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REPORT OF THE ECONOMIC COUNTERMEASURES WORKING GROUP

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REPORT OF THE ECONOMIC COUNTERMEASURES WORKING GROUP

INTRODUCTION

The Working Group was established upon the approval of NSC 132/1 of June 11, 1952 to develop plans for economic countermeasures to possible Soviet action against Berlin. This report represents the results of approximately a month's study of this problem. While Soviet harassment of Berlin appears to have subsided for the present, a very real possibility exists that such action will be intensified later this year when the Contractual Agreements and the EDC Agreement come up for ratification in Western Germany.

Terms of Reference

This report is not concerned with positive measures for the support of Berlin in the event of Soviet blockade or other form of intensified action against the city. Plans to support or strengthen Berlin, such as stockpiling, airlift or psychological action, lie beyond the scope of the present Working Group's assignment.

This report deals with countermeasures in the economic field designed to put pressure on the Soviet bloc for the purpose of inducing the lifting of Soviet restrictions which may be directed at Berlin. It should be noted, however, that while plans are being developed in response to to the Berlin situation, they consist by and large of measures which could be applied in any similar situation in which the Western Allies wish to apply economic pressure to achieve a specific objective or to counter certain specific actions on the part of the Soviets. In a sense, therefore, the report represents a survey of the economic weapons available to the Allies in situations short of war.

It is assumed that Western countermeasures would be lifted when our particular objectives in Berlin are obtained. Such countermeasures should therefore be of a temporary and reversible character distinct from the related field of multilateral trade security controls developed over the last three years through the Paris Consultative Group and Coordinating Committee. The Working Group is convinced that a program of countermeasures would encounter the strongest opposition from Western European Governments if they suspected that it was being proposed by the United States partly with an eye to bringing about further long-run restrictions on East-West trade.

Lessons from the Soviet Blockade of Berlin 1948-1949

Severe Soviet restrictions over trade, travel, and communications between Berlin and West Germany were in effect from late June 1948 until May 12, 1949. Eventual retaliatory measures were limited to a counter-blockade

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by Western Germany and western Berlin against the Soviet Zone of Germany.

The blockade against Berlin was precipitated by the West German currency reform of June 1948 which itself resulted in a sharp reduction of interzonal trade. Prohibition of shipments to the Soviet Zone from Western Germany did not take place until September 1948 after extensive discussions in Berlin and Moscow on the currency reform problem had broken down. This prohibition stopped all legal commodity movements, but did not apply to mail, newspapers, gift parcels, or international transit traffic. International transit traffic originating in or destined for the Soviet Zone was, however, prohibited beginning in February 1949 from passing through Western Germany.

The economic impact of the West German counter-blockade upon the Soviet Zone and the effect of that impact upon Soviet policy are extremely difficult to assess. A Department of State intelligence report at that time stated that although certain sectors of the economy, notably the investment program, were affected more severely than others, the general stagnation of the Soviet Zone economy during the blockade period resulted primarily from Soviet economic exploitation and political failure. It was generally thought that the success of the Allied airlift and the adverse reaction in public opinion over much of

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the world were larger factors in the Soviet decision to lift the blockade than the state of the East German economy. On the other hand, a report of the US Military Attache in Moscow suggests that it may be significant that less than two weeks elapsed between the stoppage of international transit traffic across Western Germany and the beginning of discussions in New York which led a few weeks later to the simultaneous lifting of all restrictions on transport between Eastern and Western Germany.

No counter-measures against the Soviet Zone or other Soviet-dominated areas were applied outside of Germany. In fact, imports into the Soviet Zone from Western countries other than Western Germany increased during the blockade. Imports from Western Germany, including goods illegally procured directly from that source and goods moving indirectl from Western Germany through third countries to the Soviet Zone, remained an important source of supply for scarce industrial items. The third country pattern of trade with Western Germany developed by the Soviet bloc since that time appears to have been perfected to the point where action by Western Germany alone, even if politically acceptable to the German Government, would without doubt be less effective than it was in 1949.

In the light of this situation, and in view also of the Federal Republic's virtual sovereignty under the

contractual

contractual arrangements with the Western occupying powers, it would seem unlikely that Western Germany would take action alone in the trade field as it did in 1948 and 1949.

Criteria in Planning Possible Countermeasures

The Working Group has surveyed a fairly wide range of measures in the fields of trade, finance, transport, communications and related areas, which might be taken [1] by the United States alone, and [2] measures which would require joint action or [3] action by other countries. Although the interrelations of various measures are indicated, no recommendations are made as to the timing or sequence of their application. Such determinations can be made only in the light of actual but unpredictable future circumstances and political realities.

Measures considered were assessed against the following criteria.

1. The estimated effect of each measure on the Soviet bloc, both in terms of economic impact and of political, psychological or propaganda impact. Care has been taken in applying this criterion to make no pretentions of knowledge where the facts are not available for an educated estimate . This point is particularly relevant to the question of economic impact.

2. The estimated economic and political effect of each measure on the countries of Western Europe. Naturally,

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the Working Group has been better able to estimate these effects than those on Soviet bloc countries. This is particularly true of the economic impact. The political or psychological impact will in any event be conditioned by previous actions of the Soviets directed against Berlin.

3. The feasibility or ease of application of the measure from an administrative, statutory, and political standpoint. The element might well be a crucial one in any situation short of overt Soviet military action against Berlin even including a total land blockade.

