

NSC  
DOCUMENT

~~SECRET~~

*M/R*

February 9, 1951

To:

I am attaching two copies of the report on "U.S. Policies and Programs in the Economic Field which may Affect the War Potential of the Soviet Bloc" which is being transmitted to the President today by the Secretary of State. Appendices A and B are not attached to the report, but copies can be made available at a later date.

HENRY R. LABOUISSSE, JR.

~~SECRET~~

FEB 13 1951  
2700-3

*NSC Documents*

~~SECRET~~

55303

February 9, 1951

*Paka*

Report to the President  
*NSC Doc. 104*  
on

U.S. Policies and Programs in the Economic  
Field which may Affect the War Potential of  
the Soviet Bloc

DEPARTMENT OF STATE

~~SECRET~~

*AD/EE-3*

~~SECRET~~

INDEX

	<u>Page</u>
Introduction . . . . .	i
Part I: Conclusions . . . . .	1
Part II: Recommendations . . . . .	4
A - Recommendations on Substantive Measures . . . . .	4
B - Recommendations as to Organization . . . . .	10
Part III: Bases for Conclusions and Recommendations . . . . .	11
A - Vulnerability of the Soviet Bloc to Existing and Tightened Western Economic Controls . . . . .	11
B -- Economic and Political Aspects of Trade of Non-Soviet Countries with the Soviet Bloc . . . . .	15
C - Techniques for Denying Resources to the Soviet Bloc . . . . .	19
1. Complete Embargo . . . . .	19
2. Export Controls . . . . .	22
3. Preclusive Operations . . . . .	28
4. Financial Measures . . . . .	31
5. Blacklisting . . . . .	35
6. Control of Technology . . . . .	35
7. Shipping Controls . . . . .	37
8. Civil Aviation . . . . .	39
D - Positive Programs for Economic Strength . . . . .	39

~~SECRET~~

~~SECRET~~

-i-

## INTRODUCTION

As Soviet aggressive intentions have become more and more evident, the United States, and under its leadership other important nations of the free world, have progressively adopted stronger and stronger measures, both positively to build up their own strength and negatively to reduce the strength of the Soviet orbit. The establishment of the North Atlantic Treaty Organization, the European Recovery Program, and improved international relationships in the fields of trade, finance and economic development, have helped constructively to create strength in the free world. Negative measures to impair the Soviet war potential began with the imposition by the United States, in March 1948, of export restrictions or prohibitions on the shipment of strategic goods to the Soviet Union and the satellite countries of Eastern Europe. In the following months and years these controls were progressively tightened, and, through international negotiation, were extended to cover exports of similar items from Western European countries. Today, an important segment of the free world's exports to Soviet-dominated areas has been prohibited or brought under control.

The invasion of South Korea by communist forces served as an unmistakable warning to the free world that it must accelerate its efforts to develop a preponderance of military and economic strength over that of the Soviet bloc. The defense mobilization program of the United States, Canada and Western Europe is a constructive response to this warning. It has also been necessary to step up our efforts to impair the strength of the Soviet world through the intensification or extension of controls over its trade and financial relationships with outside areas.

The present report has been prepared with a view to recommending the measures which should now be adopted, or continued, to weaken the war potential of the Soviet bloc consistently with the objective of building greater economic and political strength in the free world.

As a basis for its conclusions (Part I) and recommendations (Part II), the report in Part III surveys the vulnerability of the Soviet bloc to western economic controls, analyzes the position of the free world countries in their trade with the Soviet bloc, and examines the effectiveness and practicability of various control techniques that are available.

As used in this paper, the term "Soviet bloc" includes the USSR, Bulgaria, Rumania, Hungary, Albania, Poland, Czechoslovakia, the Soviet zone of Germany and Communist China.

PART I

~~SECRET~~

S E C R E T

PART I

CONCLUSIONS

The following are the most important conclusions reached after reviewing present policies and programs and appraising possible additional lines of action:

1. The economy of the Soviet bloc is, to a large extent, free from dependence on trading relationships with the non-Soviet world. Segments of its economy, however, and particularly some closely related to the war-making potential, are susceptible to external pressures. These vulnerable spots are, broadly speaking, in the fields of machinery and equipment, precision tools, anti-friction bearings, electronics, certain non-ferrous metals, rubber and certain grades of essential minerals. Selective controls directed at these vulnerable spots can achieve most of the results that could be achieved through a complete embargo.
2. The volume of trade between Eastern and Western Europe is today at about 40 percent of the pre-war level; the strengthening of controls proposed in this report will mean a further reduction in this trade. A diminution of trade as a result of this process of strengthening international controls is desirable, provided adequate provision is made to assist the non-Soviet world to meet the resulting economic dislocations and provided the shrinkage is effected through programs which maintain the political unity of the West.
3. It is not at this time in the best interests of the free world to pursue a policy of complete embargo against the USSR and its European satellites. (The policy with respect to exports to China is dealt with in recommendations 1 and 7). Without significantly increasing the net economic advantage to the West, a complete embargo might well serve to orient the European satellites, particularly Poland and Czechoslovakia, even more rapidly and more deeply toward the USSR; it would make more difficult the settlement of the problems of Germany and of Austria; it would increase the risk of our having to resort again to the Berlin airlift; and, if urged by us, it would raise major doubts in the minds of the other free nations as to the sincerity of our objective of a peaceful settlement of the existing differences with the USSR.
4. The effectiveness of external pressures on the Soviet bloc, to a large extent, depends upon the degree of cooperation of the members of the non-Soviet world. There are, however, limitations on the degree of control other governments can undertake. Many governments are limited in the extent to which they can take political decisions against the

Soviet bloc,

S E C R E T

S E C R E T

- 2 -

Soviet bloc, some by the presence of large indigenous Communist parties, some by public demand for an official policy of neutrality, and some by the fear of direct military reprisals. In addition, many countries of the free world are dependent in varying degrees on trade with the Soviet bloc. Complete stoppage or a significant decrease in this trade would result in serious economic dislocations, particularly among the countries of Western Europe.

5. The economic dislocations could be mitigated to some extent by gradual readjustments which would require the development of alternative sources of supply and the opening up of markets in the Western world for goods now marketed in the Soviet bloc. However, these readjustments would require major alterations in some of the domestic policies of the U.S. and other countries. Domestic policies such as those relating to the export of products in short supply, the protection of national maritime fleets and the protection of domestic industries would have to be readjusted to fit the concept of a self-contained and mutually re-enforcing Western world.

6. Despite the cost, the principal nations of the non-Soviet world are cooperating and can be expected to cooperate further in a series of measures, short of full-scale economic warfare, which can materially retard the building of the Soviet war potential. It is important, however, in order to increase the likelihood that other nations will expand and strengthen their existing controls, that the concept of "economic defense" as distinct from "economic warfare" be maintained. Certain neutral governments will not participate fully in any case, but to some extent their lack of cooperation can be offset by special measures.

7. Western Germany, although agreeing in principle to the imposition of selective controls, is faced with formidable enforcement problems in making such controls effective. Unless measures are devised for enforcing controls on exports from Western Germany, particularly illegal traffic and transshipments, the effectiveness of Western controls generally will be greatly impaired.

8. As many of the measures employed in World War II to damage the German war economy are of limited usefulness against the relatively self-sufficient Soviet bloc, new techniques for exploiting the latter's weaknesses should be constantly sought. These techniques should be designed not only to weaken the Soviet war-making potential, but also to place an increasing strain on economic and political relations within the Soviet bloc. Because of their security aspects, certain techniques in this and related fields should be closely guarded and not dealt with directly as part of the more traditional measures.

9. Plans

S E C R E T

S E C R E T

- 3 -

9. Plans should be formulated and made ready for implementation to deal with a situation of full-scale economic warfare in the event the Soviet bloc initiates such a policy, or in the event that developments make it advisable for the non-Soviet world to adopt this course.

10. The economic strength and cohesiveness of the free world will determine, in large measure, its willingness and ability to take adequate measures against the Soviet bloc. Accordingly, the various aspects of our foreign economic policy which are aimed at the positive goal of building free world strength should be adapted to the present situation and augmented. Among the programs which lend themselves to this objective, and which can be utilized to develop the alternative sources of supply, are our various loan and grant programs, Point IV, and the programs for trade barrier reduction in the free world.

PART II

S E C R E T

S E C R E T

- 4 -

PART II

RECOMMENDATIONS

It is not possible to make final recommendations covering the entire subject under review without further study and consultation with other agencies of the Government. However, the following recommendations are submitted with a view to setting a pattern for immediate action and establishing machinery for carrying forward the consideration and development of policies and programs. Because of the interests of certain other departments and agencies of the Government in this subject, and because some aspects of it have been before the National Security Council, it is suggested that these recommendations be referred to the Council for review and consideration by it and other appropriate departments and agencies.

