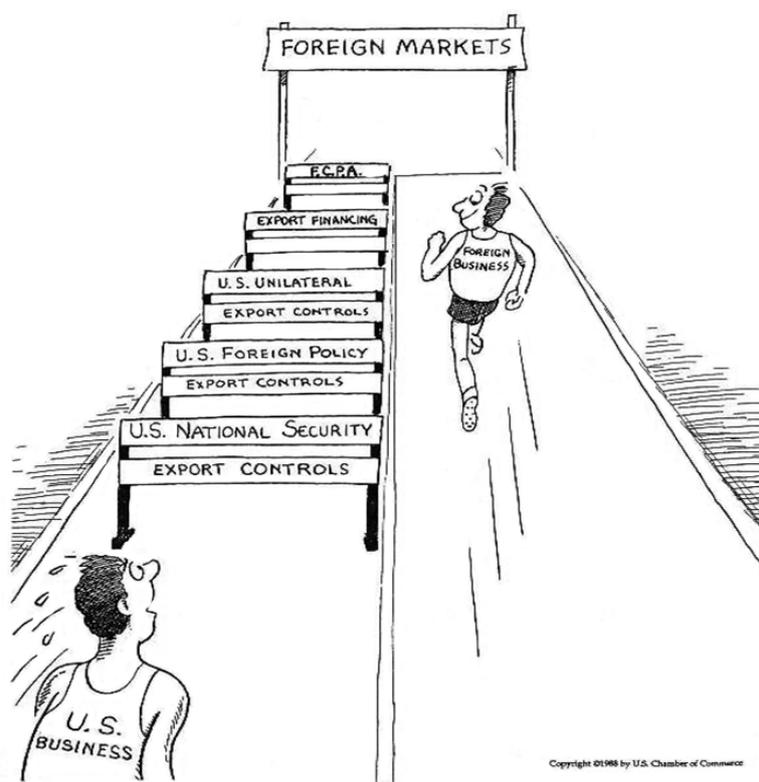


Jari Eloranta & Jari Ojala (eds.)

East-West Trade and the Cold War



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JYVÄSKYLÄ STUDIES IN HUMANITIES 36

East-West Trade and the Cold War

Edited by Jari Eloranta and Jari Ojala



UNIVERSITY OF JYVÄSKYLÄ

JYVÄSKYLÄ 2005

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ISBN 951-39-2088-7 (nid.)

ISSN 1459-4323

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Preface

The *East-West Working Group* has brought together an international research network so that researchers of the Cold War economies and trade can attain a possibility to engage in a dialogue with their colleagues. The scientific contribution of the Working Group focuses foremost on the analysis of the East-West trade during the Cold War, both at the macro as well as at the micro levels. Thus, the aim is to emphasize the study of this topic as a comprehensive phenomenon. At the same time, the purpose is to delve deep into the most significant research problems in this area of endeavor. At the macro level, the focal interest areas include especially the institutions and organizations of the Cold War trade, economic warfare and the roles of international organizations, as well as the economic significance of the East-West trade. Moreover, the project aims to bring forth new country-based case studies, concerning the Eastern Europe and the neutral countries in particular. The forms of activity by the group include workshops (the first was held in June 2002 in Florence, Italy) and conferences (the first one dedicated solely to the topic of East-West trade, held in November 2003 in Jyväskylä, Finland – other meetings have since also taken place under the auspices of other conferences), archival research cooperation, as well as cooperation on publications.

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This volume is the end result of cooperation following the Jyväskylä conference mentioned above. Thus, respectively, we need to recognize those entities that made the conference possible as well as enabled us to publish this book. First, however, we need to emphasize that this book is not solely a conference volume, since all the articles (except the invited contributions of Alan Dobson and Alan Milward, as well as the introductory chapter) have undergone an extensive double-blind peer review process. The referees (you know who you are) deserve our gratitude for their helpful criticism. Second, we need to express our deepest gratitude to several organizations and foundations that financed our endeavors: Academy of Finland, Patria, and the University of Jyväskylä (both the University as a whole and the Department of History and Ethnology in particular). The chair of the department, Professor Petri Karonen and several other colleagues from the Department of History and Ethnology kindly provided their support and academic expertise during the conference. We are especially grateful to research assistants Janne Könönen for his hard work during the conference and Pasi Saarimäki for his work in making the last

corrections to the volume. Furthermore, all the commentators and participants of the conference deserve our gratitude for their helpful comments on the articles that made it to this volume. The conference and the book could not have been completed without the help of everyone mentioned above. We would also like to thank the Faculty of Humanities and the University of Jyväskylä for giving us the possibility to publish our volume in the *Studies of Humanities*, especially Editor-In-Chief Heikki Hanka and the editorial board. Pekka Olsbo performed magnificent work in editing the volume into a printable format. Language revision for some of the articles was provided by Charlene and Jari Eloranta. The ultimate responsibility for the contents of the articles, however, rests with the individual authors.

The Editors

BIOGRAFIES

Alan Dobson: Professor of Politics and Director Institute for Transatlantic European and American Studies, University of Dundee. Fellow of the Royal Historical Society, senior research fellow at the Norwegian Nobel Institute in 1997, Chair of the Transatlantic Studies Association and Editor of the Journal of Transatlantic Studies, his interests include Anglo-American Relations, U.S. Foreign Policy, Economic Warfare, and Aviation. His publications include "The Politics of the Anglo-American Economic Special Relationship, 1940-1987" (Brighton 1988) and "US economic statecraft for survival, 1933-1991: of sanctions, embargoes and economicwarfare". (London 2002).

Jacqueline McGlade is Associate Dean of the Graduate College and Associate Professor of History, University of Northern Iowa. She is a founding member of the East-West Working Group and has published widely on topics related to post-1945 American business, US-European economic and military affairs, and Western technical assistance and technology transfer.

Uri Bar-Noi, Dr, is a lecturer at the History Department of Bar-Ilan University in Israel. He specializes in Soviet diplomacy throughout the Cold War.

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Tapani Paavonen, born 1951, Dr.Pol.Sc. 1988, Academy Research Fellow at the Department of Contemporary History, University of Turku; Publications include *Suomalaisen protektionismin viimeinen vaihe 1945-1961* [The Last Phase of Finnish Protectionism 1945-1961] (Helsinki 1998) and "From Isolation to the Core. Finland's Position towards European Integration, 1960-1995", *JEIH* 2001, pp. 53-75; Present research project is dealing with the political and economic phases in Finland's relationship to West European integration from the early 1960s up to the present.

Jari Eloranta, Ph.D, is currently an assistant professor of economic and business history at the Department of History, Appalachian State University in North Carolina. His research interests include corporate political action in the long run, public-private interactions in government contracts and public goods distribution, the financing of wars, as well as the analysis of government spending in the 19th and 20th centuries.

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Alan Milward, is an emeritus Professor at the London School of Economics and an official historian at the Cabinet Office (Historical, Openness and Records Unit, United Kingdom Cabinet Office). He has published numerous works on the economic history of Europe and the history of the European Community. His publications include *War, economy and society, 1939-1945* (London 1977), *The reconstruction of Western Europe, 1945-51* (London 1984), and *The European Rescue of the Nation-State* (London 1992).

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INTRODUCTION

Jari Eloranta & Jari Ojala

Introduction: East-West Trade and the Cold War as a Research Topic¹

"But we must remember a crucial fact: East and West do not mistrust each other because we are armed; we are armed because we mistrust each other."

*Ronald Reagan in his speech *Tear Down This Wall*, 12.6.1987²*

Exploring the Research Gaps

This volume attempts to combine different branches of historical study, namely the history of diplomacy and politics along with economic and business history in order to understand the Cold War period, especially from the perspective of international trade. This book offers both general and detailed accounts of the formation, implementation, and eventual transformation of Cold War trade environments and restrictions. The articles in the volume deal with such broad questions as: Was the economic warfare during the Cold War era successful and efficient? What role did the neutral countries such as Finland, Sweden, and Switzerland play? Were there any opportunities for individual companies or businessmen to operate in this East-West trade despite the trade restrictions? What about the role of politicians in shaping and implementing the trade constraints, both in the national and international arenas? Although we cannot hope to answer these questions conclusively, we will offer new perspectives on the various issues relating the East-West trade during the Cold War.

¹ We would like to thank Edward Behrend-Martinez and David Reid for their helpful comments on this chapter. The responsibility for any remaining errors, however, remains ours.

² At Brandenburg Gate, West Berlin, West Germany. See <http://www.reaganfoundation.org/reagan/speeches/wall.asp>.

The Cold War can perhaps be said to have started with the Yalta conference on February 4-11, 1945, in which the so-called Three Greats (USA, UK, Soviet Union) agreed for the first time on the post-war division of Europe. This period was characterized by different kinds of “hot” and “cold” crises and rivalry between power blocs that came to an end in the dissolution of the bloc led by the Soviet Union at the end of the 1980s and in the termination of the Soviet Union itself in 1991. The deconstruction and analysis of the relations between the East and the West have become one of the central aims of international social scientific research in the post-war period, especially now since the earlier research was primarily based on Western sources and data. Given the new security threats of the twenty-first century, including terrorism and nuclear proliferation, there is also a growing need to understand the implications arising from shifts in the balance of power and the international systemic rivalries better. As a research topic, reflected in Reagan’s comment, the Cold War is a multifaceted and complex phenomenon, in which various dynamic processes have intertwined with one another. Indeed, how did this interaction between the East and the West take place? And, how can we study it?

The Cold War has been studied very broadly among the social sciences. Economists and conflict researchers have focused on studying the different phases of the Cold War and the structures that characterized them, especially the behavior and relevance of alliances. For example Mancur Olson and Richard Zeckhauser presented the first findings on the military spending of the NATO (North Atlantic Treaty Organization) states as early as 1966. Thereafter the military spending behavior of the NATO, other alliances, as well as individual states have been studied frequently.³ Historians have also studied avidly the post Second World War period and especially the political processes driving the Cold War. The more recent historiography has focused on, in particular, analyzing the new archival evidence that has become available recently, with which the established picture of the Cold War has been reshaped.⁴ This topic has also inspired the foundation of new large-scale projects, such as for example the mainly American-led *Cold War International History Project*. These projects, however, have primarily centered on researching military-political questions.⁵ As Melvyn Leffler has emphasized, the writing of the so-called Cold War story, which will inevitably evolve into a very interdisciplinary ‘project’, is still not near completion: “The Cold War will defy any single master narrative.”⁶

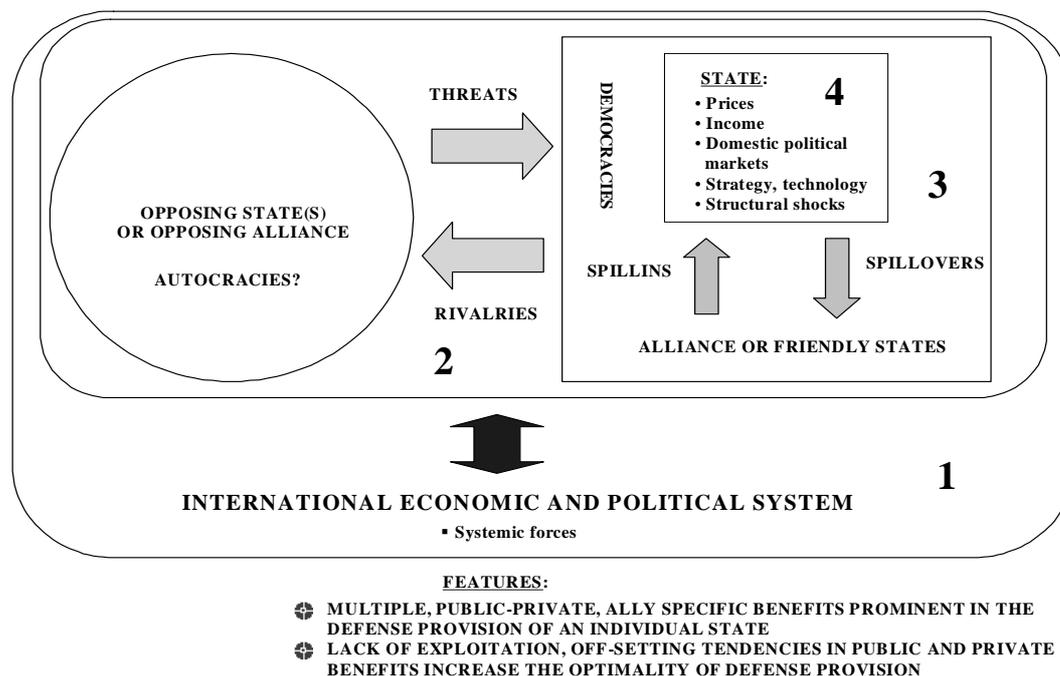
³ Olson and Zeckhauser 1966; Eloranta 2002; Sandler and Hartley 1999.

⁴ See especially Trachtenberg 1999; Gould-Davies 1999. On Finland, see in particular *Historiallinen Aikakauskirja* 2/2002. On the cultural implications of the Cold War, see especially Shaw 2001.

⁵ Cold War International History Project: see <http://cwihip.si.edu/>.

⁶ Leffler 1999, 501 - 502.

IMPURE PUBLIC GOODS: Military Spending with Public-Private Benefits



Source: Eloranta 2002, 60.

FIGURE 1 Military Spending Analysis: Levels of Influence

According to Barry Buzan et al. (1998), international phenomena, such as trade relations or the actions of alliances, can be analyzed at four different levels: 1) international system, in which there is no level of decision-making above these actors (states, international organizations, NGOs); 2) international sub-systems, such as alliances; 3) dyadic relations between nation states; 4) within the nation states, as a pluralist outcome of the power struggles and bargaining between different endogenous actors.⁷ The problem so far has been the lack of discourse between the researchers of these different levels (and different fields of science), even though the various foreign and economic policy decision-making processes (especially from the perspective of impure public goods, a reference to within-state actors and outcomes) can be analyzed comprehensively only by taking into account all of these levels. As seen in Figure 1, for example military spending decisions of individual states are influenced by all four levels. This also applies to decision-making on trade policies. Moreover, the representatives of the different fields of science have not been able to reach dialogue vis-à-vis competing explanations arising from these levels with one another, due to the typical obstacles facing interdisciplinary research (such as competing theoretical orientations).

In fact, Cold War *trade relations* have been studied considerably less than, for example, the aforementioned political and military issues. In addition,

⁷ Buzan, Wæver and Wilde 1998, 5 - 6. See also Eloranta 2002; Geller and Singer 1998.

researchers and research groups among different sciences have not had any joint endeavors in order to analyze the scope and significance of the East-West trade. Furthermore, the analyses of international politics and economic development have not made an effort to incorporate the different levels of analysis listed above, spurring the crucial debates over theoretical and empirical aspects of this phenomenon.

At the macro level (here: levels **1** and **2** as defined by Buzan et al.), the following areas are especially relevant: **a)** the institutional structures, barriers, and organizations of international trade; **b)** economic warfare as a policy and the outcome of this type of warfare; **c)** the economic impact of post-war international trade and its hindrances (especially the demand and supply effects) as well as their impact on the post-war economic development in general, the so-called Golden Era of economic growth. At the micro level (here: levels **3** and **4** as defined by Buzan et al.), the study of the Cold War as a whole has been hindered by a Western orientation and perspectives, due to for example the lack of sources on Eastern Europe up until recently, and thus European case studies at the country level are sorely needed. Moreover, the study of international actors has often ignored the role played by weaker actors (small and medium size states) within and without the various coalitions, also extending to the selection of countries to be studied. Thus, comparative studies, incorporating the various levels of analysis, are crucial in order for us to understand the East-West trade as a whole.

Most of the recent literature on the East-West trade in the Cold War period has focused on exploring the economic warfare dimension of the trade relations, with the implied Western emphasis (mostly due to the availability of sources and the usual language barriers). The traditional literature, as embodied in the pioneering efforts of Gunnar Adler-Karlsson, has argued that the United States was the dominant player in COCOM (*Coordinating Committee on Multilateral Export Controls*), established in November 1949 to control the trade of strategic goods, and that the military dependence of West European countries led them to give in to the American demands.⁸ The recent literature, sometimes called revisionist in its approach, embodied in the research of Alan Dobson, Ian Jackson, and Tor Egil Førland for example, maintains that the U.S. was not as successful in its coercion as is often claimed, and that some West European governments (especially Great Britain and France) were able to moderate and influence at least the application and effectiveness of the U.S. sanctions.⁹ However, there are still many unexplored areas vis-à-vis the levels of analysis indicated above. For example, although some scholarship has emerged studying the Eastern side of the equation (namely, the Soviet Union and the East European states), it still remains, by and large, a black box.¹⁰

⁸ See especially Adler-Karlsson 1968 and e.g. Sørensen 1991.

⁹ See especially Dobson 2002; Jackson 2001. See also Førland 1993, 151-162 and Lipson 2004, 1-20. On sanctions, see also Wallensteen 2000.

¹⁰ For the rare exceptions, see e.g. Borhi 2004, and Hessler 2004. For a review of the latter (outlining some of the research gaps), see Lazarev, Valery (2005), Review on EH-Net. Available from: <http://www.eh.net/bookreviews/library/0885.shtml>.

Moreover, the possibility of neutral countries and other smaller states being significant players between the Great Powers has not been addressed adequately.

In general, at the macro level, East-West trade has been studied both via quantitative comparisons¹¹ as well as by analyzing the underlying decision-making processes. Yet, as Alan Milward has proclaimed, the need for studies utilizing both approaches is great. In particular, it is necessary to analyze the "true" economic significance of this trade comprehensively and incorporate it to the analysis of the economic development of this period.¹² The principal aim of the East-West Trade Working Group, as well as this volume, is to focus on the study of the barriers of trade and economic warfare on the whole, yet it is only one of the goals here. Moreover, one of the key foci here is indeed to analyze the aims of COCOM as well as the efficiency of these measures in fighting the Cold War.¹³

Yet, at the micro level, the project described here is meant to broaden the research perspective on the East-West trade by bringing forth new country-based case studies and offer new interpretations on several aspects of the East-West trade. The so-called "weak" states (having limited means of influencing international political processes), as for example Michael Handel has argued, often possess only limited amounts of political capital with which to influence particular processes.¹⁴ However, both empirical research and theoretical modeling has shown, namely the aforementioned NATO-studies, that in certain situations also these seemingly "weak" actors possess significant political and economic weight.¹⁵

This aspect becomes more pronounced when we discuss the actions of states (and other actors) that functioned between the East and the West. The Jyväskylä conference, which this volume is an outcome of, has, in addition to Eastern Europe, endeavored to bring forth the latest research on the roles of Scandinavia and Finland in particular in the Cold War trade. Furthermore, the analysis of the actors within states, especially the various interest groups, should be linked to the activities of these states in the international political markets. In short, the aim of this volume is to engage in an interdisciplinary dialogue on the significance of the East-West trade during the Cold War as well as to combine the various levels of analysis presented above. In our opinion, the key areas in the future analysis of East-West trade during the Cold War should include analysis of the overall institutions and organizations aimed at managing the Cold War trade relations (economic warfare, other policy areas); comprehensive analysis, along the lines of the revisionist school, of the effectiveness and implications of economic warfare; economic significance

¹¹ On earlier studies, see especially Marx 1951; as well as on economic warfare in particular Adler-Karlsson 1968.

¹² Milward 2002. On the latest research of the post-Second World War economic growth, in quantitative terms, see especially Ark and Crafts 1996.

¹³ See more e.g. Mastanduno 1988.

¹⁴ Handel 1981. See also Eloranta 2002, Chapter 6.

¹⁵ See Eloranta 2002b for further discussion.

(quantitative, qualitative) of the East-West trade, based on new data and other sources; significance of the Eastern Europe (individual states, as a whole) as a player in the formation of the East-West trade framework; and inclusion of the so-called “weak” states in the analysis of the trade policy formation and outcomes in this period.

The Suggested Key Areas for Research:

- 1) Institutions and Organizations of the Cold War Trade in General
- 2) Economic Warfare and International Organizations
- 3) Economic Significance of the East-West Trade
- 4) Significance of Eastern Europe in East-West Trade
- 5) Role of the So-Called “Weak” States Between East and West

Scope of the Volume

The volume is structured as follows. First we begin with a general overview of the trade restrictions and economic warfare in the Cold War period offered by Alan Dobson, followed by an application of this in the U.S. context by Jacqueline McGlade. The Eastern perspectives are then explored by Uri Bar-Noi (vis-à-vis the Soviet Union) and by Lucia Coppolaro in her study of the Polish efforts to join the GATT. The British East-West trade sphere, in turn, is analyzed by Niklas Jensen-Eriksen (British-Finnish trade relations). Next we follow up with country-based studies of the neutrals in the period, starting with Switzerland (by Klaus Ammann), Sweden (by Niklas Stenlås and Mikael Nilsson), and Finland (general perspective provided by Tapani Paavonen, and a specific case study of Soviet-Finnish trade offered by Jari Eloranta and Jari Ojala). The volume is then concluded with an historical overview of economic warfare written by Alan Milward.

Indeed, was Western economic warfare in its various forms successful during the Cold War era? As Jacqueline McGlade emphasizes in her article, the Cold War, in fact, had also negative outcomes for the Western countries: For example, the U.S. share in the world exports of manufactures declined after having risen for 150 years previously. The COCOM restrictions can be even seen, as McGlade notes, as a factor that delayed globalization. Yet, the eagerness of the Eastern Bloc countries to re-establish trade relations suggests that the restrictions indeed had an impact on the Eastern economies, a fact which is stressed further in the articles of Uri Bar-Noi and Lucia Coppolaro.

Nonetheless, as Alan Milward and Alan Dobson point out in their contributions, an exact calculation of the effectiveness of economic warfare during the Cold War era is extremely difficult to carry out, perhaps impossible – as it is even for periods of “hot” conflicts. Perhaps it is in fact impossible to gauge *exactly* the effectiveness of the Cold War restrictions – at least, as the several articles in this volume point out, there were a number of possibilities to

bypass the rules of the “game”. Yet, studies utilizing the latest quantitative methods and the most up-to-date data on the East-West trade are sorely needed, as Milward has pointed out before. A better understanding of the quantitative dimensions of this trade, as well as supply and demand determinants among the various participants, would frame the debate over the importance of this trade much more adequately than the outdated, yet influential Adler-Karlsson figures have done in the past.

In her article, McGlade also explores how U.S. companies reacted against the embargo, and were more than willing to re-establish trade relations with the Communist Bloc countries. Indeed, the East-West trade during this period should also be analyzed from the business point of view, not only as events involving national or international politics and aggregate economic outcomes. The corporate activities and impacts on the Cold War trade are analyzed, respectively, in the articles by Stenlås and Nilsson, Paavonen, and Eloranta and Ojala, among others.

The adoption of pragmatic solutions in the trade relations was a key element for a number of countries, due to the influence of corporations and their interest groups. This can be seen, for example, in the articles of Paavonen (in the Finnish case), Stenlås and Nilsson (the Swedish case), Jensen-Eriksen and Bar-Noi (the British perspectives), and McGlade (the American companies’ point of view). The East-West trade was not only about the competition between the superpowers, but it was also a question of justifying the intentions of the independent countries to carry on their trade relationships despite the hostile Cold War climate, which can be clearly seen, for example, in the article by Jensen-Eriksen.

The Cold War era trade controls proved to be especially problematic for the neutral countries, though, as Dobson suggests in his article, “small and neutral countries played a significant role in the effectiveness or ineffectiveness of the embargo”. This can be clearly seen in the Swiss, Swedish, and Finnish cases, as outlined by Ammann, Stenlås and Nilsson, and Paavonen. Even if the restrictions were not specifically relevant or binding for all products, as was the case with the Finnish forest industry goods, nonetheless the bilateral trade agreements caused difficulties at least for the individual Western companies to operate in the Eastern markets, a point emphasized by Eloranta and Ojala. Yet, it can be argued that the neutral countries benefited from the situation, though the political turbulence of the period was quite disruptive for the international relations as a whole – this can be seen in particular in the Swiss and Swedish cases in this volume, as for example Ammann’s study of Switzerland highlights.

As stated before, the studies on the East-West trade during the Cold War era have been somewhat Western oriented. That is the case, admittedly, even with this volume. Most of the articles deal with the issue from the Western point of view. This is not, however, because of lack of effort on the part of the editors in recruiting experts on the Eastern European countries. It is simply very difficult to make contact with scholars in Eastern Europe, for example. Due

to a lack of resources and other constraints, the interaction between the Eastern and Western scholars, for example in analyzing Cold War trade, is still in its infancy. Remedying this situation is in fact one of the goals of the East-West Trade Working Group mentioned in the Preface. Therefore, we sincerely hope that this volume will increase the academic dialogue surrounding these topics, and also exposes researchers from the former Eastern Bloc countries to this discourse and encourages them to participate in this debate. For example, Lucia Coppolaro's and Uri Bar-Noi's articles provide some insights from the other side of the Iron Curtain, providing us with a more multifaceted picture of the phenomenon. Whereas Coppolaro engages in analysis of how Poland attempted to make overtures toward the West, Bar-Noi analyzes the trade between the Soviet Union and Great Britain in the 1950s, both providing us with rare glimpses of the Eastern (European) policies and aspirations during this period.

In this volume the articles are dealing with a long and complex period of time, starting with the beginning of the Cold War and ending with the collapse of the Iron Curtain. The beginning of the Western containment of the East-West trade and the subsequent Eastern responses are especially studied in the articles of McGlade, Bar-Noi, and Coppolaro, whereas an analysis of the trade during the collapse period is offered by Eloranta and Ojala in particular, providing us a detailed account of how a particular Finnish export trade organization failed in its exit strategy. The period also features a number of other economic arrangements between the countries that were partly or directly associated with the Western containment policies. In this volume, for example the GATT negotiations are studied by Lucia Coppolaro, whereas Tapani Paavonen explores the links to the European integration policies.

Despite the broad scope of the issues analyzed, this volume can only scratch the surface of the multi-dimensional phenomenon of East-West trade relations during the Cold War. Still, we hope that the volume will make a serious contribution to the discussion of the issues mentioned here. As many of the articles in this volume show, it may turn out to be impossible to perform exact calculations on the effectiveness of the Cold War embargo policies, nor can we reach ultimate understanding of all the complexities of the processes, actors, and activities occurring during this era. Still, we should aim for better understanding (including quantitative re-evaluation of the scope and impact of this trade) of these phenomena, especially since many issues still remain unexplored in the history of the Cold War trade and politics. In fact, the nexus between politics and economics may help us understand the Cold War events and outcomes in a more comprehensive manner. But furthermore, we can also learn from the lessons of the Cold War – for example, how efficient can embargoes and other types of restrictions be respective of their intended goals? How do such forms of economic warfare affect international trade in general, or a particular country and a region? Thus, a lot of challenges remain for the future research. The new key contributions in the understanding of this trade will surely consist of scholarship on the neutral countries, a re-evaluation of the

scale and scope of this trade, continuing debate over the forms and impacts of economic warfare, and especially a rewriting of the political and economic histories of the Eastern European countries.

Alan Dobson

Some Thoughts about Concepts and Explanation ¹

The East-West Trade Study Group has reinvigorated research and reflection on the western strategic embargo against communist states during the Cold War. It would not be going too far to say that it has set a new research agenda. The articles in this edited collection bear strong supportive testimony to that claim. It has drawn attention to the need to focus on East-West academic dialogue to enrich our understanding through in-put from scholars from countries such as Poland, Hungary and Russia about how the embargo was perceived on the other side of the Iron Curtain. It has recognised that small and neutral countries played a significant role in the effectiveness or ineffectiveness of the embargo. It has established the need for much more analysis of the economic impact of the COCOM embargo, made possible as archival material becomes available from the former communist states. It has engaged with a business history perspective from companies involved in east-west trade, which will cast much light on the political support for expanding east-west trade that gradually emerged during the Cold War. And it has acknowledged that, while the well-established approach of traditional diplomatic history must go on, it should be developed with nuance provided by the findings of this new research agenda.

Given this renewed interest, it is timely to make a number of observations about the kind of concepts and explanations that we use when addressing the various economic policies and instruments of statecraft, which we so often corral under terms like strategic embargo, economic warfare, sanctions, and economic security policy. One of the confusions that often arises in the literature is the failure clearly to distinguish between what we might call historical explanation and understanding, non-historical explanation and understanding of the past, and practical or strategic thinking and understanding.

¹ An earlier version of part of this argument appeared as chapter 11 in Alan P. Dobson, *US Economic Statecraft for Survival 1933-1991* (Routledge/ Taylor Francis, London, 2002)

The latter two types of knowledge are inter-related and their rationale is practice. They depend largely on what might be described as explanation from the outside. That is to say facts that are established by empirical observation and statistical measurement. Historical knowledge, in contrast, stands alone (though as intimated below it may be utilised to contribute towards practical thinking) and is primarily dependent upon explanation from an inside perspective, or, in other words, a reconstruction of the reasoning of agents. For example, establishing from the evidence whether or not Eisenhower had a strong commitment to liberalising the COCOM and US embargo lists is a matter for historical explanation and understanding through a reconstruction from evidence of his reasoning. Once the case is established one way or the other it is a unique piece of historical knowledge that falls into the category of knowledge for its own sake. It is valuable *qua* history for that, but it may be useful for practitioners and policy-makers for what it says about how a particular strategy unfolded when planning the use of similar strategies in the future. There is nothing inappropriate or likely to lead to confusion in that. However, problems and confusion do arise if non-historical knowledge is applied in an attempt to gain a supposedly better historical understanding of the past. For example, if one tried to provide a historical explanation of the occurrence of witchcraft in the seventeenth century what would our current understanding that there are no such things as witches with supernatural powers add to the narrative? If introduced as an integral part of the narrative it would give a distorted picture of the world of the seventeenth century because most people at that time believed in the existence of such supernatural phenomena known as witches. Knowing what we know now does not change what they knew then. In order to explain agency and understand actions in that era we need to reconstruct their understanding of their world and not impose our understanding of our own. The same applies to the study of economic data to see what was actually happening to the economy of the Soviet Union in the 1980s. Establishing how economically damaging the COCOM embargo was for the Soviet Union might be achieved through collating statistics from a variety of sources that have never been used before. As such, we in the twenty first century would have more knowledge of the damage inflicted than those who lived and ruled in the Soviet Union during the embargo. But, how could we use our greater understanding of what was happening in the past to improve on an historical explanation? We might say that the damage was greater than the Soviets realised, but that by definition is outside their understanding of the way things were and according to the argument developed here not part of an historical explanation, though it tells us about the past and could have practical relevance. Nevertheless, it belongs to our world and could never have been part of their understanding of their world.

So, if this kind of knowledge of the past is not part of historical understanding, what is it? It performs two functions. Firstly, it tells us more about the past, even though it is not the historical past if we apply the distinction of reconstructing understanding then and applying understanding

from now that could not be, or, simply was not, available at the time. Secondly, the information that the economic embargo was more effective than either the Soviets or the Americans knew at the time might have important practical consequences for the use or non-use of embargoes in the future. In short, knowledge about the effectiveness of a policy has purchase in the world of practice where it might be used for strategic purposes, i.e. how one achieves a particular goal. The third type of knowledge often sought in the literature is ostensibly practice oriented. Questions such as: Do sanctions work? Should sanctions be designed to enforce international norms? Do embargoes cost the sender or the target state more? These kind of questions, which seek practical knowledge to be employed in strategic thinking about how to deal with the present and the future are often worked out by examining historical explanations of particular sanction cases or sets of cases in order to derive generalisations for practice from them. So, historical knowledge is used, but for non-historical and practical purposes.²

All this may seem a little abstract and indeed abstruse, but important clarifications can be derived from it. An example related to my own work can illustrate this. Very rarely have I made any attempt to include statistics to indicate the effect of the western embargo on the Soviet Union. Some friendly critics have commented that my work would be much improved if I incorporated more statistical evidence, but one must pause here to enquire what kind of statistical evidence? As my work is historical I am primarily concerned with reconstructing understanding of historical agents and how and why they designed policies as they did. Thus from the point of view of writing history, agents may or may not have been moved by statistical data available, and generally during the Cold War US policy-makers were not. Secondly, and more importantly, only data available at the time to the agents is relevant to the historical narrative, data that emerges or is collated after the event are in a different category. Knowing now better than they did then about the economic damage that the western embargo inflicted can add nothing to the historical explanation because such facts, though facts about the past, are extraneous to the historical past – they could not have been known by the agents at the time. Thus as a historian this improved economic picture is of no relevance and it would be a serious category mistake if someone were to use it to evaluate or justify ‘historically’ US policy or Soviet countermeasures. This is argued not because of some procrustean view of historical explanation: it is said in the cause of clarity and coherence. However, if I were to change my historical hat for that of an analytical strategic thinker or policy-maker, i.e. primarily concerned to evaluate practice and to prescribe better practice, then this kind of ‘improved’ knowledge of the past becomes of great utility. The importance of sustaining these distinctions will be further supported in the following sections which deal with specific concepts and different kinds of economic instruments of statecraft.

² For a more detailed discussion of the distinction between historical knowledge and practical knowledge see Oakeshott 1991, chapter on history.

Economic Statecraft, Fungibility and Strategic Goods

There are two key issues that come into play when trade controls of whatever kind (except possibly a narrowly construed sanction) are deployed: fungibility and the definition of a strategic good. An examination of the way leading scholars have analysed and used these concepts discloses the intermingling of the three kinds of knowledge categorised above.

David Baldwin synthesises ideas drawn from the work of Yuan-li Wu and Thomas Schelling³ to produce a comprehensive analytical framework in his classic work *Economic Statecraft*.⁴ His declared purpose is to reassess economic statecraft as an integral part of foreign policy-making and argue that it is a more effective tool than it has been given credit for; stimulate new interest in this neglected realm; and develop an analytical framework based on social power literature. Using a taxonomy developed by Harold D. Lasswell⁵ that divides the instruments of power into information, diplomacy, economics, and force (more colloquially, words, deals, goods, and weapons), Baldwin proceeds to outline his view of economic statecraft as a branch of foreign policy in the language of the social power theorists such as Harold Lasswell, Abraham Kaplan, Frederick Frey, Jack Nagel and Robert Dahl.⁶ According to this school of thought power is a relational concept that shows how one actor influences another to do something that they would not otherwise have done. The influence may involve positive or negative sanctions (i.e. carrots or sticks) and arises from a variety of different sources of power (words, deals, goods, weapons). Influence attempts

³ Wu 1952; Schelling 1958.

⁴ Baldwin 1985.

⁵ Lasswell 1945, p. 9.

⁶ Power as an explanatory concept appears to me to be somewhat nebulous, unless it is used in an *ex post facto* descriptive sense. By this I mean that it is not possible to go from assessing potential power to predicting actual outcomes: if it were then how could one explain the outcome of the Vietnam conflict? If the reply to this were that I am failing to give weight to the subjective element of power, will-power, resolve and so on, then this would simply make the case for me, for we are then in the realm of reasoning and reason-giving explanation, not a theoretical, conceptual explanation cast at a higher level of generalisation than reason-giving. The problem with power is partly to do with the fact that we know that some situations result from the successful application of power, but to jump from that to invoking power theory to explain that outcome is tautological. Thus power theory as explanation seems to be reduced to something like the following. The question why did the Americans lose in Vietnam is answered by the observation that they did not apply sufficient power. The question why did the Americans prevail in the Gulf War is answered by the observation that they applied sufficient power. This is hardly an adequate form of explanation. However, this is not to deny the fact that notions of power are used by policy-makers, they are, but bedded in practical reasoning in attempts to apply means to achieving ends, not to produce explanation. Whether such means succeed and why can be accounted for in a reason-giving historical narrative, but not, I fear, by power theory. A recent interpretation of Hans J. Morgenthau's work on Realist power theory produces more overlap with the argument here than the conventional view of Realism might expect. See Lebow 2003). I am grateful to my long-standing mentor and friend Charles Reynolds for prompting some of these thoughts, though I take full responsibility for the formulation of the actual argument here.

are just that: they may or may not succeed. The effects they have are multidimensional - one should not look for just one outcome because there could be several of different degrees of importance. Power is not, as it is often portrayed, a zero-sum game because one could, for example, influence a state to adopt free trade policies from which all gain - a positive-sum game. Finally, power analysis always involves the consideration of counterfactuals. In order to evaluate the effectiveness of any given influence attempt one must ask what were the alternatives and how cost-effective would they have been?

Using this framework, Baldwin wishes to demonstrate how other scholars have devalued economic statecraft by claiming economic influence attempts were ineffective.⁷ He says rather than simply accepting such a judgement one should pose the following kind of questions. If negative sanctions are considered to be a failure one should ask what is the success rate of other types of influence attempts? If economic sanctions generated popular support for the existing regime of the targeted state, then one should enquire if this is a general response to negative sanctions, and one not just confined to negative economic sanctions? If the sanctions are considered to be costly, then one should ask what would have been the cost of other influence attempts? Only after asking such questions, contends Baldwin, can a fair and accurate appraisal be made of this particular instance of economic statecraft. He says: 'Merely to pose such questions is to expose the intellectual weakness in much of what has been written about economic statecraft, for most of these writings do not even acknowledge the existence of such questions, let alone answer them.'⁸

Baldwin's concerns are analytical and prescriptive: he wants to help political leaders appreciate the potential, the character and the scope of economic statecraft and to do it better. He casts his definition in terms of means, not ends. He uses categories of economic sanctions, economic warfare, and aid, and emphasises both their instrumental and expressive potential. He denies that there is any such thing as inherently strategic goods, and rules out bombing of economic targets as a category of economic statecraft because the means are military. These methodological stipulations are made in order to produce a universally applicable and coherent model of economic statecraft. In a very real sense Baldwin is not concerned to explain any substantive instance of economic statecraft (though he draws extensively and effectively on historical knowledge), instead he wants to tell us what the activity must consist of, what its implications might be, and what kind of results we can legitimately expect. Thus he is not primarily concerned with the substantive issue of what is or is not a strategic good in any particular situation, but he is concerned to explain the nature of a strategic good and what conditions must pertain for it to be so designated.

An examination of Baldwin's concept of a strategic good will help to illuminate the differences between his concern with an analytical framework

⁷ For a more contemporary take on this that also argues that sanctions have utility, see section below on sanctions and comments on O'Sullivan 2003.

⁸ Baldwin 1985, 25.

that can be useful for policy-makers in the practice of their skills and producing a historical reason-giving explanation. He argues that nothing is inherently strategic and everything in fact potentially is. In the Napoleonic Wars oil was not a strategic good, in the Second World War it was. A nuclear weapon may be a strategic good so far as modern states are concerned, but for a scientifically illiterate tribe of Amazonian Indians it could not be: at least not in the way it is for a modern state. (They might hit people over the head with it, but they would not know how to explode it.) In the early 1960s the USA took the view that wide diameter steel pipes and double-decker buses were strategic goods: the British government disagreed.⁹ It is this chameleon-like quality that goods are strategic at some times and in some hands and not in others that leads Baldwin, following Wu, to deny that there is any such thing as an intrinsically strategic good.¹⁰

Baldwin argues convincingly that whether or not a good is strategic depends upon its relative utility, substitutability, and whether or not the marginal elasticity of demand is low. Furthermore, "The 'strategic' quality of a good is a function of the situation; it is not intrinsic to the good itself."¹¹ Thus the Trident weapon system is not a strategic item in the relationship between the USA and Britain (though realists would not agree with this), but it is in the relationship between the USA and Russia: similarly wheat is not a strategic item in US-Argentine relations, but it often was in US-Soviet relations because of the comparative disadvantages the Soviets had to suffer when either producing wheat themselves or obtaining it from sources other than the USA. Producing things under comparative disadvantages means that the economy is not functioning as efficiently as it might and this reduces the overall potential of the state to produce military or civilian consumer goods, though by now it should be clear that in contemporary strategic terms there is no clear distinction to be drawn between civilian and military. Baldwin uses the term fungibility to express this: civilian and war production are either convertible into each other, or the way in which they are produced can restrict or enhance the potential production of the other. On this reading all trade could be the target of a strategic embargo because trade is entered into on the rational premise that it benefits the participants. The interruption of that trade, even if it were in the celebrated commodity of trouser buttons - soldiers cannot fight effectively and hold their trousers up at the same time - would be of strategic value to the country instituting the embargo because the targeted state would then have to get buttons elsewhere at greater cost, or devote national resources to their production under comparative disadvantages, which would thus take up

⁹ Dobson 1988b, 599-616.

¹⁰ Philip Hanson argues that according to Baldwin anything and everything could be strategic and thus the concept loses its meaning. However, Baldwin's use of the term intrinsically has purchase here. Baldwin is not saying everything is strategic. He is saying that nothing is intrinsically strategic, but that in principle anything could be strategic depending on time, place and comparative advantage, which is rather different. Hanson 1988, 8-9.

¹¹ Baldwin 1985, 214-15.

resources that could be otherwise employed more efficiently producing wealth or military products.

Baldwin does much to expose the complexities involved in trying to craft policies of economic statecraft. Calculations involved in strategic policy-making are not simply mechanical problems of objective calculation. Value here has three sides to it: the instrumental effect that produces economic benefit or inflicts economic cost, the expressive value of moral statements or of sending messages, and the tactical advantages to be gained for diplomatic bargaining. Furthermore, even when an optimum range of sanctions is determined it may have to be modified because of domestic political considerations, or because of differing assessments of optimality by allies, or because, although the sanctioning might have optimal effect in terms of maximising economic denial, there may be fear of an 'irrational' response and dangerous over-reaction by the target state. It is one thing to do an economic calculation of what is in fact the more valuable good strategically in a given situation and what it is feasible to embargo given the state of both domestic and alliance politics: wheat could conceivably have been assessed as having more strategic value than missiles in US-Soviet trade, but US farmers were politically powerful enough to curb the wheat embargo in 1981. To turn to another scenario, the USA often wanted a stricter embargo on trade with the Soviets than was possible because of pressures from allies. Furthermore, while the export of buttons may be as important strategically as the export of nuclear technology, commonsense tells us that this is only true in the long-term and decision-makers are always confronted with the dangers of the here and now. With this in mind, nuclear technology in the context of the Cold War does take on the appearance of goods with inherent strategic value (notwithstanding the example of the US selling missile systems and sharing nuclear know-how with Britain because the context tells us what to make of nuclear technology in this relationship). Baldwin bemoans the fact that: "The view of "military utility" as an inherent trait to be determined by consideration of the possible military uses of a given item is still [circa 1983] embedded in American export control policy. The law of diminishing marginal utility, the doctrine of comparative costs, and the fungibility of resources seem to be ignored by such an approach. What Wu labelled the "strategic materials fallacy" in 1952 appears to be alive and well thirty years later."¹² An appropriate comment on this is that, although embedded, it is not certain that it has been to the exclusion of consideration of the other criteria that Baldwin correctly identifies as being important in the crafting of effective policy.

The reason why policy-makers concentrate on military items is to do with politics and the fear of war. It may make more logical sense strategically to sell weapon systems to an enemy than to sell them industrial equipment: politically it does not make sense. Having one of your cities blown up by a missile exported from your own country could not be politically defended: having one of your cities blown up by a missile made with engineering equipment you

¹² Baldwin 1985, 224.

have exported is also difficult to defend politically, but there is a difference. When these political considerations are taken into account, it is difficult to see how the criteria of diminishing marginal utility, comparative costs and fungibility can define the optimum policy decision. There is also a problem with time: weapons are immediately usable, 'more strategically' valuable exports take more time to contribute to the war-making capacity of potential opponents. Fungibility can only work over time and nuclear war would be so swift that the luxury of time would be denied for the targeted state. These kinds of considerations were given weight by US policy-makers and led them to treat certain goods as inherently strategic, not out of an adherence to the strategic materials fallacy, but because of lines of reasoning of which Baldwin's own position would approve. In an ideal world of rational choice, in which economic instruments of statecraft can be deployed within a clearly delineated framework, calculations of economic loss and gain are appropriate for recommending and assessing economic statecraft. However, in the open-ended world of practice, recommendations on the basis of economic costs and a concept of strategic value, sensitive to changing circumstances, may be compromised by both political realities and context, which (as Baldwin acknowledges) may oblige policy-makers to talk meaningfully of 'inherently strategic goods'. The immediacy of nuclear war and its likely short duration limits fungibility. Hence the strategic value of such goods and those that depend for their value upon the criteria of diminishing marginal utility and comparative costs would be negated. In the event of a sudden war their potential contribution to the strength of the targeted state could not be realised, but the strategic value of direct military utility items could be realised, even though in the longer term they might not have been of such strategic value as other categories of goods. After taking these considerations into account, one could argue that whether decision-makers like it or not, and even when they accept the logic of Baldwin's argument that there is no such thing as an intrinsically strategic good, they have an obligation to treat goods with clear and present military utility as if they were of inherent strategic value. Thus while there is force to the analytical axiom that strategic value is a function of the situation, it rather begs the question as to what the situation actually is and ignores what it might become. It is often an assessment of what it might become that creates the notion of strategic value in the minds of decision-makers. This highlights the fact that fungibility is not static.

Prior to industrialisation and the emergence of total war fungibility was very limited as were notions of strategy. While warfare and the tools of power politics were so limited it was easier to identify what could be of strategic value. The constraints of the context meant that over a long period of time certain kinds of things were seen as, and for all intents and purposes were, of inherent strategic value among European states - territory, weapons, battleships, and the skill and size of armies. The emergence of total war changed that. All society and its productive forces were now mobilised for the war effort. In this situation fungibility comes into its own and is countered by attempts at total

embargo. However, as the model of nuclear war succeeded the model of total conventional war the situation changed again. If nuclear war broke out it would be so swift that it would not allow time for the fungibility factor to have effect. This scenario placed renewed emphasis on the need to define inherently strategic goods within the context of the struggle between competing superpowers in case nuclear war were suddenly to break out. At the same time, so long as war does not break out, there must also be emphasis on the need for calculations about how to define strategic in Baldwin's terms because of the fungibility of goods and the danger that non-military goods could, over time, contribute more to the power of the potential enemy than selling them missile systems or other 'inherently strategic goods'. This was the complex scenario that confronted US policy-makers after the Second World War.

Baldwin is right when he claims that there is no such thing as 'an inherently strategic good', but that all goods in principle have the potential to be strategic. One cannot argue on an *a priori* basis that a particular good is strategic. The term strategic good only counts in practical affairs when one looks at particular policies, and particular problems, at particular points in time. So far, so good, but from here onwards Baldwin's argument weakens when it underestimates the political inputs and constraints that necessarily arise in the practice of economic statecraft, and when he fails to give due weight to particular factors of time and context which make it incumbent upon policy-makers to treat certain goods as inherently strategic. These points do not challenge the logic of his argument, but they illustrate that it has limitations and that he may have misjudged the policy and actions of US policy-makers. The uncertainties inherent in the passing of time render any calculations based on fungibility tentative and provisional. Domestic and foreign political considerations can qualify what would otherwise be economic imperatives derived from calculations of marginal utility and the infliction of comparative disadvantages. And in some cases the sending of a diplomatic message to potential enemies and actual friends overrode any calculation of economic cost or benefit.¹³

What Baldwin has succeeded in doing is to explore what we might call the logic of policies and strategies of economic statecraft. He provides us with a highly sophisticated analytical tool with which to examine and evaluate the practice of past policy-makers, think more clearly about economic statecraft, and, hopefully, to do it better in the future. This is primarily of use to those in the scholarly community who wish to find out what the impact of the economic embargo actually was, irrespective of the understanding and knowledge of it at the time, in order to evaluate both the effectiveness of the strategy and the way

¹³ A good example of this is the US grain embargo imposed by the Carter Administration in order to punish the Soviet Union for the invasion of Afghanistan. In the first few months of its operation it hurt the Soviets economically. Thereafter, alternative sources of supply, notably from Argentina, combined with a good Soviet harvest in 1980 meant that the embargo then cost the USA more than it cost the Soviet Union, but it was continued for political reasons. See Carter Library, Staff Offices: Counsel Cutler box 77, folder: Grain memo. 3/80. Memo. for the President, 'Suspension of Grain Exports to the USSR', 25 March 1980.

it was deployed. Such analysis will inform policy-makers for the future. For the historian, Baldwin illuminates the kind of thinking that might have gone on in the minds of policy-makers in the past. Whether it actually did or not is a matter of evidence, but as evidence is invariably incomplete, inferences from it will be helped by these clarifications.

Sanctions

The literature on sanctions is vast and can only be reviewed selectively here. It ranges from the descriptive and policy prescriptive to the highly theoretical, from detailed case studies to broader works in which sanctions are integrated into the general category of economic statecraft.¹⁴ However, apart from a consensus that economic interdependence now offers abundant opportunities for exerting economic leverage, and that sanctions became prominent in the latter half of the twentieth century because it is more prudent to use soft economic forms of coercion than hard military force in a nuclear perilous world, there is little agreement about anything else. Indeed, there are lively disputes about both the effectiveness and the definition of sanctions.¹⁵

Definitions range from David Baldwin's broad conception, which acknowledges the difficulty of sharply differentiating between forms of economic statecraft, to a more procrustean view held by Margaret Doxey. Unlike Baldwin, who concentrates on the economic nature of the sanction instrument and a wide range of possible consequences cast in terms of 'influence attempts' by one state on another, Doxey is more explicit about the aims of sanctions in order to avoid, as she puts it, draining the term of all 'essential content'. Drawing on the ideas of David Mitrany, she asserts that 'international sanctions are properly defined as penalties threatened or imposed as a declared consequence of the target's failure to observe international standards or international obligations.'¹⁶ She distinguishes sanctions from other instruments of economic statecraft, such as economic warfare or a strategic embargo, on the grounds that the latter are 'coercive acts of an economic nature designed to secure advantages for the sender.' Not only should such acts not be

¹⁴ Renwick 1981; Barber 1979, 367-84; Hufbauer and Schott 1985, 1990; Hufbauer and Oegg 2004; Kapstein 1992; Nincic and Wallenstein 1983; Martin 1992; Doxey 1996; Holsti 1988; Baldwin 1985; O'Sullivan 2003; Rodman 1995; Wälde 2001, 183-228; Denzer 1999.

¹⁵ Nincic and Wallenstein 1983, 2; Deese (1983) was one of the first to challenge the conventional wisdom that sanctions were ineffective. He argued that those who judged them to be ineffective often made assumptions that were formulated too narrowly. If they were to have included in their criteria for judging success the impact on the sanctioning state's own domestic constituency and intent to punish, discredit and embarrass rather than change the target state's policies, then sanctions would be seen to be more successful. Baldwin (1985) made a similar argument even more forcefully.

¹⁶ Doxey 1996, 9; Mitrany 1925.

classified as sanctions, 'such manipulative and self-serving acts' might themselves 'give grounds for sanctions.'¹⁷ Sanctions cannot just be to do with one state winning or gaining at the expense of another, they have to have a moral or normative content and be geared towards upholding international standards and order. The moral components of this she discerns in the emergence in the latter part of the twentieth century of a whole raft of norms to do with self-determination, democracy, and human rights.

Doxey's prescriptive notion of sanctions is fine, at least for those who share her values and wish to promote them abroad, but for those wishing to explain practice her definition appears arbitrary. It excludes types of behaviour that fall within the scope of the normal use of the language of sanctions. The idea of an international consensus about norms is too much taken for granted and the cosmopolitan-communitarian debate too easily ignored.¹⁸ For example, if a Muslim country economically punished Western states for allowing pornographic films to be beamed into its territory would this be a sanction? Or would this be an illegal act against the right of freedom of expression? Were US punitive measures levied against neutrals for trading with the enemy in the Second World War sanctions, when such actions were in breach of international law? The repeated reference to norms prompts one to demand whose norms? What justifies them and are they indeed universal, such that it makes sense to talk about sanctions in the way that Doxey proposes? Matters become even murkier when we are told that sanctions imposed to uphold international norms, or laws, will often correspond to the self-interest of the state imposing the sanction.¹⁹ This does not sit well with the view that manipulative and self-serving acts might themselves prompt sanctions. The definition of sanctions thus becomes more and more opaque as the argument progresses. Doxey sees the US embargo against Cuba as a case of sanctions, but not the strategic embargo against the Soviet Union. Yet, in 1950, NSC 68 envisaged the strategic embargo as a means by which 'the Kremlin is brought at least to the point of modifying its behaviour',²⁰ and the strengthening of the strategic embargo against communist states during the Korean War had an element of sanction in it as well. It was a way to express moral condemnation of the invasion of South Korea.

In the end it appears uncertain how national interest, prescriptions about sanctions and international norms, and the motivation of actors for imposing sanctions can be happily reconciled. Nor is it clear why the term sanction has to be restricted to action for upholding international norms or standards of

¹⁷ Doxey 1996, 9.

¹⁸ Mulhall and Swift 1995; Brown 1992.

¹⁹ Doxey 1996, 126.

²⁰ Doxey 1996, 9; FRUS 1950, vol. 1, pp. 252-3, NSC 68, 14 April 1950. Doxey argues that economic warfare should be distinguished from sanctions when it has no 'moral or legal basis', but the US strategic embargo/cold economic warfare did have a legal basis and often, if not always, had a moral connotation to it. I am sure that throughout the existence of the strategic embargo there was always at least one senior US official involved who saw it in a moralistic light: would this qualify as a moral basis for the strategic embargo?

behaviour when common usage of language and practice often give a different meaning to the term sanction in contexts that do not immediately seem to suggest that the term has been violated. Violation would only occur if some rule, or norm, were breached, but where are such enforceable rules and universal norms in the international sphere, which could give credible meaning to Doxey's use of the term sanction? Even long-established international norms are often contested, or states find "justification" for breaching them. The main issue here is not that there is some moral connotation or link to the term sanction, but that Doxey presents the link in terms of received international norms or standards of behaviour when we can conceive of a totalitarian state sanctioning another state for 'moral reasons' liberal states would find offensive and contrary to international law. The other main problem is the attempt to distinguish clearly between sanctions and, for example, a strategic embargo, when actual practice and the understanding of the agents conducting policy often see them as overlapping.

Others take a more expansive view of sanctions. Boudreau uses the term to cover even such extensive strategies as the Western embargo directed against the communist world in the Cold War.²¹ Bruce Jentleson conceives of the difference between sanctions and economic warfare as one of degree: economic warfare is when sanctions are used aggressively and are 'close to comprehensive in scope.'²² Sanctions proper are more restricted and defensive in scope. Galtung defines sanctions both more precisely and broadly as: 'actions initiated by one or more international actors (the "sender") against one or more international others (the "receivers") with either or both of two purposes: to punish the receivers by depriving them of some value and/or to make the receivers comply with certain norms the sender deems important.'²³ Baldwin takes a similar view with his concept of influence attempts by economic instruments and his acknowledgement that sanctions merge into other forms of economic statecraft.²⁴

US policy-makers have often used the term sanction in different ways. For example, in the minds of some policy-makers the Soviet empire was so evil and embodied values so contrary to those of western notions of rights and liberal capitalism that the kind of moral perspective spoken of by Doxey was always present in their minds. To them, the strategic embargo was also always a form of sanctions against the evil of communism and part of an agenda that would bring the Soviets back into the international mainstream dominated by Western notions of international law and human rights. The more pragmatic policy-makers conceived of sanctions in a narrower context such as the US grain embargo of 1980, intended to punish the Soviets for their invasion of Afghanistan, or the refusal to extend MFN trade treatment until the Soviets lifted restrictions on the emigration of political dissidents and members of

²¹ Boudreau 1997, 28-46, at p. 29.

²² Jentleson 1986, 28-29.

²³ Galtung 1983, 19.

²⁴ Baldwin 1985, 35-36.

ethnic minorities. What emerges from these considerations is that the term does indeed have a variety of meanings and only the context makes clear which one pertains at any specific time. Furthermore, a particular act of economic statecraft might simultaneously be a sanction as well as part of a strategic embargo, or a campaign of economic warfare, depending upon one's perspective. A narrative form of explanation has to rely on the actual usage in practice. The fact that sanction is a term that can legitimately be used differently, places more onus than ever on ensuring that the context is sufficiently detailed to demonstrate the meaning that is being attributed to it in a particular case.

Notwithstanding ontological uncertainty surrounding sanctions, this has not inhibited empirical work. The widest ranging study of this kind is Hufbauer and Schott's.²⁵ In a series of case studies, they apply a framework that posits three ways that sanctions can impose costs – restricting or impeding imports, or exports, or the finances of a target state – and five intended goals – to change policies, to change policies radically, to disrupt a minor military adventure, to impair the target's military potential, or to destabilise the target state's regime. They then apply this framework to cases ranging from US sanctions against Japan in the 1930s to US sanctions against the Soviets in the 1980s. While this work is widely recognised as a benchmark study and is highly respected, there is still dispute about its findings and the extent to which sanctions have been successful.²⁶

The conventional wisdom several years ago would have instructed us *a priori* that sanctions are ineffective, but opinion has changed because of challenges by scholars like Deese, Baldwin, Holsti, Rodman, and Dobson and as a result the whole issue of effectiveness has been re-opened. Holsti, for example, argues that providing sanctions are evaluated in the context of 'alternatives, secondary objectives, and comparative costs' then they may be seen as much more effective than has often been claimed to be the case in the past.²⁷ Deese asserts that their value is often underestimated because of two inappropriate assumptions. First, that results should come primarily from changes effected by the sanctions in the target state when the impact on the domestic constituency of the sender might be more important. Secondly, that sanctions are intended to change things when, in fact, they may simply be intended to punish, discredit or embarrass.²⁸ Baldwin shares in these views and has perhaps done more than anyone to change the perspective on the effectiveness of sanctions and economic instruments of statecraft in general. Rodman takes up the case of extraterritorially applied sanctions to argue that the situation is more complex than many have allowed and that such sanctions do have impact. He claims that part of the problem in formulating a clear picture lies in the fact that hegemony theory has overstated the deployment of

²⁵ Hufbauer and Schott 1985.