4. The reversibility of the measure or the ease with which it might be relaxed or withdrawn.

5. The acceptability of the measure by other countries A good deal is known about the attitudes of other governments from our three years of experience in the Consultative Group-Coordinating Committee. Each country of Western Europe, of course, has its peculiar economic and political problems, and the extent to which attitudes stemming from these problems will be mitigated by over-riding considerations of the Western stake in Berlin can only be definitively ascertained by consultation with these governments.

All the above criteria are obviously related and interacting. Their order of importance is not necessarily that indicated in the above listing, particularly as they are applicable to individual countries.

COUNTERMEASURES

COUNTERMEASURES IN THE TRADE FIELD

Further direct restrictions on East-West trade would be the most effective method of applying economic pressure against the Soviet bloc. Many of the measures later discussed under the topics of finance, transport and communications are ancillary to direct trade controls. All of the work and agreements completed in the past four years by way of developing the International Security Lists and supplemental measures constitute a broad and sound base for such countermeasures as might be multilaterally agreed in connection with a new Berlin crisis.

It is possible that at any stage in the application by Western European countries of trade controls more restrictive than those now in effect, the Soviet bloc might take action to bring about a complete and abrupt cessation of East-West trade. For this reason the Working Group at the outset estimated the net dollar cost of replacing the supplies of coal, grain, timber and certain other products now obtained in the Bloc. This estimate is presented later in this report with a discussion of the supply and marketing problems involved, but without reference to the foreseeable highly complex and varying economic, political, and psychological difficulties in individual Western European countries.

Trade

Trade measures open to the United States are limited to restrictions on imports since this country already maintains virtually a complete embargo on exports to the Soviet bloc. Such imports as the United States now receives from the Bloc are of no significance to our national economy. Western Europe, on the other hand, relies on the Soviet bloc for important supplies of fuel, food, timber and other essential materials. In fact, the limited amount of strategic goods which Western European countries permit to be exported eastward represents the main bargaining element making it possible for them to receive essential imports from the Soviet bloc. In view of the foregoing, import controls are discussed as a possible measure for the United States to apply, whereas an intensification of export controls could only be made effective by our Western European allies.

IMPORT CONTROLS

1. The Consular Invoice Technique

Delays or denials in processing consular invoices constitute a measure which, for reasons cited above, would be appropriate only for the United States to apply. This device, which now being employed against imports from Czechoslovakia as a method of bringing pressure for the release of Mr. Oatis, could be readily extended to apply against the rest of the European Soviet bloc. At present, this measure

measure would affect only those imports subject to ad valorem duties. However, the requirements for consular invoices could be extended, perhaps with some administrative difficulty, to goods subject to specific duties as well, thus affecting most imports from the entire Bloc. If that were done and instructions given to our missions in Eastern European countries that no consular invoices were to be processed, the effect would be a virtual termination of imports from the rest of the European Soviet bloc.

Assessed against the established criteria, this device recommends itself because of its ease of application and reversibility. Its economic impact would not be very great, but would be felt, as indicated in the discussion of the next measure. The political and propaganda impact, if judged on the basis of the present Czechoslovak case, would not be spectacular.

2. Direct Import Restrictions

Direct import restrictions are likewise appropriate only for the United States. The Treasury Department has the authority under Section 5(b) of the Trading with the Enemy Act of 1917 to restrict or embargo imports from the European Soviet bloc. This could be done of itself or as part of a more drastic and sweeping blocking action. It would be accomplished by means of a licensing system, and would

would require the cooperation of United States banks in the same manner as would a full blocking.

This method of import restriction or embargo would be less flexible, and administratively more difficult to apply than the extended consular invoice technique. Its political and psychological effect would be greater, if for no other reason than its attendant publicity and formality. Its economic impact, while not very great, would be noticeable as indicated below.

Total US imports, i.e. general imports, from the European Soviet bloc in 1951 amounted to approximately $64 million. Seventy per cent of the value of US imports from the USSR, which totalled $27 million, were furs. Under the ban imposed by Section 11 of the Trade Agreements Extension Act of 1951 on imports of certain furs, some 40 per cent of 1951 fur shipments will be eliminated in 1952. Imports from Czechoslovakia, which in 1951 amounted to $22 million, have been drastically curtailed in connection with the Oatis case. US imports from the entire European Soviet bloc in the first quarter of 1952 amounted to $10 million.

64
27
$91 million

It is difficult to judge the impact on the Soviet bloc of closing this source of dollar exchange, for we have no knowledge as to its importance to the bloc. There have been

Do we pay for all this in cash?? Dollars are a highly strategic item!

been reports that Czechoslovakia is experiencing a shortage of dollars, partly as a result of its inability to obtain consular invoices for exports to the US. In any event, the Working Group wishes to caution against underestimating the potential impact of the loss of dollar earnings on the glib assumption that Soviet gold would immediately be employed to make up the difference between the Bloc's dollar needs, whatever they are, and its supplies from remaining sources.

In addition to the elimination of the relatively small and diminishing volume of direct US imports from the Bloc, there would be some curtailment of US imports from third countries, primarily Western European, of goods originating in the Bloc. There is no accurate estimate of the magnitude of such indirect imports.

EXPORT CONTROLS

As stated above, there is nothing in the export field that the US alone could do beyond its present virtual export embargo that would have any economic effect on the Soviet bloc. Total US exports to the Bloc in the first quarter of 1952 were only $236,000 as compared with total 1951 exports of approximately $3 million.

