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WITHDRAWAL SHEET

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Withdrawer

JET 5/18/2005

File Folder USSR-PIPELINE 3/6

FOIA

F06-114/9

Box Number 30

YARHI-MILO

3012

ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
10730	MEMO	BAILEY TO ALLEN RE IMMEDIATE ACTION ON THE SIBERIAN PIPELINE <i>R 9/25/2012 F2006-114/9</i>	3	8/6/1981	B1
10731	PAPER	USSR OIL: DIA OVERLY OPTIMISTIC	1	ND	B1
10732	MEMO	BREMER RE STRATEGY PAPER ON YAMAL ENERGY ALTERNATIVES <i>R 9/25/2012 F2006-114/9</i>	1	10/23/1981	B1
10734	PAPER	A US STRATEGY TOWARDS THE WEST EUROPEAN-SOVIET UNION GAS PIPELINE <i>R 3/24/2011 F2006-114/9</i>	13	ND	B1
10733	MEMO	IMPACT OF U.S. EXPORT LICENSING DECISIONS ON COMPLETION OF THE YAMAL PIPELINE <i>PAR 9/25/2012 F2006-114/9</i>	2	10/23/1981	B3
10735	PAPER	SAME TEXT AS DOC #10734 <i>R 3/24/2011 F2006-114/9</i>	13	ND	B1
10736	ROUTING LIST	DOCUMENT ROUTING LIST <i>R 3/24/2011 F2006-114/9</i>	1	10/22/1981	B1

Freedom of Information Act - [5 U.S.C. 552(b)]

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- B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
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~~SECRET~~

10730

Pipes/PS
the Pipeline

MEMORANDUM

NATIONAL SECURITY COUNCIL

4817

~~SECRET/SENSITIVE~~

August 6, 1981

ACTION

DECLASSIFIED

MEMORANDUM FOR RICHARD V. ALLEN

NLRR F06-114/9 #10730

FROM: NORMAN A. BAILEY *NAB*

BY KML NARA DATE 9/25/12

SUBJECT: Immediate Action on the Siberian Pipeline (S)

There have been several recent cases where a firm decision backed by equally determined implementation have resulted in various foreign policy successes involving our allies, our antagonists and "neutral" countries. (U)

On the issue of the Siberian pipeline, a matter of vital importance to us, Western Europe and the Soviet Union, a muddled decision process was followed by our shooting ourselves in the foot on implementation of any coherent strategy through the approval of the sale of Caterpillar pipelayers. (S)

It is not important at this moment to discuss apportionment of responsibility for this situation. It is important to make firm and precise decisions on the pipeline and on implementation of the policy adopted immediately. (S)

Since announcement of the pipelayer decision the following events have taken place: (U)

-- Diplomatic traffic indicates that the decision was predictably taken as meaning we have in fact written off the issue, whatever we say. (S)

-- The Japanese have moved heaven and earth to signal to one and all that they did not tell us anywhere at any time that they were going to go ahead with the sale of Komatsu pipelayers. (S)

-- Assistant Secretary of Commerce Brady intends to put very restrictive language in the Caterpillar license, perhaps enough to kill any chance of their making the sale. (S)

-- There is bureaucratic infighting between DOD and State over who will chair a putative SIG on the subject. State wants to chair it and DOD wants us to chair it. (S)

~~SECRET/SENSITIVE~~

Review on August 6, 1987

~~SECRET~~

-- In the meantime the Germans are moving ahead with great speed to sign the contracts, believing there will now be only token opposition from us. (S)

Policy Alternatives:

1. Accept the first pipeline as a fait accompli, try to reduce the security risk and devote most efforts to trying to stop the second pipeline. (S)

2. Mount a major, publicized, immediate diplomatic offensive to delay any pipeline contract signing, followed up by implementation of the original strategy. (S)

If the policy decision is (1) above, than we can go ahead with the usual SIG process in the usual way, as soon as DOD and State agree on the kind of SIG to be established. (S)

If the policy decision is (2) above, some or all of the following measures should be announced and done at once: (S)

-- Reiterate publicly and privately that France and Germany agreed at Ottawa to consult with us concerning excessive dependence on Soviet energy sources and the possibility of alternative energy supply.

