

RESTRICTED

1605

THE ECONOMIC INTEGRATION OF THE SOVIET BLOC

31 March 1952

CONTENTS

	<u>Page</u>
INTRODUCTION--Colonel B. D. Rindlaub, USA, Chief of the Economic Potential Branch, ICAF.....	1
SPEAKER--Dr. Harry Schwartz, Specialist on Soviet Affairs, The New York Times.....	1
GENERAL DISCUSSION.....	12

Publication L52-133

INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

RESTRICTED

RESTRICTED

1606

Dr. Harry Schwartz, Specialist on Soviet Affairs, "The New York Times" and associate professor of economics (on leave), Syracuse University; was born in New York City, 10 September 1919. He received B.A., 1940; M.A., 1941; and Ph.D., 1944, from Columbia University. He has held the following positions; lecturer in economics, Columbia University, 1940-1941; tutor in economics, Brooklyn College, 1941-1942; economist, War Production Board, 1942; economist, Department of Agriculture, first half 1943; United States Army, 1943-1945, including service as Soviet intelligence specialist with Office of Strategic Services 1944-1945; Soviet intelligence specialist, Department of State, 1945-1946; assistant professor of economics, Syracuse University, 1946-1948; and associate professor of economics there to the present time. He is the author of the following books: "Seasonal Farm Labor in the United States," Columbia, 1945; "Russia's Postwar Economy," Syracuse, 1947; "The Soviet Economy: A Selected Bibliography of Materials in English," Syracuse, 1949; "Russia's Soviet Economy," Prentice-Hall, 1950. He is the author of many articles in scholarly publications including "American Economics Review," "Journal of the American Statistical Association," "Journal of Political Economy," "The Annals of the American Academy of Political and Social Science," "Journal of Farm Economics," "Political Science Quarterly," "Rural Sociology," "The Russian Review," and many others. He has also written many articles on the Soviet Union which have appeared since 1946 in "The New York Times," "New York Herald-Tribune," "Wall Street Journal," "Colliers," "Catholic Digest." He is a member of the following organizations: American Economic Association, American Statistical Association, Phi Beta Kappa. Dr. Schwartz received a citation by General William Donovan for his outstanding work in the OSS.

RESTRICTED

RESTRICTED

1607

THE ECONOMIC INTEGRATION OF THE SOVIET BLOC

31 March 1952

COLONEL RINDLAUB: Last year a student of the Soviet economy wrote one of the most complete summaries of the economy of Soviet Russia. That same man last year left his position as professor at Syracuse University and went with "The New York Times" as a specialist on the Soviet area. I can't think of any man that we could have gotten to give our final talk on the integration of the economies in the Soviet bloc other than that particular individual. He has been kind enough to come here this morning to speak to us. I now present Dr. Harry Schwartz.

DR. SCHWARTZ: General Vanaman, Colonel Rindlaub, and gentlemen: That was a very kind introduction by the Colonel.

I think I ought to start in by saying that a person like myself feels very ignorant, even after having produced a 600-page book, because there is so much more we would like to know about the Soviet economy and the satellite economies than we do know that we are continually scratching.

I was told that I am going to have to answer questions after this talk. I will be glad to do so within the limits of my ability. I would hope that you gentlemen, who have access to classified material, can answer more of those questions than I can.

Our topic this morning is "The Economic Integration of the Soviet Bloc." I take it we mean by that the vast area now controlled by Communist Russia, including not only the Soviet Union itself, the heart land of the area, but also the eastern European satellites--Poland, Bulgaria, Rumania, and the like; China, including Manchuria, of course; North Korea; the Mongolian peoples republic; and also the Soviet zone of Germany and the Soviet zone of Austria, the last perhaps more tenuously a part of the Soviet economic empire than the others.

It is always a good idea, I think, in these matters to start off with a little backbround. And so let me give you a resume rather briefly that will bring us up to the present.

In the pre-World War II period, the men that ruled the Soviet Union had very few problems in integration to contend with, that is, integration outside their own national borders. Up to World War II at least, the only nominally independent state, which was actually a satellite of the USSR, was the Mongolian peoples republic, a rather small country populationwise, with extremely primitive people, mainly pastoral herdsmen, offering no very great problems of economic control, integration, and the like.

RESTRICTED

RESTRICTED

The Soviet leaders had to solve many complex problems of integration and coordination within their own vast country; but it was within one national state. It was within a state where there were common traditions. There was a mutual language, the Russian language, which was pretty commonly understood. There was a common economic tradition, although there were different levels of economic development in different areas.

Now, with the end of World War II and even more so with the conquest of Communist China in 1948 and 1949, the whole picture has changed very radically. The Kremlin has to coordinate roughly 10 countries, each of them with its own language, its own economic and industrial traditions, and its own level of economic development.

This is a complex problem technically. It is not one which could be solved easily by anybody, including ourselves. Those of you who are acquainted with the problems we have on NATO, trying to coordinate and integrate the military purposes and economies of western Europe with the economy of the United States, know how complex and how difficult such a problem can be.

In retrospect, looking back over the history of the past seven years, it seems clear that the Russians started this period with very little in the way of carefully thought-out, long-range plans. By that I mean, when the Russians came into the area they occupied at the end of World War II, when they came into western and eastern Europe, when they came into Manchuria, into North Korea, they came as a horde of devouring locusts. They seemed to have only one thing in their minds--and that was "grab." They looted those areas very severely.

I recall back in 1948 I was at the railroad station at Karlshorst and I saw machine tools lined for miles on both sides of the track. These machine tools had been taken out of German plants and were simply waiting, without any protection from the rain or sun, transshipment to Russia.

