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Prime Minister

A Western policy towards the Soviet economy

Leonard Schapiro and I have prepared the attached paper.

We wonder whether you would be able to cast your eye over it and, if you like the approach, perhaps give us instruction to work it out in greater detail-in collaboration with specialists in technology.

The necessary information appears to be in the public domain.

Whatever you decide about an instruction, we hope that you may find it helpful for any conversation you may have with President Reagan about policies towards the Soviet Union.

Mr. Reagan's administration may be interested in a radical approach of this nature.

Perhaps Leonard and I could discuss this paper at some point during our meeting ^{with you} now planned for 24th January.

Hugh Thomas

Hugh Thomas

December 31, 1980

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To secure fuller understanding of the methods available to improve the standard of living, the quality of life and the freedom of choice of the British people, with particular attention to social market policies.

A WESTERN POLICY TOWARDS
THE SOVIET ECONOMY.

A PRELIMINARY REPORT
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A WESTERN POLICY TOWARDS THE SOVIET ECONOMY

I THE PURPOSE

1. This paper examines how the West should exploit the economic difficulties which the Soviet Union will face in the 80's.
2. A co-ordinated and resolutely pursued economic policy by the West over the next few years could:
 - a) impede the expanding Soviet military effort;
and
 - b) place the Soviet Government in serious difficulty, perhaps threatening the survival of the regime in its present form.

II SOVIET ECONOMIC PROBLEMS

3. Soviet economic difficulties in the years to come will probably derive from:
 - a) An inefficient agriculture which will leave the country increasingly dependent on the import of foodstuffs;
 - b) the diminishing growth of Soviet industry;
 - c) labour problems deriving from geographical and ethnic imbalances;

/(d) the

d) the crying need of the Soviet over-centralized planning system for rational reform which is likely to be frustrated by ideological rigidity-as has been the case in the past;

e) the likelihood that the Soviet Union, because of increased demand (beginning in the East European satellites) will experience a medium-term shortage of oil, in place of the present exportable surplus.

Should it seek to cope with the shortage by imports, it will have to find the hard currency to pay for it. The exploitation of new resources in the Northern U.S.S.R calls both for much capital investment and also for imports of technology such as the Soviet Union cannot itself produce.

4. The basic economic problem of the Soviet Union is that it is committed to at least three, not easily reconcilable, courses of policy, none of which it is likely to discard lightly: military expansion; satisfaction of consumer demand; and the survival in power of the present ruling class of Apparatchiks.

III. SOVIET DEPENDENCE ON ECONOMIC CONNECTIONS WITH THE WEST

5. The extent of Soviet dependence on Western economic support and technology is controversial. But certain factors seem to be established:

- a) the growth of the Soviet economy has been shown by several studies* to have been principally the result of her exploitation of Western technology, either by straightforward or by covert means;
- b) the avid Soviet interest in acquiring knowledge of, and the dependence of many Soviet scientific advances on, Western technology is attested by recent emigrés from the Soviet Union;
- c) the deep, genuine and persistent Soviet interest in the maintenance of détente which the Soviet Union hopes can be exploited politically to divide the West, can mainly be explained by the economic and technological advantages which the Soviet leaders see as deriving from the policy. After all détente has risks for the Soviet Union: her acceptance of Basket 3 on human rights, at Helsinki, may have weakened the hold of the Government over the population. It would be naive to accept the repeated Soviet explanation of its interest in détente: that it could lead to disarmament and to a reduction of the risk of nuclear war. The continued build-up of arms by the Soviet Union in the 1970 s, and persistent Soviet resistance to genuine and controlled disarmament is evidence of that;

For example:-

* Anthony Sutton Western and Soviet Economic Development
(Hoover Institution 1968, 1971 and 1973)

/(d)

d) the failure of the Soviet Union to give all-out support to the French Communist party's revolutionary aims for fear of disorganizing the French economy may have been at the root of the French CP's quarrel with the CPSU some years ago. This may also paradoxically be one reason for the Soviet semi-tolerance of Eurocommunism;

e) the COMECON countries debt to the West is about \$70 billion. The Soviet Union have devoted a great deal of attention to this side of their contact with the West, and were much more hostile to the US Congress's resolution on the matter than they were to the Jackson amendment;

f) there is also the question of food. Any boycott on the trade in food could be the most powerful weapon and could if made effective be most influential. A revival of real famine in the Soviet Union would damage the regime seriously.