Nevertheless, the possibility should not be overlooked of the US achieving some desired psychological effect by official public announcement of the fact that almost

nothing

nothing is licensed for export to the Bloc. As a slightly more extreme measure, the US might announce that henceforth no export of any kind will be licensed for Soviet bloc destinations. This would be tantamount to a declaration of open economic warfare, but even as such its psychological impact, in East and West, might not be great in view of current acknowledged US licensing practice, which is well publicized by the Communist propagandists. There would, of course, be no difficulty of a statutory or administrative nature in the US Government taking such a step.

The concerted action which Allied countries might take in the export control field represents the only area in which increased trade pressures would be felt appreciably by the Soviet bloc. In devising specific export control measures the Working Group was guided by the following considerations:

1. First, a major element in any proposals of the US will be their feasibility from a negotiating standpoint, or, stated differently, their acceptability by the governments of Western Europe.

2. Secondly, the use of existing International List commodity classifications and ratings, which already have wide acceptance based on a four-year accumulation of

negotiations

negotiations and administrative agreements, would greatly minimize the negotiating problem.

3. Thirdly, the use of established categories on which a large amount of analysis already exists would greatly simplify the problem of implementation, quite apart from the negotiating problem and that of policy acceptance by the other governments.

4. Fourth, any of the proposals set forth below will raise Western European fears of Soviet retaliation in the form of a cessation of present Soviet bloc exports of economic importance to the West. It seems unlikely, therefore, that the Western European nations would be willing to discuss any of these proposals seriously without assurances that the United States would be willing to underwrite their access to alternative sources of supply. The additional problem of alternative markets for Western exports should not be minimized in this connection because that issue might well become a political stumbling block, particularly in the cases of the French and Italian Governments, which must contend with sizeable Communist minorities in their Parliaments.

5. Finally, an important factor considered by the Working Group in developing the following proposals is the disparity between the US Security Lists and the International Lists. Thus, there are a few items on US List I-A which are not

included

included in any International Lists. About one-half of the items on US List II-B are not on any International Lists. Since the desirability is obvious of clearly separating trade restrictions imposed in connection with pressure on Berlin from long-run security control measures, the Working Group decided to ignore this disparity and to draft its proposals entirely on the basis of the present International Lists. To have done otherwise might arouse suspicion and cause delay at the time the proposals were presented to the Western European governments.

Sic!

The specific proposals of the Working Group follow.

1. Delay Issuance of Licenses for all International List III (no multilateral control beyond surveillance and exchange of information) Commodities

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This would be a relatively mild measure to indicate how seriously the West regarded Soviet pressure on Berlin. It would not cause any immediate reduction in shipments of List III commodities. Its effect, therefore, would be primarily political or psychological. It is believed that this step could be taken with relatively small negotiating difficulties. It might cause some administrative bother to the Government of Denmark, which does not now require specific licenses for any List III items and for the UK, which does not require specific licenses for some List III goods.

Don't under-estimate these difficulties!

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It is assumed that through the business community, as well as through Soviet intelligence, the fact of this administrative delaying action would rapidly become public knowledge, possibly on a fairly wide scale. It must be recognized that the effects of this measure in the political and propaganda fields would be modified to the extent that the information reached a more limited public audience than would be the case with a formal publicized step of this kind. This question of formal publicity should be left open for discussion with the Western European governments.

This limited step appears to be quite feasible administratively, easily reversible, and on balance quite readily negotiable. As stated above, its short-run economic impact on the Soviet bloc, and for that matter on the West, would be slight. (Total List III exports of COCOM to the entire Soviet bloc amounted to $63 million in 1951).

2. Reduction of Actual Licensing to Some Arbitrary Percentage of a Base Period for Some or all International List III Commodities.

In effect, this would amount to subjecting some or all of International List III items to International List II treatment--that is, to quantitative export control. It

would

would eventually have an impact on shipments to the Bloc, although this would not be felt for some time. It would give rise to "prior commitments" problems, thereby possibly hampering its negotiability. The real significance of this step would be in the political and propaganda fields rather than in the economic. It would not impose an important administrative burden, and from that standpoint appears to be a measure that could be readily varied in intensity or even withdrawn.

3. Extension of Embargo Treatment to Some or All Parts of International List II

List II items are currently subject to quantitative control on the basis of agreed quotas or quid pro quo, the latter being considered a tighter form of control.

This step would have an economic impact, not so much in terms of the volume of exports as in terms of the apparent critical value to the Soviet bloc war-making potential of such exports as are now permitted. COCOM country shipments of List II items to the Bloc in 1951 were approximately $47 million, as compared with a previous estimated yearly average of $80-85 million. On the basis of information currently available, it is believed that 1952 shipments will be in the neighborhood of $30 to $35 million. It is important to note, although at the risk of over-simplifying, that this amount of strategic goods plus certain items on

List III

List III, such as rubber, represent the key bargaining element making it possible for the West to receive some $800 million in imports from the Soviet bloc.

The negotiating problem in obtaining Western European agreement to this step would probably begin to become formidable. In particular, the prior commitments problem would be relatively more serious than with respect to Item 2 above, since List II contains a higher component of capital goods requiring long lead times. The Western governments would also be faced with the problem of making good a loss on equipment made to Soviet bloc specifications, a loss roughly estimated at some $40 million.

The political and psychological significance of this step would be distinctly greater than for the previous ones, in both East and West.

