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ECONOMIC WARFARE - THE DEFENSE

A lecture delivered by
Prof. Charles Cortez Abbott
at the Naval War College
November 9, 1948

My subject this morning is Economic Warfare—The Defense. In particular I shall address myself to problems concerning the defense of the United States and her allies—actual or potential—in the present “cold war” and in the event hostilities break out between this country and Russia.

There appear to be three distinct aspects of this subject that merit attention. In the first place, there is the protection, in a physical sense, of the United States and her allies and of the areas from which they draw essential war materials. In other words, economic defense of the United States must include defense of more than the territories within our natural boundaries. There are geographical areas important to us in the light of political and economic considerations which from the point of view of national interest must be defended. In the second place, there is the maintenance and defense of the high level economy which the United States has maintained since V-J day. The protection of this condition is necessary, partly for strictly military reasons and partly because American prosperity is of great political consequence throughout the world. In the third place, there is the ideological conflict. There will not be time to say much about this aspect of the problem this morning. I would, however, like to say at this point that under present conditions economic warfare is not simply a “battle for supplies,” as it was in World Wars I and II. It is also a struggle of

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ideas, of achievements, of two opposed economic systems. In this ideological struggle, propaganda, which has always been a recognized part of economic warfare, will probably play a larger part than it did in the Second World War.

Since in my lecture a year ago I spoke in some detail regarding the problem of protecting a high level economy, most of my attention this morning will be devoted to the first aspect of that problem—the protection of the United States and her allies, and particularly of the areas from which they draw supplies.

Before examining particular facets of the problem it may be helpful if I give some of the background of my thinking on this whole general subject. It would appear that in the event of hostilities many of our actual needs, political and economic, may not be greatly different from the needs of the Second World War, but the measures needed to satisfy them I presume might differ appreciably.

As regards supplies, it seems likely that the types and perhaps the amounts of strategic and critical materials which we might need would not be greatly dissimilar to our requirements in the last war, although I would hope that the Emergency Shipping Priority List might be trimmed somewhat. One very interesting estimate that has come to my attention since my last talk, which was based on the resources available in areas one might expect would be controlled respectively by the United States and by the U. S. S. R., suggests that our chief shortages in the event of hostilities would be mercury, bauxite, manganese, and oil. I may add that this same estimate indicated that the chief shortages of the Soviets would likely be nickel, tin, copper and lead, tungsten, and of course, oil.

Satisfaction of our needs will of course require the control of the sea lanes. While sea power might not be as useful for the

blockade of Russia as it was for Germany, it nevertheless would be of the highest importance—in order to assure this country and allied areas of a steady flow of supplies, in order to support advance bases from which attacks against Russia might be mounted, such as British East Africa and Cyprus, and in order to restrict the movement of enemy agents and of persons capable of inducing subversive movements. I make this last point in full recognition of the fact that the development of the airplane and the submarine has made restrictions of the movements of enemy agents far more difficult than formerly.

In the last war the phrase “Western Hemisphere Defense” was one of the common cliches. It has been suggested that in the event of hostilities we would probably have to add “Security of the North Atlantic Community” to this former objective, and I presume, the economic and military defense of other areas as well. Certainly the maintenance of relative economic stability in Latin America would be essential, partly because of physical proximity, partly because of the essential foods and raw materials which we would need to draw from that area. None of these purposes, you will observe, can be attained without control of the sea lanes.

As before, there will probably be a price attached to maintenance of economic and political stability in the areas important to us. In its simplest and perhaps its easiest form this price may be merely the extension of various kinds of dollar loans and credits. It is more likely, however, that the price will consist of things that these areas will want from us: shipping space, scarce materials, manufactured goods, and so on. It seems to me altogether probable that the servicing by us of some so-called minimum standard of economic and business needs will be the price—if not of friendship, at least of political and economic conditions that serve our interest. Iceland presumably will want hay, fertilizer, agricultural

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machinery, and manufactured goods; the East Coast of South America will want newsprint, coal, and steel; South Africa will want railroad cars and mining machinery, as well as silk stockings, toilet paper, and dry cereals; Canada will want fats and oils, especially peanut butter. To push this thinking one step further, I would guess that Canada might ask not only for supplies but also for the maintenance in Latin America of outlets for her pulp, newsprint, and other products.