-- Publicize restrictions on Caterpillar license and reiterate that the license refers only to one order, not any subsequent orders. (S)

-- Tell the Japanese that we misread their signals and ask them to apply similar restrictions on any Komatsu sales. (S)

-- Approach Rolls Royce and the British government on DOD orders to make up for lost compressor sales. (C)

-- Encourage US companies to withdraw from competition for Algerian and Trinidadian gas and let the French and Italians know we are doing this on their behalf. (S)

-- State publicly and privately that we want to help Nigeria develop its gas reserves, since it is in serious trouble over declining oil revenues and that we will do so on behalf of the Europeans. (S)

-- Publicize widely data on past and present interruptions in Soviet gas supply to Austria, Germany and other Central European countries. (S)

~~SECRET~~/SENSITIVE

-- Extend security controls to oil and gas equipment sales. (S)

-- Announce a policy of accelerating gas price decontrol here. (S)

All the above should be helped by continuing high interest rates, increasing the nervousness of German, French and Italian bankers. (U)

Following these measures the normal SIG process should shift into gear on medium-range measures. (U)

RECOMMENDATION

That the Siberian pipeline issue be placed on the agenda of the next NSC meeting for decisions on:

- 1) Adoption of one of the two policies outlined above, and
 - 2) If policy alternative two above is adopted, that the Departments of State, Defense, Commerce and Energy be instructed to proceed at once to implement it along the lines suggested. (S)
- WJ*
Stearman, Lenz and Schweitzer concur. *WJ*

Approve _____

Disapprove _____

~~SECRET~~/SENSITIVE

Soviet Is Able to Raise Production Of Oil and Gas, U.S. Agency Says

GAS PIPELINE
4

By BERNARD GWERTZMAN

Special to The New York Times

WASHINGTON, Sept. 2 — The Defense Intelligence Agency, in its latest analysis of the Soviet economy, says that the Soviet Union's energy prospects for the rest of this century appear "highly favorable," and that Moscow will be able to increase its oil production and exports for the foreseeable future.

Clearly differing from earlier, more conservative projections by the Central Intelligence Agency, the defense agency says that the Soviet Union will, in effect, be able to meet its oil production targets of 12.2 million barrels daily this year and 12.9 million by 1985.

The C.I.A., in its most recent statement, said last May that Soviet oil production would begin to decline in one to three years. The Soviet Union is the world's leading oil producer, outstripping second-place Saudi Arabia by about 3 million barrels a day. The United States is third, with daily production of about 8.6 million barrels of crude oil.

Testimony given when the defense survey was issued also referred to a report last December of a major discovery of oil in western Siberia. Petrostudies, a Swedish research concern, said last year that the Soviet Union had discovered a major new field at Bazhenov, and put the reserves there at 4,200 billion barrels. That figure would be about six times the total proved worldwide reserves of crude oil.

Report Released by Proxmire

The defense evaluation was presented on July 8 by Maj. Gen. Richard X. Larkin, deputy director of the agency, to the Joint Economic Committee's subcommittee on international trade, finance and security economics. It was made public today by the office of Senator William Proxmire, Democrat of Wisconsin.

In an expurgated exchange of questions and answers, Mr. Proxmire, the vice chairman of the committee, asked an associate of General Larkin about last December's report of the major oil find, a report that was ridiculed at the time by Western experts.

Lloyd N. Corning Jr., the energy branch chief of the defense agency's research division, said that there was a field at Salym, and "subsequent reports have indicated that it is a large find, but it will be some time before the Soviets bring it into production."

When asked how large, he replied that it was "very large," but not so large as the 4,200 billion barrels that Petrostudies had reported in reference to Bazhenov. The figure he then provided for Salym was censored from the testimony, but Mr. Proxmire said, "That's a colossal size."

An aide to Mr. Proxmire said he could not provide the exact figure because it was classified, but he repeated the Senator's description of it as "colossal."

Economy Termed Weak Over All

General Larkin, in his presentation, depicted the Soviet economy as being in poor condition over all, with extremely low growth rates and high military expenditures. What was significant about the testimony was the very positive evaluation it gave the Soviet energy sector. State Department officials said that the testimony seemed to underscore what they said was a major difference of opinion between the Defense Intelligence Agency and the C.I.A.

For instance, the C.I.A. has said in the past that the Soviet Union has proven oil reserves of about 35 billion barrels. The defense agency says that it has increased its estimate from 75 billion barrels to between 80 billion and 85 billion barrels.

"The outlook for Soviet energy, from the perspective of the Soviet leadership, is highly favorable," General Larkin said. "Prospects for the full satisfaction of domestic needs, planned energy exports to East European Communist countries and negotiated quantities for customers in Western Europe appear to meet Soviet expectations through the 1980's and beyond."

Gain in Political Influence

"In addition to providing solid economic benefits for the U.S.S.R., Soviet energy self-sufficiency is also likely to result in greater political influence by the Soviet Union over certain decisions of its West European customers, and perhaps to a lesser extent, of Japan," the general said.

He added that production of Soviet natural gas, from the world's largest proved reserves, would continue to expand at a high rate of 7 percent to 9 percent annually, and export growth would reach more than 15 percent.

Despite a recent decline in Soviet coal production, he said, the Soviet Union "is likely to achieve a production upswing in coal, from the world's largest proved reserves, by the late 1980's."

