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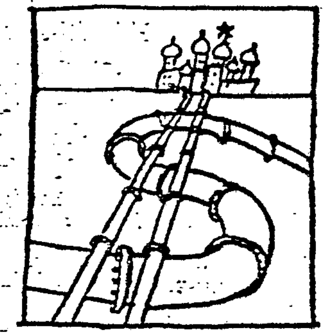

How to embargo Russia

At this week's price for natural gas, the proposed pipeline to carry billions of cubic feet of the stuff from Urengoi in Siberia to West Germany, France and other west European countries will earn the Soviet Union, after servicing debt on the project, hard currency worth anything from $5 billion to $10 billion a year from 1985 onwards. The lower of those two figures will mend Russia's stretched balance of payments to the tune of Russia's entire present earnings of hard currency from its sales of armaments and gold. The higher figure of $10 billion a year would be enough to replace the bulk of Russia's present foreign currency earnings from its largest but increasingly scarce and shaky export resource, which is oil.

That is the main reason why President Reagan's administration in Washington chose to cause fury among its allies by trying to stop them building the pipeline to carry the gas. The lesser reason is concern about increased west European dependence on Soviet energy. Last year 15% of western Europe's gas supply came from Russia. In two of the past three years both Austria and West Germany have at some moments had to suffer 50% cuts in gas supply from Russia because of cold weather and other—non-political—supply difficulties. The Urengoi line now stands to increase that dependence by half in aggregate, and by much more in key urban areas. One day the threatened supply cuts may be political.

Shocking people can be right

Against all this, the West Germans and other Europeans argue that their dependence on Soviet energy will still be less than choking, particularly since they are taking steps through Europe's gas grid to mitigate it; and that Russia will expand its hard-currency commitments to eastern Europe and beyond to match any extra freedom of action that a sudden dollop of gas money is likely to bring it. They add—and here they are certainly right—their pipeline contracts with Russia had already been signed when Mr Reagan stamped his foot. He is trying to compel American companies and their licensees to renege on perfectly legal contracts.

The shock that President Reagan has administered to his European partners over the pipeline can be made worthwhile only if one thing happens: if the much wider issue of east-west trade as a whole is at last tackled inside the western alliance. The uncouth monetary shock delivered to America's partners by Mr Nixon in 1971 did good once the pieces had been picked up. The issue now is not the huge—in our view undesirable—pipeline itself. It is the utility of promoting or restricting east-west trade as such, and the question of which bits should be promoted and which restricted. If America and its allies can get down to fundamentals, more might be achieved than by America misguidedly trying to bottle up each genie when it has already escaped from the bottle.

Principle one. General east-west trade, even inflated as it was during the 1970s, is of little overall value to the west: it accounts for less than 2% of gnp in most western countries. Fuels apart, what comes in the form of bottled stewed fruit and caviar is not vital. If any elementary Ricardian division of labour were applied in the communist world, in the place of its extravagant export subsidies, much of the rest that is sent to the west would not be sellable at its full cost price anyway.

Principle two. The same is true in Russia. The smaller your estimate of Russian gnp (if such a thing can ever be measured in western terms, see page 45) the bigger the proportion you can claim is accounted for by foreign trade. But, except for grain, the whole Soviet Union is organised to operate, if need be, as a siege economy.

Principle three. Both Russia and the west are vulnerable to cut-offs in east-west trade precisely because that trade takes place at the margins of both their economies. In deep recession the margin of any western economy is where it hurts: when big bits of AEG are already going bust in West Germany, loss of a pipeline from Urengoi can make the difference of yet more thousands of AEG jobs lost or kept. In a Russia where the military budget pre-empts the best people and the best factories, and inefficiency squanders much of the rest, it is the marginal western-provided beef, bread, 1970-model Fiats, Levi jeans, Pepsi Colas and Pink Floyd that help to keep people quiescent. Both sides can survive without east-west trade; neither side wants to. That is what gives both sides their increasing leverage over the other. So:

Conclusion one: be ready to keep general east-west trade going only wherever security and political aims are not threatened. At its margin, east-west trade may, over decades, tend slightly to relax the bureaucratic stranglehold of the party priviligentsias in the communist world. But it is at best a glacial progress, and should not outweigh the use of trade and credit, when needed, as part of the west's armoury against its communist adversary.

Conclusion two: do not subsidise your prices or your credits to Russia and eastern Europe by one jot. If you do, as western banks are belatedly discovering, all you will have achieved is an eventual threat of bankruptcy against yourself. Governments: do not underwrite cheap credits with taxpayers' guarantees.

Conclusion three: by a strict policy of lending only to bankable risks, be ready to force Russia to underwrite the credit of its satellites. That will open more market doors in the east than gift-lending that simply props up the existing system (as in Poland) until it explodes and then has to be even more repressively reconstructed.

Conclusion four: reinforce Cocom, the gentlemen's-agreement committee in Paris which vets and vetoes sales to communist countries of munitions, atomic materials and related industrial-commercial products. Technology is moving so fast that Cocom needs a staff of scientists and engineers operating a constant review system (not long, inflexible lists) under political supervision. Snag to be removed: at present any Cocom member can veto an embargo, so make majority voting mandatory.