4. Total Embargo of International Lists I, II, and III and Possibly all Non-Rated Items

This step could only be regarded as a countermeasure to extreme Soviet action against western Berlin, such as a total land blockade. The very nature of the step would render the negotiating problem most formidable, although the prior Soviet action would presumably have created an atmosphere of crisis which would ease the way for negotiations.

The political and propaganda effects of such action

would

would be profound. The economic impact, if there is any validity to the design of the International Lists, would be appreciable. This is not to say that the economic impact would be great in terms of the gross national product of Soviet bloc, but rather that the bottlenecking effect in critical industries would be intensified, thereby causing significant dislocations, particularly in the satellite states.

Total Western European (OEEC countries) exports to the entire Soviet bloc, including Communist China, in 1950 were about $790 million and in 1951, about $805 million. Approximately half of the value of these exports was constituted of "hard goods". Total imports from the Bloc in these years were about $980 million and $1,075 million, respectively. Roughly, half of these imports consisted of food, feed, fuel, timber and other essential raw materials. The composition of this trade is further examined below in the discussion of the foreseeable problems involved in its cessation.

The closer the Western Allies move toward a situation of complete trade embargo with the Soviet bloc, the more difficult the problem of reversing such action becomes. Many and complex readjustments in trade and financial relations would be curtailed which would take time to establish (see p.) and which, once established, would

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be difficult to unravel, even assuming a willingness on all sides to do so. It is a safe assumption, therefore, that if the Berlin situation deteriorates to the point where such drastic measures are called for, the likelihood of rapidly reversing those steps would not be great.

COUNTERMEASURES

COUNTERMEASURES IN THE FIELD OF FINANCE

1. Extension of United States Foreign Assets Control Regulations

These regulations now apply only to Communist China and North Korea. If extended to the entire Soviet bloc they would freeze all of the bloc's dollar assets in the United States and prohibit, except pursuant to license, all financial and trade transactions between the United States and the Soviet bloc. Such action would result not only in an embargo on imports into the United States of merchandise of Soviet bloc origin whether imported directly from the bloc or through third countries, thereby denying the bloc a source of foreign exchange, but would also (a) prevent the acquisition of foreign exchange by the Soviet bloc through dollar remittances to bloc countries; (b) prevent the dollar financing of trade between Soviet bloc countries and third countries, allied and neutral; (c) prevent the foreign branches and subsidiaries of U.S. companies from carrying on business with the Soviet bloc; and (d) prevent the acquisition of dollar exchange by the Soviet bloc through sale of gold to the U.S. This last result, however, could be effective only if the cooperation of most other countries were obtained.

A general blocking action could be instituted by the Treasury under the authority of the Trading with the Enemy Act of 1917. An administrative Foreign Assets Control apparatus now exists, although it would have to be expanded; and substantial recent experience has

been

been gained in the implementation of the Foreign Assets Control Regulations respecting Communist China and North Korea.

The political and psychological impact of such action would be great, and its economic impact would be felt both within and without the Soviet bloc. Although Soviet bloc assets in the U.S. at present are undoubtedly at a minimum level, a complete blocking would affect the trade of third countries with Soviet bloc countries in so far as such trade is dollar financed. There is no estimate of the magnitude of such trade, a substantial portion of which may possibly be in contravention of existing security trade controls.

A general blocking action would not be a flexible type of countermeasure in that it could not be easily relaxed or removed because of administrative difficulties and probable domestic opposition to such relaxation. (The same would be true, to a lesser degree perhaps, of direct import controls alone.)

The key to the effectiveness of unilateral U.S. blocking controls against the European Soviet bloc lies in the acceptability of the principle of such action to other friendly countries, particularly those in Western Europe. It goes without saying that such action taken unilaterally by the U.S. would be less effective than if undertaken jointly. Moreover, if the countries of Western Europe were unsympathetic to the idea of blocking, they might take positive steps at evasion, thereby reducing its effectiveness. The political consequences in that event would be unfortunate.

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In its present operation of blocking controls against Communist China and North Korea the U.S. Treasury has had a satisfactory degree of success in solving the major technical problems of (1) determining the origin of goods for which payments are to be made and (2) ascertaining the ultimate recipients of payments.

In the event the United States extended its Foreign Assets Control Regulations to the European Soviet bloc, supporting action by friendly governments, would be an adjunct of our controls. Quite clearly, support of our controls by the Swiss Government would be of outstanding value, since, both during World War II and during the life of the controls directed against Communist China, Switzerland has played the role of middleman in many transactions of doubtful character. Specifically, abandonment of the bank secrecy laws would assist tremendously in the execution of any enforcement program undertaken by the United States with respect to blocking controls. Unfortunately, the devotion of the Swiss to the secrecy laws, the existence of which gives them a competitive advantage in the international banking field, is so great that it seems clear that only Soviet action threatening the national existence of Switzerland could lead them to abandon their present position.

Supporting action by the sterling bloc and by other countries of Europe, although perhaps of less value than support by the Swiss, would, nonetheless, be significant in the enforcement of our controls, and should be sought.

2. Parallel

2. Parallel Financial Controls by Western Europe

Agreement by allied countries to restrict East-West trade and other transactions can be implemented through the use of financial controls, accompanied by other measures which the laws, regulations, and experience of the cooperating countries indicate would be the most useful.

Success in obtaining the agreement of free countries to adoption of controls similar to United States blocking controls would enable any desired degree of stifling of East-West trade. The difficulties which would face other free countries in arriving at this decision are well known. It is a decision which, as in the case of a total trade embargo, could only be regarded as an extreme step, thereby posing a most difficult negotiating problem--except as modified by a general atmosphere of crisis.