I can readily conceive that the price of stability in certain colonial areas may be the purchase of entire crops or outputs of raw materials, conceivably even at premium prices. Some of these commodities may be needed in their entirety, but it is not realistic to think that we will be so lucky actually as to want all of them. In the last war the loss of the European market made the entire copper output of South America available to us and, as you know, it was bought here. The Metals Reserves Corporation alone in the four years ending November 1, 1944, bought \$400,000,000 of South American copper. Fortunately we needed this item, and it was available to us. Maintenance of the Chilean economy, however, in a style somewhat better than that to which it was accustomed, was a fortunate by-product. I can readily conceive of this situation being reversed, so that the maintenance of the Chilean, or the South African, or the East African economy through commodity purchases might become the prime objective, and the acquisition of commodities a somewhat embarrassing by-product of the policy.

The ability of our adversaries to frustrate these objectives will certainly be of a somewhat different character and may be of somewhat larger dimensions than was the case in the Second World War. The mechanisms of economic penetration at the service of the Russians, which they are using and will use, are quite dissimilar to those of the Nazis. There will not, presumably, be the problem of enemy-owned business concerns and trade connections, at

least not on the same scale. There is no Russian counterpart to the I. G. Farbenindustrie. The problem of hidden or "cloaked" enemy assets will be of much smaller proportions. On the other hand, it is doubtful if the Nazis ever commanded a fifth column of the proportions of the Communist party and its sympathizers; the problem of loyalty, with its many ramifications, will be far more severe. In terms of the specific measures of economic warfare and penetration with which we shall have to contend, it is probably safe to assume that the amount of competitive buying of scarce materials in neutral markets will be reduced. While it may be ventured that the Russians have an adequate supply of gold to use as a means of payment in competitive buying, I would assume that they might be severely handicapped through lack of an effective world-wide network of trade connections. As far as I can determine, a system of trading relations and established commercial connections are almost if not quite as important for competitive or preclusive buying as is an adequate supply of the means for payment.

Against this background of thinking we may now consider in more detail two of the aspects of the problem which I mentioned at the outset: maintenance of political and economic stability in areas important to the national interest of the United States, and preservation of a high level economy in this country.

I shall not try to designate with any precision the areas which it will be important for us to defend. The forces that will determine these areas, however, are reasonably clear. There will be the countries which are our allies; there will be the interests of military strategy; there will be the areas from which we have to draw our essential supplies; and particularly there will be the areas from which our Allies will have to draw their essential supplies. For example, the Argentine will be of more importance to Great Britain than to us because of the United Kingdom's dependence upon Argentine beef, although this country will no doubt also need Argentine linseed and quebracho.

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Evidently if we are to receive aid from these areas or give it to them, control of the means of transportation and communication will be essential. Maintenance of our position will be dependent upon supremacy on the sea. While such control may be of less offensive significance than in the first two World Wars, its defensive significance will be greater and, consequently, the threat of submarine attack may be of even larger moment.

We can anticipate that economic attacks against our interests in "our" areas will be made. In general I suspect that the attacks will not be through what we might call "recognized" instruments of economic warfare—blockade, trade agreements, preclusive buying, and so forth—but will be intended to disrupt the smooth functioning of the productive process and the flow of trade. On the whole, it does not appear that Russia will be able to use effectively the recognized types of economic pressure; but she has at her disposal other means for accomplishing the same ends. Let me be more explicit.

In the first two World Wars the United States and the United Kingdom employed shipping controls and preclusive buying to cut off supplies from Central European powers. A civil disturbance in South America, the Dutch East Indies, Burma, or Malaya, sponsored by Moscow, could be used for much the same purpose—to cut off supplies from the United States or the United Kingdom. This country and Great Britain have in the past used commodity purchase agreements to shape the economy of neutral and also colonial areas in such a way as to assist our war programs. Our interest at the present time and in the future will lie in the maintenance of political stability and a continued production of necessary materials in these areas. The Russians are quite capable of various types of operation designed to thwart our interests which is the same as saying that they have methods of shaping the economic processes in these areas to their purpose.

