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COMMITTEE ON SOVIET ECONOMIC POLICY

SOVIET ECONOMIC PENETRATION IN THE MIDDLE EAST

Note by the International Staff

The Economy

1. The Middle East, which contains almost 70 per cent of the non-communist world's proven oil reserves, (unevenly distributed over the area) also contains vast stretches of desert and other terrain that cannot be usefully exploited. There exist fertile areas, some of them not fully developed, upon which most of the 90 million⁽¹⁾ inhabitants of the area earn their living by raising agricultural crops, mainly cotton, cereals and citrus fruits. Although the standard of living is low, the resources available, given capital for their development, would permit an expansion of agriculture and industry. There are, however, many factors limiting development, including a social structure which makes it difficult to create savings and which inhibits enterprise, as well as a large primitive population.

2. There are vast differences in wealth among the countries of the Middle East. Some states derive large revenues from oil⁽²⁾, others have built up modern economies (Lebanon and Israel), while the remaining⁽¹⁾ are poor countries. It is within this latter group that some young leaders are attempting to build up modern states, and the frustrations inherent in the old social structure create for these leaders a sense of urgency. Associated with this is a fierce nationalism expressed, inter alia, by attempts to strengthen the state with arms, and to develop and diversify the economy. Irrigation and flood control schemes necessary to expand agriculture, the transportation networks needed to open up the country, and the arms for a modern state, all require large amounts of capital. Lacking oil revenues, these countries must rely upon the sale of their agricultural products or upon investment from abroad for the funds needed to carry forward their development plans. But nationalism in these countries has created an atmosphere where foreign investments, especially from Western powers, are either threatened or not welcomed.

(1) For breakdown by country, see Table 4, Annex 2.

(2) Iran, Iraq, Saudi Arabia, Kuwait, Bahrein and Qatar are the main oil producers; Syria and Lebanon derive some revenue from oil transit rights.

NATO SECRET

3. It is within this milieu, exacerbated by the Arab-Israeli tensions, that the communist bloc has seized every opportunity to extend its influence by offering arms and economic aid. As late as 1954 the Soviet press was attacking Arab leaders, but in the following year this attitude shifted abruptly to suit the new Soviet line in the Middle East. In 1955 Czechoslovakia signed an arms deal with Egypt and conveniently agreed to purchase the Egyptian cotton surplus. The following year Syria and Yemen received arms from the Soviet bloc, and almost all of the countries in the Middle East signed trade agreements with the communists. Afghanistan also received a large long-term loan. Trade between these areas increased and, following the Suez crisis in November 1956, Egypt and Syria received additional supplies of arms from the Soviet bloc, and promised to deliver in return more cotton.

4. For the next eight months or so the Soviet bloc confined its activities to strengthening trade ties with many Middle Eastern countries by signing new agreements, opening trade offices, arranging air transport rights, exhibiting at trade fairs, training Middle East technicians and, in general, stabilising their gains made over the previous two years. In July, 1957, however, a large-scale economic loan was offered to Syria, and arms shipments to that country were resumed. The Sudan, which is having difficulty in selling its cotton crop this year, has been approached by the Russians with an offer to buy the surplus and to provide long-term aid for development. The Lebanese who had accepted Western aid were subjected to economic pressure by Egypt and Syria.

5. Soviet policy in the Middle East at present seems to be concentrated on winning over those countries which control the oil transport facilities. The economic interests of the oil producing countries lie with the West (Russia herself is a net oil exporter), and although the governments may press for a larger share of oil revenues they have no desire to lose their markets in Europe. Russia is, it is true, showing great friendliness to one big oil producer, its neighbour Iran, and has signed a number of agreements with her. But apart from this, and gestures towards Sudan and Afghanistan, it appears as though Russia's principal aim is to strengthen Egypt and Syria. The Russians seem to feel that the sales of arms and the glittering promises of economic aid will help Egypt and Syria to gain prestige in the Arab bloc, challenge the position of the leaders of the oil producing countries, and keep the entire Middle East in a state of turmoil.

6. The increase in Soviet influence in the Middle East has been secured at relatively little cost. The largest cost has been for military assistance and this is estimated at no more than \$500 million and perhaps as little as \$300 million. The promises of economic aid may reach \$200 million, but the actual amount received by Middle East countries so far has been almost negligible.