6. Though it is not easy to determine how far Soviet scientists and technicians have the capacity to put the devices imported from the West to efficient use, there are instances where Western exports to the Soviet Union have been of direct benefit to the Soviet military machine. Examples are:-

a) the computer industry, where US, British and West European firms have been falling over one another to export to the USSR. It is a good market since the backwardness of the Soviet computer industry is proverbial. The computers for Soviet space and missile technology come either from Western imports, or ^{ad}aptations of them. The Kama River Truck plant,

Sam

run by IBM computers, the largest in the world, was built, purportedly for civilian production, with the help of American, European and Japanese firms. There seems no reason why it should not make tank engines and military transport vehicles; (Kama products are said to have been used by Soviet troops in Afghanistan).

- b) precision grinding, in 1972, the United States sold precision grinding machines to the Soviet Union in order to produce miniature ball-bearings necessary for missile guiding systems. That allowed the Soviet Union to MIRV its ICBMs. The US firm which produces these precision grinding machines is the only one which does so—thus destroying a familiar argument of the business community against economic warfare.

(see paragraph 19 below);

- c) petrochemicals and chemicals - another field where the USSR appears to depend on the West;
- d) steel welding, which may have been used to thicken steel in Soviet tanks;
- e) advanced electronics and lasers, including undersea sonic detection.

IV

IV A WESTERN ECONOMIC POLICY AND ITS CONSEQUENCES

7. The economic preponderance of the industrialised West over the Warsaw Pact is high. This strength has never been fully put to use in the defence of the free world. Yet the nature of the nuclear deterrence on which absence of military conflict between the super-powers rests makes this economic weapon the most desirable.

(see paragraph 30)
8. An effective policy of economic warfare against the Soviet Union could:
 - a) persuade the Soviet leaders to reduce their expenditure on the military machine, and cause them to agree to a genuine policy of international arms limitation;
 - b) on the other hand, for super power and patriotic reasons, it could lead them to persist in their inflated military expenditure only at the expense of consumer demands.
9. In their different ways these results could be good for the West. Reduction of arms would diminish the Soviet threat, and provide more time for the forces of disintegration inside the Soviet Union to grow. Real disarmament would obviously be beneficial. Squeezing the consumer (in e.g supplies of food) could spark serious unrest. That could gather momentum and link up with other sources of unrest which are already present and in certain circumstances are likely to grow, for example, nationalist discontent in a number of republics.

10. It would be over-optimistic to anticipate that such unrest could necessarily bring about the collapse of the present Soviet regime. The army and police would be the last to suffer privations, and would presumably remain as ready as in the past to fire on the others.* But, as events in Poland have shown, to say nothing of a long line of historical precedents, no one can foretell how speedily popular unrest may gather momentum. The Soviet leaders are no doubt keenly aware of this.

11. It is worth saying, perhaps, at the risk of stating the obvious, that such a collapse in the Soviet Union would be far and away the best way of freeing mankind from the threat both of permanent enslavement and of nuclear war.

V. RISKS OF A STRONG POLICY

12. It is possible that the Soviet Union might seek to solve its problem of oil shortage by a policy of successful subversion, or military expansion, in the Middle East. But the temptation will always exist and does not affect the other economic difficulties. It might be deterred by fear of a determined Western economic policy.

* the case of the army is debateable.

13. It is necessary to consider another alternative effect on the Soviet leaders of a Western economic policy of denial: that they will plunge into warfare in an effort to rally the population behind them. This point of view will be put forward by critics of these ideas in the West. It is a possible eventuality but for a number of reasons unlikely.
14. First, it is inconsistent with Soviet tradition to use war as a means of enlisting popular support - Soviet (like Russian) leaders are only too well aware of the risks that war entails. They recall 1905, 1917 and 1941.
15. Second, though Soviet military leaders now argue that a nuclear war can be won like any other conflict, the traditional Communist doctrine is to use military preponderance as a political weapon in order to achieve political aims by blackmail, without engaging in conflict. This is the process which has acquired the name 'finlandization'. The exception to this rule is a situation where other means have failed, and where serious (i.e nuclear) opposition can be considered unlikely - as in Afghanistan, where a preliminary operation by the KGB had failed, and where potential Western retaliation was discounted. Tribal guerilla resistance, if anticipated, was regarded as at most a nuisance.

