CARTEL AND EMBARGOES AS INSTRUMENTS OF AMERICAN FOREIGN POLICY

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ABSTRACT

During the past decade, both producing and consuming nations have become increasingly concerned over the interaction between broad foreign policy objectives and international trade in commodities. This Agricultural Economics Report reviews some salient features of post-World War II foreign economic policy. First, it briefly explains what cartels and embargoes are; then it explores how the Great Depression influenced post-war economic theory and policy analysis. In essence, Keynesian macroeconomics was thought to be not only necessary but also sufficient for attaining full employment, price stability, and economic growth. Reviewing three instances of foreign economic policy—the strategic goods embargo, the structure of the world petroleum industry, and the recent embargo on grain sales to the Soviet Union—illustrates the importance of international trade policy and the structure of primary commodity markets. In the long run, economic policy in these areas may be as important as macroeconomic, monetary, and fiscal initiatives for sustaining a stable, growing economy with full employment.
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I. INTRODUCTION

As we enter the 1980s, economic and foreign policy are more interdependent than perhaps ever before in American history. Trade with foreign nations, our balance of payments, and the value of the dollar are common news items. Unemployment and inflation—are now acknowledged to have at least a portion of their origin in the increasing interdependence between nations. Policies based on the assumption that American dependence upon other nations is negligible have had to be revised; some have lost their potency.

Americans are concerned. No one questions political leaders when they declare that the United States is losing its absolute advantage in world affairs. We now are forced to think in comparative terms. But one can question whether initiatives such as the recent embargo against the Soviet Union enhance the American position in world affairs. Have we gained economic benefits or political stature that gives our ideas and demands more "power" in the world markets and political forums? More generally, one could ask when do the political and economic benefits of cartels, embargoes and buyer's embargoes (boycotts) outweigh their costs? These are the questions that will be addressed in this report.

Evaluating the purely economic benefits and costs of any economic action is not a straightforward endeavor. The problem becomes considerably more complicated when one includes political benefits and costs. There is no mathematical theory of political economy to suggest
II. Embargo and Cartel: Definition and General Description

An embargo is a legal prohibition on commerce by a governmental authority. The term is commonly reserved for prohibitions on sales, with the somewhat broader term boycott being used to denote a proscription on purchases. Associations other than governments can declare boycotts which may be legal or illegal. For simplicity, only an embargo on sales will be discussed; similar points hold for boycotts.

Strictly speaking, a government can only embargo shipments from its ports to other countries. It cannot embargo shipments by other nations. If the desired outcome is to retain goods for domestic use, as was the case with the embargo on American soybean and grain shipments during 1974-75, this distinction causes no problem. But when the embargo is aggressive and seeks to limit shipments to another country, the question of control becomes more critical. Exporting countries that have monopoly control over embargoed items are best able to cut off shipments to the
targeted nation. Nonetheless, even when only one country produces an item, transshipment through third countries may result in a less than perfect cutoff.

Few nations have a monopoly over the production of a large number of economic goods. Thus an aggressive embargo requires, at a minimum, some form of collective control over or among all of the nations that export the commodities in question. One such form of collective control is a cartel. Operative cartels can implement an embargo against a targeted nation. Under more general conditions, they pursue less extreme goals, usually seeking to control trade for their benefit rather than to stop it completely.

The most authoritative and general treatment of cartels continues to be the two-volume effort of Stocking and Watkins published in 1946 and 1948. Stocking defines a seller's cartel as an arrangement among, or on behalf of producers engaged in the same line of business, with the design or effect of limiting or eliminating competition among them (Stocking, 1948, p. 3). The definition of a buyer's cartel is symmetric. Using this standard, Stocking and others completed case studies of several domestic and international cartels. Without disparaging the quality of their research, one can submit that their definition was too broad and encompasses government policies to control market performance that are not accurately described as cartels. Stocking's definition is, in essence, a pre-Keynesian conceptualization that does not recognize the role of government in regulating the economy.

Consider, for example, the actions of the federal government through the Federal Reserve System to control the money supply and interest rates. Such intervention in financial markets is often at the behest of the
financial community and on occasion it does benefit them. Yet few observers consider the Federal Reserve System to be a cartel organized for bankers.

Similarly, federal intervention in agricultural commodity markets is not necessarily a cartel policy. Congress, the President and the Secretary of Agriculture can regulate agricultural markets on behalf of and for the public interest. Policies can be designed in such a fashion as to serve the interests of food processors, consumers and taxpayers as well as farmers. By controlling supply, the government has, in most cases, minimized the adverse impact of weather, poor soil conservation practices, and other exogenous shocks on the food system, such as technological change. Maintaining reasonably stable prices that reflect long-term conditions and making them known each year in advance of planting have limited risk, not competition. With a more certain outlook, growers have specialized and more rapidly adopted new techniques of production. The benefits have been primarily passed on to consumers in the form of lower prices precisely because production agriculture is a competitive industry and not a cartel.

These examples argue for a more exclusive definition of cartel. Government actions that mitigate externalities and thereby improve the performance of the market system should not be labeled cartel policies. The definition of a seller's cartel needs to be qualified to read "an arrangement among or primarily on behalf of producers..." When public agencies take initiatives to influence competition, one must apply a rule of reason to determine whether the outcome is a cartel. Many grain farmers, for example, openly resent the results and often the practice of federal intervention in their markets. They would maintain that federal
Supply and price control initiatives during recent years are most certainly not a cartel arranged by them or primarily on their behalf. On the other hand, nearly everyone agrees that the Secretary of Agriculture would be cartelizing grain markets if he used his authority to establish 100 percent parity prices, $6.19 for wheat, $4.29 for corn, as some dissident farmers are demanding.

If a cartel is to control trade in international markets it must control domestic trade of the commodity in producing nations. This is necessary not only to limit expanded exports, but also to prevent price depressing overproduction for the domestic market. For this reason only very large firms that have powerful influence over domestic markets have the ability to organize international cartels without the explicit assistance of government. DuPont, Imperial Chemicals Industries of Britain, and I. G. Farben of Germany, for example, cartelized world trade in chemicals during the inter-war period (Stocking, 1946, Ch. 9-11). Some foreign governments have used state power to aid companies desiring to form a cartel, and others have actually encouraged reticent businessmen to organize cartels. A more indirect approach is to use selectively quotas, tariffs, embargoes and subsidies to aid in the establishment and preservation of cartels (Adams, 1979). Of course these policy instruments can be used to attain other objectives as well.

The interaction between cartels and governments is subsidiary to a broader observation. International business ventures and foreign economic policy are generally interdependent. Executives in multinational firms do not dominate foreign policy, nor are they pliable tools of the State Department. Interests, needs and strategies vary depending upon the particular opportunities that a situation offers.
One should not misconstrue this interdependence between private and state power to imply that cartels are a common occurrence and always legal. American anti-trust laws generally declare illegal domestic and international combinations among firms to limit or eliminate competition. In the international arena the Webb-Pomerene Act (1918) is the only departure from the proscriptions of American anti-trust law. It allows firms to form joint selling agencies for export provided that they do not restrict imports into the United States, restrain exports of nonmember American firms, restrain trade inside the United States, or "artificially or intentionally" affect prices in the United States (Stocking, 1948, p. 433). The intent was to allow small firms the right to form cartels for sharing transport costs, selling expenses, etc., when exporting to other nations. Webb-Pomerene associations have never played a central role in American trade, and are somewhat an anachronism (Federal Trade Commission, 1967). American multinationals such as General Motors and ITT hardly find the opportunity to form a joint export association, an attractive complement to their global marketing strategies.

III. The Interaction Between the Great Depression and Post-World War II Economic Policy

Foreign policy is not designed in an intellectual vacuum; it is based upon ideas and theories about how the world operates. These ideas in turn are heavily influenced by past experience. Therefore it makes sense to review the historical interaction between events and ideas, and to explain the theoretical base from which foreign economic policy has operated during the past 35 years.

In 1945, the overriding event influencing economic theory was not the recent war or its origins per se; it was the Great Depression. Paul Samuelson voiced a common concern in the first edition of his perennial
textbook Economics. The first task of modern economic science was to describe, to analyze, to explain, and to correlate fluctuations in national income. Boom and slump, price inflation and deflation demanded explanation (Samuelson, 1948, p. 4). The war had put Americans back to work, but would prosperity persist? By applying the ideas of John Maynard Keynes, economists hoped to maintain full employment and economic growth at stable prices. The challenge was real and the stakes were very high.

During the post-war era there was debate over the relative importance of fiscal and monetary policy between such personages as Walter Heller and Milton Friedman. But economists generally believed that continuous prosperity was possible. It was to be sustained as follows. When the private sector showed signs of faltering or overheating, it could be counteracted by manipulating the money supply or government spending. In the long-run, growth of the economy could be controlled by using government policies to influence the aggregate allocation in society between consumption and investment. According to the theory, if productive capacity grows more rapidly than current consumption, unemployment and unused resources will appear. Conversely, if incomes grow faster than output capacity inflation will eventually result from "too much money chasing too few goods."

The logic of the new macroeconomics was attractive. It conformed with the experience of the 1940s. Expanded government purchases for the war had reestablished aggregate demand. Price controls and rationing were dismissed as secondary initiatives, due to war-time conditions and the need for an extraordinarily rapid and massive expansion of output. Equally important, the theory gained adherents for what it did not counsel. Government could limit its concern to aggregates and leave the
internal allocation of consumption and investment outlays to the private sector. This result is called the post-Keynesian synthesis of economic theory. It preserved the market economy and the neoclassical theory developed by economists to explain it.

For current purposes the primary question is what counsel has the theory given for the conduct of foreign economic policy during the post-World War II era? Again, events from between the two world issues strongly influenced economists' answers. During that period governments tried to export unemployment and maintain standards of living by increasing exports and reducing imports. But the resort to tariffs, quotas, cartels and other restrictive practices compounded rather than solved the problem. The new macroeconomic theory offered an alternative approach. Domestic policy initiatives could sustain employment, growth and stability. Again, citing from Samuelson's first edition of Economics:

The United States cannot sensibly regard international trade as a way of solving its unemployment problem. We cannot and should not, if we could. But we cannot. Other countries will retaliate to our beggar-by-neighbor tactics with the result that we shall all be much worse off...Instead we must...conquer the problem of unemployment by domestic policies and use international trade only to increase our present and future standards of consumption, or to serve our political aspirations and responsibilities (Samuelson, 1948, p. 375, emphasis added).

Over time it has become increasingly obvious that international trade policies must be coordinated with domestic stabilization activities. However, as Dernburg and MacDougall wrote in 1968, "until quite recently American economists have thought of the United States economy as a closed economy (for stabilization purposes) (Macroeconomics, p. 238). Thus during most of the post-World War II era, foreign economic policy was regarded as an extra policy instrument that could be used, as Samuelson counseled, to obtain other objectives, including political ends. At the
beginning of the Cold War era, America was in a position of great power by theoretical as well as actual economic and military standards.

The events during the Great Depression also led economists to examine the structure of the American and world economic system for clues to economic prosperity and stability. The Temporary National Economic Committee (TNEC) amassed large amounts of data on corporate ownership, the number and size of sellers in specific markets, corporate business methods, prices, profits and other aspects of performance. They published voluminous studies that described the market structure and performance of individual industries. In *The Modern Corporation and Private Property* (1932), Adolf Berle and Gardiner Means showed that a very few very large corporations controlled most of the nation's industrial capacity. These corporations occupied commanding positions in several industrial markets, and their control over the economy had not decreased over time. Stocking, Watkins and others, including a much younger Alfred Kahn, researched and wrote *Cartels in Action* (1946) and *Cartels or Competition* (1948). All of these efforts produced startling and intriguing facts. Yet such pragmatic and descriptive studies of industrial structure yielded few generalizations that could contribute directly and immediately to solving the unemployment problem.

The macroeconomists correctly answered structuralist queries by pointing out that "trust-busting" and other more moderate changes in incentive and control structure of industry were ridiculous ways to expand aggregate demand. Industrial restructuring, for example, requires lengthy court litigation; hence one cannot time policy impacts upon the economy, nor can one counteract the short-run fluctuations of the business cycle. Structural reform is also a politically charged issue, and
besides how would one restrict aggregate demand—allow companies to form cartels or merge into monopolies? The macroeconomists concluded that a policy on industrial structure was cumbersome and, in the first instance, not necessary for achieving full employment, price stability and economic growth. As with international trade, structural initiatives could be used to attain other objectives in the domestic or foreign policy area.

The ascendency of Keynesian ideas not only eclipsed the work of Stocking and others on cartels, and industrial structure, it influenced future thinking in the area. Samuelson wrote in 1948:

If the problem of full employment is solved reasonably satisfactorily in the years ahead, then one of our most important economic problems will become that of channeling the tremendously efficient and creative abilities of the large-scale corporation to the general public good (Samuelson, 1948, p. 131).