A - RECOMMENDATIONS ON SUBSTANTIVE MEASURES

Export Controls

1. The U. S. Government should, pending further developments in the U.N., continue to prohibit all exports to communist China, Manchuria and North Korea, but should apply licensing controls so as to permit Hong Kong and Macao to procure from U.S. sources imports for local uses and for transshipment to non-communist destinations.

2. The U.S. Government should extend its present export licensing system over trade with the Soviet Union and its Eastern European satellites by requiring an export license for all products proposed for shipment to these areas. In licensing such exports, the U.S. should continue to prohibit exports of all items of significance in the atomic energy field, all arms, munitions and implements of war, all items which are determined to be in short supply, and all items which if exported would contribute directly to the Soviet war potential (the so-called I and I-A lists). The U.S. should normally deny the issuance of licenses for all items which, if exported in significant quantities, would contribute to the Soviet war potential (the so-called I-B list). All other items should be kept under constant surveillance through the comprehensive licensing system recommended above. Specific items should be added to the list of commodities which are

restricted

S E C R E T



S E C R E T

-5-

restricted or prohibited on a selective basis and in accordance with established procedures and existing criteria for control, whenever such action is justified for short supply or security reasons.

3. The U.S. overall security objectives should be controlling in the implementation of Section 117(d) of the Economic Cooperation Act of 1948 and of Public Law 843, Section 1304 (the Cannon Amendment). Accordingly, although the U.S. Government should prohibit or restrict shipments of important strategic goods to friendly countries, in accordance with policies and procedures which have been laid down by the National Security Council, if necessary to prevent the frustration of U.S. security export controls or the misuse of U.S. economic or financial assistance, action should be taken in such a way as not to endanger other U.S. security objectives of equal or greater importance.

4. The U.S. Government should continue to provide vigorous leadership in the strengthening of the security export controls of the Western European countries, recognizing, however, that considerations of political feasibility, military risk and economic cost make it undesirable to press for European controls completely parallel to those exercised by the U.S. The U.S. should continue to press for (a) embargo to the Soviet bloc of scarce materials or equipment needed for Western defense programs, (b) international agreement to embargo or limit shipments of additional goods which are not yet fully controlled but have already been recognized by most of the Western European countries in the Coordinating Committee in Paris (COCOM)<sup>1/</sup> to be of strategic importance, (c) more effective international controls over transshipments and illegal trade, (d) maximum cooperation by countries, such as Sweden and Switzerland, which do not at present participate in multilateral export control arrangements, (e) measures to minimize past and future

trade

<sup>1/</sup> In addition to the United States and Canada, the Consultative Group and its Coordinating Committee include the German Federal Republic and the following NATO countries: the United Kingdom, France, Italy, Belgium, Netherlands, Luxembourg, Norway and Denmark.

S E C R E T

S E C R E T

-6-

trade agreement commitments to supply goods of strategic importance, (f) measures to promote coordination among the Western European countries in their trade agreement negotiations with the East, and (g) improved organizational arrangements in COCOM and in the NATO to further these objectives.

5. The U.S. Government in association with the British and French Governments should request further action by the Federal German Republic to ensure more effective control over the illegal trade and transshipment of goods agreed for control in COCOM.

6. The U.S. Government should seek the further cooperation of the American Republics and where necessary that of other countries in applying export controls to direct shipments and transshipments to the Soviet bloc of items of strategic significance or in short supply.

7. The U.S. Government, in view of the Chinese Communist aggression in Korea, should press for the application of effective controls on exports to China. Its efforts through the United Nations should be directed at achieving agreement on economic sanctions by the maximum number of countries; if necessary to achieve a wide measure of agreement, such sanctions may be confined to a list of goods including atomic energy materials, arms, ammunition and implements of war, petroleum, and industrial equipment useful in producing war materials.

8. Multilateral arrangements among free world countries for the equitable distribution of materials in short supply should be used by the U.S., to the greatest practicable extent, to deny or limit shipment to the Soviet bloc.

Preclusive Operations

9. Arrangements for governmental procurement of commodities in short supply, including government-to-government purchase agreements, should be designed in such a way as to deny or limit shipments to the Soviet bloc, to the extent that this would not interfere with the primary procurement purpose of the arrangement.

10. To the extent

S E C R E T

S E C R E T

-7-

10. To the extent that export controls, allocation and normal purchase mechanisms do not sufficiently limit the export to the Soviet bloc of materials in which the bloc is vulnerable, the U.S., after consultation with its major allies, should engage unilaterally or jointly in preclusive buying and the preemption of productive facilities to achieve this objective. Preclusive buying operations should concentrate in the first instance on such items as industrial diamonds, jewel bearings and mica, rather than bulk items. Efforts to preempt industrial capacity should be directed primarily at capacity capable of producing critical manufactured products, particularly those requiring large amounts of skilled labor, in countries which do not voluntarily prohibit the movement of these products to the Soviet bloc.

Financial Measures

11. The Strategy Board referred to under Section B of these recommendations should determine the point at which export controls have become so restrictive and other economic and political relations so curtailed that blocking of the dollars and dollar transactions of the USSR and its satellites would be appropriate.

12. Continued study should be given to the subject of gold with a view to evaluating measures of international cooperation which might prove fruitful in reducing the ability of the Soviet bloc to utilize gold.

Blacklisting

13. It would be undesirable at this time to publish a "blacklist" or "proclaimed list". However, to assist in tightening the enforcement of existing export and other controls and as a preliminary step in preparing a more formal "blacklist", arrangements should be made to develop a central file of information on individuals, firms and corporations suspected of evading U.S. or international controls.

14. The determination

S E C R E T

S E C R E T

-8-

14. The determination whether to publish a "blacklist" at a later date should be made after careful consideration by the Strategy Board referred to under Section B of these recommendations.

Technology

15. The U.S. should sponsor measures to strengthen security controls of plants and factories employing advanced technological processes.

16. The U.S. should press for more effective action by COCOM countries to implement their agreement that "the object of the embargo or quantitative controls should not be defeated by the export of technical assistance, design data, manufacturing technique, and specialized tools for making any controlled items."

17. The U.S. should develop further programs to prevent the export of advanced technological information to the Soviet bloc, including export achieved through the movement of persons, and should enlist the cooperation of other countries in this effort. These programs should be devised in such a way as to create the least possible impediment to the exchange of such information among the nations of the free world.

Shipping

18. The U.S. should seek coordinated action on the part of the important maritime powers to prohibit the carriage to Soviet bloc destinations of all goods which are the subject of embargo.

19. The U.S. should explore the feasibility and desirability of instituting, in cooperation with other major maritime powers, a system of ship warrants and of control over the issuance of ship stores in aid of our controls on the movement of prohibited goods.

Decreasing Reliance on Trade with the Soviet Bloc

20. The U.S., with the aid of friendly countries, should pursue vigorously programs for increasing production

of those

S E C R E T

S E C R E T

-9-

of those basic materials that are now exported by the Soviet bloc. These programs should be carried out as part of our general program of procurement and development.

21. The bargaining position of friendly countries which now rely on the Soviet bloc for essential materials should be strengthened by making alternative sources for these materials in the free world more readily available. To this end, policies governing U.S. export controls on short supply items should be so designed as not to foreclose a shift to U.S. sources by friendly countries. In addition, a fund should be established, possibly out of ECA appropriations, to make possible the extension of financial aid to friendly countries to offset partially any increases in cost involved in a shift from Soviet bloc to free world sources, whenever such a shift would carry net advantages for the West. Pending further consideration, it is estimated that aid for these purposes would involve something less than \$100 million annually.

22. A more comprehensive analysis than has so far been possible should be made to determine what specific products or services now being offered by the free world to the Soviet bloc could be diverted to other countries of the free world. This analysis should point out (a) how productive capacity might be reoriented to provide materials needed by the free world and (b) to what extent the diversion will require the reduction of such obstacles as high tariffs, quotas, and shipping discrimination. Further study should also be given to the need for government purchasing of goods abroad now marketed in the Soviet bloc which can only be disposed of in the free world at a loss.

S E C R E T

S E C R E T

- 10 -

B. RECOMMENDATIONS AS TO ORGANIZATION

1. Pending further consideration within the Executive Branch, the operating responsibility for carrying out approved policies should rest with the departments or agencies normally having responsibility in the particular field of action in question. In connection with its operating responsibilities, it is expected that each agency will provide the necessary staff work for the development of suggested operating programs within its assigned field.