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Strikes, sabotage, political unrest, inflation, or any other operation that reduces production or disturbs the normal tenor of business will serve the Russian purpose, much as commodity purchase agreements have served the purpose of this country and of Great Britain in the past. I make this point notwithstanding the fact that Russia is using trade agreements with her European satellites much as if she were a capitalistic power. In the last war we lost control of Southeast Asia, the Dutch East Indies, and the Philippines through Japanese conquest. If in these areas Communist or nationalistic movements sponsored by Moscow should spread, I can conceive that we might lose their resources almost as fully as if we had lost control of the areas themselves. It does not take great imagination to see that strikes in key industries and stoppage in key plants can have much the same effect on production as if those industries and plants were the object of strategic bombing. I was interested to observe that the November 1st issue of *TIME* carried a story to the effect that the coal strike in France was a political maneuver aimed at hampering the Marshall Plan and European recovery. The current strike of longshoremen in this country initially had the effect of permitting us to supply Alaska only by an air lift, and of putting extreme pressure on Hawaii; latterly it has had the effect of constricting shipments to Western Europe under the Marshall Plan.

My conclusion may seem far-fetched, but I cannot see why an effort could not be made through a world-wide movement, partly Communistic and partly nationalistic, in colonial areas, to cut off the highly industrialized, raw material importing portions of the globe from supplies that are produced in those areas. There is already trouble in greater or lesser degree in Southeast Asia, the Near East, the Far East, and West Africa. Other parts of the world, such as North Africa and certain sections of Latin America, are clearly susceptible to this type of penetration. If such an ef-

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fort were combined with strikes and sabotage in key areas, notably in docks, harbors, and the maritime industries, it would seem to me that we might have a reasonable facsimile of a blockade. If, as many people think, in the next war strategy and operations will necessarily be subject to logistics, disturbances in the areas from which supplies are obtained will come to have a new and a more sinister significance.

While the North American continent is perhaps only moderately vulnerable to this type of pressure, it is quite clear that certain other areas "on our side," notably the United Kingdom and parts of Western Europe, are distinctly vulnerable. Next to the coal shortage, probably the major shortages in Western Europe and in the low countries are shortages of such imported items as fertilizers, leather, fibers, fats, and oils. Practically all of these items are of colonial origin.

It may seem that I have belabored this point, but I believe it is of real moment and I wish to give two final examples of what I mean. Present plans for European aid assume, I believe, that by 1951 80% of Europe's petroleum imports will come from the Middle East, and that by that date there will be a greatly increased volume of European trade across the Iron Curtain. Clearly the validating of these assumptions depends much more on Russian action than on ours. It is inconceivable that Russia could not hamper shipments of petroleum from the Middle East if she so wished, and certainly the development of east-west trade in Europe depends directly on her policy. It follows of course, that if these assumptions of the European aid programs are not validated there will be a commensurate increase in the economic pressure exerted on our economy; at the very least the present pressure will not be diminished.

The conclusion of this line of thought is that the war po-

tential of the United States and her allies is most easily attacked by indirection, and that the area most vulnerable to attack is in the peripheral sectors of Eurasia and in the colonial territories that furnish raw material. The kind of attack to be expected, it would appear, is a combination of measures not ordinarily looked on as the "orthodox" measures of economic warfare, but which would have the same purpose and could be highly effective.

To meet this type of attack there are immediately evident two countermoves: One is the continuance—or better yet the extension—of international trade and the present high level of prosperity. The other is stockpiling. I do not intend in this lecture to try to explore the first of these countermoves, but I do want to say a little something about stockpiling, and in this term I include offshore stockpiling as well as reserves built up in this country.