Policy initiatives affecting the "corporation question" were a luxury that needed to be deferred while more important problems were addressed. As this attitude gained acceptance among economists, the more speculative ideas of Galbraith, Berle, Heilbronner, Friedman, and other social critics captivated the public. Several questioned the role of decentralized markets in allocating resources and distributing rewards for economic activity. If men and women could counteract aggregate fluctuations in business activity with the new macroeconomics, could they not also improve the efficiency and equity of the economic system by directly organizing and controlling production through large-scale corporate enterprises? The question introduced humanism into economics in a new and controversial fashion.

Galbraith suggested that the private economic power of large-scale entities could be held in check and directed towards socially useful ends
by the countervailing power of those who are subject to it (Galbraith, 1952, p. 115). Most notably, he argued that labor unions offset corporate power, but others who purchase goods from the powerful corporations could also countervail their power. Galbraith's idea predicts a world of bilateral monopoly, and extended bargaining among very large and powerful groups, yet this did not deter him. Nor did the very likely possibility that the countervailing power of bilateral monopoly would be short-lived as opposing groups combined to profit jointly at the expense of others in the system who are less organized. Countervailing power often becomes coalescing power (Adams, 1974, p. 363). At this point, Heilbronner would directly admit the state, and institute detailed centralized planning of the economy. The political process would replace decentralized markets and determine not only what is produced, but how rewards would be distributed among factors of production (Heilbronner, 1970). Market structure, according to Heilbronner, is attendant to political structure and superfluous.

Adolf Berle's ideas on the social control of large corporations were even more challenging to neoclassical orthodoxy. He retreated (or advanced) to ethics and philosophy, altogether deserting economics. In The 20th Century Capitalist Revolution, Berle alternately flattered and challenged American corporate leaders to become the conscience as well as the providers for American society.

The only real control which guides and limits (corporate) economic and social action is the real though undefined and tacit philosophy of the men who compose them...to anyone who studies and even remotely begins to apprehend the American corporate system, the implications of the line of thought here sketched have both splendor and terror. The argument compels the conclusion that the corporation, almost against its will, has been compelled to assume in appreciable part the role of conscience--carrier of twentieth century American society (Berle, 1953).
As Heilbronner has noted, this prospect was clearer in its terror than in its splendor for it implied that the American system was to be ultimately responsible to business leaders—hopefully enlightened men—over whom no political and very little economic control existed (Heilbronner, p. 217). Subsequently in *Power Without Property* Berle softened his interpretation by claiming that the conscience of the corporation was not the product of the "business elite." Rather, and here he takes a cue from Joseph Schumpeter, it emanated from the universities, the press, and the professors—the "spiritual elite." Freedom of speech and academic freedom are, according to Berle, the guarantors of a clear conscience and the public interest.

Milton Friedman took umbrage at predictions that the competitive market economy is outmoded as an instrument of social control and unable to ensure maximum efficiency, economic growth, innovation, and social progress. In writing *Capitalism and Freedom* (1962) and more recently *Free to Choose* (1980), Friedman condemns the expansion of the public sector since the New Deal, and defends the virtues of unfettered private initiative in a market economy. He is very explicit in his dislikes for the bureaucracy and administrative inefficiency of public institutions, yet confidently asserts that similar large-scale private organizations are efficient because they have to compete in markets. But do they? Research since the era of the T.N.E.C. has consistently reported that substantial segments of the American economy are not competitive (Scherer, 1970). Whereas Galbraith, Berle and Heilbronner recognize the economic power possessed by large corporations, Friedman denies its existence. He attributes the advantage of large corporations to skill and efficiency in a competitive winner-take-all economy. Large corporations, according to
Friedman's reasoning, retain their position by virtue of their superior efficiency, rather than by benefitting from substantial barriers to entry, some of which may be constructed by large corporations for the very purpose of limiting competition. The evidence, in several cases, places him in the position of an apologist for the private power of oligopolistic industries and monopoly.

The most incisive response to theories of social control that are openly or implicitly based upon corporate planning is perhaps a quote from Sumner Slichter, an institutional economist and intellectual forbear of Berle, Heilbroner and Galbraith. Slichter tersely wrote in 1925 "human cupidity and stupidity are dangerous in proportion to the power which men have at their disposal" (Slichter, p. 4). A decentralized economic system that assembles the offers and demands of numerous men in a marketplace may on the surface appear chaotic and directionless, but the ultimate performance of the market may be superior to the inspirations and intentions of an elite planning group, no matter how well informed, educated or virtuous these corporate planners may be.

Political scientists and historians have marshalled evidence that the American political system is not intended nor designed for directly controlling large corporate planning bureaucracies. Our republican system of government with its local, state, and federal levels, plus checks and balances between legislative, executive, and judicial branches is predicated upon an economic structure that ensures equal opportunity to all and avoids agglomeration of economic power in large private bureaucracies. Charles Lindblom, Sterling Professor of Economics and Political Science at Yale University, recently concluded a major study of this issue as follows:
...Enormously large, rich in resources, the big corporations...can, over a broad range, insist that government meet their demands, even if these demands run counter to those of citizens...Moreover, they do not disqualify themselves from playing the partisan role of a citizen--for the corporation is legally a person...They are on all these counts disproportionately powerful. The large corporation fits oddly into democratic theory and vision. Indeed, it does not fit. (Lindblom, p. 356)

Lindblom's concern is not novel. The relationship between democracy and private power has been an issue in American political economy since at least the time of Jefferson and Hamilton. During the 1830s, it assumed the form of a battle between President Andrew Jackson and Nicolas Biddle, President of the Bank of the United States. The Bank was federally chartered and effectively independent from governmental influence but very powerful due to legally granted monopoly powers in financial markets. Supported by regional interests that wished to establish state banks, western farmers and eastern workingmen, President Jackson vetoed the renewal of the Bank's charter.

In 1831, Senator Thomas Hart Benton of Missouri made the following case against the Bank:

First: Mr. President, I object to the renewal of the charter...because I look upon the Bank as an institution too great and powerful to be tolerated in a government of free and equal laws...Secondly, I object...because its tendencies are dangerous and pernicious to the government and the people...It tends to aggravate the inequality of fortunes; to make the rich richer, and the poor poorer; to multiply nabobs and paupers...Thirdly, I object...on account of the exclusive privileges, and anti-republican monopoly, which it gives to the stockholders. (Schlesinger, 1945, p. 48)

Daniel Webster, the gifted orator from Massachusetts, represented the pro-bank forces--eastern manufacturing and commercial interests--in the Senate. Upon learning of the President's veto, he condemned the veto as an irrational and unwarranted attack on the structure of American society.
(The veto) manifestly seeks to influence the poor against the rich. It wantonly attacks whole classes of the people, for the purpose of turning against them the prejudices and resentments of other classes. It is a State paper which finds no topic too exciting for its use, no passion too inflammable for its address and its solicitation. (Schlesinger, p. 54)

In his Pulitzer Prize winning study of the Jacksonian era, Arthur M. Schlesinger concluded that for both Webster and Jackson, the battle was between antagonistic philosophies of government.

One declaring, like Webster...that property should control the state; the other denying that property had a superior claim to governmental privileges and benefits. (Schlesinger, p. 54)

The relationship between American government and private power as manifested in corporations with monopoly power was clearly a topic of great concern more than 150 years ago. Writing after the rise of big business during the latter half of the 19th century and in the wake of the Great Depression, Schlesinger, like Berle, Means and others, clearly felt that the issue was more deserving of attention than ever before in American history.

To summarize this brief review of how the Great Depression influenced the thinking of American economists, it provided the historical base for the powerful intellectual impact of macroeconomic theory on economic policy. Initiatives in the areas of international trade, economic organization and social control were thought to be not necessary for attaining the primary policy goals--full employment, growth and price stability. In the trade area, the United States could pursue policies to enhance our standard of living and political aspirations. By and large this has meant participation in the periodic General Agreement on Tariff and Trade (GATT) rounds to lower tariffs and other barriers to trade. Yet the United States has abandoned the multilateral pursuit of open trade in certain circumstances. Export policies such as P.L. 480--Food for
Peace—have been used to support explicit foreign policy objectives. Other examples are the subject of this report.

In the area of structures policy some very articulate and thought-provoking economists led the debate. The ideas of Slichter, Schlesinger and other historical and empirically oriented social scientists were not as popular as those of innovative thinkers, such as Galbraith, Heilbronner and Berle. These men predicted that the large corporation was ushering in a new era of economic organization. There would be more opportunity for human progress. The market would be subdued, possibly even replaced, as an allocative mechanism by technocrats, planners and the political process. The market power of monopolists would be subjugated and used for the public interest.

Free market fundamentalists such as Friedman, on the other hand, pointed out that the current industrial structure is an expression of competitive capitalism and that large corporations in the main do not have market power. Although they disagree upon the source, both the Galbraithian and Friedman schools of thought see net positive benefits accruing from large-scale organizations in the private sector. This suggests American foreign economic policy would be increasingly interactive with the international policies of large corporations and their planners. Moreover, foreign policy strategists would not be overly inclined to worry about the influence of their policy on smaller firms. Nor would they be concerned for its possible anti-competitive effects via heightened barriers to entry and deteriorating conditions of entry.

Finally, at least prior to the collapse of the Bretton Woods Monetary system in August, 1971, most economists felt American foreign economic policy could be pursued independent of domestic efforts to attain full employment, economic growth and price stability. Even financing the Viet Nam war was viewed as a domestic issue. Given this grounding in the economic ideas that influenced foreign policies, let us now proceed to the case studies.
IV. THE STRATEGIC GOODS EMBARGO

Since World War II, the basic international political reality confronting U.S. foreign policy has not changed. The superpowers, first the United States and Russia but with the recent addition of China, have sought a balance of power among themselves to maintain world peace. At the advent of the cold war era, the U.S. and the Soviet Union solidified their spheres of influence by establishing a complex array of political and military alliances. The United States, in addition, attempted to preserve the economic advantage of the west by unilaterally instituting a strategic export embargo against the communist countries. During 1949 Congress commenced passing a chain of legislative caveats that linked European reconstruction and development and with restrictions on East-West trade. These efforts culminated in the Battle Act of 1951. The scope of the intended restrictions increased until 1953 by which time the Western European countries had regained their financial independence and discontinued accepting Marshall aid from the United States. European leaders successfully argued for a reduction in the list of embargoed civilian goods. By 1958 their lists contained only goods of an obvious military nature. The United States continued to embargo a wide array of trade with communist countries. The Cuban Revolution gave the program a renewed lease on American trade with communist nations, a lease that was not broken in a major fashion until détente in the early 1970s.

Recalling that the Korean War started in June, 1950, and that there was open conflict through much of the period up to the 1953 high tide mark of the strategic embargo, there was cause for limiting the strength of the Soviets and their allies. But most western economists and trade experts
concur that technically the embargo policy was a failure from the very start. Swedish economist Gunnar Alder Karlsson's authoritative study, *Western Economic Warfare, 1947-1967*, documents the feeble economic impact of the embargo. Recently Robert Gilpin, a political economist at Princeton University concurred:

> It was insufficient, counter productive and more costly to the West than to the Soviets or the Chinese. (The New York Times, January 13, 1980, p. F-1)

Its imposition at the time of the Korean War may have been primarily an emotional response to the Korean War by the U.S. Congress. The following excerpt from the Congressional discussion indicates the political tone of that time:

> I brought this question (of trade) up because our boys are dying by the thousands in Korea as the result of trading with Russia. They are being killed by machines, by instruments that are either manufactured in the United States or are paid for with American money. The American people are not willing for us to continue to finance that gang behind the iron curtain and have them supply the instruments of destruction to kill our boys on foreign soil. (as cited in Adler-Karlsson, p. 33)

The embargo did have a very substantial political impact in the early phase of the cold war. On the other side, Stalin used it as propaganda to cement economic and political ties between Russia and the East European nations. Many West Europeans questioned the wisdom of the embargo for this reason, but they also resented the unilateral way in which the United States attempted to control their trade. Gunnar Myrdal, noted Swedish economist and Nobel laureate, has even suggested that the superpowers saw mutual advantage in escalating the Cold War.

About the political dynamics of the escalation of the embargo policy in the first period my own view was that, together with changes of other factors instrumental in intensifying the Cold War, it formed part of a system of circular causation with cumulative effects. Whenever, up till 1953, the momentum in
this movement tended to slacken, an action on one side or the other could be expected, leading to counteraction. This implies that the political events in these years represented a strange sort of "cooperation" between the leaders of the two contesting power blocs. (Adler Karlson, 1968, p. xi)

The implication is that the United States and Russia moved simultaneously to establish economic hegemony over their allies by solidifying trade channels and capital flows with their own economies. Students of economic history quickly labeled this new era as the Pax Americana a sequel to the Pax Britannica of the 19th century when British hegemony over world economic affairs brought forth an era of free trade and economic development. Yet the American era was shortlived. By the end of the 1960s the Japanese and European economies had grown to such proportions that the Western system became truly interdependent and polycentric. One could regard President Nixon's suspension of the convertibility of the dollar and the collapse of the Bretton Woods Monetary system in 1971 as the end of the Pax Americana.