2. To formulate overall operating programs, central staff work and analysis will be required for the purpose of coordinating and evaluating individual agency proposals as to the most promising course of action. This analysis must take into account the probable effects of proposed economic defense measures on the economies of friendly and neutral countries whose cooperation is necessary to make them effective. It should also consider the possibilities of using foreign assistance and other positive foreign economic programs to reinforce economic defense objectives. This centralized staff work should be organized and directed by the Chairman of the Board referred to in paragraph 3 below, who, for completed staff work, should make maximum use of the facilities of the departments and agencies having responsibilities in these fields.

3. The operating programs in this field must be carried on in terms of and in a manner consistent with our foreign policy objectives. The operations in this field must be coordinated with other programs and efforts in the field of foreign policy. It is therefore recommended that an Economic Defense Strategy Board be established under the Chairmanship of the Department of State. Other agencies to be represented on the Board should include the Departments of Treasury, Defense, Commerce, Agriculture and Interior and the Economic Cooperation Administration, the Central Intelligence Agency, and the Office of Defense Mobilization. This Board should consider proposed economic defense programs and their relationship to foreign policy objectives and other foreign operations; should aid in coordinating the operations of the various agencies; should assist in evaluating the effectiveness of operating programs; and should stimulate the development of effective policies and programs. The Board should recommend policies to govern operations in this field.

S E C R E T

S E C R E T

- 11 -

PART III

BASES FOR CONCLUSIONS AND RECOMMENDATIONS

A - VULNERABILITY OF THE SOVIET BLOC TO EXISTING AND TIGHTENED  
WESTERN ECONOMIC CONTROLS

In reassessing the vulnerability of the Soviet bloc, the Department of State has had access to the intelligence reports of the Defense Establishment and other relevant sources. It is believed that the resulting estimate, set forth in summary form below and in greater detail in Appendix A, represents the best judgment of the United States Government.

The Soviet Policy of Self-Sufficiency

The Soviet bloc has always pursued a deliberate policy of reducing to a minimum its vulnerability to outside economic pressures.

Not only does the Soviet Union have extensive natural resources but each of the Five-Year Plans has had as a principal objective the building up of Soviet productive capacity in deficient areas, even at the cost of great wastage of resources and energies. The USSR is today capable of meeting within its own boundaries the bulk of its operating requirements in every major area of production. Where shortages of particular commodities continue to exist, a systematic attempt has been made to provide a cushion against an interruption of outside supplies through extensive stockpiling.

Soviet emphasis on self-sufficiency has been extended to the satellite countries; although the dependence of these countries on the West remains substantially greater than that of the USSR itself, this dependence has been greatly reduced as compared with pre-war.

The Chinese Communists have given every indication that they too will follow a policy of enforced economic isolation from the Western world. However, factors of geography and economic structure seriously restrict the degree to which China can be integrated with the rest of the Soviet bloc.

The Nature

S E C R E T

S E C R E T

- 12 -

The Nature and Extent of Soviet Sphere Vulnerability

Despite strenuous efforts to develop self-sufficiency, the Soviet bloc is still dependent to an important degree on the West for the rate at which it can sustain its long-term growth. The Soviet Union itself, most of the European satellites, and China, are in relatively early stages of industrialization. All of them need from abroad industrial equipment, especially high quality machines and instruments, some vital raw materials and semi-finished goods, "pilot plants", and technological information.

The Soviet Union and its satellites are also short of a number of commodities that are necessary for the operation of their economies at the current level. While substantial stock-piles of these commodities have been build up (probably in most cases at least a year's requirements), the relief that these would offer in case of an interruption of imports would be temporary.

The entire bloc constantly needs replacement parts for the vast amount of foreign equipment acquired in former years. It is estimated that approximately 35 percent of the machine tools in operation in the USSR are western built. The bulk of this equipment is now over five years old and is already beginning to present serious maintenance problems because of lack of spare parts. The problem is further complicated because most of this equipment is of an especially complex type, obtained from abroad because of Soviet inability to produce it domestically. For example, it is estimated that 75 percent of Soviet specialized machine tools are of foreign make. The constantly growing spare parts problem is therefore concentrated in the weakest and most important sector of the Soviet-orbit industrial establishment.

The importance that the USSR and its satellites attach to the continuation of supplies from abroad is directly evidenced in a number of ways. It is estimated that in 1950 the USSR and its satellites, including China, imported roughly \$1.7 billion worth of goods from the outside world. This amount is little more than 1 percent of the aggregate output of the Soviet bloc. However, except for the China trade, these imports consisted very largely of items essential for military preparedness and for the expansion of the industrial base of the eastern countries. They included, in particular, prototypes which embody Western technical improvement.

Another

S E C R E T



S E C R E T

- 13 -

Another indication of the importance of supplies from the West is the fact that the USSR and its satellites have shown great official sensitivity to western export control policies. Moreover, they have made strenuous efforts to obtain controlled items. Irregular and covert eastward shipments have assumed large proportions and range from complicated third country deals, frequently utilizing the facilities of free ports, to smuggling in knapsacks. Such imports are necessarily expensive because of circuitous hauls, price gouging, and middleman commissions and therefore strongly indicate pressing Soviet and satellite needs.

Specific Vulnerability Targets

Existing controls over exports to the Soviet bloc are aimed at curtailing current production and development prospects. The most recent vulnerability studies, which in the main confirm the accuracy of the decisions on which existing controls are based, indicate that the Soviet bloc is most vulnerable from this viewpoint in the following commodities: Swedish iron ore, on which satellite steel output depends unless and until reconversion to Soviet ores can be effected; alloy steel, and alloy metals including nickel but not including manganese and chrome; tin; copper; industrial diamonds and gems; piezo-electric quartz; sulphur, pyrites, and sulphuric acid; special types of graphite, mica, asbestos and their manufactures; natural rubber, ball and roller bearings, including high-grade bearing steels and parts; electronic equipment, including materials and component parts; abrasives, especially critical grain sizes; all types of replacement parts for equipment previously acquired by the Soviet bloc in the West.

In addition to the foregoing, the continuation, or institution where necessary of an embargo on the export of the following commodities to the Soviet bloc would substantially impair ability to raise production above existing levels: equipment for petroleum exploration, drilling, and refining, especially certain crucial components, such as drills; power generating equipment; anti-friction bearing producing equipment; machine tools (principally complex, specialized and automatic types); precision instruments and testing equipment; complete plants of all types, but especially chemical plants, steel and aluminum mills, and building materials plants; blast furnace equipment and electric furnaces; laboratory equipment, and vessels and charting services.

Soviet

S E C R E T

S E C R E T

- 14 -

Soviet Bloc Adjustment to an Embargo

In part, the USSR and its satellites can counter a western embargo of these commodities. A widespread net of more or less covert trade channels has been developed in recent years through which the Soviet bloc continues to obtain products on Western control lists. However, the volume could be reduced to a significant extent if full cooperation of the major non-Soviet producers were secured.

In those cases where it becomes impossible for the Soviet bloc to procure vitally needed imports some compensating internal adjustments can be made. Labor, fabricating facilities, and materials can be reallocated and synthetics and substitutes can be utilized; but such measures could only partially offset the damage resulting from Western trade restrictions. Since Soviet plans in allocating resources already give top priority to the development of capacity for military production and heavy industry as opposed to consumers' goods, reallocation of priorities can only take place within an already narrowed area. Furthermore, scarcity is so general throughout the Soviet sphere that there is but a small cushion for adjustment, particularly if a number of commodities are involved simultaneously.

Despite Soviet counter-measures, a control program encompassing the commodities listed above and receiving the support of at least the major producers impairs current production and makes difficult the fulfillment of existing plans. In the USSR and the European satellites, especially the latter, it forces a lower standard of living on the people. Soviet domination of its Eastern European satellites, however, permits the USSR to assign itself priority on critical items of mutual interest without weakening Soviet control.

With respect to China, elimination of a substantial part of the \$300 - \$350 million of imports received in 1950 would have relatively little over-all economic impact. While such a move would severely affect the "modern sector" of the economy, the Chinese Communists do not depend vitally on this sector for maintenance of an operating administration or for support of their military and police establishment.

Without key imports the USSR, and even more the European satellites and China, would find it difficult to carry out their plans for rapid, balanced development of their economies. The Soviet bloc's potential to wage a prolonged war of attrition would be considerably impaired but the capability of the Soviet Union to conduct a general war of limited duration would not be materially affected.

B - ECONOMIC

S E C R E T

S E C R E T

- 15 -

B - ECONOMIC AND POLITICAL ASPECTS OF TRADE OF NON-SOVIET COUNTRIES WITH THE SOVIET BLOC

The problems of the individual non-Soviet countries in curtailing or embargoing trade with the Soviet bloc vary widely. Some of these problems are essentially economic; some essentially political. Their magnitude depends in good part on how heavily the country relies on the bloc as a market for its goods or as a source for the materials it needs. Much depends also on the internal political complexion of the country; a strong indigenous Communist party, a tradition of successful neutrality, or a distrust of colonial powers can be controlling considerations.