Revenues From Exports

He said that the Soviet Union should be able to realize about \$23 billion from the sale of oil and natural gas to Western countries in 1985 to allow it to buy needed Western technology.

General Larkin said that "there is little doubt" that the Soviet Union would be able to substitute natural gas for oil for many consumers. He said that coal and oil, which represented 72 percent of primary energy fuels consumed in 1970, would represent 56 percent in 1985.

He also said that natural gas and nuclear power would rise from 20 percent to 38 percent by 1985, 38 percent by 1985 and 42 percent to 44 percent in 2000.

NATIONAL SECURITY COUNCIL

September 14, 1981 ✓

MEMO FOR:

NORM BAILEY
HENRY NAU
DICK PIPES
GUS WEISS
DENNIS BLAIR
BOB SCHWEITZER
BILL STEARMAN

FROM: ALLEN LENZ *AJL*

Staff reaction to the attached has been requested.

I suggest we meet briefly later this week to discuss the merits of the idea.

I will schedule.

3411 7

THE WHITE HOUSE

WASHINGTON

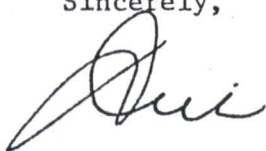
September 11, 1981

Dear Jack:

Many thanks for forwarding the input form Arnold Kramish, which I have read with interest and am having circulated to the staff for comment.

I appreciate having his analysis.

Sincerely,



Richard V. Allen
Assistant to the President
for National Security Affairs

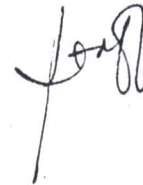
Mr. Jack Morse
499 South Capitol Street, S.W.
Suite 500
Washington, D. C. 20003

FILE:

PIPELINE

22 AUG 1981 8

August 26, 1981



MEMORANDUM

To: Richard V. Allen
Special Assistant to the President for National Security Affairs

From: Jack Morse

Subject: Arnold Kramish's Suggestion about the Yamburg/Urengoi Pipeline
to Western Europe

Yesterday Arnold Kramish, one of the most dedicated, innovative minds I have ever known, made a suggestion that created some excitement.

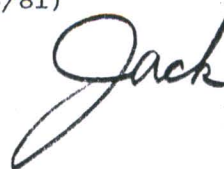
Chancellor Schmidt refuses to oppose the pipeline as now planned. The Soviets will be able to use the funds to develop first their oil fields at the Asian terminal, then perfect their lagging pipeline technology, run the line through Poland to justify a protective military presence there, and finally hold Europe as a gas hostage.

Arnold's idea is to start building from West to East rather than vice versa, build the Western terminus at Ushgorod, make progress on a pay as you go basis (the only way to deal successfully with the Soviets) and finance Soviet gas field development at the end, not the start of the project.

Secretary Buckley is already aware of Arnold's idea and its potentials. Our European allies should be persuaded to this point of view.

You may want someone on your staff to read the enclosures and fill you in. One of the attachments raises some serious technology transfer issues.

Enclosures: Memorandum to Michael Marks (8/24/81)
How to Draw the Line
Memorandum to Michael Marks (8/26/81)



August 24, 1981

~~D R A F T~~

MEMORANDUM

TO: *Michael Marks for Undersecretary Buckley (State/T)*
FROM: *Arnold Karnish*

SUBJECT: A Possible New Approach to the Yamburg/
Urengoi Gas Pipeline to Western Europe

Background:

The FRG (and other European allies) seem intent on financing a new pipeline and associated infrastructures to bring gas from the Yamburg/Urengoi area of northwest Siberia, via a 56-inch pipeline to be financed almost entirely by a consortium led by the Deutsche Bank. That means a substantial increase of fabrication jobs for the FRG economy. When completed, the line will render the FRG more than 30% dependent (as compared to 17% now) on Soviet whims as a supplier. Other potential dependencies include France (from 7% to 30%) and Italy (from 23% to 30%). Such dependence could make Allies very vulnerable to Soviet pressures not directly related to energy supply.

The potential dangers could be magnified if the western USSR terminus were moved northward, say to Grodno

or Brest on the Polish border. The present terminus for several smaller gas pipelines is at Uzhgorod, where Poland and Hungary pinch Czechoslovakia. The line then runs through Czechoslovakia, branching to customers in eastern and western Europe. Increasing the capacity of the existing distribution lines would not substantially enhance overall Soviet political control over Czechoslovakia. However, a pipeline running through the heart of Poland would be an excuse and a tool for enhancing Soviet security forces in Poland. That is something to be avoided now and in the future. If the Soviets maintain the Polish option during the period of ~~of~~ pipeline construction from east to west, that would add a substantial measure of uncertainty to western fears of political misuse of the pipeline.

