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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

POLAND: POSSIBLE ECONOMIC SANCTIONS

Note by the Secretaries

1. In the light of the Foreign and Commonwealth Secretary's suggestion in his minute to the Prime Minister of 16 December, officials have produced the attached report on economic sanctions which might need to be considered in the event of a Russian invasion or some other major act of repression in Poland.

2. The main purpose of this paper at this stage is to provide a basis for discussion at official level with other Western Governments on the steps which they and we might decide to take in concert with each other. The status of the paper is a revised draft; its present contents have been agreed by Departments, but work is continuing on its text as new questions arise in discussion with our partners and as its factual contents are refined in the light of further information.

3. The report is circulated to the Committee for information. If decisions on economic sanctions are ever required, they may have to be taken at very short notice. They would need to take account of the factual background as set out in the attached report. Their precise nature would vary, depending on the nature and form of the repressive action in Poland and the other circumstances of the time.

4. Copies of this note are being circulated to the Secretary of State for Industry, the Secretary of State for Employment, the Minister of Agriculture, the Secretary of State for Energy, and the Attorney General, as well as to the members of OD.

Signed ROBERT ARMSTRONG
R L WADE-GERY
R M HASTIE-SMITH

Cabinet Office

13 February 1981

REVISED DRAFT

ECONOMIC SANCTIONS IN THE POLISH CONTEXT

Note by Officials

INTRODUCTION

1. In his minute of 16 December to the Prime Minister, the Foreign and Commonwealth Secretary circulated a list of measures in the economic field which could be considered by Governments in the event of an outright Russian invasion of Poland. The list (copy at Annex I) grouped the measures under the following six heads, worked out by officials in consultation with some of our Allies -

a. Selective restrictions on trade;

b. Possible suspension of air services with the Soviet Union;

c. Shipping;

d. Fishing;

e. Energy;

f. Finance.

2. Officials were tasked with examining the measures with the object of reaching an agreed inter-departmental view on the various items in the list in preparation for the next round of discussions with our NATO Allies and European Community partners. This note presents the results of this examination, and reports also on the scope for Soviet or more general Warsaw Pact retaliation. It does not attempt to draw out all the policy implications of the measures.

GENERAL CONSIDERATIONS

3. It is assumed that Ministers would wish to contemplate measures in the economic field, or for that matter in the political field (although it is not the purpose of this note to consider these), on the basis that they

would be adopted only in concert with the United Kingdom's NATO Allies or European Community partners, or by some wider grouping of countries such as the Organisation for Economic Co-operation and Development (OECD). Given the differing circumstances of the allies it would be unrealistic to expect uniformity of action. As the Foreign and Commonwealth Secretary's minute of 16 December also makes clear, actual decisions on the Western response to intervention in Poland are reserved for Governments to take at the time.

4. The form which intervention took would be bound to affect the scope and severity of the Western response: one or more of the Russians' Warsaw Pact partners might be involved directly in the intervention, and the West might choose to direct sanctions against them too; the Polish Government might be implicated, raising the question of whether measures should be taken against Poland as well; and the intervention might take a form falling short of outright invasion, in which case a proportionately lesser response would be called for. The possibilities are manifold and, in order to avoid over-complicating this note, the examination of measures has been set in a worst case context rather than linked to one or other of the possible scenarios. Measures have not been ruled out solely on the grounds that their costs would be high.

5. The following general points have also been taken into account -

a. General restrictions on civil trade would fall within Community competence. Action could be taken by means of Community legislation under Article 113 (though there are divided legal views on whether Article 113 can properly be used to further political objectives) or by individual but co-ordinated member state action under Article 224 (as in the Iran case). Several of the Ten export more to the USSR and East Europe than the United Kingdom and are more dependent on energy imports from the USSR than is the United Kingdom; for economic (and other) reasons our partners might be unwilling to agree to some measures which might involve relatively lower costs for the United Kingdom.

b. If measures were primarily directed against the Russians account would have to be taken of the varying scope for evasion or retaliation by the Russians using East European countries and of costs which might arise vis-a-vis those countries.

c. Russian 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 Russians.

d. The United Kingdom, 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. But Soviet use of force in Poland in present circumstances would be an act of strategic importance to which the West could respond most effectively by economic measures. To the extent that the European Community decided to take action on civil trade, there would be least conflict with our general position if the measures adopted involved withdrawal of Governmental treatment arguably favourable to the USSR and her Warsaw Pact partners (eg withdrawal of European Community restitutions on grain or butter sales), rather than direct interruption of normal civil trade flows; and, in the field of technology were fully justifiable on strategic grounds. If the situation called for a stronger response it would be more consistent with our interests as a trading nation (as well as avoiding substantial costs within the United Kingdom) if the measures taken did not include action or existing contracts.

e. Action which was effective in terms of denying the Soviet Union goods which would otherwise be exported from the United Kingdom; or which led to Soviet retaliation, eg by withholding supplies of raw materials, would have some effects on employment. Annex XI [to be circulated with the next draft] attempts to assess what these might be.

f. Given the Soviet bloc's self-sufficiency in energy and the USSR's current and planned contribution to the energy supplies of certain Western countries, any measures which lessen the Russian contribution to world energy supplies will hurt the West too.

EXAMINATION OF THE MEASURES

6. The paragraphs which follow draw out the main points of the more detailed analysis in Annexes II-IX of the measures in the list. A summary of the key areas of Russian vulnerability to Western economic sanctions is at Annex X.

7. <u>Selective Restrictions on Trade</u>

A. <u>Trade in Food</u> (Annex II)

An effective ban on exports of food, particularly grain, could affect the Russians very significantly and reasonably quickly. To be effective, such a ban would have to be concerted by the major supplier countries for each banned commodity, and to be made proof against possible diversion of supplies through countries not the immediate target of sanctions. British involvement in restrictions on trade in food would have to take the form of participation in an EC embargo, as discussed in paragraph 5.a above.

As already noted, the Russians are particularly dependent on imported grain. Their principal suppliers are the United States, Canada, Australia and Argentina. These four countries expect at present to meet only about two-thirds of the Russians' requirement in 1981 to import about 35 million tonnes of grain. There is thus a prospective shortfall of 10-15 million tonnes, attributable to restrictions on

American supplies post-Afghanistan, and scope for increasing this shortfall substantially by withholding supplies already expected by the Russians. EC exports of grain, which we hope will not exceed the "traditional level" of some 250,000 tonnes, are small in relation both to Russian requirements and to total EC grain exports.

There are two main ways in which existing restraints on the export of food from EC countries to Russia could be stepped up -

a. Modification of existing pricing mechanisms - ie zero-rating of export refunds on all sales, a measure which would be consistent with long-standing United Kingdom pressure to end the subsidies. This would make it unattractive to purchase products, such as beef and butter, whose EC price is much higher than the world. For other products, a system of punitive export levies might be introduced. But this would require contentious Community legislation, and it would be difficult to police.

b. Total embargo on all food sales. This would be straightforward in concept, although unprecedented for the EC and difficult to police. The Commission (and FCO lawyers) believe that an embargo could be introduced by a simple decision under Article 113 of the Treaty of Rome. This view was disputed by France and Denmark when sanctions against Iran were being considered. The alternative route involves taking national action under Article 224. Implementation would be delayed by national legislative processes, although we could proceed under the Import/Export and Customs Powers (Defence) Act 1939.

The experience of 1980 suggests that the effectiveness of either kind of measure would not be complete. But the scope for diversion would be significantly reduced if the action was extended to East European countries, either in the form of an embargo (eg in the case of States participating in the invasion) or by means of limiting exports to individual countries to the level they need for their own consumption.

It is already United Kingdom government policy to seek to put an end to all subsidised food sales from the EC to the Soviet Union. Costs to the EC of a total ban (United Kingdom share in brackets) have been roughly estimated as follows: cereals, £30 million (£6 million of compensation had to be paid (cf. Annex II.6); butter, initial saving £111 million (£22 million) offset by eventual cost £300 million (£60 million); beef, £50-100 million (£10-20 million); wine, £5 million (£1.8 million); sugar and other commodities, unquantifiable.

B. Export Credits (Annex III)

ECGD's obligations in respect of orders from Russia and East Europe total respectively about £800 million and £1,700 million (£1,045 million of it in respect of Poland; £428 million Romania). Roughly 70 per cent of these sums relate to uncompleted contracts, and would be at risk if the Government took and exercised powers to prevent the completion of existing contracts. The cost of meeting claims would be reflected in the PSBR and, against the background of an unprecedented incidence of claims payments in recent years, could result in an increase in public expenditure if they completely exhausted ECGD's resources.

There are three main options for restricting credit for future business -

a. Withdrawal of all ECGD facilities. Unless this was linked to a Western ban on exports, British industry would be put at a disadvantage in comparison with, for example, German competitors who would be more likely to continue trading without credit insurance cover.

b. Limited withdrawal of ECGD facilities - ie allowing only short-term credit (6 months), or reducing the maximum term from 8½ years to, say, 5 years.

c. Withdrawal of fixed interest rate support. This could take the form of withdrawal of interest rate subsidies, or an increase in the OECD Consensus rate for Eastern bloc countries. In the first case, since domestic interest rates would then apply, the measure would bear unfairly at present on British exporters. Again in the second case, if a high Consensus rate were fixed, there would be the risk that our competitors would offer lower commercial rates either with no support from their credit organisations or with "pure cover" only.