The summary that follows indicates simply the range of these problems. The degree of interdependence between the Soviet and non-Soviet worlds is considered in more detail in the analysis (attached as Appendix B) prepared by the Economic Cooperation Administration in close cooperation with the Departments of State and Commerce and other agencies.

Economic Aspects

For the United States, the economic problems of terminating trade with the Soviet bloc are almost insignificant; our trade with the entire bloc, never very large, has already dwindled as a result of export and funds controls, to a point where it no longer has much importance to either side. Our strategic imports consist of some manganese and tungsten, for which alternative sources would have to be found. Canada's position is much like the United States; her chief problem would be the loss of the Chinese market for a range of products which, for the most part, could easily be absorbed in the West. Latin America's problems also would be marginal; she would have to forego moderate amounts of Czech manufactured products which she might have some difficulty replacing from Western sources.

The central problems of East-West trade lie largely in Western Europe from which the Soviet bloc derives the largest part of its imported fabricated products. For Western Europe the sudden loss of all East-West trade would be a serious blow to economic recovery.<sup>1</sup> This area would lose important food and

raw material

1. For a detailed analysis of the economic problems associated with a termination of East-West trade, see Appendix B, particularly Parts III and IV.

S E C R E T

S E C R E T

- 16 -

raw material items. The industries of Sweden, Austria and Denmark would be crippled if they could not replace the coal they now receive from Poland and Czechoslovakia; Sweden and Austria would lose 15 percent of their total energy supply, Denmark 22 percent. Sweden would also have to replace its entire potash supply, now obtained from Eastern Germany. The United Kingdom would be hard-hit; it receives 30 percent of its coarse grain imports from the Soviet Union, 20 percent of its timber from the Soviet bloc and an added 35 percent from Finland, and a significant amount of its acutely inadequate meat supplies from Poland and the USSR.

Western Germany's losses in being cut off from the bloc would be particularly heavy, partly because of her close ties with Eastern Germany. The artificial separation of these two areas by the present boundaries, if completed by an embargo, would compel painful adjustments in trade relations of all kinds. West Berlin is a particularly difficult aspect of the problem confronting all of Western Germany.

Western Europe's reliance on the Soviet bloc as a market is a less important problem than its reliance on the bloc for raw materials. Nevertheless, some segments of Western Europe's export industry would have difficulty in finding alternative markets. The Icelandic fishing industry, for example, which now relies on the Soviet bloc as a major market, would have little chance to sell its product in the highly protected markets of the Western world; and some segments of Western Europe's agriculture would suffer for the same reason. Even where the products involved were marketable in the Western world, it would take time to establish new channels of distribution. In addition, machinery producers of the West who have orders in process being produced to Soviet specifications would have a difficult transitional problem of limiting their losses on these products. During this transitional period of adjustment, there would be a considerable strain on Western Europe's balance-of-payment position.

Outside Western Europe, the principal economic problems are in those countries of the Near and Far East which border on the Soviet bloc. Iran, which supplies the bloc with insignificant amounts of some strategic items such as wool, relies heavily on the Soviet Union to absorb the otherwise unmarketable agricultural surpluses of its northern provinces. Afghanistan, which also contributes to the Soviet wool supply, depends on

the

S E C R E T

S E C R E T

- 17 -

the Soviet bloc to supply it with its vital gasoline requirements. A large part of Hong Kong's population is employed in its entrepot and processing trade with Communist China. Japan obtains part of its vital coal needs from China and, historically, the viability of Japan's economy has been based upon access to large volumes of coal, iron, salt, soy bean and other raw material imports from the China mainland in exchange for exports of capital and processed consumers goods. The assumption that this traditional pattern of trade will and must be resumed by Japan is, despite present obstacles, deeply implanted in the mind of the Japanese business man. In each of these cases, the problem is insignificant in dollar terms but important when measured by its effect on the economic life of the non-Soviet country it affects.

#### Political Aspects

The extent of the political problems of any country in curtailing or terminating trade with the Soviet bloc depends in part on the scope of the economic problems that such a move would create. In the United States, Canada and Latin America, where no significant economic interests are involved in a termination of East-West trade, public opinion is no obstacle to its termination. In Western Europe, where each successive step in export control has been paralleled by a shrinkage in the volume of essential commodities received from the Soviet bloc, there is widespread concern over steps which will cut further into these supplies.

But the economic impact alone does not determine political reactions and in some countries it is of secondary importance. In some Western European countries, such as France and Italy, there are large indigenous communist parties strongly represented in the parliaments and vociferous in their opposition to any move directed against the Soviet Union. In Sweden and Switzerland a policy of successful neutrality during World War II is deeply imbedded in the public mind. To a greater or less degree throughout Western Europe, there is a widespread reluctance to weaken further the few remaining ties with the satellite countries, particularly Poland and Czechoslovakia. And throughout the area, the realization that a war would turn Western Europe once more into a battleground pervades all political decisions. These are important limiting factors on the degree to which the Western European countries will go in curtailing trade, and it is therefore not practical for the United States to seek full parallel action.

Outside

S E C R E T

S E C R E T

- 18 -

Outside Western Europe and the Western Hemisphere, the political problems associated with curtailing Soviet trade have, in some instances, an even deeper significance and impose even greater limitations. The people of the Arab countries and of India, Indonesia and Ceylon are unwilling to be identified too closely with the Western world. This basic attitude results in part from a reaction against the earlier political domination of these areas by the Western powers and reflects the recent growth of strong nationalism throughout the area. In India, Pakistan, Indonesia and other countries of the Far East, it reflects also the strong attraction exercised over the peoples by their communist neighbors.

C. TECHNIQUESS E C R E T

SECRET

- 19 -

C - TECHNIQUES FOR DENYING RESOURCES TO THE SOVIET BLOC

Whenever the Soviet bloc attempts to obtain resources from the free world, it is vulnerable at three steps in its efforts: it must find a source of the goods; it must pay for them; and it must arrange transportation to move them to the Soviet bloc. Most measures intended to control or to deny goods to the Soviet bloc are directed at one or another of these three critical points. Accordingly, the summary and appraisal of these measures which follow discuss the controls at each of these points.

The principal types of action which can be taken to deny goods at the source are: complete embargo, selective export controls, and preclusive operations, including intergovernmental purchase arrangements and allocation schemes. These are considered separately below. Following them, measures to control funds are discussed, and then measures directed at the transport of goods. The question of control of technology is also considered, since by this device it is possible to accentuate what is already the greatest single strategic shortage in the Soviet bloc, skilled manpower.

1. Complete Embargo

The basic question in this entire field is whether the United States stands to gain more by advocating a complete severance of economic relations between the Soviet and non-Soviet worlds than it does by pursuing and advocating a policy of selective controls. In deciding between the two courses, a number of questions have to be answered. First, if a complete embargo were rapidly achieved, what would be the cost to the Soviet bloc as compared with a gradual and selective approach. Second, if a virtually complete embargo were in fact rapidly achieved, what would be the cost to the Western World as compared with a gradual and selective approach. Finally, if a complete embargo were announced as the United States objective for the free world, what effect would such an announcement have on the degree of cooperation of other countries in restricting trade to the Soviet bloc.

(a) Costs of an embargo to the Soviet bloc.

It is clear that a complete embargo would have a greater impact on the Soviet bloc than any less sweeping type of restrictive program. However, an effectively enforced program of selective controls directed at vulnerable spots can achieve most of the same results. Beyond that, it is difficult to generalize.

(b) Costs

SECRET

SECRET

- 20 -

(b) Costs of an embargo to the Western World.

Some aspects of the cost of an embargo to the Western World are subject to a rough kind of measurement; others can only be appraised in qualitative terms. If trade were abruptly terminated with the Soviet bloc, the first job confronting the Western World would be to achieve a reshuffling of its trade patterns; necessary goods denied to the Western World by this action would have to be found elsewhere, while markets would have to be found for a variety of Western products now absorbed in the Soviet bloc.

The goods from the Soviet bloc for which alternative sources would have to be found are, principally, coal, wheat, timber, coarse grains, potash, meat and sugar. Price considerations aside, alternative sources might be found: in the United States for coal; in the United States, Canada and possibly other countries for wheat; in Argentina and the United States for coarse grains; in Argentina for meat; in Cuba for sugar. Although part of the timber could be made up from the United States and Canada the world supply shortage would make alternative sources for the full amount difficult to find. Any undertaking to supply these products from the Western Hemisphere, to be meaningful, would need to be accompanied by firm commitments that Western Europe's needs would not be subordinated to United States domestic needs in any domestic allocation scheme. Moreover, the coarse grain demand could only be met if the United States were prepared to prevent any significant expansion in the use of animal feeding-stuffs here, and hence in domestic meat supplies.