16. As regards an attack on Western Europe or the USA, effective nuclear retaliation by the West cannot yet be discounted by the Soviet Union; it acts as a deterrent to a military assault.

VI. DIFFICULTIES OF ACHIEVING A UNITED WESTERN POLICY.

17. It would be foolish to overlook the difficulties which stand in the way of a united effort by the Western world to devise an effective policy of economic warfare such as is here envisaged. General sanctions have not as yet worked in any instance. Even COCOM, the agreement* restricting military exports to the Soviet Union and her European allies, has not been fully effective. Some still believe that in the long run, trade with the Soviet Union will lead to its taming or even to rendering it a reliable partner within the international system.
18. President Carter's policy of technological boycott after Afghanistan, in what may appear to have been uniquely favourable circumstances, did not fare very well either. As for his grain embargo, it failed because it was circumvented, principally by Canada and Argentina, and partly by Australia and New Zealand.

*COCOM includes NATO, including France - but without Iceland - plus Japan.

19. Any boycott would also have to be enshrined in law since otherwise businessmen, however patriotic, would be likely to salvage their conscience over deals with the Soviet Union with the remark: "if we don't sell it to them, someone else will" (even though that may not always be apposite: as in the case of the ball-bearing grinding machines referred to in paragraph 6b)

There would be also those who would argue that in time of peace any boycott would damage world trade in general and be an unacceptable breach of human rights.

20. It will require diplomatic skill to persuade the governments of Western Europe to act in agreement to the end proposed, even if the US were to be convinced of its desirability. Several Western governments have developed their own special 'relations' with the USSR: France because of her heritage from de Gaulle and the continuing importance of the French Communist Party; Germany because of the 'ostpolitik' and her natural gas imports; and Italy both of gas imports and of the Italian Communist Party. Even the US has her famous "back channels". At present, both the US and West Germany are negotiating commercial arrangements apparently of great benefit to the Soviet Union.

21. The dependence of the US on scarce, but vital resources may be another restricting factor, if only because of the current Soviet influence in Africa. The Soviet Union might be able to retaliate against the US through the denial of such resources - e.g by buying up supplies (see appendix II - the case of titanium).
22. In general, Western governments would probably not accept such plans unless their public opinion were to support them. Public opinion would be aroused if there were to be a Soviet military move to restore the Communists' old position in Poland. The invasion of Afghanistan and the continuing atrocities there, in defiance of UN resolutions, might even now be an appropriate pretext. Public opinion in the West is also illogical and that illogicality would have to be taken into account: while the EEC sells cheap butter to Russia, sanctions might not be credible in terms of public relations.
23. Equally, if the boycott were not to be linked to a particular outrage, the Russian people, who are instinctively patriotic, might rally to their government in time of austerity as a patriotic duty.
24. Western agreement could only be expected to last on a broad scale for a short time. It might be best, therefore, to conceive an overall boycott as a last resort to be made use of if the Soviet Union seems to be in its death throes and to reserve detailed consideration now to seeking a ban on items which are of direct or indirect military importance.

For this reason it would be desirable to make a careful new study of:-

- a) the specific items which the Soviet Union imports and which are of military value (outside those already covered by COCOM);
- b) the identity of producers;
- c) the opportunities whereby a ban could be circumvented; and perhaps
- d) the routes which goods take to the USSR.

VII LEAKS (1) : SATELLITES AND PROXIES

25 Even a limited policy of banning military transfers more effectively than is done at the moment would have to take careful account of the dangers of circumvention through three groups of Soviet allies and associates:

- a) East European satellites;
- b) close allies outside Europe, namely Cuba, Vietnam, and South Yemen; and
- c) countries such as Angola, Iraq and Nicaragua, whose relations with the Soviet Union - or one of her satellites - are close enough to make any transfer by the West easily retransferable to the Soviet Union.

VIII LEAKS (2) : ALLIES AND NEUTRALS

26 Equally an effective policy would have to cover 'Western oriented' countries such as Sweden, Switzerland, Austria or other 'neutrals' which produce, or soon will produce, high technology.