The Soviet activity, at least so far as you could judge it from the way the Russians acted, was based upon two notions: one, that they had suffered severely during the war and needed the maximum economic aid for their own domestic rehabilitation; and, second, they were now the military masters and therefore the political and economic masters, of a comparatively rich area--an area which for the most part had been enemy territory and which they therefore could loot at their discretion.

So out of this vast area--eastern Europe, Manchuria, North Korea--they took a very large portion of that which could be moved. They must have taken hundreds of factories--by "factories" I mean the machinery and equipment--and a large quantity of raw materials. They took the livestock, the tractors, and other farm machinery. They took consumer goods. They looted the citizens' apartments of their furniture and sent it back to Russia.

RESTRICTED

Various people have tried to estimate the volume, the value, of these takings. The figures are very rough. My own impressions are that if you try to add everything together as to what the Russians obtained from the area they occupied after World War II, it comes to somewhere in the neighborhood of perhaps 10 billion dollars. That is not an exact figure. It is merely an order of magnitude statement.

We ought to remember, however, that this 10 billion dollars was value in place. The material they received and finally got to Russia was worth much less than 10 billion dollars. When you have inexperienced workers to move machinery, when you have a bunch of Germans moving their own heavy machinery that they know is going to Russia, they are naturally clumsy. They are not so very enthusiastic about the idea of having everything go to Russia. Every now and then they drop it. When you drop a press, things get broken. Then they had to move these machines out in the open and let them stay in the sun and the rain for months and months. Then they put them on flat cars and they went on a very rough trip to Russia. I think it is reasonable to assume that a great part of this machinery that they moved out of these countries was pretty valueless except as scrap when it arrived at its destination.

We should not exaggerate; this stuff did have some value. The Russians have used a great deal of it in re-equipping their plants in the Ukraine and other parts of Russia and to a limited extent in Siberia. But certainly the value of that machinery, when it got to Russia, was distinctly less than before its removal.

When you loot countries like the Russians did, it means that you contribute to two factors at least. One factor is simply the political hostility that will arise. A worker who sees his factory made useless because you have stolen the equipment from it isn't going to love you. Second, it would seem that you have no long-range plan for exploiting the area.

After all, even the Russians must have asked whether it wouldn't be more worth while to them to leave the equipment in place and let those plants run for their own account in the indefinite future. Apparently the need for rehabilitation of their own economy overrode any consideration of either political advantage or long-range exploitation initially in the postwar period.

After a while, this looting had to slow down, because there was just so much that they could take out. The Russians didn't completely demude these areas. After all, there is a point beyond which it becomes not very advantageous economically to take any more out.

RESTRICTED

Secondly, international affairs were being regulated, national setups were being created, peace treaties were being signed. The Russians couldn't call this "war booty" any more after they had signed agreements with these countries. Things were beginning to get on an orderly basis.

Now, two things seem to have happened by 1948 that radically changed the Russian policy. One thing was the Marshall Plan. You recall that in July 1948 the foreign minister of France invited the foreign minister of England and Mr. Molotov, foreign minister of Russia, to the Paris Conference to draw up a program, which subsequently became what we call the Marshall Plan. Mr. Molotov showed up with his entourage of experts but left immediately thereafter without doing any business. He wasn't going to take any part in any Marshall Plan. A number of the Satellites, particularly Czechoslovakia, which had enthusiastically accepted the invitation to join, suddenly got orders from Moscow that they weren't to join; and they had to withdraw very hurriedly. At any rate, the Russians were suddenly faced with the problem that the American sphere of influence was going to be aided very substantially by the United States.

Their propaganda said that the Marshall Plan was a weapon of exploitation. But they knew the facts. They knew that unless they did something, the people in their own empire would see a very marked contrast, a contrast of western Europe receiving large amounts of economic aid from the United States, while the eastern European area and China had not yet been completely Sovietized, and eastern Europe had to struggle along as best it could.

Finally, I suspect by this time they had made sufficient progress in their domestic recovery to do some thinking about the long-range perspectives of exploiting these dependent areas, and about how these areas that they dominated politically, economically, and militarily were going to fit into the over-all scheme of the Soviet pattern.

For both these reasons--because they had to offer a counterpart to the Marshall Plan and because they had to face the long-range problem--they very dramatically reversed their entire pattern. I want to warn you, I am oversimplifying in summarizing very hurriedly, but I think it is not inaccurate to summarize it in this fashion; that since about 1948 and early 1949 there has been a quite different pattern. The pattern can be summarized perhaps in this fashion:

The Soviet Union is now attempting to manage the economic development of the satellite areas in such a way that those areas will become--they are already--positive economic assets to the Communist military

RESTRICTED

and economic potential. The Soviet Union is helping these countries to industrialize. The Soviet Union is more and more integrating its own economy with those countries and integrating the economies of all of these countries into one unified bloc.

I wrote an editorial for "The New York Times," which appeared in yesterday's newspaper, in which I made the point that more and more the countries of eastern Europe are becoming indistinguishable from the continental area of the USSR economically speaking. My own conclusion would be that certainly the end result of the present process of development will be precisely one in which the nominal political independence or autonomy of these various satellite areas will be completely fictitious in the economic sphere. I argue that today, and increasingly in the future, the entire Soviet area must be considered one economic bloc, drawing its resources from common centers, planned from a common center, and directing its output toward common objectives.