²⁶ Kunz 1994, 451-463.

²⁷ Holsti 1988, 241.

²⁸ Deese 1983.

US power and created unrealistic expectations. In fact, the USA has been reluctant to act coercively against other states on extraterritorial sanctions for fear of jeopardising broader US interests. However, exerting pressures on multinational corporations (MNCs) to comply with US extraterritorial policy wishes is a different matter. Domestic pressures have often pushed the USA into imposing extraterritorial sanctions and Washington has then been able to bring coercive pressure to bear on MNCs by inflicting or threatening indirect penalties for them in the US market. This enhances the chance of at least some success for extraterritorial sanctions even though they come at a high cost.²⁹ Dobson has illustrated the changing justifications for sanctions and economic warfare and highlighted the importance of both domestic and allied constituencies, psychological impacts, message sending, and bargaining positioning.³⁰

Notwithstanding the contributions made by Holsti, Baldwin *et al*, assessment remains problematic. This stems from difficulties first of all of quantifying impact in terms of relative costs and gains from the instrumental quality of sanctions, secondly of evaluating the subjective impact of the expressive quality of sanctions, and, thirdly and most fundamentally of all, from the problem of identifying what the criteria of success should be, whose formulation counts, and from what perspective.³¹

The instrumental quality of sanctions aims to change a situation in some way that is to the detriment of the target state and in a way that can be visibly seen or measured. Cause and effect should be ostensible: for example, if food exports to a state dependent on imports were stopped then one would have to see a change of policy or regime in order to claim success. The effect, and therefore the success, of the expressive quality of sanctions are more difficult to assess. 'When military action is impossible for one reason or another, and when doing nothing is seen as tantamount to complicity, then something has to be done to express morality, something that at least serves as a clear signal to everyone that what the receiving nation has done is disapproved of.'³² Thus, from one perspective, one could say that the act itself of imposing a sanction constitutes success within the realm of expressive sanctioning. However, a further complication is that sanctions are usually both instrumental and expressive. Even primarily instrumental sanctions are contaminated by more subjective expressive qualities that make the assessment of success or failure

²⁹ Rodman 1995.

³⁰ Dobson 2002.

³¹ The terminology of instrumental and expressive sanctions is Johan Galtung's (1983). One notion of success in cases of sanctions, which has been used in this narrative, makes sense in terms of the reasoning of the actors who impose the sanctions. They are the ones who know what was intended. It is they who might change their expectations and goals over time, and who are in positions meaningfully to assess the results of the sanctions that they have imposed. One might see this, in the terms of Hollis and Smith (1990), as a criterion of success drawn from inside understanding. The main problem of definition is from the external perspective in its ambition to generalise, because it is difficult to establish a fixed criterion that captures the nature of success in sanctioning in different cases.

³² *Ibid.*, 48.

elusive in any quantitative sense. This complex quality of sanctions is illuminated in Meghan O'Sullivan's recent study, not least of all because of her focus on the importance of changing context.

Her fundamental issue is what makes sanctions effective in the post-Cold War period at a time of American pre-eminence and globalization. With the end of the Cold War Manichean divide O'Sullivan argues that the USA can be more selective of its friends, and can now scrutinise the domestic and human rights record of other countries more freely. Globalisation means that crises in one country now have more impact on others, that both US interests and sanctions are now more targeted on other countries' domestic policies than on their external behaviour, and that new, non-state actors have come to the fore. Sanctions are conceived of as having three purposes. They either attempt to contain a target state, or bring about a regime change, or a behaviour change, or some combination of the three. In assessing how effective sanctions might be or have been one must assess impact, effectiveness, and comparative utility (i.e. compared with other policy options). Working within these assumptions the author presents four case studies on US sanctions targeted on Iran, Iraq, Libya, and Sudan. In doing so she 'presents both policymakers and scholars [with] a systematic method for the rigorous evaluation of sanctions policy.' And '... offers a greater understanding of U.S. policies towards Iran, Iraq, Libya, and Sudan ...'³³ In other words there are two main goals: one is analytical and prescriptive – how to conduct sanction policies more effectively; and the second is to explain more fully US sanctions against Iran, Iraq, Libya, and Sudan.

O'Sullivan has a firm grasp of what took place in the four sanctions campaigns that are used as case studies, and provides details of policy implementation and insightful analysis of their strengths and shortcomings. The case study on Iraq is particularly good and demonstrates the gap between impact and effectiveness, but nevertheless substantiates the claim that the sanctions were significant in containing Iraq and preventing it from acquiring nuclear capability. At the same time the author indicates shortcomings in US strategy, in particular a confusion of goals, a failure to counter Iraqi propaganda and lay the blame squarely on the regime for humanitarian suffering rather than on sanctions, and lack of a coherent policy of support for internal opposition to Saddam Hussein.³⁴ All this is generally well done and adds to our knowledge and understanding of how sanctions operated against Iraq, but when the author moves from the specific to the general, some serious difficulties with the claims that are made begin to arise. This is not to say that the author does not present a highly insightful and nuanced picture of the operation of sanctions, but it is to say that the basis of some of the more general claims are not grounded in coherent theory or dealt with in effective terminology.

The definition of sanction is described as being middle-of-the-road, and yet it could mean anything from sanctions against Mexico on environmental

³³ O'Sullivan 2003, 35.

³⁴ O'Sullivan 2003, 160.

grounds concerning tuna fishing (i.e. withdrawal of normal economic relations for foreign policy goals to do with the environment) to what some have described as all-out economic warfare.³⁵ The preoccupation of scholars like Doxey³⁶ with the normative aspect of sanctions is never really considered. These observations have more substantial consequences than simply scoring rather abstruse points. While the author alludes on more than one occasion to the importance of the political aspects of sanctions and the need to place them in broader foreign policy contexts, this does not lead to a full exploration of the way in which sanctions are used to express moral outrage, or as a means of political communication, or to satisfy the expectations of the government's domestic constituency and its allies abroad, or to appease the collective conscience of the members of the Executive, or to gain advantages for negotiations. If one accepts these points, then assessing the impact of sanctions has to take into account not only whether they contain, cause a behaviour, or regime change, but also whether they meet a need to express moral condemnation, satisfy the needs of domestic and allied constituencies, communicate messages successfully, and bolster other diplomatic, security, political and economic strategies. Once this is done it has a knock-on effect on an important analytical component of O'Sullivan's methodology, namely assessing costs for both the sender and the target state.

The issue of costing benefits and disadvantages of sanctions is never fully cashed out, partly because the more one identifies matters that should be included in the calculation the more one is frustrated by lack of a common currency. This in itself makes the goal of rationalising to make sanctions more effective extremely difficult. Such difficulty is further compounded by the fact that decisions about sanctions have always to be made in a condition of imperfect knowledge about both the existing state of affairs and about likely consequences. How does one quantify the value of benefits, looked for by decision makers, from sanctions, which help maintain domestic and allied support and deter further action by the target state? How does one know if the deterrent weapon is working or something else is inhibiting the target state? Similar questions could also be asked of the causes of domestic and allied support. And how does one set the value of such benefits against the simple economic costs of sanctions, never mind other less easily quantifiable political costs?

The elusive facet of expressive sanctions, the difficulty of assessing their impact in any objective sense, has inclined social scientists to ignore or play down their importance. They nearly always get a mention, but because their quality is not suitable for quantifiable patterns or hierarchically structured processes within analytical models, they very rarely receive much attention. Jentleson, for example, specifically excludes them from his study of the pipeline sanctions crisis of 1982. He also challenges Baldwin for merging expressive or symbolic sanctions with instrumental sanctions to create the category 'symbolic instrumental' on the grounds that this leads to confusion. It may lead to

³⁵ Dobson 2002, chapter 11.

³⁶ Doxey 1996.

confusion, but it does not logically follow that it should do. Baldwin in fact captures a real and highly complex perspective when he highlights the complexity of sanctions.³⁷ Furthermore, the effectiveness of economic sanctions often relies upon how the target state perceives them in relation to the likelihood of them being followed by the use of force. In other words, much will depend on what message is conveyed to the target state in the act of imposing sanctions, sustaining them, and withdrawing them.

What emerges from these considerations is the difficulty of assessing the success or failure of a particular case of sanctioning from the kind of external perspective, designed to generate generalisations, adopted by the scholars that we have been considering. The problem of setting out criteria for judging success or failure in general is complicated by the subjective quality of expressive sanctions and by the various types of goals that they might have. A further difficulty is the possibility of designing criteria that deems a sanction as unsuccessful when those applying it judge it to have been successful, for example we could easily imagine that kind of situation arising with the Carter Administration's 1980 grain embargo against the Soviets. One might then be intellectually inclined to seek some further criteria to justify the criteria upon which either of the two contradictory claims rest, but no criteria could reconcile the two positions. One stems from what we might call investigation inside the event, the internal reasoning of the actors involved; and the other is established by imposing criteria external to and irrespective of the reasoning of the actors involved. In situations of this kind of complexity no framework of analysis can provide easy answers and might even be unintentionally misleading and confusing. Confusing because in explanations we rely on criteria that can, at least in principle, reconcile two contradictory claims, or establish one as correct and the other as false, for example: Stalin lived in the twentieth century; Stalin defeated Napoleon's Grand Army in 1812. When claims are made that cannot, even in principle, be reconciled or corrected, we have a problem. We have two types of explanation with different theoretical frameworks with the aim of producing two different types of knowledge. Here these are historical on the one hand and practical/strategic knowledge for problem solving and policy development on the other.

Questions, posed by Rodman, Jentleson and Lisa Martin, provoke further thought about sanctions. This group of scholars is not only concerned with degrees of success and failure, but with factors that affect the chances of successful co-operation among a group of states in order for sanctions to work at all. The significance of this is highly relevant to the question of the relative influence of the USA and its allies in the formulation and execution of Western Cold War policies. Can these scholars with their analytical frameworks give insights that go beyond the historical explanation? The analytical frameworks that Rodman, Jentleson and Martin adopt produce incompatible results and it is not clear how they can be reconciled. Rodman looks at the 1982 pipeline crisis with both the hegemonic decline theory in mind and the contemporary problem

³⁷ Jentleson 1986, 98.

of state control over MNCs.³⁸ He sees some effects of hegemonic decline in the inability of the USA to persuade its allies and MNCs to its preferred way of dealing with the Soviet Union. However, he qualifies this conventional wisdom by claiming that the inability of a country like the USA to influence MNCs has been over-exaggerated and that, in fact, the USA still retains leadership abilities and powers of persuasion to prevent MNCs from radically departing from official US foreign policy.³⁹ As we shall see, these findings are out of line with the views of both Jentleson and Martin.

Jentleson stipulates five factors, three international and two domestic that need to be analysed in order to assess how US led sanctions work. The international are allied disputes over foreign policy strategy, diverging economic interests among allies, and the extent of leverage possessed by the USA both in economic terms and through leadership quality. The domestic are ideology and group economic interests. This is, of course, only a template, which indicates where scholars ought to look for answers. For our present purpose it is only necessary to note that he rules out consideration of expressive sanctions and that his primary finding about the cause of US failure with its allies in the 1982 pipeline case: 'was the increased divergence of economic interests.'⁴⁰

Martin does not exclude expressive sanctions from her focus, nor does she reach the same conclusion as Jentleson about the key factor in the failure of the 1982 pipeline sanctions. She begins by identifying several commonsensical variables that affect the chances of success or failure of sanctions. If the target is weak and there is a coincidence of interests among a group of states, which cooperate and help each other in imposing the sanctions, then the chances of success are high. Chances of success will be further enhanced if the leader of the group works through an international institution and accepts high costs of trade denial for itself in order to set a good example that will encourage bandwagoning. If the leader is suffering from hegemonic decline then this is likely to reduce the likelihood of success. Using these factors and concentrating on institutions, costs, and the bipolarity of the Cold War, Martin assesses the effectiveness of cooperation in US led sanctions against the Soviet Union in 1978, 1980 and 1982. Martin's conclusion focuses on the shortcomings of Western cooperation in 1982. She concludes that the effects of hegemonic decline were not in evidence and that the key factors involved were leadership mistakes made by the USA and in particular 'the pivotal factor of cooperation in this episode [1982 sanctions] is the U.S. government's unwillingness to bear the costs of a grain embargo.'⁴¹ Similar reasons, according to Martin, account for the

³⁸ Hegemonic decline is caused by the hegemon shouldering the costs of sustaining the system while others free-ride at its expense and improve their relative position in the system's hierarchy of power. See Kindleberger 1973, and for further discussion and references Dobson 1998; on MNCs see Spero and Hart 1990.

³⁹ Rodman 1995, 105-139, he develops this argument more elaborately and focuses on extraterritorial sanctions in Rodman 2001.

⁴⁰ Jentleson 1986, 218.

⁴¹ Martin 1992, 240; Mastanduno 1992, 9, comes to a similar conclusion: "This

failure of sanctions in 1978, whereas, in contrast, the relative success in 1980 of Western sanctions, occasioned by the Soviet Union's invasion of Afghanistan, is attributed to the grain embargo imposed by the Carter Administration. Martin's attempt to identify the most important causal factors in the 1978, 1980 and 1982 sanction cases provides interesting insights, but the overall conclusion is, at least, debatable. If the failure to impose a wheat embargo was the key factor, then presumably if the USA had imposed a grain embargo the implication is that the Europeans would have fallen into line and complied with US demands, or at least cooperated more fully with Washington. Counterfactuals are by their very nature speculative, but the circumstantial evidence available does not compel one to accept the implication derived from Martin's argument, which in turn suggests that she may not have identified the key element of failure.⁴²

Martin raises a number of factors that would be clearly significant in any analysis by policy-makers struggling to decide whether or not to adopt sanctions as a policy option and, if they decide in their favour, how best to implement them. However, rather like Rodman and Jentleson, the adoption of an analytical framework, to further the goal of identifying general factors that determine how sanctions can be most effectively deployed, results in two interconnected problems. One is to do with explaining any particular set of sanctions, and the other, a more fundamental one, is to do with the nature of explanation itself. The analytical frameworks either exclude certain types of data or perspectives, as Jentleson's does with expressive sanctions, or confer importance on selected categories of evidence, as Martin's does with self-imposed costs, and Jentleson's with diverging economic interests within the Western Alliance. The result of all this is that, not surprisingly, they come to different conclusions about the key causal factors. One should acknowledge here that Rodman, Jentleson and Martin all address rather different questions, nevertheless, their findings are not compatible. Part of the problem is that different analytical models, which tell scholars where to look for answers to questions about sanctions, result in different emphases on different causal factors. Without stepping outside these analytical frameworks and into the detail of how policy-makers formulated and implemented policies, it is difficult to see how this problem can be resolved, which brings us to the rather more fundamental problem with these types of argument. All three authors rely on a form of reductionism that extracts generalisations from the data and establishes them as key causes. When they then use these key causes to interpret the original data their search for explanation becomes circular and is in danger of falling into a veritable whirlpool of circularity. Once the original round of reductionism has restructured the data, what is there to prevent a second, third and fourth round? And would they result in ever more powerful causal factors

examination of the Western export control regime finds no simple causal relationship between the relative power of the United States and the maintenance of effective cooperation in CoCom. Although relative power matters, other factors – the interests of non-hegemonic states and the leadership capacity of the United States emerge as critical to determining the nature of cooperation.”

⁴² See Dobson 2002, chs. 9 & 10.

emerging? In science, this may work, but can this kind of reductionism be applied appropriately to explain human actions and events? The arguments deployed here do not detract from the value that Martin, Rodman *et al* have for strategic thinking and the analysis of sanctions geared towards improving practice. There are important insights given by them all, but there are serious problems involved in trying to deploy their analytical models in attempts to explain the 1982 pipeline crisis.

These observations add weight to the case for valuing evidence driven narrative explanation that relies on the specific and the historical agent's world of understanding. It cannot resolve the differences between general claims made by social scientists because they flow from the assumptions that structure the models and determine what counts as evidence, but it may be able to resolve incompatible claims that two or more models make about specific cases of sanctions, such as the 1982 pipeline case. This does little to help those concerned with improving policy-making and prescribing how to make future policy at the general level at which policy-makers often operate, unless it encourages a more critical scrutiny of the topography from which the assumptions are drawn in order to construct the analytical framework. However, it does help us to see how actual policies were made and it demonstrates the importance of keeping different types of enquiry separate, otherwise confusion will surely follow.

Economic Warfare, Cold Economic Warfare, and Strategic Embargoes

Compared to the difficulties of the literature on sanctions, settling on an interpretation of economic warfare appears much more straightforward. Nincic and Wallenstein, Schelling, Mastanduno and Holsti all agree on what constitutes economic warfare: 'economic privations are imposed with a military objective, i.e., to weaken the target's capacity to wage war.'⁴³ And those privations could be imposed by either military or economic means. Holsti takes this to its logical conclusion when he writes: 'Economic warfare refers to those economic policies used as an adjunct to military operations during wartime. The objective is either to hold or conquer strategic resources, so that military forces can operate at maximum strength, or deprive the enemies of these resources so that their capacity to fight will be weakened.'⁴⁴ These quotes bring to light some interesting considerations. Economic warfare is necessarily an adjunct to war. This is important in terms of setting out what the targets for economic warfare might be. They are necessarily related to conquering or defeating an opponent. This draws quite a clear distinction between the intensity (and as argued immediately below, the means) by which policy can be

⁴³ Nincic and Wallenstein 1983, 3.

⁴⁴ Holsti 1988, 288.

implemented in economic warfare compared with the strategic embargo and policies that went beyond this that were conducted by the USA against communist states after the Second World War. In short this distinction has implications for all those scholars who talk of economic warfare being conducted by the USA during the Cold War. This should more properly be termed (following Forland) cold economic warfare. Secondly, economic warfare is not only conducted by using economic instruments of statecraft as some, including Baldwin, have claimed, but can include military action against economic resources: sinking of supply ships or bombing industrial plant. Again this has implications for the Cold War. It was not possible to bomb Soviet industry, so this further strengthens the case for drawing a distinction between economic warfare, in which military instruments can be used to conduct policy, and cold economic warfare, for which they cannot.⁴⁵ Longstanding practice lends support to these arguments. It would be a serious mistake to ignore America's naval blockade strategies in the two world wars and the way that they developed out of its policy of neutral rights to trade, because those policies shed enormous light on the way America's overall economic statecraft developed in the twentieth century. The means of carrying out economic statecraft do not have to be restricted to economic instruments. Naval blockades and the military destruction of economic facilities of the enemy were regarded as part and parcel of economic warfare throughout the twentieth century. For example the economist Paul Einzig wrote of British policy in 1941:

The Navy is to a large extent an executive instrument of the Ministry of Economic Warfare in the enforcement of the blockade. The Air Force too acts largely upon suggestions coming from the Ministry of Economic Warfare concerning the choice of objectives of air attacks in Axis countries. In past wars it would have been almost inconceivable that the High Commands should have allowed a civilian department to interfere with their plans. In the present war, however, they fully realise the decisive importance of weakening the enemy's resistance in the economic sphere.⁴⁶

There is no compelling reason to depart from the practice of including military instruments as a means of executing economic warfare. In contrast, a campaign of cold economic warfare only uses economic instruments to achieve its aims, unless truly extraordinary conditions pertain, such as in the Cuban Missile Crisis of 1962 and the sanctions against Iraq begun in the 1990s.

Both economic warfare in time of war and cold economic warfare in time of peace aim to weaken, or bring about the collapse or defeat of the target state, with the ultimate aim of changing its political regime. The difference lies in the intensity with which these goals can be pursued and, most obviously, the range of instruments available with which to pursue them. In wartime, economic warfare always seeks the defeat of the enemy: in peacetime cold economic

⁴⁵ Baldwin does not require this distinction because he insists that economic statecraft only involves economic instruments and thus he excludes strategic bombing of economic targets and naval blockades from the scope of economic warfare. Baldwin's ideas are discussed at greater length below.

⁴⁶ Einzig 1941, 3.

warfare may have, but does not necessarily have to have, the ambition of “defeating” a regime without recourse to outright military action.

With the term strategic embargo we are back in the realm of more hotly contested meaning. Intuitively, a strategic embargo seems to stand somewhere between sanctions and economic warfare as an instrument of statecraft. Thus Michael Mastanduno claims: ‘A strategic embargo seeks to prohibit only the trade that makes a direct and significant contribution to an adversary’s military capabilities. In addition to purely military items, it focuses on the control of those commercial items that have a specific and important military use.’⁴⁷ However, in practice, fungibility blurs the line between civilian and goods of direct military utility. Furthermore, policy-makers often see a strategic embargo as a moral message sender in the way that Doxey conceives of sanctions, while others see it as tantamount to cold economic warfare and hope that the ultimate consequence will be the collapse and defeat of the target state. The main difficulty with the idea of a strategic embargo is this tendency to merge on either side with sanctions and cold economic warfare. In practice, the latter kind of merger has often occurred. In the early Cold War there was considerable debate about restricting US policy to a strategic embargo rather than extending it into what they called economic warfare. The scope for interpreting what Americans saw as a strategic embargo, but which might be seen by the Soviets as the kind of unfriendly act tantamount to economic warfare, or rather cold economic warfare, worried a number of US officials. In many ways these observations touch on the very heart of the problem of constructing a taxonomy of clearly defined analytical terms, because meaning is given to actions by those who receive the effects of economic instruments of statecraft, no less than by those who exercise them, and sometimes there may be disagreement among both the receivers and the senders as to exactly what is going on. For example, some US officials perceived of the tightening of the embargo in the early 1980s as moving from a strategic embargo to economic warfare, while others simply saw it as tightening up the strategic embargo. Just how complicated this becomes clear when we recognise that terms such as a strategic embargo are not only inherently ambiguous, but also goods are inherently fungible – in one context a good is not of strategic value, in another it is. These problems created much agonising and controversy about policy in Washington in the 1940s and 1950s and again in the early 1980s.⁴⁸

Contrary to what some analysts have claimed, US bureaucrats and politicians during the Cold War were very much alive to the difficulties of defining the strategic value of goods and tussled with that problem as they strove to maximise both benefits to the West and damage to the communists. They did this by taking into account possible Soviet economic relative gains and made calculations about the fungibility of resources. They also had to make qualitative judgements about whether or not items should be regarded as intrinsically strategic and as having potential to contribute to the Soviet Bloc’s

⁴⁷ Mastanduno 1992, 13, see also Schelling 1958, 488.

⁴⁸ For elaboration of some these issues see Dobson 2005.

immediate war-making capability. Even such an astute analyst as Tor Egil Følrand, appears to prevaricate a little on this. He argues that as the Soviets only engaged in trade because they believed it was to their benefit then the logical thing for the West to have done would have been to impose a complete embargo on all trade.⁴⁹ 'Experience from the world wars has shown that in the age of total wars, economic warfare should also be total.' By this he means shutting off trade completely, which, he claims, is the logic of the policy of wishing to inflict maximum damage on the Soviet Bloc. He appears to have fallen into the trap of suspending the relative dimension even if calculations of cost and benefit are limited solely to economic and military benefits. But, at another point he springs the trap: 'As Mastanduno observes however, one might alternatively try to practice strategic export controls selectively, embargoing those items of most strategic value to the enemy ..., and hoping to reap whatever economic and strategic benefits might accrue from the trade. Actually this has been the basis on which CoCom has functioned.'⁵⁰ This argument is in line with the idea of maximising relative benefits of trade: engaging in selective trade with the potential enemy that strengthens the home state more than the targeted state and also strengthens it more relative to the targeted state than if trade were suspended completely.

Total economic warfare does not allow us to substitute an economic calculus for good judgement. Thus the Western policy-makers did not fly in the face of the logic of their own containment grand strategy. They were, in fact, perfectly logical when they recognised that complex matters of judgement were at stake given the imponderables and incomplete information on the Soviet economy, and their desire to fashion an embargo policy that would both maximise the West's strength and Soviet Bloc weakness in relative terms. That statement deliberately avoids saying Soviet Bloc economic weakness because, at times, the West thought it prudent to strengthen economically certain parts of the Bloc in order to cause internal strains, friction and jealousies. Even when the moral or ideological perspective is excluded and only economic calculations included, the West's cold economic warfare cannot be characterised as only aiming at weakening the economy of world communism.

The above argument does not overturn the observation by Følrand that total war involves total economic warfare: it simply explicates the character of total economic warfare and some of the differences with cold economic warfare. We must not be misled by the word 'total' into believing that total economic warfare policy is thus necessarily tantamount to stopping all economic intercourse with the enemy. It is tantamount to saying that nothing may in principle be excluded from consideration as a target or means of waging economic warfare, but that is rather different. As allied policy in the Second

⁴⁹ Følrand 1991c, 191-204; Knorr 1975. I also have had the benefit of being allowed to see Følrand's, sadly, unpublished doctoral thesis, Følrand 1991a, from which I have greatly benefited. Developing the idea of cold economic warfare is an important theme in my argument here.

⁵⁰ Quoted from Følrand 1991c, 199, 200; Mastanduno 1985, 503-531, citing pp. 509 & 512-13.

World War towards the neutrals showed, particularly well illustrated by policy towards Sweden, criteria of relative advantage and political considerations held the allies back from a total embargo, even though they knew that the blockade of Germany haemorrhaged badly through Sweden. Clarity can be achieved and confusion avoided here, providing it is acknowledged: first, that nothing may be excluded *a priori* from being a strategic good; secondly, that the term total economic warfare is not the language of an absolute that would stop all trade, but only requires an embargo on goods deemed to be of inherent strategic value and those that yield a comparative advantage to the enemy; and thirdly, that there cannot be total economic warfare in peacetime and that cold economic warfare captures the sense of the restrictions that apply under these conditions.

ARTICLES

Jacqueline McGlade

COCOM and the Containment of Western Trade and Relations

While the least visible of all Cold War containment initiatives, COCOM substantially altered the pre-war foundations of world trade. It also placed severe strains on the fragile, new bonds of Western multilateralism forged by post-World War II concerns over communist expansion.

With the coming of Cold War containment, American and European companies alike quickly felt the effects of COCOM controls, which transformed world business into the tightly regulated bi-lateral spheres of East-West trade. Instead of the hoped expansion anticipated by many business groups, the postwar framework for international trade suffered frequently from painful contractions and re-adjustments as COCOM technical embargos and military considerations delineated East-West markets.

As a result of such measures, the American share in world exports in manufactured goods, after rising for 150 years, steadily declined. As a counter phenomenon, foreign industrial imports to the United States rose by more than 20% in the decade following World War II. As the Cold War wore on, the total US share in world exports slumped even further from 18% in 1950 to 12% in 1977. Conversely, the combined foreign share of world exports nations expanded rapidly in the same period from less than \$60 billion to \$1 trillion.¹

Spurred by containment policies, COCOM regulations had seriously begun to impede then American business dominance by the 1960s. For European countries struggling under the economic devastation wrought by

¹ D.C. Garfield, "Free Trade or the Lack Thereof", talk before The Conference Board, October 11, 1977, p. 1, Box 192, Accession # 1057, The Conference Board papers, Hagley Museum and Library; Claude Murchinson, *World Trade and the United States* (American Cotton Manufacturers Institute, Inc.: Washington, D.C, 1953), pp. 23-25, Pamphlet Collection, Hagley Museum and Library; Robert E. Lipsey, "Assessing the Current International Competitive Position of the United States," The Conference Board Conference: "International Trade Policy and American Industry: A Threatened Consensus", October 11, 1977, p. 2, Box 169, Accession #1057, The Conference Board Papers, Hagley Museum and Library.

World War II, COCOM also denied the important restoration of pre-war market relations with trading partners in Eastern Europe, the Soviet Union and Asia. As a result, Cold War trade controls forced a realignment of Western European export interests toward the United States and in support of further continental market liberalization and integration. American firms faced, for the first time, significant business competition from its allied partners in terms of European imports and eventually Japanese imports. For many US companies, developing countries in South America, the Middle East and Africa posed the only new markets easily penetrated though risky due to fragile economic conditions, unstable governments and enduring COCOM restrictions.

Despite such evidence of significant barriers imposed on the growth and direction of American and European postwar trade, scholars have generally assumed that businesses supported strategic controls and economic warfare measures advanced in the name of the Cold War.² However, in-depth studies of various business communities in the West reveal that the climate of executive opinion tended to be highly suspicious and wary of the increased intrusion of state regulation into world trade and economic affairs.³

Recent studies by Alan Dobson and Ian Jackson probe more fully the political reasoning and economic consequences of Cold War strategic trade controls.⁴ This study examines the management of Cold War economic warfare primarily under COCOM through the additional lens of the containment of Western business activities and growth. It also highlights the strains that COCOM negotiations and strategic trade controls placed on Western multilateralism and resolve to stem communist economic development. Finally, this study maintains that a general negative reaction on the part of American firms, as well as Western governments, resulted in persistent and critical retractions of COCOM policies, which had posed an impenetrable network of controls that gripped the Cold War business world by the 1960s.

The Rise of COCOM

Clearly, the United States and its European allies did not anticipate the extent to which the coming of COCOM and its embargoes would tax Western economic expansion and relations. In the throes of the swiftly escalating Cold War, American policymakers rushed to pass the Export Control Act of 1949 intended to block the spread of Western technology and trade to emerging communist countries. To reinforce the new embargo, the United States, along with its

² Hogan 1987, 21-22 and Leffler 1993), 3-4, 15-19.

³ Zeiler 1998, 337-360 and Mastudano 1992, Chs. 3 and 4.

⁴ Dobson 2002 and Jackson 2001.

Western European allies, agreed to create COCOM, the Coordinating Committee for Multilateral Export Controls, in the spring of 1950.⁵

Reflective of the shrouded secrecy that so marked the Cold War era, COCOM's origins and many of its activities over four decades remain mysterious. Under the mandate of containing Communist economic growth, American and European officials began to discuss in early 1950 possible frameworks for the administration of a worldwide system of business and technology export controls. As part of "an informal" forum, often unidentified government representatives began to meet regularly in Paris by the fall of 1950 to "exchange ... views ... on a more systematic basis." Known only as the Consultative Group (CG), this ex-officio body, which boasted "no direct connection to any U.S. or European government agency, NATO or the OEEC", nevertheless, managed to guide the formal organization and enforcement of a worldwide system of trade controls for several decades.⁶

Initially, COCOM's mandate was a daunting one as the complexities of instituting and managing a global trade embargo soon overwhelmed the handful of members comprising the Consultative Group. The CG countered by setting up a subordinate "Coordinating Committee" (COCOM) to revise and monitor the new East-West trade controls. Along with COCOM and its technical subcommittees, the CG established an embargo list of "goods of high strategic importance" and an "ICDV system" for foreign import-export monitoring and control, which required all Western Bloc nations⁷ to secure an "Import Certificate" (IC) and a "Delivery Verification" (DV) for cargo shipping.⁸

Over the next decade, the composition of the ICDV lists became the chief source of contention and conflict between the United States and its European partners. At first, the lists contained items immediately discernable as "strategic" or "militarily sensitive" in importance. The original list or "Class 1A" drafted in January 1950 included 167 items such as "specialized machine tools (40 items), petroleum equipment (15 items), chemicals and chemical equipment (31 items), precision scientific and electronic equipment (42 items), and certain non-ferrous metals (12 items)."⁹ After some adjustments following CG and COCOM discussions, the ICDV system was comprised as of January 1950 of three lists, List IA with 144 items which were strictly embargoed, List II comprised of limited exportable items, and List III for items under consideration for restriction and control. As the 1950s wore on, however, the

⁵ Mutual Defense Assistance Control Act of 1951, *Reports to Congress*, no. 1, October 15, 1952.

⁶ *Ibid.*, pp. 20-21.

⁷ As of 1951, Belgium, Canada, Denmark, France, West Germany, Italy, Japan, Luxembourg, The Netherlands, Norway, Portugal and the United Kingdom had agreed to participate in the Consultative Group, COCOM and the ensuing "ICDV" system. By 1953, Greece and Turkey also joined the group. Austria, as a result of its reliance on trade with Eastern Europe, and Spain remained notably absent from the list. *Worldwide Enforcement of Strategic Trade Controls*, 22-23.

⁸ *Ibid.*, 20-21.

⁹ Mastanduno 1993, 69-70.

overzealous Mutual Security Administration (MSA) forced an expansion of the COCOM list to over 450 items including such innocuous substances as Chinese hog bristles and the consumer plastic, Bakelite.¹⁰

Angered by U.S. insistence for strict controls despite the large economic costs, several European members, most notably Great Britain and Denmark, began to question the deleterious affects of the COCOM embargoes. By the mid-1950s, attempts became more frequent among the COCOM partners to restore pre-war trading levels with the Soviet Union, its Eastern European satellites, and China, especially in such in key sectors as shipping, coal and manganese purchases, railway equipment and aircraft parts, chemicals processing, scientific devices, and machine tools.¹¹ To offset the growing economic hardships of the East-West trade split, European countries also countered U.S. domination by demanding in 1957 major revisions to the international lists and also looked to diversify the representation base of the CG and COCOM committees.¹²

European Bloc Politics v. American Dominance: The Case of Japan

Early on then, European COCOM members began to unite and engage in bloc politics as a way to minimize American dominance on containment strategies. As a result of the alliances, several smaller European countries, most notably Denmark, Belgium and Italy, managed to blunt, and some cases prohibit, U.S. extension of containment into important East-West European markets such as fishing products and vessels, ball bearings, fats and oils, and wood products. The entrance of Japan as a full partner stands as a striking case of the growing power and parity achieved by smaller European countries in COCOM proceedings.

As early as 1951, Denmark, Belgium and France began to pressure the United States to allow Japan to sit as a full partner in COCOM. The establishment of the People's Republic of China (PRC) and outbreak of the

¹⁰ McClade 1995, Ch. 8 and also Office of Technology Assessment, *Technology and East-West Trade* (GPO, 1979), 156.

¹¹ Archives Diplomatiques, Ministere des Affaires Etrangeres, Paris, CoCom Papers, Folder 587, Documents Related to International Lists. The documents bear out the fact that while European pressure led to several major revisions of the COCOM lists starting in 1957, the economic and trade base of several member nations were, nevertheless, noticeably altered by the artificial barriers that had coincided with the critical period of post-WW II recovery. The drastic nature of early COCOM controls had further impeded the abilities of European firms and industrial sectors, already struggling with problems of disrupted materials markets, inflation and depleted money supplies, disabled transportation and communication systems, and depressed buying cycles, to return to pre-war markets and conduct "business as usual." As goods (or parts of goods) in both emerging consumer as well as suppliers markets became affected by East-West embargoes, a widening circle of companies were forced to alter or abandon altogether their pursuit of traditional trajectories of business development, production, management, and delivery.

¹² See Dobson 2002 and Jackson 2001.

Korean War in 1949-50 had already precipitated a shift in American thinking about the recovery of Japan due to its increasingly vulnerable position as an industrial capitalist nation in the midst of spreading communism in Asia. At the time of the COCOM discussions, American strategies for Japanese economic recovery had already moved away from protectionism toward liberalization, encouraging the resurgence of independent business activity and the restoration of competitive export production and market development.¹³ Nonetheless, while American policymakers supported efforts to bind Japan and its economy closer to the West through such aid programs as the USTA&P and JCP programs, the notion of extending full partnership in COCOM prompted negative reactions and revealed a lingering atmosphere of paternalism and hostility. Despite American resistance, European COCOM representatives persevered and, after a series of special meetings in Washington, D.C. in 1952, the United States acquiesced and extended an invitation to Japan to join the CG steering committee and its auxiliary policy and technical sub-committees.¹⁴

As a voting member, Japan soon proved an important ally for the Scandinavian countries, and later the United Kingdom and France, to fight heavy COCOM restrictions on shipping activities, shipbuilding and repair and commercial fishing levied during the U.S. dominated discussions of 1949-1950. Through the technical subcommittees and CG steering committee, Japan also gained strategic, firsthand information that led to new business opportunities over potential competitors involved in shipping and fishing enterprises in Asia, the Baltic Sea, and the Middle East. In particular, Japan took advantage of COCOM regulations that blocked the unlimited manufacture of heavy cargo ships, tankers, and large fishing craft, along with ship engines, instruments, and repairs contracts between participant countries and the Communist Bloc. For countries such as Denmark, Norway, and Great Britain, the COCOM embargoes precipitated a dramatic decline in business orders and employment in key domestic shipyards. While Japan lost lucrative repair contracts it had traditionally held with the Soviet Union, it benefited significantly by the sharp swing in Cold War shipping sales toward its manufacture of non-embargoed light fishing vessels and watercraft.¹⁵

Unable to shoulder the technological costs and labor problems involved in converting production away from heavy ship building, European countries could do little to stem Japanese dominance in world light watercraft markets. The lesson stood as an important one for not only European but American heavy producers, shift rapidly toward the manufacture of non-embargoed

¹³ Forsberg 2000, 1-4.

¹⁴ Archives Diplomatiques, Ministère des Affaires Etrangères, CoCom Papers, Folder 642, Export Controls, Document 842, "Message from the Chairman of CoCom on Japan," August 6, 1952.

¹⁵ There are numerous documents in the CoCom Papers on committee struggles to block Western ship technology to the communist bloc. For detailed technical discussions, please see Archives Diplomatiques, Ministère des Affaires Etrangères, CoCom 1954-1958 Sub-Committees Exports Controls and Lists, Folder 625, Document (54) 5 "Coordinating Committee Statement of the Chairman of the Sub-Committee on Fishing Vessels," March 4, 1954.

items and consumer goods or suffer greater contractions and loss of market share worldwide.

Business Resistance Against COCOM Controls

Along with European diplomatic maneuvering, many Western firms began to resist then a full-scale East-West trade embargo as imagined and promoted by U.S. policymakers in COCOM. As early as 1949, reports by the U.S. State Department and Pentagon frequently cited American and European violations of COCOM regulations. "Entrepot" trade, the practice of shipping items from the United States to countries outside the Soviet Union and China then immediately trans-shipping to a Communist Bloc country created the greatest levels of concern for American officials. Entrepot trade also had spurred by the 1950s a growing network of Eastern and Western European black markets, which seriously challenged trade containment effectiveness.

To placate U.S. protests, COCOM increasingly took action against Western firms engaged in entrepot and black market, especially after the end of the Korean War. Firms suspected of illegal trade were investigated (largely through the efforts of the CIA) and placed on "black lists" intended to trigger court suits and convictions against export violators. Nevertheless, the imposition of black lists and pursuit of business prosecutions remained a controversial matter in the CG steering committee as European countries, most notably France and Great Britain, resisted American aims to retaliate against companies and insisted that business regulation remain a national prerogative vs. multinational mandate.¹⁶

Despite the threat of prosecution, growing numbers of Western businesses faced resisting COCOM controls or losing significant connections, profits and markets in Eastern Europe, the Soviet Union, and Asian nations. In the case of the United States, annual exports to Communist Bloc countries plunged from \$350 million in 1949 to virtually zero by 1956 as a result of COCOM measures. A blockade on Asian exports accounted for another \$50-75 million lost in annual overseas revenues.¹⁷ However, US trade figures in the 1940s and 1950s also underscored the relative unimportance of foreign exports in the configuration of gross national profits. From 1945-1960, the amount of American national income derived from export-import trading, the majority of which rested in recovering European industrial and consumer markets, never rose above 10-11%

¹⁶ NARA, Central Intelligence Agency, Doc. #01203, Information report to department of State, May 9, 1949, Declassified Document File, 1997 and NARA, Department of the Army, Doc. #1470, Information report to Department of State, September 29, 1950, Declassified Documents File, 1997. Also see CoCom 1954-1958 Sub-Committees Exports Controls and Lists, Folder 625.

¹⁷ U.S. Department of Commerce, *Export Control*, Thirty-Seventh Quarterly Report, Third Quarter (Washington, D.C.: Government Printing Office, 1956).

of GNP. As a result, almost 90% of US wealth emanated from domestic markets, not foreign sales - a figure that only shifted upwards to 25% after the 1960s.¹⁸

The early thrust of American Cold War foreign policy did not reflect, then, the traditional promotion of national business interests. Instead, U.S. policies dramatically shifted after 1945 from business to military protectionism as European economic distress became increasingly linked to growing concerns over Soviet expansionism. To stem European economic decline, policymakers fashioned several programs under the Marshall Plan and other aid packages of the 1940s and 1950s, which allowed for the rapid transfer of American investment capital, corporate management techniques, industrial technology, and financial practices overseas. In its early stages then, the Cold War precipitated a swift, new direction in U.S. foreign policymaking in which the export of capital overseas became viewed as a "trade-creating rather than [a] trade-replacing"¹⁹ measure. Early signs of trouble loomed, however, as European aid supports and a ban on American exports of aluminum, hand and machine tools, tobacco, tuna and livestock led several US business groups to condemn such policies as discriminatory.²⁰ By 1949, the National Association of Manufacturers (NAM) and the National Industrial Conference Board (NICB) also blasted such emerging Cold War export restrictions as "creating ... permanent barriers to an expanding world trade."²¹

While not yet a dominant view, business groups, nevertheless, increasing wondered about the impact of Cold War economic policies on American investment and export interests abroad. In 1946, US companies had enjoyed an \$11.5 billion surplus in export trade, with the majority of profits flowing from unstable conditions in European industry. This surplus continued to rise on an average of \$4 billion a year until the enactment of ECA financial and export stabilization measures in 1949. American firms felt the impact of European recovery measures immediately as export markets slumped to \$13.8 billion, the lowest level since 1946. Realizing a rapid 33% decrease in exports, US companies watched in frustration as foreign imports, largely comprised of European industrial products, rose to \$12 billion, a 30% increase since 1945. Threatened by import growth, American export surplus trading continued to fall to only \$1.8 billion by 1952 and never recovered above \$5.7 billion by the end of the 1950s.²² As communist containment swiftly displaced economic liberalization then as the foundation of US Cold War foreign policy after 1950, American firms felt a dramatic loss of government support for older trade measures rooted in *laissez-faire* foreign expansionism.

¹⁸ U.S. Bureau of the Census, *Historical Statistics of the United States, Colonial Times to 1970* (Washington, DC: Government Printing Office, 1970), 228-230.

¹⁹ Bergsten, Horst and Moran 1978, 404.

²⁰ Sanford 1987, 73-74.

²¹ National Association of Manufacturers, "Report on International Relations, 1949-1950," pp. 2-4, The Papers of the National Association of Manufacturers, The Hagley Museum and Library, Wilmington, DE.

²² U.S. Bureau of the Census 1970, 228-230.

Under the Eisenhower Administration, US business groups openly opposed the proposed extension of additional industrial supports to Western Europe, first fashioned under the Marshall Plan and due to expire in 1953. Along with a substantial level of civilian business aid, the Mutual Security Administration (MSA) also had let out hefty NATO production contracts to European over American companies. Concerns escalated that, while political allies, European firms were also business competitors, moving steadily ahead with re-built manufacturing facilities into consumer and high-tech markets courtesy of US aid supports. The earliest signs of trouble for the continuation of American corporate support for Cold War economic warfare flared in 1953 as the Randall Commission attempted to build a consensus on the proposed one-year extension of the Reciprocal Trade Agreements Act.²³

Throughout the hearings it became obvious that the American business community was badly splintered in its support for the politics of embargoed East-West trade. Isolationist groups supported nothing less than the termination of all foreign assistance regardless of its intended purpose or destination. Conservative protectionists and containment militarists distinguished themselves from isolationists and liberal expansionists by purporting that foreign trade embargoes and aid supports, while financial and administratively cumbersome, remained an essential part of Western "mutual security" efforts. Free traders, while committed to economic liberalism and market expansionism, remained split on whether to fully re-open East-West trade and risk a serious compromise of Western military superiority. The Eisenhower White House also contributed to the growing business schism over by vacillating in its dealings and allegiance with conservative protectionist and liberal expansionist groups.

Led by NAM and the NICB, business groups began pushing for a relaxation of trade controls on exportable, non-military items into the Soviet Union and other communist nations in order to counterbalance growing European competition in Western and developing free trade markets. Business groups also called for an alternative set of foreign policies, aimed away from Europe and toward the development of non-communist nations located in South American, Africa, and the Middle East.²⁴

Unwilling to jeopardize either European cooperation or American business support, the Eisenhower Administration struggled to find a common ground after 1954 for the fulfillment of its Cold War commitments. A series of domestic economic downturns and the French Indo-China Aid crisis also spurred a significant reappraisal by the Eisenhower Administration of Cold War "mutual security" strategies and the future of global economic development. It eventually adopted a tri-partite strategy of "trade and aid" which included large subsidies for European industrial recovery, NATO

²³ Ibid., 18-21.

²⁴ See, the papers of the National Association of Manufacturers, The Hagley Museum and Library, Wilmington, DE.

military expansion, and American business development in Third World countries.²⁵

Countering the Cold War Business World, 1960-1990

American Business Readjustments

While support for Third World development aided some firms, most US companies remained frustrated in 1960 over Cold War barriers into mature, Western markets. Saddled with high inventories of goods, American companies had remained blocked throughout the 1950s from entering many European consumer and producer markets re-invigorated by new, intra-continental patterns of manufacturing, distribution, and trade. Business groups also blamed Cold War policies that continued to offer a substantial level of civilian industrial supports to Western Europe along with lucrative, long-term NATO production contracts. For American businessmen, the 1955 and 1957 recessions had also served as harsh proof that Cold War aid supports had advanced European industrial and trading interests to the detriment of the United States. As an added burden, Cold War strategic trade policies prohibited American buyers and sellers from dealing with Soviet satellite markets in Eastern Europe and Asia.

By 1960, it was clear to many in the American business community that the Cold War, dominated by containment geopolitics, had measurably altered and re-engineered the former landscape of world trade. Trade barriers before the Cold War had come about largely through economic competition as nations battled to protect home markets while taking advantage of an expanding base of world trade. Under the Cold War, however, trade controls strove to re-configure international business competition in support of market containment v. growth. Through COCOM measures alone, US trade with the Soviet Union which totaled \$236 million in 1946, fell to \$10 million in 1950 and to less than \$2 million with countries in the entire Communist bloc by 1956. While Soviet importation of Western technology had steadily climbed from 16.6% in 1913 to

²⁵ See Kaufman 1982, 6-11. Under the successor agency to the MSA, the International Cooperation Administration (ICA) began in 1954 a gradual shift of US trade and aid supports away from Western Europe toward developing and de-colonizing countries (DOTs). Previous DOT aid had hovered around a level of \$500 million to \$700 million since its initiation in 1949 with the exception of a steep drop to \$200 million in 1950 due to the start-up of the Korean War. With the merger of Point IV and European civilian aid under the ICA in 1954, DOT economic development funding experienced its largest leap upward from \$700 million to \$1.6 billion. After a series of slight fluctuations, DOT economic development budgets leveled off at an annual rate of \$1.5 billion in comparison to European totals of less than \$100 million by 1958. Despite such changes, the Eisenhower Administration did little to reconcile the various inconsistencies abound in the simultaneous advance strategic containment along with trade liberalization, thus failing to break the incongruent nature of Cold War policymaking.

a high of 80% of all machinery imports in 1939, by 1960 COCOM embargoes had eliminated virtually all technology transfers from the West to the Soviet Union.²⁶

Not surprisingly, the American business community began to push for changes in US foreign economic policy away from Cold War containment toward the return of trade liberalization and expansion. In the 1960s, businessmen actively went “on the defensive, seeking to temper what they ... considered to be the most destructive aspects of US [and COCOM] export control policy”.²⁷ Unable to breach ideological and governmental barriers to access new markets, American firms increasingly used the instrument of foreign investment as a lever for re-entering crucial Western markets. As a result, foreign direct investment rested as 50% of the profit base for Western world trade by 1972.²⁸ US manufacturers also resorted to direct overseas investment to stem non-competitiveness problems in their home markets due to rising importation of foreign manufactured goods, particularly in the automobiles, electronics, steel and apparel sectors, supported by price advantages and government subsidies.²⁹

European Autonomy v. Multilateralism

Along with American business, European governments also exhibited increased, open resistance against Cold War trade containment in and outside of COCOM. U.S. and U.K. relations were particularly strained starting at the end of the Korean War into the 1970s. Difficulties between the United States and Great Britain had begun as early as 1950 when American policymakers insisted in COCOM discussions that European governments cancel bi-lateral trade treaties struck with the Soviet Union and other Eastern European nations negotiated from 1946-47. Exhibiting little concern for the economic impact of such actions, U.S. officials dismissed the impassioned arguments of its COCOM partners that the cancellations of the treaties, which largely restored pre-World War II access to critical raw materials found in the Soviet Union and Eastern Europe, would seriously diminish postwar industrial recovery efforts.³⁰

For the United Kingdom, the cancellation of the bi-lateral treaties would shut off important supplies of Polish coal, fats and oils and Soviet manganese, which remained essential raw supplies for a number of British industries. In exchange, the communist bloc countries relied on British manufacturers for

²⁶ Bertsch 1983, 13-15.

²⁷ Mastanduno 1993, 28.

²⁸ James W. McKee, “The Response of the Multinational Corporation,” The Conference Board conference, *The United States in the World Economy*, January 20-22, 1972, 3-4, Box 169, Accession #1057, The Conference Board papers, Hagley Museum and Library.

²⁹ Albert T. Sommers, “The United States Economic Outlook,” The Conference Board conference, *Business Overview*, September 28, 1978, p. 7, Box 192, Accession # 1057, Conference Board papers, Hagley Museum and Library.

³⁰ Archives Diplomatiques, Ministère des Affaires Etrangères, CoCom Papers, Folder 642, Export Controls.

scientific and calibrating instruments, pharmaceuticals, ship and railway engines, and rail lines and rolling stock. In the case of the Netherlands and Scandinavian countries, Eastern European imports of fats and oils acted as key supplements for food and industry stocks as well as maintain healthy export markets of tinned fish, ship equipment, and wood and pulp products. France and Italy also suffered potential export losses, especially in such light metals industries as ball bearings, machine tools, and aluminum based products.³¹

In addition to leading the movement to reduce the COCOM lists in 1954 and 1957, the U.K. also rallied its European partners to find other avenues to re-engage with communist bloc economies. Greater usage of NATO, the European Economic Community (ECC), and the re-employment of national economic sovereignty became key strategies employed by Great Britain and European allies to blunt American diplomatic dominance.

As an illustration of growing American frustration, U.S. President Dwight D. Eisenhower sent an urgent cablegram to U.K. Prime Minister Harold Macmillan on May 5, 1959 regarding discussions being held in NATO on the possible extension of credits to the Soviet Union for the financing of industrial equipment and plant construction. In his communiqué, Eisenhower confided in Macmillan that he was “particularly disturbed” to learn that the U.K., along with other key Western countries, were leaning in favor of the credits as a measure for increased trade. “I realize that we [US-UK] have not always seen eye to eye on economic counter measures with respect to the Soviet Union,” Eisenhower stated, “on the other hand ... I believe strongly that we should ... resolve all significant ... sources of division between us ... [for] any unilateral action ... might well give the Soviets the impression that the West is not united in its ... vital security interests in Central Europe.” Eisenhower also warned Macmillan that a large scale extension of credits to the Soviet Union could potentially “disrupt world markets” particularly in the area of basic commodities which “many underdeveloped and Commonwealth countries must export.” In his message, Eisenhower continued to counsel Macmillan that an increased trade base for the Soviet Union would trigger an “expansion of Soviet economic penetration in less developed countries”, which in turn would “put great strains on our goal of liberalizing free world trade, which I know is so close to your heart.” Finally, he also shared his fear with Macmillan that any Western support for the expansion of Soviet world trade would lead to “increased difficulty in this country [the United States] of obtaining public and Congressional support for our Mutual Security program and related [aid] policies...”³² Despite the Eisenhower communiqué, Great Britain and its European NATO partners continued to support credits as a means of re-entering communist bloc countries.

³¹ Archives Diplomatiques, Ministère des Affaires Etrangères, CoCom Papers, Sub-Committees Exports Controls and Lists, Folder 625.

³² National Archives and Records Administration [hereafter NARA], Department of State Doc. #760, Cablegram from Eisenhower to Macmillan, May 5, 1959, pp. 1-5, Declassified Document File, 1997.

In addition, Great Britain pursued with greater vigor the imposition of national economic prerogatives over multilateral Cold war economic agreements. In order to compete with American high tech giants such as IBM and Boeing, British firms involved in computing and avionics accelerated efforts in the 1960s and 1970s to penetrate emerging technical equipment markets in Eastern Europe under the relaxed eye of government regulation. Italy followed suit by insisting on oil pipeline deals with the Soviet Union under a series of bi-lateral trade agreements in the 1970s. For France and the Netherlands, the export of short wave radio-electronics and telecommunications equipment to Eastern Europe emerged as a source of diplomatic tension with the United States. By the 1980s, Great Britain also began to justify a return to trade bilateralism by accusing American officials during COCOM meetings of intentionally blocking the entry of British firms interested in exporting computing and nuclear power plant technologies into Eastern Europe as a way to block U.K. technical growth and protect the dominance of rival U.S. high tech companies.³³

As championed by Britain then, the restoration of bi-lateral trade relations under the aegis of national economic prerogative and competitiveness over collective military security became an important challenge to American dominance, and ultimately re-cast Western multilateralism in a more equitable light. The finalization of the Treaty of Rome establishing the European Union also signaled increased European resolve to foster greater economic independence from the United States.³⁴

While seemingly stronger, European governments still relied heavily on American good will for military security and access to high tech weaponry, especially in the area of nuclear missile defense. The United States, despite extreme irritation over the distinctly relaxed nature of post-1950s Cold War strategic trade barriers, depended on maintaining a solid Western multilateral front to avoid showing weakness against the Soviet bloc. Mutual dependency then marked the extremely difficult and complex state of Western economic affairs as re-construed through anti-Soviet import-export and security trade controls through the first decades of the Cold War.

³³ Archives Diplomatiques, Ministère des Affaires Etrangères, COCOM 1954-1958 Sub-Committees Exports Controls and Lists and COCOM Newspaper Clippings Files, 1950s-1980s (Microfilm reels 1-4).

³⁴ Milward 1992 argues a similar point that through greater economic and political integration, European countries could champion and pursue individual economic prerogatives in a negotiated "Europeanized" environment removed from direct U.S. influence and controls.

U.S. Accommodation

Aware of growing business distress and strains on Western multilateralism, several US presidential administrations tried to re-dress the imbalance between trade liberalization and communist containment spurred by the Cold War. These attempts occurred in a difficult environment of domestic hard-line anti-communism v. the pragmatic need to foster world trade opportunities and access.

The Kennedy Administration took some of the first steps to scale back the spread of containment economic policies with its championing of the General Agreement on Tariffs and Trade (GATT) round in 1961-61. Nonetheless, it also carried the favor of Western European allies by cutting tax liabilities for foreign multinationals with interests in the United States while withholding similar advantages for American firms doing business abroad. Understandably, business pressures continued to mount for the re-opening of East West trade. Under the watchful eye of the newly formed Council for Mutual Economic Assistance (CMEA), Western exports to Communist bloc countries grew at a rate of 9.1 % annually in the period of 1960-65 with imports resting at 8.8%. In the area of machinery and equipment, import-exports figures experienced dramatic increases, in some cases as high as 50% in elevated trading.³⁵

The incoming Nixon Administration also responded by organizing through the Commerce Department new forums for American firms eager to discuss ways to substantially lower East-West trade barriers while mindful of the dangers of communist expansion. The Nixon Administration further ushered in the end of containment economic politics by opening trade with China and establishing the U.S.-U.S.S.R. Commercial Commission and the Office of East-West Trade Promotion by 1973. Reflective of the shift, a report issued by The Conference Board stated that 81.1% of 106 top American companies were seeking either new business or to repeat business with the Soviet Union, China, and other communist bloc countries by the early 1970s. Predictably, American exports to the Soviet bloc had skyrocketed after the lifting of Cold War trade controls from \$157 million in 1968 to \$255 million by 1972.³⁶ Since the 1970s, the pace of technology transfer, particular in high tech items, between Western and then Communist bloc countries also continued to quicken to encompass 7% of total technology trading of the West. However, as late as 1980 such exports only accounted for less than 15% of the total percentage of Western technology trades.³⁷

In the same vein, the CCOCOM list of embargoed items still contained around 150 categories in the 1980s and had experienced few changes after a

³⁵ Zaleski and Wienert 1980, 15.

³⁶ The Conference Board, *Evolving Corporate Policy and Organization for East-West Trade* (New York: The Conference Board, 1974), 1, Pamphlet Collection, Hagley Museum and Library.