Proposed Action:

That the U.S. propose to its Allies (especially to the FRG) that they negotiate the construction of the new pipeline from west to east ^{on a pay-as-you-go basis} commencing at the Uzhgorod terminus, expanding the latter's infrastructure to accommodate the increased flow and distribution. This to be done if and when the FRG firmly rejects the primary U.S. offer of

increased support of alternate coal and nuclear initiatives.

Advantages to the U.S.:

If the gas line deal becomes inevitable, fixing the Uzhgorod terminus soon deprives the Soviets of the option of using the western terminus as ~~■~~ another means ~~for~~ political control vis-a-vis Poland. Also, it delays the development of the Yamburg/Urengoi infrastructure thanks to western financing. The early development of that area is desired by the Soviets, and that is the most expensive part of the \$10 billion venture. That portion should be delayed as much as may be possible to test Soviet behavior, not only related to the pipeline itself, but to possible adventurism globally. The west-east mode gives the West more political leverage and minimizes the costs of cancellation either by the Soviets or by our Allies.

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Arnold Kramish

19 August 1981

How To Draw The Line

The rebuff given President Reagan by Chancellor Schmidt at the Ottawa Summit may presage other rifts for the NATO alliance. It seems that the die may be cast for the proposed Yamburg gas pipeline, that it will be built through loans arranged by a consortium led by the Deutsche Bank. In his new novel "The Last Days of America," Paul Erdman has the Deutsche Bank in a similar role but with a different scenario. This time the story is real, and many recent writings about the pipeline fear perhaps not exactly what Erdman does, but how a large share of the energy needs of the NATO alliance would be hostage to Soviet whim. Already West Germany is the main customer for Soviet gas and oil (and a significant customer for Soviet enriched uranium for power reactors.) France last year overtook East Germany, Poland and Finland to become the second most important oil and gas customer for Moscow.

The Netherlands is presently the main supplier of gas to West Germany. If and when the Yamburg pipeline begins to deliver, the Soviets will take first place as a supplier to West Germany and render at least France, Italy, and Austria deeply dependent on Soviet supplies. Austria already is, with no more than half of her gas coming from the east. Nevertheless, West Germany is the key to the ten billion dollar financing of the Yamburg line and the accompanying infrastructure which will have an industrial significance for the Soviets, transcending Western Europe's dependency in Soviet energy sources. The latter will be bad enough, for the dependency will always remain as a means to disrupt the NATO alliance at any time in

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the future.

So the U. S. concern over even more European dependence, represented by the Yamburg pipeline, is understandable. But if the pipeline is to be despite our protestations, perhaps our friends in Europe can be persuaded to negotiate with the Soviets on a another basis which entails less risk, at least while the pipeline is under construction.

The rich Urengoi gas field is to the northeast of the Ural Mountains, the gateway to Siberia. Further north, at the same latitudes as the Alaskan North Slope oil fields are sited the Yamburg finds on the Taz Peninsula (not on the neighboring Yamal Peninsula, for which the pipeline is popularly named.) The Urengoi field feeds smaller gas lines to Uzhgorod on the Czechoslovak border, where another feeder line from Orenburg, in the southern Urals also intersects. Eastern Czechoslovakia is pinched by Hungary to the south and Poland to the north. The line from Uzhgorod goes through Czechoslovakia towards customers in Western Europe. Strategic pipelines, pumping stations and terminals are protected by Soviet security troops. Sadly, any measure of enhanced security over the pipeline traversing Czechoslovakia is probably little noticed in that captive country.

Sadly also, current thinking about the Yamburg gas pipeline seems to be captive of a simple geopolitical trap. It is just as important to free ourselves from this mindset as to try to answer the conundrum of whether Moscow would be a more reliable supplier than OPEC. Uzhgorod has been the presumed USSR terminal for the new Yamburg pipeline. If so, that would hardly affect the current Czechoslovak political situation, although greater transmission capacity might have to be provided in Czechoslovakia.

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August 26, 1981

MEMO

To: Mike Marks, Office of Undersecretary Buckley
From: Arnold Kramish
Subject: Some Technological Questions about the Projected Yamburg/Urengoi Line; a Possible Delaying Tactic

Background: Soviet development and production of large compressor units for aviation, space and particularly for domestic uses (such as compressor stations in gas pipelines) has always been difficult for them. Since military requirements have the greatest priority, some of their best pipeline compressors have tapped military technology. Even so, Western pipeline technology remains superior.