I think that perhaps the best statement of what is going on has been made by a Communist. Hilary Minc, economic director of Poland, who in writing about the trade agreement between the countries of the Soviet bloc, said this: "The conclusion of the long-term agreements encourages the people's democracies"--that is, the satellites--"to set up economic plans which take into account not only their own possibilities and needs but also those of friendly nations. The development of economic relations between the USSR and the people's democracies leads to a planned tie-up of their economies. Every country builds up such branches of industry, especially of heavy industry, which have the greatest chance of development and of which there is the greatest need in other friendly countries."

In other words this is a simple statement that the entire area is being built up as an organic unit, with planned division of labor between the different parts of it, based upon the relative advantages and disadvantages of these different parts, and also taking into account the over-all need.

Now, so much for summary--I would suggest as a conclusion that what we have here is a vast area of the earth's surface, which has a very important portion of the human and material resources of the world, being planned and being directed from Moscow for the enhancement of Moscow's policy. I think that any study of what happens in these countries must bear out that conclusion. So what I would like to turn to now is a discussion in some detail, not to great detail, of exactly what is being done on these levels.

First of all, the most direct form of integration takes the form of direct Soviet control and management of parts of the economies of these different countries. This in turn takes two forms. In Eastern

RESTRICTED

1612

Germany and in Eastern Austria the Soviet Union owns directly in the aggregate in both countries almost a thousand enterprises, producing all kinds of commodities, from plants that turn out guns or repair tanks down to those that make synthetic gasoline and down to large farms producing food only for the Soviet army. So here we have simply direct ownership and control.

Now, farther east, in eastern Europe, particularly in Rumania and Hungary--and also a beginning being made in China--you have a different organizational form; it is not really new. It was used to a very limited extent by the Russians before the war in countries like Iran, but certainly new in importance and in scope. That is the so-called joint company.

In Rumania there are some 13 of these joint companies and in Hungary I believe there are 5 or 6. These companies are nominally stock companies, owned equally, fifty-fifty by the Soviet Union and the particular country itself. In theory the two partners have about equal capital investment. The theory is that the general managership of these companies will develop them as economic enterprises to produce a profit.

In Rumania, for example, these joint companies include a Danube River Navigation Company, a shipping company, an aviation company, a good portion of the Rumanian metallurgy and oil, the timber, and a whole string of others. In Hungary they include shipping, aviation, aluminum, bauxite, and metallurgy. In other words these companies control the key areas of the economy of these individual countries.

In actuality it is apparent to anyone who has had any dealings or experience with these joint companies that the legal fiction of joint ownership by the two countries is precisely that--a fiction. These companies are merely devices by which the Soviet Union controls directly and plans directly major areas of these satellite economies. Those areas are the ones that appear strategic from its own point of view.

The laws of the various countries are so adjusted that these companies have a very preferable position. In Hungary at one stage, and perhaps even today, the laws were so set up that the Soviet-Hungarian oil company can't lose money. It has to make a profit. If it doesn't make a profit, the government gives it a profit out of its budget. And those companies don't have any tariffs. They don't need any license to import or export. They have a monopoly and are in a very favored position. These are kind of ideal types of what imperialism can do when the imperialist power has carte blanche.

RESTRICTED

RESTRICTED

1613

In China a beginning has been made with this kind of instrument of economic penetration. There are already three joint companies in northwest China--one for exploitation and development of the petroleum resources, one for exploitation and development of the nonferrous metal resources, and one for civil aviation. Presumably there will be further companies in the future.

Well, that is instrument number one of integration--direct Soviet ownership and control, either openly or covertly by the joint company device, of important areas in the satellite economies. The organizations are owned and controlled by the Soviet Union and are working for the Soviet account and are very efficient instruments to drain these countries for the Soviet benefit.

A second type of integration of a more general type but nonetheless effective, is simply the fact that the economic development of these countries and the economic plans of these countries are obviously directed by Moscow.

In 1949 there was announced the creation of a body called the Council for Mutual Economic Aid, whose membership now includes the Soviet Union and all of the eastern European satellites. This Council has had very little said about it in the Soviet press. We know little about it in detail. But it is quite clear what its functions are. Its functions are to make sure that the economic plans of these satellite countries are coordinated with those of the Soviet Union. So the state planning committee, or whatever the proper body is in the Soviet Union itself, now not only plans the Soviet economy, but plans the economic development of this entire bloc. Remember what Mr. Minc said before-- These countries in their plans will take into consideration the needs of their friends and of their friends who are more friendly than the Soviet Union?

China may be a special case. I am sure there is a great deal of liaison and coordination between the Chinese Communists and the Russians. Whether a committee from the Chinese Communists is the group in control of the development of this area or not is something that I am not sure of. It may very well be and it may not be. Perhaps you gentlemen know; I don't.

What are these plans aimed at? What is the objective? All these countries in eastern Europe are trying to industrialize as rapidly as possible. When I say "industrialize" I mean industrialization in what

RESTRICTED

RESTRICTED

1614

has now become the classic Soviet pattern--a pattern of pushing the development of heavy industry, of all direct and indirect armament industries, as rapidly as possible, with little concern for the impact of this development upon the standard of living and also the liberties of the people involved.

The Soviet Union is playing a very positive role not only of a planning nature, planning this development, but also providing the raw materials required. Thus many of the new plants--metallurgical plants, machine-tool plants, mines, and so forth--being built in eastern Europe are being built on the basis of blueprints drawn up by the Soviet technicians. Their construction is being supervised by Soviet experts. The machinery which goes into them is Soviet machinery. This is a sort of gigantic Soviet Point Four Program.