Historically the decline of a hegemonic state has been followed by movements away from open international trade. During the past 150 years this has been observed after the decline of Britain (and rise of Germany) prior to World War I, during the inter-war period when there was no hegemonic power, and increasingly during the 1970's (Katzenstein, 1978, p. 9; Belassa, 1979, p. 43). Increasing interdependence generates more situations where domestic industries are threatened by imports. As the necessary adjustments become more frequent and larger, the demand for protection through tariffs, quotas and cartels increases. Affected citizens demand that their government intervene to protect and improve their standard of living.

In retrospect it seems inevitable and irreversible that Japan and Western Europe would assume first-class status in the western economic
system. Yet some political scientists disagree on this point. They maintain that the oil crisis halted the process of hegemonic decline vis-a-vis Western Europe and Japan because the United States is less dependent upon foreign oil (Katzenstein, p. 11). This is a very provocative hypothesis that deserves careful analysis. Although the U.S. is less dependent than Western Europe, we continue to import 47 percent of our oil. Our relative gain over the Europeans and Japanese is trivial in comparison to our absolute loss to the oil exporting nations. Katzenstein and others are looking to the future and speculating that we will move towards energy self-sufficiency, and that the world energy shortage will be solved by exploitation of coal, and oil shale - two raw materials that the U.S. has in very abundant supply. Yet their concern for reestablishing America as a hegemonic power may have outrun their analysis at this point. The Europeans have coal, and energy may be available from other sources such as solar, biomass, nuclear fission, and perhaps in the distant future, fusion power. One conclusion is, however, certain. How the energy crisis is solved will have important implications for international relations and world stability.

Although the above discussion digresses from the cold war strategic goods embargo narrowly construed, it does illustrate how embargoes can contribute to wider and more subtle foreign policy objectives. In the given historical situation after World War II, the strategic goods embargo may have paradoxically assisted in the establishment of a world political system amenable to open international trade.

Yet the hegemonic state theory of open international trade rests upon only the broadest sort of historical verification. As Myrdal's remarks suggest, it is not without its critics. The implications of accepting or rejecting the theory are enormous. Today's economic
challenges may not be best met by seeking to resolve the energy crisis or any other crisis in such a fashion that American hegemony is reestablished. Channeling human and material resources into programs that attain energy self-sufficiency through the use of resources, over which only the United States has substantial control, may actually retard our movement towards energy self-sufficiency. It may also produce a domestic energy system that is not based upon the most efficient combination of energy alternatives, and an energy system unduly centralized in large scale units. Rather than pursue specific energy alternatives because of their promise for restoring American power, perhaps our economic and foreign policy should recognize that the trend towards interdependence may continue during and after the resolution of the energy crisis. In light of this eventuality perhaps policy should seek in the most direct and immediate fashion to promote an efficient energy system and to preserve international commerce against rising economic nationalism and political intervention. There are difficult choices and trade-offs to be faced here. Moreover institutional constraints that determine who decides them, and the equity of the solution cannot be deleted from policy agenda.

V. CARTELS AND FOREIGN ECONOMIC POLICY TOWARDS DEVELOPING NATIONS - OIL IN THE MIDDLE EAST

Turning to a second dimension of foreign policy, several developing nations furnish raw materials for the industrialized nations of the West. It should surprise no one that our dependence on foreign raw materials did not commence with the Arab oil embargo of 1973. Rather it has influenced U.S. foreign policy throughout this century, and one could argue with some justification that the Monroe Doctrine was the first initiative to protect and promote American access to third world resources. At present the
most pertinent example of raw material dependence centers upon Middle East oil, and a case study of the western economic policy in the area illustrates how cartels can be used as instruments of foreign policy, and vice versa.

The first of the oil fields in the Middle East was discovered in 1908. William D'Arcy, an Australian who had obtained in 1901 a sixty-year concession covering 500,000 square miles or five-sixths of what is now Iran, promptly established the Anglo-Persian Oil Co. which later became British Petroleum. Other discoveries of oil in the Middle East soon followed. The most notable one was in Iraq and the earliest western oil company to benefit from it was Royal Dutch-Shell, a British and Dutch firm.

World War I precipitated a temporary domestic oil shortage in the United States. For the first time Americans realized that access to foreign oil could be vital for continued growth of the American economy. There was fear that foreign oil was being monopolized by European firms. Accordingly, Congress passed a law in 1920 requiring foreign oil firms who wished to explore for oil in the U.S. to reciprocate by allowing U.S. firms access to their concessions in third world countries (Hearings, 1974, p. 41). This quid pro quo enabled American firms to enter the Middle East during the twenties. On July 31, 1928, Exxon and Mobil joined Royal Dutch Shell as co-owners of the Iraq Petroleum Co. Later Gulf Oil Corporation entered through Kuwait. Standard of California and Texaco entered through Bahrain and Saudi Arabia. Until the early 1970's when the host countries made good on their demands for increased ownership participation and in some cases outright nationalization, control over Middle East Oil remained firmly in the hands of these companies - the "seven sisters."
It is difficult to determine whether the American oil companies initiated the expansion of United States economic influence into the Middle East. At the very outset, the government's desire for an American presence in the Middle East oil fields was at least as strong as the companies' (Stobaugh, 1979, p.20). Yet after entering the area, the five large American companies certainly had no thought of voluntarily leaving what they soon realized was the world's largest pool of oil. Multinational oil firms were there to stay.

Over time these firms arranged joint ventures among themselves, but they used a variety of methods to limit entry into the area by others (Blair, pp. 29-53). Control may actually have been concentrated in fewer companies. The Temporary National Economic Committee used 1939 data to complete the only study that has ever traced ownership of large corporations back through "owners of record" to the ultimate "beneficial owners." According to their report the Rockefeller family, family foundations and companies owned 20 percent of Exxon, 17 percent of Mobil, and 12 percent of So. Cal. (TNEC, 1940, p.127). In each case the remainder of the stock was widely dispersed, hence these holdings were considered sufficient to establish working control. This suggests that the seven oil companies in the Middle East may actually have conducted business in the world oil markets as if they were five or fewer firms.

The oil companies moved rapidly to control what they felt were excessive petroleum production and depressed prices. The first international effort to form a cartel that involved American firms was the Achnacary Agreement, dated Sept. 17, 1928. This was less than three months after Exxon and Mobil's entry into the Middle East. The president of Exxon entered into a gentleman's agreement with the heads of
BP and Royal Dutch Shell. Principles, policies and procedures were set forth that were to regulate operations (Blair, 1976, p.55).

World War II had relatively little direct impact upon the institutional arrangements and pricing goals of the multinational oil companies. Indirectly, however, the advance towards independence of the British and French colonial states raised serious issues - issues that were exacerbated by the increasing competition between the Soviet Union and United States for the allegiance of the newly independent third world nations. Writing in 1954 George F. Kennan, a noted scholar and diplomat who has had more influence on our Euro-Asian foreign policy since World War II than any other person, possibly excepting Henry Kissinger, expressed the central dilemma of American foreign policy towards third world nations as follows.

The fact that many ... raw material sources are on the territory of (foreign) governments ... coupled with the extensive value we attach to national sovereignty, seems to me to mean that in many instances our raw material supply hangs on slender threads, and ones over which we have no power of control or even redress. And I worry lest some day drastic interruptions of this supply should led to painful crisis and tensions of the sort that have often in the past been connected with the charge of imperialism. (Kennan, 1954, p. 53)

After recognizing dependence Kennan mused on how we could resolve the dilemma between respect for foreign governments and our need for their raw materials. But the political forces dominating events at that time were altogether too strong to be altered by appeals to reason in terms of common interests. At the height of the Cold war, Mr. Kennan and his contemporaries tended to think in terms of absolute control by one side or the other of third world resources. The concept of open trade among nations which exercised sovereignty over their resources was nearly as subservient to American "national security" and the needs of the "free
world" as it was in the colonial era. This dichotomous vision of the world and the neocolonialist foreign policy which emanated from it has become a procrustian bed for the western industrialized nations.

In retrospect Mr. Kennan's concerns during 1954 are tinged with irony. Then, as now, American foreign policy was deeply embroiled in a crisis centered upon Iran and Soviet influence in the Middle East. In 1951, a popular movement espousing nationalism and socialism under the leadership of a doctor named Mohammed Mossadeq became the dominant political force in Iran. Rather than trade with the new Iranian state and its nationalized oil industry, the dilemma between respect for national sovereignty and "secure supplies" of foreign oil was answered in favor of the latter. With the aid and support of the United States Mossadeq was overthrown in 1953, and the Shah returned to the Peacock throne with more authority than he had previously exercised.

When the Parliament refused to grant Mossadeq's demand that it extend for one year his right to govern by decree, a wave of demonstrations swept the country. Mossadeq directly challenged the Shah, ordered a plebiscite to dissolve Parliament and won more than 99 percent of the votes cast and counted. In a swiftly moving series of events, the Shah attempted to oust Mossadeq by decree, failed, and fled the country as Mossadeq's supporters demonstrated in the streets smashing the statues of the Shah and his father. The military moved in, and in bloody street fighting deposed Mossadeq and restored the Shah to his throne a move which was assisted clandestinely by the U.S. Central Intelligence Agency. (Report on Multinational Corporations and Foreign Policy, 1975, p. 64)

The seven majors played a strong role in these events. By virtue of the fact that they controlled 98 percent of the world oil trade, it was possible for them to boycott Iranian oil shipments. Iran's oil export revenues decreased from $400 million in 1950 to less than $2 million in the two-year period from July 1951 to August 1953 (Blair, 1978, p. 79).
From 1953 until the Shah's more recent overthrow, American Middle Eastern foreign policy depended to a large degree upon his gratitude and allegiance to the United States. The other pillar of what came to be called the "two-pillar" policy in the Middle East was the Kingdom of Saudi Arabia. On the political and military front this policy consisted of building up these two nations as the guardians of the Persian Gulf. In the sensitive economic dimension, the nationalized Anglo-Iranian Oil company (previously 100 percent owned by BP) retained formal ownership of Iran's oil. But the newly formed National Iranian Oil Company was permitted only to manage "non-basic" operations such as housing, municipal and civil maintenance, canteens, restaurants, medical training, and other personnel services (Petrole au Moyen-Orient, 1968, p.38). A consortium of western companies had actual control of Iranian oil, especially the quantity sold in world markets. This solution preserved the formal appearance of sovereign control, yet denied it.

The composition of the consortium was critical to the long-term efforts of the seven majors to maintain their control over the world oil trade. Again they needed to limit entry of other oil firms, especially American independents, into the Middle East. This need resulted in classic example of cooperation and bargaining between the U.S. government and large oil companies. The Department of State had de facto authority to determine which companies would join BP in the Iranian consortium. Yet rather than leaping for the opportunity the other majors informed the U.S. government that they felt taking on Iranian's crude would not allow them to produce enough oil in Saudi Arabia to please the Saudi King. The State Department was, pardon the pun, over a barrel because only the majors were capable of moving large enough quantities of Iranian crude in the
immediate short run to provide the income deemed necessary for the stability of the "new" Iranian government. Ultimately all six majors joined BP in Iran as the State Department limited the total share of independents to an unduly low 5 percent (Blair, p. 46; Stobaugh, p. 23). And the U.S. firms gained yet another concession. President Truman, acting on General Omar Bradley's assurance that national security called for the action, requested that the Justice Department terminate a grand jury investigation of the U.S. majors for possible criminal violation of the U.S. antitrust laws because of their alleged activities as part of a world oil cartel (Hearings, pp. 60-79).

Given this reprieve from continued investigation of their foreign activities the U.S multinationals moved with unprecedented vigor and in concert with BP and Shell to consolidate their world oil pricing systems. Blair cogently documents the complex system of production controls that the seven majors designed for the Middle East. Through a complicated system of bidding, the total output of Iran and each company's share was determined. The Iranian solution was then used to determine output in Saudi Arabia, and Kuwait was as "evener" to fine tune the available supply. In the price dimension a basing point system with two foci, the Texas gulf and the Persian gulf ensured that delivered prices tendered by the majors at any port in the world were identical, regardless of the origination of the crude (Blair, Chapter 5). This eliminated price competition by making it very easy to detect firms who were deviating from the agreed upon world price structure. In concert the domestic American market continued to be controlled through the operations of the Interstate Oil and Gas Compact and the Texas Railroad Commission (Blair, Chapter 7). Commencing in 1959 a quota on imported oil to the United States
also was used to retain control over prices. After having read the record, no one can strongly dispute the fact that cartel price and production policies have been prevalent in the world oil industry since the advent of the modern multinational oil firm in 1928.