The decision having been made, however, blocking controls could be instituted rapidly and become effective almost immediately. The long experience which Western European governments have had in maintaining exchange controls, allocating foreign exchange among foreign countries and commodities, and negotiating bulk purchase contracts would provide the administrative machinery and experience for rapid and effective action. Further, the cooperation and continuous consultation between treasuries and central banks on matters related to financial controls would facilitate the effectiveness of the operation. Finally, the existence of such forums as are provided by the NATO should facilitate arriving at the decision to cooperate, as well as agreement on the scope of control and techniques to be used.

Experience

Experience gained during World War II might be useful in implementing a decision to seek the adoption of blocking controls by other friendly countries. During World War II the United States made vigorous efforts to obtain the adoption by friendly foreign countries, particularly in Latin America, of controls similar to our wartime Foreign Funds Control. (In Europe the problem was then non-existent, since the United Kingdom had comparable controls already in existence and the other belligerents were already occupied.) Both by means of multilateral meetings and bilateral negotiations, the United States endeavored to acquaint the Latin American Republics with the nature of our controls, and to urge them to take parallel action. United States success in achieving its objective in this field ranged from considerable in the case of some countries to negligible in the case of others.

COUNTERMEASURES IN THE TRANSPORT FIELD

In the field of transport, out of a considerably larger number of measures which have been examined, the Working Group has concluded that eight have some merit and warrant careful consideration at such time that countermeasures against the Soviet bloc are desired. Because of their nature these eight cannot be listed in a satisfactory progression, since most of them are susceptible of a varying severity of application. Considered from the general perspective of increasing difficulty of negotiation and agreement with other countries, however, they may be listed as follows:

1. Imposition

1. Imposition of Bunkering Controls or Restrictions X

This measure would be largely implemented by private oil and coal companies and would not require formal governmental action. An extremely flexible measure, since only a relatively small number of companies are involved, it could range in severity from a delay in providing bunkers or ships stores to Soviet bloc-owned or operated vessels to a complete denial of bunkers. Although European governments might be unwilling to request oil or coal companies to cooperate in severe measures of this type unless the situation in Berlin became very critical, they would possibly agree to requests for less severe measures or "spot" denials of a temporary nature.

2. Further Restrictions on the Repair and Overhaul of Vessels Serving the Bloc. X

As with the denial of bunkering facilities, restrictions on the general repair and overhaul (COCOM restrictions already cover certain types of repairs and installations) of Soviet bloc-owned or operated vessels could vary considerably in severity and could presumably be carried out largely without open governmental participation. Since Western shipyards repair an estimated annual total of 150-200,000 GRT of Soviet bloc owned vessels, severe restrictions would have a substantial effect upon bloc shipping. Such restrictions would, however, have a harmful economic effect in Western shipyards.

Any restrictions agreed upon should include "modernization" installations as well as general repair work.

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The attitudes of European governments to restrictions of this type will probably depend upon the extent to which open responsibility on their part can be avoided. This should not be difficult in the less severe stages.

3. Restrictions Over the Use of the Panama, Suez and Kiel Canals by Soviet Bloc-Owned or Chartered Vessels

The international status of and the international conventions relating to each waterway mentioned above would prevent closure to Soviet bloc vessels. It is believed possible, however, that irritating restrictions over the use of these waterways by bloc vessels could be effected without great difficulty. Rigid interpretation of regulations, careful inspection of cargo, and "administrative" delays would be measures of some irritation to Soviet bloc vessels, or if carried far enough, of economic impact as well.

This type of control would be implemented by the Governmental authorities concerned. In the case of the Panama Canal, the consent of no other country would be required, while in the Suez or Kiel Canals, action would have to be taken by the British or German Governments.

The Working Group does not believe that any action of this nature should be considered in the Dardenelles.

4. Limitation or Restrictions on the Movements of Bloc-Bound Rail Cargoes

This type of measure is similar to the one immediately above in that it would be suitable for certain harassing or slow-down tactics

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at a rail crossing point to the bloc, but would not be suitable for complete denial. It is also weakened by the fact that sidings facilities near most border crossing points probably would not permit any extensive holding of bloc-bound cargoes. Governmental agreements, not only with countries with border crossing points to the Soviet bloc, but also with countries originating shipments to the bloc, would be required.

5. Increased Controls Over Time, Bareboat and Voyage Charters for the Soviet Bloc

This measure would be considerably more effective than those listed previously in denying shipping and shipping facilities to the Soviet bloc. It has been discussed at some length in COCOM, where it has been opposed by many countries as a rather extreme measure. It is believed that sufficient legislative authority for such a measure already exists in most countries, and that reluctance stems from actual policy differences. It is doubtful whether the European countries will agree to an extension of such controls in the absence of a severe Berlin crisis.

6. Denial of West European Free Port Facilities to the Bloc

A complete denial of free port facilities probably would be acceptable to West European countries only in the event of a complete trade embargo. A less-than-complete denial of such facilities would, however, be an extremely difficult measure to administer, and would require the introduction of controls in an area which until now has been relatively free of restraint. Such controls, for commercial and

other

other reasons, would be strongly opposed by many of the local interests in any free port city.

The free ports are, however, most important sections in the Soviet illegal trade channel. Successful controls over these areas would do much to curtail illegal East-West trade.