I think it is decidedly an oversimplification to think, as some people apparently do, in judging of or writing about this development, that at the present time the Soviet Union is only concerned with the short-range exploitation of the satellites. That was true five or six years ago. But today the Soviet Union, I would say, is operating from a much more long-range point of view and is contributing very substantially to the capital expansion in these satellite areas, expecting that the long-range military and economic benefits derived from the long-range expansion will more than compensate them for any short-term loss of what might have been gotten by a continuation of the old policy.

As a matter of fact, the Soviet Union is going further. It is not only providing machinery and technical assistance but also money; it has given substantial loans to some of the countries. A few years ago Poland got a loan of 400 million dollars to pay for capital investment. Somewhat more recently Poland got an additional loan of a smaller sum. By comparison China has been treated very badly. While Poland has gotten over 600 million dollars in loans, the Chinese, with their much vaster population and much greater need, only have gotten 300 million dollars. Perhaps that is an indication that the Russians consider Poland more easily controlled, more malleable, than they consider China. There have been smaller loans to the governments of some other satellite countries.

What is happening on the technical end is very interesting. The techniques of all the satellite countries are being remolded on the Soviet model. We have Soviet technical standards, blueprints, nomenclature being introduced ever more widely, with the end result of the

RESTRICTED

RESTRICTED

1615

process being ideally that 5 or 10 years from now, engineers can be shifted just as easily from, say, a factory in Prague to a factory in Vladivostok as the Kremlin can now shift engineers from Moscow to Vladivostok.

And by using the same technical standards and the same type of blueprints, they make sure of the interchangeability of parts. They are making the same machinery in the satellite factories that they are making in the Soviet factories. They are making the same armament. They are making one country, economically speaking, of this whole vast area.

You gentlemen are perfectly familiar with the problems that we get into because of the different standards that we have here in the United States and Great Britain and Canada. You know we still haven't been able to agree with the British as to which rifle we shall use. All those problems that cause such a lot of friction for us, because we are dealing with independent countries, are not problems in the Soviet sphere. The Kremlin orders and its puppets in the satellite countries simply obey. From the organizational point of view that is an enormous advantage.

Of course, in this process of integration, trade plays an enormous role. I should say a word about that. We don't have any statistics where this trade is concerned. All the satellite countries have now gone over to the Soviet practice of being very secretive about their economic data and in particular about their foreign trade.

Two years ago Mr. Mikoyan, Minister of Foreign Trade, simply said cryptically that Soviet trade with the peoples democracies composed two-thirds of their total trade. I put that together with some figures that I got from some other places and I came up with this notion, which may or may not be worth anything: that the Soviet trade with the satellite area may now aggregate one billion dollars. If anybody wants to argue and say it is 950 million dollars instead of one billion, I refuse to argue. It is a very rough estimate. There are some clues which suggest the total may be much larger.

Well, this is a very considerable volume of trade. We have to remember that most of the satellite countries did very little trading with the Soviet Union before that. Countries like Bulgaria, Rumania, and Poland didn't do more than 1, 2, or 3 percent of their total volume of trade with the Soviet Union. Today the Soviet Union is the largest single trading partner of almost all of its eastern European satellites; it is also the largest single trading partner with China.

RESTRICTED

RESTRICTED

1616

Now, not only is the Soviet Union the largest single trading partner with these countries, but these countries' foreign trade now is almost completely with themselves. Bulgaria is the most extreme case. All that we have for data shows that the Bulgarian trade at present is roughly 92 or 93 percent with the Russian or Soviet world and only 7 or 8 percent with the non-Soviet world.

Just to give you an idea what this can mean to a particular country, let me give you an example of Rumania, which has published some data. Rumania is now getting from the USSR 55 percent of its iron ore, 90 percent of its coke, 56 percent of its cotton, and practically all of its heavy machinery. It is now getting from the Soviet Union all of its new metallurgy, its machinery for setting up new factories--such as plants to make the heaviest combines, refine oil, produce penicillin, and streptomycin, textile mills, et cetera. In the long run there can be no doubt that the Rumanian economy and similarly the other satellite economies are simply going to be replicas of the Soviet economy, integrated into that economy.

One other aspect of it is interesting as well. The Soviets have made at least a beginning in trying to promote the coordinated development of various of their satellites. For example, in Czechoslovakia and Poland they are attempting to set up what is sometimes called the second Ruhr Basin. That is, they are attempting to set up a new metallurgical area which will combine coal from the Upper Silesian coal fields in Poland and from Czechoslovakia with iron ore sent from the Krivroi Rog region in the Ukraine. So from now on these areas must be considered as a total whole. The Soviet Union controls them politically, economically, and militarily.

I also want to mention two other facets of integration that are of interest. One was treated in an article in "The New York Times" on Saturday rather briefly. That dealt with the increasing integration of the railroad system.

You gentlemen know that one of the problems in integration has been that the Soviet railroad gage is the so-called broad gage, which is several inches wider than the gage of the European standard railroads. The eastern European countries have the standard gage, which means that when they ship by rail from the Soviet Union to eastern Europe or vice versa, when the train gets to the border, they have to unload the train on one side of the border and take the stuff over on the other side of the border and load it again. This is a very expensive proposition.

RESTRICTED

RESTRICTED

1617

This article--also a pretty good map--indicated that now a most important stretch of railroads in Czechoslovakia, Poland, and Rumania has either been or is in process of being converted to the Soviet broad gage, which means that when this job is finished, trains can roll from Vladivostok on the Pacific through the Soviet Union through eastern Europe to the Austrian border. This will greatly reduce the cost in the problem of transport and certainly be a tremendous aid in integration.