Even during the First World War substantial quantities of British goods (cement, for example,) or British Empire goods (cocoa, nickel, oil for aircraft and for brakes) passed to Germany through Holland or Denmark. German block houses on the Western front were said to be made from British cement. Holland imported twelve times as much cocoa from England between 1914 and 1918 as she did between 1910 and 1914: her exports to Germany rose in the same proportion. In the most recent attempt at a trade embargo, the Swiss grain market has helped Russia since January 1980. Argentina has sold Russia $4\frac{1}{2}$ million tons of grain at 25% above the US selling price.

IX DOMESTIC EFFECTS

27 The possible loss of employment at home in the West if large Soviet deals were to be turned down would be another delicate factor in all Western countries. This would make the public presentation of policies of great importance. It might also persuade governments to be more inclined towards limited goals. It is easy to imagine the uproar in any country if a lucrative contract were to be refused and it were then picked up by another Western state.

X OTHER CONSIDERATIONS

28 Against these difficulties certain other factors may be set:

- a) any new advance by the Soviet Union in (Poland, the Persian Gulf, Iran or Saudi Arabia) will surely stimulate a more positive response towards Western self-defence even from France and Germany;
- b) public opinion in Britain is more alive than it was some years ago to the nature of the Soviet threat - although more explaining could and should be done at government level (and can be done for relatively little expense);
- c) the foreign policy advisers of Governor Reagan are likely to be interested in more aggressive economic policies towards the USSR than those of President Carter.

29 A tougher economic policy towards the Soviet Union might be accompanied by private signs that the policy would be relaxed if the Soviet leaders were to show willingness to seek genuine detente or arms limitation. But the first step would be to convince them that a new and determined policy was being pursued in place of the shadow boxing of the past around which they have manoeuvred by playing one Western power off against another.

30 The survival as a free country of every country of the free world now depends on a credible US nuclear deterrent. The Soviet Union has, on occasions, been deterred from a military adventure by fear of a possible nuclear response: her threatened intervention in the Middle East in September 1973 is one example. But once the Soviet Union embarks on a military adventure, it would be too late for deterrence to work, since a US nuclear response might be prevented by fear of provoking a cataclysm. The credible threat of a hostile Western economic policy directed against the Soviet Union may therefore potentially be a more efficient barrier against Soviet expansion. It may already have an effect in relation to Soviet policy towards Poland.

31 There is much talk of the disadvantages of an 'arms race' between the West and the USSR. In 1978^{the} USA, however, spent less than 6% of its GNP on military expenditure; the Soviet Union apparently between 13% and 16%. With an overstretched economy, any effort by the Soviet Union to increase this expenditure in order to maintain its military superiority over the US could have serious consequences. The estimated percentage of 8-10% of GNP which the US requires in order to correct the imbalance before the end of the 1980's would not have comparable effects in the US. It is for this reason presumably that the Soviet Union propaganda against both the 'arms race' and particular weapons has been so much intensified of late.: propaganda is cheaper, and often more effective than arms.

XI RECOMMENDATIONS

32 Any recommendations on policy must bear in mind three considerations in particular:

- a) the prize is great. A serious diminution of Soviet military strength is the best hope of securing the triumph of Western ideals, the reduction of the power and influence of the USSR to limits which no longer constitute a threat to the peace and so of avoiding nuclear war;
- b) economic sanctions have never effectively worked but, because of (a) above it is worth spending a great deal of time considering the possibility that they might be made to work in the future.
- c) any economic sanctions embarked upon must be carried through and have a critical chance - perhaps 80-90% - of success.

33 There seem to be approximately five items in a scale of economic sanctions which should be considered:

- a) a policy aimed at military equipment and hardware, such as might be carried out through a strengthened COCOM - strengthened as regards effectiveness, as regards items covered, and as regards countries collaborating;
- b) a policy aimed at seeking to cover all fuel, equipment and hardware which, even indirectly, affects Soviet military preparedness - excluding food but including oil, oil exploration and oil exploitation;

- c) a policy aimed at food;
- d) a policy aimed at credits;
- e) a policy aimed at all other trade including luxury goods, artistic and all other visits and all connections which have no military use at all.

34 We presume that, despite paragraph 26 above, the general ban in (c) of paragraph 33 would be applied in the case of war. A general ban would always be easier to administer but is actually much more likely to be defied in time of peace. Though we should like to see that policy enacted in present circumstances, or in the weeks after the next Soviet outrage, we do not think it would be effective. It should not be carried out unless it becomes so.

