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OD(80) 1st Meeting COPY NO 42

CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

MINUTES of a Meeting held at
10 Downing Street on
TUESDAY 22 JANUARY 1980 at 9.30 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the
Home Department

The Rt Hon Lord Hailsham
Lord Chancellor

The Rt Hon Lord Carrington
Secretary of State for Foreign
and Commonwealth Affairs

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon Francis Pym MP
Secretary of State for Defence

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry

The Rt Hon Michael Heseltine MP
Secretary of State for the
Environment
(Item 2)

The Rt Hon David Howell MP
Secretary of State for Energy
(Items 2 and 3)

The Rt Hon Sir Michael Havers QC MP
Attorney General
(Items 2 and 3)

Earl Ferrers
Minister of State, Ministry of
Agriculture, Fisheries and Food
(Items 2 and 3)

Mr Cecil Parkinson MP
Minister of State
Department of Trade

SECRETARIAT

Sir Robert Armstrong
Mr R L Wade-Gery
Mr R M Hastie-Smith

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1. STATEMENT ON THE DEFENCE ESTIMATES 1980

The Committee considered a note by the Secretary of State for Defence (OD(80) 3) covering the draft Statement on the Defence Estimates 1980.

THE SECRETARY OF STATE FOR DEFENCE said that this Statement on the Defence Estimates sought to offer a more coherent basic explanation of policy and roles than those of the previous Administration. It emphasised the importance attached to defence, pointed up important areas of policy such as nuclear weapons, and the Soviet threat to United Kingdom interests outside the North Atlantic Treaty Organisation (NATO) area, and it reflected the views expressed in the discussion on future defence policy at the meeting of the Committee on 3 December.

In discussion there was agreement that the general balance of the draft Statement was right. The following points were made -

a. The section on detente and arms control was too slight, and merited some explanation.

b. In regard to the section on "The British Contribution to NATO's Conventional Forces" such phrases as "flexible response" and "forward defence" had now become imprecise in meaning, and related more to the internal politics of NATO than a clear military doctrine.

c. The definition of the threat represented by the Warsaw Pact, as stated in the Defence White Paper, did not fully reflect the growing dangers of subversion outside the NATO area as exemplified in Afghanistan, although it was accepted that the description of the threat correctly matched the present military posture stemming from the decisions taken by the previous Administration in 1974/75. It was for consideration that the draft Statement should be revised accordingly.

d. The United Kingdom requirement for a military intervention capability outside NATO should be considered as a matter of urgency, not in the context of the Statement but in conjunction with the wider study on the order of

priority to be attached to the four elements of defence policy, which had been remitted to the Defence Secretary following the Committee's discussion on 3 December 1979 (OD(79) 13th Meeting, Item 3).

e. The section on Northern Ireland did not give a clear picture of the aims of longer term policy. There was a risk that British troops in Northern Ireland were themselves becoming targets for terrorist attack rather than helping to keep down the level of violence.

f. Paragraph 803 should be amended to reflect the point that it was our economic strategy to reduce public expenditure to a sustainable level.

g. The Government were likely to be faced with a difficult situation over civil defence, on which current expenditure was small. There was a good case for doing more, and public pressure for this was building up. But the necessary financial resources were not likely to be available to either ~~the~~ central or local government.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed with the draft Statement on the Defence Estimates 1980 subject to the points made in discussion. The Defence Secretary should revise the draft for consideration by the Cabinet. consulting the Foreign and Commonwealth Secretary on the section on Detente and Arms Control and the Secretary of State for Northern Ireland on the revision of the section on Northern Ireland. The Afghanistan situation had given an additional urgency to the work already being undertaken within the Ministry of Defence on the priority to be accorded to the four main elements of defence policy. This task should therefore be completed within six weeks. A study was also in hand of the requirement in the changed international circumstances for the United Kingdom to recreate a military intervention capability outside the NATO area. This study should be completed in the same time-scale. Ministers would wish to give deep consideration to the results of all this work, perhaps at a weekend meeting to be held at Chequers.

The Committee -

1. Invited the Secretary of State for Defence to circulate the final draft of the Statement on the Defence Estimates 1980, amended in the light of their discussion, and in consultation with the Foreign and Commonwealth Secretary and the Secretary of State for Northern Ireland as suggested, for consideration by the Cabinet on 31 January.

2. Invited the Secretary of State for Defence to accelerate the study into the priority to be accorded to the four main elements of defence policy so that its outcome would be available in six weeks' time.

3. Noted that the Secretary of the Cabinet had set in hand an inter-departmental study of the political case for a United Kingdom military intervention capability outside the North Atlantic Treaty Organisation area in the light of changes in the international situation.

4. Invited the Secretary of State for Defence to examine, once the interdepartmental study was complete, the feasibility and cost of providing United Kingdom military intervention capability outside the North Atlantic Treaty Organisation area and the implications of doing so for the four main elements of defence policy.

5. Took note, that the Prime Minister would in due course arrange for Ministerial discussion of all these studies, perhaps at a weekend meeting at Chequers.

2. AFGHANISTAN

The Committee had before them a minute of 19 January (PM/80/5) to the Prime Mini from the Foreign and Commonwealth Secretary reporting on his visit to the Middle East and recommending further action; a letter of 15 January to the Prime Minis Private Secretary from the Secretary of the Cabinet's Private Secretary enclosing a report by officials on Britain and the European Community's economic involveme with the Soviet Union and Eastern Europe; a letter of 21 January to the Prime Minister's Private Secretary from the Foreign and Commonwealth Secretary's Priva Secretary enclosing a draft statement to Parliament; and a further letter of 21 January to the Prime Minister's Private Secretary from the Foreign and Commonwealth Secretary's Private Secretary enclosing draft messages to the British Olympic Committee and to President Carter.

THE FOREIGN AND COMMONWEALTH SECRETARY said that the four major conclusions from his visit to the Middle East were that the threat lay in Soviet subversion rathe than overt aggression; that Arab and other Moslem opinion saw the Camp David agreement as an obstacle to the development of a more unified response to the Soviet danger; that opinion in the area increasingly feared the break-up of Iran; and that American action against Iran was deplored both for contributing to this danger and for detracting from the condemnation of Soviet aggression by providing an alternative target for local criticism.

In discussion there was general support for the proposals in the Foreign and Commonwealth Secretary's minute of 19 January, and the following points were made -

a. In the light of President Carter's skilfully worded pronouncement on the Olympic Games, the Prime Minister would need to write to the Chairman of the British Olympic Association without delay and in terms designed to have maximum public impact. While the Government would not need to go as far as President Carter had in all respects, it was important to convince the Russians that Britain fully supported the United States. The immediate aim should be to bring maximum pressure upon the International Olympic Committee to transfer the Games away from Moscow, to another or possibly to several other locations. If that failed, it would be necessary to do every-thing possible to damage the prospects for the Moscow Olympics. As well as ensuring that there were no British official visitors, this would involve considering whether British athletes should be advised not to attend. Such

advice would be more likely to be heeded if it came from Parliament as well as from the Government. Subject to the advice of the Chief Whip on the prospects of securing a convincing majority, therefore, the Government might seek a formal Parliamentary vote endorsing its attitude to the Olympics. Useful suggestions had also been put forward in recent letters to the Press from Sir William Hayter and others: these suggestions could be reflected in the Prime Minister's letter to the British Olympic Association. The British Olympic Committee's need to appeal for funds might provide a means of pressure; but it would not be right to involve The Queen in her capacity as the Committee's Patron.

b. There was general agreement that the Government should continue to oppose subsidised food sales to the Soviet Union by the European Community; should pursue with Britain's allies the possibility of tightening and widening the restrictions imposed by the Co-ordinating Committee on the International Strategic Embargo (COCOM), while recognising that agreement on significant steps was unlikely and that unilateral British action could not be contemplated; and should refuse the Soviet Union credit terms more favourable than the Organisation for Economic Co-operation and Development's Consensus, provided that other relevant members of the European Community did the same.

c. Caution was expressed about giving too much political or military support to Pakistan, given the weak internal position of General Zia's regime, and the danger of adverse Indian reaction. The threat to Pakistan was in any case not primarily military. On the other hand, the first consideration must be to enable Pakistan to preserve her territorial integrity. The United States Government had reaffirmed the guarantee given to Pakistan under the 1959 Agreement: Her Majesty's Government were not called upon to do more than noting this guarantee.

d. There was no doubt that the Pakistani armed forces were badly under-equipped, and their morale was important. United States military aid was likely to be inadequate. Since there were difficulties over financing any British arms supplies by means of an increase in the Export Credits Guarantee Department's cover limit, it would be worth exploring the possiblity of Saudi money being made available.

e. As regards Turkey, it was noted that the present Prime Minister's plans for restoring the economic situation were sensible but unlikely to command the necessary support in Parliament; the result might well be a take-over by the Army.