The existing Orenburg-Kuibyshev gas pipeline uses compressor units developed from the NK-12-ST Soviet aircraft engine originally used to power the TU-114 and the Bear bomber. Marine gas turbines power some other compressor stations. But reverse-engineering from military to civilian uses has not been very successful. This is why the U.S.S.R.'s turning to purchases of Western compressor units to move the gas in the Yamburg/Urengoi line. It should be noted that the large-diameter gas piping is in itself an industrial achievement. Engineered for gas pressures, the large-diameter pipe can also accept oil and other liquids. (It is relevant that the pipe for the Alaska oil line was not available in the U.S., being ordered from Japan.)

Questions:

1. Do the compressors to be purchased by the Soviets in Western Europe derive from sensitive or proprietary military/space technologies developed within NATO countries? This question applies not only to concept and design, but also to metallurgical techniques and flow-control

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equipment. Will the latter incorporate advanced computer technology?

2. Will it be possible for the Soviets to reverse-engineer from Western-supplied compressor units (as they have reverse-engineered from military to civilian units) to benefit their military and space programs?

3. Will they be able to reverse-engineer to benefit critical (non-gas) components of their civil economy?

4. Are the Soviets likely to over-order large-diameter pipe and compressor units to benefit their military and other sectors of their economy?

If the answer to any of the questions is "yes," then the pipeline deal must be examined within the context of possible harm done through technology transfer. COCOM and other appropriate controls and pressures must be applied among NATO allies. At the minimum, such an examination might at least delay the Yamburg/Urengoi deal.

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The Soviets will not buy a reverse-switch unless there is also something in it for them. As the pipeline would proceed northeasterly from the Ukraine, it could provide a conduit for surplus gas to industrially important areas, back-fed from the other lines which presently converge at Uzhgorod. The Soviets are still uncertain whether the line will be fed from the Urengoi terminal or from a less-developed infrastructure near Yamburg to the north; a west to east line gives them more time to make that decision. While doing so, the Soviets will improve their skills in operating the pipelaying, drilling and pumping equipment they are trying to buy from the West, (with apparent success, as exemplified by the recent approval of the Reagan Administration of an export permit to purchase 100 Caterpillar pipelaying machines) on less difficult terrain than the permafrost of northwest Siberia. And in the final analysis, they would have their pipeline, from one direction or another.

When that is accomplished, when the Soviets have created a new Siberian economic base and when our key allies are just as dependent on the USSR as on OPEC for their energy needs, this will signify a new dimension in east-west relationships. That is what is so disturbing to many, but at least we ought to try to assure that the changes occur in a manner which minimize political and economic risk and under conditions more suitable for testing mutual intent and confidence. But perhaps such is only a pipe-dream.

Arnold Kramish is a technology consultant and the author of several books, including "Atomic Energy in the Soviet Union" (Stanford University Press)

10 / 6 / 81

ALASKA NATURAL GAS TRANSPORTATION SYSTEM (ANGTS)INHIBITION TO SOVIET NATURAL GAS EXPANSION

The Soviet Union is placing a high priority on natural gas development during the decade of the 1980's. Plans call for an increase in production from about 15 trillion cubic feet in 1980 to over 35 trillion cubic feet in 1990. This increase in production can apparently all come from the Tyumen Province in Western Siberia, about 2,000 miles from Moscow. The current five year plan calls for construction of nearly 20,000 miles of new gas main transmission pipelines. Included in this five year plan is the Siberian West Europe pipeline project (formerly Yamburg) to deliver 1.1 trillion cubic feet annually to Western Europe through a 3,000 mile pipeline system. However, it is likely that the line will not become operational before 1986, which coincides with the target date for completion of the Alaskan Northwest gas pipeline.

During the same five-year period, free world projects that are planned or forecast total 14,500 miles of transmission pipelines. The ANGTS will add another 4,800 miles. Consequently, during the current five-year period the Soviet pipeline system expansion is approximately equal to that of the free world. The construction of the southern portions of the ANGTS to import Canadian gas until the Alaskan gas is connected will be completed in 1982 and totals 1,500 miles. The remaining 3,300 miles would be constructed during the period 1983-1986.

Due to the aggressive Soviet program of natural gas development, the Soviet Union is expected to import substantial quantities of material and equipment. In addition, there will be financial requirements imposed on the free world for completion of projects such as the Siberian pipeline project. For example, it has recently been announced that the Soviet Union wants to arrange financing of \$12 billion for the Siberian pipeline. These funds are anticipated to come from free world countries such as West Germany, Japan, France, Italy, and Holland.