Since the products Western Europe would need are, for the most part, already in short supply, the effect of imposing Western Europe's added requirements on the Western Hemisphere's strained supplies would be either to drive prices up, precipitate the need for more drastic price controls and rationing here, or both. The total cost of the principal goods Western Europe needs from Eastern Europe is about \$600,000,000 a year. Assuming it were possible to redirect trade with a minimum of dislocation, the amounts which Western Europe would have to pay in replacing the essential supplies now obtained from the Soviet bloc would be on the order of \$150 millions more than they are now paying for these goods. However, a shift of these proportions would probably result in Western Europe having to pay higher prices for all of its imported supplies of these products, not merely those formerly obtained from the Soviet bloc. These added costs cannot be accurately estimated.

Another

SECRET



SECRET

- 21 -

Another element of the cost involved in a quick embargo arises out of the free world's loss of markets. For many products, no problem exists. The \$400 million spent by the Soviet bloc for rubber, cotton and wool in 1950 would presumably readily be paid by the United States. The problem of providing markets for the type of product typified by Icelandic fish, that is, products not in acute short supply which are produced by highly protected industries is far more difficult to solve.

One added aspect of the costs of an embargo which is subject to rough measurement is the transitional problem of disposing of partially fabricated machinery being produced in the Western World to Soviet bloc specifications. While no figures are available to indicate the value of these products, a first approximation can be derived from that fact that annual sales of these products to the Soviet bloc have run at about \$200 million.

The non-monetary economic costs of an embargo are probably more important than the actual dollars involved. Direct controls would have to be established in fields in which they are not now needed; European cooperation would have to be channeled for a time into dealing with difficulties of our own making; a supplementary economic aid program would have to be devised and divided, absorbing some of the energies required to mount the defense program and the rearmament effort.

Certain other non-monetary costs must be added to the total. A complete embargo would serve to orient the European satellites, particularly Poland and Czechoslovakia, even more rapidly and more deeply toward the USSR; it would make more difficult the settlement of the problems of Germany and of Austria; and it would increase the risk of our having to resort again to the Berlin airlift.

Lastly the danger that a complete embargo may precipitate new or intensified military action by the Soviet bloc in areas such as Indochina and the Malay States in order to secure supplies denied the bloc by the embargo is a risk which is difficult to appraise but one which must be weighed heavily in the balance.

(c) Free world reaction to complete embargo.

The answer to this question can be made unequivocally. A United States announcement that its objective was a complete embargo of the Soviet bloc would materially impair our efforts to obtain the cooperation of the rest of the free world on measures aimed at

limiting

SECRET

SECRET

- 22 -

limiting the strength of the Soviet bloc. The reasons for this conclusion have been indicated in earlier sections of this report. The rest of the Western World has very much more to lose than we in any severance of economic ties. Many countries are much more immediately faced with the prospect of attack and invasion; some, though hostile to or fearful of the Soviet bloc, are publicly committed to a policy of formal neutrality. Many countries of the Western World who would agree to specific measures directed at retarding the build-up of the war potential of the Soviet bloc, if these measures were presented on their merits, would reject the same measures if they were expressly labelled as steps in the direction of complete embargo.

If the United States were unilaterally to launch a complete embargo, without parallel action on the part of the rest of the free world, it would have no significant effect on the Soviet bloc. United States exports to the entire Soviet bloc now run at the rate of less than \$1,000,000 monthly and provide little of real significance to the Soviet war potential. Imports might be reduced, in order to cut off a source of dollars usable to purchase strategic commodities in other parts of the world, or for subversive purposes, but such an operation would be ineffective without an effective program to sterilize Soviet gold holdings, about which there is little the United States can do unilaterally. Any benefit to be gained from completing the American embargo on exports at this time, in terms of satisfying a public demand for action in time of crisis, would almost certainly be offset by an increased American dissatisfaction in the early future with the failure of our allies to take similar action and a resulting strain on our relations with them.

## 2. Export Controls

Given the varying vulnerability of the Soviet bloc from sector to sector and the known limitations on multilateral action, export control measures applied selectively appear to offer the best method for curbing the growth of the Soviet war potential. This technique is also one in which most progress has been made both domestically and internationally.

(a) U.S.

SECRET

SECRET

- 23 -

(a) U.S. Controls The United States imposes an absolute embargo on shipments to the entire Soviet bloc of arms, munitions and implements of war, atomic energy materials, a broad range of industrial machinery, equipment and materials of highest strategic importance for the development of Soviet war potential and an increasing number of goods which are in short supply in this country. Several hundred additional items cannot be exported to the Soviet bloc without a license, and licenses are customarily denied. A de facto embargo thus extends to all direct shipments of goods of recognized strategic significance. Careful screening, end-use checks and a procedure for penalizing those who violate export control regulations have also been instituted in an attempt to control the indirect shipments through other non-Soviet countries.

In the case of Communist China, Manchuria and North Korea, the U.S. embargo extends to all commodities, and controls almost as severe are exercised with respect to adjacent entrepot points, especially Hong Kong and Macao.

A proposal for a further extension of U.S. export controls, short of complete embargo, is currently before the National Security Council. It would be a useful precaution at this time to require export licenses for all shipments to the entire Soviet bloc, in order to keep them under close scrutiny and to enable immediate cut-off if proposed shipments of particular items seem excessive. On the other hand, it would appear to be unnecessary and unwise to change the existing standards of control or substantially to widen the area of de facto embargo, although it is clearly desirable to prevent or limit the export of specific items additional to those now controlled whenever necessary for security reasons or to protect stocks of goods in short supply. Adequate procedures already exist for extending controls in these cases.

(b) Western Europe. All of the major industrial and trading nations of Western Europe, except Sweden and Switzerland, participate with the United States and Canada in a secret Coordinating Committee (COCOM) which meets in Paris, for the purpose of developing agreed international export controls. A large measure of agreement has been reached among these countries, much of it in very recent months. Sweden and Switzerland cooperate to a more limited extent outside of the COCOM.

The European countries in COCOM embargo to the Soviet bloc, including China and North Korea, all shipments of arms and munitions, atomic energy materials, and also about 85 percent of the present

U.S. list

SECRET

SECRET

- 24 -

U.S. list of embargoed items and 25 percent of the U.S. list of quantitatively controlled items. Most of the remaining items on the U.S. control lists are currently being considered by COCOM, to determine what measures of control should be imposed.

In addition to the selective embargo and limitative controls imposed on trade with China, the principal oil-producing companies operating outside of Western Europe and North America have agreed to see that shipments of petroleum are not made to China, from sources outside the Western European and North American areas. A number of Western European countries also embargo all trade with North Korea.

When the agreements so far reached through COCOM are compared with the conclusions on Soviet vulnerability summarized earlier, it is clear that impressive progress has already been made in agreeing to deny or to limit to the Soviet bloc the goods in which the bloc is especially vulnerable. Where gaps exist in the agreed COCOM controls, they are due principally to two factors. One of these is the fact that the principal producers of some strategic goods such as tin, rubber and iron ore, are not in COCOM and are unlikely to participate in coordinated controls in the foreseeable future. The other factor is that, thus far, the COCOM countries have not agreed to extend the scope of their control activities to items which contribute to the general economic base of the Soviet bloc, but have concentrated instead on materials more directly related to its war-making potential. This latter factor explains COCOM's limited action to date on such items as construction and conveying equipment, transportation equipment, coal mining equipment and electric power-generating installations.

Any proposal to extend appreciably the existing system of agreed international controls will encounter real resistance from the other participants in COCOM.<sup>1/</sup> There are three prerequisites for any

<sup>1/</sup> During recent negotiations with the British and French and subsequently with the other COCOM countries, it was understood that there would be no further wholesale extension of export controls unless changed international conditions demanded a drastic shift in policy in this field. This understanding was last confirmed at a meeting of the Consultative Group on November 29, 1950, the day before the Communist Chinese aggression began in North Korea. The understanding has reference to the level of international controls and not to those of any individual country. successful

SECRET

SECRET

- 25 -

successful negotiations in this direction. First, we must avoid actions which appear to other countries as tantamount to economic warfare against the Soviet bloc; this would seriously hamper our negotiations for further cooperative action. Second, the financial means and administrative machinery must be at hand to deal with the problems of economic adjustment which other countries would face in any further diminution in East-West trade; these are discussed more fully below. Finally, if the list of controlled items is to be extended substantially to cover types of machinery and equipment not now controlled, the COCOM countries first must share our conclusion that circumstances now require efforts to restrain the rate at which the Soviet bloc is building its broad economic base, in addition to its war-equipping industries proper.