THE PRIME MINISTER, summing up the discussion, said that the general case for supporting the Americans in response to the Afghanistan crisis was strengthened by the need to be less forthcoming towards current American policy over Iran. Her message to the British Olympic Committee would be redrafted in the light of the discussion, and she would arrange for it to be delivered as soon as possible. She would at the same time inform President Carter as proposed. Further thought should be given to the possibility of seeking Parliamentary endorsement for the Government's attitude to the whole Olympic problem. The Government would continue to oppose subsidised food exports to the Soviet Union by the European Community; would explore with other countries concerned the possibility of tightening and widening the COCOM restrictions; and provided others did the same would not go beyond Consensus terms for credit. The Foreign and Commonwealth Secretary would pursue the various proposals for political action in the area, and would bring forward a separate paper on the possibility of a European initiative on the Palestinian question. Certain of the proposals would require further consideration between the Foreign and Commonwealth Secretary and herself. The Foreign and Commonwealth Secretary would revise his proposed statement in the House of Lords, which would be postponed until 24 January when the Lord Privy Seal would be available to make a corresponding statement in the House of Commons. She herself would meanwhile arrange for an announcement, either in Parliament or in the Press, about the Government's approach to the British Olympic Committee.

The Committee -

1. Invited the Secretary of State for the Environment, in consultation with the Foreign and Commonwealth Secretary and the Prime Minister, to redraft the proposed letter to the British Olympic Committee and to discuss with the Chief Whip the possibility of Parliamentary endorsement for the Government's Olympic policy.

2. Invited the Foreign and Commonwealth Secretary, in consultation with the Prime Minister and other Ministers as appropriate, to arrange for the other measures proposed in paragraph 4 of his minute to be pursued in the light of the Committee's discussion.

3. Invited the Foreign and Commonwealth Secretary and the Lord Privy Seal to report the Government's position to Parliament on 24 January.

4. Invited the Foreign and Commonwealth Secretary to draft a reply for the Prime Minister to send to President Carter's message of 14 January.

3. IRAN

The Committee considered a note by the Secretaries (OD(80) 4) covering a study by officials on the United Kingdom response to pressure for voluntary measures against Iran; and also had before them a minute of 21 January to the Prime Minister from the Foreign and Commonwealth Secretary, reporting the views of Her Majesty's Ambassador in Tehran and of certain allied Governments on a number of specific issues; and a minute of 21 January to the Prime Minister from the Attorney General, concerning the legal issues in the case of the fleet replenishment ship Kharg which was shortly due for delivery to the Iranian Navy.

THE FOREIGN AND COMMONWEALTH SECRETARY said that the United States policy of applying sanctions to Iran, in the absence of a mandatory resolution of the United Nations, seemed to be ill-conceived in terms of the objective of securing release of the American hostages in Tehran and ill-adapted to the new international situation resulting from the Soviet invasion of Afghanistan. There were signs that the United States Government were beginning to recognise this and to incline towards a policy of carrot more than stick; but they were constrained by strong domestic pressures.

THE ATTORNEY GENERAL said that he had not yet completed his study of the Kharg case, but it seemed likely that property in the ship had already passed to the Iranian Government, and it was clear that, if the Government wished to prevent delivery, the Iranians should be given early notice that commissioning would not be permitted and that an export licence would be required and would not be granted. In discussion it was pointed out that, while the United States Government might understand the reasons for general British failure to apply voluntary sanctions, they would be gravely disturbed by a decision to release a major ship to the Iranian Navy. The French Government were saying that in present circumstances they would find ways of not handing over the patrol boats which had been built for the Iranians in France; and the Italian Government hoped to be able to plead that military equipment built in Italy could not be handed over because American components were involved, which gave the Americans the power of veto. There were, however, very strong arguments in favour of allowing the Kharg to be delivered on the due date. Britains inter-

national reputation as an arms supplier was at stake. To frustrate delivery was not likely to improve ~~projects~~ prospects for the American hostages, and would damage the prospects for future ~~elections~~ relations with Iran. As Her Majesty's Ambassador in Tehran had pointed out, the Iranians seemed certain to regard the Kharg as a test case. If the ship was not handed over, they were likely to take damaging retaliatory action against British interests. It also seemed possible that even some American companies were managing to avoid applying sanctions.

THE PRIME MINISTER, summing up the discussion, said that the Committee agreed to reject the American proposal for Britain to apply on a voluntary basis the sanctions against Iran proposed in the United Nations Resolution which the Russians had vetoed. Limited economic measures, such as a ban on food exports by the European Community and a ban on Iranian civil aviation, could be contemplated only if agreed on by Britain's European partners. In the light of the latest views of Her Majesty's Ambassador, no action should be taken to impose a visa requirement for Iranians visiting Britain or to limit the size of the Iranian Embassy in London. The most difficult problem concerned arms exports. Existing contracts and possible new contracts would each have to be considered on their merits. The Committee would examine the Kharg case further at their meeting on 29 January, at which the Secretary of the Cabinet should arrange for a full report to be available on the facts of the case, on the legal position, on the intentions of Britain's relevant allies and on the deadlines within which specific decisions needed to be taken. Decisions should not be made public until the last possible moment, in the hope that the hostages might in the meantime be released.

The Committee -

1. Took note, with approval, of the Prime Minister's summing up of their discussion.

2. Invited the Foreign and Commonwealth Secretary to arrange for the Government's decision against voluntary sanctions to be conveyed to the United States Government.

3. Instructed the Secretary of the Cabinet to submit a further report on the Kharg case for consideration at their meeting on 29 January.

Cabinet Office

23 January 1980

cc Mr. Walk-Gery
Mr. Franklin
Mr. Hastie-Smith
Mr. Fowler
Mr. Maxey
Mr. le Cheminant
Sir K. Berrill

PM/80/5

PRIME MINISTER

Afghanistan

1. On 9-18 January I visited Turkey, Oman, Saudi Arabia, Pakistan and India, primarily to discuss with the governments of these countries the Soviet invasion of Afghanistan and their reactions to it. I had discussions with the Foreign Ministers and Heads of Government of all these countries. I also had a brief meeting during a stop-over on my return journey with the Foreign Minister of Bahrain. The following are my impressions and conclusions.

A. IMPRESSIONS

General

2. All the countries I visited, except India, agreed broadly with our own analysis of Soviet motives for their invasion and with our estimate of the dangers to the security and integrity of other states in the region, and with the need for a significant and sustained response, both from the West and from those countries which feel threatened. The Western reaction so far has disappointed them. Oman, Saudi Arabia and Pakistan probably underestimate the threat of internal subversion. India's attitude is influenced by her traditional tendency to give the Russians the benefit of the doubt and her distrust of Pakistan.

Individual Countries

3. (a) Turkey: The Turkish economy is in a parlous state and internal security is bad. The Turks are especially concerned about the maintenance of the integrity of Iran. They fear that Khomeini's policies could lead to the country's disintegration, stimulated by Soviet subversion in Azerbaijan and elsewhere. The Turks will require large-scale financial help over the next few years.

(b) Oman: Sultan Qaboos is not a natural leader and receives

/indifferent

indifferent advice. But Oman is prosperous and Qaboos is likely to survive for some time longer. He remains anxious about the threat from the PDRY. The Omanis are discussing the possible provision of facilities for US forces but do not want Western personnel on Oman's territory. Their initiative for the establishment by the Gulf States of a minesweeper capability in the Straits of Hormuz was mishandled, but this could be rectified.

(c) Saudi Arabia: The Saudis are ready to help Turkey, eg over oil. They are also prepared to offer financial help for strengthening the military capabilities of the countries in the region under threat, though they are opposed to any Western military presence. They are playing a leading role, together with Pakistan, in mobilising Moslem opinion against the Soviet action in Afghanistan. But they regard the Camp David Agreement as an obstacle to full-hearted co-operation between the countries of the region and the United States. They look for a new move on the Middle East problem when, as they expect, the Camp David process runs into the sand in April/May; (this view was shared by the Bahraini Foreign Minister). The Saudis are concerned about Soviet influence in both the PDRY and the YAR and about possible subversion through the many expatriates in their own country. The Mecca incident was a shock to them.

(d) Pakistan: The Pakistanis are deeply concerned at the new threat on their western frontier. They feel squeezed between the Russians in Afghanistan and the Indians on their eastern border. They particularly fear the possibility of Soviet ''retaliatory'' raids from Afghanistan into their own territory. They are painfully aware that their military equipment is out of date. They were affronted by the meagreness of the US offer of credit. In both respects their attitude is justified. Moreover, the refugees from Afghanistan, who they think may number one million by the Spring, are an increasing burden. But their reaction to the Soviet invasion was dominated by their complex over India, who, they are convinced, still wants to establish hegemony over the sub-continent. Nonetheless, they are ready to resume the process of ''normalising'' relations with India as a means of sanitising their eastern frontier. President Zia is in a dilemma over elections: if he holds them, the Bhutto faction will win; and if he does not, popular discontent will grow.