Some basic measures of the performance of the world oil industry from the early 1950s to the present will be useful to explain the economic forces leading to the formation of OPEC in 1960 and ultimately to the more recent economic and political revolutions in the Middle East. Figure 1 displays the posted price for Saudi Arabian light or "marker" crude oil from 1951 to present. At times prior to 1973 the actual Saudi price was below posted prices. Figure 2 displays the revenue per barrel actually paid to the government of Saudi Arabia. Similar figures could be presented for the other oil exporting countries. The breathtaking acceleration of prices and revenues after the Arab oil embargo in 1973 is the most well-known feature of these charts; however, they convey considerably more information. In retrospect, it is astounding to observe how stagnant posted prices and host country revenues were prior to 1970.

OPEC was formed in 1960 by the oil producing nations to countervail the economic power of the oil corporations. Unlike previous attempts to attain Arab unity this organization was commodity specific and focused on economic issues rather than a broad spectrum of social and political concerns. By virtues of its commodity orientation it also included non-Arab nations, most notably Iran and Venezuela. In fact Venezuela originally suggested the OPEC concept. The immediate incentive to organize was the fall in posted prices in 1960 and the resulting reduction in the producing countries' royalty and profit sharing revenue. Examining Figures 1 and 2 reveals that Saudi posted prices and revenues had been falling since 1958.
Figure 1. Average Annual Posted Price for a Barrel of Light Crude at Ras Tanua, Saudi Arabia

Figure 2. Saudi Arabian Nominal and Real Revenues per Barrel, 1952-76 (Ratio Scale)

Note: As a first approximation, real revenues per barrel are nominal revenues divided by the IMF’s index of the industrial countries’ export prices in terms of U.S. dollars (1952 = 100).

Source: Edens, 1979, p. 124.
In 1962, OPEC published a memorandum explaining its program. In particular the memorandum complained that in recent years the underdeveloped nations of the world had suffered a steady deterioration in their terms of trade with the industrialized nations.

In the long-term interests of all concerned, an equitable balance between the two groups of nations must be established. And the way to accomplish this end is not through economic aid which is dependent to some extent on the good graces of the granting nation, is sometimes tied to economic conditions serving their interests and is susceptible to shifts in their own internal political and economic conditions. Such a balance must, on the contrary, be established by building up a system which will allow the underdeveloped countries to make their way in the world of international trade through reasonable but not exorbitant prices for the exports on which so much of their future depends. (As quoted in Hirst, 1966, p. 37)

OPEC wanted favorable terms of trade, not aid. The memorandum proposed that the price of oil should be indexed to the price of western manufactured goods. During the 1960s, OPEC won only modest concessions with their bargaining from the oil companies. These are reflected in the almost insignificant rise in Saudi revenues per barrel after 1960 and up to 1970. In 1964, Saudi Arabia's revenue from petroleum amounted to 553 million dollars. In the fiscal year 1963-64, imports totaled 1,609 million dollars (Petrole au Moyen Orient, p. 61, 1968). The nation with the world's largest reserves of oil had a negative balance of payments!

The government of Libya and the U.S. independent firms operating in that country came to play the spoiler's role in the oil industry during the 1960s. Libya was granted independence in 1951, and it issued its first oil concessions to western companies in 1956. Yet the Libyans proceeded to do what the U.S. State Department had failed to achieve in Iran. It deliberately awarded concessions in such a way as to avoid making the country overly dependent on the seven majors. Libyans feared that the majors might subordinate Libyan output to the benefit of the more
important oil states in the Persian Gulf when it became necessary to control world output. In less than a decade, Libyan output increased nearly twenty-fold, soaring from 182,000 barrels a day in 1962 to 3,318,000 barrels in 1970 (Blair, p. 211). More important, in 1970 independents (Occidental, Continental, Marathon, Amerada Hess, and Bunker-Hunt) produced 44 percent of Libya's output compared to an average 15 percent share for all independents in other OPEC countries.

Access to Libyan oil meant that the independent companies had oil to move in world markets. This "uncontrolled" oil put downward pressure on prices. As indicated by the profit trends in Figure 3, the cartel pricing system collapsed during the late 1950s and the 1960s. On the other hand, because the independents were dependent in a very major way upon Libyan oil, they were more vulnerable to bargaining initiatives by the Libyan government. The revolutionary government of Colonel Qadaffi was less than a year old when it targeted Occidental Petroleum for a price-hike initiative:

...The Libyan government on June 12, 1970, informed Occidental that its output would be reduced from 800,000 b/d to 500,000 b/d. This was followed on August 19 by a further reduction to 440,000 b/d, lowering Occidental's output to 55 percent of its pre-cut level. Although curtailments were also imposed on other companies, none approached the Occidental cutback in severity. According to the (Senate) Subcommittee's chief counsel, Jerome Levinson, 'Armand Hammer, Head of Occidental, in July of 1970, had gone to see Mr. Jamieson, who is the Head of Exxon, and told him at that point he could not withstand the Libyan government's demand unless he was assured of an alternative source of crude at cost.' Mr. Jamieson was able to resist the plea of a man who was not only a vigorous competitor in international markets but had waged a vigorous and ultimately unsuccessful battle to secure an exemption from the U.S. import quota for a giant refinery in Machiasport, Maine, from which he planned to sell fuel oil at discount prices. Thereupon, Occidental capitulated and signed an agreement with the Libyan government on September 4, providing for an immediate price increase of 30 cents, rising in five years to 40 cents. In a matter of months, the other companies had entered into somewhat similar agreements (Blair, pp. 222-223).
Figure 3. Rate Return (After Taxes) on Net Worth For Integrated American Petroleum Corporations 1949-1974

The Libyan breakthrough in bargaining with the oil industry is reflected in the Saudi price and revenue series displayed earlier. It was the first capitulation by the companies to a member of OPEC on price or output policy. A loose thread in the cloth of the companies' control became known to the world's oil producers.

The Libyan breakthrough was completely unintended by OPEC. The group was, at the time, concentrating upon strategies aimed more directly at the seven majors. These companies held nearly all of the oil concession territory in their countries. In granting the original concessions, Middle East countries surrendered sovereignty over their oil reserves. They now wanted it back. The United Nations first asserted the right of permanent sovereignty by a country in the development of its natural resources in 1952. Subsequently, the doctrine was refined and expressed in its more complete form in a resolution adopted by the General Assembly on November 25, 1966 (Stocking, 1970, p. 437). OPEC incorporated the resolution into its plan of action, and set out to regain control over their oil. The most obvious method, nationalization, was used selectively, for the countries remembered the Iranian experience. A nationalized supply of oil is without value if it has no access to world markets. Their primary demand was for participation, i.e., OPEC planned to bargain for the right to buy into the subsidiaries of the multinationals that held the concessions. Rather than continue to collect royalties and tax profits, they would become majority owners of their oil.

Although participation became official OPEC policy only in 1970, it was strongly advocated by leading OPEC members before this. Saudi Arabian oil minister Yamani, at a 1968 American university seminar on the economics of the international oil industry, indicated that the major companies
must revise their whole system of operation by enlisting the partnership of their host governments (Stocking, 1970, p. 443). During the same year, the Kuwait Minister of Finance and Oil expressed the same sentiment.

One desirable means of establishing long-lasting and appreciable collaboration between a host government and a concession-holding company is the participation of the governments in the ownership and operation of such a company. This would not only give the government a more active role in the management of the most important source of its national income, but it would place the foreign country on a firmer ground. In our country, as indeed anywhere else, a partner is more welcome than an exploiter (Stocking, p. 444).

Yamani, the primary proponent of the participation strategy, revealed an extraordinary amount of realism and self-interest on the subject in a January 1969 interview.

We did not expect Aramco and the other oil companies to accept the principle of participation the moment it was announced and its application demanded. The road is long and difficult, but the day will come when the companies will share our view that participation between them and ourselves is the only way to establish a stable oil industry...(Stocking, p. 447).

Aramco is the subsidiary of Exxon, Mobil, Gulf and So Cal that markets nearly all of Saudi Arabia's oil.

The final ingredient that portended the potential for revolutionary change in the world oil industry was the expansion of world supplies at geometric rates. The seven majors targeted growth in supply at 9.5 percent annually between 1950 and 1972 (Blair, p. 101). Figure 4 illustrates the growth of supply during that period. Most of the increase came from the Middle East. Given that oil is a finite and nonrenewable resource, this geometric expansion in supply to keep prices relatively stable could not continue forever. At some point, consumption of oil would have to be reduced. The question at the beginning of the 1970s was how to do it, and who would do it.
Figure 4. World Crude Oil Production, 1952-76

Source: Edens, 1979, p. 113.
There were four groups who would gain or lose in any realignment of the world oil market: consuming nations, represented most notably by the American, Japanese, and Western European governments, OPEC members, the seven majors, and the independents. During the early 1970s, the western governments were struggling with inflation and recession. President Nixon and other leaders were certainly not in a position to acquiesce to higher oil prices for any reason.

The majors also found themselves in an extremely vulnerable position. Prorationing had broken down after Libya's entry into world markets. This had increased the downside risk on prices and profits. Yet world supply was so tight that a bulldozer accident causing a pipeline to the Mediterranean to shut down for repairs triggered the Libyan bargaining breakthrough in 1970 (Stobaugh, p. 26). As indicated by Figure 3, the major's rate of return on net worth had not been exorbitant through the 1950s and 1960s, but any shortfall in supply, whether due to long-run fundamentals or to short-run disruptions in the volatile Middle East, would result in much higher prices and profits. Western governments combatting inflation would "blame" the majors, and OPEC would accelerate their drive for participation. The oil exporters could also exploit a short crude situation by using the independents for leverage against the majors and vice versa.

Yamani's analysis of the political economy of oil carried the day. The seven multinational corporations granted participation rights to host countries in accordance with the United Nations ruling and OPEC demands. In 1978, for example, American companies retained as their equity share of Aramco only 220,000 square kilometers of its original 1,285,000 square kilometer concession. The Libyan drive for sovereignty over its oil
resources visited the most heavy losses upon the independents. All majors or independents operating in Libya succumbed to nationalization or conceded 50 percent participation to the host government. But the independents suffered drastic cutbacks in their access to Libyan oil. Occidental's draws were lowered 60 percent, others were cut 75 percent (Blair, p. 229). Although it may not have been a concerted action on the part of the majors and the oil countries, Blair refers to this move between 1970 and 1973 as "the evisceration of the Libyan Independents." It could only aid the majors in reasserting control over the world marketing system: from oil well to retail gas station.

Increased participation gave the host countries a say in the management policies of the subsidiaries of the majors, but at the same time preserved intact the corporate bureaucracies that had nearly one-half century of cumulative experience in controlling oil output and prices. This was a brilliant strategic move by OPEC. Since its founding, OPEC had studied the possibility and methods by which they could institute prorationing of supply and hence control price. They commissioned the American consulting firm, A. D. Little, to do the first such study in 1961. Its results were never made public; however, they essentially denied the feasibility of OPEC initiatives. OPEC even tried to prorate supply among its members in 1965, but failed (Stocking, p. 381).

Increased participation was also a brilliant move from another point of view. It shifted the responsibility for price increases to the OPEC leaders. Shiek Yamani and his counterparts, rather than the chairmen of the oil corporations, announce the oil price increases. The heretofore countervailing power of the majors and OPEC coalesced in such a fashion that "the Arabs" of OPEC could be blamed for price increases. These in
turn are implemented, with public chagrin as necessary, by the oil companies. The position of the leaders of the western consuming countries is perhaps typified by the reaction of Prime Minister Heath of Great Britain. He is reputed to have thrown a "temper tantrum" when British Petroleum, a company 48 percent owned by the British government, refused to comply with his request for extra oil shipments to Britain. B. P. reputedly had contractual obligations that prevented them from doing so (Stobaugh, p. 27).

The oil companies were secretly given advance notice of the impending 1973 Arab-Israeli war and the Arab oil embargo (Stobaugh, p. 27). Production was expanded to cover the impending cut-off. The embargo, actually a 5 percent monthly cutback in production and a total cut-off to the United States and the Netherlands, special friends of Israel, was declared in October 1973. Prices were raised from $3.01 to $5.11 a barrel, and again to $11.65 per barrel on January 1, 1974. Arab power rested ultimately upon dynamite wired to their oil wells and the conviction to destroy them if the Western powers attempted to seize them with military force. The era of cheap energy came to an abrupt end.

The profit rates of the largest four American oil firms (Figure 3) skyrocketed in 1973 along with the prices and revenues per barrel in the Middle East (Figures 1 and 2). Although the companies conceded partial ownership of Arab oil, the value of their reserves in the United States alone has increased more than $800 billion since 1973.