7. Until recently Russia has not played such an obvious rôle in the economic offensive. The European satellites, which have a more natural trading pattern with Middle Eastern countries (machinery traded for primary products), had previously conducted most of the business for the bloc. Even the first Egyptian arms deal, although almost certainly financed by Russia, was arranged

by Czechoslovakia. The major parts of the Middle East's trade with the communist bloc is still carried on by the satellites, but Russia has concerned herself directly with the latest offers to Syria and the Sudan, and has been the largest buyer of Egyptian cotton.

8. It is not yet clear how Russia will be able to develop this economic offensive in future. On one hand, the economic interests of the oil producing countries lie with the West, while other states have received much more assistance from the West than they could ever expect from the communist bloc. Egypt has been suffering from a shortage of foreign exchange because of her heavy trade with the Soviet bloc, and has recently been trying to restore her position in traditional Western markets. On the other hand, the USSR has succeeded in creating the impression that she is ready and able to grant large-scale loans for economic development; Syria is probably hoping to become the future showcase of the Middle East. The strong nationalist feeling in this area is conducive to countries accepting Soviet trade offers and loans, if only to show their independence from the West. All of these factors make it clear that the Middle East will present further opportunities for penetration, and the Russians have shown in the past their ability to take full advantage of such possibilities.

Palais de Chaillot,
Paris, XVIe.

ANALYSIS BY COUNTRIESSYRIA

1. Syria is not a poor country by Middle East standards. Her economy is stable, the budget is balanced, and her production of cotton, wheat, barley, tobacco and her textile industry provide sufficient exports to pay for her import needs. A seven-year development plan for about \$190 million was instituted in 1955, and the financing of this was to come from Iraq Petroleum Company transit dues and internal sources. However, the large increase in defence expenditures in 1956 and 1957 strained the economy and it became clear that Syria could not meet all its objectives for development and defence without foreign assistance. Syria had already received about \$140 million in arms deliveries from communist countries in 1956, but was still conducting only about 5% of its trade with them. During 1957, however, almost one-half of Syria's cotton sales (the most important export) had gone to the Soviet bloc. In July 1957 the Syrian Defence Minister and other officials visited Moscow and there arranged for a long-term, low-interest loan which was finally settled in Damascus in October. The amount of this loan is as yet unknown, but may range from \$100 million to \$350 million, and presumably will include assistance for roads, railways, irrigation schemes, port facilities at Latakia, and manufacturing plants. All of these schemes are sound and can be absorbed by Syria over the next few years. It is likely that the Russians have asked for repayment in Syrian wheat and cotton, the main products of the country. This should tie the Syrian economy increasingly to the bloc, since the total of Soviet arms deliveries and promised economic aid is equivalent to about three years of Syrian exports. It has also been reported that the USSR is sending large numbers of fighter aircraft and bombers to Syria.

2. Syria holds a strategic position in the Middle East by straddling the oil transport lines from Iraq and Saudi Arabia to the Mediterranean outlets. She is also a big customer of Lebanon and could threaten Lebanon's position as entrepôt centre for the Middle East. The danger of Syrian-Egyptian concerted economic action against other Middle Eastern countries was made all too clear in November 1956.

EGYPT

3. Egypt has a population problem as her growing number of people depend upon the limited agricultural land of the Nile basin. Large amounts of capital would be needed to increase the arable land, and Egypt faces the same problem as Syria, that is, the inability to arm and develop simultaneously without outside aid. Egypt depends upon cotton exports for almost all of her foreign earnings, and from late 1955 onward, when she arranged for an arms deal from Czechoslovakia, Egypt has become increas-

NAFO SECRET
ANNEX I to
AC/89-WP/18

-6-

ingly committed to the communist bloc for the disposal of her cotton crop. Egypt's economic ties with the Soviet bloc have remained strong in the past few months. It now appears that about one-half of all her cotton sales is to communist countries. The USSR is now the largest buyer of Egyptian cotton, with communist China and Czechoslovakia ranking second and third respectively. Sales to France and the United Kingdom, traditional buyers, have fallen sharply. Other economic deals with the Soviet bloc have included the purchase of a powerful radio transmitter from Czechoslovakia, orders for four ships from Poland, and a substantial order for an electrical network from East Germany. The USSR has continued to supply large quantities of wheat and petroleum to Egypt, and it has been reported that Russia has offered to assist the Egyptian General Petroleum Company in its oil explorations.