In China I haven't seen anything to indicate that the process of changing the railroad gage has begun as yet. But a great deal of work is being done in China with Soviet funds in the improvement of the railroad facilities. The last information is that there is now a complete rail line from the Soviet border straight through China to the border of French Indo-China.

We know that in 1948 and 1949 they finished a railroad which goes from the Siberian border down to Ulan Bator, the capital of the Mongolian peoples republic. So the transport system is being worked on very intensively to ease the connections and permit the more rapid and more economical shipment of goods and persons between these countries in this area. I hardly need tell an audience of this character that ease of transport has some rather important military implications as well.

One last factor, which I think is important in a discussion of military and economic integration--and this is one of the problems that the Russian state will have initially at least--is that the problems in integration of these peoples are many and varied. They have different cultures, languages, and histories. This is economically important. It is very difficult for a Soviet engineer to turn a Hungarian factory into what he wants if he is compelled to work through an interpreter. It can be done, of course, but it is clumsy and he loses time.

Well, what the Russians are doing in their entire industrial area is a very intensive process of Russification. The Russian language is now the compulsory language in all schools throughout eastern Europe. It is showing signs of becoming compulsory in China. There are a tremendous number of Russian language schools for adults. Russian culture, technical writing, and scientific work are being distributed very widely. Although this area has not been Sovietized perfectly as yet, certainly in the long range we can expect that the Russians will have no greater difficulty anywhere in this area than they had in Kazakstan, whose people are basically quite different from the Russians, but who have been Russified to a very great degree, with compulsory Russian language and compulsory infiltration of Russian culture.

RESTRICTED

RESTRICTED

If I might say just a word about the future, looking through a very cloudy crystal glass or globe: I would argue that from what we know-- and all we can judge by is a guess--this process of integration will go on and on forever greater. There is one weak area, one nonintegrated area--that is agriculture. All of these satellite countries still, with only minor exceptions, are free from organization into the Soviet form of collective farms and state farms. They have made progress. I believe about half of Bulgaria has been collectivized already. But obviously all of these they intend to collectivize almost completely, so that in a few years even that difference should be eliminated.

So I would argue this: I will put it pretty strongly. I wrote a book. My own book is out of date; it is in a very real sense irrelevant. I deliberately and very strongly give my belief today as this: We cannot any longer intelligently discuss the Communist military and economic power simply on the basis of the Soviet Union. Any meaningful discussion now, and for the indefinite future, must be a discussion of the military and economic potential of the entire Communist area.

And so it is very misleading, I think--and I plead guilty of having done this myself--to make simply a comparison between the United States and the Soviet steel production. We have to understand and reckon with the fact that there is now Communist steel production, petroleum production, and transport, because this entire area from the western borders of Eastern Germany, perhaps even Eastern Austria, to the Pacific through China is now for practical purposes a single economic entity and in time of war would operate as a coordinated mechanism, producing goods, supplies, and armament of all kinds for a unified centrally directed military effort. And anyone trying to deal with that military effort would have to deal with that hard fact.

I have been very sketchy. I have tried to hit a few high spots and left a good many untouched; but now you can bombard me with questions and I will try to answer them. Thank you.

QUESTION: Relative to this integration of the different parts of the Soviet bloc, and speaking of the connection between the Far East, the eastern Pacific, and the rest of the Russian bloc being so discontinuous, I am wondering how much contribution eastern Siberia, Manchuria, and the Chinese complex could make in the case of war. Would you say something about that situation--what are the shortages and what are the possibilities?

DR. SCHWARTZ: I must confess that I do not feel myself competent to say anything very authoritative on that. I would hope that you

RESTRICTED

gentlemen, with all the many intelligence agencies that you have, would have some pretty good analyses of the thing.

I would say this--purely my own impression--that the Russians are aware of the problems that might arise if in time of war the trans-Siberian or the east-west roads were cut and the Pacific areas had to fend for themselves. Obviously, they are trying to make provision to take care of that contingency.

This provision, obviously, takes two forms. One is the building up of the industrial resources of this area. Of course, you have to remember that with the possession of all of Sakhalin Island, they now have a major source of petroleum. In the past that has been a very important deficit commodity in this area. So on the one hand they are trying to build up production so that this area may be as self-sufficient as possible.

Secondly, if we assume that they have a target date of 1953, by which time they might anticipate a war for one reason or another, when the area might not be self-sufficient, they are no doubt stockpiling in this area so as to enable it to go it alone for some period of time.

You may recall that before Russia entered the Pacific war the last time, the Soviet Union wanted 90 days between VE-day and its entrance into the Pacific war, which was devoted primarily to stockpiling the area both with materials being sent across the trans-Siberian railroad from the main part of Russia and with American lend-lease ships stopping at Vladivostok and the other major ports in that area, where they were stockpiling those materials as well.

Of course, they are not expecting any lend-lease stockpiling to occur in a future war. But they obviously must be attempting some form of stockpiling. I would think that if war were to come, we could not assume that a mere isolation of the Pacific area from the main portion of industrial Russia would be enough to knock out that area in any short time. It might after a year or two, but they would certainly be prepared with enough stockpile to enable them to go it alone for a while anyway. Just how long they would be able to do that I suggest is a question to which the cloak and dagger boys in the CIA ought to devote a good deal of attention.

QUESTION: In this long-range business in Russia you say it has changed in the past couple of years. So probably in the extremely

RESTRICTED

1620

long range, we should consider the possibility of the Russians doing the same thing with the countries of South America. What possibility do you think there is of their doing that down there?