³⁷ US Department of Commerce, Office of East-West Policy and Planning, Position Paper, January 1981, 2.

series of dramatic reductions from 1954-1965.³⁸ Nevertheless, the United States lead all other Western nations by the mid 1980s in asking for exceptions to the COCOM list, 3,399 to 3,790 requests, 90% of which related to China, signaling a major shift in American political support and resolve for communist trade containment.³⁹

The inconsistent, vacillating stature of Western trade controls in the 1990s continued as a reflection of the compromised nature of US foreign economic policymaking as tempered by European government and American business resistance. As noted by Senator John Heinz in 1991, American foreign economic policy also took a dramatic turn away from containment towards trade liberalization when "Cold War rhetoric began to give way to peaceful coexistence in the 1960s and finally to *détente* in the 1970s."⁴⁰

The championing of a major revision to the Export Control Act of 1949 by the Nixon Administration led to the passage of the Export Administration Act of 1969, which substantially eased US trade controls to China and Eastern Europe. Additional legislation in the 1970s including the Export Administration Act of 1979 liberalized controls, especially in the area of agricultural exports and consumer products markets between the United States and communist countries. With the exception of trade sanctions levied by the Carter and Reagan Administrations (largely in response to Soviet occupation of Afghanistan), the United States has joined with its Western partners to break down many of daunting trade barriers erected in the early Cold War years. The passage of the Omnibus Trade and Competitiveness Act of 1988 substantially reduced the waiting time for firms seeking export licenses to a maximum of 90 days.

Such modifications did little to appease anti-COCOM sentiments among business and government groups in the Western bloc. In its post-Cold War days, COCOM watched over the import and export of materials and equipment, not only to communist and former communist countries but also to all countries, which posed a shared security threat to the United States and its allies. With the demise of COCOM, however, the future of world export controls remained unsettled and uncertain as government and business trends supported further relaxations in high-tech markets. It is yet known if the new security concerns that have emerged since September 11, 2001 will lead the United States and its world allies to re-institute a multi-lateral "economic warfare" approach similar to COCOM to regulate the most sensitive and potentially dangerous markets of high tech equipment, chemicals, computer, electronics, and avionics equipment. Nevertheless, the same precarious balance between business expansion, trade liberalization and international security would again challenge the multilateral unity of the United States and its allies.

³⁸ Bucy 1980-81, 135.

³⁹ Mastanduno 1993, 279.

⁴⁰ Heinz 1991, 13. Dobson 2002 also argues that pragmatic re-adjustments, though cloaked in tough rhetoric, eventually marked U.S. foreign economic policy even during the revision of "Cold Warriorism" under the Reagan era.

Conclusion

The geopolitical aims of the Cold War, as embodied by COCOM and other restrictions, resulted in the construction of a newly daunting environment for world trade unlike any previous era. While businesses had always endured, in one form or other, the artificial construction of world markets through such measures as import/export licensing and fees, tariffs, embargoes, cartels, etc., the imposition of geopolitical splits, and prohibitive trading practices under the Cold War posed an almost unalterable set of barriers for Western firms seeking to expand after World War II.

For U.S. companies such trading restrictions gave rise to the unique and disturbing political situation in which policies advanced in the name of anti-communism and Western security stood in direct conflict with the traditional American belief in economic liberalism and the minimization of government regulation in the marketplace. As a result, Cold War economic measures acted as a catalyst for heightened American business dissatisfaction over the growing role of the state in the intervention and regulation of international trading practices. Such restrictions also disabled the traditional vehicle of export sales and fueled greater offshore investment and expansion of firms seeking to enter overseas markets.

Finally, containment policies strained the relations between the United States and many of its European allies and threatened to imperil multilateralism as the basis of post-1945 Western relations. Conflicts over the composition of economic embargo, technology blockades, and restricted materials lists eventually forced the United States to amend its stringent enforcement of Cold War measures to accommodate its European partners, most notably Great Britain and France. In the end, such compromises on behalf of Western Europe acted to weaken American political and economic resolve and resulted in the relaxation of East-West trade barriers by the 1970s and 1980s.

Despite its eventual demise, containment geopolitics acted to significantly alter the pre-1945 arrangement of world trading patterns, technology transfer, and business practices by giving rise to a new Cold War "business world" constrained by COCOM embargoes and multilateral restrictions and decision making. While the economic legacy of the Cold War has been largely studied through the lens of communist nations, the intriguing question remains then as to the full impact "containment" imposed on Western business re-development and expansion over the course of more than four decades.

Uri Bar-Noi

Moscow and the Curtailment of British Exports as Part of the American-led Economic Warfare Against the Communist Bloc, 1951-1954¹

Introduction

The economic Cold War is one aspect of the postwar conflict between the Union of Soviet Socialist Republics (USSR) and the United States of America (USA) which attracts increasing attention from contemporary scholarship. Beginning from the late 1980s, studies have concentrated on the American embargo of trade with the communist enemy, the establishment of the international trade control mechanism under America's leadership and the debate between the U.S. administration and its West European allies, mainly the British, with regard to the scope of trade restrictions throughout the late 1940s and early 1950s.² Unfortunately, the role of the USSR and East European satellite governments in this aspect of Cold War fighting and the Kremlin's attempts to disrupt the American-led embargo of trade with the Soviet Bloc have been overlooked by these works.

Based on declassified records from both Soviet and British archives, this paper focuses on Moscow's response to the curtailment of British exports to the USSR as part of the West's strategic trade control mechanism, throughout 1951-1954. More specifically, it sheds light on Soviet attempts to encourage Winston Churchill's peacetime government to break away from the American-led embargo of trade with the communist bloc and increase the volume of Anglo-Soviet trade. Records indicate that Soviet foreign policy practitioners and trade officials attempted to entice the British into relaxing strategic export controls by employing

¹ I am very grateful to Professor Alan Dobson for his illuminating and resourceful comments.

² Funigiello 1988; Mustanduno 1992; Dobson 1988A; Young 1995, 247-255; Young 1996, 125-140; Cain 1994, 501-522; Førland 1991b, 221-244; Sapulding, 1993, 223-249; Jackson 2001.

both coercive measures and commercial incentives. Throughout 1951-1952, the Soviet Government threatened to withhold vital supplies of coarse grains and timber, though simultaneously sought to increase the volume of bilateral trade and was even willing to offer new contracts to British industrialists who privately attended an economic conference in Moscow. Soviet documents indicate that following Yosif Stalin's death, Moscow was eager to improve commercial relations with Britain, and in order to ensure a swift expansion of Anglo-Soviet commerce it removed potential obstacles such as its planned denunciation of the old Anglo-Soviet fisheries agreement of 1930.

In an attempt to indicate its willingness to substantially increase the volume of trade with Britain all through summer 1953 to winter 1954, the Soviet Government encouraged Churchill's Government to drastically modify its export control policy and agree to a new trade treaty. The British Government had no intention of withdrawing existing strategic controls altogether, or concluding a new commercial agreement with the Soviet Government which would result in a considerable expansion of bilateral trade. Churchill's plan was limited to reducing Cold War tensions through the relaxation of strategic export controls, and determined to maintain a good working relationship with the U.S. President Dwight Eisenhower, the British Prime Minister was prepared to join the Americans in efforts that would result in a moderate revision of embargo policy. Yet, the Soviets perceived this as a proof that the U.S. administration had persuaded the British to retract their initial plan to radically liberalize export controls. Indeed, commitment to a tighter enforcement of reduced embargo lists of August 1954 limited Britain's freedom of trade with the USSR. By this time the British Government was reluctant to enter into any new trade negotiations with the Kremlin as it feared adverse American reaction and suspected that the Soviet Government might press for greater moderation of strategic controls during forthcoming talks.

Simultaneous Use of Coercion and Inducement, 1951-1952

With the danger of an imminent East-West armed conflict looming, Western powers sought to retard communist industrial and war making potential. In order to accomplish this goal, they restricted trade with the Soviet Bloc beginning in 1949.

The U.S. Government was the first to implement strategic export controls as early as 1948. However, American trade restrictions proved ineffectual so long as West European countries, the economies of which relied on commerce with Eastern Europe, continued to supply the USSR and its satellites with commodities of either direct or indirect military value. Faced with increased congressional pressure, the Truman administration encouraged West European countries into alignment with its export control policy. In this endeavor the Americans were assisted by British Labour Government. In November 1949, a multilateral strategic export control system was established by the USA and the West European powers.

The three international control lists that were formulated covered fully embargoed strategic commodities, goods under quantitative control, and items under consideration. A control mechanism was formed, comprising of the Consultative Group (CG) that set broader guidelines for trade control policy, and the Coordinating Committee (COCOM), in charge of the technical implementation of the controls. With the establishment of the China Coordinating Committee (CHINCOM) in 1952, Western powers extended their export controls to the People's Republic of China (PRC) and North Korea.³

In view of the Western embargo, the Soviet Union resorted to an autarkic economy, and bound its East-European satellites into economic co-operation within the infrastructure of the Council of Economic Mutual Assistance (CEMA), established in 1949. It was through these close inter-bloc economic relations that the Soviet Government intended to relieve supply shortages caused by Western embargo, and to increase the communist industrial growth.⁴ However, the USSR and its East European satellites were reliant on certain essential Western supplies. Faced with delays to its industrial plan for 1951-55, the Soviet Government was forced to procure advanced technologies, machinery tools and raw materials from the West, however these were either unavailable from domestic and East European sources, or could be produced only at prohibitive costs.⁵ Determined to secure the co-operation of Western manufacturing countries, the Soviet Government bound them to bilateral commercial treaties. These agreements set a value target for the overall trade volume, as well as specifying actual and potential exports and imports and also contained provisions concerning the exchange of trade missions, the arbitration of disputes, methods of shipment, payments, tariff and credit issues.⁶

As both Soviet and British documents indicate, Moscow drew upon the Anglo-Soviet trade agreement in order to influence the British Government to relax export controls independent of U.S. embargo policy. The adoption of such an approach by Moscow proved successful due to Britain's dependence on Soviet supplies of grains and timber and also unrelenting efforts by British manufacturers to increase the volume of exports to the USSR and other East European countries. The flow of commodities between Britain and the Soviet Union was regulated by the provisions of the Anglo-Soviet trade agreement of 1947. The Soviet Union supplied Britain primarily with the coarse grains and timber that were exported under short-term contracts, subject to annual negotiations on up-to-date commodity volumes and prices. In exchange, Soviet commercial organizations were permitted to spend their turnover in sterling on the purchase of British

³ For a broader overview of the events leading to the introduction of U.S. trade control policy, the establishment of COCOM and CHINCOM. See McGlade, in this volume. See: also Funigiello 1988, 27-42; Mastanduno 1993, 68-82; Dobson 1988a, 126-127. On the British Government's role in the creation of the international control mechanism, see in: Jackson 2001b, 270-277.

⁴ On the autarkic Soviet economy and establishment of CEMA in 1949 see: Lipschetz 1988, 91; Parrott 1983; Bykov 1983, 129-130; Kaser 1965, 9-10.

⁵ Gruzinov 1979, 13; Smith 1973, 37. On delays in the USSR's industrial growth see: Hoskings 1992, 296-325.

⁶ Hardt and Tomlinson 1983, 131.

machine tools, capital goods and raw materials, such as rubber and tin.⁷

With the tightening of export controls in 1950, the majority of British supplies to the USSR was either embargoed, due to its direct strategic importance, or restricted under quantitative controls.⁸ Curtailment of shipments holding raw materials and the cancellation of export licenses for pre-embargo Soviet orders for machine tools were greeted with protests from the Soviet Trade Delegation in London.⁹ On their part, Soviet trade officials threatened to withhold timber and grain supplies as long as British exports were restricted. During bilateral negotiations on new timber and coarse grains contracts for 1951-1952, they pressed for guarantees as to the volume of future British supplies of raw materials, machine tools and capital equipment and when the British failed to offer such assurance, the Soviets reserved the right to withhold future timber and grain supplies. On 24 August 1951, N. Cheklin, the Soviet Chief Delegate to an economic conference at Geneva, approached his British counterpart demanding that Soviet orders for machine tools be honored by British firms and assured the British official of his Government's willingness to export timber and grain regularly, provided there were no restrictions placed on Soviet purchases in Britain.¹⁰

Initially, the British Government played down Soviet threats to cut off vital supplies of grain and timber. British trade officials told their Soviet counterparts that their government was willing to accept Soviet demands and include a clause in the new grain and timber agreements for 1951-1952 which would allow Soviet trade organizations to withhold or reduce supplies if they were not able to spend their earnings in sterling on the purchase of raw materials, capital goods and machine tools. By doing so, the British signaled to Moscow that they were not susceptible to any pressure to export embargoed or restricted commodities in exchange to the steady flow of grain and timber supplies.¹¹

Seemingly, Winston Churchill's incoming government was more receptive to Soviet coercion than the departing Labour administration. By the time it returned

⁷ Holtzman 1976, 24; Sutton 1973, 43-45.

⁸ Cain 1994, 514-515.

⁹ Public Record Office, Kew, London (PRO), FO 371 86788 NS1151/182 and 94862 NS1151/23. Two letters from Head of the Soviet Trade Delegation in London, Nikolae Andrienko to the President of Board of Trade, Harold Wilson, 11 December 1950 and 13 March 1951.

¹⁰ PRO, FO 371 94863 NS1151/35 and 42. Letters from the Board of Trade's Commercial Department, Cliff Baylis, to the First Secretary of H.M.'s Embassy in Moscow, John Titchener, 18 April 1951 and June 1951; PRO, FO 371 94863 NS1151/46. Letter no. RT(51)2, from the Board of Trade's Under Secretary for Overseas Trade, R.J.W. Stacy, to Foreign Office. "Draft Contract for Russian Timber, June 1951". 7 June 1951; PRO, FO 371 94863 NS1151/49. Letter from the Board of Trade's Private Secretary to the Secretary for Overseas Trade, Simpson, to Foreign Office, Roderick Barclay, 28 June 1951; PRO, FO 371 94864 NS1151/73. Foreign Office minute, James Turpin, to Permanent Under Secretary of State, William Strang, 24 August 1951; PRO, FO 371 94864 NS1151/83. Telegram no. 810, from Moscow to Foreign Office, 12 September 1951; PRO, FO 371 94323 M3443/50. Letter from Geneva, C.M.P. Brown, to Foreign Office, 24 August 1951.

¹¹ PRO, FO 371 94863 NS1151/49. Letter from the Board of Trade's Private Secretary for Overseas Trade, Simpson, to the Foreign Office, Barclay, 28 June 1951; PRO, FO 371 94864 NS1151/73. Foreign Office Minute, Turpin, 24 August 1951; *Ibid.* Minute by William Strang, 25 August 1951; PRO, FO 371 94864 NS1151/75. Letter from Treasury, Radice, to Foreign Office, Turpin, 24 August 1951.

to office, the Conservative Government confronted further deterioration in Britain's economic and financial situation following the fall of its dollar reserve. Furthermore, Britain's position as a global manufacturer had weakened ensuing tough competition with Japan and West Germany in world markets and American trade barriers.¹² The Conservative Government feared that increased tightening of trade restrictions following the enactment of the Battle Act on 26 October 1951¹³ would jeopardize imports of timber and grain from the Soviet Bloc and that reliance on alternative North American supplies might offset the British balance of payments further, and heighten economic dependence on the USA.¹⁴ Therefore, the British Government decided to maintain trade with the USSR within the limits of existing international export controls. Simultaneously, it attempted to persuade the U.S. administration to pay heed to the needs of West European countries and not to launch all-out economic warfare against the communist bloc.¹⁵ Nevertheless, independent of the views of COCOM, the Americans were determined to enforce the Battle Act. Subsequently, Britain agreed to cooperate with the U.S. administration in the enforcement of this legislation, all the while resisting American pressure to tighten control of rubber and machine tool shipments to the USSR.¹⁶

Alongside its coercive measures, Moscow genuinely sought to increase the volume of Anglo-Soviet trade by means of commercial incentives. As early as spring 1952, the Soviet Government was prepared to offer new commercial opportunities to British industrialists.¹⁷ In April, an international economic conference was convened in Moscow under the sponsorship of the World Peace Council. Private Western businessmen, including British industrialists, were invited to attend the conference, the declared aim of which was to call for an expansion of international trade based on equality. Prior to this gathering, the Soviet Embassy in London attempted to create a local body of opinion that would pressure the British Government to alter its discriminatory trade policy. The Soviet Ambassador himself argued, during a conversation with the Secretary of the

¹² Dobson 1988a, 134-135; Young 1996, 126-127.

¹³ On the American legislation, see in: Funigiello 1988, 64-70; Mastanduno 1993, 66-93.

¹⁴ PRO, FO 371 94845 NS1053/38/G and 39/G. Foreign Office minutes nos. RC/76/51 and RC/77/51, Russia Committee, 14 and 18 September 1951; PRO, FO 371 94324 M3443/65. Letter no. OPA/E/67. Draft brief from the Secretariat of the Ministry of Food's Supply Committee to British Embassy in Washington, 3 October 1951; PRO, FO 371 94325 M3443/72. Letter no. DIV3/731/51, from the Ministry of Materials to Foreign Office, 29 October 1951; PRO, CAB 134/489 M.A.C. (51)191. "Trade with Eastern Europe and Implications of the Battle Act", 29 December 1951.

¹⁵ PRO, CAB 128/24, C.C.(52)1(1), 3 January 1952.

¹⁶ Department of State, *Foreign Relations of the United States (FRUS): 1952-1954* Vol. 1 (Washington, 1979-) pp. 819-822; PRO, PREM 11/284. Memorandum by the Foreign Secretary, 17 January 1952. Annex B:- "Battle Act and East-West Trade: Report by the Leader of the UK Delegation to the Foreign Secretary"; PRO, CAB 128/24, C.C. (52)4, 17 January 1952; PRO, CAB 128/25, C.C.51(52)3, 8 May 1952; PRO, CAB 129/51 C.(52)138. Memorandum by the Foreign Secretary and the President of the Board of Trade, 5 May 1952; PRO, CAB 128/25 C.C.75(52)5, 31 July 1952; PRO, CAB 129/54 C.(52) 266. Memorandum by the Foreign Secretary and the President of the Board of Trade, 28 July 1952.

¹⁷ Dobson 1988a, 156.

British-Soviet Friendship Society (BSFS), that the generally hostile attitude of the present British Government was an obstacle to the expansion of Anglo-Soviet trade relations.¹⁸ Nevertheless, Soviet trade officials were eager to increase bilateral trade, and placed a large number of orders for consumer and near-strategic commodities to British manufacturers participating in the conference.¹⁹

The British Government was divided in its reaction to the Moscow conference. The Board of Trade hoped that the conference would result in a substantial increase in the volume of consumer goods supplied to the Soviet Bloc. The President of the Board of Trade offered the Soviet Trade Delegation in London his assistance in facilitating the purchase of British textiles. In order to encourage hesitant manufacturers to accept Soviet orders for non-strategic commodities, the Board of Trade's Commercial Department contemplated providing major publicity regarding the positive outcome of the Moscow conference.²⁰ In contrast, the Foreign Office advocated against drawing attention to the gathering, hoping to avoid raising high expectations among British manufacturers that an overall expansion of East-West trade was imminent. Mistrustful of the intentions of the conference's organizers, the Foreign Office was skeptical as to whether an expansion of trade with the Soviet Bloc was possible. The Foreign Office's Northern Department, in charge of relations with the USSR, suspected that the conference was a mere propaganda stunt, designed mainly to provoke Western opinion against the existing restrictions upon trade with communist countries and estimated that no expansion of trade with the Soviet Bloc was likely to be made in the foreseeable future. The Americans remained opposed to greater East-West trade, even in non-strategic commodities. The Soviets were more interested in commodities with strategic value and were less desirable to import consumer goods.²¹ The President of the Board endorsed this grim appraisal, announcing at the House of Commons on 16 May 1952, that the chief aim of the Moscow conference was political propaganda, and as a result, saw no reason why local manufacturers be encouraged by H.M.'s Government to accept Soviet orders.²²

¹⁸ Arkhiv Vneshnei Politiki Rossiskoi Federatsii (AVP RF) No. 686/2EO, fond (f.) 069, opis' (op.) 39, papka (pap.) 154, delo (d.) 035-AN, II. 1-3. Iz dnevnika Zarubina, 25 marta 1952g.

¹⁹ PRO, FO 371 100814 NS1018/20. Letter no. 12, from Moscow, Paul Grey, 17 April 1951; Smith 1973, 188-189.

²⁰ PRO, BT 11/4959, CRE 16201. Board of Trade minute, Ian More, 8 May 1952; PRO, BT 11/4957, CRE 13854. Board of Trade minute, Cliff Baylis, 10 April 1952.

²¹ PRO, BT 11/4959 CRE 16201. Copy of Foreign Office minute, Hugh Morgan, to the Board of Trade's Baylis, 14 May 1952.

²² PRO, BT 11/4959 CRE 1602/1952. Copy of Thorneycroft's announcement in the House of Commons on the Moscow Economic Conference, 16 May 1952.

Stalin's Death and the New Leadership's Desire to Extend Trade, 1953

Throughout the remainder of 1952, time was not yet ripe for substantial expansion of Anglo-Soviet trade. With nearing danger of a showdown between the USA and the USSR, following the stalemate in Korea and Stalin's retreat to domestic policies in the fall of 1952, neither the British Government nor the Kremlin had any intention of improving bilateral commerce.²³ However, it was after Stalin's death and succession by a collective leadership in March 1953, that Moscow began to press for an expansion of Anglo-Soviet trade. By this time, the British Government was in the midst of revising its export control policy, without any significant outcome to occur yet.²⁴ This pressure was part of attempts by Stalin's successors to emerge from the economic isolation forced upon their country by the dead dictator, as well as to procure a larger volume of Western machinery, technology, and consumer goods. The campaign for greater East-West trade also served the objectives of the new leadership's peace offensive, offering solid proof to Western public opinion that the intentions of Stalin's heirs were indeed non-hostile.²⁵

New evidence from the Russian archives demonstrates the Soviet Government's genuine efforts to expand trade with Britain, immediately following Stalin's death. Nonetheless, Moscow was reluctant to increase the level of Anglo-Soviet trade prior to the abolishment of British export controls. As early as April 1953, the new Soviet Ambassador to London, Yakov Malik, was instructed that if the British Government were to raise the question of commercial relations, he should reply that the Soviet Government would increase the volume of essential supplies to Britain on condition that the British Government relaxed trade restrictions.²⁶

A Soviet demand for reciprocal trade relations was made during Harold Wilson's visit to Moscow in May 1953. Wilson, the Labour Government's President of the Board of Trade between 1947-1951, and a proponent of increased East-West trade, arrived in the Soviet capital as a representative of British timber companies. Though his visit was private, Wilson was greeted with 'red carpet' treatment by Soviet authorities, welcomed by the Soviet Minister for Foreign Affairs, Vyacheslav Molotov and the Soviet Minister for Foreign Trade, Anastas Mikoyan. According to reports by H.M.'s Ambassador to Moscow, Wilson was told by Mikoyan that the Soviet Government was prepared to substantially increase the volume of timber supplied to Britain and in return demanded that Soviet trading organizations be allowed to purchase British commodities of strategic value.²⁷ The

²³ Stueck 1986, 305-306; Strobe 1974, 276-282, 297, 306-315.

²⁴ On the process of revising British export control policy, see in Young 1996, 129-135; Dobson 1988a, 156-159.

²⁵ Holtzman 1976, 138-139; Allen 1960, pp. 49-50, 62-64; Hardt and Tomlinson 1983, 162-163.

²⁶ AVP RF, f. 06, op. 12, p., 203, pap. 13, d. AN-020, ll. 7-10. Ukazaniia polsu SSSR v Velikobritanii, 8 aprilia 1953g.

²⁷ PRO, FO 371 106579 NS1631/14 and 18. Telegram no. 379 and letter no. 163.12/15/53, from Moscow, H. M.'s Ambassador, Alvary Gascoigne, 22 May 1953.

Soviet account of Wilson's interview with the Soviet Minister for Foreign Affairs reveals that Molotov did his utmost to reassure his guest of his country's trade organizations' ability to successfully cope with extended East-West trade.²⁸

The bilateral dispute over the temporary fisheries agreement of 1930 was an obstacle to any potential expansion of Anglo-Soviet trade relations. On 5 January 1953, Moscow declared its decision to denounce the agreement, the provisions of which granted British fishermen the right to fish up to between three and twelve miles off the USSR's North European coast. The denunciation was set to take effect from July 1953. The grounds for this unilateral action was that British fishing vessels had frequently violated the Soviet three-mile territorial water boundaries. Moscow argued that the agreement was outdated and failed to provide Soviet fishermen with any reciprocal concession.²⁹

Based upon information provided by the British Ministry of Agriculture and Fisheries, a Foreign Office's minute dated 16 January 1953 emphasized that the planned denunciation of the old bilateral agreement on fisheries would have resulted only in a minor reduction in the total revenue of Britain's deep-sea fishing industry. However, in addition to losses that ensued the limitations on fish catches at Barents Sea, drawn by both Norway and Iceland, the loss of fishing rights in Soviet waters would lead to a major crisis in the fishing industry.³⁰

In the light of the Soviet announcement and fear of an ensuing crisis in Britain's fishing industry, the British Cabinet decided to pressure Moscow to withdraw from its intended cancellation of the fisheries treaty or at least enter into negotiations on a new agreement. On 9 March 1953, the British Minister of State for Foreign Affairs, Selwyn Lloyd, informed the Soviet Charge' d'Affairs in London that his government was bound to interrupt the entire existing Anglo-Soviet commercial treaty if Moscow proceeded with its plan to denounce the fisheries agreement.³¹

Reluctant to risk trade with Britain and anxious to save face, the Soviet Government initially decided to procrastinate. In a memorandum dated 21 May, to the Chairman of the Soviet Council of Ministers, Georgi Malenkov, the Ministry for Foreign Affairs recommended that the Soviet Government not succumb to British pressure to extend the temporary fisheries agreement, nor enter into negotiations on a new accord.³² Faced with mounting pressure, the Soviet Government opted to comply with the British demand that the old fisheries agreement be extended. However, no reply was communicated to the British

²⁸ AVP RF, no. 548/2EO, f. 069, op. 40, p. 6, pap. 160, d. An-030, ll. 16-26. Priem posla Velikobritanii Gaskoina i byvshego ministra torgovli Velkobritanii Vil'sona, 21 maia 1953g.

²⁹ AVP RF, no. PR258-M, f. 06, op. 12, p. 218, pap. 14, d. 1/2E-AN, l. 27. Ot Ministerstva Inostrannykh Del SSSR k posol'stvy Velikobritanii, 5 ianvariia 1953g.. See also:- PRO, FO 371 106566NS1351/2. Telegram no. 6, from Moscow, Gascoigne, and a minute by the Northern Department's Hohler, 5 January 1953.

³⁰ PRO, FO 371 106566NS1351/14. Foreign Office Minute, Hohler, 16 January 1953.

³¹ PRO, CAB 128/26, C.C.(15)533, 26 February 1953; Selwyn Lloyd Papers, Churchill College, Cambridge University (SELO)5/8, entry 9 March 1953.

³² AVP RF, no. PR258-M, f. 06, op. 12, p. 218, pap. 14, d. 072-AN, ll. 19-21. V prezidium Soveta Ministrov SSSR, tov-u Malenkovu G.M., 21 maia 1953g..

Ambassador, and as the agreement's deadline approached, the British Government increased pressure.³³ This strategy proved fruitful when on 22 June, the Soviet Council of Ministers decided to extend the treaty for an additional year, concurrently negotiating a new accord with the British Government. Two days later, the British Ambassador to Moscow called on Molotov who informed him of this decision.³⁴

Throughout the summer of 1953, the Soviet Government pressed for a relaxation of British trade controls. As British documents reveal, during conversations with Board of Trade officials, staff members of the Soviet Commercial Delegation in London asserted that an expansion of Anglo-Soviet trade could only take place if the British Government retreated from its discriminatory trade policy. Soviet trade delegates were uninterested in proposals for an expansion of bilateral trade of consumer and non-essential commodities such as wool, textiles, and food products. Instead, they bombarded the Board of Trade with queries about the supply of embargoed strategic goods.³⁵

Moscow was well aware that the British Government was too weak to radically modify its export control policy independently of the USA. Doubts as to whether any British revision of strategic export controls was likely to be substantial were communicated to Moscow by the Soviet Embassy in London. In his account of a discussion with Kenneth Christophas, Assistant Head of the Foreign Office's Mutual Aid Department held on 25 August 1953, the Embassy's First Secretary, Georgi Rodionov, reported to the Ministry for Foreign Affairs that the British official acknowledged that his Government had shelved its plan for a drastic revision of embargo lists in view of American opposition. Christophas expressed his Government's willingness to relax some of the restrictions and supply commodities of minor strategic importance. Four months later, Rodionov reported to Moscow that the British Government remained reluctant to whittle away the controls. In his account of a conversation with Christophas, held on 14 January 1954, the Soviet diplomat emphasized that the British official had been at a loss to speculate about the prospects for an expansion of bilateral trade in the foreseeable future. Following some hesitation, Christophas stressed that export controls should remain in force as long as his Government denied the USSR commodities with strategic value. However, he then observed that "...we do not think ourselves violating the embargo of strategic goods, if we sell you only a small amount of them. Let's proceed with one deal at a time...".³⁶

³³ AVP RF, no. PR258-M, f. 06, op. 12, p. 218, pap. 14, d. 072-AN-270, l. 22. Sovet Ministrov Soiuzu SSSR, 22 maia 1953g.; PRO, FO 371 126567 NS1351/40. Telegram no. 405, from Moscow, Gascoigne, 3 June 1953.

³⁴ AVP RF, no. 407/14, f. 06, op. 12, p. 218, pap. 14, d. 072-AN, ll. 2-3. V prezidium Soveta Ministrov SSSR. Ot Molotova i Bulganina k tov-u Malenkovu, 22 iunia 1953g.; Ibid., no. 20/2E. Ot Molotova k poslu Velikobritanii, 24 iunia 1953g..

³⁵ PRO, FO 371 106554 NS1151/27. Confidential letter, from the Board of Trade's Cliff Baylis to the British Embassy in Moscow, 5 October 1953.

³⁶ AVP RF, no. 7528, f. 069, op. 12a, p. 17, pap. 47, d. AN-035. Iz dnevnika Rodionova. Priem Kristofasa, 25 avgusta 1953g.; AVPRF, no. 261/2EO, f. 069, op. 41, pap. 166, tom 1-yi, ll. 53-5. Iz dnevnika Rodionova. Priem Kristofasa, 14 invaria 1954g.

The Soviet Offer of New Trade Agreement, 1954

The Soviet Government was unwilling to concede, remaining determined to convince the British Government to revise its export control policy substantially. By the end of January 1954, a group of British manufacturers arrived at Moscow as guests of the Soviet Ministry for Foreign Trade. During the visit, Soviet officials expressed readiness to purchase £400 million of goods in Britain over the next three years, and handed over to the British businessmen an extensive shopping list comprised of strategic and consumer goods.³⁷ The business visit resulted in Soviet Government pressure for a new Anglo-Soviet trade agreement. However, during a conversation with Frank Lee and Edgar Cohen of the Board of Trade held on 24 February, Nikolae Andrienko, Head of the Soviet Trade Delegation in London, expressed his Government's reluctance to sign the new purchase contracts for £400 million unless bilateral trade was re-organized in a manner that ensured the steady flow of British supplies to the USSR over the next three years. Andrienko warned that orders might be placed to other manufacturing West European countries in the event of British reluctance to conclude a new trade agreement.³⁸

The British Government had no intention of lifting restrictions concerning commodities holding direct strategic value. Nor was it prepared to contemplate a new Anglo-Soviet trade agreement. By the time Moscow proposed a new bilateral trade treaty, the British Government had finally revised its export controls and conveyed to the Americans its proposal for a short embargo list. Churchill played a decisive role in the process of revising British controls. At his instigation, Whitehall departments completed the protracted review of the long three international embargo lists and drew a single shortened list embracing export commodities with direct strategic value and goods of indirect military importance. Churchill's motives for this action stemmed from his determination to ensure that the way to détente remain open. He was operating under the conviction that increased trade might result in a friendly Western infiltration behind the Iron Curtain. Moreover, he planned to deflect public attention from the potential failure of the Four Power Conference which opened at Berlin on 25 January 1954.³⁹

With its initiative for a reduced embargo list, designed mainly to provide a bargaining position in forthcoming negotiations with the U.S. administration, Churchill's Government had no intention of insisting on a single list, nor antagonizing their American allies and was ready to enter negotiations with the Americans and the French on the future scope of international lists of embargoed goods.⁴⁰ In the meantime, the British Government wished to avoid negotiations

³⁷ PRO, FO 371 111721 NS 1153/17. Memorandum by H.M.'s Embassy to Moscow, Paul Grey. "British Business Visit to Moscow". 11 February 1954; Ibid. Annex I: "Statement made by Kabanov to British Businessmen-4 February 1954". On the Soviet shopping list see: PRO, FO 371 111721 NS1153/3A. Telegram no. 1 CREDA, from Moscow, Grey, to the Board of Trade, 5 February 1954.

³⁸ PRO, BT 11/5108 O.N.(54)25. Note by the Board of Trade's Edgar Cohen to the Cabinet Overseas Negotiations Committee, 25 February 1954.

³⁹ Dobson 1988a, 158; Young 1996, 131-133; Young 1995, 251-253.

⁴⁰ Boyle 1990, 129-131; Young 1996, 132-133.

with Soviet trade officials concerning a new commercial agreement, fearing that this might endanger British initiative for relaxing strategic export controls. Moreover, Foreign Office officials and H.M.'s Ambassador to Moscow, Sir William Hayter, were skeptical as to whether any forthcoming expansion of Anglo-Soviet trade might be of large scale and long duration, as they suspected that the Soviet shopping list had been composed mainly for propaganda purposes.⁴¹

In the aftermath of tripartite negotiations held on 29-30 March in London, during which agreement had been reached regarding an item-by-item review of the existing three international control lists, the Soviet Embassy in London began to realize that the British Government was in no position to force the U.S. administration to radically revise its export controls. The Soviet Embassy also realized that the key to a relaxation of the Western trade embargo rested in Washington rather than London. In his account of a conversation with the Foreign Office's Kenneth Christophas held on 2 April 1954, the Soviet diplomat Georgi Rodionov, reported to Moscow that Christophas had repeatedly reassured him of British support for greater East-West trade. According to Rodionov, Christophas claimed that the London discussions resulted from British pressure for Anglo-American talks on the future range of COCOM lists. Additionally, Christophas acknowledged that during the discussions, the American envoy, Harold Stassen, criticized the fact that British businessmen had traveled to Moscow and indicated a willingness to sell strategic goods, without the consent of other NATO powers. Furthermore, Christophas informed him that American, French and British representatives had decided that the three international lists be reviewed through collective action. He then observed that the forthcoming tripartite revision might not be completed in one motion, and avoided discussing the criteria under which controlled items were to be reviewed.⁴²

Finally, despite significant relaxation of strategic export controls, the British Government's commitment to the new COCOM agreement of August 1954 apparently restricted its freedom of action with regard to trade with the USSR. Under this agreement's terms, the three control lists were cut by a little less than a half and COCOM state members, including Britain, accepted a tightened enforcement of the revised lists.⁴³ As early as September 1954, the Cabinet Overseas Negotiations Committee (ONC) resumed its review of a new Anglo-Soviet commercial agreement. During the ONC meeting, held on 15 September, the Foreign Office and the Board of Trade's officials unanimously recommended that trade negotiations with the Soviet Government not be entered into.⁴⁴ As shown in its final report, the ONC doubted that a new Anglo-Soviet commercial treaty

⁴¹ PRO, CAB 134/1097 O.N.(54)11(1), 10 March 1954; FO 371 111717 NS1151/24. Telegram no. 240, from Moscow, Hayter, 12 March 1954; FO 371 111717 NS1151/2. Letter no. 31(1121/32/54), from Moscow, Hayter, to Eden, 12 March 1954.

⁴² AVP RF, no. 602/2EO, f. 069, op. 41, pap. 41, d. 036-AN, tom II-oi, II. 34-36. Iz dnevnika Rodionova. Priem Kristofasa, 2 apreliia 1954g..

⁴³ Førland 1991b, 238-239; Young 1996, 134-135.

⁴⁴ PRO, BT 11/5108 O.N.(54)37, 15 September 1954. (The original ONC record is still retained by the Cabinet.); Ibid., O.N. (54)125. Note by the Board of Trade. "Trade with Russia", 9 September 1954; PRO, CAB 134/1100 O.N. (54)116. Note by the Foreign Office, 3 September 1954.

would make any considerable contribution to the development of bilateral trade, suspecting that during forthcoming trade negotiations, the Soviet Government might press for additional loosening of British export controls, or at least demand that commodities, currently decontrolled, remain free in the future. The ONC was also fearful that any new Anglo-Soviet trade agreement would be greeted with criticism by congressional and domestic opinion in the USA. Subsequently, it advised strongly against offending the Americans, whose cooperation in the settlement of the dispute over West European armament, following the collapse of the European Defence Community program in August 1954, was of paramount importance.⁴⁵

Conclusion

In conclusion, Soviet and British records indicate that throughout 1951-1954, Moscow attempted to influence the British Government to radically liberalize its export control policy, without U.S. consent. Fully aware that the British economy was dependent on trade with Eastern Europe, the Stalinist regime employed coercive measures such as threats to cut off vital supplies of grain and timber. Simultaneously, it was prepared to increase the volume of bilateral trade, offering incentives in the form of new commercial opportunities to British businessmen, who were experiencing intense competition in overseas markets. By doing so, the Soviets aspired to disrupt the American-led trade embargo with the communist bloc and ensure the steady flow of scarce technologies, raw materials and machine tools from Britain to the USSR. This does not necessarily indicate that the Soviets were insincere in their pursuit of greater East-West trade, especially when one considers that it appears that Soviet policy-makers and diplomats shared the opinion that both goals complemented each other, and that the disruption of the U.S. embargo policy might pave the way for a substantial increase in the volume of trade with West European countries, including Britain.

Succeeding Stalin's death, the Soviet campaign for extended trade intensified, corresponding with the new leadership's attempts to relax international tensions and cease the economic isolation forced by the dead leader. Genuinely keen to improve commercial relations with Britain, Moscow was ready to settle the current fisheries dispute that served as a potential stumbling block to greater Anglo-Soviet trade. Throughout 1953, Soviet pressure for a radical liberalization of British export controls and substantial increase in the volume of Anglo-Soviet trade followed. This resulted in the February 1954 Soviet offer for a new bilateral agreement. Nonetheless, the Churchill Government had no intention of abolishing restrictions on trade of military hardware and strategic goods, rather appeared more interested in maintaining a close working relationship with the U.S. administration than in pursuing a liberal trade policy, independent from the American embargo of

⁴⁵ PRO, CAB 134/1100 O.N. (54)131(Final). "Trade with the USSR". 7 October 1954. On the collapse of the European Defence Community and further dispute among the West European nations on armament plans, see in Dockrill 1991, 142-146; Young 1988, 95-99.

exports to the Soviet Bloc. After accepting a tightened enforcement of the revised international control lists in August 1954, the British Government was in no position to negotiate with the Kremlin a new commercial treaty. Moreover, British policy-makers and trade officials were skeptical as to whether Moscow had any desire to expand long term bilateral trade, suspecting that the Soviet Government was interested merely in a short-term endeavor to acquire the Western commodities and technological knowledge required for the expansion of Soviet industrial potential. They also feared that Moscow would attempt to pressure the British Government to relax its export control policy further during the proposed trade negotiations.

Lucia Coppolaro

East-West Trade, the General Agreement on Tariffs and Trade (GATT), and the Cold War: Poland's Accession to GATT, 1957-1967

Introduction

In 1959, the socialist government of Poland formally asked to adhere to the General Agreement on Tariffs and Trade (GATT). The request was surely a surprising one: Poland had a centrally planned economy built on controls and discrimination, yet it wanted to join the GATT, the exclusive club of rich and capitalist countries, committing itself to freer trade and non-discrimination. Grounded in a reading of American, British, French, and European Community archival sources, this article seeks to illustrate how Poland, despite having a preferential trade regime with the other Eastern European communist countries – the COMECON – and an economic system incompatible with the rules of GATT, managed to join during the Kennedy Round of GATT negotiations (1964-1967).

Illustrating Poland's accession, this article focuses on the role of GATT in the Cold War, a topic that has been only seldom investigated until now and for the first time archival sources are used. The Poland's case is significant because it was the first socialist country to approach GATT, and it was in this context that the issues of how to introduce multilateralism in East-West trade and how to fit a non-market country into GATT were raised. This article suggests that rather than on trade considerations, Polish request was accepted by the Western countries for security and strategic reasons while trade issues were approached only afterwards. In spite of the fact that Poland became a GATT contracting party, bilateralism was maintained in the trade relations between this socialist country and the other contracting parties, with the result that the multilateralism in trade relations came to nothing.

Poland's Accession to the GATT

Despite U.S. intention to shape the GATT as a global actor with universal membership, from the outset it was essentially a Western institution. Firstly, it was shaped on the basis of rules and principles assuming free market-oriented economies: non-discrimination, most favored nation rule, reduction of tariffs, and reciprocity reflected this orientation. Secondly, from the beginning, GATT was dominated by the Western industrial economies, which in 1948 accounted for 63.6 per cent of world trade. But it was not only market orientation and the weight of the Western countries that gave GATT a Western outlook. The antagonism of the Cold War strengthened the view that GATT was essentially a Western institution attached to the Atlantic alliance.¹

In 1947, the Soviet Union refused to participate in the GATT on the grounds that it was simply a tool in the hands of the Americans to implement their economic expansion and dominance of the world economy. Soviet rejection crystallized the growing tension between USSR and the Western allies, and can be explained by Moscow's apprehension that participation in a multilateral trading system dominated by the capitalistic countries might threaten its centrally planned economy and its aspiration to implement a system of bilateral trading arrangements with countries in its sphere of influence.² Thus, when the USSR refused to become a member of the GATT, the Eastern European countries were not allowed to join either. The only exception was Czechoslovakia, which had become an original contracting party before the communist takeover.³ After the death of Stalin, and with the improvement of East-West relations, the attitude of Eastern Europe and the USSR towards multilateralism and international trade organizations changed. In July 1955, the USSR even suggested the ratification of the Havana Charter and the ITO. In Moscow this switch was validated by the new situation of international trade relations, which required non-discrimination and multilateralism.⁴

In Eastern Europe this conversion to multilateralism had deeper and different justifications, and, unlike the USSR, it concerned the GATT. From a political point of view, the process of de-Stalinization led to a period of acceptance of diversity in this area, and this change towards multilateralism and GATT should be viewed in the broader context of Eastern European countries' effort to become more independent from Moscow: It was thought that a rapprochement with the West could help achieve this goal. From a commercial point of view, Eastern European countries needed to trade with Western Europe as the "socialist division of labor" did not correspond to their economic interests. East European interests in the GATT were motivated by hope of developing trade relations with the West: Trade with Western Europe

¹ Wilczynski 1969, 45 and Mayall 1990, 22.

² Kostecki 1979, 3.

³ Kostecki 1979, 3 and Kock 1969, 190-191.

⁴ Naray 2001, 2, Kostecki 1979, 5-8 and Kock 1969, 192-198.

would open if Eastern Europe could also enjoy the right of non-discrimination and if trade relations were based on the stable and regulated framework of the GATT. Geneva could help diminish Western discrimination, above all concerning quantitative restrictions (QRs) and loosen the embargo and control of strategic goods exports to the Eastern countries.⁵ All these considerations became more important and urgent with the creation of the European Economic Community (EEC) in 1957, perceived as a tool to discriminate against Eastern Europe, above all in the agricultural sector. In this sense GATT, proclaiming multilateralism and non-discrimination, was considered the only available institution to try to diminish discrimination arising from the EEC.⁶

Influenced by its security considerations, the West responded to the Eastern European's interest in the GATT by abandoning a view of the Soviet sphere as a rigid communist bloc and undertook to apply the *policy of differentiation* to trade relations. This policy aimed at developing diversity in Eastern Europe in order to reduce Soviet control and influence over this area. Instead of considering the Eastern European countries as communist regimes with which no relations should be pursued, the West focused on relations between the Eastern European countries and the USSR. In this way, preferential treatment could be granted to those countries that tried to pursue foreign and domestic policies independent from Moscow.⁷ The policy of differentiation spread to the international trading system. The General Agreement too could play a part in encouraging diversity: Some form of association, or even membership, had to be granted to those countries in Eastern Europe that were showing willingness to escape the rigid grip of the USSR. The West stopped looking at the East as compact bloc: differences existed and the West had to adjust its policy accordingly. These strategic considerations shaped Western attitudes towards socialist countries' participation in the GATT, and paved the way for some socialist countries' membership.⁸

Considering its central geographical position in Europe and its trade patterns before World War II, Poland seemed predestined to move towards the West, looking for the possibility of broadening trade relations. The first Polish approach to GATT dates to the autumn of 1957. From the political point of view, no time could have been more positive for such a move. Gomulka's return to power in October 1956 had created expectations of a more liberal Poland and his leadership was welcomed in the West. This new political climate set the context for Poland's initial approach to the GATT, which was formulated as part of a broader attempt to expand ties with the West, particularly in the economic field, so as to reduce the Soviet leverage. Moreover, Warsaw wanted to improve its export opportunities in the West, and in

⁵ Naray 2001, 12, Kostecki 1979, 5. For the embargo issue, see: Funigiello 1988 and Jackson 2001.

⁶ Kostecki, 1979, 12-13.

⁷ Haus 1992, 15 and 25.

⁸ Naray 2001, 12 and Kostecki 1979, 14-16

particular in Western Europe, and GATT could help achieve this goal.⁹ Poland's particular concern related to the QRs of the Western European countries, the existence of which counteracted the trade advantages that the Eastern European countries were granted with the concession of MFN treatment for tariffs, with the practical effect of closing, or at least diminishing, market access. As quota restrictions were prohibited under the General Agreement, by becoming GATT member Poland hoped to see such restrictions removed.

In October 1957 Poland asked to become an observer in GATT and, on the same occasion, it informally asked for full membership. Gomulka's request for observer status was more than welcomed by the West, which, in the framework of the policy of differentiation, aimed at encouraging the political changes that were taking place in Poland.¹⁰ In the same month Warsaw obtained observer status. A different treatment was reserved for the second request. Membership would have entitled Poland to rights and obligations that the Western countries were not willing to recognize. Moreover, Poland's attempt raised the problem of how to fit a socialist country into the GATT multilateral system, and how to devise a suitable entrance fee. The contracting parties had no intention of dealing with these issues at that time and they concluded that, in the light of the policy of differentiation, observer status was sufficient. Arguing that GATT rules could not be effectively applied to countries with a foreign trade monopoly, they gave no answer to the membership request. Yet, the Western countries were aware that, bearing in mind political considerations, in the long run a more active participation had to be granted.¹¹

In 1959, Poland again sought for membership. Finciszek Modrzewski, Polish Deputy Minister for external trade and one of the initiators of the *rapprochement* with GATT, formally applied for membership under article XXXIII.¹² Modrzewski made it clear Poland was not able to pay for entrance fee with the exchange of tariff concessions as capitalist countries. To the extent that GATT was like a club, contracting parties had to pay a fee, through granting tariff concessions to other contracting parties in a multilateral, MFN based system, in order to join. This fee was also a means to pay back the tariff concessions and other advantages related to GATT membership. As Poland lacked meaningful customs tariffs, it was not in a position, as required by the principle of reciprocity, to pay the GATT entrance fee in the traditional form. Only the tariff commitments of those countries whose tariffs were recognized by other contracting parties as effective instruments of trade control could be accepted.¹³ The proposal for membership had to be implemented on different basis that would assure mutual advantage to Poland and to the contracting

⁹ Haus 1992, 25.

¹⁰ Kostecki 1979, 27 and Haus 1992, 25.

¹¹ Archives of the EEC Council of Ministers, BXL, CM2 (hereinafter only CM2) 1959/1037 25 April 1958: Relations entre la Pologne et les parties contractantes, CM2 1962/788 Annex I attached to Document de Travail T/577/62 (COMER) 25 September 1962.

¹² CM2 1959/1037. Note Introductive C726/59 (31 March 1959).

¹³ Naray 2001, 4.

parties. Modrzewski suggested that, in exchange for concessions of all the rights of a contracting party, his country could assume an obligation to import global quantities of some products of particular interest to the contracting parties from among traditional Polish imports.¹⁴

Even if Polish *rapprochement* was welcomed with sympathy for political reasons by the West, from a trade point of view, however, the reaction was less encouraging. The Western countries assumed that it was inappropriate to consider Poland's request, since GATT rules could not have been applied to economic and trading systems such as the Polish one. The import commitments were judged to be of little interest and not adequate to pay for the advantages that Poland would acquire by becoming a member. The example of Warsaw would be surely followed by other socialist nations, therefore it was important to carefully study how to allow a socialist country to join the GATT. But, in 1959 GATT members were occupied with other issues – the planned trade negotiations of the Dillon Round and the way to integrate the EEC into the multilateral system – and they did not intend to put the Polish question on their agenda. On these grounds, it was agreed that Poland could not become a full member.¹⁵

However, as it was important not to give the impression to other countries that the GATT was an exclusive club of rich nations, and bearing in mind political considerations, the contracting parties concluded that Poland would be granted associate status. Such status would emphasize the desire to develop trade relations on the basis of mutual advantages, but without any precise commitment.¹⁶ A Declaration on Relations between GATT contracting parties and Poland was approved in November 1959. It established Poland's association with GATT and gave it the right to attend, as observer, the work of the Council. The Declaration provided for annual consultations and made it obligatory for Poland to make public important information concerning its law, regulations, administrative ruling and statistics. Apart from this, Poland did not enjoy a vote and GATT members did not recognize any rights formally.¹⁷

When President Kennedy in 1962 launched the setting up of a new trade conference, that from the outset promised to have an outstanding importance, Warsaw quickly understood that the moment had come to again apply for membership and to seek to attend the negotiations as a full member. If Poland did not participate, its presence in GATT would become pointless and would be reduced to a purely formal arrangement. In addition to the trade considerations

¹⁴ CM2 1959/1037 25 April 1958: Relations entre la Pologne et les parties contractantes, Kostecki 1979, 27 and Patterson 1986.

¹⁵ CM2 1959/1037, Note d'information avec des "speaking notes" de la délégation du Royaume-Uni au GATT concernant l'admission éventuelle de la Pologne, 20 April 1959, CM2 1959/1126 Note d'information R7661/59, 15 September 1959.

¹⁶ CM2 1959/1037, Note d'information avec des "speaking notes" de la délégation du Royaume-Uni au GATT concernant l'admission éventuelle de la Pologne, 20 April 1959, CM2 1959/1126 Note d'information R7661/59, 15 September 1959, CM2 1959/1037. Communauté Economique européenne, Note Introductive C726/59, 31 March 1959.

¹⁷ For the Declaration see GATT document L/1037/Rev. 1.

that had led Poland to ask for membership in 1959, increasing relations with Western Europe and overcoming Western European discrimination against its exports, in attending the Kennedy Round Poland had an additional goal. Like other GATT members, it feared the discriminatory effects arising from the creation of the European Economic Community. As, for the first time, a GATT Round would negotiate also in the agricultural sector, and as Polish agricultural exports to the EEC represented a significant share of its foreign trade, Warsaw deemed that significant trade advantages could be obtained only by becoming a contracting party and effectively attending the Round.¹⁸

The Kennedy Round began in Geneva on 4 May 1964 and ended on 15 May 1967. It was the first major post-war negotiation in which the EEC and the USA confronted each other as bargaining partners of equal strength and found themselves in disagreement on many major trade issues concerning, above all, the position of the EEC in world trade and agriculture. The issue of agriculture played a prominent role during all the negotiations. European protectionism in agriculture, as presented in the general lines of the Common Agricultural Policy (CAP), was not reassuring for Washington. The U.S. hoped that a new Round would result in substantial cuts in the protection accorded to temperate agriculture and tropical products. As the EEC resisted American goals in agriculture, the Kennedy Round was finally resolved only when, in 1967, Washington gave up this goal. To the list of disagreements was added also the Polish question, therefore, to fully appreciate Poland's negotiations with the contracting parties, the confrontation between the U.S. and the EEC should be kept in mind.

Warsaw's interest in the Kennedy Round was welcomed by the GATT members. Western countries knew that they could not continue to refuse a more active participation, without putting at risk their strategy of differentiation.¹⁹ In particular, Poland's application received the unambiguous support of Washington. President Kennedy believed in the necessity of seeking to develop as broad a range of contacts as possible between the Soviet Bloc nations and the West, to encourage greater independence of action on the part of Eastern European countries, and to increase American influence in that area. A policy of selective trade relations – considered an important channel of communication – could contribute to the attainment of this aim. Poland was also backed by Director-General Wyndham White, who was trying to enlarge GATT membership towards universalism and actively supported the Polish's participation.²⁰

¹⁸ Casadio 1973, 33 and CM2 1964 930 Aide-Memoire T/142/64, 24 February 1964 and Archives of the EEC Commission, BAC (hereinafter BAC) 2 122/1991 Participation de la Pologne aux négociations Kennedy, 30 July 1964.

¹⁹ CM2 1964 930 Note introductive sur la participation de la Pologne aux négociations commerciales multilatérales dans les cadre du GATT, S/275/64 17 April 1964.

²⁰ FRUS, IX Section 15, 308 Memorandum from the Acting Assistant Secretary of State for Economic Affairs Trezise to Secretary of State Rusk, 20 April 1962, Ibidem 304 Summary Minutes of Meeting of the Interdepartmental Committee of Under Secretaries on Foreign Economic Policy, and U.S. Senate, East-West Trade, Hearings before the Committee on Foreign Relations, Part I, GPO, Washington 1964, p. 4.

At the May 1963 GATT Ministerial meeting the Polish delegation declared its interest in attending the negotiations and requested that its associate status be upgraded to full GATT membership in the framework of the Round itself.²¹ The contracting parties agreed to set up a *Working Group for the participation of Poland in the Kennedy Round* with the main task of finding an adequate method to allow this country to attend by giving significant concessions equivalent to the GATT members' tariff reductions.²²

Considering that the Kennedy Round had to be formally launched at the GATT Ministerial meeting of May 1964, on 27 April 1964 the head of Polish delegation, Laczkowski, tabled the requests and outlined the offers of his country in order to become a contracting party and to attend the Kennedy Round.²³ Warsaw proposed a commitment to increase its imports from contracting parties as an appropriate entrance fee. The gains derived from the increase of Polish exports, to be obtained through lowering of tariffs and other obstacles to Polish goods, would be used to extend, to an agreed level, imports from the GATT area. The total value of global quantities of imports would depend on the increase of Polish exports. Laczkowski offered to include certain products of particular interest to the Western countries in the import plan of his country. Next, Poland declared itself ready to undertake annual consultations with the GATT members regarding its commercial policy, the result of the negotiations and the mutual concessions.²⁴ In exchange for these offers, Warsaw asked for concession of the MFN rule for all tariffs; elimination of the discriminatory QRs in accordance with GATT rules; contractual rights to tariff reductions where Poland had principal supplying interests; treatment compatible with the non-discrimination rule regarding non-tariff barriers; the maintenance of current level of agricultural exports to GATT, and notably to the EEC countries, and the linear tariff reductions negotiated during the Kennedy Round.²⁵ The offer did not depart from the working of the centrally planned economy system. To justify its offer, Warsaw adduced that if, in a market economy, tariff reductions were designed to facilitate international access to national markets, in a planned economy the same result could be achieved by establishing the growth rate of imports in advance. In substance, Poland suggested that the principles of a centrally planned economy to be accepted into the General Agreement as, from its point of view, the differences of the two economic systems did not represent an insuperable obstacle.²⁶ In this way, Poland's participation in GATT became a special case: A target-protected and

²¹ CM2 1964/930 Aide-Memoire T/142/64, 24 February 1964.

²² BAC 1 122/1991 Rapport 3 de la négociations de la Commission pour les négociations GATT, 25 November 1963, BAC 17 Note de la Direction Générale des Relations Extérieures, 21 October 1963 and Laczkowski 1969, 85.

²³ GATT Document TN.64/NTB/15 dated 27 April 1964.

²⁴ CM2 1964 930 Aide-Memoire T/185/64, 23 March 1964

²⁵ Laczkowski 1969, 86 and BAC 2 122/1991 Participation de la Pologne aux négociations Kennedy, 30 July 1964.

²⁶ Laczkowski 1969, 90.

state-trading system asked to become a full member, not under GATT rules, but on a completely new basis.

The GATT Ministerial Meeting of May 1964 welcomed the Polish desire to become part of the GATT and adopted a resolution expressing the wish that a *practical* solution could be arranged to allow Poland to attend the Round.²⁷ It is worth noting that in GATT's informal language a *practical solution* meant that the GATT rules were not able to deal with the subject and meant a departure from the rules of the General Agreement to settle problems, as political considerations required. This practical solution had to find a way to consent to a state-trading country paying the entrance fee and to determine a basis for reciprocal trade advantages between it and the contracting parties in a negotiation where tariff reductions were meaningless for a non-market based economy.