Stockpiling is of course one of the recognized, classical, orthodox measures of economic warfare. It is designed to circumvent the effect of a blockade, or at least to mitigate the effects of a sudden shortage of essential items. If it is done on any large scale it must be done by governmental agencies, partly because of the amount of money involved (especially if premium prices are paid), partly because of problems involved in storing and handling, and partly because utilization of stockpiles must be geared in with whatever system of allocations and priorities is being employed. Although the operation must be financed and administered by government agencies, the operation must be conducted in close collaboration with industry if it is to be effective.

It may be worth while to quote here some portions of the "Report on Activities of Metal Reserves Company" for the period June 28, 1940—November 1, 1944, signed by Charles B. Henderson, then president of the M. R. C. and chairman of the R. F. C.

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The report covers the period prior to the creation of the United States Commercial Corporation. According to this report the M. R. C. contributed to the war effort in four ways:

“It has created stockpiles of metals and minerals that provide assurance for continued production of military goods, regardless of possible interruption of supplies.”

“It has assisted in increasing the total volume of metals and minerals currently flowing into the war effort by making available to industry, on allocation by the W. P. B., metals and minerals from sources not available directly to private industry.”

“It has helped to stabilize prices.....by selling at OPA ceiling prices”—even though it had bought at premium prices, above OPA ceilings or levels we might consider “economic.”

“It has contributed to the war program by reducing the strength of the foe through its purchases of supplies from sources available to unfriendly (later enemy) powers.”

As you know, the M. R. C. was originally set up to stockpile two commodities, tin and manganese; in the four years of its operation the list increased to 49. Its transactions covered 51 foreign countries, 31 states of the Union, Alaska, and the Philippines. In addition to buying commodities it paid subsidies to marginal producers who were thereby enabled to produce and sell in the ordinary channels of trade at OPA ceiling prices. It set up subsidiary corporations to operate DPC facilities designed to produce scarce items. While a substantial number of the stockpile goals were met 100% or more, a good many goals were not attained. Achievement of the goal, of course, does not tell the whole story of the operation, since sales were continually made from stockpiles during the period when they were being built up.

I may observe here that some of the audits required of government corporations under the Corporation Control Act of

1945 are just now becoming available. If we are to take these audits at face value, the stockpiling operation, so far as its book-keeping was concerned, certainly left something to be desired. If such operations in the future are carried on on a large scale, here is surely one area where there is considerable room for improvement.

The conclusion that I reach concerning stockpiling is that a limited amount, designed to prevent a sudden interruption in supplies, may be very useful. But if events develop in such a way that more than a moderate stockpile program is urged, or if substantial reliance is placed on this type of operation, such circumstances indicate that the economic war under either hot or cold conditions, is being lost.

Let me turn to the second aspect of the problem which I mentioned at the beginning of this lecture, the defense of a high level economy. In my talk a year ago I took the line that the present high level economy in the United States—with its record-breaking national income, its “over-employment,” its high tax receipts, and its large profits—was a fact of great political and economic consequence throughout the world. For three years we have had a most successful economy, more successful than anyone could have hoped for in 1945 and certainly more successful than the best expectations of many of the “planners” who forecast much lower levels of production and employment. Except for price stability we have met all the tests of a successful economy given in the textbooks; we have had full employment and something more, record-breaking levels of production, a declining debt and burden of taxation, a high level of profits, an increasing volume of capital investment, and a rising standard of living.

It is this high level economy which makes possible support of a \$40 billion budget and a \$250 billion debt, together with the

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enormous “unrequited” exports of which shipments under the Marshall Plan are only a part. As you know, “unrequited” is the economists way of describing exports for which you are not paid. This high level economy has demonstrated to the world the volume of production possible under a free market economy, available either for armament purposes or for raising the standard of living of the population. In our “positional war” with the Soviets this achievement has been something that the Russians undoubtedly had not counted on.

Unfortunately, a high level economy is a vulnerable economy. It is vulnerable either to a recession or to a final burst of inflation and speculation that makes a recession inevitable and more severe than might otherwise be the case. The Russians have confidently expected and predicted a recession. Should that occur it would weaken our tax base and our ability to supply raw materials, food, and capital equipment to Europe. It would seriously compromise the position of the United States on the international stage, since it would validate the Marxian prophecies.