These options have been placed in descending order of severity. In each case there is a corresponding risk that the resultant strain on the Russian and East European economies (especially Romania; and Poland if the measures were directed there too) would lead in due course to defaults on existing debts.

C. COCOM and Technology (Annex IV)

Maintain 'no general exceptions' policy. Has existed de facto since invasion of Afghanistan (hence difficult to represent as a specific response to intervention in Poland). Easy to implement in COCOM if intergovernmental agreement can be reached. Some cost to United Kingdom economy (1979 United Kingdom exports of 'general exceptions' goods to the USSR: £4.4 million). Likely to be acceptable to key partners. Would have cumulative impact on the Soviet Union. Retaliation very unlikely.

Complete 'no exceptions' policy: Feasible to implement in COCOM if intergovernmental agreement can be reached. But some cost to United Kingdom economy (1979 United Kingdom exports of all exceptions cases to the USSR: £66 million, including £49 million of uranium hexafluoride exported to USSR for enrichment and subsequently re-exported). If embargo covered uranium hexafluoride business it would cause substantial damage to United Kingdom with little corresponding harm to USSR in this field. Spare parts supply could also be a problem. Possibly agreeable to key partners but eg FRG and France may be unenthusiastic. Retaliation unlikely but not impossible.

Extension of current COCOM lists: feasible to implement, but would require detailed and lengthy discussions in COCOM with no guarantee of agreement. Implications of United States proposal for additions to present list need clarifying. (Lists are under regular review in COCOM anyway.)

Settling differences over computers: would have to be agreed in COCOM, where present discussions have run into serious difficulties. Discussions on computers likely to be continued in COCOM at United States instigation early in 1981 in any event.

A selective embargo implemented through COCOM rather than other fora is a theoretical possibility, but would probably prove extremely difficult to carry out in practice. A selective embargo affecting industrial sectors of particular significance to the Soviet economy, instituted outside COCOM, might be agreed more quickly and joint action by the small number of key suppliers could have a severe impact on Soviet development.

D. Industrial Contracts (Annex V)
British exports to the Soviet Union totalled about £450 million 1980, mainly chemicals, fibres and textiles, and machinery and metals. Controls under the Export of Goods (Control) Order 1978 will have applied (and thus could have prevented export) to only about 15 per cent of this total, most of it nuclear fuel temporarily exported for reprocessing under a CEGB contract with the Russians. Of the contracts in progress there are 4 large ones worth a total of about £340 million. Some £550 million worth of project business is currently under negotiation, including (see Appendix A to Annex V) Rolls Royce's £220 million bid to supply equipment for the gas pipeline project.

Restrictions on exports could take the form of controls of selected category of goods or a total ban. Trade falls within Community competence and these restrictions could therefore be imposed by means of Community legislation under Article 113 (subject to the caveat above on the legal aspect). Alternatively they could be effected by means of co-ordinated member state action under Article 224, in which case the United Kingdom could take action by using powers under the Import/Export and Customs Powers (Defence) Act 1939 and by amending the Export of Goods (Controls) Order 1978. Restrictions going wider than the control of exports of goods would require primary legislation.

Export controls could be expected to be effective in themselves. But we supply little which the Russians could not make themselves or obtain elsewhere. The aim of introducing stricter export controls may therefore not be wholly attainable, but it would be frustrated altogether if we acted alone. If controls were applied to existing contracts the penalties for British firms and for ECGD would be heavy.

8. Air Services (Annex VI)
Denial of the right of scheduled services to and from the Soviet Union would be a breach of the spirit of the bilateral Air Services Agreement, which has treaty status. In practice the services could legally be stopped by terminating the related Confidential Memorandum of Understanding and suspending Aeroflot's operating permit issued under the Air Navigation Order 1976. The Secretary of State for Trade has powers to prevent British Airways (BA) from continuing to operate services to the Soviet Union should be Russians still, in the circumstances, permit this. BA might pick up some extra business on the United Kingdom-Japan route. The effect of terminating scheduled flights could be quite significant if our Allies followed suit.

In respect of charter flight programmes, we could revoke permits issued under the Air Navigation Order 1980 although there is a risk of compensation claims by members of the public. Charter flights to the Soviet Union are important only for the tourist traffic originating in the United Kingdom.

Suspension of overflying authorities would be unimportant unless concerted action were taken with our EC partners - in particular the Republic of Ireland (Russian flights to Cuba stage through Shannon).

9. Shipping (Annex VII)
The United Kingdom has a bilateral Maritime Treaty with the Soviet Union signed in 1968 governing access to each other's open ports (many Russian ports are closed to all foreign shipping) and generally regulating issues affecting marine traffic. Our EC partners (except Germany) have similar treaties with the Soviet Union. (The United States have a different kind of treaty, based on reciprocity of treatment. But this treaty has effectively been inoperative, because of the year old boycott by American longshoreman.) The 1968 Treaty has operated very much in favour of the Russians. The balance of commercial advantage and the security problems posed by the access to British ports enjoyed by Russian merchant seamen under the Treaty are under separate study in their own right. Termination of the Treaty would pave the way for taking more direct action, such as closing ports, which may be desirable on security grounds but could have important implications for trade. Some limitations of access by Russian merchant ships might be imposed without terminating the Treaty, but only if they could be justified as retaliation for comparable Soviet breaches of the Treaty (and invasion of Poland would not count as such). Controls would have the greatest impact if they were imposed on a Europe-wide basis, since this would reduce the opportunities for trans-shipment.

10. Fishing (Annex VIII)
Russian imports of fish total about 1 per cent of their domestic production and are almost entirely mackerel from British waters trans-shipped to Russian factory ships. There are no powers to prevent this trade. As in the case of other trade sectors, however, action would be possible, either by means of Community legislation under Article 113 of the Treaty or Rome (subject to the legal caveat in para 5a above) or by member state action under Article 224. The trade amounts to 30 per cent of the British mackerel catch. The mackerel fishery is the United Kingdom fleet's biggest fishery and the burden of any curtailment of our fleet's outlets would fall on fishing vessels which are already in difficulty and have few, if any, alternative markets or fishing opportunities. Interference with our fleet's mackerel exports would add to the increasing pressure for further government assistance. On the other hand, to seek exemption of fish from a general EC embargo on food exports would encourage other countries to seek exemptions for other producers likely to be particularly hard hit.

11. Energy
The Soviet Union is self sufficient in energy and is not likely to become a net importer until 1984. The Russians nevertheless depend on Western technology for the development of their sources of energy. They are relying on the Siberian gas pipeline project both to meet domestic energy requirements as a major source of hard currency earnings to replace in part what is now earned by supplying oil and oil products to the West. Most of the finance and equipment for the pipeline project is coming from Western consumer countries. The loss of the project would be felt seriously by the Russians and, their East European neighbours (see Appendix A to AnnexV). But this would also have an important impact on Western Europe's energy supplies; Germany and France would be the most directly affected countries.

12. Finance (Annex IX)
There are four possible measures -

a. Restriction of Acceptance of Russian Deposits by Western Banks.

This could be achieved by voluntary arrangements which may not be very effective. Existing legal powers could only be used if the Treasury were satisfied that there was or was likely to be detriment to the economic position of the United Kingdom. If the Russians retaliated or were expected to (which seems possible) this could enable the powers to be used.

This distinguishes Poland from the Iranian case, where no detrimental Iranian retaliation was judged possible, and the powers could not be used. The principal effect would be to prevent payment for Russian exports.

b. Restrictions of loans to the Soviet Union by Western Banks

Again voluntary measures could be used, but legal powers only if the Treasury were satisfied as in the second sentence of a. above. Russian borrowing is largely for the purpose of financing trade, so restrictions on borrowing may be seen as an alternative to trade restrictions (but see paragraph 7B above). Demand for loans would of course fall if trade restrictions were introduced.

c. Restrictions on the activities of Russian banks.

This could be done under the relevant legal powers if the circumstances in the second sentence of a. obtained. The Banking Act 1979 could not be used.

d. Freezing of Soviet Assets.

This could be done under the relevant legal powers if the circumstances in the second sentence of a. obtained.

Particular considerations applying to each of these measures apart, very serious risks would be run to London's importance as an international financial centre if punitive action in the financial field were taken for purely political reasons. This is a possibility which most of the Allies do not need to consider to anything like the same extent.

A MORATORIUM

13. A possibility which has not been discussed with any of our Allies is the introduction of a moratorium on economic activity with the Russians to cover the period between intervention in Poland and the taking of decisions on the Western response. This would be one way of avoiding a hiatus.

14. There is little scope for a short-term interruption in the shipment of goods to the Soviet Union without interfering with existing contracts. But the acceptance of new business could quickly be affected by making an Order under existing powers to licence exports or, on a Community basis, by suspending export refunds on agricultural products. In the financial field,

since the United Kingdom is a creditor of the Soviet Union and Eastern Europe, it is not clear what the nature of a moratorium would be - unless a decision was taken to freeze Russian assets. Here the objections to a moratorium are as strong as those to a permament freeze.

RETALIATION

15. Potentially the most serious retaliatory weapon in Russian hands in the economic field is in the financial field where bloc indebtedness to the West totals $77 billion (see Annex IX).

16. The Russians are also in a position to increase the West's already heavy dependence on South Africa for key mineral supplies, notably platinum group metals. They are less well placed to damage Western interests by withholding supplies of other raw materials, although they could cause some disruption in markets over the short term with damaging results for particular interests - such as the British entrepot trade in diamonds.