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(e) India: The Indians accept that the Soviet invasion of Afghanistan poses a danger to the sub-continent. But they are anxious to find excuses for Soviet behaviour in the policies and activities of Pakistan, China and the United States, by whom they profess to feel surrounded. They resent the possibility of a super-power confrontation so close to India, not only on grounds of national security, but also because of the effect on the Non-Aligned Movement and India's role in it if she had to make a choice. They were somewhat shame-faced and defensive over the Indian statement at the United Nations and apprehensive about the Islamic line-up against the Soviet action. They are also preoccupied with their domestic economic problems and with unrest in their north-east and eastern border areas. They are ready to talk to the Pakistanis but with little enthusiasm or hope of success, given the weakness of Zia's position and above all their congenital distrust of Pakistani promises against the background of three Indo-Pakistani wars, which leads them to express apprehension about any revival of a closer US/Pakistan military relationship.

B. CONCLUSIONS

4. My talks in the capitals I visited confirmed my view that the Soviet invasion of Afghanistan is a most serious challenge and unless the West reacts with vigour, any repetition of it eg, in Yugoslavia, could be disastrous. We must urgently pursue our discussions with the Americans and with our principal European allies. The following are among the actions we might undertake:-

(a) We should pursue the political and economic measures directed at the Soviet Union which we have been discussing in NATO, even though for the most part, apart from a boycott or the removal of the Olympic Games (See Annex), these are unlikely to cause the Russians major difficulties or embarrassment.

(b) We should encourage the non-aligned countries, and particularly the Moslem countries, to continue their denunciation of the Soviet action and, if possible, to take measures against the Afghan regime. We should continue to urge the Americans to handle the Iran crisis in

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such a way as not to hinder this.

(c) We should encourage the United States formally to guarantee Pakistan against aggression from Afghanistan and to meet Pakistan's legitimate military requirements up to a level which would give the Indians no justifiable grounds for concern. We should also support the Americans in their search for suitable defence facilities in the region.

(d) We should conclude as rapidly as possible negotiations over our own sales of defence equipment to Oman, Saudi Arabia and other states in the Gulf and to Pakistan.

(e) We should prepare a European initiative amending Resolution 242 to provide for the acknowledgement of the Palestinians' rights in return for their recognition of Israel. This proposal could be put forward when, as seems likely, the Camp David process comes to an end in April/May.

(f) We should provide friendly states in the Gulf and Pakistan with more information about our assessments of Soviet activities and intentions in the area.

(g) We should also provide these states with assistance in counter-subversion.

(h) We should encourage closer co-operation among the Gulf States, eg over the security of the Straits of Hormuz.

(i) We should work carefully for an EEC/Gulf dialogue.

(j) We should increase Western and Saudi/Omani influence in the YAR.

(k) We should consider the practicability of promoting insurgency in Soviet-dominated areas such as the PDRY, Ethiopia and Afghanistan itself.

(l) We should participate to the extent possible in further financial help for Turkey.

(m) We should encourage the Indians and Pakistanis, despite their pathological distrust of one another, to normalize their relationship.

(n) We should review with others our policy towards China including arms sales.

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(o) We should review with the others concerned possible support for Yugoslavia.

5. I am copying this minute to the members of OD and to Sir R Armstrong.

C

(CARRINGTON)

Foreign and Commonwealth Office
19 January 1980

OLYMPIC GAMES

1. Following the meeting of Ministers on 16 January, we have asked the Germans and Italians whether they would join us in a formal approach to the International Olympic Committee to suggest moving the Games. The Germans are very cautious but Dr Genscher is expected to discuss the Olympics with Mr Vance when they meet on 21 January. The Italians have yet to react. Sir N Henderson will put the matter to Mr Vance on 19 January.

2. The Canadian Prime Minister said on 18 January that Canada would approach the IOC about moving the Games and that the practical difficulties at Montreal might be less than the city authorities have said. The Japanese would probably be extremely reluctant to accept part of the Games. The Mexicans and the Germans would also be likely to see political objections to using their Olympic facilities. The Australian Government is reviewing the subject and the difficulties at Melbourne might be less than elsewhere.

3. The chances of getting the Olympic Games moved are very slight. On the other hand the Russians might be glad to have Britain excluded from the Games on the grounds of our sporting contacts with South Africa.

4. The Winter Olympics begin next month in New York State, but the United States Government do not intend to take any action on this front, such as denying visas to the Soviet team.

5. Another idea, not yet discussed with our Allies, would be a Western proposal to the International Olympic Committee that the Olympic sailing events should be moved from Tallinn in the Baltic States to another country. This would have political attractions. Summer 1980 is the 40th anniversary of another Soviet act of aggression, the annexation of the Baltic States. A number of Western countries, including the UK, France, Germany and the US, do not recognise the annexation de jure. Moreover, the relocation of the sailing alone would present far fewer practical difficulties than moving the entire Games. On the other hand, the response of the International Olympic Committee would probably be negative.

6. Yet other options include a Western boycott of the Moscow Games, or a boycott by the Western contingents of ceremonial events such as the opening and closing parades and official Soviet receptions. The British Olympic Committee would resist the first and probably the second. One thing in the Government's power is to decide that the Duke of Edinburgh and the Minister for Sport should not go to Moscow.

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cc Mr. Humphrey, FCO
PS/Mr. Douglas Hurd MP
Mr. D. G. Jones, MoD, PS/Lord Strathcona

15th January, 1980

1 attachment

South West Asia

The Prime Minister is to discuss the situation in South West Asia with her colleagues most closely concerned at 4.00 pm tomorrow, 16th January, at 10 Downing Street.

I attach for consideration at this meeting the report commissioned at Cabinet last week on the extent of Britain's and the European Community's economic interests vis-a-vis the Soviet Union and Eastern Europe.

I am copying this letter and its attachment to the Private Secretaries to those attending tomorrow's meeting, namely the Home Secretary, the Chancellor of the Exchequer, the Secretary of State for Defence, the Secretary of State for Industry, the Lord Privy Seal, the Minister of Agriculture, the Secretaries of State for Trade and for Energy, the Attorney General, the Parliamentary Under Secretary of State, Department of the Environment (Mr. Monro) and the Governor of the Bank of England.

Since the report fulfils a remit from Cabinet, copies go additionally to all members of the Cabinet not specified above, to the Minister of Transport and the Chief Whip.

M. J. VILE

(M. J. Vile)
Private Secretary

M. O'D. B. Alexander, Esq.

AFGHANISTAN: POTENTIAL COSTS OF MEASURES AGAINST THE SOVIET UNION

INTRODUCTION

1. This paper gives a preliminary assessment of the potential economic costs to the United Kingdom, either directly or through retaliation, of measures which might be taken against the Soviet Union in the context of its intervention in Afghanistan. The measures considered are those set out in paragraphs 3 and 4 of the minute PM/80/4 of 8 January from the Foreign and Commonwealth Secretary (other than the suspension of visits and exchanges).

GENERAL CONSIDERATIONS

2. i. General restrictions on civil trade would fall within Community competence and could only be adopted by agreement of the Nine. Several of the Nine export more to the USSR and East Europe than the United Kingdom and for economic (and other) reasons might be unwilling to agree to some measures which might involve relatively lower costs for the United Kingdom.

ii. Although any measures would primarily be directed to the USSR account must be taken of the varying scope for evasion or retaliation by the USSR using East European countries and of costs which might arise vis-a-vis those countries.

iii. Soviet retaliation could take a variety of forms and need not be confined to the field of any particular western measure. The United Kingdom must act in conjunction with other countries relevant in each field for measures to be effective. Also the cost to the United Kingdom would be likely to be much increased if it was identified as a prime mover in action against the Soviet Union. That cost would be risked and might materialise even if measures advocated by us were not (after discussion with our western allies) eventually adopted.

iv. Britain, which is relatively more highly dependent on overseas trade (30 per cent of GDP) and international investment than other major countries, has long been opposed in principle to the use of civil economic weapons for political purposes, except under the authority and with the near universal applicability entailed by a mandatory United Nations resolution (and even then possible implications for our policy in Southern Africa must be kept in mind). The experience of such weapons is that they have had little success. And their use unsanctioned by international law has serious implications for international economic relations. The United States has a tradition of readier use of these weapons. Her recent tendency, albeit under great political pressures, to act first and then seek reinforcing actions from her allies, presented serious problems in the case of the Iranian assets freeze; and in relation to the grain embargo on the USSR, though the United States interest in this trade is the dominant one, is not without these disturbing wider implications. To the extent that the Community nonetheless decides in the Afghanistan situation to take action on civil trade, there will be least conflict with our general position if measures adopted: involve withdrawal of Governmental treatment arguably favourable to the USSR (eg withdrawal of EEC restitutions on grain or butter sales), rather than direct interruption of normal civil trade flows; in the field of technology are fully justifiable on strategic grounds.

v. Any measures which lessen the Russian contribution to world energy supplies will hurt the west as well as the Soviet Union.