But, after having agreed, for political reasons, to welcome Poland's desire to find a new basis for its relations with the contracting parties, after having agreed that a practical solution had to be formulated, Western countries divided into two fronts on the precise trade terms and concessions that Poland should be granted. On the one side were the Western European countries, and on the other the rest of the Western countries. This split concerned above all the U.S. and the EEC, and caused a rift in the Atlantic alliance. This split was caused by the fact that their approaches differed on a basic point: Western European policy was also influenced by trade interests, while the U.S. mainly responded to political considerations.

The U.S., supported by Canada and Australia, were favorable towards the possibility of changing the bilateral relation system applied to Poland into a multilateral system and fully supported one of the most problematic Polish requests, to abolish QRs.²⁸ In considering the reaction of the U.S., it is worth recalling that Washington had no economic interests at stake, had not implemented a system of bilateral trade agreements with Poland and, thanks to its internal legislation, it could easily revoke any concession. Therefore, it was easy to speak in favor of multilateralism. But in supporting Poland, Washington also kept in mind other factors: taking into account the primary importance of agriculture in the composition of Polish exports and the request to keep the same level of agricultural outlets in GATT markets, Washington was more than glad to introduce into GATT another country hostile to the Common Agricultural Policy of the EEC. An ally like Poland, for which on political grounds some concessions had to be made, even if a socialist ally, could be usefully added to the anti-EEC front.

The reaction of Western Europe, in particular that of the United Kingdom and of the Six countries of the EEC, was totally different. They too supported the political process of Polish rapprochement to GATT and shared the political considerations of supporting diversity in the East, but they did not want to do so at their own expense. They did not share the American approach of

²⁷ GATT Document TN.64/27 dated 11 May 1964.

²⁸ Haus 1992, 30.

supporting the introduction of multilateral trade with Poland, as they were not persuaded that its economic system was not an insuperable obstacle.²⁹ The passage from a bilateral to a multilateral system could cause them trade disadvantages: the concession of the MFN rule and the elimination of QRs on Polish exports would remove the only significant trade instruments that the Western countries had to obtain reciprocity. Western European countries continued to attach importance to reciprocity and pressed to get an agreement that would allow them to continue to apply bilateral and discriminatory practices. Western European countries' support for the maintenance of QRs was also due to the fact that it was not clear how the global commitment to import could assure each of the contracting parties a share of the Polish market.³⁰ However, the refusal of the EEC and of the United Kingdom to give up QRs was not totally justified under the issue of effective reciprocity. QRs served as a means of national control in relations with the East in general and were used as a bargaining chip in bilateral negotiations and as a tool to pursue security goals in the East.³¹

As for the Six of the EEC in particular, they feared that, they, who had economic interests at stake, would be obliged to make concessions, while other countries that traded little with Poland would be free to make the *beau geste* of supporting multilateralism.³² The point was not only how to fit a centrally planned economy into the GATT multilateral system, but also how to do this while defending trade interests. A solution had to be worked out to avoid any modification in the structure and volume of trade exchanges and to lead to a merely formal Polish participation in the GATT and in the Kennedy round.³³ The EEC posed no obstacle to the concession of MFN treatment and of tariff reductions in the industrial sector agreed in the Kennedy Round as the products covered by such reductions had only a secondary importance in the EEC-Polish trade, and concerned above all the industrial sector. The most significant products for which Poland was first or second supplier to the Common Market were essentially agricultural products, and it was exactly this sector that worried the EEC. The Polish request regarding agriculture, which touched the heart of the mechanism of the CAP, was simply unacceptable. If Poland was to be granted maintenance of the current volume of agricultural exports, then the EEC would be obliged to do the same with the other country that had launched the Kennedy Round with the same goal of preserving its level of agricultural exports to the EEC, the US. For this reason the Polish requests in agriculture were not simply nonnegotiable, but were even improper.

²⁹ PRO FO 371/178093 Note of Talk with French Officials at the Quai Branly, 15 September 1964 and CM2 1965 TF 590 Rapport sur les question de politique commerciale commune de la Communauté à l'égard des pays à commerce d'Etats 24 February 1965.

³⁰ CM2 1964 930 Annex 1 Participation de la Pologne aux négociations du GATT.

³¹ Haus 1992, 30-32.

³² CM2 1964 930 Note introductive sur la participation de la Pologne aux négociations commerciales multilatérales dans les cadre du GATT, S/275/64 17 April 1964.

³³ CM2 1964 930 Note d'information S/480/64 26 Juin 1964.

The EEC had no intention to negotiate such mechanisms with the U.S. and even less so with Poland.³⁴

For the United Kingdom and the EEC, the Polish's presence in the General Agreement was made conditional to the maintenance of QRs. Poland had to be granted an ad hoc treatment, where the concessions made by the EEC and UK would be equivalent to those made by Poland. An annual consultation would have to take place to assess not only the volume of the imports coming from the contracting parties overall, but also the share of each contracting party. In case of imbalance between Poland and one GATT member, the latter would be entitled to re-establish the equilibrium. The solution envisaged by Western Europe was merely a transposition into the GATT framework of the bilateral agreements that had been established in East-West trade outside GATT. All the political considerations were not to enough justify trade concessions.³⁵

These different approaches regarding Polish application generated a transatlantic split that was related to key issues negotiated in the Kennedy Round, mainly agriculture, but also to other broader issues, such as the relation between non-discrimination and reciprocity, and multilateralism and bilateralism that had been discussed since 1946. For Washington, it was easy to support non-discrimination and the multilateralization of other countries' trade as it had only insignificant trade interests involved. As has been illustrated, one of the aims of Poland in joining GATT was to win better exporting conditions to Western Europe, not to the United States. Therefore, Western European countries, with more relevant trade interests in the balance, championed reciprocity and bilateralism.³⁶ The split emerged within the Atlantic alliance over trade policy issues dragged throughout the accession negotiations, and well beyond. The Polish request got trapped in this transatlantic rift, characterized by a clear pattern of alignment: the U.S., backed by Canada and Australia, against the European Community and the United Kingdom. The result was astonishing: The U.S. supported the socialist country against their Western European allies.³⁷

On 1 April 1965, Poland presented a document that was to be the foundation of the final bargain. Taking a step from the proposal made in 1964, the Polish offer consisted in an engagement to increase within five years the level of its imports from the contracting parties by 40 per cent, with the inclusion of determined categories of products for which the level of imports could be fixed at a higher level. Poland was ready to establish a procedure of consultation with the GATT concerning its external trade. In exchange, it asked

³⁴ Ibidem, CM2 1964 930 Aide-Memoire T/185/64, 23 March 1964 and CM2 1964 930 Comité Spécial 111 (S/813/64, CoS 131) 27 Novembre 1964, 3 December 1964

³⁵ Public Record Office (hereinafter PRO) FO 371/178093 Note of Talk with French Officials at the Quai Branly, 15 September 1964 and BAC 122/1991 Rapport 19 de la délégation de la Commission pour le négociations du GATT présenté par Rey et Marjolin, 10 July 1964; Ministère des Affaires Etrangères Français (MAEF) Coopération Economique et Financier GATT 932. Entretiens de M. Wahl avec le Dr. Reinhardt et le Dr. Sachs, 25 July 1964.

³⁶ Haus 1992, 5-8.

³⁷ Haus 1992, 51.

for the application of the MFN rule and the total removal of discriminatory QRs. Again, Warsaw asked to maintain its current level of agricultural exports to GATT members and in particular to the market where it had its major interest, the EEC.³⁸

To fully understand the relevance of Polish demands it is necessary to recall that agriculture had an utmost importance for Warsaw. Firstly, Poland could import from the West only if it was able to export to this area. As in the past ten years, Polish agricultural exports to Western Europe represented between 40 and 45 per cent of total Polish trade with the GATT members; in order to import, Poland needed to maintain its level of agricultural exports in the sectors of main interest, namely meat, eggs and dairy products. Secondly, among the Eastern countries Poland was the most concerned by the CAP, which would affect 31 per cent of its sales to the EEC. Warsaw was interested in exporting agricultural products to West Germany, and the implementation of the CAP could preclude this goal. Polish request to maintain unchanged the level of its agricultural exports, however, did not have a peculiar aspect. U.S., Canada, and Australia too wanted to see the CAP dismantled and wanted to maintain their level of exports to the Common Market. Thus, the Polish request was linked to the broader confrontation going on during the Kennedy Round between the U.S. and the EEC, and would follow that pattern. As to the QRs, these concerned the exports of coal, which had been drastically reduced since 1958. Lacsowsky pointed out that Poland wished for freer access to the EEC coal market, and if the EEC was planning to keep the quota for coal, then to increase exports by 40 per cent. Chemistry, wood manufactures, and non-ferrous metallic semi-factures were the other sectors of interest for which Lacsowsky asked to increase EEC imports.³⁹

The pace of negotiations with Poland, like all of the Kennedy Round, was dictated by the internal negotiations of the European Community. When, in June 1965, the EEC institutional crisis of the *Empty Chair* broke down, the active participation of the Six in the Geneva talks was suspended causing the deadlock of the entire Round, resumed only after the end of the crisis in January 1966. When the negotiations with Poland also resumed in November 1966, the chief stumbling blocks were the same: QRs and agriculture. Besides, not only did the GATT members remain divided, but the transatlantic conflict even escalated. The EEC and UK continued supporting the position that it was absolutely necessary to keep the QRs.⁴⁰ On the other side of the Atlantic, Poland's membership on a multilateral basis was taken for granted and was held that it would be possible to convince the EEC to draw up terms of agreement to

³⁸ BAC 3 122/1991 Note à l'attention des membres du Comité 111, 11 June 1965 and Lacsowski, 1969, 90-91.

³⁹ BAC 19 Délégation de la Commission pour le négociations commerciales au GATT, Pologne/CR/4, compte-rendu de la 2ème réunion avec la délégation de la Pologne du 9 Novembre 1966, 16 November 1966 and BAC 20 Délégation de la Commission pour le négociations commerciales au GATT, Pologne/CR/5 compte-rendu de la réunion du 16 novembre 1966, 5 December 1966.

⁴⁰ Ibidem.

support non-discrimination and to develop multilateralism, eliminating bilateralism and discriminatory trade practices.

It was only in December 1966 that the Western countries finally agreed on a basic point. In an unofficial meeting in 2 December, while the head of the European Commission's delegation, Teodorus Hijzen, repeated the EEC position, the head of the American delegation, W. Michael Blumenthal, considering the intransigent position of Brussels, abandoned the request to eliminate QRs. This meant that Washington finally stopped supporting Poland's goal of structuring trade on a multilateral basis. Canada and Australia and, obviously, Poland followed suit.

As for agriculture, the U.S. were at a crossroads in their bargaining with the EEC: Either they decided to continue to ask for a meaningful negotiation in this sector, risking to break up the entire Kennedy Round because of the drastic refusal of Brussels to discuss serious concessions; or they had to make up their mind to negotiate only in the industrial sector in order to successfully conclude the Round. At the end of April 1967, they opted for the second choice, with the result that the Kennedy Round had no meaningful negotiations in agriculture. After this decision, it followed that Poland's request to maintain its agricultural outlet to the EEC had to be abandoned.

Thanks to the agreement reached within the Atlantic alliance on the QRs, on 15 December 1966 Lacsowsky formally applied for Poland's full membership under Article XXXIII. The contracting parties agreed to set up a Working Group on Poland's accession with the task of examining the request and presenting to the GATT Council recommendations to be eventually included in the final protocol.⁴¹ However, not all the obstacles were yet removed. After having agreed to maintain the QRs, Poland, supported by Washington, asked to formulate a deadline for their elimination. Whereas, neither the EEC nor the United Kingdom had any intention to insert a deadline, this last request became a "key U.S. objective", as such intention was more pronounced in Washington than in Warsaw.⁴² The conflict between the Western European countries and Poland and the U.S. became so strong that, at the end of February, formal meetings were given up and negotiators were obliged to resort to informal discussions. It was only on 22 June 1967, one month after the formal conclusion of the Round and just one week before the signing of the Final Act, that Poland gave up its request and decided to "take what it could get" from the agreement with the EEC.⁴³

The conditions for membership were laid down in the *Protocol for Poland's accession*, approved by the GATT Council on 26 June 1967 and signed by the Polish representative on 18 September 1967. Under this instrument, Warsaw undertook the obligation in the same way as all other acceding countries to apply the provisions of the General Agreement with the usual reservation for

⁴¹ BAC 9 122/1991 Rapport 95 de la délégation de la Commission pour les négociations, 17 January 1967.

⁴² Haus 1992, 31 and 34, BAC 13 122/1991, Pologne p. 72 and PRO BT 241/849 UK Mission in Geneva, Telegram 312 to Foreign Office, April 1967.

⁴³ Haus 1992, 34.

existing legislation.⁴⁴ As entrance fee, Poland committed to increase by no less than 7 per cent per annum the total value of its imports from the territories of the Contracting parties. This commitment could be renegotiated on January 1, 1971, and thereafter on the dates which were stipulated in the General Agreement for re-negotiations schedules. The most original element of the Protocol was the agreement between Poland and the contracting parties to annually review the evolution of their mutual trading relations. Thanks to the annual consultation, it would be possible to verify whether the Eastern European country had respected its obligation to increase the volume of imports by 7 per cent a year, to study geographical and commodity distribution of its exports and imports, and to discuss the way in which Poland was implementing the rules of GATT and, in particular the MFN rule. Moreover, Warsaw committed to giving extensive information on its economic activities and commercial policy.

The Protocol stated that the GATT contracting parties that applied to Polish exports prohibitions or QRs inconsistent with article XIII, could continue to apply them, but these restrictions could not be increased and should be progressively relaxed so to eliminate all inconsistencies with Article XIII. However, the final date for complete elimination was not specified. The vagueness of this commitment from the contracting parties involved a risk that the fixing of the final date could drag on for years, reducing the value of the membership of Poland, for which, as has been shown, the elimination of the QRs was one of the principal goals.

The Protocol also provided safeguard clauses to defend bilateral interests, in the event of market disruption caused by Polish exports, and bilateral consultations, with the possibility of suspension of concessions if consultations did not lead to any agreement. Under article XIX restrictions were to be applied regardless of the origin of the products. By contrast, the clause inserted in the Protocol permitted action to be taken specifically against Poland. In practice, while the import of a given product could be suspended from Poland, it could remain unrestricted from other countries.⁴⁵

The Protocol recognized that socialist countries could not attend the GATT negotiations under liberal rules and that the only remaining way was to revert to a system of planning under the framework of the GATT, and pretending that such a system was compatible with the General Agreement. Thus, instead of Poland making an effort to change its economic structure to accommodate GATT, a process that was impossible to achieve because Poland had no intention to change its economic system, it was up to GATT to find a pragmatic solution, departing from its own rules.

After the first request of membership had been initially posed in 1957, Poland finally joined GATT in 1967, but it did so under conditions that did not satisfy its trade interests and did not represent a step towards multilateralism. The specific terms of the accessions were not appropriate tools with which to

⁴⁴ Kock 1969, 213.

⁴⁵ Laczkowski 1969, 92 and Haus 1992, 35.

pragmatically build a bridge between market and non-market economies, as Laczkowski had commented at the end of the accession negotiations.⁴⁶ With the course of years, all the contracting parties came to the conclusion that the mechanism of the entrance fee was not a suitable tool for obtaining reciprocity: It was impossible to find evidence that contracting parties increased their exports to Poland due to the entrance fee or whether exports would have increased anyway. Moreover, the Polish commitment to import from the GATT area did not influence Polish import decisions. The dispute over the QRs that had plagued accession negotiations became a source of persistent conflict, and the periodic review meetings established by the protocol became enmeshed in broader conflicts over bilateralism and multilateralism between the U.S. and the EEC. Above all, Poland's terms of accessions had nothing to do with multilateralism, the main rule of the GATT. In fact, the QRs, which Western countries maintained also for political reasons, kept trade in a strict bilateral dimension. As a result, Poland did not really integrate into the GATT, its trade was not gradually adjusted to a multilateral dimension, and its presence in Geneva was barely symbolic: In the end, the notion of "second-class GATT membership" was informally elaborated.⁴⁷

Conclusions

De-Stalinization and the increased acceptance of diversity in the East led Poland to seek GATT membership both for political considerations, to become more independent from Moscow, and for mercantilist reasons, to export more to Western Europe. Changes undergoing in Eastern Europe paved the way for the West to pursue a policy of differentiation. This policy filtered to the GATT, in which the membership of Poland hinged on Western political objectives and policies. Political-security considerations drove the Western approach towards Poland's bid for membership, and led to acceptance even before trade concerns were approached and discussed. It was strategic and security policy rather than economic elements that decided that Poland was eligible for the GATT.

Economic concerns became meaningful only after GATT contracting parties had already agreed to accept Poland and, on these economic concerns, the Atlantic alliance split. The accession negotiations got trapped in the transatlantic dispute over non-discrimination and reciprocity, multilateralism and bilateralism, and over the EEC's position in world trade. In supporting Poland's requests on the QRs and agriculture, Washington was sustaining its own interest of maintaining the multilateral system and implementing an outward-looking European Economic Community; in rejecting Polish demand, the EEC defended its own interest of applying a strict reciprocity, keeping trade relations on a bilateral dimension and setting up a preferential regional area.

⁴⁶ Laczkowski 1969, 93.

⁴⁷ Naray 2001, 9-10 and Haus 1992, 61.

To accept a non-market country into the GATT system, the contracting parties could either make this participation dependent on the reform of the applicant's economic system or they could elaborate a practical solution departing from the GATT rules. Being aware that it was not possible to ask Poland to change its economic system, the contracting parties opted for the second way out, showing a high degree of flexibility, but setting aside GATT rules and creating a strong bias towards bilateralism in trade relations, recognizing that to deal with Poland it was necessary to depart from the General Agreement and to embark on bilateralism, in the GATT framework itself. This GATT flexibility was a product of the Cold War. If an Eastern European country showed some signs of independence from Moscow and there was a hope that GATT membership could contribute to lessen the Soviet Bloc's cohesion, the bid for membership was accepted. A practical and flexible way to accommodate the request would be invented. In this way Polish, and later in the 1970s Rumanian and Hungarian bids were accepted, whereas in the 1980s Bulgaria's bid was drastically refused, as this country was clearly linked to the USSR.⁴⁸ The fact that it was only for political and security reasons that Poland was admitted to the GATT and that multilateralism was not applied to trade relations led to the non-integration of this country in Geneva and to only a symbolic presence. Therefore, the GATT played only a geopolitical role but did not contribute to the multilateralization of East-West relations.

The fundamental incompatibility between the market and non-market systems was unquestionably one of the aspects that precluded an effective participation of Poland in Geneva. Poland was admitted under the pragmatic rules that deviated from the General Agreement, and it did not undertake reforms leading to the economic liberalization needed to effectively attend the GATT. But this factor was not the only one to be blamed. In attending the Kennedy Round, Poland was primarily interested in exporting agricultural products to Western Europe, and mainly to the EEC. However, as the EEC had decided to implement the CAP, the Polish capacity for export was limited. Consequently, its importing capacity was limited. The problem for Poland was not only that it had a different economic system, but also that it was not part of the regional trade agreement, the EEC, that was pursuing a discrimination policy and to which it wished to export. This problem not only concerned the centrally-planned system, it was also that discriminatory economic integration was taking place in Western Europe and Poland belonged to another regional trade agreement.

⁴⁸ Naray 2001, 12

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Just Rhetoric? The United Kingdom and the Question of Western Economic Aid to Finland, 1950-1962

Introduction

During the Cold War, both the Western alliance and the Soviet Union repeatedly used economic methods to promote political goals. They, for example, supported allies by offering economic aid, coerced others by cutting off supplies, and promoted economic development when it was considered to be desirable for political reasons.¹ However, foreign trade could not be entirely subordinated to political calculations because of its economic significance as a source of export revenue and vital imports. This was particularly true in the case of the U.K. which was suffering from a number of economic problems, most important of which were the weak balance of payments situation and the relatively slow economic growth rate in Western European standards.²

This article focuses on one particular case where political motives captured a particularly visible role in British foreign economic policy and where the conflict between economic and political motives was particularly clear, namely the case of Western aid to Finland between 1950 and 1962. During this period, the U.S. and British governments repeatedly considered the use of economic methods to support the small, neutral country against her large socialist neighbor, the Soviet Union. In the interwar period, the British had competed with the Germans for political and economic influence in Northern

¹ See for example Dobson 2002; Adler-Karlsson 1968; Freedman 1970; Jackson 2001; Kaufman 1982.

² Cairncross 1999, 26-32; Milward 2000, 126-127; Tomlinson 1985, 45-49.

Europe.³ Now these hegemonic struggles seemed to continue in Finland, but this time the opponent of the U.K. was the Soviet Union.

But how willing was the British government to make economic sacrifices in order to support Finland? Were the British really willing to use trade and financial relations as “tools” of foreign policy in the Finnish case? After all, in the literature on the general British role in the economic Cold War it is often argued that the U.K. was less willing to sacrifice its economic interests for the Cold War political considerations than the USA, because of the importance of the East-West trade to the country, because of the British economic difficulties and its greater dependence on international trade, and because of the differing estimates of the level of Soviet threat.⁴

Many historians such as Jukka Seppinen, Vesa Vares, Markku Kuisma, Jussi Hanhimäki, Vesa Lehtola and Hannu Rautkallio have written about the role of political considerations in Western foreign economic policy towards Finland in the 1950s and the early 1960s. However, none of the scholars have studied systemically and in detail how the British policy towards Finland was formulated and what the role of various government departments in this process was. Too often the historians have focused on the Foreign Office views and desires without giving due regard to the crucial impact the economic departments had on the policy formulation. This situation may be to a large degree the result of the fact that the historians have often studied British policy towards Finland only as a part of some other framework, such as Finnish foreign economic relations, developments in Finnish political life, or the U.S. policy towards Finland.⁵ It is argued in this article that in order to understand how willing the British really were to manipulate economic relations for political purposes, we must not only understand the relative importance of various motives but also how the institutional decision-making process influenced policy outcomes.

The Foreign Office Overruled

During the Cold War, Finland was a democratic country with a market economy, but it had a long common border with the Soviet Union and a large communist party. Many Western observers feared that in the long run the Soviet Union would not be willing to let its small neighbour remain as an independent, non-communist country. During the Second World War, the Soviets had failed to occupy Finland, and in the 1950s the British and American diplomats and military analysts believed that it was unlikely that the Soviets

³ See in particular, Salmon 1997; Schröter 1983; Sundbäck 2001.

⁴ Jackson 2001; Sørensen 1989; Dobson 2002, 26,101,103-104,137,186; Funigello 1988, 41-42,47-49. See also Bar-Noi, in this volume.

⁵ Hanhimäki 1997; Kuisma 1997; Lehtola 1999; Rautkallio 1991; Rautkallio 1990; Seppinen 1997; Vares 1997.

would attack Finland except as a part of a new global war.⁶ Instead of military force, they would use indirect methods, such as economic pressure.⁷ These were not only theoretical options, since the Soviet Union had shown in 1950 and 1958 that it could, if willing, stop the trade between Finland and the Soviet Union quickly for political reasons.⁸

The majority of Finnish exports were sold to non-communist countries throughout the 1950s. The share of the Sino-Soviet bloc of Finnish foreign trade peaked in 1953, when 31.3 per cent of total Finnish exports were sold to socialist countries, and 34.6 per cent of imports came from them.⁹ However, the figures of total Finnish foreign trade do not tell the whole story. Western observers were particularly concerned about the strong dependence of the Finnish engineering and shipbuilding industries on sales to the Soviet Union. The Soviets had demanded that most of the Finnish war reparations to the Soviet Union (\$300 million paid with goods valued by 1938 prices) were paid with engineering goods and ships.¹⁰ The need to fulfill Soviet demands led to the rapid expansion of these industries, but lack of competitive advantages meant that after the war reparations had been paid they remained dependent on Soviet orders.¹¹

Another economic factor that caused anxiety in Western capitals and among the non-communist Finns was the relative backwardness of the Finnish economy compared to other Nordic countries or the Western European countries. Many observers believed that it was the harsh social and economic conditions that persuaded many voters to support the communists and their fellow-travelers in the elections. Rising living standards might make people less likely to vote communists.¹² *"In the longer-term, always provided that external events, e.g. developments over Germany, do not prompt the Soviet Union to turn Finland into a satellite, her stability and neutrality must depend on economic health,"*¹³ Joint Intelligence Committee of the U.K. argued in 1959.

One could expect that the British had an important role in the Western efforts to keep Finland as a part of the non-communist world because the U.K.

⁶ Memorandum by the Director of the Office of European Affairs (Hickerson) to the Secretary of State, March 1 1949. FRUS 1949, volume V, pp. 434-435; Department of State Policy Statement, December 1, 1949. FRUS 1949, volume V, p. 444; NA. FO371/159309. NF1072/2. C. O'Neill, Helsinki, to R.H. Mason, FO, February 15, 1961.

⁷ Kuisma 1997, 22-27.

⁸ See below.

⁹ SVT 1 A 1950-1970.

¹⁰ Hoffman 1988, 130-132.

¹¹ The Archives of the Bank of England, London. OV30/4. "Report on Finland". C.A. Gunston, August 19, 1946; NA. FO371/159327. C. O'Neill, Helsinki, to Earl of Home, March 14, 1961.

¹² Suomi 1990, 205,384,525; NA. T299/12. "USSR 1/60 Research Department Memorandum: An outline of Fenno-Soviet Relations" Soviet Section, Research Department, July 1, 1960; FO371/142874. NF1121/8/G. D.L. Busk, Helsinki, to J.E. Chadwick, FO, May 13, 1959.

¹³ NA. CAB158/35. J.I.C.(59)25, April 15, 1959. "The outlook for Finland up to 1960. Report by the Joint Intelligence Committee". Annex: "Western interests in Finland".

was traditionally the most important export market for Finnish woodworking industry, the main export industry of the country. The British typically purchased at least a fifth of all Finnish exports. Between 1951 and 1955, the share of the U.K. of total Finnish exports was no less than 24.9 per cent, while the share of the Soviet Union, the second most important customer, was 17.5 per cent and the share of the United States only 6.2 per cent.¹⁴

The British were often somewhat less concerned about developments in Finland than the Americans. Vesa Vares has argued that the Americans underlined the communist aspect more than the British had and took a more "global" perspective than the British in regards to Finland.¹⁵ Nevertheless, it is easy to find statements from the Foreign Office files that seem to indicate that at least from 1948-1949 onwards it shared the U.S. desire to stop Finland from gradually gliding to the Soviet Bloc. The department seemed to recognize how important a role the British could have in the Western efforts to contain the expansion of Soviet power in this Northern "front" of the Cold War. For example, Foreign Office official G.W. Harrison wrote to the Board of Trade in February 1950, when the Soviet Union seemed to be using economic pressure against Finland:

"It is clearly in the interest of His Majesty's Government that Finland should remain a free, democratic and independent state. It follows that we should do what lies in our power to counter Soviet economic pressure on Finland. We would, therefore, recommend that all reasonable efforts be made to meet Finnish requests for the supply from the United Kingdom of materials and commodities necessary for the preservation of a stable and sound economy."¹⁶

The Foreign Office was not blind to the economic constraints the weak state of the U.K. economy placed on British foreign policy, but still the department believed that something could be done to help Finland.¹⁷

Yet, I am arguing that the statements of the FO represented the views of that particular department, not necessarily British government policy in general. The Foreign Office and the British Legation might have been converted to a Cold War frame of mind, but this did not mean that Whitehall in its entirety would follow.¹⁸ The students of British political decision-making system have often underlined the fragmentation of the British government machinery, conflicts between departments, and their strong internal cultures and identities.¹⁹ These characteristics were clearly visible in the formulation of the British foreign economic policy towards Finland. In this article, it is argued

¹⁴ STV LXVII 1971, 159.

¹⁵ Vares 1997, 185.

¹⁶ NA. T236/2513. C.W. Harrison, FO, to S.H. Levine, BOT, February 20, 1950, copy for the Treasury.

¹⁷ NA. FO371/71426. N12192. Minutes; R.G.A. Etherington-Smith, FO, to C.G. Thorley, Treasury, December 31, 1948.

¹⁸ See for example NA. FO371/77369. N314. C.G. Thorley, Treasury to R.G. Etherington-Smith, FO, January 8, 1949.

¹⁹ Drewry and Butcher 1991, 83-86; Kavanagh and Richards 2001; Gray and Jenkins 1985, 34-35; Greenway, Smith and Street 1992, 30.

that the Cold War rhetoric of the British Foreign Office and its attempts to make the political considerations of the Cold War crucial factors in the formulation of British policy had, in the end, little impact on British foreign economic policy towards Finland. This was the result not only of economic problems the British were facing after the Second World War, which in part limited the policy options available to British foreign policy makers, but also the result of the categorical refusal by the Treasury and the Board of Trade to take political factors into account and to use economic methods as tools of foreign policy. Regardless of whether the economic costs of the proposed policies would be extensive or insignificant for the British, the economic departments treated them as an unwelcome interference in the promotion of British economic interests and in their attempts to strengthen the British economy.

The widely held view from the end of the Second World War onwards, that the British should try to solve their economic problems, gave the economic departments an effective weapon to oppose policies that would not be compatible with their goals, even if the negative impact on the British balance of payments would have been limited or even negligible. When the Foreign Office failed to get other departments to agree to its policy proposals in interdepartmental correspondence, it chose to refrain from referring the matter to the Cabinet committees, as it could have done. As James has illustrated,²⁰ there was a strong pressure to settle issues at as low a level as possible. If the Foreign Office had raised the issue of Finland to the higher ranks, it would have taken time from other, more important issues.

The First Crisis

The possibility of giving emergency aid to Finland was first considered in 1950 when members of the Finnish government as well as Western diplomats began to suspect that the Soviets were deliberately holding up negotiations for a new Finnish-Soviet trade agreement in order to put pressure on the Finnish government.²¹ Finnish historians have described how U.S. and British officials began making preparations to increase Western supplies of those raw materials, mainly grain and oil, which Finland was normally importing from Soviet Union.²² Yet as far as Britain is concerned, this picture is misleading. The Foreign Office did indeed want to make special arrangements to provide Finland with the necessary materials, but the economic departments overruled it.

²⁰ James 1999, 54.

²¹ NA. FO371/86453. NF11338/2. Chancery, Helsinki, to Northern Department, FO, January 18, 1950; NF11338/5. Telegram no. 21 from Scott, Helsingfors to FO, January 24, 1950; NF11338/10. Minutes by J.E. Powell-Jones, February 25, 1950.

²² Hanhimäki 1996, 82-84; Kuisma 1997, 33-36.

From the point of view of the Foreign Office, the Finns had been successful in avoiding the fall under Soviet domination and had managed to limit Communist influence within their own borders. The Foreign Office was anxious to ensure that Soviet economic pressure did not reverse these developments, and argued in favor of supplying Finland with those essential goods from the U.K. or other Western sources, which she had previously imported from the Soviet Union.²³ The Economic Intelligence Department of the Foreign Office estimated that Finland would need cereals, fertilizers, iron, steel and, above all, petroleum products (81 per cent of the Finnish consumption in 1950 was originally supposed to come from the Eastern Bloc).²⁴

Since the Finns had few dollars to spend on oil, but relatively more sterling, the U.K. became an obvious Western choice in supplying oil to Finland.²⁵ Increasing British shipments of various raw materials to Finland through normal trade channels within the framework of the annual Finnish-British trade agreement would also serve as a less conspicuous way of giving Western economic aid to Finland than would emergency shipments or U.S. loans.²⁶ The negotiations between Finland and the U.K. for the trade agreement began in February 1950. The Finns hoped to compensate for the decline of imports from the Soviet Union by increasing imports from the U.K. and to get as much freedom as possible in spending sterling on imports from other countries if necessary.²⁷

The suggestions that the British negotiations should agree to special arrangements and supply Finland with the goods she could not get from Soviet sources did not receive support from the economic departments in Whitehall. The economic arrangements were ready to accept these proposals only if they were fully compatible with British economic interests. The Treasury and the Board of Trade did not want to sell any more sterling oil to the Finns, since the U.K. itself was trying to substitute oil imports from dollar sources with the increased use of sterling oil. If the U.K. would sell the Finns oil, it would have to import more dollar oil itself.²⁸ Therefore economic departments refused to agree to increase oil sales to Finland,²⁹ even if the Finns in the actual negotiations requested smaller quantities than had been expected. This change brought the difference between that which the Finns requested and that which

²³ NA. T236/2513. C.W. Harrison, FO, to S.H. Levine, BOT, February 20, 1950, copy for the Treasury; BT11/2839. Minute by S.H. Levine, March 8, 1950.

²⁴ NA. T236/2513. "Note on Probable effects on Finland of a Breakdown in Fenno-Soviet Trade Negotiations." J.V. Denkin, FO, February 2, 1950, copy for Treasury.

²⁵ NA. FO371/86453. NF11338/2. Chancery, Helsinki, to Northern Department, FO, January 18, 1950.

²⁶ NA. FO371/86453. NF11338/10. Minutes by C.W. Harrison, February 7, 1950.

²⁷ Archives of the Finnish Forest Industries Federation. ME03.31. Englanti, kauppa 1950-1953. "Muistio kauppaneuvotteluista Englannissa 28.2.-13.3.1950". J. Nykopp, March 20, 1950, copy for the Central Association of Finnish Woodworking Industries.

²⁸ NA. FO371/86453. NF11338/11. Minutes by T.F. Brechley, February 13, 1950; FO371/86482. NF 1532/1. M. Rudd, Treasury, to T. F. Brechley, FO, February 16, 1950.

²⁹ NA. FO371/86462. NF1151/15. Minutes by J.F. Wearing, March 9, 1950.

the British were willing to offer on commercial grounds down to a mere 30,000 tons of petroleum products.³⁰ The strict British line with oil and the similar line with wheat seemed surprising even to the British Foreign Secretary, who asked for an explanation from his officials.³¹ Unable to secure enough oil from U.K.-controlled sources, the Foreign Office approached the State Department, which in turn approached Standard Oil of New Jersey. Standard arranged the necessary shipment from Italy and agreed to take sterling payment from the Finns.³²

The Ministry of Food, with the support of the Treasury, opposed the suggestion to give the Finns the right to purchase wheat from Argentina with sterling, for this would interfere with the Ministry of Food's own plans to purchase from Argentina,³³ and because the interdepartmental Overseas Negotiations Committee decided to ensure that Argentina used its sterling to settle its old debts to the U.K.³⁴ Overall, there was little possibility that the U.K. would provide Finland with the goods it needed beyond the amounts they were ready to sell on purely commercial grounds, but the conclusion of the Anglo-Finnish trade agreement nevertheless eased the Finnish supply position and therefore strengthened their hand in negotiations with the Soviets.³⁵ Ironically, the British-Finnish trade agreement, which from the British point of view was in the end a standard commercially motivated agreement, might have made the Soviets more inclined to solve the crisis.³⁶

Fortunately for the Finns, they managed to buy enough grain from world markets in spite of this³⁷ and, more importantly, the Finnish-Soviet deadlock was finally solved without the need for outside help. In the spring of 1950, Finnish-Soviet negotiations began again and this time led to a successful conclusion. In June 1950 the Finns and the Soviets concluded two trade agreements, one for the year 1950 and one long-term trade agreement.³⁸

³⁰ NA. FO371/86482. NF1532/7. Telegram no. 1287 from FO to Washington, March 8, 1950.

³¹ NA. FO371/86462. NF1151/19. "Trade with Finland". C.W. Harrison, March 15, 1950 and Secretary of State's handwritten comments on it.

³² NA. FO371/86462. NF1151/19. "Trade with Finland" C.W. Harrison, March 16, 1950; FO371/86482. NF 1532/1. Telegram no. 1068 from FO to Washington, February 24, 1950; NF1532/8. Telegram no. 819 from Franks, Washington to FO, March 10, 1950; NF1532/11. Telegram no. 934 from Franks, Washington to Italy, March 21, 1950.

³³ NA. T236/2514. T.M. Wilson, Ministry of Food, to R.S. Symons, Treasury, March 1 1950; "Mr. Bancroft. Treasury Cocktail Party to the Finns", R.S. Symons, March 15, 1950; T238/220. O.N.(50) 48, February 21, 1950: "Finland: Note by the Board of Trade"; S.H. Levine, BOT, to F.C. Milner, Treasury Chambers, March 6, 1950.

³⁴ NA. FO371/86462. NF1151/19. "Trade with Finland" C.W. Harrison, March 16, 1950.

³⁵ NA. FO371/86453. NF11338/21. Telegram no. 103 from Scott, Helsingfors to FO, April 12, 1950; FO371/86462. NF1151/25. O. Scott, Helsinki, to E. Bevin, FO, April 19, 1950.

³⁶ Rentola 1997, 135.

³⁷ Nykopp 1975, 106-107.

³⁸ NA. FO371/86454. NF11338/42. O. Scott, Helsinki, to K. Younger, FO, June 15, 1950; Suomi 1990, 59-63.

The Night Frost Crisis

The British attitude during the next serious Finnish-Soviet crisis from 1958-1959 was very similar to their attitude during the crisis in 1949-1950. The "Night Frost Crisis" began in August, 1958, when social democrat K.A. Fagerholm formed a new coalition government. The Soviets disapproved of the new Cabinet, and illustrated it in many ways in September and November of 1958. For example, they refused to set a date for negotiations for the next year's trade agreement, cancelled all other important economic negotiations and several existing contracts, delayed payments on old ones and informed several large Finnish firms that they would no longer receive any new orders from the Soviet Union.³⁹ These actions put the Finns in an economically difficult situation, and the Foreign Office and the State Department began considering ways to help Finland.

The Americans acted quickly. U.S. government authorized Ambassador John D. Hickerson to offer the Finnish government credit as economic contingency aid. The Americans also began to make arrangements to supply Finland with those commodities it could no longer import from the Soviet Union. Hickerson approached the Finnish authorities in November 1958 and made it clear that the U.S. government could offer economic aid in the form of supplies and credit to Finland.⁴⁰ On the question of Western loans to Finland, the Foreign Office was only a sympathetic bystander when the Americans formulated their plans.⁴¹ The British argued that they could not afford to grant loans to the Finns themselves,⁴² and the British Ambassador Douglas Busk suspected that for tactical reasons the Finns might have given too bleak a picture to Hickerson about the state of the Finnish economy.⁴³ The British Ambassador hoped that the British could help by encouraging an increase in the Finnish-British trade, but this would be a slow process and could not provide immediate help for the Finns. He was more interested in the possibility that the Germans could buy more from Finland and help balance the Finnish-West German trade, but claimed that the German "*selfishness*" would make it unlikely that they would in fact do this.⁴⁴

³⁹ NA. FO371/134762. NF1015/34. D.L. Busk, Helsinki, to Selwyn Lloyd, FO, November 4, 1958; NF1015/35. D. L. Busk, Helsinki, to M.G.L. Joy, FO, November 12, 1958; "Intelligence Memorandum. Recent Trends in Finnish-Soviet Trade". CIA/RR IM 59-2. March 10, 1959. CIA FOIA, Electronic Reading Room. <http://www.foia.cia.gov> (30.11.2004); NA. FO371/142867. NF10338/21. "Soviet-Finnish Relations" A FO memo (1959).

⁴⁰ Suomi 2001, 146-147,155; The archive foundation of the President of the Republic. The archives of Urho Kekkonen. Yearbook 1958. "Muistiinpano". O. Kaila, November 26, 1958.

⁴¹ NA. FO371/134778.

⁴² NA. FO371/134762. NF1015/34. D.L. Busk, Helsinki, to Selwyn Lloyd, FO, November 4, 1958.

⁴³ NA. FO371/134762. NF1015/35. D.L. Busk, Helsinki, to M.G.L. Joy, FO, November 12, 1958.

⁴⁴ NA. FO371/134762. NF1015/34. D.L. Busk, Helsinki, to Selwyn Lloyd, FO, November 4, 1958.

While the U.K. would not make a direct financial contribution to Finland, it was ready to support an International Bank for Reconstruction and Development (World Bank) loan to them. In January 1959, when the crisis was already nearing its end, British representatives urged the Bank staff to expedite the administrative preparations for the \$37 million loan to be granted for the modernization of the Finnish woodworking industries.⁴⁵ The World Bank loan was an effective method to support Finnish economy, but for the U.K. it had another advantage: It would not cost anything directly to the British.⁴⁶

The British attitude towards American plans to supply Finland with oil and other fuels, as well as wheat and cotton from Western sources, was not very enthusiastic. The U.S. government had approached their oil companies operating in Finland, Standard Oil of New Jersey and Gulf Oil, asking whether they would be willing to help Finland in getting supplies from the West. The State Department hoped that the companies would be willing to extend credit or to enter into barter agreements with the Finns. The companies did not like the idea of barter agreements, but they did agree to provide credit on the condition that the third Western oil company in Finland, Shell, agree to do the same. The State Department asked the British government to approach Shell. The proposals for oil were not unique. The State Department was hoping that Western countries could supply Finland with coal and coke, and receive pit-props from Finland in return.⁴⁷

In principal, Shell expressed their support with U.S. suggestions, but in practice it downplayed the risk that the Soviets might cut off supplies.⁴⁸ The Foreign Office was more concerned about the halting of Soviet imports from Finland than of their exports of raw materials to Finland.⁴⁹ The Board of Trade was not willing to encourage barter arrangements, but it said it would not try to discourage them, either. However, it was reluctant to grant any special import licenses for Finnish products that would form part of the tentative barter agreements.⁵⁰

⁴⁵ NA. FO371/142872. NF1111/1. Minutes; Telegram no. 34 from Busk, Helsinki, to FO, January 26, 1959; Telegram no. 27 from FO to Helsinki, January 30, 1959.

⁴⁶ NA. FO371/134778. NF11345/5. D.L. Busk, Helsinki, to D.A.H. Wright, FO, December 4, 1958.

⁴⁷ NA. FO371/134783. NF1531/3. Telegram no. 3132 from Caccia, Washington, to FO, November 18, 1958 and telegram no. 3199 from Hood, Washington, to FO, November 24, 1958; FO371/134778. NF11345/4. M.G.L. Joy, FO to D.L. Busk, December 2, 1958; The National Archives and Records Administration, Washington, United States (copies in the Finnish National Archives, Helsinki). State Department, Internal Affairs of Finland. Record Group 59, box 3488 (760 E.00) 1958-59 USA TK 21. Department of State. Memorandum of Conversation, November 18-20, 1958.

⁴⁸ NA. FO371/134783. NF1531/4. J.R. Jenkins, Ministry of Power (Hereafter MOP), to J. Doyle, FO, November 25, 1958; FO511/134. Telegram no. 234 from FO to Helsinki, November 27, 1958.

⁴⁹ NA. FO371/134783. NF1531/5. Telegram no. 8445 from FO to Washington, November 27, 1958.

⁵⁰ NA. FO371/134783. NF1531/3. D. W. Savage, BOT, to R.G. Stuart, MOP, November 24, 1958.

Increasing Shell's supplies to Finland would not be a problem in practical terms. Earlier in 1958 the Finnish government, anxious to import more from the Soviet Union in order to balance the Finnish-Soviet trade, had asked Western companies to reduce their supplies to Finland. If Soviets suppliers were to cut off transactions, it would not be difficult to restore Western supply to its previous level. Similarly, extending credit to six months was not a problem in the short run, since Shell had already done this for various reasons to its subsidiary in Finland. A period longer than six months, however, would establish an undesirable international precedent,⁵¹ and barter agreements were totally unacceptable to the company.⁵²

Providing coal for Finland also seemed a possibility to the U.K. In fact, the Finns had been slow to take all the coal contracted before due to the shortage of funds and the fact that it had been cheaper from the Soviet Union. If Soviet and Polish sales to Finland were to be cut off, there would in fact be an interesting commercial opportunity to increase British sales to Finland. Finding coal was therefore not really a problem, but shipping it to Finland could pose one. J.E. Chadwick from the Foreign Office felt that if the Soviets would cut off their supplies during the winter when the Baltic ports were frozen, it might not be possible to get additional quantities of coal and coke to Finland.⁵³

Preparing for the Next Crisis

The Night Frost Crisis was finally solved without Western help. Even though the immediate urgency had disappeared, the potential threat remained and the State Department decided to put its supply plans, including the oil companies' promises, "on ice" and wait for potential new problems.⁵⁴ The Foreign Office asked the Joint Intelligence Committee (JIC) to prepare a report on the outlook for Finland.⁵⁵ The report, drafted by the Joint Intelligence Staff and approved by the JIC in April 1959⁵⁶ concluded that

"the West's interest is that Finland should remain an independent neutral but essentially pro-Western country" and that "Finland's economy is peculiarly

⁵¹ NA. FO371/134783. NF1531/4. J.R. Jenkins, MOP, to J. Doyle, FO, November 25, 1958; FO511/134. Minutes by W.N.R. Maxwell, November 20, 1958.

⁵² NA. FO371/134783. NF1531/5. J. Cooper, Shell, London, to J.R. Jenkins, MOP, November 26, 1958, copy for FO.

⁵³ NA. FO371/134778. NF11345/4. D.L. Busk, Helsinki, to M.G.L. Joy, FO, December 2, 1958; J. E. Chadwick, FO to P. L. Carter, Washington, December 5, 1958; FO371/134772. NF1121/33. D.L. Busk, Helsinki, to M.G.L. Joy, FO, December 9, 1958.

⁵⁴ NA. FO371/134783. NF1531/5. J. Doyle, FO, to J.R. Jenkins, MOP, December 11, 1958; FO371/142897. NF1531/1. D. Eagers, Washington, to J.R. Jenkins, MOP, December 29, 1958, copy for FO.

⁵⁵ NA. CAB159/31. J.I.C.(59)17, item 1, February 19, 1959.

⁵⁶ NA. CAB159/31. J.I.C.(59)27, item 1, April 15, 1959.

vulnerable and this, along with the strength of the Communist party, has been a main cause of the country's political instability since the Second World War".⁵⁷

In the spring of 1959, Ambassador Douglas Busk and some Foreign Office officials considered possibilities to give additional long-term Western aid to Finland in the aim to relieve unemployment in the remote areas of Northern and Eastern Finland (the electoral districts of Lapland, Oulu and Kuopio East), and to make Finland less depended on the Soviet Union. The Communists had made significant gains in the areas in question in recent elections, and this fact was widely considered to be the result of poor social and economic conditions facing the local population. By improving the living standards of these areas, the growth of communist support could be halted or even reversed.⁵⁸ JIC was even more alarmist and warned that unless the West helped Finland to reduce unemployment, the communists might gain enough support in the next elections to lead Finland into the Soviet Bloc.⁵⁹

These suggestions did not receive crucial support from the upper levels of the Foreign Office. Commenting on Busk's suggestions, Under-Secretary of State Con O'Neill, whose area of responsibilities included the Northern Department, argued that "*they did to a considerable extent represent the special pleading which one naturally expects from an Ambassador in a friendly country*". In O'Neill's view, the unemployment in the whole of Finland (5% in the previous winter) was not particularly high in comparison to other nations, and even if the unemployment problem in Northern Finland was indeed severe, this area had relatively few inhabitants. It would not seem wise to spend financial resources in order influence the voting behavior of a relatively small number of voters. In addition, the Finns themselves had not asked for help and it seemed odd to give money to a country that had not asked for it, especially when there were many countries which had. Instead, O'Neill preferred additional loans from the World Bank and the U.S. Export-Import Bank.⁶⁰ Curiously, O'Neill apparently felt that his arguments concerning unemployment were not relevant if the money came from these sources. O'Neill's views received support from other Foreign Office officials who were also conscious of the fact that in order to help Finland with British money, the Foreign Office would have to ask for funds from the U.K. Parliament. The Export Credit Guarantee Department might be able to loan funds to Finland, but they would have to be tied to the sales of British goods. The whole issue was eventually abandoned without even

⁵⁷ NA. CAB158/35. J.I.C.(59)25, April 15, 1959. "The outlook for Finland up to 1960. Report by the Joint Intelligence Committee".

⁵⁸ NA. FO371/142873. NF1121/4-5; FO371/142874. NF1121/8/G. D.L. Busk, Helsinki, to J.E. Chadwick, FO, May 13, 1959; "Aid for Finland" by T. Brimelow, April 14, 1959; NF1121/9G. Third draft of the Joint Economic Measures Committee paper "The Economic Position of Finland. Note by the Foreign Office".

⁵⁹ NA. CAB158/35. J.I.C.(59)25, April 15, 1959. "The outlook for Finland up to 1960. Report by the Joint Intelligence Committee".

⁶⁰ NA. FO371/142874. NF1121/8/G. Minutes by C. O'Neill. April 15, 1959.

taking the paperwork up to the interdepartmental Joint Economic Measures Committee, as had been intended.⁶¹

Ironically, Con O'Neill himself was the next to be appointed Her Majesty's Ambassador to Helsinki. In his new position, O'Neill took the time to study in detail the crisis of 1958, and as a result he concluded that his previous views had been ill-informed. The Ambassador changed his views and on his suggestion the Foreign Office decided to do a study on the history of the Finnish-Soviet crisis of 1958, and to examine with the U.S. State Department, how the West could provide economic support in order to diminish Soviet possibilities to exert economic pressure. O'Neill felt that since economic pressure had been successful in 1958 and still provided an obvious tool to the Soviets to promote their interests, it was likely that the next time they decided to intervene in Finland's internal affairs, the Soviets would again use this same method.⁶² *"Russian take-over in Finland would be a severe blow indeed to the West and equally the frustration of a Russian attempt to do so would be a great gain"*,⁶³ wrote R.H. Mason, the Head of the Northern Department at the Foreign Office.

The State Department shared O'Neill's fear about the future of Finland and, in fact, by January of 1961 the Department had already proposed to the Foreign Office joint Anglo-American talks on the current Finnish situation.⁶⁴ The State Department and the Foreign Office agreed that the Americans would write a draft study on the economic ties between Finland and the Soviet Union, as well as possible Western economic aid to Finland.⁶⁵ The U.S. paper "Finland's Ability to Resist Soviet Pressure" predicted that if the Soviets decided to cut off their trade with Finland, unemployment in the Finnish shipbuilding and engineering industries would grow to serious levels, and that Finland would find it difficult to find new markets for its products and pay for imports from new sources. These problems could be overcome through the gradual expansion of Finnish trade with Western countries, but during the transitional period Finland would require credits. According to U.S. preliminary estimates, these credits would amount to a total of \$100-150 million.⁶⁶

O'Neill and R.H. Mason felt that if an operation would really cost no more than \$150 million, it would be a cheap price to pay when compared to the advantages. O'Neill felt that the U.S. and U.K. governments should make a

⁶¹ NA. FO371/142873. NF1121/5/G. Minutes; FO371/142874. NF1121/8/G. Minutes by D.A.H. Wright, April 16, 1959; NF1121/9G. Minutes.

⁶² NA. FO371/159309. NF1072/3. "Trends in Finland", R.H. Mason, April 7, 1961; NF1072/4. Con O'Neill, Helsinki, to A.D. Wilson, FO, April 5, 1961; Wilson to O'Neill, April 7, 1961.

⁶³ NA. FO371/159309. NF1072/3. "Trends in Finland", R.H. Mason, April 7, 1961.

⁶⁴ Rautkallio 1992, 29-30.

⁶⁵ NA. FO371/159309. NF1072/6. J.B. Denson, Washington, to R.H. Mason, FO, April 3, 1961; "US-U.K. Bilateral Talk April 14, 1961 Ad referendum. Finland"; FO371/159307. "Visit of Finnish President. Brief No. 1: Finland's position in East-West Relations". Foreign Office, April 28, 1961.

⁶⁶ NA. FO371/159317. NF 1151/12. "Helping Finland to withstand Soviet Pressure", Draft memo by R.H. Mason, September 1961.

decision to offer Finland economic aid if Finland asked for such aid due to Soviet economic pressure. The Ambassador believed that the U.S. government would be ready to pay for most of the costs, but the U.K. and other European countries should pay a small part of the requirements.⁶⁷

The suggestion that the U.K. should provide aid to Finland was supported by the Northern Department and the British Embassy in Helsinki, but the Economic Relations Department of the Foreign Office stopped it before it left the Foreign Office to the interdepartmental Joint Economic Measures Committee. F.C. Mason, Head of the Economic Relations Department, made a number of critical comments about the proposal. Mason claimed that the Ambassador was overestimating the importance of Finland to the West, but his main arguments concerned the economic implications of the proposals. According to Mason, the aid commitments of the U.K. government had already exceeded the limits set by the Treasury.⁶⁸ Furthermore, Finland might become a long-term burden if the country failed to adequately expand its exports to the West, not to mention that success in this process might not be a welcome development after all, as Finnish products would then compete with Britain's own exports in the foreign markets. Mason felt that the British should not encourage Finland to redirect its export products from the Soviet Union to other markets. Even if most Western diplomats had seen the Night Frost Crisis as a sign of Finland's true vulnerability to Soviet economic pressure, Mason argued that if Soviet pressure had not transformed Finland into a Soviet satellite country at that time, certainly there was no reason to believe that this pressure would be more successful in the future.⁶⁹

The Northern Department feared that the Board of Trade and the Treasury were going to adopt a negative attitude towards the proposals to support Finland,⁷⁰ and indeed A.G. White, the senior Board of Trade official most actively involved in the Finnish-British trade issues, had already taken an extremely hostile view on the U.S. paper. Finnish commercial policies towards U.K. economic interests had left the Board of Trade officials with such bitter memories that they had little desire to support proposals for aid to Finland. White accused the U.S. paper for exaggerating the vulnerability of the Finnish economy in many ways. To begin with, he felt that the paper did not underline strongly enough the fact that the products of the woodworking industries, which constituted a portion of Finnish exports to the Soviet Union, would be competitive in the Western markets. Secondly, White was not at all certain that were the Soviet Union to cut off its trade with Finland, other communist countries would be forced to do the same. Thirdly, White accused the paper of selective and confusing use of labour statistics in a manner that seemed to

⁶⁷ NA. FO371/159317. R.H. Mason's draft memo "Helping Finland to withstand Soviet Pressure", September 1961; FO371/159297. NF103138/9. C. O'Neill, Helsinki, to R.H. Mason, September 12, 1961.

⁶⁸ NA. FO371/159317. NF1151/12. Minutes by F.C. Mason, October 3, 1961.

⁶⁹ NA. FO371/159317. NF1151/12. Minutes by F.C. Mason, October 3, 1961.

⁷⁰ NA. FO371/159309. NF1072/8. R.H. Mason, FO, to C. O'Neill, Helsinki, September 25, 1961.

underline too heavily the role of Finnish-Soviet trade as a source of employment.⁷¹

Having said all that, White admitted that if three important categories of Finnish exports to the Soviet Union – engineering products, ships and dairy products – were cut off, it could become impossible to find alternative markets for several years. Even so, as only 1.4 per cent of the entire Finnish workforce was unemployed in March 1961, White considered that it would pose “*no insoluble problems*” from an economical point of view for the Finnish to tackle increased unemployment. Considering political consequences was not the Board of Trade’s responsibility. This gave White a convenient reason to ignore the fact that the consequences Western diplomats most feared were political, i.e. labor unrest, the potential increase of communist power within the industrial workforce which was already heavily present, and as a result of these developments the general increase of communist and Soviet influence within Finland. White’s faith in the ability of the Finns to tackle the serious balance of payments crisis, which he expected would follow from the halting of Finnish-Soviet trade, was weaker, and he expected that the Finnish would need Western financial aid in this respect.⁷² N.J. Barrington of the Foreign Office admitted that the Americans might have indeed exaggerated the economic vulnerability of Finland, but he pointed out that the Soviets had already used economic pressure successfully against Finland in 1958.⁷³

When they considered the new proposals, officials in the Economic Relations Department remembered very well the faith of their 1959 paper on Finland, which never even reached the Joint Economic Measures Committee.⁷⁴ F.C. Mason suspected that if the Foreign Office made suggestions to the other governmental departments, these suggestions would most likely be rejected and would only damage the department’s position within Whitehall. If the FO nevertheless decided to go ahead, and managed to elicit wider support from the other departments, the officials would have to set a limit on the maximum level of aid. Mason proposed £15 million, expecting that this would be cut down to £10 million. He felt that it was essential to get the other Western European countries, particularly West Germany and Sweden, to make a contribution, because the Board of Trade and the British shipbuilding industry would expect the West Germans, their feared commercial competitors, to pay a part of the costs.⁷⁵ R.D.C. McAlpine, the Assistant Head of the Northern Department, agreed that it would be difficult to get adequate support from the other governmental departments. Therefore he hoped that necessary funding for the

⁷¹ NA. FO371/159297. NF103138/8. A.G. White, BOT, to R.D.C. McAlpine, FO, August 31, 1961.

⁷² NA. FO371/159297. NF103138/8. A.G. White, BOT, to R.D.C. McAlpine, FO, August 31, 1961.

⁷³ NA. FO371/159297. NF103138/8. Minute by N.J. Barrington, September 22, 1961.

⁷⁴ NA. FO371/159297. NF103138/8. “Procedure for getting a Whitehall view on aid to Finland”. N.J. Barrington, September 25, 1961.

⁷⁵ NA. FO371/159317. NF1151/12. Minutes by F.C. Mason, October 3, 1961.