17. As regards manufactured products, the Soviet Union is an important source of British supplies of naphthas and of semi-processed oil products.

18. Neither we nor our Allies are dependent on the Russians for more than a small fraction of our imports of crude oil, agricultural products and fish.

POLAND CONTINGENCY PLANNING

POSSIBLE ECONOMIC MEASURES

1. Selective restrictions on trade.

   (a) Trade in food (note EC competence).

   (b) Export credits.

      (i) Lines of credit

      (ii) Export credit subsidies

      (iii) Export credit insurance

      (iv) New consensus on terms for the Soviet Union.

   (c) COCOM and technology.

      (i) Maintain existing post-Afghanistan restrictions

      (ii) Further tightening - a complete 'no exceptions policy'

      (iii) Extension of the three lists, to include eg semi-conductor manufacturing technology, laser interferometers, categories of automatic testing devices, etc.

      (iv) Settling differences over computers.

   (d) Problems related to industrial contracts (sic)

      (i) New or existing contracts?

      (ii) Large contracts only?

2. Possible suspension of air services with the Soviet Union.

      (i) Scheduled passenger services

      (ii) Charter flights

      (iii) Overflights

3. Shipping

(i) Closure of ports

(ii) Possible termination of maritime agreements

(iii) Trans-Siberian Railway

4. Fishing

(i) Termination of fishing agreements

(ii) Factory ships

5. Energy

(i) Suspension of gas pipeline project

6. Finance

(i) Restriction of acceptance of Soviet deposits by Western Banks

(ii) Restriction of loans by Western Banks to the Soviet Union

(iii) Restrictions on the activities of Soviet Banks

(iv) Freezing of Soviet assets.

POLAND CONTINGENCY PLANNING

TRADE IN FOOD

1. An effective ban on exports of food, particularly grain, could affect the USSR very significantly and reasonably quickly (see accompanying commodity notes). But to be effective it would have to be -

a) on a Community basis;

b) capable of covering other Eastern bloc countries to avoid possible diversion; and

c) supported by other major supplying countries.

2. The crucial question would be whether the USA would be willing and able to cancel their long-term contract to supply 8 million tonnes of grain a year to the USSR (the current contract expires at the end of September 1981). Without this it might well be difficult to persuade some of our Community partners, in particular France, to go further than the Community's present action to limit subsidised exports of certain food to Russia to "traditional levels" (which themselves have never been properly discussed, still less agreed).

Possible Further Measures

3. More effective action following an invasion of Poland could take one or other of the following forms;

(a) Modification of existing mechanisms, ie "zero rating" of export refunds on all sales to Russia and possibly other Eastern Bloc countries (which would require the separate zoning of these countries), coupled, where necessary, with supplementary export levies. "Zero rating of the export refund would have the effect of making it economically unattractive to these countries to purchase products, eg beef and butter, whose Community price is significantly above the world prices. Such action would not affect sugar exports, the world price of which is above the Community price. Here, short of an embargo on sales to Russia, the only way of curtailing sales would be by increasing the existing export levy to punitive levels. Grain is already 'zero rated' but, with the upward movement of world prices, this might not in itself be enough to prevent sales; here too a penal export levy might be necessary.

Given the political will, zoning and zero-rating, for both of which the necessary legislative powers and administrative mechanisms exist already, could be implemented very quickly. But supplementary export levies would require probably contentious Community legislation and novel policing mechanisms (eg to operate the system it would probably be necessary to charge a security equivalent to the whole of the potentially chargeable extra levy). There would be plenty of scope for argument over the detailed arrangements and this could affect the speed at which effective action is introduced.

One advantage of this approach is that we should have achieved our long standing objective of ending subsidies on food exports to Russia. This would put a question mark over the principle of subsidies on sales to Russia which could be useful to us if and when relations with Russia return to normal and we seek to continue to avoid refunds on such sales.

(b) <u>Total embargo on all food sales to Russia and other Eastern area countries as necessary</u>

This would be the cleanest way of seeking to stop Community food supplies getting to the USSR, although as with any method there would be no guarantee that supplies would not be diverted to Russia from third countries. It would be necessary to establish effective control over sales to non-Eastern Bloc third countries so as to police the arrangements. To achieve this it would be necessary to impose additional controls on Community traders, but in the aftermath of an invasion of Poland such a burden might be tolerated more readily than in other circumstances.

This approach would mean breaking new ground for the Community which has not hitherto imposed a total ban on food exports to a third country. FCO lawyers support the Commission view that a trade embargo could beput into effect by a simple decision under Article 113. This was contested by France and Denmark when the question of an embargo on exports to Iran was discussed earlier and national action under Article 224 (which allows derogation from the common commercial policy in the event of serious international tension constituting a threat of war) was envisaged. If Article 224 rather than 113 were used, the process of implementing an embargo could well be delayed by the different national legislative processes involved although in our case it would be possible in principle to proceed under The Import/Export and Customs Powers (Defence) Act 1939. If the Article 224 solution were adopted, it would be essential to make adequate arrangements to avoid differences between Member States in applying an embargo. Regardless of whether the measure were on a Community or a national basis, its policing would have to be in the hands of national authorities.

4. For each of these courses it would be necessary to decide how to treat refunds already prefixed and/or licences already issued which constitute the basis for contractual export undertakings at some future date. A sizeable proportion of the food that went from the Community to the USSR in 1980 was covered by refunds authorised before Afghanistan. If commitments already entered into were not honoured there would be strong opposition from the trade, which would no doubt be supported by some Member States, and probably the Commission. The Community's attitude would no doubt be affected by the position adopted by other Western countries and on whether the USA stands by its existing long-term grains contract or not. But if commitments were to be broken, the difficult question of compensation would arise.

5. It is not possible to say with any certainty which of the two courses suggested would offer the easier passage through the Council where the basic decisions would have to be taken. Much could depend on the reactions of other Western countries as well as on the detailed provisions themselves.

Given the need for speed we are inclined to favour whichever course seems likely to secure quick agreement in the Council, provided it is effective. From the point of view of the impact of the measures a total ban has attractions provided it can be implemented speedily by all Member States. Further notes on this and other apsects are given below.

Cost to the United Kingdom economy and budget of an effective embargo on food sales

6. It is already United Kingdom government policy to seek to put an end to all subsidised food sales from the EC to the Soviet Union. But the United Kingdom would bear significant costs if an embargo were imposed both as an exporter of certain foods to the USSR, and as a contributor to the EC budget. The main first round costs to the Community and thus the United Kingdom of storing or disposing of commodities which traditionally would otherwise go to Russia could be of the order indicated below (these figures are rough estimates and do not purport to be comprehensive):

a) Cereals: Current indications from the world market for barley are that the quantity traditionally exported by the EC to Russia would be unlikely to find an alternative outlet. On this assumption the barley would remain in intervention and the extra cost to FEOGA of intervention storage would be of the order of £0.5 millions (£0.1 million borne by the United Kingdom). If compensation had to be paid (because contracts had already been incurred - not the case at present) the cost would be some £30 million (United Kingdom £6 million). If the United Kingdom's proposed exports of 175,000 tonnes of barley to Poland were stopped, compensation might be payable, depending on the extent to which commitments had been incurred, but the cost of this and the loss of this outlet would be offset to the extent that we were able to resell elsewhere at an unsubsidised price and with better prospects of actually being paid.

An effective ban on cereal exports supported by other major suppliers could lead to a significant fall in world market prices. Each $1 fall in the world price would mean a net increase of £1.8 million in the United Kingdom's contribution to the EC budget.

b) Butter: On the assumption, that alternative means of disposing of the 200,000 tonnes of butter which the Russians are thought to want in 1981 is not practicable, costs of some £43 millions would be incurred by the Community for storage. But these would be offset initially by savings in export refunds of some £156 millions to FEOGA yielding a net saving to FEOGA of some £111 millions (UK £22 millions). The cost of disposing of this extra quantity on the internal Community market for butter would be upwards of £300 millions to FEOGA (UK £60 millions). The alternative, of disposal on the world market, would lead to lower world prices and a need for higher refunds. Each £100 reduction in world prices would increase the UK contribution via the budget by about £10 millions. Lower world prices of butter would also be particularly damaging to the New Zealand economy.

c) Beef: In the absence of alternative markets for the Community's likely exports of at least 60,000 tonnes in 1981 (when the EC will be in substantial surplus) the extra net cost to FEOGA of disposal on internal markets could be £50-100 million (UK £10-20 million) depending on the method used.

d) Wine: The 2 million hl of wine which the Commission forecast would be exported in 1981 to the USSR would need to be disposed of by distillation or other alternative means, at an extra cost to FEOGA of £5 million (UK £1.8 million). Ending of restitutions would not necessarily make the purchase of Community wine uneconomic for the USSR which can offer it for re-sale as a hard currency earner.

e) Sugar: In the event that no EC sugar was exported to Russia it is likely that the Soviets would obtain supplies elsewhere on the world markets, although possibly in raw instead of white sugar. The Community would then have to find alternative outlets for its white sugar. Given that the world market for raws is to a degree separate from the world market for white, the latter could be weakened by a Community embargo and this would have some effect, unquantifiable, on the Community's current levy income from exports.

7. Costs could also be incurred for the alternative disposal of other products, such as poultrymeat, and whole milk powder, which are not established exports to the USSR but which could well find a market there in the light of Soviet shortages. In addition, the United Kingdom's exports of whisky (worth £$\frac{1}{2}$ million per annum) would be lost if a total ban were imposed on food and drinks exports.