The Russians could—as could any state with sufficient resources and particularly an authoritarian state—undertake from the outside measures to precipitate either a bust or the final states of a boom that precede a bust. In my lecture a year ago I mentioned certain maneuvers that could be undertaken for this kind of purpose, such as the disorganization of markets for international commodities, the use of gold shipments for political purposes, and the falsification or misinterpretation of government statistics.

The greatest danger, however, I believe lies in the pressures that can be exerted from the outside in this country on the federal budget, with the consequent repercussions on taxation, spending, and borrowing. I am so thoroughly convinced that the greatest

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danger of overstraining the American economy lies here, in the problem of the big budget, that I will not even stop to argue the case. The methods available to the U. S. S. R. for exerting pressures in the field of "big government" and "big spending," both in foreign and domestic fields, are numerous. The implications of these pressures are almost infinite and extend far beyond the limits of this lecture. They involve not only the whole field of public finance and fiscal policy, but also a detailed consideration of how our economy works—down to, say, the adequacy of depreciation policies of individual companies.

I will make only two observations as regards this type of pressure. Insofar as Russia, in what we may call the area of "foreign spending", can increase the needs for such things as ERP or European rearmament through political tensions, disruption of trade, diminution of production, or civil disturbance, the pressure on our economy is increased. This fact is now becoming generally recognized. On November 4, Edson Smith, the financial editor of the *Boston Herald* said: "It is becoming increasingly apparent that whether by accident or design the Russian government is forcing us into a spending program which makes the achievement of a stable economy at home practically impossible." The implications of such a situation, as I have indicated, are extremely serious.

"The area of domestic spending" seems to me to fall naturally in the orbit of ideological warfare. Insofar as a public opinion can be created which demands and expects big government spending for social security, farm parity prices, grants and aids, and so forth, the pressure on our economy will evidently be increased. That is, the problem of the "big domestic budget" is essentially one of domestic public opinion. If the public wants a large volume of spending there will be a large budget; if the pub-

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lic does not want such spending the budget will be small. The point of this line of argument, of course, is that public opinion in a foreign country is exactly what ideological warfare seeks to influence.

In conclusion let me say that the framework, the setting, the logics, and the position of economic warfare in the present cold war between the United States and the Russians are quite different from the situation prevailing in either of the first two World Wars. This is what might be expected on *a priori* grounds. The whole geography of the situation is different and it seems virtually impossible to blockade the Russians. The U. S. S. R. is not so highly industrialized a country as Germany and not so susceptible to shortages of food and raw materials. Nor is it so dependent on foreign commercial connections and foreign trade. Consequently it is distinctly less susceptible to offensive measures of economic warfare, at least of the traditional type, than was Germany. On the other hand, in view of our logistic and ideological position, we are more susceptible to offensive measures of economic warfare than we were heretofore. We are particularly vulnerable to types of operations that lend themselves to the Russians' abilities. This country, at least this country together with her allies, is very dependent on an even flow of supplies. Our national interest lies in the preservation of "normal" economic activity and economic and political stability. Our interest in such stability is more intense and will extend over a wider area than was the case before. As an industrialized, highly integrated, capitalistic nation with a delicate and delicately balanced economy, we are particularly susceptible to the effects of strikes, sabotage, civil disturbance in colonial areas. Some of these areas are no further away than Latin America. Ideological warfare evidently has played and will play a larger part in the situation than it has before. Consequently it seems necessary that more of our efforts should be, and

will be, spent on defensive operations than on offensive operations designed to injure the Russian war potential directly. The Marshall Plan is a case in point.

Lest this should seem a pessimistic, unaggressive point of view, I may point out that few things can be so damaging to the Russian program, or at least large portions of it, as a failure on their part, because of the excellence of our economic defense, to accomplish the world wide proletarian revolution they have so confidently predicted. They are in the position of having to validate a prophecy. If the prophecy is not validated their ideological position is not likely to stand the disappointment.