Conclusion five and most vital: trade and financial sanctions rarely stop trade, but they often hamper it—and that may sometimes, and at a cost, work as a

A deal on west-west trade?

The disagreement between the United States and western Europe over trade with the communists is compounded by a series of west-west, American-Europe, rows over their own trade. The loudest arguments at the moment are about exports of steel and food from the EEC, which the Americans say are unfairly subsidised.

Such disagreements are not new. It is inevitable that the world's two biggest and most liberal trading entities should constantly argue about the rules governing their $500 billion worth of world trade each year. High unemployment on both sides of the Atlantic has sharpened the quarrel, because it has increased the power of protectionist lobbies.

It is important that both sides should try to calm the dispute before it boils over into the trade war that has long been expected but has never actually taken place. This should have been the purpose of last month's seven-country western economic summit at Versailles. Instead, the summiteers spent their time pulling wool over each other's eyes on other subjects. Both Americans and Europeans agreed not to look closely at the other side's ideas about the economic relationship with Russia. President Reagan failed to make it clear what he would do about the gas pipeline from Russia if he did not get his way on that wider issue.

The Americans have reason to complain about certain European subsidies. That is not sufficient reason for them to impose protectionist tariffs, since these are merely another way of subsidising their own producers. Yes, the European steel industry is subsidised. But, no, the American commerce department's decision last month to slap duties of up to 40% on EEC steel imports was not the right response, because it failed to take into account what the EEC is doing to put things right. The EEC governments have at last begun to mend their ways on steel bail-outs, and now most of the subsidies are being used to pay sacked workers' redundancy payments and to slim the industry. In the past six years EEC steel firms have sacked 25% of their workforce. This ought to be welcomed, not penalised, by the Americans.

Besides, the Americans provide disguised subsidies for their own steel producers, through the trigger-price system, which has stopped cheap steel imports that undercut American prices. The only difference is that the American steel industry is mainly subsidised by steel consumers paying higher prices rather than by government handouts. Negotiators are now trying to work out a deal to restrain EEC exports, but the excessive demands of American steel firms—they want to cut the EEC's market share back, rather than just freeze it—are blocking their path.

When it comes to agricultural trade, the boot is on the other foot. Europe's protectionist common agricultural policy has long—and rightly—been the cause of American fury. In the last round of trade-freeing Gatt negotiations, the Americans decided that they had no chance of persuading farm-vote-loving European governments to agree to radical changes. But the Americans did extract a promise from the EEC that it would not expand its share of world trade, at the Americans' expense, by dumping even more of Europe's food mountain outside its "traditional markets".

The Europeans have flagrantly broken that promise. They have encouraged a huge expansion of subsidised exports of European farm goods like beef, sugar, dried milk, poultry and—most worryingly for the United States, the world's breadbasket nation—cereals. Last year, the EEC became a net exporter of cereals for the first time ever.

The Americans are right to complain about this, particularly as farmers' incomes in the United States have just fallen by more than in any year in the past half-century. It is no good for the EEC to point out that it still imports $29 billion more food than it exports. If the laws of comparative advantage were given free rein, the EEC would import far more. The Europeans are on better ground when they point out that the Americans are increasingly subsidising their own farmers; but this is partly just a reaction to European subsidies.

What is the best way to forestall a full-scale trade war? Clearly not by another blurry summit of presidents and prime ministers. The Gatt ministerial meeting in November would be a better occasion for trying to tie up a package deal on the most awkward issues. America's trade representative, Mr Bill Brock, hinted at such an approach when trade officials from America, Europe and Japan met in May. He told his colleagues that, unless they were prepared to make concessions, he would find it hard to divert the wave of protectionism washing through congress in Washington. An old gambit, but a sensible one.

The Americans could promise to lift their duties on European steel exports, if the Europeans agreed to stick to their promise to phase out subsidies when the present round of steel-mill closures is over (meantime a quota could be negotiated). And the Europeans could promise to freeze their spending on food-export subsidies, and not to introduce new protective measures against American products like corn gluten (a cheap substitute for animal fodder which is undercutting Europe's over-priced feed grains).

The new slogan for transatlantic harmony should be: "we will stand up to our lobbies if you will stand up to yours". The best way to save jobs is to outlaw "job-saving" protectionism.

political deterrent against invasions of Afghanistan and martial laws in Poland provided the sanctions are (a) certain to be applied (b) not just by one western country but by all. The sanctions after Afghanistan did help postpone the clamp-down in Poland. They sent signals that such Soviet actions were forcing the west to walk backwards down the road to detente. Likewise, America's grain embargo was starting to hurt when it was withdrawn by President Reagan. But the grain and other sanctions would have hurt much more had such friends as Argentina, Canada, Australia and Europe not filled the gap.

That fifth conclusion—if you cannot introduce sanctions in unison, you are likely to [illegible] key to present and past west-west disputes over east-west trade. Mr Reagan's men are probably right to argue for sanctions to discourage more Afghanistans. They are probably right to discourage outsize projects that give outsize benefits to an economy whose biggest single sector is devoted to building means to intimidate the free and third worlds. But the Americans would now also be right if they were to trade in their belated pipeline embargo in return for a real and combined western arrangement to outlaw cheap credit and to police hi-tech and big-ticket trade deals. That is what the pipeline shock should be used to achieve.