Effectiveness

8. Action by the Community to suspend, or maintain the suspension of, export refunds or to remove them entirely in the case of the USSR could be taken promptly given the political will. Where such restrictions already apply, as (for the moment) with barley, butter and beef, the effect would be immediate. Where trade is in progress and exports have been prefixed for export refunds, suspension of further refunds alone would not cause sales to cease; to achieve this exceptional steps to cancel prefixations and to rescind grain export licences (to prevent switching between destinations) would be required.

9. The impact of a withdrawal of all export refunds or an embargo would depend on the USSR's supply situation and the attitude of other major exporting countries. The Community's potential exports of cereals, sugar and notably butter are significant in the present and foreseeable state of the Soviet domestic market. Experience in 1980 in maintaining and restricting exports of cereals, butter, beef and poultrymeat indicates that these measures cannot eliminate the possibility of such supplies being diverted to Russia. The scope for such diversion would be significantly reduced (but not eliminated) by extending the action taken to include other East European countries. This would be feasible, administratively, but would involve further increased costs from the loss of trade involved, notably in cereals - of the order of 1 million tonnes of barley on average.

Reversability

10. There should be no particular legislative or administrative problems in reversing any action taken by the Community.

Key partners

11. Experience with the selective food embargo in 1980 has underlined the importance of solidarity within the Community of decisions are to be made effective. Outside the Community the other suppliers with whom action would need to be co-ordinated are:

a)	NATO:	USA	Grain, beef, poultrymeat
		Canada	Grain

b) Non NATO:

Australia	Grains, wine, beef, sugar
New Zealand	Butter
Argentina	Beef, grain, wine
Uruguay	Beef
Cyprus Spain Algeria Morocco	Wine
Brazil Colombia Peru	Sugar - in addition to these countries Cuba is the major supplier of sugar to Russia. If Russia were seeking sugar from the world market generally the list of significant suppliers would include another 9 or 10 countries.

There is an established mechanism for liaison between the grain exporting countries. But the effectiveness of this and any other commodity liaison arrangements depends on the political willingness of our partners to co-operate.

Moratorium

12. The simplest way of imposing an immediate moratorium would be to suspend the authorising of all new export refunds and licences. In addition, to ensure as complete and immediate a stop as possible, pre-fixed refunds and licences already issued would have to be suspended.

APPENDIX A
TO ANNEX II

NOTES ON FOOD COMMODITIES

1. Grain Grain is the most important of the Soviet Union food imports. In the year to September 1981 the Soviet Union will probably want to import some 35 million tonnes (in addition to domestic production of 189 million tonnes). The bulk of this would come from the United States (8 million tonnes under the current agreement which expires in September 1981), Canada (about 5 million tonnes), Australia (about 4 million tonnes) and Argentina (from 5-8 million tonnes). These amounts, totalling 22-25 million tonnes, suggest that already (as a result of the United States' embargo imposed following Afghanistan) the Soviet Union would this year have serious difficulties. These would be substantially increased if this 22 million tonnes, or most of it, were also withheld.

2. The Community is not an important additional supplier of grain to the Soviet Union, although imports have increased recently largely due to commitments incurred before the invasion of Afghanistan.

3. If other major grain exporters to the Soviet Union imposed an embargo the Community would therefore be able to follow suit without substantial damage to its economic interests (only the remaining traditional trade of about 250,000 tonnes would be affected; this is a small proportion of the Community's total grain export trade of about 18 million tonnes).

4. Sugar The Soviet Union seems this year to have contracted to buy between 1.5 and 2 million tonnes on the world market, but only about 500,000 tonnes (a provisional estimate) of this is likely to come from the Community. This is in addition to at least 3 million tonnes from Cuba. As a result of the bad harvest Soviet production is likely to be only 7½ million tonnes.

5. Meat The Soviet Union's imports of meat from non CMFA supplies have not traditionally been large, but the Community has become relatively more important among them. In 1979 and 1980 imports of beef from the Community have been at a higher level: the trade was halted in June when exports had reached 64,000 tonnes in six months. Recent EC exports of poultrymeat have also been high - 55,000 tonnes in the first ten months of 1980. The poor Soviet harvest may again lead to some distress slaughtering and a temporary rise in meat production, but the indications are of continued Soviet demand for meat imports in 1981.

6. Butter The Community is the major source of Soviet imports which have averaged 77,000 tonnes per annum in 1977-80, with the benefit of substantial export subsidies representing the difference between world and EC prices (currently around £900/t and £1,800/t respectively). Soviet domestic production seems unlikely to recover in the near future. Recent applications for prefixation of export refunds (now suspended) indicated that Soviet demand in 1981 could be for 200,000 tonnes from the Community alone.

ANNEX III

EXPORT CREDITS

1 In considering the implications of cutting off trade with Bloc countries it has been assumed that HMG would take powers to prevent UK exporters and contractors from completing existing contracts. If HMG acted on these powers ECGD would expect to have to meet substantial claims arising from the frustration of such contracts.

MAIN OPTIONS

2 (a) HMG ACTION TO FRUSTRATE EXISTING CONTRACTS

This is the "worst case scenario" where HMG exercises powers to prevent the completion of contracts not yet fully performed. The UK contractors involved would thereby be able to claim "force majeure" and they or the UK banks financing the business would look to ECGD to pay claims on amounts already owing and not paid by the Bloc customer and/or due under termination provisions. The precise incidence of loss would depend upon the contractual arrangements and loan agreements involved: in some cases it might be preferable for ECGD to pay claims as they arise at due dates over the repayment periods, in other cases it may be preferable to "accelerate" the loans and settle the full claims promptly. (It is assumed that in conjunction with action to frustrate uncompleted contracts, HMG would also require ECGD to cease support for all new business with the Bloc countries against which sanctions were being taken see (b) below.)

The cost of taking such "worst case" measures would be heavy. No precise figures are available, without actually making inquiries of ECGD's 12,000 policyholders, on the volume of uncompleted short term contracts with Bloc countries. The following figures must therefore be regarded as simply an indication of the order of magnitude of ECGD's commitments.

UNCOMPLETED CONTRACTS GUARANTEED BY ECGD

£m

USSR	POLAND	GDR	HUNGARY	ROMANIA	CZECHOSLOVAKIA	BULGARIA
491	735	82	34	328	42	9

These figures represent the element in ECGD's exposure which would be most likely to generate claims should uncompleted contracts be frustrated by HMG's sanctions. They do not represent the full extent of ECGD's commitments on the Bloc countries which in the "worst case" scenario, ie an extreme confrontation with the USSR and its satellites could just conceivably lead to the Bloc defaulting on all its ECGD obligations. In very round terms the amount involved is £2,500 million split as follows.

ECGD'S TOTAL COMMITMENTS ON BLOC

£m

USSR	POLAND	GDR	HUNGARY	ROMANIA	CZECHOSLOVAKIA	BULGARIA
800	1045	100	52	428	53	16

As a result of the unprecedented incidence of claims payments by ECGD in recent years, the Department's reserve and cash position has been considerably depleted. Should claims continue at a high rate during the next 12 months period up to a figure of say £450m (as could possibly happen if there was a major series of defaults by the Bloc countries) not only would these sums be reflected in the PSBR but if further claims had to be met ECGD would become a net borrower on the Consolidated Fund thus incurring public expenditure.

(b) WITHDRAWAL OF ALL ECGD FACILITIES FOR FUTURE BUSINESS

Administratively, it would be comparatively easy to come off cover for future contracts with the Bloc countries. However, unless this action was taken in conjunction with a ban on exports to those countries which would be adhered to firmly by all Western countries, UK industry would be at a marked disadvantage in comparison with eg German competitors who, having the benefit of lower commercial interest rates, are more likely to continue trading without credit insurance cover or officially supported financing.

If an effective total ban on further exports to Bloc countries by Western countries can be envisaged, the impact on the Bloc's economies would be severe but, among forms of retaliation possible, it is again conceivable that substantial default on ECGD's insured debts could follow.

The reinstatement of ECGD facilities would present no difficulty per se but UK exporters could find that Bloc customers will have tried to find other sources of supply in the meantime and a considerable volume of trade might thereby be lost. Similar considerations apply to a lesser extent should it be decided to halt ECGD facilities for a limited period while longer term action is coordinated with other Western countries.

In any event it would be administratively almost impossible to operate a suspension of ECGD facilities for a limited period without incurring substantial losses in claims made by policyholders holding up shipments or delaying work under existing contracts, which might be disproportionate to the likely adverse impact on the Bloc countries.

(c) LIMITED WITHDRAWAL OF ECGD FACILITIES FOR FUTURE BUSINESS

It would be possible to apply a less severe form of withdrawal of ECGD facilities eg by

(i) limiting cover to business transacted on short terms (up to 180 days credit); or

(ii) limiting terms for projects to 5 years maximum (as compared with a maximum of 8½ years at present).

The effect of (i) would be severe in its impact upon the Bloc's economies in that it would probably restrict substantially the amount of capital goods they would buy from countries participating in this sanction. Again, it would be imperative that all Western countries coupled the withdrawal of credit insurance facilities and subsidised fixed interest rate financing with an embargo upon longer credits extended <u>without</u> official support.