In addition to these measures taken through COCOM, steps have been taken in the North Atlantic Treaty Organization to control exports of scarce materials required for the defense programs of the North Atlantic Treaty nations. The main purpose of the action is to ensure that materials which are not at present prohibited or effectively controlled by other measures and which are clearly required for the NATO defense program are not exported eastward. These arrangements are still in an early stage of development and the extent to which they may make it unnecessary to expand other control measures cannot yet be determined.

Perhaps the most urgent and most difficult problem faced in the effort to make international export controls more effective is that presented by transshipments and irregular trade. Agreement has been reached after numerous technical discussions in COCOM on various methods to control transshipments, but the measures recommended are not yet fully in effect and may be found impracticable in some countries. The problem of Western Germany is particularly acute. Not only are border controls ineffective but the arbitrary character of the division between the Eastern and Western zones has, as indicated earlier, cut across natural production and distribution areas, accentuating the economic consequences of an embargo and hence stimulating evasion. Although the United States can take some measures unilaterally to limit irregular operations of this sort, really effective action depends upon effective international cooperation.

In addition to this action by the countries represented in the COCOM and the NATO, efforts are being made in cooperation with the British and French to obtain an expansion in the export controls exercised by Sweden and Switzerland. So far, these countries have undertaken to control shipments of the highest strategic importance

and

SECRET

SECRET

- 26 -

certain types of transit movements. Although these traditional neutrals will probably not agree to adopt controls as extensive as those imposed by other Western European nations, further expansion in the scope of their present controls may well be achieved and efforts to this end should be continued.

The question of expanding the membership of COCOM is under active consideration and it appears likely that Portugal, and perhaps Greece and Turkey, will be invited to participate. None of these countries exports significant amounts of strategic goods to the Soviet bloc, but there may be advantages in obtaining wider cooperation in controls over transshipments and irregular trade movements.

In addition to agreeing on export control lists and on methods for limiting transshipments, the COCOM countries have agreed that trade agreement commitments with the Soviet bloc should not in the future be allowed to frustrate the internationally-agreed security controls. These countries have also agreed to exchange information concerning their current trade negotiations with bloc countries, especially with respect to the goods most desired by the bloc; and the U.S. has urged an expansion of the COCOM staff for this purpose.

Consideration has been given to the possibility of encouraging some form of thoroughgoing bloc-trading by the Western World in its trade relations with the East. It seems clear that an international trading corporation or similar organizational arrangements are not administratively feasible while East-West trade remains at or near its present levels. Nevertheless, there are clear advantages to be gained by fostering a much greater coordination of Western trade agreement negotiations, perhaps even to the point eventually of bulk purchases to meet total Western needs for a critical commodity such as Polish coal. In addition, the bargaining power of the countries in the West could be strengthened if there were alternative sources to which they could turn for needed goods, and alternative markets in which they could see the products now sold to the bloc. The first of these objectives would be assisted by a number of measures. New sources for the products now imported from the bloc could be developed through the various United States and international development programs. Moreover, friendly countries could be offered alternative supplies at prices which reduced the monetary sacrifice

involved.

SECRET

SECRET

- 27 -

involved in turning to higher-cost sources in the West. The objective of opening up new markets for their goods is more difficult to achieve. It may require the elimination of protectionist devices employed by the countries of the Western World which now exclude the goods and services offered by their neighbors. In some cases, it may even require the purchase and extraordinary disposal of unmarketable surpluses abroad.

(c) Other countries. The trade of many non-Western European countries with the Soviet bloc is now under review by a special committee of the National Security Council. Although some instances of shipment of strategic items may be found, it is not expected that the magnitude of trade with the Soviet bloc will be significant enough to require extensive negotiations with most of these countries.

In so far as the other American Republics are concerned, there have in the past been some shipments to the Soviet bloc of goods of strategic importance; these have included export of petroleum to China and of copper and quartz crystal to the Soviet bloc. However, in all such cases, the United States has promptly received the cooperation of the countries concerned in terminating such trade. The subject of security export controls will be discussed further with the other American Republics at the forthcoming Foreign Ministers Conference in Washington. Such a discussion should cover not only the movement of specific strategic commodities from these countries to the Soviet bloc, but also the means of avoiding the use of Latin America as a transshipping point to the bloc.

The question

SECRET

S E C R E T

- 28 -

The question of cooperation on the part of the Far Eastern suppliers of commodities such as tin and rubber is more difficult. In most of these cases the problem of strategic shipments can be solved better by U.S. or Western Europe allocation, purchasing and stockpile programs, than by the development of a parallel export control policy by the country concerned.

(d) Legislative policies. From the first, Congress has taken an extensive interest in the security export controls exercised by other countries. This interest has crystallized in two statutory provisions, the Cannon Amendment to the Supplemental Appropriations Act of 1950, and Section 117(d) of the Economic Cooperation Act of 1948. Both measures are intended to insure that the U.S. will not extend economic or financial aid to a country which by its own exports is frustrating our efforts to deny strategic goods to the Soviet bloc.

In invoking these legislative sanctions it must be borne in mind that for some countries, the costs of cutting off trade with the Soviet bloc bulk large and the fear of retaliation is well grounded. Accordingly, if pushed to a decision, they may undertake commitments they will not enforce, or, by being unwilling to accept United States' aid on these grounds, be unable to undertake their share of programs for strengthening the defenses of the free world. Greater U.S. security objectives may thus be imperilled.

### 3. Preclusive Operations

Since the Soviet bloc relies upon the outside world for significant quantities of certain basic materials and highly fabricated products, there are possibilities of engaging in preclusive buying operations to cut off the supply of these products to the bloc. Operations of this sort can take several forms; the principal techniques and their applicability to the present situation are described below:

#### (a) Government-to-government purchase agreements.

One technique is to negotiate with governments, from whose territories the Soviet bloc obtains its supplies, contracts under which the supplying government would undertake to sell its total production to friendly countries and to deny any of its production to the Soviet bloc. Under present circumstances, however, this technique can be applied only to a limited degree. The Soviet bloc is

vulnerable

S E C R E T



S E C R E T

- 29 -

vulnerable principally in two areas: in the supply of highly fabricated manufactured products, such as electric power installations and machine tools, and in the supply of a limited number of raw materials, notably, copper, rubber, tin, cotton and wool. Government-to-government purchase agreements are impracticable for highly fabricated manufactured products, since these products are typically manufactured to specification and are not sold in bulk.

Government-to-government buying is much more practicable for copper, rubber, tin, cotton and wool. However, these are all commodities which are short in the free world and the supplies that the U.S. and its allies must obtain are much more important to us than is the denial of the relatively small amounts reaching the Soviet bloc. Accordingly, the first objectives of procurement of these products must be to stimulate their production and to avoid adding to their cost, objectives directly at variance with those of a preclusive buying operation. While most supplying countries will cooperate fully with us in the stimulation of production, some of them would refuse outright a negative covenant requiring them to deny these products to the Soviet bloc. This is illustrated by the cases of rubber and tin; Ceylon and Indonesia, while willing to negotiate for an increase in their shipments to the free world, strongly resist efforts to preclude all shipments to the bloc.

Another illustration of the drawbacks of government-to-government buying as a technique of preclusion is that it induces undesirable demands on the part of supplying countries, which are less likely to arise in connection with normal procurement operations. The type of demand most likely to be made as a price for a government-to-government commitment not to sell to the Soviet bloc is the demand that the buying governments, in return, guarantee certain specific goods to the selling government; this type of bargaining makes difficult any attempt to ensure an equitable distribution of scarce commodities in the free world.

Accordingly, in the use of government-to-government buying operations the object should be to insure that the aim of preclusion does not interfere with the more pressing objective of maximizing free world supplies and thus result in net harm to the economic strength of the free world. Nevertheless, the possibility of preclusion must always be kept in mind as a desirable by-product of an arrangement aimed essentially at procurement.<sup>1/</sup>

(b) Other

<sup>1/</sup> These same conclusions apply in general to inter-governmental allocation agreements.

S E C R E T

S E C R E T

- 30 -

(b) Other preclusive operations. In addition to the government-to-government procurement activities described above, there are other types of purchase operations. The principal one of these is preclusive buying in friendly or neutral countries of the world.

Techniques in this field differ greatly from normal procurement operations and must be conducted discreetly and at times secretly. One prerequisite for a successful operation of this kind is that the inflationary effect of such buying must not be so great as to endanger legitimate and essential procurement operations being conducted elsewhere in the world. Another is that the operation should seek to avoid stimulating increased production in the areas in which conducted.