POTENTIAL DIRECT COSTS

3. A. <u>Ending credits to the USSR at lower than OECD Consensus rates</u>

No costs, provided other western countries also offer no rates below the OECD Consensus (see Annex A). To the extent they did not conform and undercut our rates United Kingdom companies would be seriously disadvantaged. The Anglo-Soviet 1975 Credit Agreement expires on 16 February. Those of France, Italy and Canada have already expired. Refusal to renew the Anglo-Soviet Agreement would not involve costs to the United Kingdom if others did not renew but if they did our exporters would also be at a disadvantage.

B. Tightening COCOM Restrictions

The loss to United Kingdom exports would be around £14 million (1979) if all COCOM countries agreed to suspend present procedures for exceptions. However some member countries are likely to resist complete suspension and the end result may fall short of this; the United Kingdom export loss would be proportionately less. See Annex B.

The Americans have said that they wish to pursue a differentiated policy designed to encourage signs of independence in Eastern Europe. This fits with our own views. Although there is always some risk that technology sold to Eastern European countries will be passed on to the Soviet Union, this risk is limited by the COCOM requirement for end use certificates. A stricter COCOM embargo on exports to the Soviet Union should not involve significant extra costs for the United Kingdom in terms of reduced exports to Eastern European countries.

Widening the scope of COCOM would require detailed and difficult technical study. Much will depend on what the Americans envisage. We understand that they have not yet reached any conclusions on what new products might be covered by an extended embargo; we have been told informally that they see this as a second phase which would have to be taken more slowly than tightening the existing rules. At this stage it is not possible to make even a rough guess at the possible cost to the United Kingdom of the widening of COCOM's scope. cf C. below.

C. Extending the scope of COCOM

The United States has proposed significantly extending the scope of present COCOM controls to prevent the transfer of a wider range of civil technology to the Soviet Union. The United States could do a certain amount of this unilaterally by refusing re-export licences where equipment provided by other countries incorporated American technology. The effects of this, and of a wider ban on exports would of course depend on the extent of new restrictions but they could seriously affect United Kingdom exports to the Soviet Union which mainly comprise specialist chemicals, plant and other advanced industrial products. Other countries can and do supply most of these products so the ban would be ineffective unless applied in concert with our allies and the Soviets could make much in propaganda terms of less than

concerted action. Restrictions on particular areas of technology could raise broader policy considerations such as the implication for future world energy markets of limiting Soviet oil and gas development. See Annex C.

D. EEC restrictions on food sales to the USSR

i. Grain

Any restrictions on grain sales to the USSR would be a matter of Community competence. The Commission have just proposed a change in the system of export restitutions which, if confirmed, should shortly prevent any future sales of EEC grains to the USSR except at the full Community price - ie well above the present world price; monitoring of restitutions on grain sales to East European countries would also be extended to cover all such countries.

There would be no significant cost, unless withdrawal of export restitutions were extended to East European countries (though France, the principal Community cereals exporter, claims that she stands to lose some trade with the USSR). If however the United States or Community were to seek to seal up every gap and as a consequence restitutions for East European countries were withdrawn United Kingdom grain prices would be severely hit by the loss of feed barley sales to Poland (which is a major market for the United Kingdom's current surplus of about 1 m. tonnes). See Annex D.

NB The United States unilateral action may already entail United Kingdom costs if world prices are thereby lowered. Each $1 fall in world prices would mean a net increase of £1.25 million by the United Kingdom to the EEC budget. See Addendum A to Annex D.

Shipping freight rates have already fallen as a result of the United States action and this could affect the profitability of United Kingdom shippers. See Addendum B to Annex D.

ii. Meat

An effective United States food embargo will result in an increasing meat shortage in 1980/81. Community exports of meat to the USSR have fluctuated substantially in the past. Recently they have been mainly poultrymeat: until last year (when it reached 10,000 tonnes) the United Kingdom's share of this trade was negligible.

It is understood that the Commission have indicated to the United States that they will be seeking arrangements to ensure that any withdrawal of United States supplies shall not be replaced by the Community. The Commission have therefore suspended pre-fixing export refunds for poultrymeat. They are expected to propose reductions in the level of refunds and the exclusion of the USSR, while seeking other ways of regulating this trade.

What support is likely for these proposals is not clear. The Community has a surplus of poultrymeat. Member States are therefore concerned about the repercussions on the EEC industry, for which there are no alternative support measures. To attempt to maintain the Community's level of exports it would be necessary to increase export refunds, thus adding to the budgetary cost (there is no intervention for poultrymeat). Given the great fluctuations in the volume of Community trade and the increased pressure from United States sales, it has not been possible to quantify the additional FEOGA expenditure.

iii. Butter

Ending subsidised EEC sales, beyond the quantities already contracted for this winter, would produce a saving to the EEC budget in the short term, since much of the butter would be offered to intervention, and storage costs the community less than export refunds. But in the longer term continuing restrictions on butter sales to the USSR would require a shift in EEC policy towards lower producer price levels, allowing higher unsubsidised consumption; if this did not occur there would be major new costs for the Community with increased expenditure on subsidised internal disposal and on export refunds. Pressure for higher refunds would be greater if New Zealand also restricted sales to the USSR, since this would increase the quantity of butter surplus to requirements on the

world market. Officials' estimate of the cost of clearing 100,000 additional tonnes of butter on present EEC policies is of the order of £16-17 million for the United Kingdom. See Annex E.

iv. Sugar

The Russians generally import about 4 million tonnes a year and usually get most of this sugar from Cuba. This year, following a poor Cuban crop, they have bought about half their needs from the free world market and have contracted already to buy a fair quantity (which Tate's now think may be as much as 1 million tonnes) from the EEC. Because of the large numbers of importers and exporters and the multiplicity of trade flows the Community has little possibility of hurting the Russians by restricting their purchases from the EEC in future should they again need to make substantial imports from the free world market, though it could force them to rely mainly on raw rather than white sugar. However, action to withdraw EEC subsidies from sales of sugar to Russia could not be achieved without substantial changes in the present EEC regime, would not prevent the substantial EEC sales of unsubsidised quota C sugar (likely to total nearly a million tonnes this year), would be strongly opposed by the French and would be particularly costly to the United Kingdom in terms of increased FEOGA contributions. It is estimated that, for every ECU per tonne that the world price dropped relative to Community price and the export refund increased, our United Kingdom expenditure via our share of Community expenditure on export refunds would increase by about £3 million.

POTENTIAL COSTS FROM RUSSIAN RETALIATION

4. A. Trade: raw materials and manufactured goods

Russian retaliation would be limited by the country's overriding need to earn hard currency but, at a cost to itself, the Soviet Union could use its central planning machinery to steer orders so as to damage the interests of particular suppliers. The effect could be increased, to a limited extent as far as the United Kingdom is concerned, by co-ordinating action with other East European countries. Exports of raw materials could not be manipulated as specifically because the Western market mechanism would generally spread

the effect over the market as a whole. Nevertheless withholding supplies could disrupt particular markets and interests. While the importance of Russian supplies of strategic metals such as chromium, vanadium and manganese to the West should not be exaggerated, it could create difficulty in the future that in each case South Africa is a very important alternative supplier. The situation over platinum group metals, used in industrial catalysts, could be more serious; here South Africa dominates supply. Diverting supplies of industrial diamonds worth some £200-250 million a year from the United Kingdom market would lose us a valuable entrepot trade. Previously the USSR has supplied about 2 per cent of the free world demand for oil but shortages at home and in other CMEA countries suggest that this proportion is likely to drop anyway. As regards manufactured goods, the USSR is an important supplier to the United Kingdom of methanol and particularly naphtha. Withholding Soviet supplies would cause ICI serious difficulty and Eastern Europe as a whole supplies 60 per cent of the methanol used in Western Europe. See Annexes F and G.

B. Agricultural trade and fishing

No significant costs or difficulty from losses of imports from the USSR. See Annex H.

C. Credit Exposure

ECGD has at risk on the USSR some £20 million on up to six-month credit and £860 million (including interest) over 10 years. In addition United Kingdom banks have outstanding against the USSR uninsured lending of some £500 million. But it seems likely that the USSR would be reluctant to abandon its excellent repayment record by defaults, particularly in view of the implications for the credit worthiness and requirements of its East European allies. See Annex I.

ANNEX A

ECGD CREDITS AND THE OECD CONSENSUS

THE CONSENSUS

1. The OECD Consensus sets out guidelines related to the relative wealth of importing countries for maximum credit periods and minimum interest rates which may apply to officially supported export credit of 2 years or more. The United Kingdom, all other EEC countries and the major Western trading countries subscribe to the Consensus. The minimum interest rates currently applying to countries in the category in which the USSR is placed are -

for credits between 2 years and 5 years inclusive	$7\frac{1}{4}\%$
for credits of over 5 years	$7\frac{3}{4}\%$

THE ANGLO-SOVIET CREDIT AGREEMENT

2. The Anglo-Soviet Credit Agreement was signed in February 1975. It provided a framework for ECGD support for export credits to USSR. ECGD indicated willingness to support contracts of up to £950m over a 5-year period on up to $8\frac{1}{2}$ years credit terms. In order to match the French, lower than Consensus interest rates (7.1 per cent to 7.45 per cent) were indicated. So far firm contracts for some £540m have been financed under the Agreement. The Agreement comes to an end on 16 February 1980. There is no provision in the Agreement for its renewal, and ECGD could continue support trade with the USSR on a case by case basis without a formal Agreement. On the other hand it is Russian practice to operate with Agreements of this nature and it is likely that other Western countries will renew existing Agreements. Every effort is being made to ensure that if they do so the interest rate charged will be on at least Consensus terms. If other countries renew Agreements the United Kingdom could be at a disadvantage in future trade with the USSR if a new Agreement was refused. Similarly United Kingdom exports would suffer if we offered less favourable credit terms than the USSR could obtain elsewhere.