It might be feasible effectively to limit credit terms to 5 years ((ii) above) by a simple agreement between Western governments to limit official credit insurance terms to this maximum for the Bloc countries. (In effect reclassifying these countries as "relatively rich" in the OECD Consensus for which the maximum terms are normally 5 years under current arrangements.) Since it could be expected that few if any projects on longer terms would be financed commercially, ie without official support, this action would probably not need to be strengthened by an absolute ban on trading on longer terms.

For both options (i) and (ii) there would seem to be a danger of retaliation in the form of defaults on existing debts if these sanctions put severe strain on any of the Bloc markets concerned. Poland is an obvious example in this category and Romania is another possibility.

(d) WITHDRAWAL OF FIXED INTEREST RATE SUPPORT FOR FUTURE BUSINESS

Currently, for credits of 2 years and longer, Bloc countries fall within the intermediate category in the OECD Consensus and enjoy subsidised fixed interest rates of 8% per annum for terms up to 5 years and 8½% per annum for terms in excess of 5 years up to 8½ years.

ECGD is contractually committed to UK banks to maintain interest rate support on existing contracts but support could readily be withdrawn for future contracts or, alternatively, an amendment to the OECD Consensus could be envisaged to apply a higher special minimum interest rate to Bloc countries. In the first case however since domestic commercial interest rates would then apply this would bear unfairly upon UK exporters at present and with the alternative option of trying to apply an exceptionally high Consensus rate of interest there is again the likelihood that eg German competitors will offer lower, commercial, rates without direct official support for the financing (but possibly with "pure cover", ie credit insurance only, being given by the official agency concerned).

3 The above seemed to be the broad options available if sanctions were to be imposed in the export credits area, in roughly descending order of severity. All seem to carry penalties for the UK's future trade prospects with the Bloc and some would involve serious financial penalties for the PSBR. It would be important if any of these sanctions had to be seriously considered to ensure that the effect did not bear more hardly upon UK exporters that their competitors in other Western countries.

POLAND CONTINGENCY PLANNING

COCOM AND TECHNOLOGY

1. Maintenance of present, de facto policy of making virtually no general exceptions (ie cases requiring COCOM approval) to the COCOM lists:

i Administratively and legally feasible.

ii No cost to UK budget (as long as contracts already concluded are not broken and HMG is not liable to pay compensation). UK export of COCOM 'general exceptions' goods to USSR, 1979: £4.4 m; potential cost to UK economy if policy maintained should take into account subsequent inflation and potential growth in trade with USSR.

iii Retaliation unlikely (no noticeable retaliation in response to restrictions imposed post-Afghanistan).

iv Impact of restrictions, which have already had effect of depriving USSR of key technology, would be cumulative.

v Restrictions could be lifted quickly through intergovernmental agreement.

vi COCOM member governments should take a joint decision to continue restrictions: COCOM Committee would be directed to continue to implement them.

vii Ideally all COCOM members (NATO members minus Iceland, plus Japan) should be involved (France, which did not agree to restrictions post-Afghanistan but has in practice acquiesced in them, should be brought into agreement).

Comment: given de facto agreement on 'no exceptions' policy post-Afghanistan, Western partners should at the very least maintain existing restrictions. Areas exempted from current policy (eg public health and safety items) could be included to reinforce these restrictions. A formalisation of the present 'no exceptions' policy could be sought through amendment of COCOM regulations: but this is

/unlikely

unlikely to be more effective in practice than an informal approach, would be less likely to be agreed upon, and, if implemented, would be more difficult to reverse.

2. <u>Further tightening of COCOM restrictions: a complete 'no exceptions' policy</u> (ie in addition to no 'general exceptions', no exceptions in areas subject to national discretion).

i Administratively and legally feasible.

ii No cost to UK budget (as long as contracts already concluded are not broken and HMG is not liable to pay compensation). Total UK exports of licenseable goods to USSR, 1979: £66 m (of which £49 m were atomic energy items subsequently re-exported from USSR). Virtually all the remaining £17 m worth of licenseable exports was COCOMable. Potential cost to UK economy should take into account subsequent inflation and potential growth in trade with USSR. Loss of business in atomic energy items would cause substantial damage to UK, with little corresponding harm to USSR.

iii Difficult to see how USSR could retaliate in similar fields. But if embargo covered spares and essential equipment for maintenance, and particularly if this involved breaching contracts, USSR could retaliate eg against the premises and property of supplier companies in USSR pending legal action; and, perhaps, blacklist such companies.

iv Complete 'no exceptions' policy would be more effective than the present restrictions and would affect a number of sectors where the USSR would have difficulty in finding substitute supplies. (But note loss to UK of atomic energy business with little corresponding harm to USSR.) Effect would be cumulative.

v Restrictions could be lifted quickly through intergovernmental agreement.

vi COCOM member governments would need to take decision to impose restrictions: COCOM itself would then be directed to implement them.

vii All COCOM members should be involved (some, eg FRG and France, may be unenthusiastic). Substitute supplies of goods involving advanced technology might be found in non-COCOM industrialised countries (eg Austria, Sweden, Switzerland)

/and

and NICs (eg South Korea, Singapore). The cooperation of some key non-COCOM countries might therefore be sought.

Comment: problem of spare parts and servicing equipment for goods previously supplied should be considered: this is a possible area of exemption from these measures. Other exempted areas (ie items assisting public health and safety, serving Western security interests, or protecting Western access to vital commodities or services) might also be considered.

3. Extension of the three lists, to include eg semi-conductor manufacturing technology, laser interferometers, categories of automatic testing devices etc.

i Legally and administratively feasible (but see vi below).

ii No cost to UK budget. Value of potential lost business unquantifiable.

iii Retaliation unlikely.

iv Speed of effectiveness would depend on time taken to agree extensions to lists: this, even if achievable, would almost certainly take several months.

v Reversible in practice if COCOM partners were subsequently prepared to allow exceptions in these new areas.

vi Agreement on extension of lists would have to be sought through COCOM, and would involve lengthy and complicated technical discussions.

vii Agreement of all COCOM members would be necessary in theory: in practice would need agreement of US, Japan, FRG, France, UK, Italy, Canada, Netherlands, Belgium.

Comment: A US proposal. Unclear what areas of technology it would embrace (note 'etc' ...). Even if agreed in principle that lists should be extended - and it is very possible that some key COCOM members, eg FRG and France, would not agree - agreement on details would require lengthy technical discussions by experts which could not be circumvented. This is therefore a measure which could not be implemented quickly.

4. <u>Settling differences over computers (ie refining and widening scope of current COCOM restrictions on computer hardware and software</u>)

i Legally and administratively feasible. (But see vi below)

ii No cost to UK budget. But tighter restrictions would reduce business prospects for UK computer companies.

iii Retaliation unlikely.

iv Speed of effectiveness would depend on time taken to 'settle the differences' on computers (see 'Comment' below). If agreed and implemented, greater restrictions on computer supplies would have impact on USSR.

v Reversible in practice if COCOM partners subsequently prepared to allow exceptions in these areas.

vi Agreement would have to be sought through COCOM. This could not be done quickly, if at all.

vii Agreement of all COCOM members would be necessary in theory: in practice this would mean US, Japan, FRG, France, UK, Italy, Canada, Netherlands and Belgium.

<u>Comment</u>: A US proposal. Post-Afghanistan the US proposed tighter control of computer software exports and a redefinition of the COCOM computer controls. Subsequent discussion in COCOM has been prolonged, largely unsuccessful, and at times acrimonious. (We now understand that the US intend to submit revised proposals in early spring 1981.) Willingness to compromise needed by all concerned if agreement is to be reached.

5. Selective embargo: FCO note on USSR dependence on imports from the West sets out areas where a selective embargo would cause particular harm to the USSR. These sectors could not be made subject to COCOM restrictions if COCOM's ground rules were not amended (which would be a very time-consuming and difficult task). It would therefore probably be best to pursue the idea of a selective embargo outside COCOM (in which case our EC obligations would have a bearing). A selective embargo could also apply to sectors identified by US in their recent proposal that COCOM review contain turnkey projects worth over $100 m: this proposal has run into strong opposition in COCOM and is unlikely to be accepted in its present form.

ANNEX V

INDUSTRIAL CONTRACTS

1. There is considerable scope for Ministers to limit British exports to the Soviet Union which amounted to £453m in 1980, although these are likely to be lower in 1981 as a result of a reduction in Russian purchases following from tension over the invasion of Afghanistan. Our main exports are chemicals, fibres and textiles, machinery and metals.

Control Powers

2. At present only sensitive items are subject to export control (valued at £66m in 1979 including £49m worth of uranium for processing and return to the West). Further controls could be imposed by means of Community legislation under Article 113 of the Treaty of Rome (subject to the legal caveat in paragraph 5 of the main paper), or by individual but co-ordinated member state action under Article 224 (as in the case of Iran). Article 224 lays down that member states of the European Communities shall 'consult each other with a view to taking together the steps needed to prevent the functioning of the common market being affected by measures which a member state may be called upon to take ... in the event of war or serious international tension constituting a threat of war, or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security'. Thus Article 224 action requires at least consultation with our partners to prevent distortion of the common market. To be safe from legal challenge it is probably necessary that member states should agree that action on a member state basis is justified. In the United Kingdom action under Article 224 could be taken by making use of powers provided by the Import Export and Customs Powers (Defence) Act 1939 to ban any export to any destination. Standing provision for the control of exports of goods is made in the Export of Goods (Control) Order 1978 which lays down that the export to most destinations of all goods specified in the Schedule to the Order are subject to licences which may be issued, or withheld, by the Department of Trade. A new Order could extend quickly the range of goods affected either to cover all goods or those for which the Soviet Union is particularly vulnerable to loss of imports. This would not need Parliamentary approval, but following the Iran ban,

Parliament should be informed. When no longer required, controls could quickly be reversed either by issuing licences or making a fresh Order. This of course does not mean to say that the Soviet Union would then necessarily resume purchasing.