Finnish shipbuilding and engineering companies would come from the World Bank or the International Finance Corporation.⁷⁶

Facing opposition, R.H. Mason had to conclude that there was little chance of getting sufficient support within Whitehall for aid to Finland because of present U.K. economic problems. The possibility that funds could come from the World Bank or the International Finance Corporation was a much more appealing option, though there would still be problems to face. The successful implementation of the aid project would require co-operation with the Finnish government, and it was far from certain that President Kekkonen or other Finnish politicians would be interested in Western proposals.⁷⁷

Western fears of the possibility of a new crisis in Finnish-Soviet relations were not unfounded. On October 30, 1961, less than two weeks after R.H. Mason formulated the above negative conclusions, the Soviet Union sent the Finnish Government a note proposing military consultations based on the Finnish-Soviet Treaty of 1948 and referring to the "West German military threat". This spawned what has since been known as "the Note Crisis".

While the new crisis seemed to prove that Western concern for the future of Finland was justified, the Soviets did not use economic sanctions as the Foreign Office and the State Department had expected. Even so, as a part of broader U.S. plans to support Finland in the crisis, the U.S. Ambassador brought President Kekkonen a personal letter from President John F. Kennedy, in which the latter offered Finland economic and political aid.⁷⁸ Based on earlier discussions in Whitehall, the Foreign Office decided that the British would not offer economic aid to Finland, but would give diplomatic support within the United Nations, if needed.⁷⁹ When O'Neill came to see Kekkonen on November 21, 1961, the same day as his U.S. colleague, he offered no help to Finland.⁸⁰

President Kekkonen was reluctant to receive any help from Western powers and the crisis finally ended without the need for Western economic aid. The crisis had no real impact on British government policy in regards to aid to Finland. Neither did the Finnish association to the British-led European Free Trade Association (1961). The British Embassy in Helsinki and the Northern Department of the Foreign Office were still interested in proposals to tighten Finnish economic ties with the U.K. as a part of wider joint Western efforts,⁸¹ but they recognized that there was little chance of pushing this agenda successfully through Whitehall departments. Foreign Office officials had learned their lesson from the unsuccessful attempts to bring the economic aid question to the Joint Economic Measures Committee in 1959 and 1961. This

⁷⁶ NA. FO371/159317. NF1151/12. Minutes by R.D.C. McAlpine, October 11, 1961.

⁷⁷ NA. FO371/159317. NF1151/12. R.H. Mason, FO, to T. Brimelow, Washington, October 17, 1961.

⁷⁸ Telegram From the Department of State to the Embassy in Finland, November 20, 1961. FRUS. 1961-1963, volume XVI, pp. 419-420.

⁷⁹ NA. FO371/159301. NF103138/98. R. H. Mason's "Finland - Western policy". November 22, 1961.

⁸⁰ Suomi 2001, 447.

⁸¹ Rautkallio 1992, 255.

became clear in 1962, when economic support to Finland was again under consideration.

The British Embassy in Finland was still trying to argue, though with little success, that the U.K.'s strongest competitors were also her best trading partners and that the development of the Finnish economy would most likely allow the country to not only buy more from the U.K., but such an expansion of British exports to Finland would offset any losses caused to the U.K. industry by increased Finnish competition.⁸² However, when the U.S. State Department was considering new aid proposals in the spring of 1962,⁸³ neither the Northern Department nor the Economic Relations Department saw any chance of getting support from the Treasury or the Board of Trade for agreements to any British contingency aid contribution in advance. Unless the Foreign Office could present "*cut and dried proposals*",⁸⁴ the Treasury would not even be willing to consider providing the necessary funds, nor would the Board of Trade be willing to support any scheme resulting in increased competition to U.K. industry, although in a crisis situation the chances of the Foreign Office would be stronger. The Northern Department also hoped that the British could buy more Finnish products, but it was hard to see how the British government could encourage private companies to do so.⁸⁵

Conclusion

Because of the U.K.'s own economic difficulties, the British could not offer large loans to Finland, but this was not the sole reason for their unwillingness to support Finland. The Northern Department of the Foreign Office hoped that the British could participate in joint Western efforts to provide funds for Finland, but the Board of Trade, the Treasury, and occasionally the economic sections of the Foreign Office as well, effectively torpedoed any attempts to provide British economic assistance to Finland. Therefore, the Cold War rhetoric of the Foreign Office gives a misleading picture on actual British government priorities.

Despite the Cold War-motivated views expressed by the Foreign Office and the Americans, for the economic departments Finland was solely a trading partner and in some fields an actual or potential competitor in world markets,

⁸² NA. FO371/165937. NF1121/11. C. O'Neill, Helsinki, to R.H. Mason, FO, June 19, 1962.

⁸³ NA. FO371/165931. NF103138/42. T. Brimelow, Washington, to R. H. Mason, FO, April 4, 1962 and April 18, 1962.

⁸⁴ NA. FO371/165931. NF103138/42. "Helping Finland to Withstand Possible Soviet Pressure" R.H. Mason, March 27, 1962.

⁸⁵ NA. FO371/165931. NF103138/42. Minutes by N.J. Barrington, April 13, 1962; "Helping Finland to Withstand Possible Soviet Pressure" R.H. Mason, March 27, 1962; F.C. Mason's and F.G.K. Gallagher's minutes with the same name, April 6, 1962 and May 8, 1962 respectively; R.H. Mason, FO, to T. Brimelow, Washington, June 4, 1962.

and thus the departments were reluctant to accept that the British economic interests should be in some cases subordinated to the need to contain the expansion of Soviet power in Finland. If the Americans and the Northern Department of the Foreign Office were successful in their attempts to move the direction of Finnish shipbuilding and engineering industry exports from the Eastern Bloc to Western markets, these industries would compete with Britain's own industries. Even if it were unlikely that a small country like Finland could become a particularly formidable competitor in the world markets, the British economic departments strongly opposed any policy that would further integrate Finnish engineering and shipbuilding industries with the (Western) world economy; an attitude that was much closer to Soviet policy than to Foreign Office or U.S. policy. Despite the long history of British involvement in hegemony struggles in the Northern Europe, the majority of the British decision-makers felt in the 1950s that the British economic interests were much more important than the need to contain the expansion of Soviet influence in Finland.

U.S. and U.K. diplomats often had differing views on the seriousness of the situation in Finland, but we should not explain the differences between U.K. and U.S. government policies by merely referring to conflicting political and strategic assessments. In the end, the British views on the desirability of providing economic aid to Finland often depended on who was providing the funds and on whether or not the proposals were compatible with the economic interests of the UK as defined by the BOT and the Treasury.

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Klaus Ammann

Swiss Trade with the East in the Early Cold War

Introduction

Swiss bank Credit Suisse First Boston opens a new office in Moscow, Swiss multinational food producer Nestlé buys Ukraine's biggest Ketchup, Mustard and Mayonnaise producer, Volyn and the United States threaten to punish Swiss companies that did not cooperate during the war in Iraq – these three headline topics of the past months in 2004 find parallels and explanations in the history of Swiss trade during the Cold War. Swiss investment and trade in a difficult but promising Eastern European market and American pressure on Swiss economy that takes advantage overtly of the political concept of neutrality are two constant paradigms of Swiss Cold War history.

This paper focuses on the history of economic relations between Switzerland and Eastern Europe in the 1950s. Whereas the Swiss trade strategies after World War II in general have been the subject of various studies in the past, this article tries to discern the particularities of trade with the East. It depicts the way the small but relatively powerful Swiss politico-economic elite defended its interests between the two blocks. The present analysis constitutes a first step in the elaboration of a doctoral thesis dedicated to the role that Swiss private companies played in the East-West trade.

The findings of this paper are based mainly on literature as well as on the most central records concerning East-West trade – in the Swiss Federal Archives (SFA) in Bern – partly published through Swiss Diplomatic Documents – as well as the Swiss Archives of Contemporary History (SACH) in Zurich. The consulted records document the two principal actors in Swiss foreign policy, the Division of Commerce in the Federal Department of Economy and, on the side of private company interests, the Directing Committee of the Swiss Federation of commerce and industry (Vorort).

The analysis will be launched by a short assessment of the making of Swiss commercial policy. Third chapter gives a general survey of the situation in

Switzerland after World War II. Based on these two chapters, the core of the article will treat the development of Swiss trade interests in the 1950s, particularly focusing on the relations with Eastern European countries.

The making of Swiss commercial policy

The particularities of East-West trade – state-monopoly on foreign trade in the East and state-directed payment operations on both sides – can be seen as conditions for an unusually tight internal cooperation between the state and private actors within a country.

On an institutional level under the Swiss constitution, competence for Switzerland's foreign policy is attributed to the federal government, although the border cantons entertain in fact diverse relations with neighboring countries. Federal legislative and executive power share or rather compete for responsibility in foreign policy making while de facto the Federal Council plays a predominant role.¹ This article alone cites the Federal Council as a body or one of its members more than any other political actor.² This does however not allow direct conclusions on the actual power of influence of the federal Executive.

Since the end of the 19th century, Switzerland has developed a strongly export-oriented economy. Swiss companies export enormous amounts of capital and quickly started to act beyond the regulating mechanisms of nation-states. Jakob Tanner defines the relation between state and economy in foreign policy as follows:

“The state disappears in the shadow of the economy – official Switzerland organizes its relations with the exterior through business, para-state and semi-official contacts, which makes foreign policy, primarily foreign economic policy, keep a chronically low profile whereas commercial representations set the tone and determine the course”³

Diplomacy is a sort of go-between in this model. Without having brought our research on the separation of tasks between public and private organs in foreign economic policy towards Eastern European countries to a close, some observations that fit into the picture provided by Tanner can be made at this point: First of all, the two key players in Swiss foreign policy were the Division of Commerce in the Department of Public Economy on the one side – the fact that this division did not belong to the Political Department (nowadays

¹ Wildhaber 1992, 148.

² The Swiss Federal Council consists of seven members with equal rights. Each member is head (minister) of one department. The President of the Confederation is elected for just one year and is regarded as *Primus inter pares* for this period. She or he chairs the meetings of the Federal Council and undertakes special representational duties.

³ Tanner 1993, 4. (Translation of all French or German citations by Klaus Ammann.)

Department of External Affairs) is not surprising in the above-mentioned context – and the Swiss Federation of Commerce and Industry (Vorort) on the other side. Both bodies were closely related. Several officials took a seat in the Vorort after leaving the public service, some went the other way. Different authors have analyzed the respective influence on foreign policy of these two bodies. So far majority of them have concluded - on the basis of empirical analysis of the participants at negotiations - that the Vorort lost influence in favor of the Division of Commerce in the 1950s.⁴ However, Dirlewanger et al. question this interpretation stating that the negotiations are not necessarily the deciding factors. In fact, they say

“reality is more complex [...] from the point of view of its functions and its composition, this division [the division of commerce] constitutes such an ambiguous institution that one has to ask to what degree it is not rather a sort of state relay of the Vorort.”⁵

Another organ that participated in the process of decision-making in foreign economic policy was the Delegation of Finance and Economy of the Federal Council, which institutionalized cooperation between the Departments of Public Economy, the Political Department and the Department of Finance and Tariffs. Finally, the Permanent Delegation (*ständige Wirtschaftsdelegation*) did not have a legal base. It was composed of both government officials and representatives of private business. Most analysts agree that in fact the Permanent Delegation was the most important organ in tuning the cooperation between the administration and organized private interests.⁶ However, even thorough archival research by Dirlewanger et al. has brought up no more than some dispersed minutes of this body.⁷

Overall, Swiss commercial policy was made mainly by private actors that are often closely linked to state institutions. For this reason, it is often difficult to reconstruct the decision-making process before a decision is finally announced at a high political level.

Switzerland's uncomfortable Position after World War II

War begins at the end of the war

One key element of Swiss foreign policy – neutrality – was under pressure by 1945. Switzerland had declared its return from differential neutrality to integral neutrality – *integral* meaning excluding any participation in an international organization whatsoever – in 1938 and had left the League of Nations. During

⁴ For example Gees 1998.

⁵ Dirlewanger et al. 2004, 26.

⁶ Meyer 1999, 24-25.

⁷ Dirlewanger et al. 2004, 30.

the Second World War, the country managed to keep out of hostile activities, mainly thanks to the key economic and financial role it played in Hitler's "*New Europe*". The period of war itself had therefore not been a catastrophe for the Swiss economy. On the contrary, it was during World War II that Switzerland overcame the effects of the Great Depression, and the Swiss economy was able to prepare for a postwar boom. Right from the outbreak of World War II, the Allies pressured Switzerland to reduce economic relations with Nazi Germany, but with rather meager results. By the end of the war, Swiss neutrality had lost much of its credibility in the eyes of the Allies. Whereas the League of Nations had accepted the differential Swiss neutrality, the newly-born United Nations did not.⁸ From an economic point of view, according to Swiss historian Hans Ulrich Jost, it was in 1945 that the war started for Switzerland, because many Swiss companies were black-listed by the Allies and the country had to face a difficult struggle for a position in the postwar economic order.⁹

The Comeback of Neutrality

Thus, at the end of the war the fully functioning Swiss industrial sector was eager to export to and deal with partners in the East and West, most of whom needed help in reconstructing their war-damaged economies. The Swiss delegation that traveled to the United States in order to settle war affairs in 1946 stressed the fact that Switzerland had the potential to play a substantial role in the reconstruction of Europe – successfully. The treaty of Washington seems *ex post* as a relative success for Switzerland: Without recognizing any legal obligation, Switzerland offered 250 million Swiss Francs for the European reconstruction. In turn, owners of confiscated German assets were indemnified and Swiss companies taken off Allied black lists.¹⁰

This comparatively mild attitude that the Western Allies under American leadership showed towards Switzerland had long-lasting consequences for the future foreign policy of the country. The contradictory existence – as Jakob Tanner puts it – of a rich country with a strong and outward oriented industrial and financial sector on the one side, and an introverted, neutral and in some cases isolationist foreign policy persists.¹¹ The emerging Cold War offered Switzerland, after the encirclement by the Axis powers during the war, the possibility of "*ne uter*" again – neither Atlanticism nor Stalinism, neither NATO

⁸ Bretscher-Spindler 1997, 78-83. In 1920 a large majority of citizens approved Swiss membership in the League of nations. However, for the reasons explained above joining the UNO was out of question for the majority of the voting population as well as of the politicians after World War II. It was only in 1986 that the Federal Council submitted the issue to popular vote again, but suffered a bitter defeat. A popular initiative requested a new vote in the spring of 2002. This time Swiss membership in the United Nations was approved by a small majority of voters.

⁹ Jost 1998, 107.

¹⁰ Meier et al. 2002, 295-297. This is one of a series of 25 volumes that the Independent Commission of experts Switzerland-Second World War mandated by the Federal Council published in 2001-2002.

¹¹ Tanner 1993, 4.

nor Warsaw pact. De facto Switzerland integrated into the Western front, but the growing conflict between the East and West made neutrality a valuable diplomatic instrument again.¹² With reference to neutrality, good offices – such as membership of the United Nations Neutral Commission for Korea – were promoted, but the possibilities of active foreign policy were reduced and isolationist thinking became more common.

“This way neutrality contributed to the fictionalization of “national identity” and for several decades foreign policy pursued the goal of symbolic self-presentation of a country, whose actual influence in the world rested on completely different foundations.”¹³

The contradiction between this neutral self-conception and the social and economic de facto integration into global and European realities has become more and more absurd,¹⁴ but remains a Swiss reality up to this day. The actual basis of Swiss influence lay in its economical power much more than in its diplomatic services or military strength. This is valuable in general as well as with regard to Eastern Europe. Using this hypothesis as a backdrop, the following section will focus on Swiss trade interests at the beginning of the 1950s, in particular towards the East.

Swiss trade interests between East and West

Statistical overview

Before analyzing the mechanisms and structure of Swiss trade and particularly Swiss trade with Eastern Europe – that is with the Soviet Union, Poland, the German Democratic Republic (GDR), Czechoslovakia, Hungary, Romania, Bulgaria, Yugoslavia and Albania – statistics provide an initial overall picture. Figure 1 illustrates Swiss total exports in comparison to exports to the Eastern European countries as well as Swiss total imports in comparison to imports from the Eastern European countries.

While all four curves show clearly increasing tendencies, growth was uninterrupted only for Swiss total exports. The growth of Swiss total imports, however, was interrupted four times by periods of decrease, two of these being significant: 1949 (20 per cent) and 1958 (10.4 per cent).¹⁵ Concerning Swiss trade with Eastern Europe, the growth pattern was less clear: The first period of growth in the second half of the 1940s was followed by a period of three to seven years of decreasing values. Similar to overall trade, imports show more significant changes than exports. A second period of growth in the middle of the 1950s was again followed by several years of decreasing imports (1957-60). Exports, however, grew slowly throughout the second half of the 1950s and

¹² Ibid., 7.

¹³ Ibid., 5.

¹⁴ Ibid.

¹⁵ Dirlewanger et al. 2004, 34.

decreased only in 1962. After that, both export and import values grew and finally decisively passed pre-war levels. Figure 2 offers a more focused picture of trade growth revealing that growth of trade between 1946 and 1970 with Eastern Europe (24.7 per cent) almost doubled compared to the growth of overall trade (13.1 per cent). It is striking that the overall trade developed in a much steadier way.

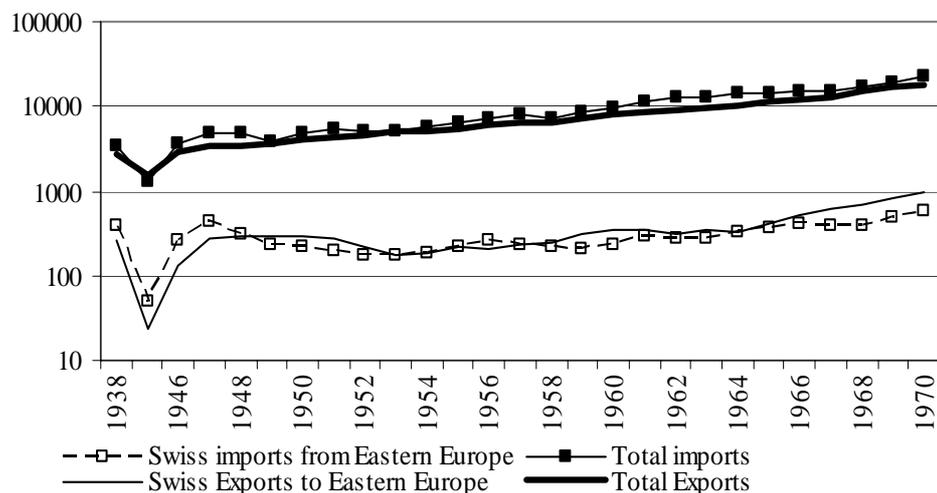


FIGURE 1 Swiss Exports and Imports - Comparison of Eastern Europe to World, 1938/1945 - 1970 in Millions of Constant 1955 Swiss Francs (log.)¹⁶

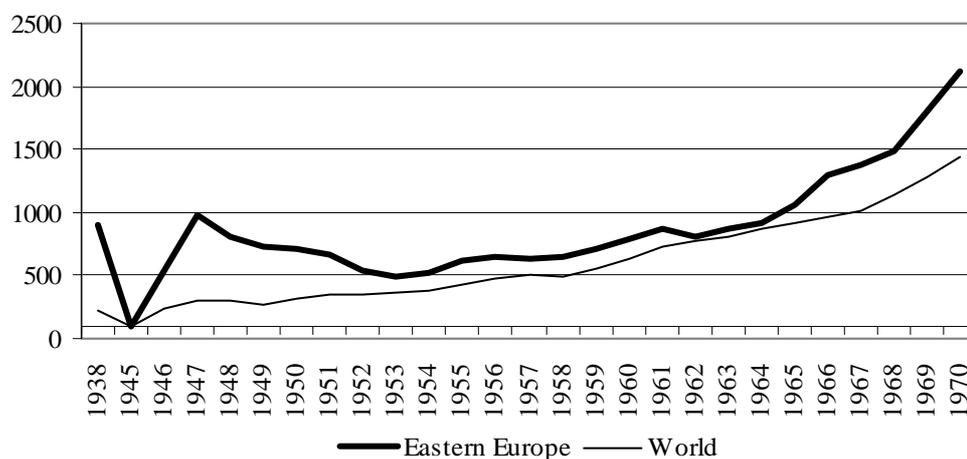


FIGURE 2 Index of Trade Development: Swiss Overall Trade in Comparison to Swiss Eastern Trade 1938/1945-1970 (1945=100)

All these general conclusions drawn from value figures are equally correct when considering the trade volume for the period and the countries mentioned.

¹⁶ All figures based on data from Ritzmann-Blickenstorfer 1996, 698-707. Conversion into constant Swiss francs (1955 = 100) using the index of wholesale prices by months in Ritzmann-Blickenstorfer 1996, 491.

A second observation concerns the trade balance: While it is generally negative throughout this period for the Swiss foreign trade, it is positive for most of the years with regard to Eastern Europe. Figure 3 underscores this point.

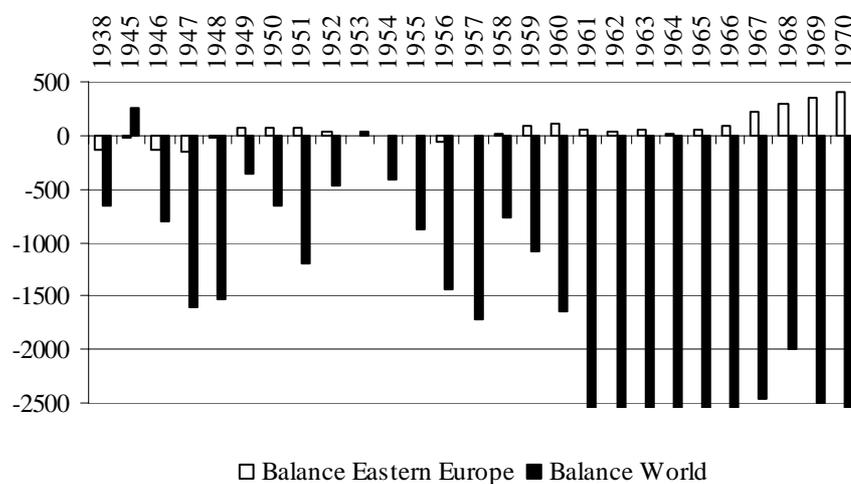


FIGURE 3 Swiss Balance of Trade with Eastern Europe and with the World in Millions of Constant 1955 Swiss Francs

Thus, except for the late 1940s and some years in the middle of the 1950s, the trade balance with Eastern Europe behaved contrary to the total trade balance of Switzerland. One very important detail remains: Even though the trade balance was mostly negative, the balance of all operations remained positive thanks to the largely positive balance of payments and tourism.¹⁷

With regard to trade with Eastern Europe, Switzerland followed more or less the pattern of other Western European countries: Here and there trade decreased between 1948 and 1952. Swiss East-West trade was on the level of France or the Netherlands.¹⁸ Direct political context seemed to have more impact on the trade with the East than with other regions. Each time the Cocom embargo was loosened, trade increased. Any crisis between the East and the West, however, could muffle it as the downturns in the figures after 1956 (Hungarian crisis) and after 1961 (Berlin Wall) indicate.¹⁹ Percentage-wise, Swiss trade with Eastern Europe between 1945 and 1970 was at no time very important, as Figure 4 illustrates.

¹⁷ Ibid., 36.

¹⁸ Førland 1991, 214.

¹⁹ Meyer 1999, 423.

TABLE 1 Eastern European Trade Shares as Percentages, 1938/1945-1970²⁰

Year	%	Year	%	Year	%
1938	10.4	1953	3.5	1962	2,7
1945	2.6	1954	3.5	1963	2,8
1946	6.0	1955	3.7	1964	2,7
1947	8.5	1956	3.5	1965	3,0
1948	7.1	1957	3.2	1966	3,5
1949	7.0	1958	3.4	1967	3,5
1950	5.7	1959	3.3	1968	3,4
1951	4.8	1960	3.3	1969	3,6
1952	4.0	1961	3.1	1970	3,8

As we have seen, trade with Eastern Europe measured in constant values topped the values of the last year before the war in 1947 (imports) and 1948 (exports). These years marked the after-war peak for the share of trade with Eastern Europe - 8.7 per cent for the imports in 1947 and 8.4 per cent for the exports one year later. However, the post-war trade never reached the shares of imports from and exports to Eastern Europe in 1938, which were at 11.2 per cent and 9.3 per cent respectively.²¹

The structure of Swiss trade underwent two major changes between 1945 and 1960. Most importantly, Germany - in the form of the Federal Republic of Germany - regained its position as Switzerland's most important trading partner in 1954. Secondly, while the share of trade with Eastern Europe stagnated, Western Europe enlarged its share both on the export as well as on the import side; exports, for example, growing from 52 per cent in 1946 to 62 per cent in 1970. At the same time, the U.S. lost importance. Now, how do these figures translate into developments in trade policy?

Participating in Western Europe's New Growth

Sortir du réduit²² – leaving fortified positions the end of World War II – was much simpler for the Swiss army than for the Swiss economy. In order to overcome its isolation and to find a position in Europe's new economic order, Swiss foreign policy was, according to Dirlewanger et al., guided by three main ideas: First of all, policy makers wanted at any cost to launch an export offensive supported by credits. Secondly, relations with Germany had to be

²⁰ Figures from Ritzmann-Blickenstorfer 1996, 698-707.

²¹ Calculations made on the basis of figures from Ibid.

²² The Swiss army followed during World War II the so-called réduit-strategy. Only few troops would have defended Swiss borders in case of attack through Nazi Germany. Defense would have been organized in the "réduit", that is in the alpine region. The core of the Alps is naturally much easier to defend than the long border along the river Rhine. However, this strategy has been heavily criticized for the great majority of the population would have been left to the will of the attackers. Critical historiography moreover sees first of all a propagandistic strategy behind it. Jost, for example, shows that troops were retired to the alpine fortifications according to economic necessity rather than military threats. Cf. Jost 1998.

normalized as soon as possible, since Germany has always been Switzerland's most important trading partner. And thirdly, Switzerland wanted to act according to the formula "*neutrality and solidarity*". As a consequence Switzerland dismissed *integration* – which was interpreted as cooperation with political and military goals -, but approved *cooperation* – meaning technical and economic cooperation.²³ This policy was applied with respect to the United Nations for example – Switzerland only joined the UN in 2002 but cooperated on a technical level right from the beginning – but also in its relations with many other European and global organizations. According to a self-defined differentiation between political and technical organizations, Switzerland declared it incompatible with its neutrality as far as joining either the NATO or the European Economic Community (EEC). At the same time, the OEEC was considered technical enough for Switzerland to join. However, Swiss officials repeatedly threatened to quit the organization if it intensified cooperation with the NATO. This tendency of separation between politics and economics was characteristic of the Swiss foreign policy also regarding Eastern Europe.

Dirlewanger et al. examined the structure of Swiss foreign trade, concluding that Switzerland managed to compensate for the absence of Germany as its most important trading partner by extending relations to other European countries as well as to the United States. Thanks to the Marshall Plan, Western Germany rapidly caught up economically. Forced by the Allies in 1946 to furnish only financial and essential goods to Germany, Swiss export industries pressured for a change until the existing treaty was denounced in 1949. Negotiations resulted in a new treaty that stimulated Swiss-German trade enormously. Eventually, in 1954 Germany was once again Switzerland's number one trading partner, a position it maintains up until today.²⁴

Even before the end of World War II, multilateral cooperation in European and world trade intensified. In order to understand the context in which Switzerland formed its position in East-West trade, it is important to have a brief look at how the country related to certain key developments. The Treaties of Rome in 1957 laid the foundations for the European Economic Community between Belgium, France, the Netherlands, Italy, Luxemburg, and the Federal Republic of Germany. The goals of a common market and tariff union seemed too radical for Switzerland to join the EEC. At the same time, the country could not allow itself to stand completely aside. After all, Western Europe was its biggest trading partner by far. Over the years Switzerland joined many initiatives on a technical level, but tried to avoid any political implications. Eventual Swiss participation in the European Payments Union (EPU) and in the European Free Trade Association (EFTA) has to be seen in this context. Reactions to these steps, such as the Swiss Workers Party's (PdA) demand of a credit-extension towards Eastern Europe in 1950, arguing that this was

²³ Maurhofer 2001, 446.

²⁴ Dirlewanger et al. 2000, 8.

necessary in order to counterbalance the predominance of the West, did not result in successes.²⁵

Switzerland perceived – similar to the Soviet Union but for different reasons – most European integration initiatives – starting with the Marshall Plan – as detrimental to its political and economic interests.²⁶ The country participated in the OEEC, but feared the economic impacts of this interventionist project that was oriented by the interests of the powerful allied economies on the Swiss liberal economic order. The participation was mainly due to Federal Council's Petitpierre's personal initiative. Switzerland joined the OEEC before the Soviet Union refused to do so but only after Great Britain had confirmed that the OEEC would not be used as an instrument of close cooperation in the Western alliance. In fact, the Marshall Plan was a very welcome opportunity for Swiss capital to work. At the same time, on a symbolic level, it could be used as proof that Swiss neutrality did not exclude economic solidarity.²⁷

Throughout the 1950s, Switzerland tried to improve relations with the EEC and access to the European market. The six founding members of the EEC, France in particular, strongly opposed the Swiss attitude of participating when and where it pleased, which led to a series of conflicts including a period of non-agreement in the late 1950s with France.

Despite numerous concerns, in the second half of the 1950s Switzerland started to negotiate with the General Agreement on Tariffs and Trade (GATT) because this international agreement had the potential to eventually strengthen the Swiss position towards Europe. Long negotiations and a provisional entry in 1960 preceded full participation in the GATT from 1966 on.²⁸

New and Hopeful Relations with Eastern Europe

One member of the Directing Committee of the Swiss Federation of Commerce and Industry (Vorort) saw two main tasks for the Swiss government to tackle with regard to Eastern Europe:

“...to retie trade relations interrupted by the war and preserve Swiss interests that were threatened by nationalization. Both tasks were closely related; without the reestablishment of commerce which required bridging loans, indemnification agreements were not conceivable...”²⁹

Being only partly tied to Western Europe, Switzerland wanted to stay an attractive partner also for the Eastern European countries. Even though Swiss neutrality had fallen as deeply in disgrace in the East as in the West, bilateral

²⁵ Interpellation Jeanneret, Maurice, National Council, PdA, 25.10.50. SFA E 7110 (-)1976/16/42 “Oststaaten: Osthandel, Osthandelskampagne”.

²⁶ Maurhofer 2001, 443. Pinder 1991, 8.

²⁷ Maurhofer 2001, 445.

²⁸ Dirlewanger et al. 2000, 18-21.

²⁹ Minutes of Swiss Federation of Commerce and Industry, Vorort, 18.12.1961, p.26, SACH Vorort 1.5.3.16 I.

relations with the East were established right after the war. While diplomatic and effective economic relations with the Soviet Union only started to form in 1946, negotiations with all other Eastern European countries – except for Albania and the Soviet zone of Germany (the later GDR) – started very soon after the armistice and led to the first agreements on trade and transfer of payments in December 1945 (Czechoslovakia) and in March 1946 (Poland). Federal Council's Walter Stampfli, Minister of Economy, expressed the hopes of many Swiss officials that the Eastern European countries could become important trading partners when he said in October 1945:

“...there [in Eastern Europe] the chances are highest, for us within our limited possibilities to occupy the space left by Germany. Through intensification of commerce with Eastern Europe we can hope to avoid too unilateral dependency on the Anglo-Saxon economic bloc.”³⁰

Both objectives could in fact be reached within a short amount of time. Figure 5 once again illustrates the impressive take-off of Swiss trade with Eastern Europe starting virtually from zero yet already topping pre-war values by 1947. This climax was not reached again for almost 20 years. Official Switzerland regretted the decline, especially for imports, and cited three reasons for it: Eastern Economies were constantly being rebuilt, the internal demand was growing rapidly, and Comecon integration was being pushed.³¹

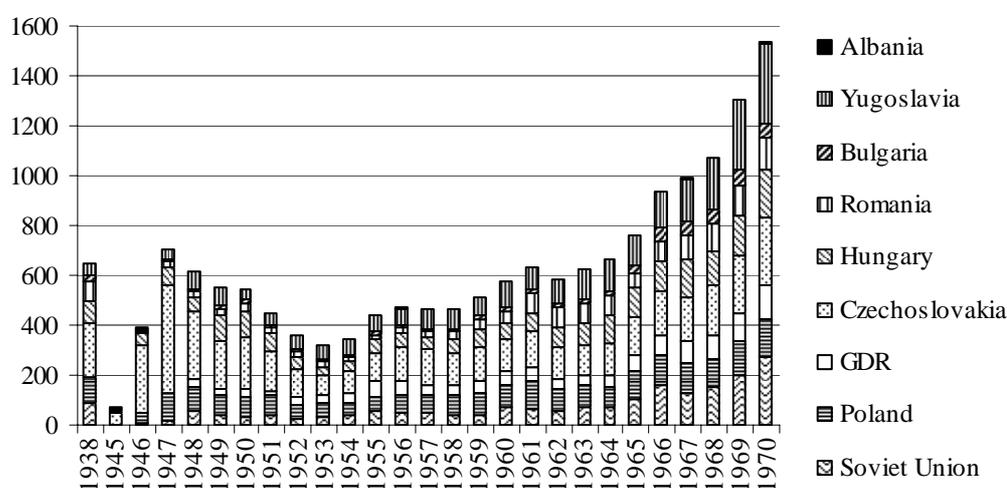


FIGURE 4 Swiss Trade (Exports and Imports Added) with Individual Eastern European Countries, 1938/1945-1970 in Millions of Constant 1955 Swiss Francs

Czechoslovakia was by far Switzerland's most important partner, except for 1963, until 1968. This was mainly due to the fact that Czechoslovakian industry

³⁰ Minutes of the meeting of the Federal Council, 12.10.1945, SFA E 7001(B)-/1/256 cited in Bulliard 1995, 114-115.

³¹ Report Ministry of Economy to Federal Council, 4.6.1952 SFA E 2001(E)1969/121/4.

had suffered hardly any war damages. Yugoslavia, starting at a much lower level, gradually caught up and took the lead at the end of the 1960s. Poland, traditionally also an important trading partner, could not match Czechoslovakia and after a couple of years in second position it joined a group of countries of average – in Eastern European terms – importance. The Soviet Union itself, in spite of its enormous territory and resources, did not excel at all. Only towards the end of the 1960s did it take a more prominent position, passing even Czechoslovakia. On the bottom end of the scale is Albania. There were no diplomatic relations between this small isolated country in the South of the Balkans and Switzerland until 1970. Only at the end of the 1960s slight growth is visible, yet the total volume of exchange remains at a very low level. The German Democratic Republic at last joined the middle class-partners, in spite of not being recognized by the Swiss government until 1972.

Although trade intensity varied widely as we have seen, the basic problems in bilateral relations with Switzerland were the same for the entire region: All the Eastern European countries were mainly interested in importing Swiss machines. The Swiss readily served these new clients, but wanted to solve the problems of the past at the same time. Max Troendle, Swiss delegate for trade agreements, planned negotiations in two phases: As a first step, he wanted to get trade going and carry out reconnaissance of Swiss interests – which proved to be a complicated matter³² – and, secondly, wished to secure indemnification for the nationalized former Swiss assets through the balance of trade.³³

In accordance with this strategy, Troendle and a group of experts negotiated almost permanently with some of the Eastern European countries. The fast changing circumstances of the different economies as well as of transport possibilities favored short-term agreements. Overall, the Troendle-strategy paid off, as Vorort-Secretary Albert Grübel confirms:

“The lengthy, painstaking negotiations were crowned by considerable success taking into account the extraordinary circumstances. Although the Soviet Union had already refused after the First and again after the Second World War to come up with any indemnification, and the other Eastern European states usually take the Soviet Union as their example, it was possible to negotiate indemnification for the lost Swiss assets with these Eastern European states.”³⁴

³² It turned out to be rather difficult and exhausting to prove the Swiss nationality of the owner. The case of the pharmaceutical company F. Hoffmann – La Roche in Warsaw is just one example of many, where Swiss ownership was alternatively hidden and then stressed again. Under the nationalist Polish pre-war regime, Roche did everything to appear a Polish company. But while Warsaw was part of the Nazi German Generalgouvernement during World War II, Roche emphasized its traditionally good relations with Germany. And after the war the Swiss company stressed its neutral Swiss origins. Ammann 2001, 105-114.

³³ Notice sur la conférence présidée par M. Troendle au sujet de la reprise des échanges avec la Pologne. 3.10.1945 SFA E 2001(E)-/2/633.

³⁴ Minutes of Swiss Federation of Commerce and Industry, Vorort, 18.12.1961, p.26, SACH Vorort 1.5.3.16 I. Translated to English by the author.

Towards the end of the 1940s, the balance of power shifted more and more in favor of the Swiss positions. Switzerland became less dependent on access to the Eastern European markets since more and more interesting trade possibilities came up in Western Europe. At the same time, the Swiss delegate for trade agreements – who was by then very experienced in negotiating with the Eastern European delegations – predicted that Eastern Europe would ask for Swiss mediation in its trade with Western Europe. At this point, the West would apply pressure

“in order to prevent us from re-exporting commodities that we get according to Marshall Plan in processed form towards Eastern Europe. On the principle of neutrality we will have to try with all means to defend ourselves against this pressure in order to maintain economic relations with Eastern Europe that are important to us.”³⁵

U.S. Pressure and the “Gentlemen’s Agreement” of 1951

In fact, as early as 1947 the U.S. started to control exports of certain strategic goods towards Eastern European countries. After December 1947, export approval was needed for these goods for the rest of Europe. At the end of 1949, the U.S. obtained support for their policy from their Western Allies and founded the Consultative Group and the Coordinating Committee (COCOM) in Paris. The three lists of goods established by COCOM³⁶ were sources of conflict between Western Europe – traditionally closely linked to Eastern Europe – and the U.S. right from the start.³⁷ Several OEEC-member countries, including Switzerland, opposed the logic behind the embargo, arguing that it contradicted the objectives of the Marshall Plan. Swiss delegates - among others - informed the British that the prohibition of exports to Eastern Europe would have severe domestic political repercussions. Still under the impression of wartime shortages, many Western European countries, including Switzerland, were not prepared to risk losing supplies of raw materials and foodstuffs.³⁸

When China entered the Korean War in 1950, the U.S. and its allies discussed tightening the embargo, eventually passing the Mutual Defense Assistance Act in June 1951. This signified more pressure on Switzerland to join the Western efforts. Swiss economic circles felt that they would once again make use of the argument of neutrality

“... it will be necessary for us, as during the last war, to assume that the trade policy of a neutral state like Switzerland has to be based on the principal of “do ut des”. In

³⁵ Political Department to Troendle, 8.5.1948, SFA E 2001(E)-/1/1.

³⁶ I: goods that are excluded from export to Eastern Europe; II: goods with limited export levels; III: goods that have to be statistically controlled

³⁷ Lohm 2000, 53. See also McGlade, in this volume.

³⁸ Jackson 2001, 32. The Swiss attitude up until 1949 is summarized in a note of 26.11.1949 of the head of the Division of political affairs of the Foreign Department, Alfred Zehnder to his superior, Foreign Minister, Max Petitpierre. [Note, Zehnder to Petitpierre, 26.11.1949] *Swiss Diplomatic Documents (DDS)*, Vol. 18, Zurich 2001, No. 25, (DoDiS-7202, <http://www.dodis.ch>).

this respect we do not have to reproach ourselves over anything concerning our commerce with Eastern countries, since that trade completely relies on reciprocity.”³⁹

Reciprocity, however, was tending to get very uneven in bilateral relations, namely with Romania and the Soviet Union. The members of the Vorort agreed in the autumn of 1950 that Switzerland had to take autonomous measures if only to prevent the U.S. from harassing individual Swiss companies. Vorort delegate Heinrich Homberger⁴⁰ saw in the radical control of East-West trade the sword of Damocles for the Swiss economy. Particularly since in his opinion “*the countries of the Atlantic treaty show a cynical tendency to blame Switzerland for everything that goes to the East.*”⁴¹ In this situation, the Swiss Federal Council decided to survey import and export of certain products in order to ensure import of raw materials.⁴² The U.S., however, was not satisfied and called for general import and export controls. Swiss officials refused complete control, believing it to be too complicated. The Federal Council introduced in January 1951 a system of facultative import certificates. As U.S. demands became more and more urgent, Homberger proposed for Switzerland not to allow “*excessive*” extension of exports towards Eastern Europe. This way the reproach of taking advantage of the absence in trade with the East of economies that complied with COCOM should be avoided. In order to do so, future exports should not exceed the so-called “*normal trade,*” that is average commerce with a specific good during the past couple years. At the same time, Swiss economic circles asked the U.S. to increase imports from Switzerland; otherwise these goods would have to be sold elsewhere – in Eastern Europe, for example.⁴³ Defending a special position for Switzerland became more and more difficult in the first half of 1951, though. In April, the U.S. made good what they had threatened for several months: 40 Swiss import demands were blocked. As a result, Switzerland reintroduced control of strategic goods in June and invited an American delegation to Berne in order to avoid the impression that it acted under American pressure only. While the Swiss talked about *conversations* and reciprocal orientation, the U.S. made clear that they wanted negotiations. On 2 July a Swiss delegation headed by the director of the Division of Commerce in the Department of Public Economy, Jean Hotz, received American Deputy Assistant Secretary of State for Economic Affairs Harold Linder and his

³⁹ Minutes of Swiss Federation of Commerce and Industry, Vorort, 3.10.1950, p.19, SACH Vorort 1.5.3.14 I.

⁴⁰ Heinrich Homberger (1896-1985) was a key figure in Swiss economic policy for more than 30 years. He joined the Vorort in 1922, became its director in 1939 and later its delegate. The minutes of the Swiss Federation of Commerce and Industry illustrate what a dominant position Homberger occupied in the organization and as a consequence in Swiss economic policy-making. For more information on Homberger see the online-database at: <http://www.dodis.ch>.

⁴¹ Minutes of Swiss Federation of Commerce and Industry, Vorort, 28.12.1950, p.10, SACH Vorort 1.5.3.14 I.

⁴² Decision of the Swiss Federal Council of 11.12.1950. Lohm 2000, 56.

⁴³ Minutes of Swiss Federation of Commerce and Industry, Vorort, 12.3.1951, SACH Vorort 1.5.3.14 I.

delegation.⁴⁴ As negotiations or talks – depending on the perspective one takes – proceeded, both sides made concessions. Linder accepted exports in justified cases and thus changed *strict prohibition* into *prohibition by principle*. In exchange, the Swiss reduced “*normal trade*” to “*essential trade*” for goods on COCOM-list I. The agreement between Hotz and Linder was concluded on an oral basis only and was later referred to as a “*gentlemen’s agreement*”. It was in many aspects comparable to the one concluded between the American Ambassador to Sweden, Walton Butterworth, and Dag Hammarskjöld, then Secretary General of the Swedish Cabinet in mid-June 1951.⁴⁵ Both sides were satisfied with the outcome, as the author of the most referred to monograph on this topic, André Schaller, confirms. Schaller is right in his interpretation that the Swiss delegation had ceded to American pressure, because the failure of the talks would have meant serious consequences for the Swiss supplies.⁴⁶ Swiss companies, fearing to be put back on the American black list as they were during World War II may also have favored concessions to detriment of trade with the East.

The question whether or not Switzerland had preserved its neutrality by accepting the Hotz-Linder agreement has been the subject of many debates. Schaller and others claim that the gentlemen’s agreement was in line with neutrality. In my opinion, this is not only incorrect but irrelevant, since Switzerland has never been economically neutral – one strongly doubts that that is even possible. Simply the fact that such talks or negotiations between the U.S. and Switzerland, regardless of their outcome, took place proves, however, that Switzerland was de facto part of the Western bloc. In addition, Trachsler is right when he states that from the American point of view, the Hotz-Linder agreement constituted a Swiss concession and that was all that counted for the U.S. government. Washington did not care about what the Swiss government told the population on this subject.⁴⁷

The concessions made by the Swiss delegation have to be seen in relative terms. During the following year only half of the allowance for list I goods – 4.2 of 8.4 Million CHF – and not even 1/6 of the allowed list II exports – 9.7 of 65 Million CHF – were used up.⁴⁸ However, Switzerland managed through the gentlemen’s agreement to preserve symbolic independence in dealing with Eastern Europe. Homberger, representing the Vorort, was convinced of the future importance of good relations with Eastern Europe in spite of the low trade activities:

⁴⁴ Alfred Zehnder, head of the Division of political affairs in the Department of Political Affairs reported to his superior, foreign minister, Max Petitpierre, on the “conversations” with the US-Delegation. [Note, Zehnder to Petitpierre, 27.7.1951] DDS 2001, No. 105, (DoDiS-8820).

⁴⁵ Førland 1991, 215. See also Stenlås and Nilsson, in this volume.

⁴⁶ Schaller 1987, 214.

⁴⁷ Trachsler 2002, 227-235.

⁴⁸ Minutes of Swiss Federation of Commerce and Industry, Vorort, 26.1.1953, p.19. SACH Vorort 1.5.3.14 III.

“One may wonder sometimes, what this trade with the East, that we are defending is still worth. But to look at things this way is misleading. [...] Even purely economically writing-off these Eastern countries would not be right. There may come a time when Switzerland will be happy to have these Eastern markets again. We have a lot of good will to loose there. It is also obvious, that if trade stops, it is over with transfer of compensation for nationalization.”⁴⁹

Under these circumstances Swiss trade with the Eastern European countries declined in the first half of the 1950s and only slowly regained intensity towards 1960, as Figure 5 shows. In spite of the Hotz-Linder agreement, some sources of conflict with the U.S. and COCOM remained. The U.S. tried to control Swiss controls as the American legate’s repeated inquiries prove. Swiss authorities refused to give the U.S. more information than absolutely necessary.⁵⁰ The exploitation of COCOM list contingents was subject to constant change. These same contingents were adapted according to the intensity of Cold War tensions as well as according to internal COCOM pressures several times. Each time Swiss officials adapted their own contingents, they stressed that they were doing this only to avoid Swiss profits on behalf of restricted OEEC countries.⁵¹ As a rule, Swiss trade found room within this framework. It will be an objective of further research to detect, analyze, and compare cases of American accusations made against individual Swiss companies of illegal trade with the Eastern Bloc.

Limited Success of Bilateral Agreements

Bilateral treaties regulated economic relations between Switzerland and most of the Eastern European countries. In the early 1950s, the above-mentioned system, introduced after the war, persisted more or less unchanged. For most countries imports and exports had to be in line with the pre-established list of goods. This way the balance between the exports and the imports was to be guaranteed. Through these lists Switzerland tried to force the Eastern European countries to import not only producer but also consumer goods, such as cheese, watches, and textiles.

However, in reality this system met various difficulties. The import-export lists had to be established and adapted regularly via painstaking negotiations that very often proved to be of little use. Vorort Secretary Albert Grübel reported for example that the negotiations with Hungary had always been very long but showed meager results. Import lists were, in Grübel’s eyes, always far too optimistic. Very often state companies, monopolizing foreign trade, were not ordered afterwards to buy the goods as scheduled in the corresponding lists. Hungary as well as many other European states tried to export as many non-essential goods as possible, limiting its own imports of the same category

⁴⁹ Minutes of Swiss Federation of Commerce and Industry, Vorort, 14.7.1951, p.5. SACH Vorort 1.5.3.14 II.

⁵⁰ See for example Notice Weitnauer for Hotz, 5.1.1952. SFA E 2001(E)1969/121/4 A.14.62.3.0.West-Ost.

⁵¹ For example: Minutes of Swiss Federation of Commerce and Industry, Vorort, 6.7.1959, p.15. SACH Vorort 1.5.3.15 V.

to a strict minimum. Import-export lists, Grübel concluded, *“have actually the only purpose of guaranteeing to these countries that they get certain amounts of the goods they absolutely need from Switzerland.”*

The Vorort as a consequence called for new, more flexible methods in negotiating with the East.⁵² However, throughout the 1950s import-export-lists remained as the basis of many trade agreements between Switzerland and many of the Eastern European countries – the Soviet Union and Yugoslavia being exceptions. Because negotiations on individual list positions turned out to be long but of little effect, more and more lists were simply prolonged without discussion, with Swiss officials counting on their reactivation when needed.⁵³

Another characteristic of Swiss agreements with most Eastern European countries in the early 1950s was bilateral clearing in payment transactions. This was necessary because of the inconvertibility of Eastern currencies. By splitting off part of the import payments, Switzerland could assure indemnification payments to Swiss holders of nationalized assets. However, with trade decreasing most of the agreements had to be revised several times because fewer imports signified less money on the corresponding indemnification account, which in turn prolonged the payment period. The most striking case in this respect is Poland: The amount of 53.5 Million CHF of indemnification negotiated in 1949 was thought to be paid within 13 years by taking 3 per cent off incoming payments for regular imports and 6 to 18 per cent for coal imports from Poland.⁵⁴ However, Swiss imports of coal – Poland’s number one and only interesting export good for Switzerland – decreased rapidly after being very important among Swiss supplies for some years. Thereafter the indemnification agreement had to be re-negotiated several times and the total amount of indemnification was only paid in the middle of the 1970s. The matter got even more complicated as some of the Eastern European countries confiscated or nationalized Swiss assets after the conclusion of the first agreement. A complementary set of agreements with Yugoslavia (1959), Poland (1964), Czechoslovakia (1967), and Hungary (1973) was necessary.⁵⁵

Both problems – malfunctioning import-export lists and clearing problems – were due mainly to insufficient trade. It became clear to the Swiss concerned that the stagnation in trade with the East could not simply be remedied through negotiations, but that there were structural causes behind it.⁵⁶ With the foundation of the Council of Mutual Economic Assistance (COMECON) in 1949, the structure of Eastern economies had undergone substantial changes.

⁵² Minutes of Swiss Federation of Commerce and Industry, Vorort, 27.10.1952, p.25. SACH Vorort 1.5.3.14 III.

⁵³ Internal report Department of Public Economy, „Wirtschafts- und Handelsbeziehungen zu den Ostblockstaaten“, 11.12.1961, p.1. SFA E 7110(-) 1976/16/42.

⁵⁴ [Minutes of the Federal Council on negotiations with Poland, 8.7.1949] DDS, <http://www.dodis.ch>, DoDiS-7087.

⁵⁵ Hug and Perrenoud 1997.

⁵⁶ Minutes of Swiss Federation of Commerce and Industry, Vorort, 31.5.1954, p.22. SACH Vorort 1.5.3.14 V.

Traditionally Western-oriented economies like Czechoslovakia now had to direct their commerce towards Moscow and other socialist capitals. Consumer goods as offered by the Swiss economy were now only rarely required in the so-called planned economies. Some academics blame the COCOM for having hindered trade in another category – Swiss exports of producer goods, such as machine tools.⁵⁷ My research so far shows, however, that even in this sector the COCOM was not to blame, rather than systemic incompatibilities and the growing unwillingness of the Swiss industries to export under conditions that had become better in other places.

The situation led to reciprocal blaming for the low level of trade, as for example in 1957, when a Swiss delegation met its Soviet homologue. Soviet representatives blamed Swiss companies for not accepting orders and/or offering unacceptable delivery periods and payment conditions. The Swiss, on the other hand called for a diversification of Soviet orders, which contain almost exclusively machines.⁵⁸

New Perspectives in the 1960s

It was only in the late 1960s that new perspectives opened up. As the graphs in chapter 4.1 show, trade in that period grew due to long political efforts and international developments even faster than Swiss overall trade. Switzerland and the COMECON countries felt more and more obliged to adapt the existing economic treaties – some as old as twenty years – to the new realities. The Swiss Federal Council adopted a new policy of commerce with Eastern Europe arguing as follows:

“Given the changes in the foundations on which these *[old]* agreements that carry the signs of the after-war period base, *[existing]* instruments of commercial policy appear today in many respects as out-dated...”⁵⁹

With this in mind, the Federal Council abolished the system of regulated payments (clearing) that was still in use with several Eastern European countries and concluded a new series of treaties with all COMECON members in the first half of the 1970s. All of them introduced the convertibility of currencies and based trade relations on modern principles by installing mixed governmental commissions, offering most favored nation treatment, providing in-line-with-market-prizes, and good-will-clauses on economic cooperation.⁶⁰

A completely new feature started changing the structure and appearance of economic relations with Eastern Europe in the 1970s: joint-ventures.⁶¹ This form of Eastern-public – Swiss-private cooperation cannot be treated within the

⁵⁷ For example Hug and Perrenoud 1997.

⁵⁸ [Dep. of Public Economy to Swiss Embassy Moscow, 13.11.57] *DDS*, <http://www.dodis.ch>, DoDiS-12174.

⁵⁹ Report of the Federal Council, 25.1.1971. Feuille fédérale, 1971 I, 45-46.

⁶⁰ Probst 1975, 753.

⁶¹ Arioli 1992, 830.

limits of this paper but would be another vast field of research hardly studied so far in the case of Switzerland.

Conclusion

Swiss trade with Eastern Europe in the early Cold War has long been neglected in historiography. Political and ideological conflicts between the East and the West, cultural relations, mutual comprehension problems have been dominant themes. The analysis of East-West trade, however, adds important aspects to the multifaceted image of Switzerland during the Cold War. Pragmatism and the clever use of the concept of neutrality in order to keep all doors open – challenging even such big and important partners as the United States, France or Great Britain – characterize Swiss commercial policy during these years. Perhaps most stunning is the persistence with which Swiss economic circles stuck to an *essential* degree of trade with these countries during all these years, hoping to take advantage of this long-lasting presence in Eastern Europe once political circumstances changed. Even during the period studied here, the overall picture is positive for the Swiss economy: Eastern Europe was a region that contributed actively to overall trade growth. At the same time, it had a positive although minor effect on the balance of trade. On this background, today's massive expansion of different Swiss companies in Eastern Europe mentioned in the introduction is hardly surprising. Particular company attitudes and how they influenced official policy in the 1950s and 1960s is just one of the many fields that remain to be explored in this context.

Archival sources

SFA Swiss Federal Archives, Bern
SACH Swiss Archives of Contemporary History, Zurich

Niklas Stenlås & Mikael Nilsson

Cold War Neutrality and Technological Dependence: Sweden's Military Technology and the East-West Trade

It goes without saying that neutrality in war is beneficial to trade. Neutral countries can preserve trade relations with belligerents, form new trade relations to exploit relations that have been severed by war and they can function as arenas for trade that cannot take place elsewhere because of war. International law guarantees the rights of neutrals to trade, which makes them 'blockade runners' or 'holes' in the blockades belligerents are waging against each other.

During the Napoleonic wars Sweden acted as a neutral strategically out of reach of the upheavals on the continent. This allowed Swedish Gothenburg to work as 'leak' in Napoleon's continental system. This was a highly beneficial arrangement for Sweden as British capital flowed into the country and provided an economic basis for much of Sweden's 19th century growth.¹

Since the end of the Napoleonic wars Sweden has remained neutral in all international conflicts in the Baltic area from the Crimean war through both the world wars. During the world wars the allied blockades of the continent did not provide much room for the neutral Sweden to trade. Swedish companies, however, were unharmed by the war and they did not have their foreign assets confiscated or destroyed. Swedish ownership even became an attractive front for the German companies that sought to avoid expropriation of their assets in the U.S.

Sweden's geopolitical position spared the country from the Second World War. In Sweden, however, this was interpreted as the outcome of a successful policy of neutrality. This interpretation gave neutrality an almost sacrosanct position in Swedish political life after 1945. The policy that kept Sweden out of the war would have to be continued in peace and in the Cold War. The official doctrine became non-alignment in peace aiming for neutrality in case of war.

¹ Therborn 1989, 88.

However, neutrality in a world increasingly dominated by the United States posed certain problems. In essence, Sweden's position became that of trying to balance between East and West, attempting to assert an official policy of neutrality, while at the same time as inconspicuously as possible, making the adjustments necessary to comply with the U.S. demands for cooperation.

During the Cold War Sweden became increasingly dependent on American military technology. Neutrality provided justification for Sweden to keep strong and technically advanced military forces. According to the official doctrine of non-alignment, Sweden should not be dependent on foreign producers of military technology. Sweden possessed a strong arms industry, and most weapon systems ranging from fighter-bomber aircrafts to tanks and naval vessels were of domestic manufacture. In fact, 90 per cent of all military equipment was domestically manufactured from 1945 through to 1973.² Sweden's biggest and most internationally oriented companies such as Volvo, Saab, Bofors, ASEA and Ericsson were all involved in weapons production. These companies were at the same time the backbone of Sweden's economy, and their dual focus on civilian and military production meant that they integrated civilian and military technology and that technology developed in one area could be used in another.

The seeming independence based on control of its own arms supply, however, paradoxically relied on access to mainly American but also British and French military technology. Advanced Cold War weapon systems could not be produced within a small country without the benefit of international technological exchange. A number of agreements were signed from 1952 onwards between neutral Sweden and the United States providing Sweden with the technology necessary to produce its own weapons. We will attempt to show that technology was the most important lever possessed by the Western Powers to prevent Sweden from trading with the East and integrate the Swedish economy on the Western side in the Cold War.

This article asks the question: How did Sweden manage to secure Western technology for its leading industrial companies and arms producers during the Cold War, and how did these efforts (if at all) affect Sweden? The problems dealt with here have been a major issue for Sweden's industry and defense since 1945 up until today.