OFFICIALLY INSURED COMMITMENTS ON THE USSR

3. i. ECGD has at risk on the USSR some £20m of business on up to six months credit and £860m, including interest, on business on terms in excess of six months. This latter figure is repayable over the 1980s.

ii. other EEC countries have collectively £230m at risk on terms up to six months credit and £7,142m on terms in excess of six months. Of this latter figure French commitments amount to £2,928m and West German commitments to £2,495m.

OFFICIALLY INSURED COMMITMENTS ON EASTERN EUROPE EXCLUDING USSR

4. i. ECGD has at risk on all other East European countries some £44m on up to six months credit and £1,540m on terms in excess of six months.

ii. Other EEC countries have collectively £110m at risk on up to six months credit and £5,191m on terms in excess of six months. Of this latter figure French commitments amount to £2,545m and West German commitments to £954m. The West German figure excludes commitments on East Germany.

ANNEX B

TIGHTENING COCOM RESTRICTIONS

1. Application of the "full rigour" of COCOM regulations would affect -

a. goods caught by COCOM's embargo on strategic exports, but which member countries agree unanimously should be exempted (General Exceptions Procedure);

g. goods caught by the COCOM embargo but of low strategic importance, for which individual member countries may issue an export licence without reference to COCOM (Administrative Exceptions Procedure). Spare parts etc of goods already approved under the General Exceptions procedure can also be approved administratively.

2. British goods, for which application was made for export to the Soviet Union under category a. were worth a total of US$ 13.51 million in 1979. Much the biggest item was a crop forecasting system worth $8.75 million, for which approval is still pending. The bulk of the other cases were computer-related. British goods, approved administratively under category b. in 1979, were worth $18.66 million. Of these, computers and related equipment accounted for $16.75 million.

3. If no exceptions were made under either category, either by unilateral United Kingdom action or as a matter of (unanimous) COCOM policy, the cost in terms of British exports to the Soviet Union foregone would be of the order of £14 million. The Americans are likely to aim for the exclusion of all exceptions and have the sanctions both of a veto on exceptions and of the refusal of an export licence for essential components of United States origin. But other member countries of COCOM might be unwilling to accept a policy so rigorous as to exclude all exceptions. For example, the French, who seem particularly lenient in their application of COCOM regulations to computer exports, might be expected to resist a complete ban. In the last resort COCOM must operate on the basis of consent and the end result may be less than complete suspension.

4. If all COCOM countries agreed to apply the regulations more rigorously the Soviet Union might retaliate in some unrelated area. Also if only certain countries applied the regulations rigorously not only might the Soviet Union's ability to obtain high-technology goods be little affected but it might discriminate against the goods of the countries which had applied the regulations rigorously even after the rigour has been relaxed.

5. The Americans are now seeking our support for a differential in favour of China within COCOM. A differential has long been an objective of British policy in order to facilitate our defence sales to China. It will be important to ensure that British policy on exports of technology to the Soviet Union takes account of the requirements of our policy towards China.

ANNEX C

EXTENDING THE SCOPE OF COCOM

1. The United States has proposed a significant extension to the scope of the present COCOM list to cover sales to the Soviet Union of items closely allied to those already on the list (eg additional computer equipment and machine tools, new areas of technology (eg oil extraction technology) and to deal effectively with inadvertent transfer of technology though sales which, while being individually unimportant are much more significant when taken together.

2. The extent of these proposals still has to be defined but, as a rough guide perhaps one-third of total United Kingdom exports to the Soviet Union involve some transfer of relatively sophisticated technology. Looked at in terms of sales under the 1975-80 credit agreement, the proportion is even higher - perhaps £300 million out of a total of £500 million. Such sales include some items covered by present COCOM controls but as shown in paragraph 3 above, these are relatively small. Thus it seems likely that United Kingdom trade interests would be considerably affected by extending the controls and, unless other countries observed the same restrictions, the Soviets could readily place the business elsewhere. Germany, France and Japan have potentially even more to lose because their sales of technology-based equipment to the Soviet Union are larger than the United Kingdom's. A further factor which is difficult to quantify would be the effect of a United States decision to impose more stringent conditions on the issue of re-export licences for equipment containing some element of American technology (as is the case with nearly all computer installations and a significant proportion of process plant). Re-export licensing is burdensome for firms; to tighten it would be liable both to create greater uncertainty for them and increase the risk of circumvention.

ANNEX D

GRAIN SALES TO RUSSIA: CHANGES IN THE EEC RESTITUTION SYSTEM

1. Export restitutions are provided in two main ways. The bulk of the Community's exports are made under a system of weekly tenders which are awarded to those traders who bid for least subisdy. In order to take account of market conditions in different areas the tenders are held on a regional basis. This system is designed to enable the Commission to minimise the FEOGA cost of export restitutions and to control the quantities exported. Because subsidy payment is not made until the trader has produced evidence of delivery at the destination specified it could also provide a measure of control, but only post hoc, of destination. In addition to the tenders there is a less attractive standing restitution which normally operates on a general basis though currently restitutions are available only for certain near destination in Western Europe and for East Germany (which for legal reasons has hitherto been excluded from the tender system). All exports require an export licence: but licences are transferable and do not provide information about destinations. The Commission thus relies mainly on trade sources for information about exports to individual countries though the tender system provides information about exports to the various zones.

2. The information available suggests that so far this year the Russians have not bought up significant quantities of EEC grain though, since Russia is at present covered by two of the tender zones (for Baltic and Black Sea ports) they may, to the extent that present licences have not been taken up for other destinations, be able to benefit from tenders already held. The Commission however believe that in practice there is little scope for Russia buying: so far as the standing refund is concerned the Russians could have obtained no subsidised EEC grain because they fall into the class of destinations for which a zero refund is set.

3. In order to prevent Russian purchases of subsidised EEC grain in future and to monitor more effectively the supplies of grain going into Eastern Europe the Commission have proposed -

a. to take East Germany out of the standing refund which would then exclude all Eastern bloc countries;

b. to rearrange the zones for the weekly tenders so that Russia is removed from the tender system and the satellite countries including East Germany are all brigaded into one group including no other countries.

4. The effect of this will be that export restitutions will not be available in future on exports to Russia though of course they will not be prevented from buying Community grain without restitutions at the full Community price (which is at present substantially higher than the world price). A total embargo on sales to Russia could only be achieved by imposing a comprehensive destination control through export licences and enforcing it with stringent penalties eg by requiring payment of substantial caution money: this would represent a major interference with normal trade.

5. The Commission is not proposing at this stage to lay any fresh restraints on trade with the satellites. There is obviously a danger that the Russians may seek to divert such supplies to their own use but this will be resisted by the East European countries who have considerable need of Community grain particularly barley this season following a poor harvest. Moreover no such restrictions have been proposed by the United States and politically it would seem unwise to take action which would unite rather than divide the Eastern bloc.

6. So far as United Kingdom interests are concerned we rely heavily on outlets in Eastern Europe, particularly Poland, for our exports of feed barley, likely this year to amount in total to about 1 million tonnes of which Poland could take a substantial share. Because the French are nearer to the main alternative outlet they have the edge on us in the Mediterranean market and, since we have only a limited intervention capacity, any restriction of Community exports to Eastern Europe would have serious effect on United Kingdom grain prices.

7. Most other Member States have supported or gone along with the Commission proposals except France who took the unusual step of refusing to participate in the Management Committee discussion and voting on them. It is evident that this attitude is governed not only by her interest as the largest Community cereals exporter but also by her general political coolness towards sanctions against the Russians.

Addendum A to ANNEX D

FINANCIAL CONSEQUENCES OF THE UNILATERAL UNITED STATES ACTION

1. The unilateral United States action on grain exports will have financial consequences for the United Kingdom and other EEC countries quite apart from any costs associated with EEC support for the United States action. But these depend on the effects on world grain prices and cannot be realistically estimated at this stage. World prices could firm slightly if the United States takes effective steps to withdraw from the market quantities of grain equivalent to those being denied to the USSR and if other grain exporters do not fill the gap. But if these conditions are not fulfilled there could be a fall in world prices. This could affect the United Kingdom contribution to the EEC budget in two ways. First by increasing income from import levies on grain, it would increase what the United Kingdom has to hand over to the Community and decrease the need for VAT contributions from other Member States: secondly it would increase the unit cost of the export restitutions needed to dispose of the Community's grain surplus - expenditure from which we benefit less than most other Member States. Both effects would be likely to be adverse for the United Kingdom contribution.