4. This shift in trade to the Sino-Soviet bloc has not been without cost to Egypt. The loss of hard currencies has been met by curtailing imports, so that, while the balance of payments has not deteriorated, there has been a fall in the supply of goods. Rising prices have followed this shortage, and Egypt has been searching for means to increase trade with the West. The price of Egyptian cotton, artificially high as a result of the barter agreement with the Soviet bloc, has been reduced to western countries by means of discounts ranging from 7% to 20% for various kinds of foreign exchange. In October 1957 the Egyptians curbed barter deals, so that essential import goods would be obtained at world prices. The Egyptians at this time appear anxious to rebuild their trading relationships with the United Kingdom and France, and have held financial talks with them recently in Rome.

THE SUDAN

5. The economy of the Sudan is quite primitive, and agriculture is the main source of production, cotton being the main item of export. Sudan's trade is mainly with western Europe, Egypt and India, the Soviet bloc accounting for no more than 4% of Sudan's total trade. There is almost no manufacturing or mining, despite recent government attempts to establish some small-scale industry, and most fuel, clothing, machinery and some food must be imported. In recent years the level of cotton exports has more than covered imports, and the surplus funds have paid for development projects. In 1957, however, difficulties in marketing their cotton crop led the Sudanese into a position of seriously considering a Russian offer to buy their surplus and perhaps provide assistance for Sudan's projects. This year, the Gezira Marketing Board, responsible for marketing most of the cotton, set the price too high. It is likely that this price was related to the Egyptian one, which was only nominal, most of the sales being on a barter basis with the Soviet bloc. Along with this high price, the Sudan also had a record crop of over 600,000 bales of cotton, and less than half has been sold. If the crop remains unsold, the financing of the development projects will be hampered, and the Government, facing an election next year, will be in a difficult position. In October 1957 the cotton price was lowered, but it is not yet known how much this will stimulate sales.

NAFO SECRET

-6-

Lebanon

6. The Lebanon is the banking and entrepôt centre for the Middle East. Her exports only cover about one-sixth of her imports, but income from trading, banking and related activities makes up the difference. Indeed, the Lebanese economy is one of the healthiest in the entire area. At the same time, good relations with Syria are necessary for carrying out these activities. Any dispute with Syria which would seal off the border would deprive Lebanon of access to Iraq, Jordan and inner Arabia. The planned expansion, with Soviet aid, of the port facilities at Latakia, Syria, may threaten the position of Beirut.

7. Some economic pressure was put on the Lebanon by Egypt and Syria when they placed an embargo on the import of Lebanese apples in September 1957. Although the total amount involved was relatively small, it was directed at a pro-western group in the Lebanon and was indicative of the pressure that Egypt and Syria could exert on many Middle Eastern countries. Consultation within NATO led to increased purchases by Germany, France and the United States, so that the problem was solved. Nevertheless, the embargo may have intimidated Lebanon. It has been reported that, following Ibn Saud's visit to Beirut in October 1957, Lebanon was reconsidering its commitments under the Eisenhower doctrine.

Iran

8. About two-thirds of Iran's foreign exchange earnings are derived from oil exports, and she appears anxious to develop her other industries. To this end she has been willing to co-operate with Russia. A border-river agreement has been signed with Russia which provides for joint development of a hydro-electric and irrigation project. Iran and Russia have also signed a transit agreement allowing duty-free movement of goods through either country. This will result in a saving for Iran on shipments to Europe. A three-year commercial agreement, calling for trade of \$35 million per year, was also approved. The Soviets have also offered Iran an unlimited credit at 2% interest, partly for use in expanding port facilities on the Caspian Sea to handle a larger volume of USSR-Iranian trade.

Other Middle Eastern countries

9. Soviet bloc activities with other Middle Eastern countries have been very limited. Poland has offered to buy 100,000 tons of phosphate from Jordan. This offer, plus a previous sale to Czechoslovakia of 80,000 tons, would account for one-fifth of Jordan's exports. However, Jordan is quite poor and is unable to exist on her export proceeds, requiring a subsidy to pay for most of her essential imports. Egypt and Syria have reneged on their promise to share with Saudi Arabia the cost of a subsidy to replace that previously granted by the United Kingdom. Only a loan from the United Kingdom of £1½ million⁽¹⁾ and \$50 million of United States aid has kept Jordan solvent this year. Yemen has been granted a \$3 million credit by East Germany for the construction of 1,000 kilometres of telephone lines, while the Soviet bloc countries have built a jetty at Salif to permit

(1) So far, loans from the United Kingdom to Jordan for development have totalled 27½ millions.