Trade with the Soviet Union: From Economy to Ideology

In the beginning of 1943 the Soviet Union showed some interest in increased trade with Sweden after the war. The proposal was in accordance with Swedish business interests at that time. It was generally believed that Sweden would experience difficulties in regaining the markets that had been lost during the wartime blockade. In September 1946, a trade agreement was reached between

² Olsson 1977.

Sweden and the Soviet Union. The agreement stipulated that deliveries up to one billion SEK would be made over a period of 5 years. These deliveries were to be paid for in 10 years, the interest-rate being set at 2,375 per cent, including 3 interest-free years, plus a 50 per cent reimbursement for sized Swedish property in the Baltic States.³ As it turned out, the agreement was never to be fulfilled to the stipulated amounts.

The reasons for reaching the trade agreement, however, were not just economic. The trade negotiations had been surrounded by several political discourses. According to Birgit Karlsson – the author who has written most extensively on the issue – the controversy about the Swedish credit-agreement with the Soviet Union can be best understood within the more general framework of the domestic debate over a planned versus a liberal economy.⁴ The domestic debate, however, hardly decided the U.S. and Soviet concerns. An American note was issued in which the U.S. government expressed its concerns that Swedish trade would become tied to the Soviet Union, which would not be in accordance with American free trade ideals.⁵ The emerging Cold War frontlines in general and the American note in particular, thus, turned the agreement into politics. The Soviet negotiators were suddenly more eager to conclude the negotiations. The Swedish negotiators were also more or less forced to conclude the agreement in order to demonstrate that the Swedish non-alliance policy was not subject to American pressure.⁶

Swedish Adaptation to the U.S. National Embargo Policy

Like all European nations, Sweden had a quite substantial balance of payment problem due to a dollar deficit.⁷ This deficit, in turn, was due to the breakdown of the convertibility between the dollar and the pound sterling. Swedish exports were primarily directed towards the European market (i.e., not the dollar area),

³ Karlsson 1992, 44-48.

⁴ During the Second World War Sweden was governed by a coalition government comprised of all political parties except the communists. In 1946 the coalition government was replaced by a Social Democratic regime. This shift had been preceded by an extensive public debate on the issue of a planned versus a liberal economy, in which the Social Democrats had been advocating a regulated economy. *Dagens Nyheter*, the country's largest newspaper and a liberal one, had pursued a campaign against the Soviet trade agreement arguing that it was an exponent for government economic planning. Concerns were now raised that this was part of a scheme to socialise the entire Swedish economy, something, which, if realised, would constitute a threat not only to the liberal, capitalist market economy – but even to the entire parliamentary system of democracy in Sweden. Karlsson 1992, 71.

⁵ Also the Soviets regarded the trade agreement as a political tool in order to lessen Anglo-Saxon influence in Sweden after the war. If the Soviet Union had claimed the entire one billion SEK credit, it would have made it harder for Sweden to also grant credits to Britain. Karlsson 1992, 47; Karlsson 2001, 35.

⁶ *Ibid.*, 48.

⁷ Deighton 1990, 174.

and at the same time an increasing share of Swedish imports (about 50 per cent in 1947) now came from the United States.⁸ The United States took this balance of payments problem very seriously, and William Clayton, Under Secretary of State for Economic Affairs, envisaged large American grants for three years to stem the deteriorating balance of payments situation in Europe.⁹

During the summer of 1947, Sweden, represented by Dag Hammarskjöld, had renegotiated its 1935 trade agreement with the United States. The new agreement stipulated that the volume of Swedish imports from the United States would be dependent on the Swedish financial situation. These *de facto* import regulations would gradually be lifted as the Swedish balance of payments improved.¹⁰ The problem was that the financial situation did not improve at all. As mentioned above, it actually got worse. The European market did not manage to recuperate on its own.

During the course of November 1947, Hammarskjöld repeatedly asked the American embassy in Stockholm for a loan.¹¹ According to the chief of the Swedish Central Bank (Riksbanken), Ivar Rooth, Sweden would need a 100 million dollar loan. By this time, however, Marshall Aid was being planned, and the Americans did not intend to give Sweden any financial assistance outside of that institutional framework.

Whereas Sweden sought bilateral agreements with the U.S., the U.S. on the other hand was dealing with problems common for the entire Europe. In the American policy that was now emerging there was no room for neutral small states. In order to receive aid, Sweden would have to align itself with the rest of Western Europe to fit into the institutional framework of the Marshall Aid.

On December 17, 1947, the US National Security Council (NSC) decided that all exports to Europe should be subjected to licensing. The decision was made with the explicit purpose of cutting off the flow of strategic commodities to the Eastern Bloc. Only ten days later, on December 27, the British concluded a trade and financing agreement with the Soviet Union. The American reaction was instant. On December 31, the U.S. Department of Commerce issued a new export licensing regulation calling for improved destination controls of goods, which were already under licensing, and in January 15, 1948 a second licensing regulation was issued. The latter required that *all* goods sold to Europe must have individual licenses after March 1, 1948.¹² The idea that economic aid to Western Europe might help recipients to export strategic goods to the East was intolerable to many Americans. As a consequence, an American national embargo policy was now taking shape.¹³

American pressure on Sweden now increased. In January 1948, during a visit to the U.S., Dag Hammarskjöld was invited to the State Department for

⁸ Jonter 1995, 148.

⁹ Deighton 1990, 172; Dobson 2002, 85.

¹⁰ Jonter 1995, 145f.

¹¹ *Ibid.*, 149.

¹² Adler-Karlsson 1968, 22f; Dobson 2002, 89.

¹³ Dobson 2002, 88.

negotiations. American officials stressed to him the absolute importance that the U.S. attached to a full-fledged participation in the reconstruction of Europe. Hammarskjöld was told that this co-operation would not only consist of economic matters but also of political matters with ideological content and that the Americans had sensed a certain hesitance in the Swedish position. Hammarskjöld interpreted the American position as a highly ideological one, where 'those that are not with us are against us'. The Marshall Aid, Hammarskjöld thought, was used as a touchstone in this sense.¹⁴

On April 2, 1948, the Congress approved the Marshall Plan, which in its legal form was named the Economic Cooperation Act. As a country that had not participated actively in the war, Sweden could only be granted loans. The act contained several components that were problematic to the Swedes. First, it required that all participants signed a bilateral Economic Cooperation Agreement with the U.S. Second, it required that all participants signed a 'letter of intent' stating the intention to adhere to domestic American legislation, i.e. the Economic Cooperation Act. Third, article 117(d), the Mundt amendment, gave the U.S. the right to deny assistance used to increase the military strength of the Soviet bloc.¹⁵

Eventually and somewhat reluctantly Sweden signed the treaty on July 3, 1948, at the latest possible date before the Truman administration's deadline. In the proceeding negotiations Sweden did consult regularly on an informal basis with the governments of France, Britain and Holland, which all had serious problems with the initial draft. It seems that these negotiations resulted in some concessions on the part of the U.S.¹⁶ For domestic reasons, the Swedish Labor government did not want to appear to turn to the U.S. for financial aid. Nor did Swedish government want to commit itself in any way that would constitute an infringement of the non-alliance policy. On the other hand, the government did not want to alienate the Americans by opting out of the agreement altogether. The Swedish strategy, thus, was to sign the agreement and at the same time secure special arrangements that could be used to justify it at home. The result was a unilateral Swedish declaration and a guarantee from the U.S. that any disputes arising out of the agreement would be subject to further negotiation. This deal fulfilled the primary objectives of both sides. Swedish government could refer to the agreement as "a broad framework not applicable to each participant in detail".¹⁷ Washington, on the other hand, had incorporated Sweden into a united Western front built upon the adherence to the ECA policy.

The American license regulations prescribed that administrators from the Economic Cooperation Administration (ECA) had the right to inspect that goods delivered to companies in the aid receiving countries were really delivered and not re-exported. The ECA had been created to administrate the

¹⁴ Karlsson 2001, 31-32.

¹⁵ Silva 1999, 94.

¹⁶ *Ibid.*, 97. For a different opinion c.f. Sevón 1995, 261-266, 306-311.

¹⁷ Silva 1999, 98-101.

Marshall Aid in Europe. Hammarskjöld managed to work out an arrangement with John Haskell, an ECA official in Stockholm, which was acceptable to both parties. Swedish authorities would supervise that the commodities that were delivered through the Marshall Aid in fact were used for the specified purposes. The ECA could ask to be allowed to inspect matters for themselves, in which case the Swedish authorities would simply invite the ECA representatives to participate in the inspections. Companies that obtained the privilege included AGA, ASEA, and the steel producing Sandviken. A source of consternation for the ECA was that they were not allowed access to the state-owned companies. This problem was solved by letting the Swedish Industrial Commission (*Industrikommissionen*), one of the remaining war regulation authorities, arrange that no ECA purchases were made by state-owned companies.¹⁸

Sweden and COCOM

Sweden took part in the discussions of multilateral European export controls at the French Foreign Department at Quai d'Orsay in Paris in January 1949 initiated by Britain and France. A list comprising roughly half of the items on the American list was discussed. Belgium, the Netherlands, Sweden, and Switzerland were all highly reluctant to accept the embargo policies imposed on them by the Americans. While most of the European states considered a multilateral organization the best way to vindicate their interests against American pressure, Sweden and Switzerland both declined participation with reference to their non-alliance policies. They both propagated free trade, and Sweden claimed not to have any control of its exports except regarding weapons.¹⁹

The Swedish representative, Hammarskjöld, was not altogether happy with Sweden's position. Sweden and Switzerland were becoming perceived as obstacles and Sweden risked ending up outside the embargo wall that was now being formed and, furthermore, risked being subjected to the same treatment as the Eastern Bloc countries. He suggested to Johan Beck-Friis, who preceded Hammarskjöld as State Secretary of Foreign Affairs, that by extending the definition of the term 'contraband' (which were de facto controlled) to include embargoed items, Sweden could in practice if not in principle comply with the embargo. The Swedish trade policy was now being adapted to the embargo policy and the East-West trade realities. Birgit Karlsson emphasizes two typical characteristics for this policy. First, the argument versus the West was that the content of the policy was more important than the form. It had to be more important to the West that Sweden de facto followed the common course rather

¹⁸ Karlsson 1992, 203f.

¹⁹ Adler-Karlsson 1968, 51; Karlsson 1992, 161f. See also Ammann, in this volume and McClade, in this volume.

than that Sweden formally adhered to the Western policy. Versus the Eastern Bloc countries, the argument was that the form was more important than the content. If Sweden did not formally discriminate against the East, there was no discrimination at all. Second, Sweden did not accept any formal obligations and did not agree to sign any formal treaties as this would not be in accordance with the non-alignment policy. However, the government would inform United States about the policy it independently pursued. If this was interpreted as a guarantee or not was of no concern for the Swedish government.²⁰

On February 28, 1949, a new Export Control Act was enacted in the United States, and on August 12, the same year, the Department of Commerce issued a 'master list' of all goods requiring an export license. The Consultative Group and COCOM was created on November 22, 1949; COCOM started operating on January 1, 1950.²¹ According to Gunnar Adler-Karlsson COCOM

[...] has had no foundation in any formally binding international treaty, but has been considered as a 'gentlemen's agreement' only. In spite of this it has in reality functioned as an international treaty with binding effects on the participating nations. [...] The United States concluded bilateral agreements with more than 50 nations in the West, concerning restrictions on trade with the communist nations.²²

During 1949, Sweden revised its classification of contraband. In December, a law was issued that banned export of contraband that now also included the material on the American lists. The Americans were very pleased with this arrangement. It was regarded as highly efficient. In fact, the Swedes were told it was more efficient than the export controls of many of the COCOM countries.²³

However, the fact that Sweden was not a formal participant in COCOM soon became apparent. In April 1950, a number of export licenses from the United States were withheld or delayed. Signals from the State Department indicated that this was due to Sweden's continuing trade with the Eastern Bloc. After the outbreak of the Korean War in the summer, the American pressure increased and during the fall Swedish companies really began to suffer from the fact that Sweden formally remained outside the Western embargo. Orders from Swedish companies were given a lower priority. According to American information, Swedish manufactured equipment was used in Soviet atomic bomb production. Such equipment was now re-categorized as contraband and export licenses were no longer issued. The decision hit the steel manufacturer Sandviken hard. The re-categorization meant that exports were allowed neither to the East nor to the West. Several other companies suffered the consequences of the implementation COCOM list I. Exports of deep-drilling equipment, electrical ore-finding equipment, thread of tungsten, molybdenum and nickel were all stopped.²⁴

²⁰ Karlsson 1992, 171-173.

²¹ Adler-Karlsson 1968, 6, 25, 51; Dobson 2002, 96-99; McGlade, in this volume.

²² *Ibid.*, 6.

²³ Karlsson 1992, 172-173.

²⁴ *Ibid.*, 211-213.

The ball bearing producer SKF was the subject of much of the American attention. In 1949 SKF experienced a decrease in demand and planned to increase exports to Eastern Europe. The trade agreement of 1946 with the Soviet Union, however, made matters complicated. According to SKF, the negotiations within this agreement were politicized, and a game ensued during which both sides tried to get as much as possible while at the same time giving as little as possible in return.

A few months after the outbreak of the Korean War, the U.S. State Department informed the Swedish Foreign Department that SKF's ball bearings were used in the Soviet tanks that had been encountered in Korea. The bearings were reported to be of special manufacture used to mount the turret of the tank. SKF denied that any such bearings had been exported since World War II. However, such bearings had been produced by a former SKF plant in Eastern Germany, over which SKF had had no influence since 1939. The American information became subsequently altered. The bearings in the Soviet tanks had been of standard model. This might have been possible, according to SKF, but it was equally possible that the bearings in the Soviet tanks originated from the U.S. American bearings had been sold to the Soviet Union before the embargo was implemented, and it was even possible that they originated from Lend-Lease.²⁵

Wise from its experiences during the war, SKF wanted to avoid publicity or black listing at all cost. Rather than risk the wrath of the Americans, SKF voluntarily agreed to follow the COCOM lists. One fourth of SKF's exports went to the Eastern Europe. According to SKF's own estimates, 90 per cent of these exports comprised of embargoed bearings. The company was now willing to cancel these 90 per cent of its eastern exports for which orders had not yet been placed. Just like in the case in 1944, the Swedish government let SKF negotiate directly with the American representatives. Although the company disliked the way in which ball bearings were categorized on the COCOM lists, they assured the Americans that they decidedly belonged to the Western side and that they would permanently follow the embargo restrictions. It was agreed that SKF, in addition, would not export any embargoed bearings to the East nor would they accept orders for any specially manufactured bearings.

SKF received much appreciation from the U.S. as well as Britain and France for their accommodating attitude. They had actually gone much farther than the COCOM countries. While the COCOM community were 'testing the possibilities' of embargoing ball bearings, SKF had now actually done it. The Swedish Foreign Department was not pleased and thought that SKF had gone too far. Also, SKF discovered that their commitment was much more extensive than what was really called for. As a consequence, both the Foreign Department and the company acted to point out that the same rules ought to apply to all Western countries.²⁶

²⁵ Ibid., 182-183.

²⁶ Ibid., 86-189.

In early 1951, the American ambassador to Stockholm, Walton W. Butterworth, contacted Hammarskjöld. Butterworth informed Hammarskjöld that the United States was not satisfied with the Swedish case-by-case insurance anymore and wanted a general guarantee that strategic commodities would not be re-exported to the Eastern Bloc. Hammarskjöld could not agree to formal multilateral discussions, but he was willing to discuss matters on a bilateral basis. Sweden did indeed enact regulations concerning the foreign trade policy's most sensitive areas. Out of these regulations it is possible to infer that most of the commodities that the Americans had been complaining about were no longer exported to the Eastern Bloc.²⁷

These discussions between Hammarskjöld and Butterworth took place at about the same time as the Americans introduced the Import Certificate/Delivery Verification-system. The government of the importing country issued an import certificate, and a delivery verification could be demanded by the exporting nation.²⁸ On June 15, 1951, Hammarskjöld and Butterworth signed a treaty. The treaty allowed for the trade agreement with the Soviets to run its course [the credit agreement ended in 1952], yet it was still very satisfactory to both parties. Sweden would *if possible* avoid exporting the listed commodities to the East, and the American embassy would be kept posted about Swedish undertakings on the subject. Birgit Karlsson argues that this indicates that the United States obtained Swedish cooperation, if not to the letter, then to the spirit of the American wishes. For the United States, *the content* was what mattered, while to the Swedes the important thing was *the packaging* of that content.²⁹

The agreement is mentioned in a United States Senate report from 1951. Adler-Karlsson quotes this source as saying that "'no measures have been instituted to cope with the transit trade problem. [...]' The report continues by stating that on this issue the neutral nations had been more co-operative with the U.S.A. than several COCOM-nations, including Britain. 'Paradoxically, two West European governments, Switzerland and Sweden, in order to escape the criticism leveled at them as transit countries for strategic materials, have undertaken to issue [...] in the latter [case] import licenses issued by the Swedish government [...].'"³⁰

The Battle Act and the Rearmament of Europe

With the outbreak of the Korean War, the U.S. policy in Europe shifted from economic recovery to military rearmament. American defense spending quickly quadrupled to the amazing sum of 50 billion dollars. A considerable part of that

²⁷ Ibid., 176f.

²⁸ Adler-Karlsson 1968, 65.

²⁹ Karlsson 1992, 178f.

³⁰ Adler-Karlsson 1968, 55.

amount was aid and transfers to Western European allies. Already with the creation of NATO in 1949, some smaller rearmament programs, such as the Military Assistance Program and the Mutual Defense Assistance Program, had been undertaken. Now, however, a much more extensive rearmament initiative was introduced in the form of the Battle Act.

The official name of the Battle Act was The Mutual Defense Assistance Control Act of 1951, and it was approved by Congress on October 26, 1951. The Battle Act was in turn tied to The Mutual Defense Assistance Act of 1949, and it was the most important legislative document connecting the American foreign aid program with specific demands upon the aid-receiving nations to conform to American regulations in their external commerce with communist nations.³¹ It demanded that the aid to any nation that exported strategic commodities included in the COCOM no. 1 list to the Eastern Bloc be cut off immediately.³² Hence, it was an important lever. What were the implications of this Act for Sweden? Well, not many at first because Sweden was not yet eligible for military assistance in the eyes of the Americans. But this would soon change.

In February 1952, the American president decided that Sweden, according to The Mutual Defense Assistance Act of 1949, was eligible to buy military equipment from the United States government. American law prescribed, however, that the receiver of such equipment issued certain guarantees to the United States.

The Swedish-American 'Military Technology Alliance'

The Swedish position now became increasingly ambivalent. On the one hand, Sweden's non-alignment policy was thoroughly cemented on the diplomatic and domestic arenas. On the other hand, Sweden's adaptation to COCOM and far reaching military and military technological co-operation with Norway, Denmark, and Great Britain meant that Sweden played an important part in the joint planning of the defense of the West. Cooperation with NATO countries in military-security matters occurred on two different levels. On a political, diplomatic level Sweden sought to avoid formal political discussions in order not to compromise the non-alignment policy. This meant that all kinds of formal agreements in military-security matters were shunned and that Sweden opposed the introduction of rearmament issues in the European bodies where it was a member, such as OEEC and the Council of Europe.³³ However, the Swedes did not oppose informal cooperation. On a more practical, military, and technological level a substantive cooperation was developed. This consisted of regular high-level military contacts, joint staff talks, officer exchanges, sharing

³¹ Ibid., 28.

³² Karlsson 1992, 167.

³³ af Malmberg 1994, 193-196, 268 ff; Silva 1999, 318-330.

of military intelligence, and a significant standardization of war material and military procedures.³⁴

Sweden's compliance with the American and COCOM embargo policies made the country eligible for integration in the Western Cold War front. Previous American mistrust of Sweden's policy and intentions turned into benevolence as a result of Sweden's informal adaptation to the embargo policy. In the National Security Council document NSC 121 from 1952, the United States accepted Sweden's non-alliance policy even if they did not understand it. Rather than focusing on Sweden's declared policy, the Americans concentrated on Sweden's actual willingness to cooperate. A strong Sweden was regarded as essential in the defense strategy for Scandinavia. Measures should be taken to increase Sweden's contribution to the defense of the West. Among these were allowing Sweden to buy strategic technology under the same terms as the NATO countries, strengthen Sweden's defense through exchange of military technology, allow Swedish officers to be trained in the U.S., and to encourage common military planning between Sweden and the NATO countries Norway and Denmark.³⁵

The gradual integration of Sweden into the Western defense and embargo systems now provided Sweden with access also to American arms technology. In the summer of 1952, Sweden and the U.S. reached a first agreement regarding the terms on which Sweden was allowed to purchase military equipment and services from the U.S. This was done through an exchange of diplomatic notes. In essence Sweden joined the Mutual Defense Assistance Program.³⁶ But this also meant that Sweden had to abide by the Battle Act regulations concerning war materials. The Swedish government undertook not to re-export any American equipment without permission and to guarantee the security for equipment and information received.³⁷ Sweden had now accepted a full integration into the Western trade embargo, and was on its way to being integrated in the Western defense structure as well.

Sweden's foremost supplier of military technology from the end of the 1940s at least up until the end of the 1950s was, however, not the U.S. but Great Britain. During this period Sweden bought hundreds of fighter and fighter-bomber airplanes from Britain. Also, radar, control and reporting systems, and navigation systems as well as guided missiles were bought.³⁸ Britain had strong economic incentives to sell surplus military equipment to Sweden and did so at some point even contrary to the American wishes.

Sweden possessed a strong defense industry that had been built up during the Second World War. Much of this industry was engaged in building fighter-bomber airplanes for the air force. During the 1950s, neutral Sweden possessed the fourth strongest air force in the world. Sweden's weapons systems were

³⁴ SOU 1994:11.

³⁵ Ibid., 105-106.

³⁶ Ibid., 130.

³⁷ SOU 2001:108, 293.

³⁸ Aunesluoma 2003.

often of unique Swedish design. It was regarded as essential for the credibility of the non-alignment policy that Sweden was not dependent on any of the superpower alliances. This meant that the capacity for building advanced technology weapons became increasingly important. Advanced and unique Swedish weapons designs thus possessed a major symbolic value.³⁹

Even if it possessed a strong and advanced air force, Sweden lagged far behind in areas such as guided missiles and radar technology. In 1958 and 1959, Sweden managed to get permission to buy guided missiles from the U.S. The American condition was extended to security guarantees. At this time, both Sweden and the U.S. wished to extend the agreement from 1952 to encompass not just purchases but all kinds of military and technical information, services, and support. In order to do this, another exchange of ministerial notes was initiated in January 1961, and at the end of August 1962 an extensive agreement was reached under the title *Memorandum of Understanding Concerning Technical Information*.⁴⁰ The purpose of the agreement was to facilitate the exchange of technical information between the two countries. Information was now to be passed both ways. This was, of course, of more benefit to Sweden than to the U.S. The main agreement comprised of several *Data Exchange Agreements* (DEA), which each regulated a specific area of weapons technology such as guided missiles, torpedoes, artillery ammunition etc. Certain unique Swedish weapon designs, such as the fighter-bomber *JA 37 Viggen* or the tank destroyer *Stridsvagn S* were also included as specific DEAs.⁴¹ Thus, paradoxically, the high technology symbols of Sweden's independent, neutral stance in the Cold War were entirely dependent on American technology.

The military-technical information agreement from 1962 was later modified, yet its basic structure has remained unchanged and it has regulated all the technical information co-operation with the U.S. probably up until today. It has also had a tremendous impact on Sweden's domestic political and social life by prompting the organization of a security regime that brought the Cold War bipolar mentality into everyday life. As a consequence of the technology exchange agreements, Sweden needed to organize industrial security that would meet the American standards. During the 1950s, the security service and the trade union congress organized a secret surveillance system, within which 'security risks' such as communists were registered and denied access to work within defense industrial companies. The surveillance system relied on the union representatives on the shop floors.⁴² The system was illegal, and despite repeated disclosures in the media the authorities have denied its existence up until recently.

³⁹ Dörfer 1973.

⁴⁰ SOU 1994:11, 131.

⁴¹ SOU 2002:108, 293-294.

⁴² Agrell 2000, 202-204.

About Face: The Swedish Leak in the Blockade, 1967-1979

During the Cold War *détente* in the 1960s and 1970s' American export control policies was dominated by the ambition to balance trade policy interests with the security interests. Both the Kennedy and the Johnson administrations relaxed the export control regulations. The 1969 Export Administration Act and its 1972 amendment opened up the possibility for increased trade with the Soviet Union and China. The liberal signals also reached Sweden. As a result of general *détente* and relaxed American policies, Sweden could stop implementing the export control regulations that it regarded as difficult to reconcile with its non-alliance policy with relative impunity.

In December 1967, the Swedish government decided to end Sweden's unilateral commitment to COCOM. A parliamentary election was coming up during the following year, and the government knew that Sweden's involvement in COCOM would be exposed in Gunnar Adler-Karlsson's dissertation *Western Economic Warfare* that was going to be published later in the year. The decision not to follow COCOM restrictions was an attempt to forestall criticism for deviations from the sacrosanct non-alliance policy.⁴³ A few months later, in February 1968, the Swedish Prime Minister Olof Palme attended an anti-Vietnam war demonstration in Stockholm together with North Vietnam's ambassador to Moscow and strongly criticized the Vietnam policies of the U.S. in public.

Both of these developments prompted American responses. As a reaction to Palme's criticism, the American ambassador to Stockholm was recalled. At the same time, Sweden had recently obtained permission to buy Redeye anti-aircraft missiles from the U.S. The missiles were technologically highly advanced and they had not yet been exported to the U.S.'s NATO allies (with the exception of a small amount sold to Australia). The Swedish purchase order was now withheld while the U.S. reviewed its policy *vis-à-vis* Sweden. Questions were raised within the U.S. administration as to whether Sweden was still reliable and whether military technology sold to Sweden even might end up in North Vietnam where it could be used against U.S. forces. Such concerns, however, were found groundless. The Americans did not want to endanger the existing military and military-technological exchange agreements with Sweden, and they believed that if Sweden was denied the American missiles, similar technology could be bought from Great Britain. Thus, a compromise was negotiated with the Swedes. The Redeye missiles were still to be sold to Sweden but they would not be delivered as long as the Vietnam War was still going on. Training equipment was still going to be released according to the initial deal.⁴⁴

However, a new situation arose when Sweden in January 1969 announced its decision to open diplomatic relations with North Vietnam, and Conservative

⁴³ Holmström & von Sievers 1985, 42.

⁴⁴ SOU 2002:108, 310-328.

senators in Congress started to ask questions about the missile deal with Sweden. A number of unofficial visits to the U.S. by prominent Swedes such as the Chief of Staff Stig Synnergren, the entire Foreign Committee of the parliament, and the owner of the major arms manufacturing business group, Marcus Wallenberg, served to assure the Americans that there were no security risks involved in supplying the Swedish armed forces with the Redeye missiles. Assurances from the supreme commander, Torsten Rapp, also served the same purpose.⁴⁵

The government's decision to end its commitment to COCOM put Swedish companies in a rather awkward position. The U.S. reaction was instant. Sweden was downgraded as an export country, and Swedish companies experienced increasing difficulties to obtain export licenses. Applications from Swedish companies were reviewed more thoroughly, which of course increased the handling times and caused delays. However, a solution to the problem was invented specifically for the Swedish companies. By signing a *Letter of Assurance*, Swedish receivers of U.S. technology could obtain a more favorable treatment. The signing part undertook to follow U.S. rules, not to re-export without the consent of American authorities, to re-export only to trustworthy receivers, and, to, upon demand, account for the disposition of American goods. The system was unique and a consequence of the fact that the Swedish state authorities no longer controlled exports. It also meant that the Swedish companies that signed a *Letter of Assurance* could become subject to revision and control by U.S. authorities in Sweden.⁴⁶

Even if Swedish trade policy did no longer comply with COCOM restrictions, this did not affect what we have called the 'the military-technological alliance', i.e. the thorough and well-regulated exchange agreements for military technology upon which the Swedish defense industry now relied. The United States did no longer connect Swedish compliance with COCOM with the eligibility to receive advanced military technology. However, severe problems were caused by the fact that advanced technology could be applied in ever more general ways. The so-called 'dual-use technology' was difficult to control because it was applicable in both military and civilian products.

In 1975, the partly state-owned company Stansaab (in competition with French Thompson and American Univac) won a contract for a computerized civilian air traffic control system in the Soviet Union. The Soviet buyer voiced its concern for the Swedish company's ability to fulfill its obligation because the system contained American components. The Swedish Minister of Industry, Rune Johansson, assured the Soviet Minister of Trade, Nikolaj Komarov, that Sweden 'forcefully' would influence the U.S. authorities to grant the required permission. The system to be sold was based on the same technology as the Swedish control and reporting system Stril-60, in which radar and computer

⁴⁵ Ibid.

⁴⁶ Homström & von Sivers 1985, 44-45, 146; SOU 2001, 424-425.

was combined in order to identify and keep track of friendly and enemy air movement.⁴⁷

In 1977, when deliveries were already underway, American authorities announced that the export license for the American components would not be granted because of the military potential of the system. Negotiations were initiated and the Swedes tried to reduce the application with the result that the system would not be able to perform all the intended functions. The U.S. accepted the reduced application but under the condition that the Swedish government would consult the U.S. in order to get permission for each particular delivery. Despite the reduced application, 24 denied circuits would still be required in order to get the system operational. The Soviets were now becoming impatient and the entire deal was in danger. The Swedish technicians brought the circuits with them to Moscow 'for testing' and simply 'forgot' to return them.⁴⁸

In November 1980, the Swedish media reported that Datasaab (the company had changed name) had violated American security regulations. The U.S. demanded that the Swedish government deny the allegations. The Americans also threatened to inhibit the Swedish purchase of Sidewinder missiles for the Swedish Air Force and to break the ongoing negotiations to have the American jet engine GE 404 intended for JAS 39 Gripen fighter-bomber manufactured under license in Sweden. The Swedish government did deny the allegations but an investigation by the CIA subsequently found that restricted components had been smuggled to the Soviet Union.⁴⁹

The 'Datasaab affair' now became a prolonged humiliation for the Swedish government. Sweden was now punished in a way it had not been before. The Sidewinder missile purchase was inhibited for several years and Ericsson, the new owner of Datasaab, was fined with the biggest sum ever to be levied for a violation of the export control regulations.⁵⁰

Sweden and the Re-erection of the Embargo Wall, 1976-1989

The severe consequences of the 'Datasaab affair' were in turn a consequence of a new U.S. embargo policy. In 1976, Pentagon presented the Bucy report. The chairman was Fred Bucy, vice president of Texas Instruments. The report was a reaction to new problems associated with the more liberal détente export controls and the emergence of the new information technology. Bucy advocated a much harder export control policy with regard to information technology, know-how and dual-purpose technology. As a result of the Soviet invasion of

⁴⁷ Agrell 2000, 205.

⁴⁸ Ibid., 206.

⁴⁹ SOU 2002:108, 246-365.

⁵⁰ Agrell 2000, 206.

Afghanistan in December 1979 and the election of Ronald Reagan in 1981, the recommendations of the Bucy report were finding their way into U.S. policy.⁵¹

The new American policy reflected the transformation of technology during recent years. Advanced technology was internationally integrated, appeared everywhere in all kinds of systems, and was 'perishable' and could thus not be stockpiled. In 1984, Sweden was almost totally dependent on foreign imports regarding computers and electronics. In an inquiry made in 1984 by the Stockholm Chamber of commerce, 64 per cent of companies asked stated that they could not survive without American technology. A majority of the same companies bought more than 65 per cent of their technology from the U.S. and 23 per cent of the companies bought more than 90 percent of their technology from the U.S. In 1989, more than half of Sweden's total import of electronics came from the U.S., Japan, and West Germany. The new technological vulnerability was a major concern for a number of Swedish authorities during the 1980s but not much could be done about it. One governmental report stated that: '[o]ur possibilities to reduce vulnerability in this sense are diminutive. The chances to affect American export legislation are about the same as those we have to affect the weather or the acts of God'.⁵²

The Reagan administration advocated a much tougher export policy. They were determined to use 'the weapon of technology' against the Soviet Union and this included reinvigorating allies with American leadership and reasserting control over technology flows through neutrals like Sweden.⁵³ The 'Datasaab affair' was caught in the midst of this thorough policy change. It became somewhat of an opportunity for the new regime to state an example.⁵⁴ In February 1981, an internal document was issued within Pentagon prescribing caution concerning the exchange of technology or know-how with Sweden. It was no longer to be considered a reliable partner in military matters. During the summer Sweden was denied the purchase of Sidewinder missiles, the U.S. government did not grant Sweden permission to buy the GE 404 engine for JAS 39 Gripen fighter-bomber, placing the entire development project in danger.

The Swedes sought to distinguish between civilian and military technology, and pointed to the long tradition of handling secret American military technology. The Americans, on the other hand, insisted on some kind of special arrangement for dual-use technology before releasing any more military equipment to Sweden. During his visit to Washington in August and September 1981, State Secretary of Defense, Sven Hirdman, was informed that the U.S. had suffered military damage amounting to hundreds of million dollars as a consequence of the 'Datasaab affair'. If the Soviets adopted the Swedish system in their air defense, American cruise missiles and bombers would have difficulties in penetrating it. The Soviets were alleged to have

⁵¹ Mörth & Sundelius 1998, 62-63.

⁵² Ibid., 99-100. [Our translation.]

⁵³ Dobson 2002, 264.

⁵⁴ SOU 2002:108, 351.

gained four years of weapon technology development. The Swedes made an entirely different estimate.⁵⁵

In October 1981, the new U.S. minister of Defense, Caspar Weinberger, visited Sweden. This was the first visit ever by an American Minister of Defense. Officially it was only a formal visit and no negotiations were going to take place. However, it is difficult not to connect the visit with the past few years of severe strain on Swedish-American military technology and embargo policy relations and the risk Sweden faced (however small it might have been) of being placed outside the re-erected embargo wall.⁵⁶ The Swedish purpose with the visit was to inform the new administration about the Swedish non-alignment policy (which meant that all kinds of formal deals were unthinkable) and to assure the Americans of the effectiveness of the Swedish military forces, and of course, to solve the technology crisis. Weinberger managed to tell Swedish journalists that he did not regard Sweden as neutral and that he wanted to discuss military effectiveness and co-operation. A perfectly logical statement according to what we know today. The Swedes, however, regarded it as a blunder, and Weinberger's staff corrected the statement as soon as it was understood how it would be interpreted.⁵⁷

Shortly after Weinberger's visit an agreement was reached between Sweden and the U.S. concerning the dual-use technology. The Americans had sought a formal arrangement reintegrating Sweden into the COCOM framework. Just like the situation in the 1950s, the Swedes would not agree to a formal arrangement because that was considered as compromising the non-alignment policy. The real issue, however, that American dual-use technology must be controlled, did not pose a problem. On such grounds, an agreement could be reached.

To grant Swedish companies export licenses, the American Department of Commerce required extended security guarantees. Receiving companies' security arrangements had to be controlled within Sweden and that had to be done by Swedish authorities. When the Swedish police refused to accept the task, arguing that it would not act on behalf of the United States, the task went to the Defense Material Administration (FMV). FMV visited a particular company, issued advice in security matters, and reached an agreement where the company undertook to follow FMV's instructions. FMV then issued a certificate, which the U.S. Department of Trade required to issue an export license.⁵⁸

The system was called 'The Arrangement'. American authorities were very pleased with it. FMV was a military authority and held in high esteem by the Americans. They interpreted 'The Arrangement' as if the Swedish government had assumed a responsibility for the matter. Also, the Swedish part was

⁵⁵ Ibid., 352.

⁵⁶ SOU 2002:108, 339-346.

⁵⁷ Ibid., 342.

⁵⁸ Holmström & von Sievers 1985.

pleased. 'The Arrangement' was not a binding agreement with the U.S. and as such it was not thought to compromise the non-alignment policy.

However, 'The Arrangement' did not work very well. Sweden did not have export control laws and this made it difficult for customs authorities to act. Neither was it clear exactly what kind of products that should not be exported or re-exported. In one important case in 1983, that received much attention, Sweden was used as a transit country. As a result, the U.S. placed Sweden on the list of non-communist states outside COCOM that were 'risky' (The Pentagon List). A number of measures were taken to insure stronger security and to restore the American confidence. The American embassy in Stockholm received an export control attaché and the Swedish government instituted a scientific council to support the War Material Inspection. Still, Sweden was the only land in Europe that did not have export control laws.

Swedish industry pressured the government to re-regulate exports. Swedish companies were subjected to harsh treatment in their dealings with the U.S. and moreover, they risked being subjected to US jurisdiction because there was no Swedish regulation in place. In 1986, Sweden issued such a law (1986:89). As a result, Sweden was removed from the Pentagon List. During the years 1986-1990, Sweden made a number of minor adjustments to meet the COCOM export regulations and had thus re-regulated its exports just in time for the end of the Cold War.⁵⁹

Conclusions

At the beginning of this article, we posed the following question: How did Sweden manage to secure Western technology for its leading industrial companies and arms producers during the Cold War, and how did these efforts (if at all) affect Sweden?

The story of Sweden, and advanced military and civilian technology, during the Cold War is a story of integration and independence. Sweden's neutrality during the Second World War was transformed into a non-alignment policy during the Cold War. This policy was an official assertion of independence, from the Cold War, from the superpowers, and from conflicts of all kinds.

However, integration into the Western defense and strategic trade systems were necessary for a number of reasons, not least because the United States connected the two issues to each other. Sweden needed Western military technology, first the kind of technology that had been developed during the Second World War, later technology from the world's leading technical power, the United States. Conversely, the American attempts to organize a Western defense system in the beginning of the 1950s needed strong local forces in Scandinavia. Sweden played an important role in American geostrategy.

⁵⁹ SOU 2002:108, 427.

The American strategy of integrating Sweden into the Western systems was largely successful. By connecting the question of access to American military technology to the question of Sweden's adaptation to COCOM, Sweden did in fact follow the COCOM regulations by cutting its trade with the East to a minimum.

When, however, the military technological co-operation between Sweden and the U.S. had been institutionalized at the end of the 1960s, and during a period of *détente* Swedish government ended its one-sided adherence to COCOM, this shifted the responsibility to the individual companies. The system worked until the United States again put emphasis on export controls during the Second Cold War in the beginning of the 1980s. Several incidents showed that Sweden ran the risk of becoming a transit country with respect to the strategic embargo. Finally Sweden re-regulated its foreign trade in 1986.

Recent research, however, suggest that the embargo policy was never very effective in thwarting the Soviet strategic capacity, neither was it intended to be effective in this way. It was a U.S. tool to keep up the frontlines in the Cold War, and "most important of all, it was vital to anchor Western Europe in the Free world as a willing and co-operative ally and as a thriving economy".⁶⁰ However, its symbolic meaning can hardly be overestimated.⁶¹ It was a highly effective tool in the alignment process of the Western forces in the Cold War. In this sense it was a touchstone which could be used to probe the alignment of hesitant or refractory countries such as Sweden or Switzerland. Moreover, the embargo policy served to muster the domestic forces of the Western countries. Extensive economic, political, scientific, and technical systems had to be built up in order to assure that technology was kept from diffusing to the enemy. It pinpointed the enemy and made him real even to those that would never meet him. It fostered a mentality of conflict or even war, and it made possible for politicians, researchers, soldiers, businessmen, and civilians to contribute to a common war effort, a war effort that made the Cold War real.

⁶⁰ Dobson 2002, 86; c.f. Gunnar Adler-Karlsson 1968, 187-200.

⁶¹ Adler-Karlsson 1968, 128.

Tapani Paavonen

Special Arrangements for the Soviet Trade in Finland's Integration Solutions - A Consequence of Finland's International Position or Pursuit of Profit?

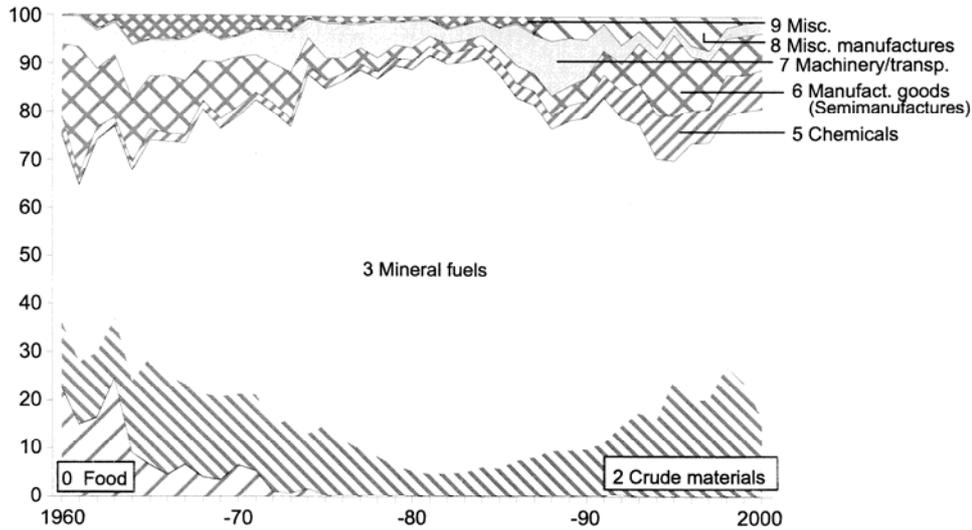
Safeguarding the Soviet Trade

The large-scale trade relations between Finland and the Soviet Union from the aftermath of World War II up to the collapse of the Soviet Union were a manifestation of friendship and good neighbor relations between the two countries, as recorded in numerous official and semi-official statements. The Soviet rhetoric preferred, as the main characterization, "peaceful co-existence between two countries with different social systems". The most important foundation for these relations was, as recorded in every Finnish-Soviet communiqué, the Agreement of Friendship, Cooperation and Mutual Assistance, or FCA Pact, concluded in April 1948.

The basic structures of the post-World War II Finnish-Soviet trade were consolidated by the early 1950s. The trade system was analogous with that practiced between the Soviet Union and the Peoples' Democracies. The payments were based on bilateral clearing, from 1950 onwards counted in Soviet rubles. From 1951 onwards, the trade was based on 5-year framework agreements, on which basis the annual commodity exchange protocols were concluded. When Finland otherwise, in her Western trade, returned to the stand of multilateralism from the mid-1950s onwards, the bilateral trade regime remained intact in the Eastern trade. This trade and payments system with the Soviet Union lasted up to the end of 1990.

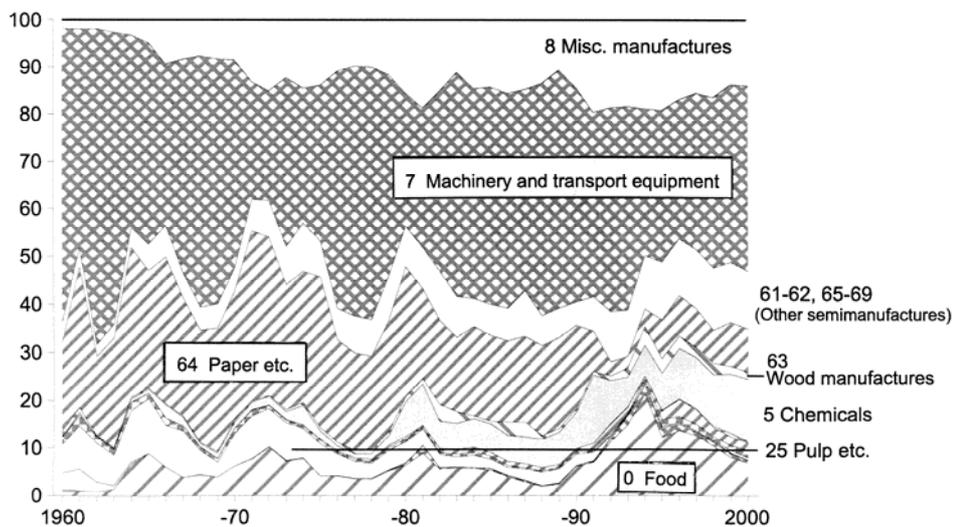
The Soviet trade comprised in some years even a quarter of Finland's total foreign trade, and in average 17 per cent in 1945-90. With these figures, Finland had the largest Soviet share in foreign trade among the Western market economies. For the Soviet Union, Finland was one of the most important Western trade partners, at times even the most important. The share of Finland in the Soviet foreign trade varied usually between about 2 and 4 per cent. The trade pattern was a typical example of trade between two countries, of which

one is economically more advanced than the other. Finland exported mainly manufactured goods to the Soviet Union and imported mainly raw materials. The main Finnish export articles were ships, machines, and paper. Among the import articles, oil became gradually dominant from the 1960s onwards. Figures 1 and 2 outline the trade pattern based on Finnish statistics.



Sources: Finnish Official Statistics. Foreign Trade.

FIGURE 1 Distribution of Finnish Imports from the Soviet Union/Russia by Selected Sections of SITC, 1960 - 2000, per cent



Sources: Finnish Official Statistics. Foreign Trade.

FIGURE 2 Distribution of Finnish Exports to the Soviet Union/Russia by selected Sections and Divisions of SITC, 1960 - 2000, per cent

Maintaining mutual trade at a high level represented a priority for both the Finnish and the Soviet policy, and, without any doubt, the large-scale trade relations were based on the political relationship between the two countries. When participation in West European economic integration became topical for Finland, the Finnish policy was to combine Finland's international position, requirements of the Western trade, and maintenance of the Soviet trade in a coherent contractual construction. The Finnish solution was to counterbalance the Western integration solutions with special arrangements for the Soviet trade.

During the negotiations in 1960 for what was to be known as Finland's association with the EFTA (FINN-EFTA or EFA), the most conspicuous measure in this respect was the Finnish-Soviet Tariff Agreement in November 1960, which granted the Soviet Union the same benefits with regard to its exports to Finland as to the EFTA countries. As argued later on in this article, the practical economic significance of the agreement remained modest. The really significant element for safeguarding the Soviet trade was the exemption clause of Article 4 in the FINN-EFTA Agreement, which entitled Finland to retain import regulations on fossil fuels and phosphate and potassium fertilizers. This stipulation remained almost unnoticed in the public debate over Finland's EFTA-USSR solution.

The negotiations process in 1970-73 on a free trade agreement between Finland and the EC was analogous with the one that took place in 1960-61. In 1973, Finland, "as the first market economy country", concluded a cooperation agreement with the Council for Mutual Economic Assistance (CMEA or "Comecon"). The Tariff Agreement with the Soviet Union in 1960 was modified to correspond to the new situation. In 1974-78, Finland concluded the so-called KEVSOS agreements with five Peoples' Democracies for reciprocal removal of obstacles to trade, creating five bilateral arrangements analogous to free trade zones. The agreement with the EC included the same exemption clause with regard to import regulations on fossil fuels and phosphate and potassium fertilizers as the FINN-EFTA Agreement. Even though most conspicuous, as argued later on in this article, the CMEA agreement remained mainly a political manifestation without major practical significance and the KEVSOS agreements' actual significance remained modest, too, while the exemption clause with regard to import regulations was continuously the really effective instrument to safeguard Finland's Eastern trade.¹

The Adaptation Point of View in Finland's Integration Policies

The adaptation model of international politics has been the most consolidated explanation of Finland's relationship to West European integration. In a

¹ For the emergence of the FINN-EFTA Agreement and the free trade agreement with the EC and the Eastern commercial diplomacy in these connections, see especially, Hakovirta 1976, 191-220, 269-299; Rytkönen 1978, 117-124, 127-133; Baban 1980, 183-198; Antola and Tuusvuori 1983, 131-137, 147-160; Seppinen 1997, 88-263; Paavonen 1998, 101-115; Paavonen 2001, 57-66.

nutshell, this explanation can be summarized as follows: Finland, as a small country, highly dependent on foreign trade, was compelled to safeguard her export interests, vital to her subsequent economic development, when the formation of large West European markets began to take shape. The delicate international position within the Soviet sphere of influence, however, imposed upon Finland restraints to achieve her integration aims. Nevertheless, the political wisdom of the Finnish state leadership and especially President Urho Kekkonen (1956-81) enabled Finland, from time to time, to overcome these constraints by maneuvering ingeniously between the Great Powers. According to this explanation, Finland adapted herself to the constraints imposed on her by Great Power politics but managed to do it in a very successful way through special arrangements in the Eastern trade.

In the Finnish scholarly literature, the adaptation model was first and most thoroughly elaborated in Harto Hakovirta's *Puolueettomuus ja integraatiopolitiikka* ["Neutrality and Integration Policies"] (1976). The author summarizes his conclusions, covering the Finnish policy from the Marshal Plan (1947) to the free trade agreement with the EC (1973), as follows:²

"Historically, the Finnish model has evolved from near-total adaptation *to* restraints to adaptation *of* restraints and, finally, to predominantly balance-seeking adaptation in the sense that the model even at the final stage still comprises elements from both adaptation *to* and adaptation *of* restraints. The adaptation model applied in Finnish policy toward Western integration can be considered to have approached with time the normal case represented by the other neutrals as far as the extent of participation is concerned, but to have moved farther away from it as far as the methods of solving the participation problem are concerned."

Since then, among political scientists and historians the adaptation model has been consolidated as standard wisdom. Economists, for their part, have been interested in the economic effects of the integration solutions, i.e. aspects which can be calculated in numeric format.

The adaptation model is well suited to explain the emergence of the basic contractual structure of Finland's relationship to West European integration up to the 1980s, when the question is examined from the viewpoint of diplomatic history. The rhetoric of sources, especially the public ones expressing the main arguments of the state leadership, supports this explanation model. An additional point of view is that it is suited to the aspirations of the academic community of historians and political scientists, who are educated and acquainted with the study and commentary of "High Politics", i.e. security policy points of view, ideological controversies, bids for power, etc.

In terms of international law, the Finnish-Soviet contractual relationship included from the late 1940s onwards two stipulations with crucial consequences for Finland's foreign trade policies. In the Trade Agreement of December 1947, Finland and the Soviet Union granted each other "unconditional and unlimited" most favored nation treatment.³ In the FCA Pact, Finland and the Soviet Union pledged, among other things, "not to conclude any alliance or join any coalition directed against the other High

² Hakovirta 1976, 365.

³ See e.g. Möttölä et al. 1983, Supplement A, 250.

Contracting Party". Additionally, the parties assured that they will "act in a spirit of co-operation and friendship towards the further economic development and consolidation of economic and cultural relations between Finland and the Soviet Union".⁴ The agreements were in force until replaced in early 1992 by new agreements between Finland and the Russian Federation.⁵

As the result of World War II, Finland's position vis-à-vis the Western world economy and the West European economy was relatively isolated in institutional terms, even though the bulk of Finland's foreign trade was still conducted with Western countries. Finland, for example, joined the International Monetary Fund and the International Bank for Reconstruction and Development in 1948 and GATT in 1949/50. As the result of direct Soviet pressure, however, Finland was compelled to decline participation in the Marshall Plan in 1947. Consequently, Finland was left outside the Organization for European Economic Cooperation (OEEC) and the European Payments Union (EPU). The Finnish endeavor to join the OEEC or at least the EPU in 1957-58 was foundered on opposition by the Soviet Union. Thus, Finland joined the OECD only in 1968.

President Urho Kekkonen's foreign policy maxim was to tie Finland's foreign action to consent with the Soviet Union. Every decision of principle was consulted in advance with the Soviet leadership. President Kekkonen expressed what he called "the Finnish paradox" at the National Press Club in Washington in October 1961, a couple of days before the so-called Note Crisis, as follows:⁶

"(...) the better we succeed in maintaining the confidence of the Soviet Union in Finland as a peaceful neighbor, the better are our possibilities for close cooperation with the countries of the Western world (...)"

With the consolidation of Kekkonen's power position from his second term (1962-68) onwards, this consent with the Soviet Union became the generally recognized political wisdom of the Finnish statecraft.

With regard to the Soviet trade, the Finnish position in the EFTA negotiations was expressed in early 1960 as follows:

"Finland's present significant commercial relations with third countries, especially with countries outside GATT with which Finland has a bilateral commercial agreement on most favored nation treatment, will not be endangered."

In 1960, the Soviet Union demanded the EFTA countries to apply the EFTA stipulations also to Soviet imports on the basis of the most favored nation clause in the bilateral trade agreements. The EFTA countries proper refused, appealing to Article XXIV of GATT, which exempted customs unions and free trade areas from the general most favored-nation rule. Finland, or to be exact President Kekkonen, instead, did not even consider refusing to comply with the Soviet interpretation of this contractual obligation.

⁴ See *ibid*, 248.

⁵ Suomen säädöskokoelman sopimussarja - Finlands författningssamlings fördragsserie 63/1992 (Agreement between the Republic of Finland and the Russian Federation of the foundations of relations) and 70/1992 (Agreement between the governments of the Republic of Finland and the Russian Federation of trade and economic cooperation).

⁶ Jakobson 1987, 120; Suomi 1992, 468.

The Tariff Agreement with the Soviet Union in 1960, initiated by Finland as a way to satisfy the Soviet demands, was the precondition under which Nikita Khrushchev, Secretary General of the Soviet Communist Party and Prime Minister of the Soviet Union, was ready to accept Finland's association with EFTA. It granted the Soviet Union the same benefits with regard to its exports to Finland as to the EFTA countries. The Finnish-Soviet agreement was, of course, carried out outside the EFTA agenda, but, in fact, it was an essential element of the EFTA negotiations process. In the Western world, the event was a scandal. The Finnish-Soviet Agreement did not officially belong to the GATT agenda, but Finland announced it to GATT together with the FINN-EFTA Agreement. In the XVIII session of GATT, May 1961, most of the contracting parties expressed their embarrassment caused by Finland's proceeding. Fortunately for Finland, this discussion did not lead to any decision, seemingly because the United States Government regarded it appropriate that Finland, too, participated in the EFTA cooperation, in spite of the general negative U.S. attitude towards the EFTA. The exemption clause with regard to import regulations on fossil fuels and the two kinds of fertilizers, instead, passed unnoticed in GATT once included in the FINN-EFTA Agreement.⁷

From 1961 onwards, also the Finnish state leadership was preoccupied by the question of Finland's position with regard to a possible EEC enlargement, even though the topic was hardly discussed in public until the mid-1960s. The supporters of President Kekkonen's foreign policy began to articulate a special Finnish view of integration policy. The Finnish discourse was based on the relationship between neutrality, on one hand, and the needs of the economy, especially the export interests of the Finnish forest industries, on the other hand. The main requirement was compatibility with the neutrality policy. Especially Minister Ahti Karjalainen, President Kekkonen's right hand in foreign trade policy matters, used the wording "our neutrality policy" (*puolueettomuuspolitiikkamme*). In this discourse "neutrality" and even more strongly "our neutrality" included an implicit connotation to consent with the Soviet Union. To this was connected the emphasis on Eastern trade in general. According to the Finnish argument, mere West European solutions remained insufficient. Finland expected, instead, international economic arrangements which would promote trade and economic cooperation in the framework of the entire Europe, East and West. This structure of the Finnish argument remained intact, by and large, up to the 1980s.⁸

Finland's integration aim with regard to those negotiations which the EC started in late 1970 with those six EFTA/FINN-EFTA countries which did not apply for EC membership was, briefly, a "purely commercial agreement" on mainly industrial goods which was compatible with Finland's neutrality policy and safeguarded Finland's Eastern trade. Compatibility with neutrality included, in the Finnish view, that the agreement would not contain any supranational elements nor include the so-called development clause, i.e. commitment to further integration. When giving, in November 1970, his opening address in the negotiations for a free trade agreement with the EC, the

⁷ Paavonen 1998, 108-115.

⁸ See Paavonen 2001, 60-67.

Finnish minister expressed the Finnish aim with regard to the Soviet trade as follows:

“For Finland, it is important not only to ensure the continuity of this [Soviet] trade but also to develop this trade with our neighbour and, thus, it is essential to maintain the traditional arrangements connected with our Soviet trade.”

Safeguarding the Soviet trade was for Finland a “precondition not subject to negotiations”.⁹

During the EC negotiations in 1970-72, the Western attitude towards Finland was, in general political terms, altogether positive and responsive. The negotiations partners expressed “understanding” towards Finland's aspirations. The EC Commission, anxious to preserve the internal decision-making free from any interference from outside, was even pleased by Finland's low ambition level. For the EC Commission, the Finnish intention not to participate in EC institutions contrasted in a positive way with the Swedish ambitions, which from the EC point of view were quite impossible to accept, and even the claim not to commit herself with future developments in European integration suited the EC well. From the very beginning the EC also adopted a positive attitude towards those Finnish claims which aimed to safeguard her Eastern trade. To be sure, the EC negotiators remarked that the EC was entitled to argue for a similar exemption clause which Finland claimed with regard to mineral fuels and the two kinds of fertilizers, but a concrete proposal was never put on the agenda. The real difficulties in the negotiations arose from the transitory arrangements for the so-called sensitive branches of the EC manufacturing industries, in the first place the paper industry, i.e. purely economic interest matters.¹⁰

Especially France was eager to present herself as an advocate for Finland's cause. However, the general rhetoric of the French diplomacy contradicted with the actual French negotiations stance on the economic stipulations of the agreement. At the level of general rhetoric, the West German attitude was more reserved. Finnish West German relations were aggravated at that time by the Finnish initiative of mutual diplomatic recognition between Finland and the “two German States”, which the Federal Republic perceived as a disturbance for the new *Ostpolitik*. However, Finland's participation in the EC-EFTA deal

⁹ “Opening Statement by Mr. Mattila, Minister for Foreign Trade, at the Ministerial Meeting of EEC in Brussels, November 24, 1970”, *Ulkopoliittisia lausuntoja ja asiakirjoja - Foreign Policy Statements and Documents (ULA)* 1970, 134-8; “Opening statement of Finland given by Minister Pentti Uusivirta on December 13, 1971 at the Negotiations on Trade Arrangement between Finland and EEC”, *ULA* 1971, pp. 207-15; Paavo Kaarlehto, Helsinki 22 Dec., 1970, “Muistiinpano keskusteluista, jotka käytiin Brysselissä 21.12.1970 suurlähetiläs Rossin ja EEC:n komission apulaisjohtajan Braunin välillä”; “Introductory note”, 6 Jan. 1971 (= presentation of the Finnish negotiations position); “Muistiinpano. Suomi/EEC. Komissiokeskustelut. Avajaisistunto 6.1.-71”. Archives of the Finnish Ministry for Foreign Affairs (FMA) 73 D1:28.