X

7. Limitation or Prohibition of Carriage of Strategic Goods to the Bloc by Western Vessels and of the Movement of Western Vessels to Bloc Ports

Such measures are now already in effect for the carriage of goods by United States vessels in violation of established export regulations and for the movement of United States carriers to Communist China. This field is therefore one for action by the Western European countries alone. They have not agreed that measures of this nature on their part are advisable, although such measures would decidedly improve the efficiency of present Western export controls.

The prohibition of carriage of certain strategic goods to the bloc by Western vessels has been advocated in COCOM in support of general trade restrictions. Efforts to obtain agreement on this point should be continued as a device for enforcing existing trade restrictions rather than in the context of the Berlin situation. The prohibition of movement of Western vessels to Soviet bloc ports is a measure which Western European countries would be likely to agree to only in the event of a full trade embargo against the Soviet Fare. In that event such a prohibition could serve as an additional means of enforcing the trade embargo.

8. Restriction

8. Restriction or Cancellation of Soviet Bloc Overflight and Landing Rights in Western Europe

Under the policy established by NSC 15, Soviet and satellite aviation operations to Western Europe have been progressively curtailed during the past few years and are now limited to the Polish carrier LOT flights to Brussels and Paris (now flown twice weekly) and the Czechoslovak carrier CSA flights to Copenhagen and Stockholm (thrice weekly). LOT has been granted overflight and landing rights to Copenhagen and Stockholm, but these are not exercised at present.

The Belgian carrier SABENA, the Dutch KLM and SWISSAIR now fly to Prague; in addition Soviet permission is granted for Scandinavia's SAS, Israel's EL AL and Dutch KLM flights to Vienna. No Western carriers other than the occupying powers fly into Berlin.

Although it would appear likely, it cannot be stated with certainty that rescission of Soviet bloc carrier rights in Western Europe would result in retaliatory action stopping the larger number of Western flights into Prague and Vienna. Withdrawal of the remaining bloc rights would have little economic effect upon the bloc countries concerned; the political and psychological effects probably depend upon the extent to which they are related in the minds of the bloc authorities to the situation in Berlin.

A possible Soviet reaction to the rescission of landing and overflight rights might be increased harassment of an Allied airlift in Berlin. It is believed more likely, however, that other factors

will

will determine the Soviet attitude towards the airlift. Aircraft of the nationality of the Occupying Powers have the right to fly over the Soviet Zone to and from Berlin. This right is in no way related to satellite landing and overflight rights in Western Europe. In any event, relating Western pressure on satellite aviation to Soviet interference with a possible Berlin airlift is strictly conjectural.

Other Measures in the Economic Field

Beyond the measures discussed above, the Working Group has considered briefly the following: (a) prohibiting US nationals resident abroad from engaging in business with the Soviet bloc; (b) terminating all postal and communications facilities between the United States and the bloc; (c) the denial of fishing or similar privileges in Western territorial waters; and (d) further restrictions on the movements of American and Soviet bloc personnel.

The question of preventing US nationals resident abroad from engaging in business with the bloc is an aspect of the broader question of blocking controls. It poses vexing legal problems, and is a marginal type of action, the effects of which are immeasurable and probably insignificant. The Working G roup has therefore discarded this as a possible counter-measure.

As to (b) above, the informal view of the Postmaster General is that, although an order cutting off mail service to Soviet bloc countries might be issued under existing statutory authority, there is no precedent for such action. The Post Office Department would regard such a course as undesirable since it is difficult to see what benefits could be gained by the United States that would outweigh the disadvantages. It is the consensus of the Working Group that, in view of the difficulty of administering such an order and the formidable administrative apparatus that would be needed, as well as the possibility

of easy

of easy circumvention through third countries, this measure is not feasible. Similarly, in the field of telecommunications it is the considered judgment of the State Department technicians that there are no opportunities for retaliatory measures that would injure the Soviet bloc more than the western nations.

Regarding (c), it is the opinion of the Working Group, based on consultation with the State Department's adviser on Fish and Wild Life, that there is nothing that the US alone or in concert with other Western countries could do by way of bringing pressue on the Soviet bloc in this field. Soviet bloc countries exercise virtually no fishing or similar rights in the territorial waters of the United States or other Western countries, except in the Spitzberfen area, where they are well protected by treaty to which both the USSR and the US adhere.

(d) above is definitely not a feasible measure for the United States to take. The main argument against the United States taking such action is the fact that the Soviet bloc, by the very nature of its police states, can do this type of thing so much more effectively than can the Free Nations. Further, there are definite constitutional limitations on the United States Government which make the enforcement of this type measure most difficult if not impossible. Finally, the existence of United Nations headquarters in New York City offers a wide loophole through which Soviet bloc countries could avoid the effects of such action.

EFFECT ON WEST OF CESSATION OF EAST-WEST TRADE. DOLLAR COST OF REPLACING WESTERN IMPORTS FROM SOVIET BLOC.

At any stage in the application of economic measures more restrictive than those now in effedt, it is possible that the Soviets would take corresponding or much more severe measures in retaliation. There is, of course, no point in conjecturing as to which countermeasures by the West would bring about any particular act of Soviet retaliation. It is necessary, however, that the West be prepared for the extreme situation of a complete cessation of Soviet bloc exports to Western Europe.

Before undertaking measures which might produce this result, Western European countries would undoubtedly want assurances that the United States was ready to replace or to finance the replacement from other Free World sources of the supply of coal, grain, timber and other essential products now obtained from the East.