The institutional revolution in oil pricing inundated the Middle East with several billion dollars of instant wealth. The magnitude of the shift in terms of trade is perhaps not as important as its abrupt and unexpected occurrence. If the change had occurred according to an
announced timetable over several years, it would have allowed the Arabs to ease into economic development, the politics of wealth, and social change. But the price explosion has subjected the world to increased social and political turmoil in an already volatile area. King Faisal of Saudi Arabia was assassinated in 1975, and many observers predict a social revolution in Saudi Arabia during the next decade. The cultural schizophrenia between traditional Moslem and modern civilization may be too much for the Saudi monarchy to mediate and resolve peacefully. As one American Middle East scholar frankly assesses the current situation:

'Many of these countries have acquired the outer appearance of modern government but very little of the substance,' he said. 'They have councils of ministers, but half the ministers are members of the ruling family. Loyalty is the only basis for the distribution of wealth and power. Corruption at the top is unquestioned. There is no debate on what constitutes national interest; no perception of what the ruled want from the rulers. If anything at all, the oil money has widened this gap. I predict serious upheaval in every one of these states in the next decade.' (Ibrahim, p. 48)

In Iran, the Shah's downfall could be attributed to the fact that he executed or caused to disappear approximately 60,000 of his countrymen during his reign (Le Monde, Nov. 26, 1979, p. 1). Using Iran's 1974 population as a base, one person out of 566 Iranians disappeared during the Shah's era. Nearly everyone in the large cities must have known at least one such person. A more abstract explanation for the Shah's demise has to be the accelerated social, economic and military changes encompassed in his autocratic policy of westernization. Finally, the connection between the Shah's imperial dreams and American foreign policy, and American oil companies is straightforward. Opposition to the Shah came from several uncoordinated groups--nationalists, socialists, communists, and fundamentalist Moslems--that apparently can agree upon at least two things, their hatred for the Shah and American interference in the internal affairs of Iran.
One should not overlook the impact of our Middle Eastern foreign policies upon our own economy. Figure 5 displays an annual index of producer prices for energy in the United States between 1951 and 1978. The correlation with Saudi prices in Figure 1 is immediately obvious. For nearly 20 years, the American economy enjoyed nearly constant energy prices. Given that oil is an exhaustible resource in relatively fixed supply, this price series up to 1970 did not reflect the long-run supply situation. Nor did it reflect the institutional strife that was brewing in the oil industry. The majors regularly expanded supply from the Middle East to meet demand at relatively stable prices. The result was a massive misallocation of resources in the United States and other industrialized nations due to underpriced, freely available oil.

In retrospect, it appears that whatever extra profits the oil industry earned through cartel pricing schemes prior to 1973 were not as damaging as the political interaction that the structural configuration of the oil industry attracted and made feasible. Western governments could order or tacitly encourage large oil companies to break a Middle Eastern nation's economy by boycott in the 1950s. Conversely, the companies could also bargain from a position of power with these governments. The majors' private concerns for limiting competition from independents in the Middle East were deemed in the "national security" of the United States. The necessity, if not the power of large companies to pay meager revenues to the oil producing nations--even to lower them--ignored the long-run implications of such exploitive policies. And Western foreign policy in the Middle East ignored or at best dealt inadequately with the implications. After World War II, the skill levels in political organization, economics, engineering and other subjects improved with the
Figure 5. U.S. Producer Price Index for Energy: 1951-1978.*

*Energy consists of fuel, power and related products that are refined from petroleum.

return of increasing numbers of students from American and Western European universities. Shiek Yamani, for instance, has an advanced degree in economics from Harvard University. Some of these professionals moved into OPEC staff positions. Rather than expel the "imperialist" companies, as Arab propaganda often demanded, OPEC preserved their dominance, assumed control of pricing and redirected the "imperialist" companies at the industrialized and oil dependent Western nations.

From the viewpoint of both the industrial and oil exporting nations, the policy failure occurred before 1973. If a different set of pricing institutions had been developed for both the domestic and world oil markets, the outcome might have been dramatically superior to our current condition. The multinational oil companies cannot and should not be made the scapegoat for this policy failure. To a certain degree, one must implicate Western governments and our basic theories on economic policy, most notably the prevalent thinking during the post-war era on social control over private power and international trade. Nonetheless, the large oil companies were undoubtedly a substantial hurdle to reforms in world oil marketing systems that would have diminished their position or power.

How could the performance of the oil marketing system have been improved? An earlier recognition of national sovereignty concomitant with structural initiatives to establish a more competitive oil industry might have channeled OPEC's efforts towards a more moderate price policy consistent with their original aims. Deconcentration in the oil industry would have insured that nationalized oil has access to processing and marketing channels but not controlling positions in them. Without deconcentration, the outcome would most likely resemble our current situation. If the sovereignty and deconcentration approach had been applied in the
1950s, prices probably would not have been relatively flat and then explosive.

Short-run surpluses or shortages may still be a problem in the competitively structured industry. An international regulatory commission representing both producing and consuming nations could have been formed under U.N. auspices to stabilize the market in an equitable fashion that would not mask the long-run supply and demand forces.

Such approaches are now being considered for other world commodity markets. The United Nations Council for Trade and Development (UNCTAD) drafted the Integrated Program for Commodities in 1974. It consists of five basic features: the establishment of international buffer stocks of commodities; the creation of a common fund for the financing of those stocks; arrangements to compensate for fluctuations in export earnings; multinational commitments on individual commodity schemes; and proposals to increase processing facilities and diversification within the developing countries (Belassa, 1980; Huddleston, 1977).

The program's comprehensive and systematic approach to commodity trade matters is intended to stabilize wild price swings in international markets and to provide a "trade not aid" vehicle for development in third world countries. This approach is central to the developing countries' push to create the "New International Economic Order" that they first proposed at the United Nations in 1974. Its similarity with OPEC's initial demands during the early 1960s is striking.

VI. THE IRANIAN REVOLUTION: EMBARGOES ANEW

Even if the downfall of the Shah was inevitable and was associated with a dangerously narrow foreign policy for 25 years, that insight is cheap counsel for the American President in power when it happened. Ini
tially, the Carter Administration avoided strong pronouncements. It discreetly coped with events within the context of its "new leaf for American foreign policy"—advocating human rights, popular sovereignty, and democracy. Peter Jay, the former British Ambassador to the United States, recently gave the Administration high marks for its conduct and noted the difficulty of the situation.

Perhaps the clearest lesson of the ongoing Iranian crisis is the great difficulty of trying to practice good (policy) in the wake of two decades of bad policy. Those two decades of excessive reliance on the Shah and his politically unrealistic programs had led to a situation from which no strategist would have chosen to start out (Jan., 1980, p. 506).

Indeed the Administration's first initiative was not auspicious. It dispatched the Secretary of Defense to Saudi Arabia to explore strengthening military ties, thinking that external security would be the principal anxiety of the Saudis. It was otherwise. To the Saudis, Iran illustrated the explosive danger of fusing Arab radicalism and anti-American Islamic fundamentalism. The remedy, they submitted, lay in resolving the issue that unified Arab radicalism and Islamic anti-Americanism—the problem of a homeland for Palestinians. Events in Iran convinced the Saudis that for their security they had to move to a hardline position on the Palestinians' rights for an autonomous state. Implementing the Camp David accords between Egypt and Israel in a fashion acceptable to the Palestinians, and at the same time guaranteeing Israeli security, therefore became a more urgent goal for American foreign policy.

Progress towards resolving the Palestinian issue suffered a severe setback when Iranian militants seized the U.S. Embassy and its staff. Ostensibly, the Shah's arrival in New York for medical treatment and demands for his extradition triggered the action. But this veneer has worn
thin, for it is increasingly clear that the Iranians "apologies" from the United States and "promises" of noninterference in their internal affairs. That an American President would not turn the other cheek is not surprising, especially when it is an election year and the T.V. evening news was showing thousands of Iranians chanting "Death to Carter." The hostage crisis is replete with paradox and irony. Iran is now interfering in the internal affairs of the United States!

American-Iranian economic relations were not immune to the political crisis. The revolutionary government threatened to withdraw all Iranian assets from American banks. In response, the President froze Iranian assets and sought passage of trade sanctions by the United Nations Security Council against Iran for violation of international protocol and law. The freeze was reluctantly accepted by the banking community (Arens- son, p. 23) and the embargo was vetoed by the Soviet Union in the Council. When the Western European countries and Japan reacted very coolly to a joint embargo by Western industrialized nations, the President decided to unilaterally impose sanctions. American shipments, except for food and emergency medical supplies, were to be embargoed. In addition, the Administration strongly implied that the U.S. would resort to military action --possibly a blockade-- if Iran put the hostages on trial or harmed them.

The Russian invasion of Afghanistan brought the specter of superpower confrontation directly into the Middle East crisis. Why did the Russians take such a risky and aggressive step? Was it because no one could stop them; they want to take over Iran; they seek to inhibit the spreading of religious fundamentalism among the 40 million Moslems living in the Soviet Union; or they view it as a step towards a warm water port? The American press has commonly cited one or all of these reasons, but they are not entirely convincing explanations.
On the first point, the Soviets have always had the opportunity to invade Afghanistan, and the United States has never had the military capability of stopping Russian tanks and infantry from crossing the Soviet Afghan border. It does not explain why they chose to invade in December 1979. If the Russians wanted to take over Iran, they could have invaded that country directly across the Soviet-Iranian border. Why incur the wrath of the Afghans? In fact, the Soviet Union did send troops into Iran immediately after World War II, but later withdrew them. Keeping religious ideas from Soviet Moslems is also a weak explanation for Soviet aggression. Western diplomats and journalists who have traveled in the Moslem Republics of Soviet Central Asia and the Caucasus report that the Soviet system of education and substantial improvements in living standards during recent years have reduced religion to a minor concern in the lives of the average citizen (Austin, 1980, p. 14).

The final proposition, that the Soviets seek a warm water port, may have some long-term validity; however, the most plausible explanation for intervening in Afghanistan centers upon the geo-political situation of the Middle East. The danger, as the Kremlin saw it, was the disintegration in strategic terms of a historic buffer zone along one of its borders (Austin, 1980, p. 14). Put more directly, it is highly probable that the Soviets moved into Afghanistan in reaction to stated and contemplated American actions against Iran. They did not want to witness a repeat of a 1953 counter-revolution backed by the United States. Nor did they wish to see the weak Marxist regime in Afghanistan topple to religious fundamentalists.

This interpretation is supported by the ambivalent reaction of Iran's President Abolhassan Bani-Sadr to the Russian intervention. On
February 11, in an interview with *Le Monde* reporter Eric Rouleau, Bani-Sadr responded:

I don't know if (the Soviet invasion) is related to the situation in Afghanistan or whether it actually constitutes pressure on the Iranian government. In any case, I have transmitted some advice to Mr. Brezhnev through the Ambassador of a friendly country: pull your troops out of Afghanistan as soon as possible, or else you will lose all credit in the eyes of Iranians. My fellow Iranians have wanted to forget the past behavior of the Soviets, notably when they did not oppose themselves to the CIA coup in 1953 that re-established the Shah on his throne. (Rouleau, p. 10)

In the same interview Bani-Sadr emphatically reaffirmed his desire for a Moslem republic independent of both superpowers, particularly on the ideological level. "Mixing marxism and Islam," he said, "will not be tolerated."

A countervailing power explanation also accurately predicts U.S. post-invasion policy. The Administration's language became conciliatory. More important, they did not implement the embargo. The reversal was primarily due to fear of pushing Iran into the "Soviet camp" or further destabilizing Iran's internal politics, and advancing the course of leftists who might "invite" Russian intervention. It appears that recent events are converting Iran from an American client state into a buffer state between the superpowers, albeit a very complicated buffer because of its open affection for Yasser Arafat, the P.L.O., and Arab radicalism. Iran's hopes and aspirations seem to be centered on not only neutrality but also an activist, ideological leadership position in the Middle East. What this portends for more secular concerns such as trade and oil sales to Western Europe, Japan and the United States is not clear at this time.

As with the hostage crisis in Iran, when the Russians invaded Afghanistan, the Administration could not allow the opposite side to have the
final move. Shortly after the invasion, which was a reaction to American reaction to the hostage predicament, still another reaction became public—the American partial embargo on trade with the Soviet Union. One cannot ignore the influence of domestic American politics on this decision. An American President whose ratings in the public opinion polls were nearly off the bottom of the scale at the outset of this foreign policy imbroglio could not afford to back down or appear to have backed down in the face of Russian aggression against an independent nation. It would be too costly even if the Administration thought, which they did not, that the Russians made a fatal miscalculation when they decided to take on the fiercely independent and bellicose Afghan tribesmen. Concerning this unwritten rule of American political conduct, it is legitimate to ask whether we are not more the victims of our own fears and frustrations augmented by the news media and the extended 12-month process of electing a president than we are the victims of the Russians. This question addresses more than a minor technicality. The Korean War embargo lasted 20 years, and the current embargo is to remain valid until all Russian troops are removed from Afghanistan.