¹⁰ See, e.g., Martti Korhonen, Helsinki 8 Jan. 1971, “P.M. Suomi - EEC; Selvitysluontoiset keskustelut Brysselissä 6.1.1971”; “P.M. Suomi - EEC. Selvitysluonteiset keskustelut valtuuskuntatasolla Brysselissä 22.-26.3.1971”; FMA 73 D1:28; “P.M. Suomen ja EEC:n välinen valtuuskuntatason neuvottelu 12.6.1972 Brysselissä”; (Veli) Sundbäck, 27 August 1972, “Suomen ja EEC:n välinen valtuuskuntatason neuvottelu 14.7.1972 Brysselissä”. FMA 73 D1:35.

was not questioned by any of the Six. In the subsequent negotiations on concrete economic stipulations, it turned out very soon that France, notorious for her protectionism, was the most restrictive among the Six towards the aspirations of the EFTA countries, among them towards the Finnish economic interests, while the Federal Republic of Germany, known for her liberal view on international economy, was the most responsive.¹¹

The attitudes of the two superpowers were rather more negative than neutral towards the EC-EFTA negotiations. The Soviet Union opposed, in principle, all Western mutual arrangements, among them the projected West European free trade area for industrial goods, even though its opposition was not vehement in this case. The United States was from the onset in principle opposed to the EFTA and hence also to the projected free trade between the EC and the EFTA countries. The US motivation was commercial. From the U.S. point of view, both the EEC/EC and the EFTA hurt the U.S. export interests, but the EC formed a strategic advantage as a counterweight to the Soviet Bloc, which the EFTA did not. But the U.S. criticism was directed, in the first instance, against Sweden and Switzerland because of their self-chosen neutrality, while the U.S. Government understood Finland and Austria, which were regarded as being forced to their neutral position.¹²

According to the argument elaborated from the 1960s onwards, Finland was keen to promote international trade in an all-European scale. Accordingly, in the early 1970s Finland was concluding not merely a West European but a large-based trade arrangement, which comprised trade both with the Western and Eastern Europe. Approximately from 1973 onwards, this was called the Comprehensive Solution for Foreign Trade Policy (*kauppapoliittinen kokonaisratkaisu*), which name Kalevi Sorsa, then the Social Democratic Prime Minister, claims to have introduced.¹³

President Kekkonen and the Finnish Government emphasized in many ways their decisiveness to safeguard the Eastern/Soviet trade in connection with the EC agreement. President Kekkonen's negotiations with the Soviet leadership in February 1972 resulted in that the Soviet leadership seemed to be

¹¹ See, e.g., Pentti Uusivirta, 22 Jan. 1970, "Muistiinpano Ranskan suurlähettiläs Gerald André ja osastopäällikkö Pentti Uusivirran keskustelusta 22.1.1970"; "Muistiinpano Ranskan suurlähettiläs M. André ja osastopäällikkö Pentti Uusivirran välisestä keskustelusta 13.2.1970"; Martti Salomies, 24 August 1970, "P.M. Suomen suhteet EEC:hen; Bonnin käsityksiä"; Pentti Talvitie, 9 Sept. 1970, "Keskustelu Saksan pysyvän edustajan suurlähettiläs Sachs'in kanssa 8.9.70"; Paavo Rantanen, 15 Sept. 1970, "P.M. Väinö Leskisen ja Ranskan UM Maurice Schumannin väliset keskustelut 10. ja 11.9.1970". FMA 73 D1:27; Paavo Laitinen/The Finnish Legation in Paris to Pentti Uusivirta/Foreign Ministry (FM), 6 April 1971. FMA 73 D1:28; Paavo Laitinen/The Finnish Legation in Paris to Paavo Kaarlehto/FM, 7 June, 1971; Erkki Mäentakanen, Helsinki 27 Sept. 1971, "P.M. Suurlähettiläs Rossin keskustelut Pariisissa 24.9.1971". FMA 73 D1:29.

¹² See e.g. Cipher from the Finnish Legation in Paris to FM, 9 July 1971. FMA 73 D1:29; Cipher from the Finnish Legation in Washington to FM, 8 Oct. 1971; Telegramme from the the Finnish commercial representation in Bonn to FM, 9 Nov. 1971; Erkki Mäentakanen, 9 Nov. 1971, "P.M. USA:n asenne EEC:n ja sen jäsenyyttä anomattomien EFTA-maiden välisiin neuvotteluihin". FMA 73 D1:30.

¹³ Sorsa 2003, 108; "Pääministeri Kalevi Sorsan puhe Teknisten Liitto ry:n luontopäivillä 5.10.1973 'Suomen ja Euroopan taloudellinen yhdentyminen'", *ULA* 1973, 199-202; "Ulkoasiainministeri Ahti Karjalaisen puhe Valion osuuskunnan kokouksessa Helsingissä 13.12.1973", *ULA* 1973, 213-214.

prepared to accept the projected Finland-EC agreement, provided that the agreement would not hurt the Finnish-Soviet economic relations. Nevertheless, when negotiations in Brussels were completed and the agreement was introduced but not yet signed, it turned out that the Soviet leadership presumed that

Finland will “postpone” signing the agreement, seemingly indefinitely. As the result of the Soviet pressure, signing was first postponed and the above-mentioned agreement with the CMEA was concluded instead. In Autumn 1973, when the dead-line was running out, President Kekkonen at last decided to sign the agreement without waiting any longer for a final Soviet approval. The Soviet leadership approved his actions without objections.¹⁴ When the agreement was brought to the Parliament for approval, the rhetoric of the official Finland focused on assuring the Soviet Union of the harmlessness of the agreement. The Finnish Government and the Parliament even declared that the agreement would be noticed “(...) if it would turn out (...) that it causes such damage to the Finnish-Soviet cooperation that the cooperation would not develop as envisaged in the agreements concluded between Finland and the Soviet Union (...)”.¹⁵ The Tariff Agreement with the Soviet Union of 1960 was also suited, with minor modifications, to the new situation.¹⁶ The Soviet agreement was complemented with the KEVSOS agreements with five Peoples Democracies, namely Bulgaria, Hungary, Czechoslovakia, East Germany, and Poland in 1974-78. Within GATT, these agreements raised embarrassment, but eventually they were, in fact, passed.¹⁷

None of those Eastern agreements which attracted large-scale, even international attention had any major effect on Finland's trade relations. The practical economic significance of the Finnish-Soviet Tariff Agreement was modest, since the bulk of Finnish imports from the Soviet Union consisted of duty-free raw materials outside the coverage of the agreement. The cooperation agreement with the CMEA was in the first place a political manifestation. According to Kalevi Sorsa, the Finnish Prime Minister at that time, the Soviet leadership was pleased by the Finnish initiative for prestige reasons, yet was only mildly interested in developing cooperation on this basis.¹⁸ The KEVSOS agreements increased trade with the “small socialist countries” of Eastern

¹⁴ See Suomi 1996, 435, 679-680; 1998, 43-51, 69-90, 104-108, 112-114, 119-120, 128-131, 146-160, 167-175; Suomi 2003, 266-267, 280, 284, 285-289, 292-295, 309, 311, 318-319, 323-324, 338, 339, 346, 347, 350, 353, 359, 365, 368.

¹⁵ Hakovirta 1976, 278-281, 288-290; *Valtiopäivät - Riksdagen 1973, Asiakirjat - Handlingar III:1*, Government Proposal No. 171, p. 16 (quot.); (...) *Pöytäkirjat*, spec. pp. 3184-3192.

¹⁶ *Suomen asetuskokoelman sopimussarja - Finlands författningssamlings fördragsserie*, No. 50/1974 (Correspondence).

¹⁷ See Baban 1980, 178-9, 198-9; *Basic Instruments and Selected Documents (BISD). Twenty-second Supplement. Protocols, Decisions, Reports 1974-1975. Thirty-first Session, The Contracting Parties to the General Agreement on Tariffs and Trade*, Geneva 1976, pp. 47-54 (Finland-Hungary); BISD (...) 1975-1976 (...), Geneva 1977, pp. 67-80 (Finland-Czechoslovakia); BISD (...) 1976-1977 (...), Geneva 1978, pp. 106-7 (Finland-GDR); *ibid.*, pp. 107-16 (Finland-Hungary); BISD (...) 1978-1979 (...), Geneva 1980, pp. 327-30 (Finland-Czechoslovakia); BISD (...) 1979-1980 (...), Geneva 1981, pp. 136-45 (Finland-Poland).

¹⁸ Sorsa 2003, 103, 107-108.

Europe a little during the latter half of the 1970s,¹⁹ but even their significance remained modest.

Eastern Trade as International Protectionism

An economic, contrary to a "High Politics", approach emphasizes the role of economic interests in the integration policy. The West European integration is not seen as a materialization of ideological or power ambitions, but as a result of adjusting economic interests among national states and interest groups in different countries.

Alan S. Milward characterizes the West European integration after World War II as "Neo-Mercantilism". The close connection between industrial policy and commercial policy resulted in an integration policy which has been a mixture of liberalization and protection. This policy has been selective by industries. Political decision-makers in different countries tend to enlarge markets for their own competitive industries while protecting the uncompetitive ones against foreign competition. A characteristic feature is that obstacles to trade do not, in the first place, consist of duties but non-tariff barriers.²⁰

Andrew Moravcsik questions the very basic structure of the "High Politics" model. For him, economy appears not as an instrument to achieve "geopolitical objectives" but, on the contrary, ideological preferences, security policy points of view etc. are harnessed to support the economic interests. According to Moravcsik:²¹

"(...) the political economic theory predicts confidential policy discourse among top decision-makers about the efficient attainment of economic objectives. Economic accommodation should be viewed as "inevitable"; geopolitical constraints or rhetoric as malleable. We should see geopolitical rhetoric adapted to support economic objectives, not the reverse."

The crucial question for Finland is to which extent the economic relationship between Finland and the Soviet Union was imposed onto Finland by the tough realities of Great Power politics and to which extent it was created by the Finns themselves to pursue their particular economic interests. Was President Kekkonen really so submissive towards the Soviet Union as the rhetorical sources seem to indicate, or was he, primarily, paving the way for profitable deals? As is generally known, President Kekkonen also carried out personally many of the trade negotiations with the Soviet Union. Most notably he was engaged in the negotiations over the renting of the Saimaa Canal, but he was also lobbying for export deals, especially for construction exports and exports of consumer goods.

During the Cold War, the superpowers, the United States and the Soviet Union, subordinated their trade relations to geopolitical goals. France and the

¹⁹ Kivikari 1983, 95-99, 131-136.

²⁰ Milward 1992, 129-31.

²¹ Moravcsik 1998, 50.

Federal Republic of Germany were, at least seen from the Finnish horizon, Great Powers which create international regimes. Finland is a small country whose lot is to adapt herself to an international order created by the big ones. A closer examination gives the result that, for the main part, Finland's special arrangements for the Eastern trade in connection with the free trade agreements with Western Europe were carefully accommodated to the Finnish economic interests. Finland, in fact, utilized her special international position, since without the special political relationship to the Soviet Union the special arrangements for safeguarding the Eastern trade would not have been acceptable to her Western trade partners. The special arrangements manifested Finland's international position, yet the contents consisted of pursuing economic interests.

The Finnish-Soviet economic relationship formed a regime of international protectionism for a part of the Finnish economy. In the sense of market integration,²² the Soviet trade clearly limited the sphere of Finnish economy that can be regarded as integrated to Western world economy or West European economy. From the aftermath of World War II up to the turmoil of the late 1980s/early 1990s, the Eastern trade was a government-led system, even though the ultimate operations were carried out between the Finnish firms and the Soviet foreign trade organizations. Through Eastern trade, competition by foreign firms was excluded for about one sixth of Finland's total exports. For the governmental economic policies, the Eastern trade promoted above all the maintenance of employment and the balance of payments. From the employment point of view, it was important that the Soviet exports consisted less of paper and pulp, which are traditionally capital-intensive branches, and more of products of more labor-intensive metal and consumer goods industries. The Bank of Finland appreciated especially the "saving currencies" point of view. The License Office controlled that the domestic content of exports was adequate. It has been estimated that the domestic content was on average about 85 per cent during the 1980s.²³

Because of the requirement of balanced trade, the trade volumes depended on Finnish imports from a bilateral country. In the circumstances of West European free trade, especially the exemption clause in the FINN-EFTA Agreement and the free trade agreement with the EC with regard to import regulations on fossil fuels and phosphate and potassium fertilizers gave the government an effective instrument to direct a part of the foreign trade. The authorities used this instrument decisively to promote Finnish exports. For example, during the first Oil Crisis a cooperative house was established for the imports of oil products from the West, named *Osuuskunta Tuontiöljy*, yet the License Office refused its applications for an import license.²⁴ For the other commodities, the Finnish firms had no legal obligation to direct their acquisitions according to the governmental will. The high level of consensus spirit manifested in the Finnish corporatism, concerning foreign economic

²² E.g. Bela Balassa defines "economic integration" as "measures designed to abolish discrimination between economic units belonging to different national states". Balassa 1969, 1-2.

²³ Laurila 1995, 70-71.

²⁴ Öljy - kallis neste [1975], 31-34.

relations, is the main explanation for the fact that also imports of other raw materials from the Soviet Union and other so-called bilateral countries were maintained at a relatively high level.

Imports from the Soviet Union consisted mainly of raw materials, which were to be imported in any case. From the late 1950s onwards, crude oil became the predominant import article. Oil imports from the Soviet Union were the overwhelmingly most important article safeguarded by the exemption clauses of the FINN-EFTA Agreement (1961) and the free trade agreement with the EC (1973). The share of the Soviet Union in the acquisition of crude oil to the Finnish state-owned oil-refining company Neste Oy became gradually even more predominant. In 1981, at the highest, oil and related articles covered 87 per cent of Finnish imports from the Soviet Union. The share of the Soviet Union in the Finnish acquisition of petroleum products was at its highest in 1988, i.e. 91 per cent.²⁵

The Soviet Union was also keen on selling machines and transport equipment to Finland. These exports were facilitated by the Finnish-Soviet Tariff Agreement of 1960. However, even though Soviet-made cars were a familiar sight on the Finnish roads and the Soviet-made electric locomotives, nuclear power reactors etc. aroused much attention, machines and transport equipment never exceeded a few per cent of the Finnish imports from the Soviet Union. (See Figure 1.)

The bulk of Finnish exports to the Soviet Union consisted of ships and engineering products. Machines and transport equipment comprised about half of the Finnish exports to the Soviet Union for whole of the post-World War II era. Ships were the most predominant individual export article. Other important export articles were, among others, paper-mills and pulp-mills machinery, wood-working machinery, hoisting equipment, excavating machinery, and electro-technical machinery. Only about a fifth consisted of paper and related articles²⁶. (See Figure 2.)

The argument about the beneficial impact of the war reparations when compelling Finland to develop her ship-building and engineering industries can be one of making-necessity-to-virtue type. Nevertheless, that view can also be true, albeit it conflicts with the "Pure Theory of International Trade". In the formative years of the 1950s, the East European countries and especially the Soviet Union were the main export markets for the Finnish ships and engineering products, while the Western markets were opened mainly from the 1960s onwards. The Eastern market was quite obviously an important springboard for the Finnish engineering industries, especially paper and pulp machines, with regard to wider international markets.

The two Oil Crises, i.e. 1973-74 and 1979-80, gave a new impetus to the Finnish exports of consumer goods to the Soviet Union, when this became a means to pay for the increased oil bill. Thus, the Finnish clothing and footwear industries, recently grown into export branches under the auspices of EFTA trade, found additional markets in the Soviet Union. The increased oil bill gave also impetus to

²⁵ For the oil trade, see spec. Kuisma 1997, 212ff, Picture 19 b in appendix. Originally, half of the crude oil to the Finnish state-owned oil-refining company Neste Oy was to be acquired from the Soviet Union and half through Western companies.

²⁶ See also Eloranta and Ojala, in this volume.

large-scale construction exports. There is no exact public information of the size of construction exports. Some of them are recorded into the foreign trade statistics (materials and equipment), while the rest (compensation for work and services) is included in the balance of payments statistics without detailed specification. According to calculations of the Research Institute of the Finnish Economy (ETLA), from the mid-1970s to the mid-1980s the combined invoicing of construction firms from the Soviet Union varied between 6 and 16 per cent of Finland's total revenue from the Soviet Union.²⁷

From the viewpoint of accommodating the special arrangements to the Finnish economic interests, the KEVSOS agreements with the five Peoples' Democracies were, however, less successful. When carrying out the negotiations, Finland emphasized the principle of reciprocity. Also, these arrangements were to promote Finnish exports at least as much as they increased imports from the countries concerned. The first Government Report to the Parliament on foreign trade policy in 1986, however, assessed that the KEVSOS agreements had not promoted Finnish exports in the expected way but, on the contrary, they rather had caused trade deficits.²⁸

International protectionism appeared even more conspicuously in that the exemption clauses of the free trade agreements enabled two state-owned companies, i.e. Neste Oy and Rikkihappo Oy/Kemira Oy, to acquire and consolidate a monopolistic position on the domestic market, a state of affairs which would have been unthinkable for Finland's Western trading partners with regard to their international commitments. To be sure, the monopolistic position concerned only the main products of these firms, i.e. oil products and fertilizers, respectively.

Oil refining under the state-owned company Neste Oy started in 1957 under the auspices of import regulations. Import regulations for oil products lasted until the collapse of the bilateral trade regime in the early 1990s. To be sure, also foreign oil companies maintained in Finland retail chains all the time, but they had to adjust their commercial operations within a framework controlled by the Finnish state. They, for example, had to, in general, acquire from Neste Oy those oil products which the Finnish refining company could offer. Under these circumstances, Neste Oy became gradually the biggest oil refiner in the Nordic countries.²⁹

Contrary to the situation of Neste Oy, the fertilizer monopoly of Rikkihappo Oy/Kemira Oy did not serve essential trade policy interests. The share of fertilizers imports in Finnish foreign trade was quite negligible for the whole period when the exemption clause was effective, both for total and Soviet/East European imports. The main significance of the stipulation concerned was for the internal Finnish fertilizers market. The state-owned fertilizer producing company Rikkihappo- ja superfosfaattitehtaat Oy was established in the interwar years, from 1961 with the name Rikkihappo Oy and from 1972 with the present name Kemira Oy. The monopolistic position of the firm was originally based on the import regulations arising from World War II and the fact that, in 1948-62, the state subsidies to small farmers for purchase of

²⁷ See Alho 1986, 46.

²⁸ *Valtiopäivät - Riksdagen 1986, Pöytäkirjat, 3462-3463, 3475-3476.*

²⁹ See Valtionyhtiöt markkinataloudessa 1989, 52-56; Kuisma 1997, 361-375.

fertilizers were channeled through this state-owned company. When another state-owned fertilizer producing company, Typpi Oy, started its production in 1952, Rikkihappo- ja superfosfaattitehtaat Oy concluded with the wholesale corporations a cartel agreement in which these committed themselves to acquire all fertilizers marketed by them from the company. At the same time, the company concluded with the newcomer Typpi Oy an agreement in which this committed itself to market all its production through the older fertilizer producer, until Typpi Oy merged with Rikkihappo Oy/Kemira Oy in 1971. Under these circumstances, in the autumn of 1957, fertilizers were formally liberated from import regulations, thus increasing the Finnish liberalization rate for their part. The exemption clause in the free trade agreements with regard to fertilizers was never implemented through legislation but through the cartel agreement. The cartel agreement lasted until 1989.³⁰

From 1984 onwards the Finnish integration policy was oriented towards what later on became known as the European Economic Space/Area (EES/EEA) and globalization. International capital movements were liberalized mainly in the period 1985-90. From 1986 on, Finland became a full member of the EFTA. In 1990, Finland started together with the other EFTA countries negotiations with the EC Commission on the EEA. These new orientations were no longer counter-balanced in the Eastern direction. The Finnish Communists accused the Government of adopting a hostile attitude towards the Soviet Union and other Socialist countries. In fact, however, the government policy was as Soviet-friendly as before. The question was rather that the stagnating East European economies could no longer offer new forms of economic cooperation parallel to the Western projects.

Explanation versus Evidence

Were the special arrangements to safeguard Eastern trade in connection with Finland's participation in West European integration conditioned by Finland's general international position or were they based on particular economic interests? An explanation based on the "Adaptation Theory of International Politics" gives an answer which emphasizes the "High Politics" points of view. An explanation based on Alan S. Milward's and Andrew Moravscik's views of economic interests as the driving force gives a coherent answer too.

The adaptation model explains the contractual structure, especially the contractual parallelism, in Finland's integration policies as part of Finland's foreign policy in general. The contractual parallelism, which meant that the agreements with the West were "balanced" by parallel agreements with the East, was practiced from the FINN-EFTA Agreement in 1961 up to the 1980s. To balance the FINN-EFTA Agreement, Finland concluded with the Soviet Union a Tariff Agreement, which granted the Soviet imports the same duty-free treatment than to the EFTA countries. To balance the free trade agreement with the EC in 1973, Finland concluded a cooperation agreement with the Council for

³⁰ Valtionyhtiöt markkinataloudessa 1989, 44-46; Seppälä 1999, 51-64.

Mutual Economic Assistance (“Comecon”), modified the Tariff Agreement with the Soviet Union to correspond to the new situation, and concluded with five Peoples Democracies the KEVSOS agreements for reciprocal removal of obstacles to trade. These agreements attracted a lot of international attention. In practice, however, their impact on Finland's trade relations remained modest. What was effective for safeguarding the Eastern trade was the exemption clause in the FINN-EFTA Agreement and the free trade agreement with the EC, in which Finland retained import regulations on fossil fuels and phosphate and potassium fertilizers. This stipulation was carried out with low profile, and for the bulk of observers it remained virtually unnoticed.

The “Economic Interests” model, again, explains the integration policies as part of the economic policy. The most interesting feature in this respect is that Finland made virtually no economic concessions to meet the requirements of her international position but, on the contrary, she exploited her international position to acquire special rights which would not have been allowed to any other participant. The possible benefits of the parallel agreements for the Finnish economic interests remained modest already because of their small economic significance, and in any case they did not hurt any Finnish economic actors. The exemption clause in the free trade agreements, instead, corresponded completely to the aspirations of the governmental economic policies and the economic interests of many Finnish business firms. Together with the state-led corporatist structures, it provided favorable conditions for about a sixth of the Finnish exports, protected against competition from abroad. Furthermore, it provided a monopoly position on the domestic market for the main products of two state-owned companies, i.e. Neste Oy and Rikkihappo Oy/Kemira Oy, for oil products and fertilizers, respectively. The former one's special position was connected to the firm's important role for the whole national economy, while the latter utilized its position mainly for its own business interests. An important point of view which also supports the “Economic Interests” approach is that from the 1980s onwards, when Finland entered a new phase in her industrial and integration policies, the contractual parallelism was no longer practiced in the new policy projects connected with deepening integration and globalization, since there were no economic gains to be attained in that way.

History is a multi-dimensional space in which the right answer depends on the question. A coherent answer on a complex question requires an adequate synthesis of theoretical approaches. For Finland's policies vis-à-vis West European integration, the adaptation model explains the contractual structure of Finland's participation up to the 1980s. The “Economic Interests” approach again explains why the low-profile exemption clause in the free trade agreements was the really important element to safeguard the Eastern trade, while the conspicuous ones, subject to large international attention and polemics, remained insignificant. The “Economic Interests” approach also explains the dynamics of the Finnish integration policies from the 1980s onwards.

A further question is whether the Soviet trade really was profitable for Finland. One can argue that it provided an export market for a section of the Finnish manufacturing industries and employment for a considerable part of the Finnish population for a particular historical era, to a large extent in addition to what had been the case otherwise. The main counter-argument is that a secured

market might have hampered the international adjustment of the Finnish economy. In any case, a profound process of internationalization took place in the Finnish economy during the 1980s and 1990s, and the Finnish enterprises managed to adjust themselves to the new circumstances of global competition. An ultimate answer to the question would require new empirical research.

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Converta - A Finnish Conduit in the East-West Trade

Introduction

“Soviet Union is in any case a planned economy for now and for the future as well.” This was a statement made in late September 1989 in the strategy meeting of Converta – the Finnish Paper and Board Converters Association, owned by the Finnish forest industry companies. When analyzing the markets, the strategy of the association was clear: Though the turbulence in Eastern Europe and the Soviet Union was to remain, trade was going to decline only for temporarily². Converta was not the only one who failed in forecasting the future of the Eastern block, and the Soviet Union in particular³. However, Converta was an organization that, if any, should have known better. Namely, it had been organizing trade relations during the whole post-war era between the most important Finnish export industries and the Eastern block. Internationally, Converta was not only a minor player in Soviet trade. For example, in 1987, when Converta’s trade to the Soviet Union had already declined, the Finnish exports through Converta to the Soviet Union were larger than in many Western European countries to the Soviet Union; for example, comprising almost the same volume as the combined exports from Denmark and Norway.⁴ Thus, Converta offers a good case to study not only the East-West trade, but also the actual trade practices, the importance of information channels, exit strategies, and institutional patterns. However, in order to understand the role

¹ Authors in alphabetical order.

² Center of Finnish Business Records (ELKA), Mikkeli, Archives of Converta, Strategy of Converta 27th September 1989.

³ See e.g. Eriksson 1989, Iivonen 1992, Möttönen 2002.

⁴ Finnish Official Statistics; ELKA, Converta, Minutes of the Soviet Trade Division 19th August 1988 (Appendix:the Finnish Embassy in Moscow, Annual report of commercial secretary for year 1987); Annual Reports of Converta

played by the Converta in this particular trade, a short description of Converta, its trade focus and practices are provided covering the whole post-war period. Converta was a Finnish sales association – or export cartel – that aimed to operate especially in the Eastern markets during the post-war period. In order to understand why Converta was created in the first place, one must consider: 1) the role played by the Soviet Union in the post- and pre-war Finnish foreign trade; 2) the role played by sales associations in world trade (and in Finnish export trade in particular); 3) the problems of in organizing exchange relations in general.

Before the Russian revolution of 1917, Russia was the most important export market for many Finnish industrial sectors, especially for paper and pulp industries, and even circa 40 per cent of the Finnish exports to Russia consisted of paper products before the First World War. At the time, however, sawmill products were still the dominant export items, with markets mostly in the Western European countries. For the Finnish paper and pulp industries, thus, the Russian revolution was a catastrophe; the Finnish companies had to seek new markets in the West. At the time, the first Finnish sales associations (or export cartels) were founded, such as *Finnpap* for paper products and *Finncell* for pulp exports.⁵

The model for the associations came especially from Germany, though sales associations were widely known and used throughout the world during the 20th century.⁶ As Auquier and Caves (1979) stress, these cartels were part of the national trade policies to secure monopoly profits abroad, but at the same time aimed to control competition at home. Thus, a group of companies were permitted to organize a cartel to exploit the foreign markets. Finnish industries, forest industries in particular, fit well with the notions introduced by Auquier and Caves, namely, that sales associations were tolerated especially in countries with larger fractions of manufactured output exported. Export cartels were used, for example, in the late 1960s in countries like the USA and Germany – in the latter, it was reported that at the time 31 of 78 cartels controlled two thirds of the domestic markets.⁷

As Avner Greif has demonstrated, collective action problems and the lack of trust have usually been overcome by collective entities engendering networks of trust, which in turn would enable the enforcement of the rules of the game in the exchange both within the group and putting pressure on outside enforcement as well. This can provide a solution to the so-called Fundamental Problem of Exchange (FPOE).⁸ Sales associations were practical solutions to the FPOE; in fact, they enabled even the smaller companies to operate in international markets, thus allowing them to achieve scale economies. Large economies of scale involve high fixed costs and greater risks

⁵ See e.g. Oksanen and Pihkala 1969, Oksanen and Pihkala 1975, Ahvenainen 1984, Hjerppe 1988, Hjerppe 1989, Kuisma 1993, Laiho 1998, Heikkinen 2000, Lamberg and Ojala 2001.

⁶ Wurm 1989, Heikkinen 2000, Hjerppe and Lamberg 2000.

⁷ Auquier and Caves 1979, 571 - 573.

⁸ See especially Greif 2000; Greif 1993; Greif et al. 1994.

for the firms, especially in connection with risky international markets. Since in a small country the domestic demand is not enough, access to foreign markets is vital for most industries.⁹ Therefore, in international trade, for example the Finnish paper producers were understood as a singular entity, operating through Finnpapp. Of course, associations caused numerous problems as well. First of all, all the individual companies had to adjust their production to the export quotas decided upon jointly within the association. Secondly, in certain cases the associations might constrain technological development due to the fact that companies were satisfied and passive respective of the current situation rather than seek innovative, new ideas.¹⁰

There were only minor steps taken in the Soviet-Finnish trade during the inter-war period, yet quite naturally the trade ceased altogether when war broke up between the countries in 1939; first, the Winter War in 1939 and then the Continuation War in 1941. After the war(s), Finland had to pay war indemnities to the Soviet Union – this has previously been argued to have been a push for a number of Finnish industrial sectors and enterprises to (re)-enter to Russian markets.¹¹ Also, the forest industry companies perceived new opportunities in the East; perhaps not with the traditional export items (paper, pulp and timber), which all were produced in the Soviet Union as well, but with some processed products, such as packages, that Finnish companies had started to produce before and during the war. In fact, companies saw huge opportunities in the Soviet markets with these kinds of products. In organizing such trade, a new sales association was thought to be practical, therefore Converta was founded. It would manage the exchange relationships of Finnish forest industries with this new kind of “market”; one that was based on secrecy, abundant rent seeking, and extremely centralized system of autocratic rule. Of course, one must bear in mind that Converta operated also in the Western markets, though the share of Western sales was far lower compared to the Eastern share, especially the Soviet markets. The most important export products through Converta were sacks, cardboard boxes and packages, and various special types of papers. For example, in the 1970s and the 1980s sacks constituted about 40 to 50 per cent of Converta’s sales to the Soviet Union, packages 22 per cent, and special papers about 20 per cent.¹²

The key questions in this kind of analysis are: 1) How would agents be able to enter markets characterized by collusion and non-price competition? 2) How would such agents be able to gather and process reliable information in order to adapt to the dynamics of these markets after entry? 3) How would these agents manage their activities in such markets during a downturn? Our aim is to investigate all of these problems, yet we focus especially on the third question. As we suggest, one has to analyze this process through information

⁹ Milner and Yoffie 1989 - see also e.g. Auquier and Caves 1979.

¹⁰ Heikkinen 2000, Lamberg and Ojala 2001 Innovations can, however, sometimes speeded up by collusion, see e.g. Baumol 1992.

¹¹ Fellman 1996, Heikkinen 2000, Lamberg and Ojala 2001.

¹² Elka, Converta, Minutes of Soviet Trade Division 23rd March 1983 (information and strategy seminar).

asymmetries in the trade relationship, the way a collective entity would be invoked by firms to seek rents and collude with political players to smooth out the effects of business cycles, the lack of an exit strategy, and sunk costs involved in creating a particular path dependent behavioral pattern. We will not discuss, by and large, certain elements commonly associated with collusive behavior or cartels in general, such as internal battles over price setting as well as possible price wars arising from demand shocks.¹³ Our focus is solely, as far as the external activities of this cartel are concerned, on the rent seeking strategies it utilized vis-à-vis the state and the Soviet authorities, and, as far as the cartel's internal activities are concerned, on the information acquisition and processing features of Converta.

In the following, we will first review the relevant theories and build an analytical framework for this study. Then we will offer a brief glance of the post-Second World War Finnish foreign and trade policy, to be followed by a macro-level quantitative and descriptive analysis of Converta's activities in the post-war period. Then we shall take a closer look at the actual functions of Converta, especially the way it processed and utilized information during the turbulent years in the late 1980s and the early 1990s. Finally, we will conclude this study by returning to the key theoretical propositions and assess their relevance in the Converta case.

Theoretical Framework

This section will concentrate on drawing inspiration from an interdisciplinary pool of theoretical ideas in order to understand the activities of Converta during the gradual collapse of the Soviet trade, namely in the 1980s and the early 1990s. Thus, we will focus especially on the role played by: 1) asymmetric information and transfer of knowledge; 2) the way this group sought rents and colluded with other players in order to achieve gains from markets that were not characterized by "traditional" competition; 3) the lack of exit strategies; and especially 4) the role of institutional path dependence.

As most rational actors realize, gathering and processing information is costly and often asymmetric by nature. One of the key questions is how the economy adapts to new information. In terms of firms and individual agents, according to the tenets of information economics, they recognize both that prices convey a multitude of information about their products and that their actions convey information to other players in the market place.¹⁴ In terms of individual agents, each would prefer others in a particular reference group to bear the cost of acquiring information, thus the free-rider problem inhibits these activities. For example, in an auction context, buyers have incentives to pool

¹³ See especially Porter 1983, Green and Porter 1984, Porter 1985. On demand fluctuations and collusion, see e.g. Porter 1983, Porter 1986.

¹⁴ See e.g. Porter 1995, Stiglitz 2000.

information or to gain an advantage by learning of a rival's intentions. In terms of groups (such as Converta, which was a coalition of firms), asymmetries in group size translate into an information disparity; the more so when the relevant decision-making groups are of different size and internal structure. As Mancur Olson has stressed, larger groups often suffer more profoundly from the free-rider problem, thereby making them less effective in collective bargaining.¹⁵

In the markets problems arise when some agents either have more information or more reliable information than others. As said, often the seller knows more about the product being traded than the buyer. Yet, when discussing non-competitive markets and economic interdependence, namely the Soviet Union, where the entire economy was based on withholding information from outside the small elite, and bilateral (clearing) trading of goods with a politically essential partner, the buyer might have had the advantage in the exchange of that particular good, especially when trade was considered politically necessary by (most likely) both parties.¹⁶

As already noted, the FPOE has usually in history been overcome by some form of collective action. Interest groups, such as Converta, were especially necessary to seek monopoly rents from a market not conforming to the usual rules of international, capitalist commerce. In general, firms, either on their own or more commonly through joint trade organizations and ultimately national peak association(s), attempt to obtain monopoly rents from the government via different rent seeking strategies such as campaign funding and political networking. As expounded by Gordon Tullock¹⁷, rent-seeking behavior can be said to occur when the *profits* of this activity exceed the opportunity *costs* for the owners of resources in the political markets, with the costs of these actions entailing a waste of social resources. These political rents, as opposed to profits garnered through competitive activities in the markets, can also be thought of "super profits", which will induce self-interest maximizing individuals to invest in the political markets, depending on an interpretation of the costs involved with less than perfect information. Firms can also seek monopoly rents in the competitive markets by forming cartels and other collusive organizations.¹⁸ Thus, the idea of profit, implying self-interested behavior, can be considered essential in rent seeking. Nonetheless, describing the utility maximization of economic interest groups, usually by clusters of firms organized for a common purpose or by large individual firms, as straightforward profit maximization is too simplistic. As argued in Lamberg et al. (2003), the rent seeking of such agents can be based on multiple, often coinciding motives arising from various levels influence, from intra-firm dynamics to the national peak associations.¹⁹

¹⁵ Olson 1965; Porter 1995, Lohmann 1998.

¹⁶ Harrison 2003. On economic interdependence, see Wagner 1988.

¹⁷ Tullock 1967, Tullock 1980. See also Gradstein 1993.

¹⁸ Buchanan 1980; Posner 1975, Tullock 1980. - On the various schools of thought and definitions, see Benson 2002.

¹⁹ See Lamberg et al. 2003 for details and theoretical discussion.

What about networks and other forms of cooperation, i.e. when the agents have joint interests? It is important to make a distinction between “regular” rent seeking and collusive rent seeking among the agents involved. Collusion, essentially a special case of rent seeking as the interests of principals and agents coincide, can occur in many ways, at many levels, and between many combinations of actors. For example, at the level of economic interest groups collusion enables rivalrous agents to pool their probabilities of winning the contract in question.²⁰ Collusion is also possible between the state agencies responsible for the rules of the game in trade and firms interested in entering particular types of markets. Repeated transactions and extensive cooperation are likely to occur in countries with less developed production capabilities and trade constraints, including also a limited pool of professional expertise in technology transfers. This relationship usually involves transaction costs in the form of acquiring information about the possible products and suppliers, organizing competitions, bargaining with the contractors, and then the writing, monitoring, and enforcing of the contracts.²¹ In short, the government as the principal or the intermediary has to promote a particular contractor or agent, and to ensure that the agent pursues the goals of the principal, in this case in the highly-centralized Soviet markets. Entry into the Soviet markets for Finnish firms was contingent on excellent networks and acquired political capital. In general, collusion tends to be more difficult in societies with secure property rights and developed political markets. The Soviet markets, in terms of entry in particular, were extremely attractive for collusion to develop among the Finnish firms and the political elites, since they would be able to obtain lucrative long-term contracts²². The Soviet motivation for dealing with centralized actors is not entirely clear. In the Soviet trade the role played by the state was vital: In the Soviet command economy the trade was centralized to the governmental bodies. For the Soviet party, this was obviously a more practical solution, even if the Finnish companies were joined together as joint organizations, such as Converta. Most likely they either wanted to keep the Finns near the Soviet foreign and economic policy sphere (implying the possibility of Finnish firms obtaining higher than world market prices) or that this trade was politically too important for the Finns to leave uncontrolled and unsubsidized (implying a profit motive for the Soviets and the Finnish firms, with the Finnish taxpayers incurring the cost). In addition, the Soviet side was certainly avidly pursuing Western (military) technology, the flow of which was largely regulated by the United States.

Following Graham Wilson, here interest groups are defined as organizations, separate from government, attempting to influence public policy. Thus these groups — unions, producers’ groups, or for example corporations —

²⁰ Harrison 2001, 4. - On “collusion-proof” contracts and third-party mediation, see Laffont and Martimont 1997.

²¹ See e.g. North 1990; Ojala 1997.

²² On the advantages of longevity in business operations, see e.g. Boyce 1995, 203; Casson 1998, 17 - 18; Ojala 1999, 311 - 319; Alajoutsijärvi 1996.

provided an institutionalized linkage between the state and the major sectors of the society.²³ However, the state should not be understood to be a cohesive, unified actor; rather, the sectors and departments within the state have the ability to act autonomously in particular situations, depends on the availability of resources. Equally, as suggested by Martin Smith, we can improve the above definition of an interest group by emphasizing that these groups, in order to achieve their goals, were dependent on policy networks: the government needs the assistance of groups in the development and implementation of policy, whereas groups may be equally dependent on the state for “rents”.²⁴

Here Converta can be understood as an interest group seeking stable (=countercyclical), alternative markets for its members, whereas the Finnish state would be instrumental in providing access to these markets, namely the “rent”. For the individual companies Converta offered a solution on how to enter the Soviet markets (and other markets that Converta was involved to), yet at the same time it – as other associations as well – was constrained in its individual decisions. The sales quotas, products, prices and quantities were decided upon by Converta, though companies took part in the decision-making collectively. Thus, Converta embodied fairly typical problems of collective action for the individual companies. From the companies’ point of view, the potential rents, however, exceeded the various costs involved.

The functionality of these networks was of course contingent on the available choice sets. One conspicuous feature for companies or interest groups managing their exchange relationships in the Eastern Europe and the Soviet Union was that these markets did not provide foreseeable exit strategies. Equally, the companies dealing in these markets came to regard them as stable, yet inflexible alternatives in their commercial strategies. In essence, during an economic downturn, these kinds of markets would become very attractive for them. As such, in simplistic terms, firms can choose either to cut costs or invest more in new innovations during an economic downturn, and in fact both strategies can be successful, depending on the internal structure, financial position, and the external markets the particular firm is connected to. Cartels offering monopoly profits may help firms minimize the adverse effects of business cycles, for example. Competitors can be excluded and cloudy non-price considerations introduced if the product markets are not price-competitive. Yet, in most situations the firms in question always have choices, and the deliberation of the agents in various cases can be based on complex motives.²⁵

The “East” offered various kinds of exit possibilities only *after* the collapse of the Soviet Union, small and large, based on different legal foundations. In all cases, the domestic conditions in socialist economies entailed to some extent distortions in prices, the credibility of the socialist institutions varied, the population’s memory of market-based exit processes again differed, and their

²³ Wilson 1990, 8-9.

²⁴ Smith 1993, 50-61.

²⁵ See eg. Perry 1999; Whittington 1989, i.e. 16-21, 45-46, 197-199.

readiness and ability to embrace exogenous economic shocks were very diverse. There were by and large two important considerations in the possible exit: 1) The identity of the organization which was in control of the process; 2) Exit mechanisms were usually governed by special laws or transitory legal framework. All in all, this meant that the so-called transition economies, which had enormous pressures for exit amidst the big changes, had usually weak institutional capacity to handle the exits from the market.²⁶ Moreover, what kind of shocks did they encounter? In general, they faced: 1) The elimination of soft budget constraints; 2) Foreign trade shocks; and 3) Devaluation. As far as trade was concerned, they had to deal with a terms-of-trade shock, Soviet import collapse due to collapse of trade links, and Soviet import collapse due to dwindling domestic demand in the Soviet Union.²⁷

The Finnish firms, at least in principle, should have had adequate possibilities of, firstly, obtaining information of the state of affairs in the Soviet Union via their political partners abroad and in the Finnish government and, secondly, exiting from the markets if necessary. However, they did not have exit strategies respective of the Soviet markets. Why? Politically it was difficult to openly speculate on or forecast the collapse of the Soviet system, and it would have been risky for Finland to have bet on such a contingency. For the firms, the Soviet market required significant investments in the previously mentioned networks and continuity, thus the costs were sunk into these politically determined markets, combined with asymmetric information, which led to path dependence in business strategies and overvaluation of the Soviet markets in the 1980s.

The analysis of historical constraints has gained some momentum in economics in the 1980s and the 1990s, especially in the context of re-evaluating technological development. An essential tool in this may be the *path dependence* hypothesis, advocated as an alternative framework in the recent years as a method of explaining certain features of technological change, which should be understood, as Douglass C. North applies it, as the dependence of economic development on historical preconditions.²⁸

Path dependence has also been applied into explaining the historical development of economies.²⁹ There are two important basic factors in North's institutional framework, which are crucial for applying path dependence: increasing returns and inefficient markets (which embody large transaction costs). He assumes quite implicitly that institutions have no significance in economies in the absence of these factors. For example, he maintains that

²⁶ Balcerowicz et al. 1998, 1-10.

²⁷ Rostowski and Nikolic 1998, 57-64.

²² Eloranta 2002; North 1990. See also David 1986. - On criticism of Paul David's famous QWERTY-case, see e.g. Liebowitz and Margolis 1990. For more recent discussion, see David 2001.

²⁹ See North 1990, e.g. 93-95 - W. Brian Arthur's research, published at the end of the 1980s, possesses a much more narrow and technologically oriented perspective than North's does. North, however, fails to define path dependence as e.g. Liebowitz and Margolis have attempted; see Eloranta 2002.

perfectly functioning markets explain economic development perfectly. According to North, with these factors in effect, organizations develop and function in order to attempt to increase their gains within an institutional framework.³⁰

The strength of the factors mentioned above, combined with historical contingencies, define the strength of the path dependence in a given situation, respectively.³¹ Thus, here path dependence can be understood as a way of analyzing structural development, which is constrained by the economic factors and historical continuities, as well as discontinuities, of the initial observation year and its institutional framework.³²

Often, however, the path dependence hypothesis has been applied to explaining technological development. It has been aptly characterized by the phrase "lock-in by historical events". The processes in question can usually be termed as self-enforcing or self-re-enforcing, cumulative events. In such processes small differences in initial conditions, such as the formal or informal institutions or the pool of players involved in the game, become magnified in time, producing multiple stable equilibria.³³ In terms of firms, the sunk costs involved in the use of capital and other endeavors (such as pressure activities) shape the behavioral trajectory of these actors. As Gary Becker has noted, sunk costs are important in the "political sector" since they reduce the short-run elasticity of supply in human or physical capital.³⁴ Converta was locked into the Soviet markets by: 1) The attraction of smoothing out business cycles with these "stable" markets, complementing their commercial activities elsewhere; 2) The asymmetric nature of the information in this relationship; 3) The sunk costs involved in securing entry to the Soviet markets via collusion with the Finnish political elite; 4) The lack of an exit strategy; 5) The previous successes in the Soviet markets and the promise of increasing returns due to liberalization of the press, for example.

In sum, Converta can be analyzed on the basis of the asymmetric nature of the information in its Soviet trade relationships, the way they sought rents and colluded with Finnish political players in order to achieve gains from markets that were not characterized by "traditional" competition, the lack of exit strategies and the subsequent implications, and the role of institutional path dependence and sunk costs.

³⁰ North 1990.

³¹ Of course, like in public choice, the difficulty in NIE is how to measure, especially quantitatively, this interaction. Also, it is practically impossible to recognize all of the multiple constraints in a historical process. On empirical applications, mainly focusing on property rights, see for example Alston et al. 1996.

³² David 2001. On nonlinear econometrics, a good introduction can be found in Granger and Teräsvirta 1993 (see e.g. Chapter 5). A good effort in this direction can be found in Durlauf 1991, which discusses many aspects of technological path dependence and economywide shocks in a quantitative manner.

³³ David 1993, e.g. 19.

³⁴ Becker 1983.

Finnish Foreign and Trade Policy During the Postwar Era

The Continuation War, in which Finland had fought the Soviet Union with Germany, came to an end in the Armistice of September 1944. The terms of the treaty were considered harsh by contemporaries, yet Finland was able to maintain her independence. A specific "Russian policy" was initiated by J.K. Paasikivi (President 1946-56) after the war. The most compelling fact guaranteeing the domestic success of this policy after the war was the military superiority of the Soviet Union vis-à-vis Finland and the new tense Cold War environment.³⁵

The Paris Peace Treaty, signed on 10 February 1947, imposed significant constraints on Finland, for example on the size of her armed forces. It also included a provision for the signatories to refrain from attacking one another or forming an alliance against one another.³⁶ The second cornerstone of the new foreign/security policy constraints was the Treaty of Friendship, Cooperation and Mutual Assistance (FCMA) signed in 1948. It also integrated Finland into the Soviet Union's external security framework from a formal standpoint. However, any assistance from the Soviet Union would have had to be agreed upon separately. Despite the Treaty, Finland was in fact considered to be a neutral country from a legal standpoint. Finland had to refrain from membership in international organizations, including the United Nations, up to 1955, and initially in the Nordic Council as well, because such commitments could have resulted in the eventuality of having to take sides in conflicts between the Great Powers.³⁷

Finnish foreign policy assumed a more focal role when U.K. Kekkonen, a controversial figure in Finnish history, became president in 1956. Kekkonen's initiatives during his 25-year presidency included a Nordic nuclear-weapon-free zone and organization of the Conference on Security and Cooperation in Europe (culminating in the signing of the treaty 1.8.1975), with the consent of the Soviet Union. Whereas the beginning of Kekkonen's lengthy presidency was marked by the intensive Cold War and the ensuing crises, the late 1960s and 1970s were clearly, as the CSCE initiative proves, a time of lessening internal tensions, and thus provided more room to maneuver in the Finnish foreign policy. On the other hand, the Soviet Union applied more pressure toward the Finnish doctrine of neutrality due to its more stringent application of communist doctrine. In actuality, Finland often favored the Soviet Union's strategic interests in the 1970s, yet attempted to further her own goals at the same time and gain more recognition for her neutrality stance.³⁸

³⁵ See e.g. Polvinen 1986, 13-36; Allison 1985, 8-18; Tervasmäki 1978; Korobochkin 1998; Rusi and Salovaara 1993, 148.

³⁶ Allison 1985, 16-17, appendix I.

³⁷ Allison 1985, 17-37; Korobochkin 1998; Kirby 1979, 181-186.

³⁸ Kirby 1979, 187-192; Allison 1985; Tervasmäki 1978, 385-386; Möttölä 1993, 72-73; Rusi and Salovaara 1993, 142-143. Neutrality in the Finnish foreign policy referred to

Thus, Finnish security policy was dependent on good political and economic relations with the Soviet Union. Out of this premise, the security policy environment of Finland can be divided into three, intricately linked sub-sections: 1) The strategic environment, including military strategy, dictated by the antagonism between the military alliances of the East and the West; 2) The conflict environment, which was shaped by the contemporary crises in the international system; 3) The trade policy environment, which was constrained by the strategic and conflict environment mentioned above.³⁹ Finnish trade policy, and indirectly the entire Finnish foreign trade, were thus in reality subjugated to the security policy and the maintenance of good relations with the Soviet Union. This situation differed drastically from the interwar period. Although Finland had to adjust to the new foreign policy situation and the new trade constraints, Finland may also have benefited from the extensive trade with the Soviet Union up until the late 1980s.⁴⁰

Changes in the Finnish institutional framework of political decision-making and public goods provision was triggered by the international Oil Crises and the ensuing recession in the 1970s. The first Oil Crisis had relatively little impact on the Finnish economy, yet the recession reached Finland eventually in 1974–1975. Production declined, economic policy became constricted, and unemployment soared in 1975–1977. Devaluations in 1977 and 1978, as well as moderate wage agreements, paved the way for the economic growth of the 1980s once again.⁴¹ The ending of the intense growth period from the 1960s and the unprecedented high unemployment made it attractive for the government to support some ailing industries.

Trading practices

The trade agreements between Finland and the Soviet Union formed formal institutional framework for all trade. The trade was balanced through “clearing” agreements; namely, the trade was not conducted with a convertible currency, but was based on actual trade of goods. Within the clearing system the exports and imports were balanced at the national level each year. Thus, actual money transfers were not needed between the countries – or between Finnish and Soviet companies, but only within the countries. In Finland the role played by the Bank of Finland was pronounced: it took care of the payments to private companies. The actual payments were processed through the clearing

maintaining the Finnish independence, despite FMCA-treaty and its military clauses, by remaining neutral in Great Power conflicts.

³⁹ Based on Möttölä 1993, 72.

⁴⁰ See e.g. Paavonen 1998, 69-72; Rusi and Salovaara 1993. Cf. to the interwar situation, see Lamberg 1999. On Finnish foreign trade, see Hjerppe 1989, 149-170. On economic integration, see also Rehn 1993. The economic importance of the Finnish-Soviet trade has not yet been analyzed comprehensively enough to provide an answer to the questions: Which side benefited from the trade and how much?

⁴¹ Pekkarinen and Vartiainen 1993, 125-126; Hjerppe 1989, 50. On the collapse of the post-war international economic boom in the early 1970s, see e.g. Maddison 1991, 177-192.

system, in which several actors were involved (Diagram 1, from A to H); again in a very centralized fashion. Namely, only the products crossed the border into the Soviet Union, and the payment was achieved via the Bank of Finland, as is stated in the Diagram. Thus, also the role played by for example the Finnish government in providing the framework for the trade through clearing system was pronounced. Therefore, for the companies it was, firstly, vital to try to influence governmental decision making, and secondly, also form centralized organizations, such as *Converta*, for the trade with the Soviet block.⁴² Therefore, also *Converta* had close relationships with the Finnish Government, which can be perceived, for example, from the number of joint meetings the association had with various governmental bodies and the information it acquired directly especially from the Finnish Embassy in Moscow⁴³.

The Soviet foreign trade was, quite naturally, very hierarchical and dominated by the state. In order to make an offer to the Soviet "markets" and obtain payment (Diagram 1), several steps had to be taken. First, the offer went both to the field-specific Soviet ministry and to the Soviet factory or corporation in question. Thereafter particular foreign trade organizations took care of the trade for different lines of business, like *Exportles* in forest industries, *Izopolimer* in chemistry, and *Actoexport* in car industries. After the negotiations (and possible competing offers), the deal was signed. Of course, the deal had to be adjustable vis-à-vis the five years plans and the trade agreements between Finland and the Soviet Union.⁴⁴

The context and methods utilized in the Finnish-Soviet trade, especially from the Finnish perspective, varied greatly. Trade with the Soviet Union usually precluded the possibility of contacting the consumer or the end user of the product directly. The Soviet state had a monopoly in practicing foreign trade, and trade was concentrated to the hands of specialized trade organizations, such as *Exportles* and *Vneshtorgizdat* in the case of *Converta*⁴⁵. For a Finnish company, the easiest and cheapest way of opening trade relations with the Soviet Union was to contact the official Soviet trade mission in Helsinki. Thus, role of the state and the political networks were heightened. The ways of achieving sales to the Soviet Union included trade shows, symposiums, and personal sales negotiations – the longevity of the personal networks were crucial. Individual firm (or sales association) had to make sure the deals were in line with the existing agreements covering the trade between the two countries. These agreements were agreed upon in five-year periods, thus, offering stability. Furthermore, the bureaucracy involved was made more extensive by

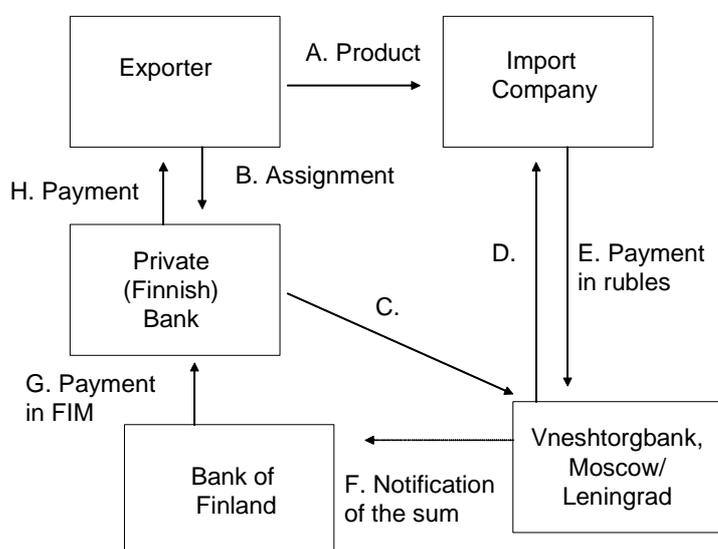
⁴² On the organisation of Finnish-Soviet trade see e.g. Tiisanen et al. 1984; Tiisanen 1986, Tervonen 1993; Alho 1986; Holopainen 1981, Keskinen 1987.

⁴³ See e.g. ELKA, *Converta*, Description of operations by the Finnish commercial secretary in Moscow 26th April 1988; various materials provided by the Finnish Board of trade and Ministry for Foreign Affairs in *Converta* archives (especially file 339)

⁴⁴ ELKA, *Converta*, Minutes of Soviet Trade Division 19th May 1988 (especially Appendix 6).

⁴⁵ See e.g. Elka, *Converta*, Annual report 1991.

the export and import licensing system as well as the tight system of standardization in the Soviet Union



Sources: Tiusanen et al. 1984.

DIAGRAM 1 The Process of Obtaining Payment for the Exported Goods in the Clearing System

Bureaucracy congealed this trade. Because the trade was agreed upon in five-year terms, there were no possibilities for quick changes. This induced path dependent qualities to the trade. As far as the conditions set by Douglass C. North are concerned, these were indeed inefficient markets with increasing returns available from rent seeking. Once the framework for the trade was established, the trade associations congealed the trade even further. In the western markets forest industry associations such as Finnpap and Finncell controlled the entry to the export markets for the individual companies: export quantities were negotiated beforehand within the association. The situation was similar within the eastern trade. For example, within the meeting of this trade association, Converta, the export quotas for each company were negotiated. However, the export quantities were based on, according to the working committee minutes, the "traditional procedure", whereby the position of old producers was secured. In other words, the companies that had exported products to the Soviet Union had privileges for the future as well, and the export quantities and shares were based on the previous experience. Only in the case where the exports were growing significantly the new producers were able to enter the markets.⁴⁶ Thus, the establishment of the trading practises led to a path dependent framework that, on the one hand, secured the status of the old exporters, but on the other was harmful for possible market entry.

⁴⁶ ELKA, Converta, Minutes of Working Committee, 18th August 1983.