35 We think that both policies (a) and (b) in paragraph 33 should be instituted as soon as possible, through COCOM. COCOM should be expanded and tightened. If after six months there has been a high rate of success in relation to this, then the third policy, (c) about food, could be broached or it could be threatened as a "linkage" demand- for example for human rights for the Soviet opposition. A general boycott, (d), could be considered later.

36 An Anglo-US initiative along these lines in the diplomatic field to secure this might be begun as soon as possible, after President Reagan takes over.

APPENDIX I

RECENT SALES OF US TECHNOLOGY TO THE USSR.

US Approves Sale of Pipe-Laying Tractors to USSR

The Carter administration today announced that it has approved the export to the Soviet Union of pipe-laying tractors worth some \$79 million. The application for an export license had been filed by the Caterpillar Tractor Co. for 200 D9 bulldozers, specially configured for pipe-laying, to help lay the gas pipeline from Western Siberia to Western Europe, the construction of which was disclosed on November 17. Caterpillar Co. officials are said to be confident that this initial deal could lead to orders worth up to \$1 billion for the company over the next five years.

The whole project apparently consists of a 4,000 kilometre pipe-line from the Yamal field in Western Siberia which will transport about 40 billion cubic meters of gas each year to West Germany, France, Italy, Holland, Belgium and Austria. Deliveries are planned to start in the mid-1980s and continue through the end of this century. Initially, a consortium of West German banks is expected to advance DM 10 million to finance the purchase of gas pipe and pumping equipment at a favourable interest rate over a ten-year term (Der Spiegel, Frankfurter Allgemeine Zeitung, Suddeutsche Zeitung, November 17; The Times, November 19; New York Times, November 19; Washington Post, November 18.)

APPENDIX II.

"THE RESOURCE WAR": THE CASE OF TITANIUM

[Extract from Radio Liberty Research RL 433/80 of November 14 1980]

Titanium, a lightweight, heat-resistant metal, is widely used in the production of military aircraft. In 1977, the United States filled 33 percent of its titanium needs with imports from the Soviet Union. Two years later, the USSR, which controls 16 percent of the world's titanium reserves, unexpectedly stopped exporting the strategic metal. Many Western analysts viewed this move as an attempt to forestall an anticipated expansion of American aerospace defenses in the early 1980s. Others saw it as part of the USSR's own military build-up. Whatever the cause, the United States was faced with a shortfall of titanium. In September, 1980, however, the situation changed: US Defense Department officials revealed that the People's Republic of China was willing to supply the United States with titanium, as well as other strategic metals necessary for the construction of military aircraft.

Maneuverings such as these are part of an expanding "resource war" between the United States and the USSR, and the field of battle is a world raw materials market where goods are more and more in short supply.

The United States, for all its technological wealth and military power, is exceptionally dependent on foreign countries for imports of critical raw materials. Minerals have been defined as "critical" or "strategic" if they are neither found nor produced in the United States in sufficient quantities to sustain the country during periods in which the security or the economy of the nation is threatened. Among the leading strategic minerals are: chromite (used for stainless and other special steels); cobalt (because of its resistance to high temperatures and corrosion, cobalt is an indispensable component of standard jet engines); manganese (also essential for steelmaking), and platinum (a necessary catalyst in the automotive, electronic, and petroleum industries).

As a percentage of consumption, the United States in 1979 relied on imports for 90 percent of its chromite, 98 percent of its cobalt,

98 percent of its manganese, and 89 percent of its platinum. Unlike the United States, the Soviet Union has long been self-sufficient in all but a few strategic raw materials. Until recently, the USSR imported only six of the ninety-three minerals that the US government has listed as critical. Of the four strategic minerals noted above, the USSR is self-sufficient in all but one, cobalt, and for years it has been a major supplier to the West of chromite, manganese, and platinum.