2. On the assumption that there was no change in the volume of Community grain imports and exports and that the prices of all grains were affected to the same extent, a rough estimate suggests that the United Kingdom contribution to the budget would rise by £1.25 million net for every $1 fall in grain prices.

Addendum B to ANNEX D

SHIPPING CONSEQUENCES

Restrictions on grain sales would have significant implications for our shipping interests. There is minimal involvement of United Kingdom and United States ships in the Russian grain trade at present but cargoes carried by other countries' ships could have an appreciable effect on the market for charters and consequently on bulk freight rates, which in turn would affect the revenues of our shipping companies.

ANNEX E

EXPORTS OF BUTTER TO THE USSR

1. It is estimated that between 75,000 and 100,000 tonnes of Community butter might be sold to the USSR over the winter of 1979/80. 70-80,000 tonnes would be a more normal figure but Community stocks are higher than usual and the USSR has an increasing deficit as butter consumption rises faster than production. New Zealand also sold exceptional quantities to Russia in 1979 because of this situation. We do not know how many of the winter deals remain to be completed; it would be prudent to assume that the bulk has either been delivered or is contracted for. On the assumption that, while Soviet deficit lasts, Russia could purchase up to 100,000 tonnes a year, any restriction would only affect sales from the second half of 1980 onwards, say, 50,000 tonnes this year.

2. It is reasonable to assume that the Russians would not take up butter which did not receive a large refund, since they would be unwilling to establish the precedent that they were prepared to purchase at full Community prices (although in practice they sell at over Community prices to Russian consumers). Any butter which was prevented from going to Russia is likely to go into intervention in Member States other than the United Kingdom (our butter is too salty for the Russian market and is not therefore at issue).

3. The storage and interest charges for a tonne of butter in intervention for the year amounts to about 357 ECUs, whereas the cost of disposing butter by means of export refunds is 1880 ECUs per tonne. The purchase price of intervention butter is borne by the Member State until the butter is sold. If 50,000 tonnes of butter which would otherwise have gone to the USSR went into intervention the cost to the Community's budget for storage would be 24 MCUAs of which 4 MCUAs would be borne by the United Kingdom. Assuming the USSR imported 100,000 tonnes in a full year the cost on storage alone to the United Kingdom would be £5m.

4. In the short term the budget would gain from the saving (some 100 MCUs) on refunds on sales to Russia. However this benefit would be lost in subsequent years as the butter had to be disposed of, and the prospect of this old butter going by the cheapest route, ie export, would be significantly reduced with further adverse budgetary effects in subsequent years. The cost to the United Kingdom in those circumstances could be £20m per annum.

5. Moreover the effect of restrictions on sales to the USSR on the cost of the Community's export policy as a whole would depend on the actions of New Zealand, who is virtually the only other major supplier of the world market. Clearly if New Zealand supported the Community policy and avoided increasing her sendings to the USSR, increased pressure on world prices would result. This process would put great pressure on the Commission to increase export refunds, if not immediately then in 1981, at a time when we are campaigning to reduce them by substantial amounts. Every £100 fall in the world price of butter could involve an increase in the United Kingdom contribution via the budget to the cost of refunds of £7m additional to the costs cited in paragraph 4.

6. If on the other hand New Zealand made up the assumed shortfall of 50,000 tonnes to the USSR to the limit of her ability (say 25,000 tonnes) the surplus of butter on world markets would be significantly reduced, and Community traders would find it easier to place exports at existing refund levels.

7. Community exports to Eastern Europe are normally small, under 10,000 tonnes, to Poland and it should be possible to monitor exports to prevent any unusual increase which would indicate Poland importing on behalf of the USSR.

ANNEX F

SCOPE FOR SOVIET RETALIATION BY WITHHOLDING RAW MATERIALS

The Soviet Union is a major producer of essential raw materials. They could retaliate against the West by withholding or decreasing supplies of the following -

Metals - The Soviet Union is estimated to produce over 30 per cent of the world's gold and about 45 per cent of the world's platinum group metals (important as industrial catalysts). It is also a significant supplier to Western markets of chronium, manganese and vanadium. By withholding supplies of any of these materials, the Soviet Union would increase Western dependence on South African sources. Other consequences would include a further upward movement in gold prices and, in the longer term, the need to cut back Western consumption of platinum group metals, particularly palladium.

Oil - The Soviet Union is not a major supplier of crude oil to the United Kingdom and supplies only 2 per cent of free world oil demand. Nevertheless, the withdrawal of Soviet supplies could lead to a material increase in world oil prices, assuming that the Soviet Union were willing to forego vital foreign currency earnings by such a move. The Soviet Union is an important source of United Kingdom supplies of semi-processed crude oil products (about 10 per cent of our supplies) and of napthas (about 7½ per cent of our supplies); in the short term, we should have difficulty locating alternative sources.

Diamonds - The Soviet Union is after South Africa the United Kingdom's largest supplier of diamonds (mainly industrial). The trade is extremely valuable to the United Kingdom in view of the value added in this country before many of the diamonds are re-exported.

Monetary Gold - If the Soviet Union restricted sales of monetary gold it would be quite as damaging for itself as to others on account of the hard currency foregone. There would be little effect in foreign currency markets on speculative gold prices.

Uranium Enrichment

The electricity generating boards have placed contracts for the enrichment of 1000 tonnes of United Kingdom uranium in the Soviet Union over the next 10 years at a cost of $100m. The work could be switched to United Kingdom processing facilities, although there would probably be a resulting financial penalty. If the Soviets refused at any time to release uranium in their hands, a relatively small (but nevertheless valuable) quantity would be affected. Additional uranium is being processed for German and Austrian users.

ANNEX G

UNITED KINGDOM-USSR TRADE : GENERAL

1. The Soviet Union ranks about 20th in the league of Britain's export markets accounting for around 1 per cent of our total exports. Trade figures for 1974-78 and January-November 1979 are set out in the Addendum as are figures for the same periods for our trade with the other Eastern Bloc countries.

2. Both imports from and exports to the Soviet Union are concentrated in relatively few sectors. Timber, furs, oil and non-metallic minerals (mainly diamonds) account for over 80 per cent of our imports from the Soviet Union. A significant proportion of the furs and diamonds is re-exported. Plant and equipment account for over 25 per cent of our exports to the Soviet Union.

3. A wide range of companies, large and small, conduct regular business with the Soviet Union including Shell, Courtaulds, ICI, Davy, ICL and Rank Xerox. The market has been and will continue to be important for the process plant and engineering sectors. The largest contract currently under discussion (worth approximately £175m) is for oil rig fabrication yards at Baku and Astrakhan on the Caspian Sea. The United Kingdom bidder is the International Offshore Consortium (BP, Wimpey and Brown and Root). A Russian decision on placing this contract is expected this year. Other major projects under discussion, mainly for plant, are worth about £300m.

4. The Soviet economy is at present in the doldrums and, the Afghanistan situation apart, it is unlikely that there would be a significant expansion of trade with Western countries. However, the United Kingdom could expect continuation of the current level of exports. Also energy is expected to be given high priority in the next Five Year Plan (1981-85). The United Kingdom's experience in the North Sea and elsewhere puts her in a good position to bid for energy projects, particularly in the offshore oil and gas sectors.

5. The United Kingdom's main competitors in the Soviet market (all with higher shares of the market) are the USA, West Germany, Japan, France, Italy and Finland. There are very few areas in which the United Kingdom has a clear competitive advantage so that any unilateral action by Britain

to withdraw from business in the Soviet Union would result in opportunities being quickly taken up by our competitors with little or no loss to the Russians.

6. As the second page of the table shows, which also deals with visible trade, Eastern Europe other than the USSR and Yugoslavia is a rather more significant market for United Kingdom exports than the Soviet Union, but our imports from the Soviet Union exceed those from the rest of Eastern Europe. The proportions of Soviet and other Eastern Europe exports and imports in United Kingdom manufactured trade follow a very similar pattern to trade in total. Imports of manufactures from the Soviet Union are dominated by precious stones.