The new embargo against the Soviets was an amalgamation of several independent policy actions. It cut Aeroflot flights to the U.S. from three to two per week. It banned Soviet fishing in American waters—an action that will reduce Russian fish supplies by 3 percent. It deferred new cultural and economic exchanges. It prohibited Soviet scientists from attending professional conferences in this country. It closed the Soviet consulate in New York. It put an import quota on ammonia imports to the U.S., something the domestic fertilizer industry wanted for some time to stop alleged dumping of "cheap" fertilizer in the U.S. market.
Ammonia is used to make nitrogen fertilizer. The price of ammonia rose 25 percent last year and will probably increase at an equal rate this year due in part to the quota. The embargo also cut off sales of high technology equipment to the Soviets. Finally it cut off all agricultural exports beyond the contractually agreed upon 8 million metric tons per year of wheat and feed grains.

Total American exports to the Soviet Union were slightly over $3.0 billion in 1979. This amounts to 5 percent of Soviet imports and less than 2 percent of American exports. Grain shipments totaled $2.6 billion in 1979, accounting for approximately 80 percent of our exports to the Soviets. Thus one can with justification limit analysis of the embargo to its influences via shifts in the Soviet and American agricultural sectors and shifts in the world grain trade.

During the week before the President announced the embargo, grain markets were generally stable because most individuals with positions in the market felt that the rumored embargo was not within the practical realm of choice. The 1977 Food and Agriculture Act was generally believed to require 90 percent of parity price supports if the government embargoed grain exports. Ninety percent of parity--$5.57 for wheat and $3.86 for corn--would be too stiff a price to pay. Also the President and other Administration officials had repeatedly promised that food would not be used as a "political weapon." The standard metaphor was, "using food as a diplomatic weapon made as much sense as shooting oneself in the foot." In addition, domestic political observers pointed out that it would be politically disastrous for the President to move against farmer interests given the importance of the impending Iowa caucus.
But he did, and he did it with such finesse that nearly everyone was left gasping for breath. The President, in the face of great adversity at home and abroad, embargoed 17 million tons of grain shipments scheduled for delivery to the Russians. Some grain marketers were embarrassed, and many were poorer when they reread, or perhaps read for the first time, the 1977 law to see how the embargo sidestepped 90 percent of parity prices. The Act stipulates:

...Whenever the President...causes to be suspended, based upon a determination of short supply, the commercial export sales of any commodity...the Secretary of Agriculture shall set the loan level for such commodity...at 90 percent of parity... (Food and Agriculture Act, 1977, Section 1002)

This embargo, unlike the earlier episode in the 1970s, is not due to short supply.

To prevent leaks to the public, very few government staff persons contributed to the embargo decision, hence ONLY the most basic legal and economic analyses were available in advance. This caused some confusion within the Administration immediately after the embargo announcement. At his first post-embargo news conference, the Secretary of Agriculture stated:

"The grain embargo was not a case of using food as a diplomatic weapon, which President Carter promised he would never do. Food becomes a weapon when you deny it to the people of a hungry nation." (New York Times, January 6, 1980)

The Secretary continued by explaining that the embargo would not cause any hunger in the Soviet Union, therefore food was not being used as a political weapon. The official U.S.D.A. explanation was more polished; it discreetly avoided the political issue by citing the President's legal authority under the Export Administration Act of 1979. (USDA News Release, 46-80, January 5, 1980)
One might pause for a moment and ask exactly what is at issue here. The influence of domestic politics on our food policies is not new. Similarly foreign and trade policies such as tariffs, export subsidies, quotas and P.L. 480 have influenced and continue to influence our food system's performance. Even the use of food as an aggressive weapon in foreign policy is not new. The strategic goods embargo included food items; also, as Emma Rothschild (1975) and others have argued, P.L. 480 shipments are often used to reward client states (yesterday South Vietnam, today Egypt) and withheld from others. In sum, then, the issue cannot be the intrusion of politics upon our agricultural economy. Rather it is the sudden reversal of policy and the costs and benefits attendant upon such an unexpected reversal.

Stakeholders in the U.S. grain marketing system were concerned about the substantial economic losses that could result from a prohibition of shipments to the Soviet Union. Grain exporters in other nations had similar concerns. Taxpayers and consumers were less vocal in their concerns over the embargo's impacts on higher government outlays and domestic food prices; yet, they were, at the very least, apprehensive. Beyond pocketbook fears, everyone was eager to know what impact the embargo would have upon the Soviet Union. Let us now turn to an evaluation of these concerns.

The Administration realized that it could not declare an embargo for "national security" reasons without taking immediate offsetting actions to protect the domestic grain economy. Otherwise several grain marketing firms would have defaulted upon contracted purchases and a rash of bankruptcies could have soon followed. To prevent this eventuality, the U.S.D.A. moved to consolidate control over at least 17 mmt. of grain in
order to mitigate the impact of the embargo on price and sales opportunities.

Table 1 is an accounting summary of U.S.D.A. short-run moves to offset the price impact of the trade suspension. For wheat the U.S.D.A. made a direct offsetting purchase to remove all of the embargoed grain from the market. It is now earmarked for an international emergency food reserve. Offsetting actions for corn were more complicated because it involved larger quantities of grain. U.S.D.A. purchased 5.9 mmt, at an auction on February 4th. A major sweetening of the incentives for placing grain in the farmer-owned reserve program will result in estimated placements of 7.6 mmt. These two changes predict that available corn will decrease .5 mmt. If corn does not flow as rapidly as expected into the reserve, U.S.D.A. can purchase more corn by accepting delivery on some of the Soviet-destined export contracts that it assumed from grain traders. These contracts cover 10.8 mmt. of corn and give the government more than adequate leeway to influence flow of corn to market or into storage.

There are, however, disadvantages associated with using the government purchases policy instrument. Such grain under current law cannot be sold until market corn prices are above $3.05/bu. This price is substantially higher than the embargo price that the government seeks to protect--$2.40/bu. and even above the price that triggers releases from the farmer-owned grain reserve--$2.63/bu. A less expensive strategy for the government to pursue might be to pay growers for diverting acres from corn production in 1980. Lowering corn acreage would reduce the projected 1980 harvest and support present as well as future corn prices without forcing the government to store larger amounts of grain for extended periods of time. On March 1, 1980, however, the U.S.D.A. announced that there will
Table 1. Changes in Available Supply of U.S. Grain During 1980
Attributable to the Grain Embargo

<table>
<thead>
<tr>
<th></th>
<th>Wheat</th>
<th>Corn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of Grain not to be Shipped to U.S.S.R.</td>
<td>4 mmt.</td>
<td>13 mmt.</td>
</tr>
<tr>
<td>U.S.D.A. Direct Purchases</td>
<td>4 mmt.</td>
<td>5.9 mmt.</td>
</tr>
<tr>
<td>Estimated Placements in Farmer-Owned Reserve</td>
<td>-</td>
<td>7.6 mmt.</td>
</tr>
<tr>
<td>Preliminary Net Change</td>
<td>0</td>
<td>-.5 mmt.</td>
</tr>
<tr>
<td>Contracts Under U.S.D.A. control</td>
<td>-</td>
<td>10.8 mmt.</td>
</tr>
<tr>
<td>Final Net Change</td>
<td>0</td>
<td>Less than -.5 mmt.</td>
</tr>
</tbody>
</table>
be no diversion program for 1980 corn. They reasoned that a cutback in production might combine with poor yields to trigger a shortage and higher prices—something to be avoided in our inflationary era. In the interim, they will continue to influence prices via their control over grain previously destined for the Soviet Union.

Supply control initiatives influence market prices, but the amount of price buoyancy gained from whatever action the Administration takes depends, among other things, upon the U.S. position in world grain markets. Can and will other supplying countries bring grain out of storage or grow more to offset American stockpiling? In the short run, other producing nations have little leeway because they have allowed the United States to store, manage and pay for most of the exportable annual carryover. They do not have appreciable stocks of grain from which to make sales. Also there are transportation bottlenecks that limit the ability of some other nations to expand supply in the short run. Once one looks beyond a marketing year, expanded production by other countries can be problematic, and the question of volition becomes more important. Will other producers "cooperate" over the long run?

The question of cooperation is even more complex. Until this point, we have only discussed, in a general fashion, the actions and ability of the U.S. government to limit supply and raise prices. But the current policy goal is complicated by the fact that demand was reduced by a unilateral American declaration of an embargo on an importing country. Will others cooperate not only to limit supply, but also to limit supply to the Russians? After all, that is the professed Administration policy objective. American efforts to obtain such cooperation are an attempt to cartelize the world grain trade. The cartel label is appropriate and
reasonable because the benefits of this action, if successful, would accrue to producing nations and not importing nations, most notably not the Soviet Union.

Whether a grain cartel among exporting nations will succeed depends primarily upon the supply-side structure of world grain markets. Table 2 presents the export volumes and market shares for leading exporters of wheat and coarse grains. Clearly, the U.S., in quantitative terms, dominates the world grain trade. Combined with its political, military and general economic influence, its large share in grain markets gives the United States substantial power to discipline other exporting nations, multi-national grain trading corporations and importing nations who might contemplate reselling grain to the Soviets. But nearly everyone doubts that the influence of the U.S. government, as substantial as it may be, is adequate to enforce a cartel policy against the Soviets. Even if American power was sufficient to punish countries or firms who would sell to the Soviets, the export monitoring and market intelligence capabilities of the U.S.D.A. within the framework of their current legal authority and staffing fall short of what is needed to enforce a cartel. The multi-national grains firms are in a better position to monitor the flow of trade than are governments. Experience in the oil industry suggests that "cooperation" between the companies and the governments of exporting nations would be a first step towards successful cartelization. Since such commonality does not exist, and for the other reasons cited, the question is not whether noncompliance will occur, but when will it occur.

The Argentine government announced soon after the embargo that it does not have and will not seek legal authority to determine where private trading firms sell Argentine grain. In fact, its recent behavior
Table 2. Export Volume and Market Shares for Trading Exporters of Wheat and Coarse Grains (Corn, Barley, Millet and Sorghum): 1977

<table>
<thead>
<tr>
<th>Rank</th>
<th>Coarse Grains</th>
<th></th>
<th>Wheat</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Quantity mmt.</td>
<td>Market Share (%)</td>
<td>Rank</td>
<td>Quantity mmt.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>1</td>
<td>51.3</td>
<td>59.0</td>
<td>1</td>
</tr>
<tr>
<td>Argentina</td>
<td>2</td>
<td>9.5</td>
<td>10.9</td>
<td>5</td>
</tr>
<tr>
<td>Canada</td>
<td>3</td>
<td>4.1</td>
<td>4.7</td>
<td>2</td>
</tr>
<tr>
<td>South Africa</td>
<td>4</td>
<td>2.3</td>
<td>2.6</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>5</td>
<td>1.8</td>
<td>2.1</td>
<td>3</td>
</tr>
<tr>
<td>France</td>
<td></td>
<td></td>
<td></td>
<td>4</td>
</tr>
</tbody>
</table>

Total for Leading Five Countries: 79.3 for Coarse Grains and 86.0 for Wheat

Total Gross Exports: 87.0 for Coarse Grains and 74.4 for Wheat

Source: Mitchell (1980)
indicates that the United States has gained no unique leverage over other exporters by injecting confrontation politics into the world grain trade.

Welcoming the Russian buyers to Buenos Aires, (the Argentines) boosted prices and offered to make good for Moscow at least part of the embargoed North American grain, unless Washington stops it wrist-slapping over the thousands of Argentinians tortured or listed as "missing" by human rights groups. (New York Times, February 3, 1980, p. 2E)

This amounts to noncompliance with the embargo by our largest export competitor in feed grains. As harvest time nears, other exporters facing domestic pressure to export grain may also break the embargo, not to mention intermediate countries and traders who may seek gain through arbitrage.