3. The 1939 Act is however restricted to goods and does not cover the activities of United Kingdom nationals and companies abroad, or the provision of services including banking of financing operations; provisions restricting trade via third countries are minimal.

New Powers

4. Any extensive control of commerce with the Soviet Union going wider than the licensing of goods for direct export to the Soviet Union or other East European countries would require fresh primary legislation as in the case of Iran. Article 224 of the Rome Treaty lays down that Member States of the European Communities shall consult so as to prevent the functioning of the Common Market being affected by measures which a Member State may have to take in the event of serious international tension constituting a threat of war or to carry out obligations for the purpose of maintaining peace and international security. Thus it would be necessary to hold discussions with our partners even though we believe that the United Kingdom retains freedom of action in the commercial field to respond to the threat to security which would arise from an invasion of Poland.

Manning New Controls

5. New licensing operations carried out under the 1939 Act or fresh legislation would require additional staff; the preliminary estimate is that three people would be required for a rough and ready control of all exports to the Soviet Union and about three times that number to ensure that no evasion occurred in a selective system where licences were issued in a significant number of cases.

Application and effect of controls

6. Any quick control of exports would have to be based on selected categories of goods (or a total ban) rather than the choice of individual contracts, although the signature of major new contracts could almost certainly be prevented by denying officially-backed credit. In 1980 no buyer-credit contracts for exports by British firms to trading organisations in the Soviet Union

have been concluded. Our knowledge of individual contracts is limited to cases where firms approach either the Department of Trade or the Moscow Embassy for help, or request credit facilities from ECGD. We only know of three substantial contracts (respectively worth £4.5m, £5.8m and £6m) signed in 1980 out of total orders known to us amounting to £58m. Similarly we know of some £550m worth of project business currently under negotiation by British firms including Rolls Royce's £220m bid in connection with the West Siberian gas pipeline project.

7. While United Kingdom export licensing controls could be highly effective in themselves, Britain supplies little which the Soviet Union could not in normal circumstances obtain elsewhere (or in some cases make itself) so the impact would depend upon the extent to which other suppliers (Japan as well as EC Member States and the USA) matched our actions.

Existing Contracts

8. The controls could be applied to shipments under existing contracts but at heavy cost to British firms and to ECGD. In addition to the three contracts mentioned above, there are four large projects currently in progress worth a total of about £340m. Potential liabilities here would be well in excess of the cost of outstanding deliveries, which can only be roughly estimated but may amount to about £200m. A significant proportion of contracts are believed not to contain a force majeure clause and the Soviet Union has in the past shown little reluctance over enforcing its contractual rights. Many firms would be faced with uninsured losses leading them to seek compensation from Government. In addition to the financial costs, there would be long term implications in setting a precedent by interfering with existing contracts both in relation to trade with the Soviet Union and for our exports generally. In the case of Iran, Ministers decided against such interference.

Retaliation

9. This would depend very considerably on the sanctions which provoked it and the extent to which the United Kingdom acted in concert with our allies. Trade with the Soviet Union and other bloc members (United Kingdom exports to bloc members other than the Soviet Union in 1980 were £672m)

would take a long time to recover. The bloc might withhold supplies of certain key raw materials discussed in Addendum A. Our tentative conclusion is that, while the United Kingdom could manage without East European supplies, the present level of our dependence on this source is such that purchasing elsewhere would involve paying higher prices in the short term because of the consequential effect on world trade. In the longer term supply and demand could be expected to come more into balance but the possibilities of shortages cannot be ruled out unless the Soviet Union decided to release materials onto the world market or new sources could be developed economically. The West would become more heavily dependent on vanadium, manganese and platinum group metals from South Africa.

A Moratorium

10. There is little scope for a short term interruption in the shipment of goods to the Soviet Union without interfering with existing contracts since the time lag between acceptance of an order and shipment is usually at least several weeks and often longer. Delaying goods would lead to contractual losses, demurrage charges, etc. There would also be problems over identifying goods not consigned direct to the Soviet Union. As noted in paragraph 2 above, the Department of Trade could quickly make an Order under existing legislation whcih could affect acceptance of new business. It could also refrain from issuing further export licences for goods currently under control. Licence applications for the Soviet Union now with the Department cover goods worth about £80m.

Suspension of gas pipeline project

1. The Soviet Union is planning a new pipeline about 4,500 km in length which could convey at least 40 bn cubic metres/year of natural gas from Western Siberia to both Eastern and Western European countries. The Federal German Republic and France are expected to take the largest amounts of supply, followed by Italy, Benelux, Sweden and Austria. This might represent about 5 per cent of the Federal Republic's present total energy requirements; and her dependence on Soviet gas is expected to rise from the current 16 per cent to 26 per cent by the mid 1980's. France's dependence on Soviet gas supplies might rise from the present 14 per cent to 30 per cent. The project is likely to cost about £5,000m, the bulk of this and the supply of equipment coming from the consumer countries. There are however opportunities for British companies to supply compressor station and other specialised equipment. Both John Brown Engineering Ltd and Rolls Royce Ltd have supplied gas generators for compressor installations in three earlier pipeline projects. Rolls Royce have the prospects for selling lightweight aero-engine derived generators worth at least £220m (and perhaps substantially more). This potentially profitable order is of considerable importance to the company, particularly after its recent disappointment over major aero-engine contracts. It would provide 400-500 jobs for four years in the company's Industrial and Marine Division and its sub-contractors. A number of other companies are also pursuing large orders.

2. The project is still at an early negotiating stage; an initiative to suspend it could be taken quickly provided that all countries capable of supplying the essential equipment agreed not to do so. The main consumer countries would also have to be prepared to forego the gas supplies. British participation could if necessary be forestalled by refusing to grant officially-backed credit facilities and by licensing controls. The Russian Ministry of Foreign Trade is now pressing for an assurance that, if a contract is awarded to Rolls Royce, the Government will not subsequently interfere with its completion.

3. The loss of this project would be seriously felt by the Soviet Union and other bloc countries; the latter are expecting the pipeline to provide them with about 10 bn cubic metres/year of gas; while the Soviet Union appears to regard the project as a major source of hard currency earnings to replace in part what is now earned by supplying oil and oil products to the West. On the other side, these countries would be looking elsewhere for supplies at a time when the world energy balance is likely to tighten. Simultaneously the Western Europeans would need to find alternative sources. In the narrow sense the United Kingdom would not be affected since no imports of Soviet gas are planned.

Suspension of air services

i. Scheduled services

Services between the United Kingdom and the USSR are operated within the framework of a bilateral Air Services Agreement, which has treaty status. Denial of the right of scheduled services by unilateral action would be a breach of the spirit of the Agreement. In practice, the services are governed by a Confidential Memorandum of Understanding (CMU) dated 22 October 1980. This could be terminated legally by giving reasonable notice; in the event of the invasion of Poland a few hours to get our aircraft out of Moscow could be 'reasonable'. It would then be necessary to suspend or revoke Aeroflot's operating permit issued under the Air Navigation Order, 1976. This might be challenged in the courts and since the termination of the CMU was for reasons not connected with civil avaition, there is a strong possibility that the challenge would be successful. However the possibility of Aeroflot taking legal action is remote.

Termination of the CMU would also remove British Airways' entitlement to operate services to the USSR. Nevertheless, if the Russians decided to allow them to continue and BA wished to do so, the Secretary of State for Trade could use his powers to direct the Civil Aviation Authority to withdraw BA's licence to operate to the USSR.

The effect of termination of scheduled services would be immediate. The impact would be moderate but increased significantly if all western countries and Japan took similar action.

Reinstatement of scheduled services would require a new CMU. In view of the newness of the current CMU, we would envisage proposing it for re-signature. Since the Russians would probably want services to resume, this should not present much difficulty.

Termination of scheduled services would have no direct cost for the United Kingdom budget and minimal effect on the economy. A small net gain is possible from the extra revenue which BA would derive from denial of access for Aeroflot to United Kingdom-Japan traffic. Conversely there could be indirect costs if United Kingdom businessmen had fo find alternative routes to the USSR, given that any of them wanted to visit.

There is a possible risk that the Russians might retaliate by preventing access to Berlin for United Kingdom airlines for scheduled services, including those from Federal Germany, and charter services.

ii. Charter flights

Aeroflot and Britannia Airways operate charter flight programmes, the latter only in the winter season. Only United Kingdom-originating tourists are carried. The flights are covered by seasonal permits, that for Aeroflot being issued under the Air Navigation Order, 1980. We could suspend or revoke the permit. If challenged in the courts on the ground that suspension was for reasons not connected with civil aviation, there could be no guarantee that the courts would not find in favour of Aeroflot. It is also possible that individual tourists would seek compensation from the Government in the courts. Again there could be no guarantee that the courts would not find in their favour.

If Aeroflot applied for permits for individual charter flights, we could refuse.

If Britannia Airways were permitted by the Russians to continue their flights and they wished to do so, the Secretary of State for Trade could direct the Civil Aviation Authority to withdraw their licence.