There is no doubt that the Siberian pipeline and other Soviet pipeline projects will compete with ANGTS in the capital and supplier markets of the industrialized world to accomplish its objectives. The question is the degree by which their effort would be stalled. The following points identify some measures of this potential:

- In order to finance the U.S. facilities of the ANGTS, it is anticipated that over 60% of the debt will come from foreign institutions. The ANGTS funding studies which establish targets for borrowing are predicated upon the creation of a climate favoring foreign investment. Obtaining these funds will be in direct competition with Soviet efforts to finance certain of

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its projects such as the Siberian West Europe project. For example, it is public knowledge that negotiations are in progress by the Soviets for financing of over \$7 billion from some of the same banks that will be financing the ANGTS in West Germany, Japan and France as well as additional financing from Italy. The strategy for financing ANGTS targets over \$4 billion from these countries. There is no doubt that expeditious final authorization of the debt commitments for its financing will compete directly with and will inhibit the Soviet financing effort.

- The potential areas for competition for supplies include pipe, compressor units, valves, heavy construction equipment, and special fittings. Since several countries that could supply material and equipment would also offer attractive financing arrangements, the competition for capital is directly related to purchases from that country. Consequently, with a high level of pipeline construction worldwide, the competition for supplies and equipment also results in capital competition.
- As an illustration of the expected supplier competition, the current five-year plan contemplates a total of 280 compressor stations. Soviet pipeline systems traditionally are underpowered and hence not up to optimum capacity. Consequently, an unusual increase in the procurement of compressor stations is contemplated for both additions to existing systems and for new systems. It is reported that approximately 100 compressor stations would be ordered from the West. The requirements for the ANGTS including the conditioning plant are for 60 compressor units. Hence, depending upon other worldwide requirements there is a direct correlation between Soviet needs during this time period and the ANGTS.
- There is also a potential competition for supervisory management personnel. It is common practice for the Soviets to contract for pipeline construction management expertise. The ANGTS will require all available U.S.A. contractor management personnel, providing an opportunity to limit Soviet access to this critical resource.
- The ANGTS will utilize chilled gas technology. Development of this technology will permit the free world to develop far north gas reserves to compete directly with Soviet exports to Europe.

Advances in the technology of transporting chilled gas as planned for the ANGTS will place the U.S.A. in an advantageous position to advance such technology to other countries in the free world. This should result in the construction of other projects to compete with Soviet exports of natural gas. The Soviet Union is just beginning to utilize chilled gas technology and is not as well advanced as the plans contemplated for the ANGTS.

An example of this potential is that Sweden, which does not have an indigenous pipeline industry, is seriously considering a pipeline from the north based on North Sea gas supplies for delivery to Europe. Such a project would directly compete with Soviet exports and reduce the reliance of Western Europe on Soviet energy resources. Swedish technicians are consulting with ANGTS sponsors regarding chilled gas technology. Completion of ANGTS will provide the U.S.A. with proven technical capability which will permit maximizing this type of assistance. More indirectly, but equally helpful, the far north Alaskan and Canadian reserves that could be transported by ANGTS the potential export of LNG from Canada would also reduce the pressure on world supplies and thereby compete with Soviet exports.

September 25, 1981

RECEIVED 23 OCT 81 15

TO LENZ FROM BREMER

DOCDATE 23 OCT 81

DECLASSIFIED
White House Guidelines, August 28, 1997
By AS NARA, Date 7/29/02

Pipes

Pipeline

KEYWORDS: USSR OIL
EAST WEST SIG

SUBJECT: STRATEGY PAPER ON YAMAL ENERGY ALTERNATIVES FOR SIG WEEK OF 26 OCT

ACTION: PREPARE MEMO FOR ALLEN DUE: 26 OCT 81 STATUS S FILES

FOR ACTION	FOR CONCURRENCE	FOR INFO
LENZ	FEITH NAU	STEARMAN
	<u>PIPES</u>	BAILEY

*N.C.
10/30/81
22*

COMMENTS

REF# 8130828 LOG NSCIFID (D /)

ACTION OFFICER (S)	ASSIGNED	ACTION REQUIRED	DUE	COPIES TO
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DISPATCH _____ W/ATTCH FILE _____ (C)



DEPARTMENT OF STATE

Washington, D.C. 20520

October 23, 1981

~~CONFIDENTIAL~~(With ~~SECRET~~ Attachment)

TO : OVP - Mrs. Nancy Bearg Dyke
 NSC - Mr. Allen Lenz
 DOE - Mr. Henry Thomas
 DOC - Ms. Jean Jones
 DOD - Mr. Jay Rixse
 JCS - LTC Edward Bucknell
 USTR - Mr. Richard Heimlich
 Treasury - Mr. David Pickford
 CIA - Mr. Thomas B. Cormack
 OMB - Mr. William Schneider

SUBJECT: Strategy Paper on Yamal Energy Alternatives

Attached for interagency consideration and comment is a working level draft strategy paper on Yamal energy alternatives as tasked by the SIG on East-West Economic Relations in its meeting October 9. The draft is being circulated in advance of SIG-level clearance owing to the presence of senior officers in Cancun.