DR. SCHWARTZ: Well, when the Russians think of South America, they have to recognize that they are under the same disadvantages vis-a-vis South America, that we are vis-a-vis the Soviet Union and eastern Europe. There is the mere fact of propinquity. I doubt very much if the Russians would think they could control or hold any countries in South America, although they are very powerful in Guatemala and there are substantial Communist movements elsewhere in South America.

I think that the Soviet strategy in South America would be mainly directed at another objective--that is, building up sufficient Communist or fifth column strength in these countries so as to make them troublesome areas for us in the event of war and thereby force us to divert some portion of our military manpower to keeping these countries in check. Also attempting to build forces which could be used for sabotage in this area, so as to diminish as much as possible the availability of raw materials from the various countries to ourselves. I don't think we are being very realistic about the Russians if we think that they might be thinking of setting up a Russian zone in Venezuela to work against us, when you consider the distances involved.

QUESTION: I gain the impression from your talk that a considerable quantity of Russian resources are going into the European satellites of Russia in order to shift those economies over to one of heavy industry. I would judge from this that those satellites now might be an economic liability to Russia. If that is so, when will they become an economic asset instead of an economic liability?

DR. SCHWARTZ: Well, it is difficult to judge whether those areas are economic liabilities or economic assets, because we know very little about the nature of the trade, about what the Russians are getting out of those countries. The Russians, after all, in their trade with this area hold the whip hand. They set their own specifications for the trade and they do not pay any attention to world prices. We know from the Yugoslavian experience that the Russians like to sell dear and buy cheap. The trade is carried on, on some sort of Russian accounting system; and perhaps, even in the capital investments that they are making now, the Russians are possibly getting more out of the area than they are putting into it. I don't know. I am merely saying that it is not certain that they are an economic liability.

But to answer your question specifically about these satellites, by 1954 or 1955 the satellites expect to have pretty much finished

RESTRICTED

RESTRICTED

1621

their initial plans for economic development. That is, by 1954 or 1955 the satellites expect to have completed all or most of the heavy industrial plants now being built. At that point certainly the production of those plants will be available. In Poland, for example, it has been announced that the loan of 400 million dollars which the Poles got from the Russians for capital investment will be paid off with the production of the factories being equipped and built that will have gone to Russia.

When I say "1954 or 1955" I hope you gentlemen will remember that already the Russians are getting a good deal out of this area; that every month new plants and new mines are being completed. Certainly by 1954 or 1955 they will be getting a very substantial contribution from this area.

QUESTION: Doctor, three or four days ago I read an article in which it was stated that Russia itself is just a hollow shell behind a big, blustery mouthpiece. I just wondered what you would say about that.

DR. SCHWARTZ: I know that there is such a school of thought in this country. I don't quite know what people mean by "hollow shell." These are emotional words and the people that are using them don't often specify.

I assume that what people mean by this term is that the Soviet Union is far weaker vis-a-vis the United States than would be indicated by the preparations we are making for possible conflict. I would say that it is simply a misapprehension, an illusion, to feel that way. We know that the Soviet Union, largely through its own efforts, stopped Hitler after he had penetrated very substantially into its country and threw him back and marched far west as Berlin, if not beyond. A hollow shell would not have done that.

We know the Soviet Union is much stronger today than it was at the time it faced Hitler. I feel pretty good, with kind of a morbid spirit, that I guess in 1945 that it would be this way--but the one thing that surprises me to this day is this: I had felt that, although we knew that Russia was stronger than it ever was before, it was still sufficiently weak vis-a-vis the United States that its leaders would take every precaution not to run any substantial risk of war. But the fact that the Russians had the North Koreans march into South Korea, and, second, that they then permitted the Chinese to march into Korea, both of which steps might very easily have precipitated World War III, indicates to me a degree of readiness, both from a military and an economic point of view, and from the psychological point of view, which I had not anticipated.

RESTRICTED

RESTRICTED

1622

Let us put it this way: If the Russian leaders themselves thought they were a hollow shell, they would not have done what they have done in Korea. And we know that the Russian leaders have a pretty good estimate of their situation and are concerned about preserving their skins and their power. I think the only course we can follow in the interest of our national security is precisely the course that we are now following. I only wish we had airplanes coming out more rapidly than we are able to have now.

QUESTION: South and southwest Asia supply many materials which are critical to the industrialization of the Soviet Union. Would you discuss the relationship of the Soviet Union to Southeast Asia and whether or not its gold supply is playing any part in that trade?

DR. SCHWARTZ: I take it that by "Southeast Asia" you mean Indonesia, Malaya, Singapore, and that area. There are a few things to be said about that. In the first place, the Russians have been primarily interested until rather recently in the buying of natural rubber and tin and some other raw materials from that area. They have been able to do that because they have had a favorable balance of trade with Great Britain and they have had a sterling surplus and have used that sterling surplus that they accumulated in western Europe to buy materials from Southeast Asia.

Now, more recently, the Russians have been making a bid for these countries, arguing that if they will increase the flow of their raw materials to the Soviet Union, it is in a position to help them with machinery to help their industrialization. The Russians made that bid most recently at a meeting of the United Nations Economic Commission for Asia. They held up very alluring promises that if these countries will play ball with the Soviet Union, they will be paid well with precisely what they need for industrialization.

So far nobody has bitten. There is no specific arrangement of that sort being talked about. So we don't know whether this is just a propaganda bluff or whether Russia could deliver.