The effect of termination of charter flights would be immediate. The impact would be small, but moderate if all Western countries and Japan took similar action.

Reinstatement of charter flights on the present pattern would be possible with a few months' notice to allow time to organise and sell new tour programmes.

There could be a direct cost to the United Kindom budget of about £1 million if it was decided to compensate tourists for their lost deposits. In the absence of such an arrangement, there could be costs, which are not quantifiable, resulting from successful court actions by individuals for compensation. There could be a very small gain to the economy from the saving in foreign exchange which tourists would otherwise have used.

iii. Over-flight of United Kingdom territory

Permission for over-flight of United Kingdom on services to beyond countries eg Cuba is at our discretion. We could therefore refuse Aeroflot's applications. The impact would however be minimal unless other Western European countries took similar action.

SHIPPING

Closure of Ports

1. New primary legislation would be required for the closure of ports. Our current powers to take such action only apply when our shipping or trading interests themselves are under threat. Two cases must be considered -

a. there are Soviet ships engaged in trading directly between the two countries (bilateral trade). This traffic includes imports, mainly in Soviet ships, of oil, timber and some general cargo. Denying access to these ships would be contrary to the UK/USSR Maritime Treaty (see below) but would not be economically very damaging to our shipping interests. It would of course affect our general trading relations with the Soviet Union so that any decision on this issue would need to reflect the action taken over trade generally. Limited counter measures are already under consideration to improve Britain's share of cargoes shipped directly between the two countries in the event of the Soviets failing to help us over this;

b. most Soviet vessels using British ports operate between the United Kingdom and third countries (cross trade). They earned between £25 million and £45 million from these activities in 1979. Earnings by cross trading out of the Soviet Union by British ships are negligible. Closures of our ports to Soviet cross traders would also be in contravention of the Maritime Treaty. It would be administratively a complicated task for Customs and Excise if we wanted to keep our ports open for bilateral but not cross trading activities. Bilateral trade currently accounts for about 200 calls at British ports a year out of the 1,600 or so made by Soviet ships.

2. Soviet retaliation to ports closures for either type of traffic would almost certainly include banning United Kingdom vessels from Soviet ports. Although our bilateral and cross trading activities are small, Britain earned about $30 million from chartering ships to the Soviet Union in 1979 and retaliation could spread to trade with the Soviet Union generally.

3. Any controls would be most effective on a European basis since this would reduce the opportunities for trans-shipment.

Termination of Maritime Agreements

4. The United Kingdom has a Maritime Treaty with the Soviet Union signed in 1968. This

- gives mutual access to each other's open ports,
- covers a number of important technical, marine and legal issues.

So far it has operated very much in favour of the Soviet Union. Termination of the Treaty would deliver a political rebuff to the Soviet Union and remove an impediment to taking more direct action like closing ports. We are currently considering the limitation of access by Soviet ships to some British ports for security reasons. Although such limitations would be technically in breach of the Treaty, this would be unlikely to lead to abrogation by the Soviet Union.

5. 12 months' notice would need to be given before termination would be legally effective, and it could probably only be reversed by negotiating a new Treaty. There would be no budgetary cost, while the economic effects would depend on Soviet retailiation, which is difficult to predict; there could be a complete breach in shipping relations leading to disruption of desirable Anglo-Soviet trade or nothing could happen at all. There seems little point in terminating the Treaty in isolation from taking other action that would be contrary to it. Most other EC countries (excluding Germany) have similar Treaties. The United States has a fundamentally different type of maritime treaty based on reciprocity of treatment; and at present the treaty is effectively inoperative because of the continuing boycott by longshoremen of Russian shipping in American ports which has now lasted about a year.

The Trans-Siberian Railway

6. 25 per cent of European containerised surface trade with Japan now travels via the Trans-Siberian Railway. The modest United Kingdom share of this could probably be stopped, or at least seriously frustrated by action against the Soviet feeder vessels operating between the United Kingdom and Leningrad. This would be an automatic part of the action against Soviet cross traders above and is subject to similar considerations. To halt the operation of the land-bridge entirely, co-operation between the EC countries and Japan would probably be necessary. There would be considerable administrative and enforcement problems in imposing controls on containers destined for the railway.

FISH

1. Soviet domestic production (1979) totalled 9.4 million tonnes. Imports totalled 107,000 tonnes from the United Kingdom and Iceland (of which 90,000 was mackerel from the United Kingdom). Exports were about 474,000 tonnes. The impact of a ban on Community exports to the USSR would therefore probably not be very great.

FISHING AGREEMENTS

2. The USSR has no fishing access to United Kingdom or other EC member states' waters nor do EC member states have any fishing rights in USSR waters.

3. There is a 'grey zone' which is still the subject of a formal dispute between Norway and the USSR although agreement on temporary policing arrangements has been reached. There might be scope for harassment of United Kingdom vessels fishing in this zone by agreement with Norway.

4. The USSR and its Baltic satellites are parties to the Baltic Fishing Commission. Their withdrawal or non-co-operation could embarrass Denmark and Germany but not the United Kingdom. The USSR could obstruct or withdraw from the International Whaling Commission. While such moves would cause the USSR itself some embarrassment, they could prevent us from achieving our objectives in the Commission.

FACTORY SHIPS

5. Currently a substantial proportion (1979, 30 per cent) of the British mackerel catch (the United Kingdom's largest fishery) is trans-shipped to Russian factory vessels within United Kingdom waters and ports from British fishing vessels. There are no United Kingdom powers enabling the Government to ban trans-shipment, although action would be possible as part of a more general embargo on exports either under Article 113 Community legislation or by means of national action under Article 224. There are no United Kingdom powers to exclude factory ships from United Kingdom fishing waters.

6. EC exports of fish and fish products to Russia in 1979 were made up almost entirely of United Kingdom catches of mackerel trans-shipped to Russian factory vessels. The value of these exports was in excess of £9 million, some 6 per cent of the total value of United Kingdom exports of fish and fish products in that year.

7. Export refunds are payable on frozen whole mackerel only to certain destinations which exclude the USSR.

8. There is no provision for export levies to be imposed on exports but under Management Committee procedure a Commission regulation could be enacted. The only possibility for rapid action would lie with an embargo on trade. Given the political will to act under Article 113, this could be achieved relatively rapidly.

9. The burden of prolonged curtailment of exports, ie of trans-shipments of mackerel to Russian factory ships, would fall chiefly on the deep sea fleet and certain Scottish fishing vessels which have few, if any, alternative fishing opportunities from late summer to early spring. This sector has had a very difficult year. Markets continue to be weak and fishing opportunities limited. To be faced with the loss of outlets for mackerel would be very serious. Following the breakdown of EC fisheries negotiations and the continuing absence of EC structural aid, the industry would be bound to claim compensation. Failure to meet any claim could have political consequences. These factors would have to be weighed against the fact that, if other countries sought similar exemptions from a general embargo on food exports for their own hard-hit groups, the effects of such an embargo could be weakened significantly.

POLAND CONTINGENCY PLANNING: POSSIBLE FINANCIAL MEASURES

1. General considerations

Any punitive action in the financial field pursued for purely political reasons could well have grave consequences for London's standing as an international financial centre, all the more so if any other country such as France, Austria or Switzerland refrained from parallel action. For most of our NATO allies the consequences of financial action would be very much less than for the United Kingdom because of London's outstanding importance in this regard. It was for that reason and in order not to sap confidence in, and hence the stability of, the international banking system, that in analogous circumstances the OD Committee expressly ruled out formal action to freeze Iranian balances, notwithstanding the imposition of formal sanctions in other fields.

2. Retaliatory action

The risk that the USSR might take retaliatory action, even to the extent of repudiating debt, in response to financial sanctions, would no doubt depend on their severity, their likely duration (in the USSR's judgment) and how widely they were implemented elsewhere. The fact remains, however, that, unlike Iran, the USSR is currently a net debtor of the West and could therefore in the short term inflict more damage to the West in money terms than it would suffer itself. If the entire bloc followed suit the case would be still worse. The chances of their doing so would be all the greater because from the point of view of the West it would not make much sense to restrict action solely to the USSR; there would otherwise be ready scope for circumvention through other East European nominees (to cite the most obvious channel). Even if the rest of the bloc were left outside the scope of restrictions, the fact that the USSR is seen by many Western leaders as the ultimate guarantor of other East European countries would mean that any action against the USSR alone would still cast doubt on the value of claims on other East European countries borrowing under the Russian umbrella. That in turn could reflect on the banks and credit guarantee organisations exposed to those countries. The cost to the West in financial terms of full-scale bloc retaliation by repudiation of debt - as discussed above - could therefore extend to the whole $77 billion of bloc indebtedness to the

West. ECGD's exposure to the bloc amount to £2.5 billion, and unguaranteed claims of British-owned banks (at end-June 1980) £1.4 billion. It need hardly be mentioned what a fearsome legacy of intractable legal problems would be left in the event of Russian retailiation against sanctions, when those sanctions were eventually lifted.

3. Inter-relationship between financial and other sanctions

Of the specific proposals (discussed in detail in 5 below) item ii., credit restrictions, is a partial substitute for a trade embargo. On the other hand, item iv., the freezing of balances, far exceeds in severity and potential consequences most of the other items on the list for consideration.