Only the unfolding of events will resolve these contingencies. Indeed the outcome of the embargo is even less certain, for it also depends upon Soviet reaction. Table 3 classifies outcomes into three broad categories depending upon the responses of the non-Soviet grain trade, and the Soviet economic planners. For purposes of analysis it assumes that the U.S.D.A. only seeks to offset suspended Russian shipments by removing 17 mmt. of grain, and that other factors influencing grain prices are constant.¹

The Administration has targeted the embargo to damage the rapidly expanding animal agriculture of the U.S.S.R. Both outcomes 1 and 2

¹As this report goes to the printer it is very apparent that grain prices have been depressed by upward revisions in estimates of last year's harvest and Federal Reserve monetary policies that have pushed interest rates to historically high levels. The lack of credit has forced grain farmers to sell stored grain to obtain cash for planting costs. U.S.D.A. has not withdrawn enough grain from markets to support prices at pre-embargo levels during March and early April 1980. The Administration apparently feels that the impact of high interest rates are separate from those of the embargo and that the U.S.D.A. should not shield farmers from the oncoming recession.
<table>
<thead>
<tr>
<th>Non-Soviet Grain Trade Reaction</th>
<th>Soviet Reaction</th>
<th>Impact on 1980 Average World Price</th>
<th>Impact on Soviets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) --</td>
<td>Reduces imports 17. mmt.</td>
<td>No Change</td>
<td>Increases meat supply in short run. Lower meat supply in long run.</td>
</tr>
<tr>
<td>2) Compliance</td>
<td>Seeks to maintain import level</td>
<td>No Change</td>
<td>Same as above.</td>
</tr>
<tr>
<td>3) Non-compliance</td>
<td>Seeks to maintain import level</td>
<td>Increase</td>
<td>No change in Agr. Econ. Modest increase in foreign exchange requirements.</td>
</tr>
</tbody>
</table>
influence their agricultural economy but their differences suggest very different outcomes for world trade in the long run. Under outcome one, the U.S.S.R. unilaterally reverts to autarky (no trade). The reaction of the non-Soviet grain trade is irrelevant. There is a reduction in international trade until such time that the Soviets decide to return to the world market. Outcome 2 is the scenario predicted by Administration spokesmen. The Soviets seek to maintain imports; they would even pay much higher prices for them, but the western world stands firm. Western nations comply with the U.S. request and the Soviet people receive less meat.

U.S.D.A. estimates indicate that either of these outcomes would reduce grain fed to livestock in the U.S.S.R. between 10 and 30 percent—probably nearer 10 percent. (U.S.D.A. News Release 46-80, p. 3.) Unconfirmed sources indicate that the embargo decision was based upon CIA estimates that Soviet meat supply would be reduced between 15 and 20 percent. U.S.D.A. estimates made soon after the announcement predicted that Soviet meat supply would decrease only 4 percent.¹ The impact of the embargo will be negligible. For comparison, per capita consumption of beef in this country declined 11.1 percent in 1979 due to smaller supplies in the short run. Consumption in 1979 was also 4 percent lower than 1969. (U.S.D.A., 1980a).

One should also note that Russians in the near future would have more meat on the table as flocks and herds are cut back due to lack of feed. Therefore, if the embargo has an impact beyond symbolizing America's...
anger at the Russians, the timing of the impact is perverse. By the time Russian meat supplies begin to drop, the embargo may be swamped by other events, the most important of which may be its collapse at harvest due to noncompliance by traders eager to move grain. It would be especially attractive to deal with the Soviets, if they offered to pay a premium over world prices to sustain their agricultural expansion program.

Under either outcome one or two, the impact on the U.S. economy will be as predicted by the Administration. Farm income will be only slightly lower due to temporary transport blockages and associated low cash grain prices. Federal expenditures of between 2.5 and 3.0 billion dollars would remove the embargoed grain from the market, much of it moving under government ownership. The taxpayers would support farm income, but the net cost would be less than the stated dollar amounts because acquired grain is an asset, saleable in the future. Agricultural exports would be reduced about $3.0 billion in 1980. This would increase our balance of payments deficit, put added pressure on the dollar, and indirectly accelerate domestic price inflation. The direct impact on inflation through increased food prices would be negligible.

The third outcome respects the powerful incentives for nations and businesses to benefit from trade in spite of national political differences, and in spite of third party attempts to restrain trade. In this scenario, the Russians remain active in the world grain markets. As they offer higher prices, an increasing number of traders respond by selling directly or indirectly to them. The Soviets bid away with enough grain to sustain planned meat production levels. An increase in world price would have little effect upon the internal Soviet economy because it is centrally planned and prices for consumer goods do not reflect changes in
supply and demand. Russian consumers, in short, would not pay higher meat prices. There would be a modest increase in foreign exchange requirements, but another effect of the Middle East crisis, the recent appreciation of the Soviet Union's large stocks of gold, could easily cover this additional outflow.

In the United States, an increasing world price increases farm income and reduces taxpayers' expense. Although we would export less grain, the price rise would most probably be large enough to insure that the dollar volume of exports actually increases during fiscal 1980. Our balance of payments would improve, the dollar would strengthen, and indirect pressures on inflation would be lower. Direct inflationary pressure through rising food prices would be higher.

Even though the Administration's official rationale centers upon outcome two, "punishing the Russians who want our grain," they are actually looking over their shoulder at the short-run political and economic benefits associated with the more likely scenario--outcome three. U.S.D.A. estimates that corn exports will decrease only 9 mmt. (U.S.D.A. News Release, 162-80, p. 12.) There will be some slippage and additional sales due to increased sales promotion efforts. The government's announced initiatives (see Table 1) will remove more than this amount from the market. Therefore prices will be higher than they would have been without an embargo. Speaking to wheat growers on January 15, 1980, Howard Hjort, Chief Economist of the U.S.D.A., emphatically pointed this out:

If there were panic in our markets and people start selling cheap, these programs won't work...I know that none of us has any experience with this kind of a situation. Never before have all the stops been pulled to try to offset a suspension action. Since our experience with previous suspensions or restrictions on exports was that prices went down--and since those actions were taken to move prices down--we are faced with an alarmist psychology. Believe me, prices do not have to fall. The
package of actions now moving into place is strong enough to
more than offset the suspension actions. But let me emphasize
once more, it takes all of us to make them work. (U.S.D.A. News
Release, 162-80, p. 13.)

When U.S.D.A. spokesmen talk to farm audiences, they seem to base their
thinking upon a combination of the third scenario and their supply control
initiatives. To the extent that the Russians and non-cooperative grain
traders do not bid up price, U.S.D.A. will withhold grain to insure that
prices rise. Welcome to the world of heads we win, tails they lose. It
really doesn't matter whether the embargo works, the short-run costs are
within the control of the U.S.D.A. The fact that the Administration sent
such well-aimed spokespersons to Iowa immediately after the embargo ex-
 plains in part why 60 percent of the voters in that Corn Belt state
supported the President one week after the embargo and 59 percent of the
Democrats voted for him 2 1/2 weeks later at their Presidential caucuses.

Having covered the possible short-run costs and benefits of the
grain embargo, there remains the question of more permanent impacts. One
line of thought is that the embargo--a supply-side action--doesn't mat-
ter. Whether it works or not is irrelevant because demand is growing very
rapidly from a world hungry for food grains and the animal protein avail-
able from increased use of feed grains. This observation is understand-
ably hoped for and attractive among grain farmers and traders. Yet demand
becomes effective demand only when purchasers have income and foreign
exchange with which to purchase grain imports. Moreover, even if effec-
tive demand "from a hungry world" expands strongly so that American far-
mers can sell to others, the embargo results in producer losses unless a
specific and improbable situation arises. Not only must demand from other
sources rise, these new buyers must also be willing to pay more than the
Russians would pay for American grain. The "doesn't matter because of a
"hungry world" view in its present form predicts that the Russians would have been squeezed out of the market during the near future, hence the embargo does no harm. It is wishful thinking in the extreme, and depends upon an unrealistic view of world supply trends as well as demand conditions.

On the supply side it conjectures a Malthusian view of the world. Limits on land and other physical resources prevent the supply of food from expanding in response to real price increases. In its most reductionist form this reasoning bets upon the uniqueness of the rich soils and production agriculture of the American Corn Belt. Theodore Schultz, an agricultural economist who recently received the Nobel prize in economics, pointed out that over the long run this is an unattractive wager.

We have learned that agriculture in many low-income countries has the potential economic capacity to produce enough food... the decisive factors of production in improving the welfare of poor people are not space, energy and cropland...most observers overrate the economic importance of land and greatly underrate the importance of the quality of human agents. (Schultz, 1979, p. 2)

It stands to reason that the Soviet Union would react to this embargo by accelerating attempts to expand and stabilize its own agricultural production. Agricultural research and development has very high priority in the U.S.S.R.

In no (research) area is the gap (between the United States and the Soviet Union) widening more rapidly...The number one research and development priority for the Soviets is defense and the arms race. The second is for the enhancement of the magnitude and stability of agricultural production...There are approximately 60,000 agricultural scientists in the U.S.S.R. ...This compares with 12,000 agricultural scientists in the U.S.A. receiving public support...(plus) approximately an equal number from the private sector. (Wittwer, 1980, p. 1)

Although quantity is no substitute for quality, these numbers suggest that the Soviets are working to solve the two most serious production
problems facing their agriculture—lack of water and a short growing season. The embargo can only enhance the pay-off from large-scale attempts to divert Siberian rivers that flow north towards the arid steppes of the South. Research on hardy plant varieties to withstand wider variations in the weather and short season varieties also bear a more valuable pay-off now.

Even if the Soviets cannot expand their production other nations may do so, and the Soviets may enhance their efforts by purchasing from them. They could sign long-term purchase agreements as they did with the United States in 1975. Argentina, Brazil and France may be especially responsive to Soviet import needs. A recent review of the French economy illustrates just how attractive such an offer could be.

"One bright spot in the French economy is agriculture...the value of agricultural exports has recently reached as high as $1.5 billion annually and the Government hopes to increase that sum to around $5 billion in a couple of years, if only to offset some of the costs of oil imports. In fact...economic journalists already are calling French agricultural production "green gold." (Priail, p. 42)

Exporting wheat and barley to the Soviet Union would be a lucrative long-term benefit for the French. Such support for the French farmers might also help to dislodge stalled negotiations on the revision of the common agricultural policy of the E.E.C.

In another fashion the embargo combines with the previous American embargo on food exports to send an ominous message to importing nations. Although the United States is capable of supplying food, it may consciously choose not to supply it. This encourages importing nations not only to look elsewhere, but also to resort to increasingly protectionist policies to enhance their own agricultural production. The economic and political risks of being dependent upon the world market become
too high. Therefore the embargo will not only reduce our exports to the 
Soviet Union, it may also marginally reduce the growth rate if not the 
absolute level of our exports to other nations (Thompson, 1980, p. 1031).

The most recent example in history of a simultaneous shift by all 
nations to protectionist policies occurred during the inter-war period. 
Figure 6 illustrates the impact of those policies on agricultural trade. 
The value of food exports plummeted from approximately $900 million to a 
low of $204 million in 1933. Theodore Schultz authored a pamphlet in 1935 
entitled Our Vanishing Farm Markets and World Trade. Schultz attributed 
the decline to mistaken public policy by farm interests, and clearly 
placed the blame upon high tariffs and the industrial cartels that bene-

fitted from them.

Since farmers generally believed that the sudden collapse of 
farm prices in the fall of 1920, which continued into 1921, was 
due largely to the threat of imports...Congressmen from the 
farm states at once insisted on higher tariffs. Much to their 
surprise, representatives of the industrial east were only too 
glad to join hands with the spokesmen of agriculture in a gen-
eral raising of tariffs...Behind the high tariff wall erected 
at that time, manufacturers of chemicals and dye-stuffs, among 
others, grew large, monopolistic and opulent. The considerable 
literature rationalizing and advocating ultra-nationalism is-

sued currently by some chemical interests suggests that spokes-
men for this industry, at least, are fully aware that foreign 
trade means both buying and selling. Moreover, they realize 
that if American farmers actually again seek to sell their 
surpluses abroad, tariffs will have to be lowered in order to 
permit a larger volume of foreign wares to be sold in this 
country. Therefore, the industrial interests of this type ad-
vocate economic isolation, which chiefly reflects a vested in-
terest in existing tariff subsidies. (Schultz, 1935, p. 8)

Then as now different interest groups in society benefit or lose when an 
economic policy is promulgated. Apparently most Congressmen found pro-
tectionism attractive in 1930. They did not realize that beggar-my-
neighbor trade policies would harm all Americans as aggregate demand
declined due to shrinking international trade. Upon passing the Smoot-Hawley tariff in 1930, one of its sponsors is reputed to have seen protectionism as the solution to unemployment. He proclaimed "within six weeks the depression will be over" (Fetter, 1943, p. 478).

The 1970s have seen renewed application of such dangerous logic. Some observers thought that protectionist pressures in many nations recently peaked; however, they continue to mount and are building upon an already very high level of protectionism.

...More than 46 percent of world trade is controlled by governments through tariffs, quotas and other barriers--up from 40 percent in 1974...protectionism is no longer unrespectable (Revzin, 1980). The same article reports that 50 percent of developing countries' manufactured exports already have to contend with import controls in the industrialized world. If protectionism continues to grow coupled with are facing in the early 1980s, demand for U.S. agricultural exports will not be as robust as that predicted by many market analysts.