So far as gold is concerned, I see no evidence myself that this gold plays any major part. I might say, however, that the whole gold system in the Soviet Union is a very interesting one. We know that the Soviet Union has a very substantial supply of gold--how much it has is anybody's guess--but it is no doubt in the neighborhood of several billion dollars anyway. But it has just sat on that gold throughout the entire regime or throughout the last decade at any rate.

RESTRICTED

RESTRICTED

1623

Now, at some time it may decide to use that gold as a weapon of economic warfare. I myself suspect that at this international economic conference which begins on Thursday at Moscow, where the Russians have promised that there will be some sensational offers, it may be that they will offer to expand their purchases from the outside world and to pay for them in gold. But so far, up to the moment at any rate, the gold has always been something that they just hoarded at their equivalent of Fort Knox rather than something that they used very actively for international trade.

QUESTION: What is this conference for? Specifically, and not wishing to be personal, could you have gotten an invitation to it? Could the State Department have gotten an invitation if it had wanted one?

DR. SCHWARTZ: Could I have gotten an invitation? Yes. I was told that by the man who headed up that particular effort. Anybody whose name meant anything in the American economic world could have gotten an invitation regardless of his connections. The Russians are so eager to make this conference ultrarespectable that they would even give an invitation to a reactionary bourgeois warmonger or an agent of the capitalist intelligence service, as they call me.

There is a letter in "The Washington Post" this morning that made me a little angry. It is from some American professor, referring to our use of all this "lousy material," about all our economists preferring to use third-rate specialists to give them their data instead of accepting this honest invitation to go to Moscow and see for themselves.

I would argue that any idea that you can go to this conference and really get a first-hand notion of what Russia is like purely fallacious. In the first place this is going to be a gigantic Potemkin village. All the people who are going to this village are going as straight VIP's. They are going to be shown the best factories and the best collective farms. So I think that anyone going over there will come back, if he isn't careful, with a quite distorted idea of what the Soviet Union is like, because he will see only selected areas of it.

Now, the conference itself is obviously a major propaganda move. Why are the Russians doing it? I had a long article in the "Times" yesterday, which I will summarize by saying that basically my feeling is that our economic restrictions are pinching the Russians and their satellites; they would like very much to get raw materials and machinery, which we are now cutting off under our embargo policy. They are trying

RESTRICTED

RESTRICTED

1624

to create within the non-Soviet nations a powerful enough flow of public opinion so that the governments concerned will either have to remove the existing restrictions or at least weaken their present severity.

Also I think they are trying to strengthen these elements in the non-Communist world, like the Bevanites in Britain, who will grasp at any straw in the hope that maybe trade will bring about a better world and that maybe in this way these differences can be ended.

Just last week a Bevanite in Parliament proposed that Britain offer to sell the Soviet Union textile and machine tools on a tie-in basis; in other words, that the British offer a million dollars worth of textiles to the Soviet Union, and if the Russians bought them, they would get a certain amount of machine tools. To textile manufacturers in England this would seem to be a very attractive prospect; and, well, the Russians are perfectly happy to have people have such ideas. Why are they? Because they need machine tools badly.

I think Secretary Acheson is fundamentally correct in his statement two weeks ago wherein he said that any American who goes to this conference is simply in one way or another letting his name be misused for Soviet propaganda purposes in Soviet economic warfare against the West.

QUESTION: Doctor, do you feel that this forced economic integration of Soviet Russia, and the industrial development that will result from it will in time get the satellites to be willing partners with Russia, or do you feel that the force that is involved will only intensify the normal hatred that exists against Russia?

DR. SCHWARTZ: That is a very complicated question, because it is psychological as well as economic. I would argue that the evidence so far is that the resentment of these people toward the Russians has been increased by what the Russians have done in this area, because the Russians imposed their own system of work organization, business, and social organization; they have seen that the standard of living of these people is reduced toward the Soviet standard of living. The people can see that they are building factories which will not make the things they want, but will make things to be used for military purposes, and so on.

In the long run they can use the steel from a steel plant either to make guns or to make passenger cars. Maybe in the long run the Russians will have enough steel so they will permit the satellites to make passenger cars. That may change the atmosphere; I don't know.

RESTRICTED

I think that for the period we can talk about--in the short-range future--I don't see any possibility of this industrial development promoting any greater love for the Russians in these countries. The industrial development has shaken up the lives of the people. The Soviet government has forced people to leave the farms and go into the cities to work. It has forced them to be crowded into horrible, overcrowded quarters in the cities. It has forced them to live completely different lives. People are relatively conservative. They don't change very easily or very willingly. If they are forced to change drastically, as they are in eastern Europe today, there must be an inheritance of resentment which will continue for some time at least. What will happen when the people who are now five, six, or seven years old grow up to be adults may be another story, but that is still 20 or 30 years away.

CAPTAIN ALEXANDER: I am just wondering what effect this east-west integration and reorientation of the satellites toward Russia has really had on what they could get from western Europe. Also what else do they need besides the manufactured products that you spoke about, that is, the machinery that they are really deficient in to carry out their plan of development?

DR. SCHWARTZ: Obviously, if you integrate a very large area, you would use its resources more efficiently than you would if that area were broken down into small parts. You might perhaps find new surpluses or increase your surpluses for foreign trade. That might be one result.

But, so far as what they need goes, I think they need a lot of things. The need is more pressing in some cases and less pressing in others. I would assume from my own reading that the most pressing need at this present time probably is for the nonferrous metals. At least that would be my guess.