Addendum to Annex G

UNITED KINGDOM - SOVIET TRADE

£ million

	1974	1975	1976	1977	1978	Jan-Nov 1979*
EXPORTS:						
Manufactures	99	196	227	326	373	N/A
Non-manufactures	10	12	11	18	47	N/A
Total	110	210	240	347	423	381
IMPORTS:						
Manufactures	231	229	278	319	275	N/A
Non-manufactures	164	179	389	461	413	N/A
Total	395	408	667	781	688	752
BALANCE						
Manufactures	- 132	- 33	- 51	+ 7	+ 98	N/A
Non-manufactures	- 154	- 167	- 378	- 443	- 366	N/A
Total	- 285	- 198	- 427	- 434	- 265	- 371

*provisional

UNITED KINGDOM/EAST EUROPE TRADE (EXCLUDING USSR AND YUGOSLAVIA)

UK Imports	283	282	376	464	499	529
UK Exports	319	374	416	488	553	499
Balance	36	92	40	24	54	- 30

[After the Soviet Union Poland is the United Kingdom's only other substantial market in Eastern Europe]

EEC TRADE WITH THE SOVIET UNION

£ million in 1978

	Imports	Exports	Balance
EEC total (excluding UK)	3512	3314	-198
France	636	757	+121
West Germany	1403	1636	+233
Italy	868	590	-278

PROPORTIONS OF TOTAL UNITED KINGDOM VISIBLE TRADE WITH THE USSR AND EASTERN EUROPE (EXCLUDING USSR AND YUGOSLAVIA)

Per cent

	1974	1975	1976	1977	1978	1979 (Jan-Nov)
USSR						
Exports	0.7	1.0	0.9	1.1	1.1	1.0
Imports	1.7	1.7	2.1	2.1	1.7	1.7
Eastern Europe (Less USSR and Yugoslavia)						
Exports	1.9	1.9	1.6	1.5	1.5	1.3
Imports	1.2	1.2	1.2	1.3	1.2	1.2

ANNEX H

AGRICULTURAL TRADE: SCOPE FOR SOVIET RETALIATION BY WITHHOLDING EXPORTS

GENERAL

1. Details of trade in agricultural and food products between the USSR and EEC and with the United Kingdom are given in tables A and B of the Addendum.

2. Trade between the USSR and the EEC is substantially in the Community's favour. Dairy products, cereals and sugar products accounted for some 50 per cent by value of EEC exports. For these products the possibility of action to restrict exports is being examined. Meat and meat products were the largest element of the balance in 1977 due to an exceptional quantity of poultry meat exports.

3. Table B gives the corresponding figures for United Kingdom/USSR trade in both 1977 and 1978. The substantial United Kingdom surplus in 1978 is attributable to exceptional shipments of unmilled barley and to fish exports, mainly mackerel trans-shipped from United Kingdom fishing vessels. This surplus compares with a more customary deficit in 1977, when United Kingdom imports and exports were, respectively, some 24 per cent and 1.8 per cent of total EEC trade with the USSR.

4. Imports from the USSR are not significant as a proportion of total United Kingdom and EEC supplies. The effect of any Soviet retaliation on exports in this sector would therefore be very limited. Comments on the more significant commodities follow.

Meat and Meat Products

5. Minimal quantities of Beef and Pigmeat and more significant amounts of poultry meat are imported into the Community from the USSR. Any shortfall could be made up from a variety of alternative sources without any problem, and there is no likelihood of any effect on prices.

Fruit and Vegetables

6. The United Kingdom does not import any significant amount of fruit and vegetables from the USSR, and would have no difficulty in finding alternative supplies. Information on imports by other Community members from the USSR is not readily available, but it seems most unlikely that withdrawal of Soviet supplies would have any serious impact, since there are many alternative sources.

Sugar, Sugar Products and Honey

7. The quantities involved are negligible in relation to total supplies. The Community as a whole has a substantial surplus over consumption. Small quantities of honey are imported for blending and could be replaced without great difficulty.

Coffee, Tea, Cocoa and Spices

8. Imports into the United Kingdom are entirely of low grade tea. The 8,075 mts imported in 1977 were only 3 per cent of total imports. Withdrawal of Soviet supplies would have a minimal effect on the market. The United Kingdom accounted for some 75 per cent (by value) of total EEC imports of these commodities from the USSR in 1977. The Netherlands was the only other substantial importer, taking 6 per cent (by quantity) of its supplies from the USSR in 1977.

Beverages

9. Vodka imports are not particularly significant to the United Kingdom (9,476 proof gallons in Jan-Oct 1979, valued at £45,112) and domestic and other supplies could make up the shortfall both in the United Kingdom and the rest of the Community. Certain flavourings for gin and liqueurs are imported from the Soviet Union: information on alternative supplies is not readily available. There could be some risk that the Soviet Union would retaliate with barriers against Scotch whisky, although their imports (£541,000 worth in 1977) have in any case been small.

Fish and fish products

10. These are the largest item in Soviet food exports to the Community. In 1977 they accounted for 60 per cent by value of the total and 47 per cent in the case of the United Kingdom. France was the largest importer of Soviet fish products, taking some 38 per cent of the total. The United Kingdom's share was 19 per cent, the products involved being canned salmon, prawns and cod. However, Soviet supplies have represented only a tiny fraction of total United Kingdom (and EEC) imports around 2 per cent in 1978. Curtailment of this trade would therefore have negligible effect on our importers, except possibly for those committed to Soviet supplies of canned salmon.

Fishing rights

11. EEC Member States have no fishing rights in Soviet waters and the only possible countermeasures Russia could take would be harassment of United Kingdom vessels fishing, by agreement with Norway, in the 'grey zone' which is the subject of a formal dispute between Norway and the USSR. There would also be scope for the USSR and its Baltic satellites to withhold co-operation in the Baltic Fisheries Commission (of Baltic States). Further afield, the USSR could obstruct, or even withdraw from the International Whaling Commission. Any such public moves, however, would cause the USSR itself some embarrassment. (The USSR has no fishing access to United Kingdom or other EEC Member State waters and the scope for measures against Russia is limited to facilities such as transhipment.)

TABLE A

Addendum to Annex H

EEC/USSR AGRICULTURAL TRADE IN 1977

(£000s)

	EEC IMPORTS	EEC EXPORTS
Meat and Meat Products	2,738	42,630
Dairy Products and Eggs	-	26,524
Fish and Fish Products	28,726	101
Cereals and Cereal Products	16	11,739
Fruit and Vegetables	3,545	6,512
Sugar, Sugar Prpducts and Honey	801	43,022
Coffee, Tea, Cocoa, Spices	6,901	13,578
Miscellaneous Food Products	-	2,574
Beverages	6,101	6,887
TOTAL	48,828	153,569

TABLE B

UK/USSR AGRICULTURAL TRADE IN 1977-78

(£000s)

	IMPORTS		EXPORTS	
	1977	1978	1977	1978
Live Animals (Chiefly for food)	9	5	58	264
Meat and Meat Preparations	-	-	18	3
Dairy Products and Eggs	-	-	1	0
Fish and Fish Preparations	5,491	3,842	59	4,438
Cereals and Cereal Preparations	8	-	5	15,398
Vegetables and Fruit	860	319	6	65
Sugar, Sugar Preparations, Honey	116	115	1	42
Coffee, Tea, Cocoa, Spices	5,192	1,214	160	1,139
Animal Feedingstuffs (except unmilled cereals)	-	20	-	49
Miscellaneous Food Products	-	-	1,866	3,944
Beverages	58	49	548	600
Total Agricultural Trade	11,733	5,563	2,721	25,944
Total Trade	780,572	688,170	347,432	423,085
% Agricultural Trade	1.5%	0.8%	0.8%	6.1%

ANNEX I

BANK CREDITS

1. As can be seen from the following table, United Kingdom banks have a significant net creditor position vis a vis the USSR, and there are further potential claims of varying degrees of formality in the form of as yet unused credit lines. Thus, if the United Kingdom took action against the USSR in the financial field, USSR retaliation could result in substantial direct losses for United Kingdom banks. The possible damage to London's role as a financial centre would also need to be considered.

2. The possibility that the USSR might take extreme action, such as repudiation of debts, would presumably be increased by the fact that, deprived of the possibility of at least some imports of capital goods and grain, the USSR would have less need of credit in the future; moreover, the current gold price and rising prices for Russian oil exports (as long as these can continue) are further factors reducing the USSR's need for Western credit, and hence reducing the potential cost of repudiation.

3. In the case of Eastern Europe, the considerations are somewhat different. Net claims of United Kingdom banks are very much greater than those towards the Soviet Union. The Eastern Europeans, who have been notably reticent about the whole Afghan adventure, are far less self-sufficient than the USSR and are hence in greater need of Western credit - assuming that they could still get it in the changed atmosphere prevailing, after Afghanistan.

4. Action directed solely against the USSR would have implications for the other East Europeans. First, as some United Kingdom banks lend under the "umbrella" theory, countries such as Bulgaria who are particular beneficiaries would suffer if Western bankers assumed that the USSR would no longer tacitly guarantee debt to the West.

5. Even if it were felt that the risks of retaliation were not too great, it is not entirely obvious what course of action in the credit field would most hurt the USSR at the present time, particularly if it is hoped to avoid hurting the other East Europeans. If the USSR cannot buy the grain it had expected, then it will save foreign currency not only for the grain, but also for shipment etc. It might, therefore, be able to reduce gold and oil sales still further, thus further improving its terms of trade by putting up their respective prices.