The growth and stagnation of the Finnish-Soviet Trade - and Converta

After the Second World War, the Soviet Union emerged as one of the major trading partners for the Finnish industries (Figure 1). Russia was in fact the most important export market for the Finnish industries, for paper and pulp industries in particular, up to the Finnish independence in 1917. During the inter-war period, exports to the Soviet Union played only a minor role, yet the trade accelerated after the Second World War. The Soviet trade constituted around 10 to 20 per cent of the Finnish exports from 1950 to 1991 - in certain years the share was over 25 per cent (Figure 2).⁴⁷

The Finnish trade with the Soviet Union grew especially during the 1970s. This growth was related to the more hostile international economic environment (especially the Oil Crises) and the new trade agreements that were concluded in the 1970s. The role played by oil was central, forming an average of 74 per cent of the Soviet imports to Finland.⁴⁸ The Soviet trade peaked during the Oil Crises: the clearing trade smoothed the problems caused by the oil prices. In fact, the price of crude oil and the exchange rate of US dollar were, according to Tervonen, the central exogenous factors that had an impact on the Finnish-Soviet clearing trade. The trade with oil was seen as a key factor in the Finnish-Soviet trade, giving further possibilities for the Finnish companies: the higher the oil prices in the "capitalistic" markets were, the more oil was imported from the Soviet Union, thereby providing the Finnish export industries lucrative possibilities to trade in order to balance the trade between the two countries. In turn, when the oil prices fell (like in the mid-1980s), this harmed the exports to the Soviet Union.⁴⁹

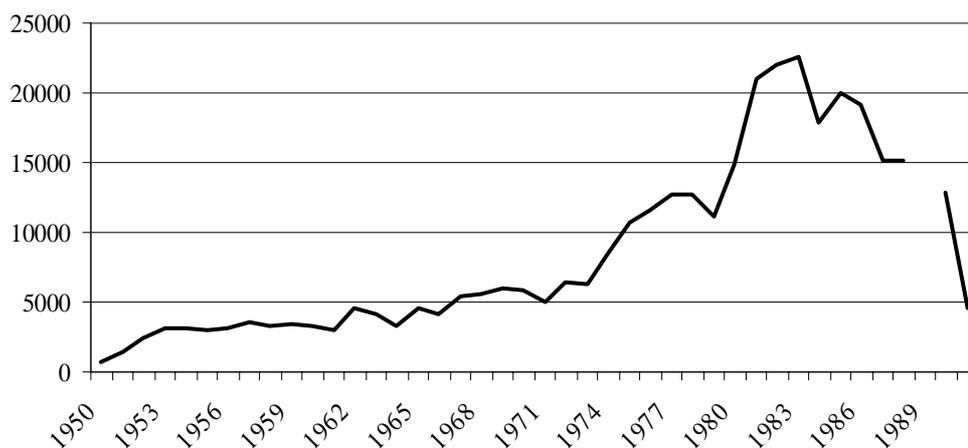
Also, for the Soviet Union Finland was among its most important western trading partners. For example, in 1987 the Finnish trade was the second largest among the western countries with Soviet Union, right after West Germany, constituting circa 16 per cent from the trade with the ten most important western trading partners of the Soviet Union (Table 1). Finnish trade was indeed export-oriented, though the imports to the Soviet Union from Finland were declining already in 1987. The share of exports by Converta in the total Finnish-Soviet trade was rather modest (Figure 2). For the whole period from 1950 to 1991, it was about seven per cent, though in the 1970s Converta's share was over eleven per cent (in 1971 even 15 per cent). Converta's share of the Finnish forest industry's sales to the Soviet Union was around 25 to 35 per cent in the 1970s and the 1980s.⁵⁰

⁴⁷ Hjerpe 1989, 158 - 163.

⁴⁸ Pekkarinen and Vartiainen 1993, Haaparanta 1997.

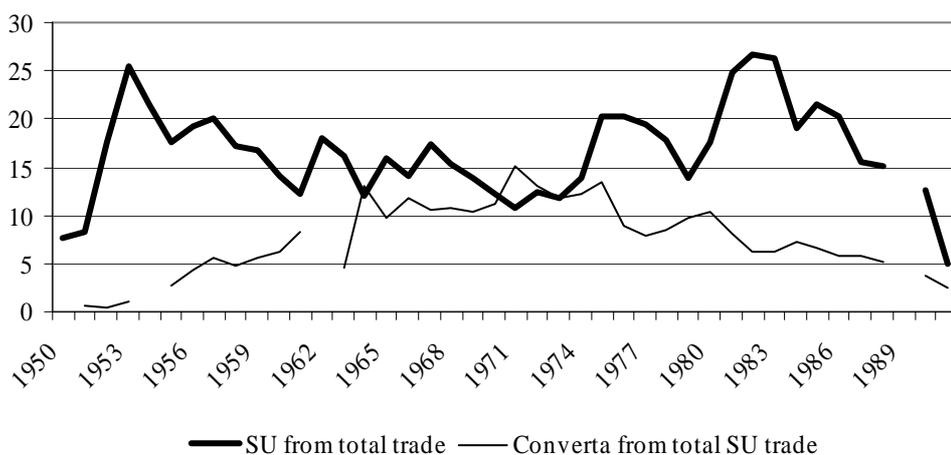
⁴⁹ Tervonen 1993, 8.

⁵⁰ Elka, Converta, Minutes of Soviet Trade Division 23rd March 1983 (information and strategy seminar).



Sources: Suomen taloushistoria 3; Finnish Official Statistics.

FIGURE 1 The Value of Finnish Exports to the Soviet Union, 1950 – 1991 (Millions of 1991 FIM)



Sources: Finnish Official Statistics; Annual Reports of Converta.

FIGURE 2 The Soviet Union's (SU) Share of the Aggregate Finnish Exports (%) and Converta's Share of the Exports to the Soviet Union, 1950 - 1991

TABLE 1 Ten Most Important Western Trading Partners for the Soviet Union in 1987, Millions of Rubles

Country	Total Trade	Share of Top 10 (%)	Exports from Russia	Imports to Russia	Change in Imports to Russia Compared to 1986 (%)
West-Germany	5168,0	21,5	2491,9	2979,1	-8
Finland	3742,7	15,6	1706,8	2035,9	-14,4
Italy	3490,6	14,5	1804,2	1686,4	+14,4
France	2608,2	10,8	1518,0	1090,2	-3,5
Japan	2600,7	10,8	972,5	1628,2	-26,2
Britain	2110,5	8,8	1586,2	524,3	+1,7
USA	1198,4	5,0	279,0	919,4	-19,8
Belgium	1104,6	4,6	738,4	366,2	-13,2
Austria	1030,7	4,3	431,0	599,7	-29,6
Netherlands	1012,8	4,2	781,3	231,5	-6
Together	24067,2	100,0	12309,3	12060,9	..

Source: ELKA, Converta, Minutes of the Soviet Trade Division 19th August 1988 (Appendix: Finnish Embassy in Moscow, Annual report of commercial secretary for year 1987)

The Finnish exports to the Soviet Union consisted mainly of ships as well as products of the metal and engineering industries. The major industrial sector, forest industry, was an exception within the Finnish-Soviet trade. With the huge forest resources, Russia was not a good market for the Finnish major forest industry products, namely bulk goods such as timber, pulp, and paper.⁵¹ For example, we may gauge the importance of Finnish-Soviet trade from the development of the shipbuilding industry. After the Second World War, the Soviet Union demanded nearly 70 per cent of the war reparations of 300 million gold dollars to be paid in metal goods, and more than one third of these goods were to be ships. This was the beginning of continuous, high-volume exports of ships from Finland to the Soviet Union: from the war reparations until the late 1980s, two thirds of the production of Finnish shipyards went to the Soviet Union – and in peak year 1983 even 84 per cent.⁵² However, even though the Soviet export shares remained quite high throughout the 1980s, changes in the shares from one year to another began to fluctuate rapidly after the mid-1980s, and the Soviet Union became more and more indebted to Finland as the price of oil decreased.⁵³ Surprisingly enough, the Finnish shipyards could not assess the

⁵¹ Russia's forest resources are discussed in several reports found in Converta's archives, e.g. in ELKA, Converta, FPB Tietokeskus Oy - FPB Information Center Ltd: A New Era in The Forest Industry of the USSR, Present Status and Emerging Business Potential (Jaakko Pöyry Sovkonsult Oy, Helsinki June 1990); Economic Commission for Europe, Timber Committee, Forty-seventh session, 9-13 October 1989; special topic: Timber trends and prospects in the USSR. - See also e.g. Palo 2001 (esp. Map 1); Sheingauz et al. 2001, 457 - 467; Hjerpe 1989, 162.

⁵² Sipilä 1994, 62.

⁵³ Rissanen 1997, 6 - 9; Eloranta 2000.

reliability of the Soviet markets and the durability of these trade relationships in the 1980s and the beginning of the 1990s.

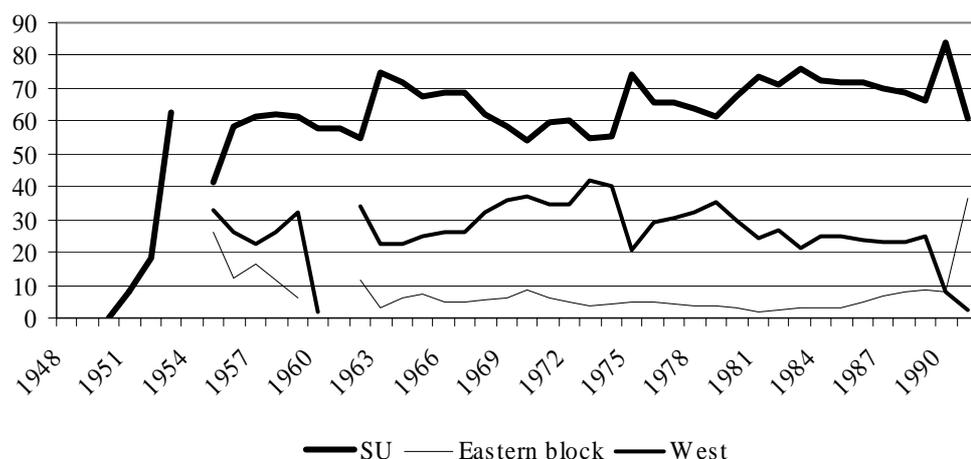
For example, the Finnish shipyards considered orders from the Soviet Union, which represented circa half or more of the orders in the late 1970s and early 1980s, as the future strength of the Finnish industrial production. This at first seemed to have been the right choice, since exports of ships to the Soviet Union peaked at 84 per cent in 1983. However, even though the Soviet export shares remained quite high throughout the 1980s, changes in the shares from one year to another began to fluctuate rapidly after the mid-1980s, and the Soviet Union became more and more indebted to Finland as the price of oil decreased. Therefore, we might conclude that the role of domestic purchases, such as naval acquisitions, were crucial in filling the slack resulting from the recession, along with gradually dominating Soviet contracts, until the biggest external post-war shock occurred: collapse of the Soviet Union.⁵⁴ Surprisingly enough, the Finnish shipyards could not assess the reliability of the Soviet markets and the durability of these trade relationships in the 1980s and the beginning of the 1990s.

Though the majority of the Finnish forest industry companies were not dependent on the Soviet trade, still for certain companies the Soviet Union was the primary market. A calculation made in the mid-1980s claimed that the Soviet markets constituted over 20 per cent of the sales for one third of the Finnish forest industry companies. Furthermore, for 19 factories the dependence was between 20 to 80 per cent.⁵⁵ Finnish forest industries sought markets from the East for products with a higher degree of refinement, namely processed forest industry products. These included sacks, packages, industrial papers, and various consumer products that were exported through Converta. Products that were not raw materials or semi-finished products (such as pulp or bulk paper) were defined to be outside Converta's business interests. Traditionally these products were produced for domestic usage, which was also the case with Finland in late 1940s. However, already by the late 1960s, about half of the Finnish production of these goods was exported.⁵⁶ The idea was to offer goods for the growing Soviet consumption. In order to do that, there were at least three obstacles to deal with: 1) The terms of trade and trading practices involved with the closed Soviet economy; 2) Unawareness of the "real" consumption markets in the Soviet Union; 3) Questions surrounding the products that were produced only for a short period of time.

⁵⁴ Rissanen 1997, 6-9; Eloranta 2000.

⁵⁵ ELKA, Converta, Minutes of Board of Directors 5th March 1986.

⁵⁶ Converta 1969.



Sources: Elka, Converta's annual reports.

Note: SU = Soviet Union; Eastern block = SEV-countries; West = "rest" of the world (mainly Western European countries).

FIGURE 3 Share of Converta's Exports by Export Area (Per Cent)

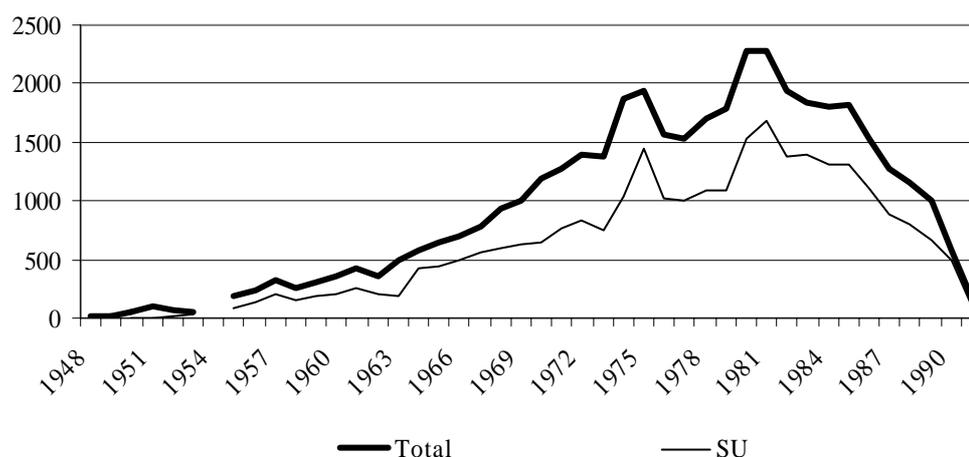
Converta and crucial information asymmetries

Converta was founded during the wartime in 1944, first as a pressure group for the industrial companies that produced processed forest industry goods. The idea for the founding of the association came from the CEO of United Paper Mills (UPM), Juuso Walden, who stated in a letter to other paper company leaders that it would be in their common interest to join forces when negotiating quotas and tolls – thus, avoiding unnecessary competition. An interesting piece of information is that the negotiations started during the wartime, and by founding an association the producers already sought to acquire an edge in how to handle business after the cease fire.⁵⁷ After the initial letter, the founding of the organization proceeded so that in the spring of 1944 the charter of Converta was signed by nine major forest industry companies, including the leading firms such as *UPM*, *Kymi*, *Enso-Gutzeit*, *Serlachius*, *Ahlström*, *Tampella*, and *Rosenlew*.⁵⁸ Right after the war the association was reorganized for practical reasons as a sales association (more correctly, an export cartel). Exporting commenced in 1945, and the target was already by then the Eastern markets. Namely, the first deal handled by Converta contained 813 000 napkins that were exported to the Soviet Union.⁵⁹

⁵⁷ ELKA, Converta, Juuso Walden to industry leaders 6th July 1943.

⁵⁸ Converta 1969.

⁵⁹ Converta 1969, Nordberg 1980.



Sources: Elka, Converta's annual reports.

Note: deflated to 1991 values with wholesale price index, obtained from Hjerpe 1996.

FIGURE 4 The Value of Converta's Trade (Millions of 1991 FIM)

Nonetheless, during the early years the trade with the Soviet Union was not significant compared to the still small trade with the Western countries. However, within the association the importance of the Soviet Union was slowly realized. The Soviet trade accelerated from the early 1950s on, especially from the mid-1950s (Figures 1 & 2). By the beginning of the 1960s, the Eastern block and the Soviet Union in particular, were already dominating the exports of Converta. For example in 1962, 55 per cent of the exports went to the Soviet Union, yet in 1963 this had already increased to 75 per cent. In other words, in 1962 34 per cent of the total value of exports went to the Western markets, but this share diminished to 22 per cent in the following year.⁶⁰ The other Eastern block countries played only a minor role (with few exceptional years) in the beginning. The total number of countries where the products were exported grew large; for example in 1961 the number was 98⁶¹. In official listings Converta always emphasized the number of countries it was dealing with, though in the reality the trade concentrated to few key players. European countries dominated the trade: For example, in 1968 about 86 per cent of the exports went to European countries. Besides Soviet Union, important trading partners in the East Bloc were Bulgaria, Poland, Romania, and Hungary. Of the western countries, Sweden, Denmark, Britain, West-Germany, and Belgium were the most important ones. In addition to these European countries, Converta had also certain amount of dealings with Asian, African, and American Countries.⁶² Average annual growth throughout the 1960s equaled about 10 per cent, during the 1970s it dropped down to five per cent (with

⁶⁰ ELKA, Annual Reports of Converta 1962 and 1963.

⁶¹ ELKA, Annual Reports of Converta 1961.

⁶² Converta 1969.

rather big annual differences), and during the 1980s the average annual decline in trade was almost seven per cent.

Throughout the 1950s, 1960s, and 1970s, Converta was engaged in selling a variety of produced paper products. As was stated in the early years of the association, it concentrated on the “products that are not raw materials”, which was the case with most of the products produced by Finnish forest industries at the time (namely, paper, pulp, and timber). The main groups of products included all kinds of package materials (like sacks and cardboard boxes) and certain coated special papers. Later on, it was decided that all papers that needed special production methods could be included in the selling lists of Converta. The growth of the demand for such products were rising both in the western and eastern markets, due to the increased use of packages due to hygiene and health reasons. Paper products still dominated the markets during the 1950s, yet afterwards plastic materials started to provide more and more competition. Although, still in the early 1970s an estimate maintained that plastic materials covered only circa 10 per cent of the package markets. Throughout the period there was also growing demand for such a products in the domestic markets as well, but they were not sold through Converta but directly by the companies themselves. Furthermore, a certain amount of products – especially those for the western markets – were sold directly by the companies and in some cases even through the other sales associations. Thus, only about half of the “converted” paper products produced in Finland were actually sold through Converta.⁶³

Throughout the Soviet period the concentration of trade to organizations such as Converta was practical, not only because the trade was concentrated in the East (thus, enabling negotiations among smaller circles), but also because it enabled a centralized procurement of information. Before the mid-1980s, obtaining information from the Soviet markets had its difficulties, yet one could still rely on the five or ten year plans outlined for the Soviet economy, which provided a certain level of security for the business operations. Yet, to obtain detailed information was difficult, which made information asymmetries more pronounced. For example, up-to-date macro-level, not to mention micro-level, statistical information on the Soviet economy was scarce before the end of each five year plan rolled around.⁶⁴ The problem in the Soviet system was rather how to get the information on the needs of the Soviet customers, and also how to offer information for these customers as well as for the official organizations, as was stated in the Converta strategy meetings in the early 1980s⁶⁵.

However, the changes in the political as well as in the economic life during the 1980s forced the Finnish exporters to find different sources of information, and in fact, at the time one of the major roles played by the Converta was to collect and circulate information among its member

⁶³ Converta 1969.

⁶⁴ For more on Soviet secrecy and the five year plans, see Harrison 2003.

⁶⁵ ELKA, Converta, Minutes of Soviet Trade Division 3rd March 1983 (strategy meeting).

companies. Information was obtained, for example, from the various governmental (Finnish) administrative bodies, such as the Ministry of Trade and Industry, the Ministry for Foreign Affairs, and even from the Ministry of Agriculture and Forestry. Also, both Finnish and Russian newspapers and magazines were read carefully among Converta members at the time.⁶⁶ The Soviet five-year plan for 1986 – 1990 was of special interest, due to the *glasnost* and *perestroika* policies. It seems to be evident that though the information about the possible influences of the new policies were obtained from market surveys, experts, or discussed in seminars, there was a lot of uncertainty about what would be the real influence of these changes for the forest industries in particular.⁶⁷ Joint ventures between the Soviet and Western companies were allowed in 1987. This was also a factor that was of major interests for Converta – in fact, joint ventures offered possibilities for private companies to make deals with the Eastern partners without such centralized associations as Converta.⁶⁸

Estimating demand factors: Quantitative analysis of Converta's behavior

In fact, how did Converta's export behavior change in this period? Can we find certain aggregate factors that explain its exporting decisions, especially in terms of various demand factors and specific key years. Here we also investigated a simple quantitative model⁶⁹, which shed some light to this issue. Our model consisted of the following variables:

$$\begin{aligned} \text{CONUSSRSHARE} = & \alpha + \beta_1 \overline{\text{FINDEMAND}}_t + \beta_2 \overline{\text{USSRDEMAND}}_t + \beta_3 \overline{\text{USSRSHAREFIN}}_t \dots \\ & \dots + \beta_4 \overline{\text{WESTDEMAND}}_t + \beta_{5-13} \overline{\text{DUMMIES}}_t + \varepsilon_t \end{aligned} \quad (1)$$

in which the dependent variable was the Soviet Union's share in Converta's aggregate exports (=CONUSSRSHARE), and the independent variables included an estimate of the Finnish aggregate demand (=FINDEMAND, represented by the Finnish real GDP), an estimate of the Soviet aggregate demand (=USSRDEMAND, represented by the Soviet real GDP), Soviet share in the Finnish aggregate exports (=USSRSHAREFIN), an estimate of aggregate

⁶⁶ See e.g. ELKA, Converta, Soviet Union Statistics, The Finnish embassy in Russia to Converta 5th December 1989, the Ministry of Agriculture and Forestry to Converta 15th November 1989 (A7.1. file 258).

⁶⁷ See especially ELKA, Converta, five-year planning 1986 - 1990 (C1.2. file 330); Ryzkov's commentaries (C1.6. file 336); Market Surveys in Soviet Union 1987 - 1991 (C1.8., files 339 - 340).

⁶⁸ ELKA, Converta, Soviet Foreign Trade, Joint Ventures 1987 - 1991 (C1.7. files 337 - 338)

⁶⁹ Typical demand (or trade, such as gravity) models include variables such as prices, incomes, as well as tastes and preferences (and various kinds of environmental and spillover effects, and distances in gravity estimations). Here we are intuitively more interested in seeing what roles different export markets played in Converta's decision making and how well they were able to adjust to changes in the fluctuating demand in these markets. The small size of the sample is duly recognized.

demand among the Western economies (=WESTDEMAND, calculated as a volume index of 20-country total real GDP, see Table 1 for details), and various dummies, representing certain key years (such as the Oil Crises, liberalization of the capital markets and the Soviet collapse). All variables were estimated in logarithmic form. Thus, Converta was, firstly, expected to respond to changes in aggregate demand in the domestic market and the Soviet market. Since the Soviet market could be thought of as a complimentary market for the Finnish forest industries, an increase in the Finnish demand was expected to be offset by a decline in exports to the Soviet Union (relatively, incurring a negative coefficient). Similarly, an increase in Soviet demand was expected to increase exports to that market (a positive coefficient). Correspondingly, an increase in the aggregate demand in the Western markets should have decreased its willingness to commit to the Soviet markets (a negative coefficient). Moreover, Converta could be expected to follow trends in aggregate Finnish exports to the Soviet Union (a positive coefficient). Finally, it would be difficult to forecast the impact of endogenous and exogenous changes in the trading environment, yet we attempted to capture some of these impacts with dummy variables. What do the results show?

TABLE 2 Soviet Trade's Role in Converta's Exports, 1955-1991

INDEPENDENT VARIABLES	COEFFICIENTS (DEPENDENT VARIABLE: Soviet Share in Converta's Exports)
<i>Constant</i>	-12,49**
<i>Finnish Real GDP, log</i>	-
<i>Soviet Real GDP, log</i>	2,99*** (t-1)
<i>Soviet Share in Finnish Exports, log</i>	0,77*** (t-1)
<i>Western Aggregate Demand, log</i>	-2,54*** (t-1)
<i>Dummy 7 (1989-1991=1)</i>	0,14**
<i>Number of Observations</i>	40
<i>Adjusted R²</i>	0,58
<i>S.E. of Regression</i>	0,11
<i>DW</i>	1,13

Sources: see previous figures; "Groningen Growth and Development Centre and The Conference Board, Total Economy Database, July 2003, <http://www.ggdcc.net>". "Western" (including some countries not geographically in the "West") aggregate demand calculated from the same source, as a 20-country (Australia, Austria, Belgium, Canada, Denmark, France, West Germany, Greece, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the UK, the USA) total, then transformed into a volume index, in 1990 Geary-Khamis dollars. The Breusch-Godfrey LM serial correlation test was used to test the null hypothesis that there is no serial correlation up to lag order p (here: 5 years), where p is a pre-specified integer. See Godfrey 1988 for further details.

Note: * = null hypothesis of no correlation rejected at 10 per cent level; ** = null rejected at 5 per cent level; *** = null rejected at 1 per cent level.

As we can see in Table 1, the results were mostly as expected. However, a change in Finnish demand did not seem to be relevant for Converta, which makes sense for many reasons: namely, the Finnish markets were too small. A 100 per cent increase in Soviet aggregate demand increased Converta's trade (with a lag of one year) with the Soviet Union by circa 300 per cent, which means that they were able to interpret changes in the Soviet aggregate demand quite well. Western markets supplemented Converta's trade with the Soviet Union, with a negative coefficient. Whilst we experimented with nine dummies all in all, only the period 1989-1991 stands out as a peculiar episode in Converta's trade behavior: During this period Converta's Soviet trade share increased quite abnormally compared to the earlier periods. Why? Firstly, in order to analyze Converta's activities and motivations more comprehensively, we need to take a closer look at the way it processed information and risks at the micro-level.

The End of Converta: How to Manage and Exit from the Markets?

After the decades of growth in trade (Figures 1-4), the Soviet-Finnish trade started to decrease in the mid-1980s. In the case of Converta, the peak was reached in 1981. The real dramatic decrease in trade occurred in 1985 and after; annually the trade decreased by about twenty per cent for the next four years. Thus, by only looking at the export figures it was clear that something was happening in the trade environment, especially in the Soviet trade, where the drop was even more dramatic. An interesting question is how the agents in Converta reacted to these changes. Were the changes seen as a part of even more dramatic, political changes, or just as normal annual fluctuations in trade? The minutes of Converta's meetings as well as annual reports and other archival sources from the mid-1980s onwards shed some light on the issue.

During the early years of the 1980s, the strategy meetings of Converta stated that the Soviet Union was the key market for the sales association, although already in 1982 the strategy committee considered it necessary to devise backup plans in the case of convulsion in the Soviet Union⁷⁰. During the mid-1980s, the changes in the Soviet trade were noticed in the Converta meetings, however the changes were not analyzed – in fact, the trade of lesser importance for example with the African nations and the Western Europe was seen more problematic.⁷¹ The situation changed by the end of the 1980s: the changes in Soviet trade were widely discussed in meetings, new strategies were adopted, and new organizations were developed to deal with the changes, such as a special “trading-unit” for the Soviet markets and introducing a special

⁷⁰ ELKA, Converta, Minutes of Strategy Committee 2nd February 1982.

⁷¹ As can be seen e.g. in: ELKA, Converta, Minutes of Executive Group 4th August 1986 and 12th August 1986.

Soviet Trade Division into the management of Converta⁷². The primary focus in the late 1980s was within the organization of trade. It was unclear whether the centralized system could continue in trade or there would be – due to the perestroika – numerous actors in pulp and paper trade to deal with. Also, the secure clearing trade era was coming to an end. The changes were seen as threats but also as new possibilities for Converta.⁷³

The amount of the trade was not seen as a problem as such in the late 1980s. The Soviet trade for example in 1989 was almost as large as predicted, and the trade with the other Eastern Bloc countries was doing even better. Furthermore, the trade statistics showed that the Finnish exports with the Soviet Union as a whole and for Converta in particular were exceptionally high in the early 1980s (Figures 1 - 4). Thus, rather it was seen that the diminishing of trade in the 1980s resulted from getting back to the “normal” situation. In fact, in a strategy meeting in the early 1980s, when the trade was at its highest level, the possible fluctuations in the future were discussed.⁷⁴ During the Oil Crises in the 1970s the Soviet trade provided security for the Finnish foreign trade due to the trade with oil. Thus, also in the 1980s the Soviet trade was seen as stabilising the changes in world oil prices, and thus, the emphasis was not in the changes in the Soviet trade as such.⁷⁵ It was predicted in Converta for example at the turn of 1988-1989 that the trade with the Soviet Union would rise again in two or three years due to either the changes in prices of energy products (oil and natural gas) or due to new conditions in trade. As a starting point to developing the Soviet trade was the notion that the markets for Converta’s products in the Soviet Union were almost endless.⁷⁶

As already stated in the beginning of this article, even in 1989 Converta’s strategy was focused on the Eastern (Soviet) markets, though it was already clear that there were numerous changes that the sales association had to adjust itself to. The most important issue was the fading of the clearing trade that had been so stable before, which also meant that in the Eastern trade they had to adjust to the tightening competition. On the other hand, at the time it seemed to be evident that in certain segments the markets in the Soviet Union were in fact growing, for example in packages. According to Converta’s strategy in 1989, Soviet exports and domestic consumption were growing and needed more packages than could be produced by the domestic producers.⁷⁷ Market research at the time also showed a promising future for the whole Finnish forest industry sector in the Soviet markets, for paper and pulp industries in particular. There were various reports stating, for example, that there would be high pent pent-up demand for paper due to the subsequent liberalization of the

⁷² ELKA, Converta, Minutes of Executive Group 17th March 1989; 15th May 1989

⁷³ ELKA, Converta, Minutes of Soviet Trade Division 19th May 1988.

⁷⁴ ELKA, Converta, Minutes of Executive Group 8th August 1989; Minutes of Soviet Trade Division 3rd March 1983 (strategy meeting).

⁷⁵ ELKA, Converta, Minutes of Executive Group 1st April 1986; 6th October 1988.

⁷⁶ ELKA, Converta, Minutes of Soviet Trade Division 26th May 1989.

⁷⁷ ELKA, Converta, Minutes of Board of Directors 27th September 1989

press and subscription quotas as well as the increased packaging needs of consumer goods.⁷⁸

The trade with the West was important for Converta throughout its history, though as can be detected from Figure 1, it never exceeded 50 per cent. During the late 1980s, when the association was already facing problems in its Eastern markets, it actually decided to abandon the Western European trade as a whole. At the time, the Western trade was not profitable enough for Converta, because industrial companies handled their business mostly by themselves already in the West. Moreover, the trade previously directed through Converta was now done by the companies themselves. A similar pattern can be found in the activities of the other forest industry export associations. Finnpap, the most important and influential Finnish trading association started to lose its membership from the early 1970s on, when some of the key players begun to export their products by themselves.⁷⁹

In 1989, the strategy choices that Converta had were either 1) to continue as before (though without Western Europe, yet to concentrate on the East and trade outside Europe); 2) to concentrate only on the Soviet and SEV trade (as it was decided); 3) to merge with another Finnish sales association (like Finnpap or Finncell); 4) to sell businesses to some private trading house; 5) to change the association into a limited company; 6) to dismantle the company. Yet, as late as in 1989 the last alternative, an actual exit, was not possible, because the Soviet and SEV trading partners had trade agreements only with Converta. Thus, alternatives one and two were at the time really the only possible choices the association – and the companies that jointly owned it – could make.⁸⁰ Even the new strategy in the autumn of 1990 still stressed that Converta was aimed at marketing member companies' products to the Soviet Union and to the Eastern Europe. Now it was already stated clearly in the strategy that the Soviet Union was about to change towards a confederation of 15 states, and the role played by the Russian federation was to be emphasized. The strategy still saw a lot of possibilities in the Soviet markets; the recovery was predicted to take place in two or three years.⁸¹

As late as March 1990 the Board of Directors of Converta saw possibilities in the Soviet trade, though only a couple of months later much more pessimistic views were presented. The situation in the Soviet Union had not, according to CEO Leo Mamontoff, gotten any better. The acute problems related to financial difficulties and the fact that the planned economic reforms had not materialized. Though the rising oil prices in the summer of 1990 provided new opportunities for the Soviet Union to purchase products from the West, the organisation of trade became more and more unclear. For example, it was not

⁷⁸ ELKA, Converta, FPB Tietokeskus Oy - FPB Information Center Ltd: A New Era in The Forest Industry of the USSR, Present Status and Emerging Business Potential (Jaakko Pöyry Sovkonsult Oy, Helsinki June 1990).

⁷⁹ See especially Heikkinen 2000.

⁸⁰ ELKA, Converta, Minutes of board of directors 19th January 1989; 24th April 1989.

⁸¹ ELKA, Converta, Minutes of board of directors 23rd August 1990 (appendix: strategy for Converta).

known whether the old governmental foreign trade organization for forest industries, namely Exportles, would be reformatted into a joint stock company⁸². Furthermore, there were plans to close down the whole Ministry of Forestry and to reorganise its duties. The situation got worse during the autumn of 1990. For example, the CEO's report on the Soviet economy in late 1990 and early 1991 stated quite clearly that the Soviet economy was about to collapse. Still, Converta was able to collect its receivables for the year 1990 from the Soviet Union by the beginning of 1991 – though the sales were only about 20 per cent from the intended exports.⁸³ The board of directors of Converta tried to follow the rapid and unpredictable changes in the Soviet Union during the early 1990s, without any possibilities of influencing events or even to adapt to changes.

Although the trade with the Soviet Union decreased throughout the 1980s, the final collapse occurred in 1991. In the said year Converta's exports diminished (in value) by almost 80 per cent. As indicated by the quantitative analysis, Converta had increased its stake in the Soviet Union significantly, relatively speaking, from 1989 onwards. Furthermore, all product groups faced this stagnation in trade: exports of sacks diminished by 70 per cent, packages 95 per cent, industrial papers by 61 per cent, and consumer papers by 57 per cent. At the same time, also the sales to the former Eastern block countries diminished – with the exception of Poland⁸⁴. This collapse of trade was felt also in the headquarters of Converta in Helsinki: The office changed to four days working week, and by the end of the year the number of employees decreased from 40 to 27.⁸⁵

Converta and its member companies were locked into this mode of action in the Soviet trade. When the changes in the exogenous trading environment occurred in the 1980s, it was obviously difficult to adjust to them. They did not possess a credible exit strategy, rather than chose to stick to an optimistic interpretation of these changes, despite the lack of information. This can be detected in a number of instances. For example, in October 1988, even a 30 per cent drop in the value of trade was expected as a result of the Finnish-Soviet trade negotiations, yet the executive group of Converta, based on their previous successes, did not expect any decline in the coming year.⁸⁶ However, the group was also cautious in dealing with their Soviet counterparts, for example in terms of avoiding extensive credit arrangements and long payment schedules.⁸⁷

⁸² This change actually occurred about a year later. ELKA, Converta, Minutes of board of directors 10th June 1991.

⁸³ ELKA, Converta, Minutes of Board of Directors 29th March 1990; 10th May 1990; 28th June 1990; 23rd August 1990; 8th November 1990; 14th February 1991; 20th March 1991.

⁸⁴ In fact, in 1992 circa 60 per cent of Converta's sales came from Poland and Hungary. ELKA, Converta, Minutes of the board of directors, 25th November 1992.

⁸⁵ ELKA, Converta, Annual Report 1991.

⁸⁶ ELKA, Converta, Minutes of the executive group 6th October 1988.

⁸⁷ ELKA, Converta, Minutes of the executive group 13th April 1988.

The collapse of trade with the Soviet Union in 1991 was, of course, related to the political and other changes of the time⁸⁸. At a more practical level, there were a plethora of obstacles to deal with for the actors in Converta. First, the clearing trade ended at the end of 1990, which caused uncertainty among both parties. Without the clearing agreements, the terms of how to achieve trade were almost impossible to negotiate, thus, the trade with Russia was almost totally cut off for the first months of 1991. Secondly, the contracts made with the "official" Soviet customers (Exporteles and Vneshtorgizdat) were not realized due to the shortness of currency. Thirdly, the structure of clientele changed dramatically in just a few months due to the collapse of the centralized, "official" organizations – before the collapse, the trade was concentrated to a few key customers, now there was a wide variety of smaller players geographically located all over the former Soviet Union to do business with. There were plans in the Soviet Union to re-centralize the paper and pulp trade in the hands of an international association called "Interbum" in the early 1990s; however, Converta was not interested in for such cooperation.⁸⁹ Fourthly, the lack of formal institutional structure caused problems after the collapse of the Soviet government in 1991. The new Commonwealth of Independent States (CIS) was lacking vital economic legislation and commercial agreements, and the role played by the Russian Federation and its president was unpredictable. Even the old political agreements between Finland and Soviet Union ceased to exist – most importantly the Treaty of Friendship, Cooperation, and Mutual Assistance (FCMA).⁹⁰

Though still in late 1991 a plan for the Soviet trade was launched, but they were never realised in practise: Converta was dissolved in 1992, after the important Soviet/Russian trade had decreased even further to half of its value of the collapse year of 1991.⁹¹ The main reason was the collapse of the Eastern markets. The association even suffered some credit losses in the process, though luckily most of the products had been exported for an advance payment. The total value of bad debts comprised 20 million FIM, of which 70 per cent was insured, thus the loss was only six million FIM.⁹²

However, it would be too simplistic to say that the collapse of the Soviet Union was the only reason for dissolving Converta. Namely, at the same time also the sales associations that operated in the Western markets ceased to exist. The reasons for that included: 1) The EU legislation that considered sales cartels illegal; 2) The concentration and internationalization process of the Finnish

⁸⁸ On explanations of the collapse of the Soviet Union see: Iivonen 1992, Harrison 2002.

⁸⁹ ELKA, Converta, Statistics of Soviet trade 9th January 1992, statistics on sacks; minutes of the executive group 28th January 1991, especially appendix 1 (negotiations on Soviet trade at the Finnish Forest Industry Federation 24th January 1991); Minutes of Executive Group 4th March 1991 and 18th March 1991.

⁹⁰ ELKA, Converta, Minutes of board of Directors 7th November 1991.

⁹¹ ELKA, Converta, Annual Report 1992; Minutes of Board of Directors 7th November 1991. - Certain parts of the Converta's sales organisation was merged to United Paper Mills. ELKA, Converta, Minutes of Board of Directors 11th March 1992; 19th March 1992.

⁹² See e.g. ELKA, Converta, Minutes of Board of Directors, 25th November 1992.

forest industry companies, which made joint sales organizations useless – the companies were now large enough to compete in the international markets by themselves.⁹³

Conclusions and Discussion

Converta was a sales association of the Finnish forest industry companies, aimed at selling converted paper products especially in the Eastern markets during the post-war era. Thus, Converta offers a good case to study the practises in the East-West trade, and especially the changing patterns in the late 1980s and the early 1990s. This paper concentrated on analyzing the role played by: 1) asymmetric information and transfer of knowledge; 2) the way this group sought rents and colluded with players in order to achieve gains from markets that were not characterized by “traditional” competition; 3) the lack of exit strategies; and 4) the role of institutional path dependence.

The paper concludes, firstly that the centralized information channels provided selective, yet stable information on the Soviet command economy up until the mid-1980s. The number of users of the products provided by Converta was huge and spread all over the enormous Soviet Union. For example, in January 1992 an estimate was made that there were over one hundred industrial units in the former Soviet Union that needed the sacks provided by Converta. Previously the trade was handled in a centralized manner through the Soviet governmental bodies, yet now Converta had to handle the dealings with each unit separately and thus, also to try to acquire the necessary information of their needs without the help of the centralized bodies.⁹⁴ Therefore, the *glasnost* and *perestroika* politics changed the dynamics of the information flows as well, which accentuated the existing information asymmetries. Secondly, the quantitative analysis confirms that the firms within Converta considered the Soviet markets complementary to their “normal” commercial activities in the West. Again, in the 1980s the companies had to adjust themselves slowly in the Eastern markets to more Western-like, decentralized markets and trading practices. Thirdly, Converta failed to develop an exit strategy and chose to believe in the continuation of slow and stable transformation of the Soviet economy. The collapse of the Soviet system came to Converta members as somewhat of a surprise, which was the most important reason for the dissolution of Converta as well. Fourthly, this

⁹³ Heikkinen 2000, Lamberg and Ojala 2001. - In fact, the CEO of Converta (today the CEO of UPM-Kymmene, the major Finnish Forest Industry Company), Juha Niemelä stated to the board of directors in 1992 that the changes in the market environment had led to a situation, in which companies themselves had to take more seriously the responsibility of marketing the products abroad. ELKA, Converta, Minutes of the Board of Directors 13th February 1992.

⁹⁴ See especially ELKA, Converta, Statistics from Soviet Union 1945 - 1992, Sales of sacks in 1991, 9th January 1992.

reluctance to develop an exit strategy was connected to the strong path dependence relative of its past political and economic successes.

The future analysis should focus, for example, more on the actual changes that took place in the Eastern markets in the late 1980s and the early 1990s, from a comparative perspective in particular, by using various theoretical tools. Converta as a case offers also possibilities of analyzing the trading practices in the East-West trade at an intriguing micro-level throughout the post-war period. The actual functioning of information channels and asymmetries should also prove of theoretical importance. Institutional economics, finally, offers numerous possibilities of developing a fuller understanding of the actual transitions, and the role of firms, between economic systems. In the Finnish context in particular, the economic and political significance of the Finnish-Soviet trade needs to be analyzed in detail, in order to evaluate the dynamics of the profit flows and the actual rents arising from these transactions, both from the perspective of the aggregate Finnish economy and the firms involved.

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Paperi ja Puu

Talouselämä

CONCLUSION

Alan Milward

Economic Warfare in Perspective

It is not surprising that economic warfare played so prominent a role in the Cold War. Its most persistently appealing attribute has always been that it is a way of striking at an enemy against whom it is inherently too risky to embark on a prolonged period of armed combat or too dangerous to risk the escalation of an existing state of combat. Once Mutually Assured Destruction (MAD) was understood to be the inescapable boundary of strategy in the Cold War, unless some inimitable technological breakthrough by one side destroyed the stasis reached through investment in nuclear weapons technology, cold warfare by the West had to resort to the pursuit of the struggle by means which still gave advantage to it as the economically stronger side.

A successful solution was eventually found in the American decision to invest heavily in the strictly defensive technology of "star wars", in spite of its poor prospects of complete technological success. It was in fact a decision for economic warfare. The Soviet Union could not risk assuming the military inadequacy of "star wars" and neither could it afford the investment needed to compete in producing the same technology without reducing the capacity of its economy to satisfy the rising consumption expectations of its citizens, nor even perhaps to maintain its nuclear weaponry at the same level of effectiveness as the USA. Before the American decision to invest heavily in new technologically sophisticated defensive armaments systems, the Cold War was pursued by the West by methods which already had a long history

The ultimate "victory" of the West surely leads to the conclusion that economic warfare, whatever pattern it takes, can not be separated politically or economically from the aims and objectives of armed combat. The history of economic warfare thus requires a comprehensive understanding of the strategic possibilities open to each state in any particular concatenation of political and economic circumstance. This in turn must assume that belligerence and readiness to resist belligerence at any time in any international state system are

dominant stances and that for a high proportion of that time it is economic warfare as much as armed combat towards which policy is directed

In the French Revolutionary Wars and the Napoleonic Wars, for example, economic warfare became increasingly prominent as a strategy, because it was not until the closing stages of that long period of warfare that Britain could keep a sufficiently large armed force on the continent to match French military power there, while France proved incapable of successfully invading the British Isles. Close-cordon naval blockade by Britain of continental ports to prevent the supply of strategic goods to the French economy became the substitute for armed combat on the European continent almost until the end of the first decade of the nineteenth century. The cost of maintaining so large a fleet in action together with other costs of the blockade was fully as high as the cost, the organisational effort, the production and the time required for the alternative of fighting a land battle on continental soil. It was, though, considered less risky, because losses of men and equipment were lower.

France's response, to forbid imports from Britain by other continental countries as well as exports to Britain, was only enforceable by extending its military power on the continent. It required large scale military campaigns at different times against Austria, Prussia, Russia, and in Italy, and provoked the conquest of areas of the continent which might otherwise have sustained their neutrality or even remained relatively friendly to France.

Between this prolonged period of intervention in foreign trade as a form of warfare and the trade discrimination and embargoes of the Cold War there seems a common lineage. In reality, however, economic warfare is as subject to technological and managerial change as armed combat, so that the lineage is more one of purpose than of method. During the First World War deprivation of supply and the blocking of exports were enforced by licensing cargoes, mostly by requiring neutral vessels to acquire a certificate and clear documentation on the nature and origins of the cargoes they carried. Without those documents their cargoes were liable to seizure. The bureaucratic rules replaced naval blockade as the prime control barrier.

Nevertheless, enforcement of the rules still ultimately relied on a sufficient superiority of naval power to conduct stop and search operations, if necessary, on enemy or neutral ships. This was made much easier, of course, by the entry of the U.S.A. into the war, this time on the British side, but it still required a large increase of strength and fire power by what had been already before the war the world's two largest navies.

"Control at source" foreshadowed the procedures applied in the Cold War, especially as it relied increasingly on collaboration with intelligence services and diplomats. Several essays in this book indicate the problems that arose in the Cold War in trying to supervise or interrupt neutral trade with the East. Stopping and searching Swedish ships was not a way to strengthen the unity of the West. The comitology through which control at source was practised was thus more important than possession of a naval superiority sufficient to enforce decisions with which Western countries might have disagreed.

The comitology was able to go so far with so little friction because the universal spread of trade controls across world trade after 1929 for protectionist reasons proved a powerful generator of new methods of bureaucratic trade control methods. In 1947, as programmes for economic warfare against the Soviet bloc began to be discussed between America and its western allies in the context of the Marshall Plan, absolute non-tariff barriers to trade, such as bilateral trade agreements specifying quantitative quotas for each category of commodities or even for single commodities, embargoes on goods deemed strategic, and refusals of export and import licenses merely for domestic peacetime economic and political stability had come to be the norm. The inconvertibility of eastern bloc currencies guaranteed that the persistence of this norm for trade with the eastern bloc or with China was not likely to provoke much clamour for its relaxation on the part of western exporters. Given the nuclear stalemate, neither was it likely to provoke an armed conflict. Furthermore, the Soviet Union and China would have been poor markets even if freely open. In historical perspective therefore there were many reasons why the argument in favour of an already familiar form of economic warfare met with widespread approbation. It was probably in the Cold War period that the practice of commercial economic warfare reached its apogee in western public estimation.

The essays in this volume show what a variety of tactics the phrase "economic warfare" covered after 1947 and with what ingenuity it was pursued. It is, however, much more difficult to measure its success. Forcing the Soviet Union to attribute a larger share of GNP to weapons development, as the Reagan administration did, while it can indeed be seen as an extremely successful act of economic warfare is still far from being seen as inaugurating a decisively successful shift in methods of armed combat. How far the finer detail of other forms of economic warfare against the Soviet Union contributed to the displacement of the Soviet Union from its superpower status is a question which few studies as yet have made any significant attempt to answer. This, too, is also not surprising, even though the question is central to evaluating the effectiveness of economic warfare. Economists and historians have shown the same reluctance to fully evaluate the effectiveness of economic warfare in the two world wars.

Their reticence has one universal cause in all these cases. Economic warfare, like armed combat, is costly, but the measurement of its cost-effectiveness is highly elusive. It justifies its cost only if it helps to achieve the overall objective of the prevailing strategy, when that could not have been gained by armed combat alone, or when its use reduces the cost of success below what it would have been had armed combat been the only means chosen to pursue the war. To prove either of these desiderata in the world-wide cataclysms of 1914-18 or 1939-45 has proved too complex a calculation even for scholars poring over postwar information. The mass of so many different strategies and tactics contemporaneously pursued by so many different combatant powers complicates the calculation beyond any possibility of reaching a credible conclusion. It was, of course, much more difficult to reach

credible judgments while the war was actually being fought. Two examples from the Second World War establish this point.

Japan is an island power and therefore particularly susceptible to commercial economic warfare of the kind practised in the Second World War, much more so than a central continental power like Germany. Thorough post-war studies undertaken by the USA suggested that Japan, by spring 1945, had been so weakened by deprivation of supply by blockade and other forms of economic warfare, including massive aerial bombardment, that it must have soon collapsed militarily. If this conclusion was correct, the decision taken by Washington to avoid the need for an invasion was unnecessary, for Japan would have surrendered either before the invasion could be launched or, had it chosen to fight on, it would have been able to mount any serious opposition to the invasion for only a short time. From these studies sprang the conclusion that it might not have been necessary to deploy the nuclear bombs on Hiroshima and Nagasaki.

The debate has never been satisfactorily resolved. Partly that is because the extent of the bombs' destructive capacity was underestimated before they were deployed in combat, so that they were thought of as a useful preparation for or an adjunct to an invasion. Partly it is because while the war was still in full flow contemporary estimates of the impact of economic warfare on Japan were much less optimistic in their conclusions than were the immediate post-war ones. This, in turn, illuminates another reason for deploying the bombs. The Allied experience in the Second World War was that from all enemy countries it was very difficult to obtain reliable intelligence or intelligence coherent enough to be cumulated into a base for making decisions about the extent to which economic warfare might have spared military casualties. In these circumstances the atomic bombs appeared the surest way to avoid excessive military casualties. No doubt this decision was also influenced by the fact that their manufacture was the most costly investment in any single category of weapon by the United States in the whole course of the Second World War. The whole purpose of this expenditure had been from the outset to use the bombs and the greatest fear had been that so massive an investment would not produce a usable weapon before the war had been won by other means with a much bloodier outcome for the American armed forces. The cost of the bombs was calculated at about 2,000 billion U.S 1944 dollars. No estimates of the cost of continuing the economic blockade were made for purposes of comparison, because so many different forms of expenditure by different organs of the government were involved that to make a reasonable estimate for comparative purposes would have been a major distraction from winning the war in progress. It was evidently not worth doing, when the measurement of the blockade's effectiveness would have been based mostly on guesswork.

The second example is that of the use of heavy bombers to pursue economic warfare against Germany. This was an exceptionally costly decision in terms of human capital. The air crews, composed entirely of highly-trained men, suffered fearful casualties and before the German collapse there were

already difficulties in replacing them. The bombers themselves were extremely expensive machinery and prone to exemplify the eighteenth-century French economist Jean-Baptiste Say's sardonic observation about eighteenth-century warships, that they were the technological peak of contemporary manufacturing ability, but very expensive to operate even, as he elegantly put it, when they met with no accident. In these circumstances the debate about the use of bombers in the Second World War for economic warfare purposes grew in intensity throughout the campaign against Germany. Would it not have been wiser and cheaper to use them, as the Soviet Union did, as an adjunct to land warfare?

In this case the post-war assessments of the effectiveness of so-called "strategic bombing" came up with different answers, but the basic difficulties of reaching a conclusion were akin to those relating to Japan. A distinguished team of U.S. economists concluded that many of the economic targets selected for attack were mistaken selections. The notorious case became that of the raid against the Swedish company SKF's ball-bearing plant in Schweinfurt in Austria. The idea was to immobilise German tanks and mobile guns by cutting off their supply of specialised bearings. The losses of aircraft and men, in relation to the numbers used in the attack, were the highest of the war; the result of the raid was that it made no impact at all on the land campaign.

Other examples of this kind incited an argument within the Royal Air Force during the war that "conventional" bombing of cities caused, in terms of the cost to the attacker, much greater disturbance to the German economy than selecting specific industrial targets. This included the effect on German civilians. Post-war analysis by a British team suggested that that might well have been so. Post-war analysis by an American team concluded, however, that with fuller knowledge of the economy under attack the principle of using aircraft for purposes of economic warfare was economically justified. Attacking Germany's supply of oil, and in particular of aviation spirit, was selected as the most notable success of strategic bombing. For aviation spirit Germany was dependent, given the quantities needed in wartime, on the manufacture of synthetic fuel and the manufacturing plant was relatively vulnerable to air attack. Bombs placed more regularly at shorter intervals on synthetic fuel plant would, the report argued, have brought Germany's capacity for air defence and support to so low a level that the land war would have ended much earlier, perhaps before winter 1944.

Considering the range of that argument, it becomes easier to see why the U.K. and the U.S.A. were so enamoured of economic warfare conducted by bombing. It seemed a logical continuation of economic blockade but conducted by superior new technology. The long-range bomber was seen as a warship that could strike at inland targets and thus overcome the main objection to commercial blockade, that countries like Germany could thwart its purpose by the annexation and economic exploitation of other continental economies. The same economic intelligence which had drawn up the lists of goods which could not be sold to the enemy could concentrate on where the planes should strike to destroy manufacturing plant. It was a natural sequential logic for two

historically mighty naval powers to pursue, and the return to commercial Cold Warfare against the Soviet bloc after 1947 seems to be the progression of a long lineage.

Nevertheless, while the theoretical interest of the question about the cost effectiveness of economic warfare is enhanced when looked at in that light, the ability to answer it is only made more difficult. The same obstacles to reaching credible conclusions remain as in the Japanese example. To throw so much investment into economic warfare when knowledge of the enemy's economy is insufficiently detailed, more so of course in wartime than in peacetime and more so in the case of secretive dictatorial regimes like Nazi Germany or Stalinist Russia. After the German surrender it was discovered, for instance, that Germany had been repairing synthetic oil production plants in less than one-third of the time that British and American intelligence services had assumed to be possible in their calculations for selecting targets for bombing. When they were choosing not to deliver new blows against what, in terms of cost-effectiveness, was a good target, they were sending costly aerial flotillas to attack other targets whose destruction would not be bringing a German collapse nearer.

Both these examples suggest a hypothesis that in warfare the tactics which on the evidence immediately to hand come closest to promising speed and certainty of success will be those chosen and on the basis that future costs are not calculable. This would have applied perhaps to Cold War economic warfare. For how long would the West's economic warfare against the Soviet bloc after 1947 have had to be prolonged to bring about the situation where there was only one superpower? Certainly for longer than it took a positive programme of defensive rearmament seems to be a safe answer.

Nevertheless there has to be some theoretical basis for providing such answers if we are to go further and make an attempt at measuring the success of economic warfare against the eastern bloc in the Cold War. The effort needed to achieve success is, so the evidence from earlier examples of such warfare indicate, to be measured by a series of carefully calculated reductions of that nominal and perhaps unattainable sum of effort and output usually characterised as "total war", taken to mean the maximum possible allocation of resources in the task of defeating an enemy. For the Cold War to end in a "victory" over the Soviet bloc what was needed therefore was a level of war expenditure which forfeited only the level of domestic consumption which it was necessary to forfeit, only to forfeit the amount of investment which it was necessary to forfeit for Cold War objectives, and only to forfeit the existing pattern of economic interchange, of the domestic political system, and of domestic social policy as far as it was necessary. The Cold War was intended to demonstrate the superior virtue of the West's domestic and international economic policies, of its sustained capacity for economic growth, and of its political and social systems. The object was to win without tarnishing in any way the image that the West could hold up to the world as an example to follow. For almost the whole of its duration it was fought by the West carefully

and slowly, avoiding all domestic risk. The argument against “star wars” was that the scale of the investment needed did incur destabilising risk.

Such an attempt at measurement goes beyond the immediate contribution of this volume. It would have to be the work of many hands, but those hands would have to have some overall concept of how the cost of each aspect of the Cold War might be measured, both the costs to the western countries involved and to the Soviet bloc. Otherwise the history of Cold War economic warfare remains on large compendium of political and economic facts. Its conclusions would have no greater credibility perhaps than the attempts referred to here to attempt something similar as a test of the effectiveness of Hot War economic warfare, but they would surely have as one result of the effort the capacity to provide a closer understanding of why the Cold War was fought in the way it was and, as another, a better overall vision of the part played by the Cold War in “the West” and “the East” alike.

ABBREVIATIONS

BOT	Board of Trade
BSFS	British-Soviet Friendship Society
CAP	Common Agricultural Policy
CG	Consultative Group (COCOM)
COCOM	Coordinating Committee for Multilateral Export Controls
CMEA	Council for Mutual Economic Assistance (COMECON)
CHINCOM	The China Coordinating Committee
COCOM	Coordinating Committee
CG	Consultative Group
DEA	Data Exchange Agreement
DOT	Developing Overseas Territory
EC	European Communities
ECA	Economic Cooperation Administration
EEA	European Economic Area
EEC	European Economic Community
EFA	see FINN-EFTA
EFTA	European Free Trade Association
EPU	European Payments Union
FCMA Pact	Agreement of Friendship, Cooperation and Mutual Assistance between Finland and Soviet Union
FINN-EFTA	EFTA-Finland association
FMV	Swedish Defence Material Administration
GATT	General Agreement on Tariffs and Trade
H.M.	Her Majesty
ICDV	Import Certificate Delivery Verification System
IMF	International Monetary Fund
IBRD	International Bank for Reconstruction and Development
JCP	Japanese Committee for Productivity
JIC	Joint Intelligence Committee
KEVSOS	Reciprocal removal of obstacles to trade between Finland and the Socialist countries
MFN rule	Most-favoured-nation rule
MSA	Mutual Security Administration
NAM	National Association of Manufacturers
NATO	North Atlantic Treaty Organization
NFTC	National Foreign Trade Council

NICB	National Industrial Conference Board
OECD	Organization for Economic Cooperation and Development
OEEC	Organization for European Economic Cooperation
ONC	Overseas Negotiations Committee
PRC	People's Republic of China
QRs	Quantitative restrictions
SOU	Swedish official government reports
USA	United States of America
USSR	Union of Soviet Socialist Republics
USTA&P	United States Technical Assistance and Productivity Program

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