It is estimated that in the first year the total dollar cost of replacing these supplies would be approximately $525. As an offset to this, it is estimated that approximately $190 million worth of goods now marketed by Western Europe in the Soviet bloc could be diverted to dollar markets or used to replace dollar imports. The net additional dollar cost, therefore, would be in the neighborhood of $335 million in the first year. The assumptions and derivation of this estimate are set forth in the Appendix.

The above type of exercise cannot begin to take account of the impact of a complete cessation of East-West trade on individual Western

Western European countries. While it is true, for instance, that the combined receipts of Polish coal by Norway, Denmark, Sweden, Austria, Italy, and Switzerland total only some 7 or 8 million tons -- a little better than one percent of total Western European consumption requirements -- the degree of dependence of each of these countries individually is very great.

In the case of Norway, imports of bread grains from the Soviet bloc are of sufficient importance in terms of total supply (one quarter of Norway's consumption) to constitute a problem, but the quantity involved, namely 100,000 tons, is not large. On the other hand in the case of Italy the quantity of bread grains received from the Soviet bloc has been fairly large (250,000 tons), but is small in terms of total consumption (2-3 percent). With respect to coarse grains, only the United Kingdom is in a vulnerable position in terms of its dependence on the Soviet bloc (UK imports have been running at about 10 percent of consumption requirements),but there the cutting of meat rations, if replacements were not readily forthcoming, might well have serious political repercussions. Similarly only the UK is so dependent on Soviet bloc supplies of lumber (imports from the bloc in 1950 accounted for 13 percent of consumption) as to constitute a serious immediate problem if that source were suddenly closed.

A major problem which must be dealt with immediately is how the additional net dollar cost of imports from the Soviet bloc would be financed. It is especially necessary to have at least tentative and general agreement within the United States Government on this subject

prior

prior to undertaking active consultations with other governments on economic countermeasures. MSA has been requested to submit a paper on this subject to the Working Group.

Internal Western Impact of Cessation of East-West Trade

Assuming that adequate financing and alternative supplies of these essential commodities were in sight, the domestic impact of a complete rupture of East-West trade would be greatest in those countries whose export markets would be hurt most. France and Italy probably would present serious problems in this respect because of the large Communist Parties in those countries which would take immediate measures, whatever they might be, to capitalize on increased difficulties in marketing textiles and citrus fruits. Danish and Dutch agricultural products would give rise to difficult problems, especially in the light of U.S. restrictions on cheese imports from which those countries have already been suffering. Norwegian and Icelandic fish would present marketing problems, and would give rise to internal economic and political problems, as would to some extent non-strategic manufactured goods in all Western European countries.

SECRET - SECURITY INFORMATION

CONCLUSION

The Working Group has come to the conclusion that there are a number of measures in the economic field(these are outlined in some detail above and are summarized below) which should be given serious consideration as counteraction to Soviet restriction of access to or from Berlin. A program of action for each measure has not been drawn up in detail because of the complexity of many of the measures, the absence of the necessary international agreement, the widely varying degree of severity with which almost each one could be implemented, and the need to adapt each measure to future economic and political realities.

The Working Group has also come to certain conclusions regarding the general use of these measures:

1. Despite the fact that during the 1948-49 blockade of Berlin no countermeasures against that blockade were taken outside of Germany, it would be a completely unrealistic procedure to confine action against new Soviet restrictions to action within Germany.

2. Cooperation by the Western countries concerned would be much more easily obtained were some formal action to be taken, probably by the United Nations, regarding the state of affairs in Berlin. The United States Government would probably re-open the Berlin case in the United Nations for other reasons but a formal call by the U. N. on the U.S.S.R. to cease its undesirable activities in Berlin, formal condemnation of the U.S.S.R. because of its action in Berlin, or any

agreement

agreement reached by the U.N. which would provide a legal or moral basis for action by Western European countries would considerably improve the changes for their cooperation.

3. As importent as any economic impact on the Soviet Union of the measures listed above would be the psychologic effect of agreement by the Western powers to take steps of such a drastic and far reaching nature.

4. Whatever the economic impact of counter restrictions may be, these should be considered as only one of several fields for action by the Western countries. As in the 1948-49 blockade, the success of the West in sustaining the city's economy and the success in creating widespread public opinion against the Soviet move to drive the West from Berlin might do as much or more to attain Western goals than economic retaliation.

APPENDIX

Estimated Net Additional Dollar Cost to Western Europe of a Cessation of East-West Trade

It is difficult to estimate with accuracy what Europe's net additional dollar cost would be in the event of a complete cessation of trade between Western Europe and the Soviet Bloc. For one thing, the available data do not enable us to determine with precision even the physical quantities of the major commodities now imported by Western Europe from the bloc that would have to be replaced. This is, however, a relatively minor imperfection. Far more difficult is the task of estimating the net dollar earnings that Western Europe might reasonably be expected to realize from sales in the Free World of goods formerly exported to the bloc.

Notwithstanding the difficulties of estimation, it is believed that the figure indicated in the table below--about $335 million in the first year of trade cessation--gives a useful approximate answer to the question. This figure is probably a conservative estimate of the net dollar cost.