These prerequisites narrow substantially the field where preclusive buying can be really effective. Nevertheless, among those raw materials the Soviet bloc must obtain through imports, a few offer possibilities for successful preclusive buying operations. In general, these are materials of small bulk but high unit value and are commodities with relatively few sources of supply. They are also commodities the denial of a comparatively small amount of which could impair the Soviet war potential. For example, diamond buyers located in each of the principal diamond markets and the major diamond producing areas, if liberally supplied with funds, could probably intercept a significant part of the industrial diamonds now reaching the Soviet bloc. The total inflationary effect on the economy of Western countries and on the cost of our own war effort resulting from such an operation would be negligible. Similarly with jeweled bearings: the scarcity of skilled labor for their manufacture suggests the possibility of purchases in the areas supplying the Soviet, notably Switzerland.

Although preclusive buying is not a promising mechanism for denying strategic manufactured goods in general, it may be possible by purchase to intercept key items of machinery designed to Soviet specifications. Of even greater importance would be the preemption of the productive facilities of countries supplying these products to the Soviet bloc by placing forward orders in sufficient volume to utilize these facilities completely. In some cases, it might even be possible to purchase the facilities outright.

4. Financial

S E C R E T

S E C R E T

- 31 -

4. Financial Measures

The Soviet bloc obtains in several ways the funds with which it buys the Western World's goods and finances propaganda, espionage and sabotage. The bloc has available certain liquid assets including bank deposits in Western countries, supplies of currency of Western countries, and gold. These resources can be augmented by net earnings which the bloc manages to achieve through its merchandise trade with the West, and by its current gold mining production.

Theoretically, the ability of the Soviet bloc to use any of these funds could be impaired. Attempts could be made to locate and place under control assets physically located in the West, including any assets earned in the future through the sale of goods; and obstacles could be placed in the way of their using their gold production and reserves.

(a) Blocking Soviet assets. There is nothing to prevent the United States from blocking the assets of the Soviet-bloc countries subject to our controls; we have already done so with respect to Communist China's assets. However, the sums involved are believed to be insignificant. Accordingly, the principal impact of the order would be on future earnings. Since the Soviet bloc then could not retain control of the funds it might earn by selling goods in the United States, such imports would cease; this conclusion might be qualified to the extent that our blocking policy permitted the arrangement of specific barter deals mutually attractive to the United States and the Soviet bloc, but this is a minor qualification at best. Accordingly, the wisdom of instituting a blocking regulation depends largely upon a broader question, namely, the wisdom of terminating United States trade with the Soviet bloc.

Blocking and related action by the United States could also have the effect of denying to the Soviet bloc the privilege of using United States dollars in the settlement of their international transactions outside the United States. But the loss of this facility would

be of

S E C R E T

S E C R E T

- 32 -

be of little significance unless accompanied by parallel action from certain other key countries in the blocking of Soviet funds. For example as long as the Soviet bloc was in a position to offer Swiss francs to the world, they could finance their trade through Swiss francs almost as easily as through dollars. The prospect of obtaining the necessary degree of cooperation from Switzerland effectively to deny the Soviet bloc the privilege of using Swiss francs is remote. In addition, as a member of the so-called "transferable account system", the USSR is in a position to spend freely in the sterling area and in certain countries associated with the area, earnings acquired by it in any country in the group. Since the only basis on which the USSR will sell its goods to the United Kingdom is on the assurance that it can use its sterling earnings in other countries, a decision to drop the USSR from the transferable accounts system would greatly impair the United Kingdom's bargaining power in its dealing with the USSR.

Effective international action limiting Soviet freedom in the use of the West's currencies would seem to depend upon a prior decision of the countries of the West that a drastic reduction or virtual cessation of trade with the Soviet bloc is desirable. Once this decision was made, however, more direct trade controls would be available to achieve the result. Effective financial measures, such as blocking, might then be applied, ancillary to these direct trade controls.

(b) Denying the Soviet bloc use of its gold.

Gold is one of the Soviet bloc's most important potential means of commanding goods and services in the West. Conservative estimates put the gold reserves of the Soviet bloc and its satellites at about \$3 billion; annual gold production is estimated at approximately \$200 million. Almost all of these reserves are probably in the USSR.

Gold has an acceptability even greater than that of dollars in many areas of the world, notably the Middle and Far East. Its source is difficult to trace. It can

be used

S E C R E T

S E C R E T

- 33 -

be used in cash transactions, avoiding official surveillance. It makes an ideal form of payment for underground activities.

The USSR is reported to be making a considerable effort to establish and maintain channels for the sale of gold in Western Europe. Satellite airlines are reported shipping gold clandestinely to Paris, Brussels and Amsterdam; French and British gold coins are reported being counterfeited in the bloc and shipped for use in outside areas.

A program for the effective suppression of Soviet bloc gold sales would necessarily involve two major lines of action. First the United States and other countries would have to cease buying gold from the Soviet bloc and from third countries which have had gold dealings with the Soviet bloc, and would have to cease selling gold destined for the bloc. Second, the free markets for gold which exist in many countries of the world and on which the Soviet bloc has heretofore primarily relied, would have to be curtailed or suppressed.

The problem of obtaining the cooperation of other countries in limiting official transactions in Soviet gold cannot be separated from the broad policy of such countries with respect to trade with the Soviet bloc. It is unlikely that real cooperation could be obtained in limiting these official gold transactions unless countries were prepared to take the full step of blocking Soviet assets and instituting a de facto embargo on trade with the Soviet world.

The United States could take unilateral action against Soviet gold. This could be done either by blocking all Soviet assets or by measures short of a complete blocking operation. If Soviet assets were blocked, we would treat the proceeds from any sale of Soviet gold to the United States the same as the proceeds of any other commodity. Importation of gold would be permitted only against payment in blocked dollars. This is the principle

currently

S E C R E T

S E C R E T

- 34 -

currently applied to Chinese gold. Any unilateral action, however, would be of limited effectiveness to the extent that other countries were prepared to continue to take Soviet gold and to sell essential supplies against the proceeds of the sale of gold.

The United States might attempt to obtain international cooperation by such drastic means as a declaration by the United States that we would buy no gold from any country unless it refuses to purchase Soviet gold. Such a step would be difficult to justify unless we were willing to go even further and refuse generally to trade with any country which traded with the Soviet. Furthermore, such action with respect to gold alone would probably be of very limited effectiveness in forcing other countries to curtail trade with the Soviet bloc and might well have important adverse implications with regard to the ability of the United States to use its own gold for the acquisition of essential imports.

The curtailment of Soviet gold sales in the private markets of the world, notably those of the Middle and Far East, would be difficult even with the cooperation of the governments of those areas. However, the possibility of obtaining some measure of cooperation in limiting such sales is somewhat greater than the prospect of cooperation in blocking Soviet funds in general. Some of these measures, such as those aimed at the suppression of free-gold transactions in general, could be publicly associated with the International Monetary Fund objectives of stabilizing exchange rates and of protecting monetary reserves; such an association would render these measures more palatable to other countries. Furthermore, transfer of the proceeds of gold sales into currencies other than those obtained in the countries in which the gold was sold could be restricted by appropriate exchange control measures. Possible action in respect to Soviet gold sales in private markets is worth further exploration.

5. Blacklisting

S E C R E T

SECRET

-35-

### 5. Blacklisting.

The development of a blacklist is a means of enforcing other measures which have been put in effect to deny resources to the Soviet bloc. The purpose of the list depends on the nature of these other measures. For example, in enforcing export controls, a list has already been developed of domestic consignors and foreign consignees suspected of helping in the evasion of those controls; transactions involving such persons are prohibited or are subjected to particularly careful scrutiny. Such a list might also be developed to enforce the blocking of Soviet bloc funds; drafts drawn by such persons on dollar funds might be specially screened. Similarly a "black list" could be used to reinforce shipping restrictions, import restrictions or other measures which were a part of an economic defense program. In its extreme form, a consolidated list could be developed of persons or corporations, at home or abroad, who should be treated in all respects as enemy aliens.

The need for an elaborate blacklisting operation is much less important in the present emergency than it was during World War II. On the other hand, there is need for a continuous improvement in enforcement techniques. The information which the Commerce Department has already compiled in the enforcement of its export controls should be merged with that developing out of the Treasury Department's fund control work and should be supplemented by the information available to ECA and the intelligence agencies. A central blacklisting file should be developed and maintained by an operating agency. Since the list would at this time contain the names of persons in NAT countries and in other potential allies, unlike the practice during World War II in which listings were usually restricted to those in neutral countries, it should not be published at this time. Its publication in the future should only be made after careful consideration of its implications for our allies and after consultation with them.