Addressees are asked to review the draft promptly. Suggested revisions, in writing, should be sent to this office by COB Monday, October 26. A SIG meeting to discuss the draft will be scheduled for the week of October 26.

Katherine Shirley for
 L. Paul Bremer, III
 Executive Secretary

Attachment:
 Strategy paper with appendices

87 : 8 87

~~CONFIDENTIAL~~(With ~~SECRET~~ Attachment)

GDS 10/23/87

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A US Strategy Towards the West European-Soviet Union Gas Pipeline

Background

The ideal European response to the President's concerns about the pipeline would be total abandonment of the Siberian pipeline project. This would effectively reduce European vulnerability to the disruption or threat of disruption of Soviet gas supplies and eliminate the hard currency earnings the project would provide the Soviets.

Given the strong political commitment by European leaders to the project and the progress made in the negotiations to date, the project is expected to proceed. Since President Reagan aired U.S. concerns to European leaders at the July Ottawa Summit, the only critical unresolved issue is price. The Soviets and the Germans hope to conclude the discussions before the November 23-24 Brezhnev visit to Bonn. Agreement is expected to be announced at that time.

A fundamental issue is whether the U.S. can effectively pursue with the allies the development of a coordinated and mutually beneficial strategy for international energy security and East-West trade. Parts of this strategy are in place, but the pipeline raises broader strategic problems which must be considered. The Europeans view the Soviet gas as an important means to diversify their energy supply. Pursuing energy diversification has been an important objective in the IEA and at Economic Summits. However, European economies and political systems will remain vulnerable to Middle East oil disruptions and the pipeline would create still another source of vulnerability. The Europeans must be prepared to minimize the risk resulting from energy disruptions from one or the other or both of these sources.

A second fundamental issue exemplified by this project is the divergence of views on East-West trade between the US and the Europeans. The Europeans believe that trade results in benefits to both sides. The pipeline has wide labor and business support in those participating countries.

If the pipeline proceeds despite our strong concerns US objectives should be sixfold:

- (i) Minimize European vulnerability to Soviet gas disruptions due to technical and/or political reasons;
- (ii) Maximize the European options and incentives to achieve a favorable price and set of conditions for the gas;
- (iii) Reduce the benefits which would accrue to the Soviet Union;
- (iv) Signal that the United States is willing to do its share to strengthen the energy security of the West;

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(v) Take into account the need for Allied and other European support for broader US objectives (e.g. TNF and tighter multilateral export controls); and

(vi) Ensure that any US economic restrictions should hurt Soviet interests more than US interests.

To address U.S. concerns and influence the timing, terms and conditions of the project it is imperative that the U.S. begin discussions with the FRG and other European participants by the first week in November, although at this late stage it may not be possible for the U.S. to prevent the construction of the pipeline. However, we should still continue to voice our basic concerns to the Europeans and, as President Reagan has promised, offer them options for meeting their energy needs.

Strong actions initiated by the United States--like an embargo of equipment needed for the project--may delay construction of the pipeline and could reinforce our arguments and their doubts about the need for future increased quantities. Valuable time could be gained--time which can benefit the Europeans in their continuing negotiations with the Soviet Union, as well as provide an important window of opportunity in which to strengthen European defenses against a possible future cut-off of gas supplies. The Europeans, however, may view such a delay as an extension of their vulnerability to Middle East energy. In addition, such a step would exacerbate our political difficulties with European allies and make progress on other high Administration priorities more difficult.

Major U.S. Points to be Raised

Achieving the above objectives would require joint action by Western European countries and the United States. In forthcoming discussions with the Europeans, the U.S. should emphasize the following points:

(1) The economic viability of the pipeline is becoming more uncertain. There are growing indications that gas demand will be significantly lower than previously anticipated and that other, less risky energy supplies might be available from elsewhere. We must, however, recognize that while on purely energy grounds the pipeline is becoming less economically attractive, the Europeans see the pipeline as helping to provide jobs and to support key depressed industries within Europe.

The Europeans are trying and may be successful in holding out until the Brezhnev visit to Bonn for a better price and more favorable conditions. This is a point which we should emphasize. Barring renewed conflict and disruption in the Near East, a delay, even beyond the Brezhnev trip, could work to the advantage of the Europeans. The Europeans may oppose a protracted delay, however, since they view the period preceding the Brezhnev visit to Bonn as the best time to complete the deal.

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In the best of circumstances, Europe's gain can be maximized at the expense of the Soviet Union and the objective of reducing the benefits to the Soviets will be partially realized. (Annex I has a detailed discussion of the economic viability of the pipeline.)