NATO SECRET
APPENDIX I to
AC/89-W/18

-8-

the unloading of the arms previously promised. The \$100 million loan granted by the USSR to Afghanistan in late 1955 is being slowly implemented; oil storage facilities, small assembly plants and some irrigation schemes have been started. Arms have also been delivered. Probably one-half of Afghanistan's total trade is now carried with the Soviet bloc. Bulgaria has obtained a meat-packing concession in Ethiopia, and no significant Soviet bloc activities have been reported in Israel, Iraq, Saudi Arabia or Libya.

NATO SECRET

-8-

TABLE I

Development of Trade between some Middle East Countries
and the Sino-Soviet bloc

Reporting countries	Imports from and exports to Sino-Soviet bloc countries							
	Millions of US dollars				Percentage share in reporting country's total trade			
	1954	1955	1956	1957	1954	1955	1956	1957
Turkey	100.1	160.0	119.3	125(a)	12.3	19.8	16.7	
Israel	11.3	8.8	8.5		3.0	2.1	1.8	
Iraq (b)	3.7	10.3	13.8		1.8(b)	4.0(b)	4.5(b)	
Iran (b)	27.6	37.2	36.8		12.4(b)	13.4(b)	13.2(b)	
Lebanon	5.2	8.6	9.9		2	3	3.3	
Syria	5.9	7.3	19.1		1.5	2.2	5.5	
Egypt	83.5	141.8	216.5	534(a)	9.8	15.3	23.0	43
Sudan	12.2	8.3	13.2		4.3	2.9	4.1	
	249.5	382.3	437.1					

- (a) Estimates based on trade during first quarter.
(b) These figures include imports only.

Source: AC/89-WP/11

TABLE 2

Importance of each communist country in the
Middle East's trade with the Sino-Soviet bloc

Countries of origin and destination	Trade of the Middle East				
	Total Trade (Exports plus imports with)	Imports from		Exports to	
		The Sino-Soviet Bloc			
	1956	1955	1956	1955	1956
Sino-Soviet Bloc Total percentage	100.0	100.0	100.0	100.0	100.0
USSR	17.5	38.2	25.4	16.8	11.6
China	15.8	1.8	10.7	30.4	19.7
Bulgaria	3.1	2.3	1.7	0.9	4.1
East Germany	5.8	3.4	8.1	3.1	3.9
Hungary	6.0	5.1	8.3	12.4	4.1
Poland	7.7	3.5	5.2	6.5	9.6
Rumania	10.2	17.3	15.2	9.5	6.3
Czechoslovakia	33.9	28.5	25.4	20.4	40.7

Source: AC/89-WP/11

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TABLE 3

Importance of the USSR, the European Satellites and China in some Middle East countries' trade with the Sino-Soviet bloc

Total Country Trade (exports plus imports) with the bloc in 1956 = 100

Reporting Middle East Countries	Countries of Origin and Destination			
	Sino-Soviet Bloc Total % = 100	of which %		
		USSR	Satellites	China
Turkey	100	10	90	
Israel	100	25	75	
Iraq (a)	100		42	58
Iran (a)	100	51	20	29
Lebanon	100	28	72	
Syria	100	8	82	10
Egypt	100	18	66	16
Sudan	100	3	76	21

(a) Imports only

Source: AC/89-WP/11

TABLE 4

Population of Middle East Countries in 1954

<u>Area</u>	<u>Population</u> (in millions)
Aden	0.2
Aden Protectorate	0.6
Afghanistan	12.0
Bahrain	0.1
Egypt	22.7
Iran	20.7
Iraq	4.9
Israel	1.7
Jordan	1.4
Kuwait	0.2
Lebanon	1.4
Libya	1.1
Muscat and Oman	0.6
Qatar	0.03
Saudi Arabia	7.0
Sudan	8.9
Syria	3.7
Trucial Coast	0.1
Yemen	4.5
Total	<u>91.8</u>

Source: Statistical Handbook of the United Nations, 1955.