### 6. Control of Technology

In the long run, the chief economic advantage the Western World holds over the Soviet bloc is the advanced state of Western technology. 1/ The West is far ahead of the Soviet bloc in the number of

---

1/ This section does not deal with the enforcement of security classifications applicable to technical data classified by the United States Government. Nor does it deal with the problem of protecting data which might be used by the Soviet bloc for sabotage or actual warfare, such as information on U.S. plants. These are security problems directly related to the prevention of espionage which is outside the scope of this paper.

SECRET

SECRET

-36-

of its trained scientists and production specialists. We are capable of using these specialists both intensively and extensively to a much greater degree than the U.S.S.R.; we can mobilize greater skill to meet a particular problem and we can deal with a wider range of problems at any given time.

The enormous extent to which the Soviet bloc has so far relied upon Western technology is evident from the study of the Soviet bloc vulnerability, attached as Appendix A. An effective embargo on the export of technology to the Soviet bloc would have a measurable deterrent effect on its economic growth.

There are, however, obvious inherent difficulties involved in preventing scientific and technical information from reaching the bloc. Such information usually takes a form difficult to intercept-- a concept in someone's mind, a formula, a model, a single blueprint, or a bundle of plans. Once these end-products are in possession of the Soviet bloc, unlike a ton of copper or barrel of oil, they can be used not once but repeatedly. In addition, since effective measures to prevent the leakage of scientific information to the Soviet bloc would necessarily involve limitations on interchange within the Western world, a major problem is to ensure that any measures adopted are more costly to the Soviet bloc in terms of technological advance than to the free nations of the world.

The advantages to the West of restricting the dissemination of information are greater for detailed technical information on specific production processes than for information which is in the nature of abstract science. The Soviet bloc's greatest deficiency is in the applied science and engineering fields rather than in abstract science. Accordingly, the measures taken so far have been directed primarily at restricting data in these applied fields.

Since 1949, the export of any technical data relating to the production or use of commodities has been under general license, although this standby control has only been implemented so far by inviting "exporters" of technology to seek an advisory opinion of the Department of Commerce on the advisability of exporting any such data. This voluntary program has been exceedingly useful in blocking the export to the Soviet bloc or other undesirable recipients of various types of unpublished technology. There is now under consideration a proposal to put screening of more important types of unpublished technology on a mandatory basis. This would provide legal sanctions against persons not cooperating in the present system of voluntary controls. The problem, however, is to devise a technique whose principal effect is not simply to create a new impediment in the shipment of technical data to friendly countries and prospective

allies.

SECRET



SECRET

-37-

allies. If a satisfactory program can be devised, it would be desirable to attempt to persuade the other nations of the free world to adopt parallel controls.

In addition to the actual and prospective licensing measures discussed above, the patenting abroad of inventions made in the United States is subject to license by the Patent Office. This licensing procedure is supplemented by the power on the part of the Patent Office to require that an invention on which an application is filed be kept secret for as long as the national interest requires. Similar laws also exist in a number of other industrialized countries. Here again, parallel enactments and policies would be useful in countries where such legislation does not exist.

While discussion so far has dealt with information which is not ordinarily published, there are also various possibilities in the suppression of information which might normally be published. It is hoped that a "Voluntary Program for the Protection of Technical Information", now being given wide publicity by the Department of Commerce, will produce useful results through a judicious process of screening material prepared for publication and voluntarily submitted by editors and publishers.

For controls in this field to be meaningful, they must also extend to the movement of persons. The inspection of the plants of American companies and overseas subsidiaries by suspected foreign agents must be prevented. Moreover, travel abroad by American scientific and technical personnel for the purpose of imparting advanced technological information to the Soviet bloc should be prohibited wherever the direct export of that information would be embargoed. The great risk to be avoided in this field, as in others relating to the exchange of technical and scientific information, is the risk of impeding the interchange among friendly countries to a degree which more than offsets the benefits of denying such information to the bloc.

#### 7. Shipping controls.

Controls in the shipping field serve to supplement export controls. Since the degree of effectiveness of shipping controls is dependent upon the degree of cooperation of the various maritime powers and upon the extent to which we are prepared to resort to such belligerent acts as blockade and contraband control, the potentialities are somewhat limited in the present "gray period."

Analysis of registration of world merchant shipping indicates that the ownership of substantial tonnage is in the hands of those who could not be expected to cooperate voluntarily in drastic

measures

SECRET

SECRET

-38-

measures to deny shipping to the Soviet bloc. Assuming a list of proscribed commodities and prohibited destinations, and some form of coordinated export licensing by the participating countries, it should be feasible for each country to control the export of commodities from its own ports in the ships of all non-participating countries. The effectiveness of commodity controls enforced by shipping controls would vary according to the tonnage of countries participating. This would range from 79% of world tonnage, if commodity controls are implemented only by NATO countries, to approximately 95% if such controls are put into effect by all maritime countries outside the Soviet bloc.

The only actions that have been taken to date in the field of shipping are (1) the U.S. Maritime Administration Order forbidding U.S. flag vessels to call at Chinese ports or to make available their facilities for the transport of any cargoes to Communist Chinese destinations and (2) issuance of General Order 59 of the U.S. Maritime Administration which prohibits the charter, without specific license, of U.S. flag vessels to satellite operators. So long as ships of other flags continue to trade with China, however, the economic effect of the U.S. action can be largely nullified. A similar situation would result if the U.S. alone were to extend its embargo on shipping to the U.S.S.R. and its European satellites.

In view of the fact that participation by all non-Soviet countries in shipping and commodity controls cannot be expected, certain indirect controls on non-participating shipping could be applied which would have some value in curtailing shipment of strategic items from non-participating countries to the countries of the Soviet bloc. The most effective control of such shipping, short of naval blockade, would be application by the NATO countries and other governments of the World War II warrant system. Under this system ships' operators would undertake to operate in accordance with agreed objectives, or suffer the loss of bunkering and other shore facilities and of access to insurance markets and financial accommodations under jurisdiction of participating countries.

There is certain to be leakage. A small amount of uncontrolled tonnage can move substantial amounts of critical items of a concentrated nature and shipping interests would be offered tempting rewards to engage in bootleg trades. To be effective, the controls used must be enforced rigidly and the "blacklisting" of unreliable consignees made possible by a competent intelligence system. As a possible means of meeting this situation consideration should be given to the feasibility of setting up a cargo control along the lines of the British navicert system of World War II. That system, however, depended on the British naval blockade for enforcement. Whether other sanctions in lieu of naval blockade, such as denial

SECRET

of

~~SECRET~~

-39-

of access to port facilities, insurance markets and financial accommodations would be adequate should be further explored.

#### 8. Civil Aviation

United States policy regarding relations with the Soviet bloc is set forth in NSC 15/3. It covers two principal points. Any exchange of air rights with a member of the Soviet bloc should be only on a reciprocal and short-term basis, only when such an exchange would result in some real advantage to the West, and only on the basis of providing no more than minimum facilities to the satellite lines. Moreover, the U.S. objective should be to deny aircraft and aviation related material, and maintenance facilities to the Soviet bloc to the maximum extent possible.

The U.S. has been using every opportunity to urge these positions on the other countries of the world. Partial success has so far been achieved. The remaining steps short of complete success in urging the adoption of this policy are not of sufficient importance to justify any significant change in present tactics.

#### D - Positive Programs for Economic Strength

In concentrating upon the measures of denial and restraint on which this report has primarily focussed, it is easy to overlook the fact that the strongest weapons in our arsenal are the positive ones, the weapons which are directed primarily at adding to the strength of the free world, rather than primarily at weakening the Soviet bloc. These measures are particularly important because they are the surer means of strengthening our ties with other friendly countries and of convincing neutrals of the sincerity of our purpose in achieving peace and economic betterment.

In one way or another, the major facets of our present foreign economic policy are aimed at that objective. The Military Defense Assistance Program, Point IV, the European Recovery Program, the Trade Agreements Program, and the various programs of grants and loans which the U.S. has fostered are all designed to build strength and cohesiveness in the free world.

The relevance of these programs to our foreign policy has been increased rather than lessened by the present emergency. By strengthening the economic and political fabric of the countries concerned, we can hope for more forthright stands by those countries in their relationship to the Soviet bloc. More specifically, our objective should be to ensure that U.S. economic aid programs are aimed at building up sources of supply in the Western world which decrease

its

~~SECRET~~

~~SECRET~~

-40-

its dependence on the Soviet bloc and augment its supplies of strategic materials. Our Point IV program should be directed to building up the health and literacy of the peoples in those parts of the world where discontent and disaffection of the west is based in part on disease and ignorance. Our trade barriers program should be designed to a greater degree than heretofore to assure that the surpluses produced in some countries of the Western world will be marketed in other Western world areas from which trade barriers now bar them. These objectives call for the adjustment and extension of the "peaceful" aspects of our economic foreign policy, rather than their subordination and neglect.

~~SECRET~~