Estimated Gross Dollar Expenditures

Gross dollar expenditures for the first year (assumed to coincide with fiscal 1953) are estimated at $526 million. With one or two exceptions, this estimate is based upon the physical quantities of imports from the Soviet Bloc that were realized during fiscal 1952 or are believed to be programmed for fiscal 1953 within the framework of existing trade agreements.

agreements. The unit dollar values in all cases reflect estimated average dollar prices for fiscal 1953.

Exceptions to the foregoing statements about quantities of imports from the bloc concern the entries for bread grains to replace bloc livestock products on a calorie basis, lumber, and miscellaneous imports.

Because of tight Free World supplies of livestock products, it will not be feasible to replace bloc livestock products except by providing either the calorie equivalent in bread grains or a combination of items other than bread grains (such as cheese, dried beans, skim milk, sugar, and fish). The dollar cost of a bread grain replacement program for livestock products is estimated at $45 million. The same figure would probably take care of the dollar cost of the alternative combination (especially if Scandinavian fish were made an important part of the bundle of commodities).

In the case of lumber, ties and pitprops, the estimated figure of $54 million is based in part upon British import plans which, for financial reasons, call for a reduced volume of imports coupled with a reduction in commercial stocks of timber. The dollar cost of replacing Bloc timber would be increased about 25 percent if, in the interest of maintaining balanced inventioris in Free World countries that rely on water-borne imports, it were deemed inadvisable to effect the presently planned reduction in the level of British lumber stocks.

The figure for "other merchandise imports" is an arbitrary estimate of the dollar cost of acquiring minimum amounts of important commodities

at present

at present being imported from the Soviet bloc. The figure reflects the composition and value of recent miscellaneous imports from the Bloc, as reduced by estimates of comparable commodities that (a) have been moving eastward and that could now be retained for consumption in Western Europe, and (b) probably could be acquired in non-dollar Free World markets against delivery of hard goods that are now moving to the Bloc.

Estimated Gross and Net Dollar Earnings

The most controversial part of any attempt to measure the additional dollar cost of a cessation of East-West trade is to be found in the dollar earnings that Western Europe might realize from the sale in the Free World of goods that are now moving to the Bloc.

On the basis of the latest commodity export data (for 1950), as supplemented by figures of total exports (without breakdown) for 1951, it is estimated that Western Europe is selling about $400 million a year of machinery, vehicles, metals, and key industrial raw materials ("hard" goods) to the Soviet Bloc. Many of such goods are sold at a substantial premium as compared with Free World prices, and in some cases equipment is being produced to bloc specifications and thus will probably not be marketable in the Free World. Deductions of $50 and $40 million have been made for premiums and goods made to bloc specifications, respectively, to indicate the approximate Free World value of the hard goods that could be sold outside the Soviet Bloc in the first year of trade cessation. This net value is about $310 million.

The critical

The critical question is the amount of such hard goods that are saleable for dollars. Given the fact that the OEEC countries are already exerting great efforts to maximize exports to the dollar area, it is likely that something substantially less than the total available supply of additional hard goods can in fact be saleable for dollars. A renewed effort coupled with a crisis demand for hard goods in the non-U.S. dollar area may be expected to provide an outlet for OEEC hard goods equal to about a third of the quantity that has been going to the bloc, i.e., $100 million.

The overseas territories of some Western European countries (mainly the sterling area) ship such raw materials as rubber, tin, wool, jute, and the like to the Bloc. If these are withheld from the Soviet area and diverted to Free World dollar markets, it is estimated that about $90 million of dollars could be realized. Under sterling area arrangements, Britain acquires the resulting dollars against sterling credits to the accounts of supplying overseas areas. Since Britain would have extra dollar earnings of the sterling area would represent a net addition to Western Europe's dollar earnings within the context of a cessation of East-West trade.

Thus, estimated gross dollar expenditures incident to trade cessation totalling $525 million would be subject to a deduction of $190 million for dollar earnings, leaving net additional dollar expenditures of $335 million for the first year of trade cessation.

The following table recapitulates the main facts of the foregoing discussion.

Estimated Net Additional Dollar Cost of a Total Cessation of East-West Trade,

First Year (1952/53)
(In Millions of Dollars)

Dollar expenditures:

Coal—8 million tons @ $20 delivered		160
Bread grains—800,000 tons, direct replacement		92
—400,000 tons, replacing livestock		45
Course grains—1,200,000 tons		114
Lumber, ties and pitprops—1,022,000 cu.meters		54
Other mdse. imports (based on commodity data for 1950) a/		60
		525
Sugar	12	
Minerals	15	
Base metals & mfrs.	8	
Chemicals and fertilizers	9	
Protein feedstuffs	6	
Miscellaneous	10	
	60	

Dollar earnings:

Hard goods sent to Bloc (based on commodity data for 1950) b/		400	
Less: Premium on sales to Bloc	50		
Loss on goods made to Bloc specifications	40		
	90		
Net hard goods exportable to the Free World		310	
Hard goods assumed to be exportable for dollars (about one-third of total) c/			100
Raw materials exported to the Bloc by the overseas territories and now saleable in Free World for dollars c/			90
Total estimated dollar earnings			190
Net additional dollar expenditures by Western Europe			335

Footnotes on page 2.

a/ Excluded: meats, dairy products, fats and oils, fruits and vegetables, paper, textiles, machinery, live animals, inedible animal products, iron and steel, and miscellaneous (total, about $200)

b/ Since total exports to the bloc in 1951 were about the same as in 1950, it is assumed that hard goods exported have also remained about the same.

c/ Assumes some measure of crisis buying for dollars if there is a cessation of East-West trade.