4. Legality

The advice of the Treasury Solicitor is that Section 2 of the Emergency Laws (Re-enactment and Repeals) Act 1964 would be applicable if the Treasury were satisfied that action was being, or likely to be, taken by the USSR to the detriment of the economic position of the United Kingdom. (Although a Russian invasion of Poland would not damage United Kingdom economic interests, Russian retaliation against other sanctions might do so; and this risk would justify the use of the legal powers.) This would enable the Treasury to prohibit the carrying out of any Soviet order for the transfer of any gold, securities or money. Such action would be applicable only within United Kingdom jurisdiction, but would permit the freezing of Soviet balances with banks in the United Kingdom. Circumstances which enabled the 1964 Act to be used would, assuming the detriment was not trivial, also mean that use of the Exchange Control Act would be intra vires though its reactivation would be technically complex. Informal action, as in the case of Iran, would also be feasible.

5. Specific proposals

i. Restrictions of acceptance of Soviet deposits by Western Banks

If the Exchange Control Act could be used it would be possible to prohibit or restrict the acceptance of identifiable deposits from the USSR. Voluntary arrangements could also be used, as in the case of Iran. It would need to be decided whether the restriction is to be applied solely to Soviet deposits or to deposits from the bloc at large; and whether it should apply solely to incremental deposits or to roll-overs of existing deposits.

At the limit, the prohibition of payments to Soviet (or bloc) accounts would be tantamount to the prevention of exports from the USSR and a barrier to contractual payments due to the USSR. Restrictions of this kind would be feasible, but it is not clear what purpose would be served since the West would merely deny itself access to Russian goods (regardless of their priority). Failure to meet contractual financial obligations could increase the prospect of relatiation.

An alternative effect of such restrictions would be to prevent disruptive switching of USSR balances to the United Kingdom. This would be a supportive action if others intended to freeze Soviet assets. It would be effective only if it were implemented before others acted to freeze balances, and if the USSR tried to take evasive action ahead of a freeze. The USSR would need to anticipate which countries were about to freeze balances and which would refrain. Any restriction of acceptance of Soviet deposits could be circumvented through nominees.

ii. Restrictions of loans to the USSR by Western banks

If Exchange Control powers could be used they would provide a means to restrict lending. Voluntary action, as in the case of Iran would also be possible. It would need to be decided if action should be applied solely to the USSR, or to the bloc as a whole, and whether it applied solely to new long-term loans, to all incremental borrowing, or even to rolling over existing credit.

As borrowing by the USSR is largely to finance trade there would not be much need for restrictions on new trade credit if a trade embargo were introduced, but as indicated above credit restrictions could be a potential substitute for trade restrictions. Since there would no doubt be less disposition to lend to the USSR anyway if other measures had been taken or were thought to be imminent, the voluntary route would not require much pressure and could achieve substantially the same effect.

To the extent that the restrictions did not frustrate existing contractual arrangements there would be no ready-made pretext for retaliation by the USSR through their own contractual commitments.

iii. Restrictions on the activities of Soviet Banks

Depending on their nature, restrictions could be imposed under the 1964 Emergency Act or the Exchange Control Act if it could be used. Action could not legitimately be taken under the Banking Act as it stands to withdraw or restrict Moscow Narodny's licence to operate. There are other European banks in London some of which have some Western shareholders, Soviet banks are also located in non-NATO countries, such as Austria and Switzerland. There are branches of Moscow Narodny Bank in Beirut and Singapore.

Advances of the Soviet banks are largely to Eastern Europe. Action to restrict their activities would mainly affect those who lend to them, including Western Banks, and at the limit could force Moscow Narodny Bank to close down. Since that bank is a United Kingdom registered bank, however, it would be against the standing of London to bring that about. Indeed, in such circumstances the possibility of life-boat action would have to be considered to protect Western depositors. It seems unlikely that the costs to the USSR of such restrictions would be as great as those to the United Kingdom. There might, however, be a domino effect in the Euromarkets.

iv. Freezing of Soviet Assets

Formal action to freeze Soviet financial assets would be possible, in appropriate circumstances, under the 1964 Act. This action would be the most likely to trigger a default by the USSR or the bloc as a whole (for the umbrella theory would become increasingly inoperative if Russian balances were frozen). Since the USSR (and a fortiori, the Eastern bloc as a whole) are net debtors of the United Kingdom, such an action would be costly in its own right, before any allowance is made for the effect on confidence in London and in the international banking system. The risk of default, even if only for purely financial reasons, by other bloc countries would increase, and there would be a knock-on effect for other borrowers in the crisis of confidence that would develop. Potential depositors might consider switching to countries which refrained from political action in financial matters, to gold, and to leaving oil to appreciate in the ground. The recycling process could be seriously damaged, and the ultimate costs incalculable.

Current United Kingdom banking exposure to the USSR and the Eastern bloc is set out in the attached table.

6. Temporary Action

In addition to the four courses of action discussed above the question has been raised whether a temporary "moratorium" might permit more detailed consideration and co-ordination or reactions. Although it is possible in some fields of activity to "stop the clock" the declaration of a financial moratorium, however temporary, is taken as a positive decision not to meet commitments and is, in effect, a form of default. It is therefore debtors, not creditors, who declare moratoria. In this case the West are the creditors so that it is far from clear what the nature of the "moratorium" would be. In practical terms, it is difficult to envisage anything but a unilateral decision to freeze Soviet assets, the most extreme of the possibilities considered above.

However, it might be possible to use the Banking and Financial Dealings Act 1971 to prevent certain banking transactions or dealings on selected exchanges for a very short period such as a long weekend. These powers (which have not hitherto been employed) could not be used selectively against one, or a group, of countries. Any use would have some adverse effect on banking confidence even though they did not bear particularly on the USSR. Moreover, action to prevent dealing in foreign currency or gold (if such dealing is not a banking transaction) would be applicable only to dealers authorised under the Exchange Control Act 1947, and as long as there are no authorised dealers in gold and foreign currencies the powers relating to such dealing under the 1971 Act are not exercisable.

LIABILITIES AND CLAIMS OF BANKS IN THE UK VIS A VIS EASTERN BLOC

MID-NOVEMBER 1980

£ mns

I All Currencies	USSR Liabs	USSR Claims	USSR Net	USSR Unused Credit Facilities[2]	Eastern Europe[1] Liabs	Eastern Europe[1] Claims	Eastern Europe[1] Net	Eastern Europe[1] Unused Credit Facilities[2]
All banks	950	1,251	+311	445	1,634	6,558	+4,924	1,362
Of which: British	151	613	+462	262	288	2,364	+2,076	875

SECRET

II British Supervised, Banks Worldwide Claims on Eastern Bloc - end June 1980

	USSR Total Claims	USSR Unguaranteed Claims	Eastern Europe Total Claims	Eastern Europe Unguaranteed Claims
All banks	801	439	3,471	2,444
Of which: British	631	276	2,449	1,458

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

2 End-June 1980

SECRET

Key Areas of Soviet Vulnerability to Western Imports

The following list of key areas of Soviet vulnerability is based on detailed studies carried out by the Ministry of Defence and the Foreign and Commonwealth Office. It sets out the areas of vulnerability in descending order of importance to the Soviet economy, the main criterion being the speed with which cutting off Western exports to the West would adversely affect Soviet economic development. It is assessed that restrictions to exports in the first three categories listed would have the most immediate and damaging effect.

1. Large diameter steel pipe

Plans for expansion of gas output during 1981-85, for Soviet and East European consumption and for convertible currency earnings, depend to a very great extent on high quality Western pipe. Often the delivery dates specified are short term and Soviet pipelaying programmes depend not only on getting the pipe but on Western ability to deliver it on time.

2. Grain

Imports are likely to be necessary to preserve living standards even when harvest is reasonably good. With major shortfalls on plan speedy, as well as large scale, deliveries of grain imports may be vital.

3. Heavy earthmoving and road-building equipment

The Soviet Union is not yet capable of making the quality or quantity required of important pieces of equipment which are fundamental to the exploitation of mineral resources in difficult areas, primarily Siberia.

4. Technology for the energy industries

Achievement of plans dependent on Western equipment in selected areas. To reduce labour needs for repair and maintenance of oil wells in Siberia large scale imports of gas-lift equipment will be needed to replace to large extent the traditional Soviet waterflooding technique. Pipe suitable for drill strings becomes more vital with increased drilling depths where defects of Soviet metallurgy cause expensive and time-consuming breakdowns. Need for high quality drill-bits for same reason. For exploration to find new reserves in areas such as Barents Sea will need imports of sophisticated equipment, some of which will be at the limits of present Western technology. Continuing need for Western pumps and compressors to reduce the degree of under-utilisation of pipeline capacity.

5. Chemical industry

Imports needed for the fertilizer industry, particularly for phosphate and compound fertilizers in support of the agricultural targets. Plastics manufacturing equipment needed to support efforts to replace and conserve conventional raw materials which are becoming increasingly difficult and expensive to extract.

6. Metallurgy and metal working equipment

Imports needed to expand the range and improve the quality of metals and metal products to replace imports of finished metals and metal goods from the West. Also to reduce large-scale waste resulting from production of unusable metal goods.

7. Computers and numerically controlled machine tools

With emphasis on increased productivity to achieve economic targets imports from West will be needed to improve efficiency of Soviet equipment and to fill gaps in specialised tools.

8. Automotive industry

With rail transportation system becoming overstrained there is a need to build up a modern distribution system of road transport. Manufacturing equipment for lorries has been and will continue to be needed. In some cases it takes time for projects to become self-sufficient in spares and even components and materials for the product and Western imports may be vital to performance of new plants even after they are in production.