Figure 6 also illustrates the trend of exports during the post-World War II era. Although one cannot claim that the advent of the strategic goods embargo was the sole cause for stagnation in the series during the 1950s, the opportunity of trade with Eastern Europe and the Soviet Union certainly would have increased our exports and provided some relief for the farm income problem of the era. The impact of detente via agricultural exports to Eastern Europe and the Soviet Union and periled by in 1973 was dramatic. One should note that it was the same year that oil prices exploded; this was hardly coincidental. The United States needed the income from increased food exports to offset oil imports. Food exports doubled in value the stagflation we between 1972 and 1973, from
Figure 6. Value of U.S. Food Exports: 1925 - 1978.*

*Includes food, feed and beverages

$7.5 billion to $15.2 billion. Selling to the Comecon nations clearly shifted our export sales to a higher, more valuable growth path. Assistant Secretary of Agriculture, Dale Hathaway, also noted as recently as August 1979, that the most rapidly growing markets for exports are the developing countries and the centrally-planned countries (Hathaway, 1979, p. 1019). This suggests that the recent embargo, if effective, will not only cause our export trend line to shift down, it will also dampen the rate of growth.

Hathaway’s observations were corroborated by Mr. Jeffrey Gain, Executive Director of the American Soybean Association, in a speech at a conference on Agricultural Trade, held at Purdue University during February 1980. U.S. soybean exports to the U.S.S.R. in 1980 were projected to be 1.3 mmt. Gain estimates that shipments would have expanded to 3 mmt. by 1985 if the embargo had not been imposed. This amounts to a 231 percent increase in soybean shipments. Total U.S. exports of oil, meal and beans were 19 mmt. in 1978.

The Soviet Union is not our largest export customer. Figure 7 breaks down the value of U.S. agricultural exports by destination. Japan, for example, is a much more important customer. But the Soviet Union is important at the margin, and prices for all quantities are set by the marginal units traded between buyers and sellers. A relatively small change in quantity traded can produce a significant impact on price and total value of exports. Figure 7 illustrates this proposition. The dollar value of increased exports to the Soviet Union in 1973 is only a small proportion of total export value, but it was this increment to exports that caused prices to shift strongly upward, and more than doubled the value of agricultural exports. The loss of an export market therefore
can influence the value of exports by resulting in weaker prices as well as lower quantities traded.

Over the long term, some of the Administration's other initiatives may replace the Soviet shipments. P.L. 480 shipments will be increased .45 mmt. this year and next. Export credits are also being increased to $1.8 billion this year and another $200 million next. Even if continued, neither of these efforts at their current levels of operation account for a significant amount of the shortfall in exports to the Soviet Union. Gasohol plants supported by Federal tax credits, loans and loan quantities may be able to absorb up to 5 mmt. annually of corn by 1982, but one cannot attribute this development to the embargo. They were before Congress during the summer of 1979 and essentially decided before the Administration declared the embargo (Congressional Quarterly, October 20, 1979, p. 2321).

The long-run implications of the embargo for foreign policy are in the main lackluster. The Europeans, more dependent upon trade, have predominantly unfavorable memories of the strategic goods embargo unilaterally imposed upon them by the United States at the advent of the Cold War. They hardly find the recent unilateral action against the Soviets more attractive for it raises the spector of a renewed Cold War. Chancellor Schmidt of West Germany speaks for most Europeans when expressing his views on this subject.

One of the necessities of the alliance as well for us Germans is to get along with the eastern power. We don't want to get back into the cold war. There is nothing to be gained for the Germans in a cold war, divided as our nation is, divided as our capital of Berlin is, nothing to be gained from a new cold war period. A return to the cold war is still thinkable; I hope it doesn't occur, but we have not passed the point of no return as yet. (Schmidt, 1979)
FIGURE 7

Where We Ship Our Agricultural Exports

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20 —

10 —

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<table>
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<tr>
<th>Fiscal Year</th>
<th>1970</th>
<th>72</th>
<th>74</th>
<th>76</th>
<th>78</th>
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<tr>
<td>Asia, excluding Japan</td>
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<td>Japan</td>
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<td>Canada</td>
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<tr>
<td>Eastern Europe</td>
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For Western Europe, detente with the East is an essential condition of its prosperity as well as its peace of mind. Trade with the Comecon nations is an important and growing component of their economies. The Europeans harbor no illusions. Breakdowns in international trade in Europe have been precursors of war, not peace. Still this does not imply that they wish to appease the Russians. One prominent European newspaper editor summarized the European view as follows:

Europe will not bow to Russian pressure, it will stick with the United States. On the other hand, it would hate to see the real, if limited achievements of detente jeopardized by either the willful inclinations of the American President or the vagaries of the American political process. (Sommer, 1980, p. 633)

Whereas strong rhetoric and trade sanctions against the Russians may excite and satisfy some of the American public, they generally scare and alienate most Europeans. Basically they feel that there are more effective ways to encourage Soviet withdrawal from Afghanistan than a revival of full-scale East-West tension in Europe.

VII. CONCLUDING REMARKS

Covering the subject of embargoes and cartels from so many angles produces much information and hopefully insight into their use as instruments of foreign policy. Although the evidence can support differing points of view, it seems that in the long run the political and economic costs outweigh the benefits from such aggressive economic policies in world markets.

One could cite the world's experiences during the 1930s as evidence for this conclusion and exit from the discussion honorably. But more recent cases reviewed in this report also support the conclusion. Why
then does one continue to observe governments using them to obtain foreign policy objectives?

One answer could be that the short-run economic and political benefits are so attractive, and the future so uncertain that, **ex ante**, the government policymakers conclude that the decision to restrain trade, or condone its restraint, promises positive net long-run benefits as well. They don't see the long-term costs or write them off in favor of short-term benefits. The prevailing attitudes during the post-World War II era towards economic policy may have fostered this type of distortion.

Short run macroeconomic stabilization policies were generally thought to be adequate for sustaining full employment, growth and price stability. Yet in retrospect the evolution of pricing institutions in the oil industry--an intertwined issue of corporate power, international trade, and foreign policy--was and remains critical to economic performance and political stability throughout the world. Westerners hardly noticed the stagnant petroleum prices resulting from the cartel of corporate purchasing power and control over Middle Eastern oil prior to 1970. But oil-producing nations noticed and they formed O.P.E.C. Today's experience stands in stark contrast. Nearly everyone recognizes the impact of the radical realignment of economic forces that occurred in 1973. In the long run rising real energy prices cannot be avoided; however, the long stable price trend followed by a price explosion could have been avoided. Then the West, especially the United States, might have reduced the long-term misallocation of resources in an economy based upon intensive and extensive use of petroleum.

The policy failure commenced when Western nations were unable to restructure the world petroleum industry so that it reflected more
equitably the rights of producers as well as consumers. In 1973 the locus of power shifted to producers, and consuming nations now feel the inequities that are invariably associated with the exercise of market power by a cartel. A basic point is that neither a buyer's nor a seller's cartel in the case of an industry as critical as the oil industry is a stable solution. One can but be apprehensive as the politics and economics associated with oil unfold in the 1980s.

A second reason why governments may resort to embargoes and actually attempt to organize cartels that are net political and economic losses may be found in the political process. The average citizen has little experience and often less evidence upon which to evaluate complex foreign policy initiatives. In the heat of an election campaign politicians cannot pause to give lectures on foreign policy. The candidate that strikes the most resonant chord quickest, wins votes. This tends to produce quick, action-oriented solutions that appeal to voters. An embargo fits the bill nicely.

This is especially true for an embargo of agricultural exports to a communist country. First farmers are not a large segment of the voting public. Secondly, the government has at its disposal a complex system of federal programs which can mitigate the immediate impact of the act upon the food system. The long-run impacts can be dealt with in similar fashion in the event that export demand falters so badly that farm prices drop below cost of production. The American agricultural economy can be retracted toward the "mothball" status that it was in prior to 1973. If export demand does not falter, the long-term loss will only skim the cream from what would have been several very good years for U.S. agriculture during the 1980s. In either case this lost foreign revenue exacerbates
the U.S. balance of payments problem, diminishes our ability to pay for foreign oil, weakens the dollar, and thus exacerbates the long-term inflation problem facing the U.S.

Future export demand depends primarily upon how soon the Soviets attempt to re-enter the world market and how rapidly thereafter the unilaterally imposed cartel breaks down. It also depends in a very important fashion upon the effective demand for food from the developing nations, especially the rapidly industrializing ones. Their effective demand in turn depends upon income levels and foreign exchange earnings, both of which may be very susceptible to rising protectionism in the developed countries and the projected downturn in the world economy during the early 1980s. The embargo, itself, is an aggressive form of protectionism.

Just as an international commodity agreement between producing and consuming nations could have mitigated the explosive institutional and pricing changes in the oil industry, similar agreements might have removed the grain embargo from the U.S. administration's list of retaliatory options. Such an agreement for wheat and feed grains might guarantee the access of both importing and exporting nations to world grain markets. Access is crucial for the food security of nations that would like to increasingly rely upon food imports. It is equally important for farmers in the United States and other countries that increase investment in export-oriented crop production. This is especially true for third world countries gearing their development strategy to the foreign exchanges earnings and employment generated by primary commodity exports. In conjunction with guarantees of access to world markets, a buffer stock under the control of an international agency could take actions to offset politically motivated as well as weather-based shocks to the world food
system. Reducing the United States' role as the world's residual supplier would reduce its ability to withhold grain from other nations for reasons not consistent with the charter of a grain agreement.

The promise of international commodity agreements has in the past greatly exceeded the actual ability of nations to establish strong and effective agreements. Huddleston (1977) reviews the numerous international agreements in operation at one time or another during the past 50 years. An agreement for wheat and feed grains broke down in 1968 and has not been replaced. At the Multilateral Trade Negotiations of GATT in Geneva during 1978, the major exporting and importing nations attempted to reestablish an international program. The negotiations were not successful because of disagreement over what crops should be included. The U.S. wanted feed grains to be included as well as wheat; the E.E.C. nations did not. There also was disagreement on the specific design of a buffer stock's accumulation and decumulation rules. Much of this hinged upon harmonizing such rules with the operation of the E.E.C. common agricultural policy, and questions of who would bear the cost of a buffer stock. The current system places the cost of carrying excess stocks upon the United States--the residual supplier.

Attitudes towards international agreements may be changed by the recent illustration of how world and domestic U.S. political exigencies can rapidly influence the international grain markets with repercussions for trade that may persist long after the original political issue is settled. Americans as well as importing nations may see increased merit in removing some dimensions of food policy for the arena of national politics.
A final source of inappropriate action lies firmly lodged in the belief that the Russian leadership has a large advantage over democratic states because of their regimented control over their population and their freedom to use any means, even the most ruthless, to establish Russian hegemony over the world. How can the United States compete with an authoritarian state, without taking authoritarian actions itself? This question was even more acute at the height of the Cold War when George Kennan answered as follows:

If there is any great lesson we Americans need to learn with regard to the methodology of foreign policy, it is that we must be gardeners and not mechanics in our approach to world affairs. We must come to think of the development of international life as an organic and not a mechanical process. We must realize that we did not create the forces by which this process operates. We must learn to take these forces for what they are and to induce them to work with us and for us by influencing the environmental stimuli to which they are subjected, but to do this gently and patiently, with understanding and sympathy, not trying to force growth by mechanical means, not tearing the plants up by the roots when they fail to behave as we wish them to. The forces of nature will generally be on the side of him who understands them best and respects them most scrupulously. (Kennan, 1954, p. 93)

Kennan's plea is for intelligent analysis of cultural, military, economic and political systems and their interrelations. Then perhaps one can begin to comprehend the impact of such powerful changes as increasing education, new technology, declining or stagnant natural resource endowments, and expanding third world nationalism. If western political and economic systems serve human progress better than Soviet statism, then Americans should be confident that developing nations will pursue western ideas as well as western technology.

What is at issue here may not be the alleged tactical advantages enjoyed by the Russians. It may in fact be that Americans have yet to confidently repudiate the dire predictions of Marx and Soviet propaganda
that the capitalist economies and democratic governments of the West contain the seeds of their own destruction. Since the time of Marx, capitalism has survived many crises, and the economic well-being of working people in democratic mixed economies has improved to heights that no one writing when Marx wrote could have responsibly predicted. To escape the Mathusian dilemma as visualized during the early 19th century, a revolution was needed, and indeed we have had a revolution. But it was a technological revolution rather than the political revolution predicted by Marx. More recent criticism of our economic performance will also be most likely proven wrong by history. Contrary to Nikita Kruschev's famous prediction, for example, we have not yet been "buried" by the Soviet Union.

Kennan explicitly rejects authoritative or coercive power by a superpower as a useful foreign policy strategy. Conflict is failure rather than success in foreign policy. Rather than imitate the Russians or exact retribution for every move that an adversary makes, a more constructive policy might heed Kennan's advice. The challenges that the United States faces in the economic and foreign policy area during the next decade absolutely demand only the most carefully planned and reasoned responses. These responses must be based upon the broadest possible understanding of the issues if they are to be sound. Anything short of such effort and the consequences may bring severe economic dislocation, and open military confrontation. The stakes are very high. Hopefully there will be a compromise rather than a winner-take-all solution. For as recent history has shown in outbursts of economic warfare as well as military entanglements, even winners often lose.
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