Despite its dependence on strategic mineral imports, the United States has taken comfort in the fact that the Soviet Union has, for the most part, been an exporter of raw materials rather than a competitor for imports on the world market. Recently, however, analysts have detected a shift in the USSR's raw materials policies. Exports of certain minerals by the USSR have declined sharply, and it has begun to import some strategic nonfuel materials from countries whose output has traditionally gone to the United States and its allies. For instance, Soviet exports of chromite have dropped by 50 percent over the past two years. Exports of platinum have fallen even more sharply, and exports of manganese are in extreme decline. The USSR has already begun to import chromite and manganese for the first time. Other new materials on its buying list include titanium; vanadium (used as a toughener of structural steel); lead (used in a wide variety of items, from batteries to nuclear shields); beryllium (another steel toughener); tantalum (used mainly in electronic components); and lithium (needed for aluminum production).

According to Daniel Fine, a resource specialist at the Massachusetts Institute of Technology, the new pattern in Soviet minerals trading is not a passing phenomenon that can be explained by temporary shortages of key minerals within the USSR or short-term speculation by Soviet trading organizations to take advantage of dips in world prices. "On the contrary," says Fine, "it is more like the beginning of a historic shift. The mineral-resource balance of the USSR is following oil into a new era of less-than-self-sufficiency."

Fine believes that two factors--the high financial and technological cost of extracting minerals from Siberia, the USSR's main depository of raw materials, and the shortage of raw materials on the world market--have produced the shift in Soviet minerals policy. In his view, the USSR recognizes that the value of Siberian resources will increase with time, as world energy and mineral supplies diminish. From Moscow's perspective, the world will eventually need Siberia's resources at any price, and this will provide the USSR with increased influence in international affairs. In the meantime, Fine believes, the Kremlin has decided to cope with the problem of lagging resource development in Siberia by tapping the world market for raw materials. He argues that this policy of "world-first and Siberia later" offers long-term political and economic assets that outweigh any short-term liabilities.

The liabilities that Fine and other analysts have in mind concern the potential risk of conflict with the United States over access to strategic raw materials. Most of the minerals now sought by the United States and the Soviet Union are located in Africa, a highly unstable region of the world in which the USSR has considerable political, economic, and military stature.

Because of its mineral resources, Africa, especially its central and southern regions, is of vital economic as well as politico-military importance to the United States and its allies. The United States imports almost all of its chromite and cobalt from countries located in those regions, and Western Europe and Japan are even more dependent on the area for their mineral needs. Civil unrest in central and southern Africa is a chronic problem, however, and interruptions in mineral production or transportation are always possible. Few Western resource traders, for instance, have forgotten the effect that the Katanganese invasion of Zaire had on the world cobalt market several years ago. When the cobalt mines of the Shaba Province in Zaire were temporarily shut down because of the incursion in 1978, a worldwide shortfall of cobalt ensued, and cobalt prices jumped over 300 percent.

The strategy of the USSR in Africa seems geared to trying to avoid such shortfalls and securing a steady supply of strategic raw materials. In the past several years alone, for example, the Soviet Union has negotiated, either on its own or through COMECON, more than twenty-seven technical and economic-assistance agreements with African countries, most of which produce strategic minerals or have mineral deposits. The agreements generally feature large-scale Soviet technical aid for exploration and development of new mines, with repayment in the form of recovered minerals. At least one agreement, that between the USSR and Zambia, exchanged Soviet arms for Zambian cobalt.

The proliferation of economic pacts such as these, combined with the USSR's and Cuba's continuing military presence on the African continent, have caused many observers to ask whether the Soviet Union, in its sudden reach for raw materials imports, has adopted a strategy to deny the United States access to foreign mineral supplies. Congressman James D. Santini (D-Nevada), chairman of the House Subcommittee on Mines and Mining, believes that the answer is yes.

"The Soviet Union appears to have concluded that Western commercial influence in the resource-rich but less developed world is fading rapidly," Santini observes. "Given the Soviet Union's undeniable global resource strategy, Soviet actions in Afghanistan and Africa, and their deteriorating mineral resources, can there be any doubt that the (United States) and the Soviet Union are engaged in a resource war?"

Soviet American competition for the world's strategic mineral resources is an issue sure to gain importance in the years ahead. Cognizant of the national security implications involved in the "resource war," President-elect Ronald Reagan has appointed a "strategic minerals task force" to prepare recommendations concerning legislative and executive actions that the new administration might take

to mitigate the problems surrounding American dependence on foreign sources of critical raw materials. The task force, comprised of twenty-three representatives of the business and academic communities, is the first such panel to examine the national security aspects of strategic minerals since the Korean war.