15 January 1980

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Liabilities and Claims of United Kingdom banks vis a vis Eastern bloc

Mid-November 1979 (in £ millions)

(a) Foreign Currencies

	USSR				Eastern Europe[1]			
	Liabilities	Claims	Net	Unused Credit Facilities[2]	Liabilities	Claims	Net	Unused Credit Facilities[2]
UK banks	1,402	1,240	- 162	476	2,022	6,023	+ 4,001	1,246
British banks	261	304	+ 43	306	385	1,487	+ 1,102	1,089

(b) All Currencies

UK banks	1,436	1,508	+ 72	759	2,106	6,771	+ 4,665	1,866
British banks	287	562	+ 275	490	438	2,225	+ 1,787	1,089

(1) Bulgaria, Czechoslovakia, GDR, Hungary, Poland, Romania, USSR

(2) end-June 1979

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FOLIA 25

Foreign and Commonwealth Office

London SW1A 2AH

CABINET OFFICE
A 8246
22 JAN 1980
FILING INSTRUCTIONS
FILE No.

cc Mr Wright
Mr Hooper
Mr Smith

21 January 1980

cc Mr. Fowler
Mr. Maxey

Dear Michael,

Afghanistan

The Prime Minister and those attending the OD meeting tomorrow will wish to see the attach draft statement to be made in the House of Lords tomorrow. This is being submitted to Lord Carrington overnight. The Secretary of State has not himself seen this draft.

I am copying this letter to the Private Secretaries to the members of OD, the Private Secretaries to the Secretaries of State for Industry and Energy, the Private Secretary to the Attorney-General, the Private Secretary to the Parliamentary Secretary at the Dept of Environment and to Martin Vile (Cabinet Office).

Yours ever

(G G H Walden)
Private Secretary

This has been form up
+ sent back to the
drafting bod.

M O'D B Alexander Esq
10 Downing Street
LONDON
SW1

DSR11

DRAFT

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HOUSE OF LORDS
DRAFT STATEMENT

Noble Lords will expect me to describe the Government's position about the Soviet aggression in Afghanistan, in the light of my visit to Turkey, Oman, Saudi Arabia, Pakistan and India, and a brief call at Bahrain, between 9 and 18 January.

The view of Her Majesty's Government, which I expressed to all whom I met on my tour is that set out in some detail by my honourable friend the Minister of State for Foreign and Commonwealth Affairs, when he spoke in another place on 14 January. Briefly, the Soviet Union acted for selfish reasons to establish a military hold on a sovereign country. The invasion cynically violated all the international principles which the Soviet Union constantly calls on others to observe. It was a demonstration of the Soviet drive to gain wider influence wherever possible and to use force for the purpose. The geographical position of Afghanistan and its presence in the Moslem world give the events there the greatest significance. I found that most of those to whom I talked shared our assessment of Soviet objectives, and our estimate of the dangers to the security and integrity of other states in the region, and with the need for a significant and sustained response, both from the West and from those countries which feel threatened.

Naturally the leaders in different countries all viewed the crisis and Soviet actions from their own standpoints, but

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certain important points of agreement emerged. One was that the Gulf and the Straits of Hormuz are now a region where the interests of the countries of the area and the Western powers are identical: there is a pressing need for stability and freedom against attack.

A second important point was the urgent need for Pakistan's friends to recognise that the Soviet threat requires their full support for Pakistan in the face of the economic, political and now military problems which this country ~~now~~ faces.

A third and very important consideration is the real need for Pakistan and India each to lose the fear and distrust which it has for the other's motives and intentions. They have a common interest in the stability and prosperity of the Sub-Continent. The achievement of this will be the best guarantee of the region's future stability.

I visited Turkey first, a NATO ally deeply concerned about events in the region. It is clear that Turkey needs the commitment of Western support as much as ever under present circumstances.

I went on to Oman and Saudi Arabia: countries very concerned at the Soviet attack on another Islamic country. There, as in Turkey, I also discussed Iran. There was a general feeling that the real threat to Iran's recent revolution and to her future security lay not in the past relationship of the US to the country's former regime, but in the present menace from the Soviet invasion.

I had significant talks with President Zia and his Foreign Affairs adviser Mr Agha Shahi. As Noble Lords would expect, they are deeply concerned at the new threat on Pakistan's Western frontier. Their resolution to defend their country is emphatic but they made it clear that they

/need

need the support of their friends materially as well as politically.

I also went to see the Afghan refugees in Pakistan. President Zia told me there were over half a million already there. This is a serious problem for Pakistan. We have sent aid from Britain in the form of blankets, tents and medicines. The UN Commissioner for Refugees is seeking more world aid. But the problem for Pakistan is not just dealing with the humanitarian needs of the refugees. Amongst these refugees are Afghans bitterly opposed to the Soviet conquest of their country and determined to return to Afghanistan. The Pakistan Government are worried that the Soviet Union might make this a pretext to make attacks into Pakistan or for Soviet-inspired subversion. There were similar worries expressed elsewhere during my tour about a regional threat.

In India, a country with which we have had long close and friendly relations, I was particularly pleased to be able to see Mrs Gandhi and members of her Government so soon after they had taken office. In Pakistan President Zia had assured me of his wish for the process of better understanding between the two countries, begun under the Simla agreement of 1972, to be continued. I found a similar wish on the part of the Indian Government, and this is encouraging. However, I must tell Noble Lords frankly that the Indian Government is concerned with the effect on the Sub-Continent of the provision of assistance to Pakistan from the US and other Western countries. On this the British Government is quite clear that any support to Pakistan would not reduce Indian security: it is a direct consequence of the Soviet action in Afghanistan. This creats a very special case for a generous response as well

s understanding on the part of the ~~Government~~ leaders of India.

The Government are urgently considering a range of possible measures that will help countries of the region - the most urgent need is to respond to Pakistan's request for assistance. We are consulting with allied governments about how we can play our part in helping Pakistan. I am also seeking to strengthen cooperation with Turkey both bilaterally and multilaterally in as many fields as possible. I will keep the House informed of progress. But it is axiomatic that all the countries themselves must make up their own minds how to act to meet the present dangerous situation. A firm political commitment to the security and independence of the countries of this area is perhaps the most reassuring thing the West can give.

I turn now to another important aspect of the situation facing the world after the Soviet aggression in Afghanistan: the effect on our relations with the Soviet Union. The immediate motive for the Russians' move may have been to consolidate their influance in Afghanistan. But if the Soviet Union is to be deterred from similar aggression in the future, perhaps in countries of great importance to us all, it is essential that we show that their action affects the whole range of the world's contacts with the Soviet Union. Concrete steps are needed. Noble Lords will know that Britain proposed the intensive

discussions which have been taking place in the North Atlantic Alliance and among the members of the European Community. Some of our Allies, notably the United States, have already announced measures in their relations with the Soviet Union, I expect others to follow suit. I shall now announce the measures which the British Govetnment have so far decided to take.

The British/Soviet credit agreement, concluded by the Labour Government in 1975, expires on the 16th of February. Its terms were too favourable to the Soviet Union for the export credit was subsidised more than that which we extend to other countries. The Government's view is that all trade should be pursued on a basis of mutual advantage and we shall apply that principle to British/Soviet trade. We do not propose to renew the credit agreement when it expires. Assuming that other Western countries do likewise - it is very much to our collective advantage, that we all do so. We shall not provide export credit to the Soviet Union at rates more favourable than those set by the international consensus on credit terms.

On technology we are studying with other countries the tighter application of the COCOM rules for controlling the transfer of sensitive technology to the Soviet Union.

The European Community has decided not to export food to the Soviet Union which directly or indirectly would take the place of the supplies denied by the United States. The Community has thus decided to curb exports of grain in the future. Britain also favours an end to subsidised butter, meat and sugar sales and we are pressing for this.

The Government have also decided to avoid high level and Ministerial contacts with the Soviet Union for the time being, to cancel military exchanges which were under consideration and to avoid the kind of cultural and other events which would give an impression that nothing has changed and thus appear to condone Soviet aggression.

As Noble Lords

Amended Version

DSR 11C

Mr Ferguson
Mr Mallaby
Mr Morgan

As Noble Lords will have seen from the statement of my Right Honourable Friend the Prime Minister in another place on 17 January, Her Majesty's Government is deeply concerned at the prospect of the Olympic Games taking place in the Soviet Union.

Sadly, one can no longer divorce sport from politics as was the case in 1936. So now for the Soviet Union the Olympic Games are a major political undertaking designed to gain prestige in the world. It would be wrong for those people and countries which deplore aggression to cooperate in giving the Soviet Union the success it is seeking. To do so could give the appearance of condoning what is happening in Afghanistan.

The practical difficulties of moving the games are formidable but should not be beyond the capability of the 104 countries which condemned the Soviet Union in the United Nations. If necessary the Games could be held in more than one country. We ourselves have some facilities: we would be particularly well equipped to help over football.

Noble Lords will know that President Carter has asked the National Olympic Committee of the United States to approach the International Olympic Committee urgently to propose that the Summer Games be relocated. My Right Honourable Friend the Prime Minister has addressed a similar request to the British Olympic Association.

Britain has outstanding sportsmen and women who have been training for years for these Olympics. The Government want to see them win as many medals as possible in Games which give no comfort to the Soviet Union.

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