almost a year. A tripartite working group (UK, France and US) meeting in Washington for over a year has been examining possible non-military countermeasures against the USSR and its satellites, excluding Communist China. These basic studies should now be considered first by the UK, France and Fed. Rep. and then within NATO, looking to agreement on:

1. Countermeasures which, in the absence of legal or administrative problems, could be implemented promptly, provided necessary preliminary preparations are now made on a stand-by basis; and

2. Countermeasures on which existing legal and administrative obstacles to implementation should now be removed.