Besides the nonferrous metals they need a wide variety of chemical raw materials. They could use certain types of machinery, like electrical equipment. They would like some of this new machinery. They produce some of this machinery themselves, but they know that the Western World is producing more advanced equipment which they would like to get. They probably could use some more natural rubber, although they are building up their synthetic rubber industry. They might want some petroleum in some areas. There is a wide list of products that they want to get.

Now, I think the fundamental problem of the Soviet leaders is this: Let us imagine that we are the Soviet leaders sitting with Mr. Stalin in

RESTRICTED

the Kremlin. What are they trying to do economically? They are trying to prepare for war and to expand their armament economy very rapidly. It is now taking a substantial fraction of the national product to do that. That is the first objective.

Secondly, they are attempting to increase the capital investment of the Soviet economy itself. They are engaged in building a number of gigantic hydroelectric irrigation projects, as well as plants for steel, petroleum, and various other things.

Thirdly, they are attempting to promote the industrialization of eastern Europe and China. This is an immense order, isn't it? They are attempting to do all this without making too deep inroads on the standard of living of their people, for morale reasons.

Well, even the Russians are only human beings. They have only finite resources. The obvious result is that their resources are being strained. If the outside world could be influenced to give them for 10 years 10 billion dollars worth of materials, that would ease their problem enormously.

There has been a lot of Soviet discussion of the international economic conference. Of course, according to the Soviets, they are holding it merely because they want to help the poor capitalist world solve all its problems. For the first time in the last two issues of the Soviet government's information bulletin about this economic conference, some gentleman mentions that sacred word "credit" and points out the fact that, after all, the Soviet Union has a very good credit record. It pays its obligations and there might be a profit for the capitalists if they are willing to give the Soviet Union credit. It may be the Russians will come forward with a proposition for a billion dollars worth of credit from someone, and show that they have always had good credit; that they will say: "We have paid our debts in the past and we are a good risk."

CAPTAIN ALEXANDER: Like they did to Sweden?

DR. SCHWARTZ: Yes. Sweden was a very interesting case. It was one of these bad blunders made at the end of the war. Some economists in Sweden said that our economy was going to go into a condition of unemployment and chaos. It did nothing of the sort. But, anyway, in Sweden these economists agreed that the American economy was going to go into a depression in the next one or two years; they said: "The

RESTRICTED

only way that we can save ourselves from the United States depression is to get ourselves a very substantial market. The Soviet Union is that market.* So on the insistence of these gentlemen the Swedes gave Russia a five-year credit, which they figured would take them over the period of the American depression. They are still looking for this post-war depression. It was a very sad experience for Sweden.

QUESTION: Doctor, your comments about this program of integration with the satellites are very interesting. I can't quite agree with your optimism about its success. Looking back on the history of the Russians during the postwar period in their various industrial programs that they have had since World War II, I am wondering what they have actually achieved, what progress toward their goals has occurred since 1948.

DR. SCHWARTZ: That is a very fair question. I want to answer it honestly.

I assume that you have heard before from other speakers here various estimates of things like Soviet steel production, petroleum production, and so on. I won't try to go into that. But I would say that it is a fair question to ask whether the Soviets really have achieved their objectives.

When I make a statement about the Soviet steel production being 31 million metric tons and someone else has something less, the way we find it out, is because the Russians have published certain data. So you take their figures and you multiply, add, subtract, and divide and you come up with 31 million tons.

But what is to prevent the Russians from putting out false data? May be it was only 15 million tons. Maybe their percentage was too high and instead of 31 million tons, it was only 7.5 million. After all, I doubt if even the CIA could have an agent in every Soviet steel plant to give you plant-by-plant production figures, so you could see whether it was 31 million tons or not. There is always that possibility.

However, I would say this: It is probably untrue that they are faking this, at least to any such magnitude as to make it 15 or 20 million tons or even 25 instead of 31. I would say that we have perfectly objective evidence that the Soviet military and economic potential today is great. I would simply cite two things to show that.

You gentlemen will recall at the end of the war, when the atomic bomb became public knowledge, all the experts, including General Groves,

thought it would take the Russians at least 20 years to make an atomic bomb. They were the optimists. The pessimists thought they would never make it. The Russians made an atomic bomb in three or four years. They have exploded at least three atomic bombs and presumably are busily stockpiling them now. We will probably get reports about more atomic bomb explosions.

Now, we know perfectly well that an economy to be capable of making atomic bombs has to be a pretty darn highly developed economy and have a high level of technical efficiency and have the good manufacturing facilities and the complex productive machinery required. The Russians obviously have them at the atomic bomb level. That is one piece of evidence.

The next piece of tangible evidence that we have, again to our discomfiture, is the Soviet aircraft in Korea. I know that some Air Force generals say that our weapons are superior to the Soviet weapons. Earlier there were reports that the Soviet airplanes were better than our planes. I don't know whether they are or not. But I will say one thing that is clear, that is the Soviet Migs in Korea are darned good airplanes. Well for a country to produce jet fighters that are as good as ours at least--and that is what they have done--it has to have a well-organized industry, high technical efficiency, and so on.

All I am trying to say is that at the points where we have been able to get tangible evidence of what the Russians have done, the Russians have shown up with flying colors. Why should we assume that they haven't been making similar progress in other areas that we don't know about? And if they are, it is a plain national security matter for us to make one other assumption--that they are basically at the level as indicated by the American specialists.

COLONEL RINDLAUB: I am sorry that we haven't time for any more questions. Thank you very much for a splendid lecture.

(15 July 1952--250)S/mmg