(2) In a worst case scenario, Europe would be susceptible to increased political and economic leverage applied by the Soviet Union. Although European reliance on Soviet gas will only account for 5 percent of total energy consumption, some regions and sectors would be far more dependent. In the event of an interruption in Soviet gas supplies, there would be no readily available substitutes unless there was excess capacity in other parts of the gas grid. Unless there is sufficient stored gas and infrastructure to deliver it, gas is difficult to replace on short notice: there is no spot market and storage is expensive and technically difficult.

In the event of a Middle East oil disruption, the Soviet Union would have enhanced leverage which they might exploit. If both the Middle East oil deliveries and Soviet gas imports were disrupted simultaneously, Europe and its Allies would face serious economic, political and strategic difficulties.

(3) Other energy alternatives are available over the medium and longer term that can better serve European economic, security and political interests than the Soviet gas option. Imported coal, nuclear power, and intensified indigenous North Sea oil and gas production could all contribute to meeting future European energy demand and thereby replace the need for Soviet gas (see Annex 3). There are new developments which suggest that the Nigerians may be willing to provide significant quantities of natural gas at competitive prices. (DOE will circulate, shortly, an annex to this paper which goes into detail on this issue.)

(4) There are additional alternatives which the United States could choose to strengthen Western energy security. The U.S. is in the process of strengthening its own energy security: the President's move to decontrol oil has resulted in a dramatic drop in oil imports which has benefited all consuming nations; the size of the Strategic Petroleum Reserve has doubled in eight months; and nuclear power and Alaskan natural gas prospects have been given strong Presidential endorsement.

The U.S. could consider further actions which would require interagency approval before these ideas could be presented to the Europeans. Some of these would include deregulation of natural gas, more active stock build and the imposition of an oil import security fee. The U.S. could also explore with the Europeans ways to accelerate the already promising outlook for U.S. coal exports to Europe. In addition, the U.S. and others could appeal to the new government in Norway to expand its natural gas production and capacity and transport systems. Plans could be developed

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to assist Norway with recycling revenues into profitable long term sources of income so that its domestic economy is not adversely affected. The US could also discourage imports of long haul LNG to U.S. markets (for example, by applying a prohibitive import fee and/or a comparative fuel price test) and thereby induce some producers to reconsider their pricing decisions. European gas consumers would clearly benefit from such action. (Annex 4 goes into more detail on possible US action.)

(5) In the event that the pipeline proceeds, means must be found and put in place to reduce European vulnerability. The best defense against a politically motivated cut-off is to have convincing emergency precautions in place that can be readily activated. Some of these precautions would include larger oil and gas stocks, shut-in gas reserves in European fields which could be used in a gas emergency, and more dual-fired capacity among large industrial users and electrical power plants--so that oil and coal could be substituted in the event of a disruption of the gas supply. There are several means to "internalize" the security costs (e.g., a gas import security fee) which could be used to finance security initiatives such as those described above. Such suggestions to the Europeans must be accompanied with convincing arguments for the need and preliminary assessments of the costs of these security measures. (Annex 2 has a fuller discussion of European vulnerability.)

(6) If it wished the US could try to delay construction of the pipeline by seeking a joint US/UK embargo of key compressor components and technology for the project. Current plans for the pipeline call for West European compressor component manufacturers to procure compressor turbine rotors and drive shafts from General Electric. Only Rolls Royce now produces a turbine which is not based on U.S. technology and Rolls Royce is now prepared to deliver these key components. If we can obtain and effectively enforce a US-UK embargo of turbines to run the pipeline compressors, we may be able to delay the delivery of key components for up to two years. By that time a French licensee of G.E. technology could retool to produce a similar product. On the other hand, it is doubtful that the UK would go along with such an equipment embargo. (British Defense Minister Nott's reaction to Secretary Weinberger was very negative.) The US could also consider unilateral action. Such action would not be as effective as a joint US-UK embargo, but it would signal the seriousness of US concerns over the pipeline. U.S. companies would lose sales; GE, for example, would lose some \$175 million in sales and release a new competitor on world markets. Any other actions we might take are not likely to have the same impact in establishing the seriousness of our intentions.

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However, unilateral action is likely to meet with sharp European criticism and may weaken allied cooperation on other high Administration priorities. The motivation for such action will have to be clearly explained and understood because there could be charges that the US is unilaterally imposing its viewpoint on the Western alliance. If we choose to discuss the embargo option with the Europeans it will be necessary to develop a convincing argument to counter the likely European response that this is a move to punish Europe for going through with the deal. We should emphasize that such action is a worthwhile security measure and in long term Western security interests. Because such action could delay construction, it would give Europe more time to reassess the economic viability of the pipeline in light of recent and expected world energy markets. (See Annex V)

Recommendations

(i) That the objectives and means outlined in this paper be cleared by members of the SIG on East-West Economic relations and, shortly thereafter, by a Cabinet level group (probably NSC).

(ii) That a high level State-led team visit Bonn, Paris, Rome and other selected capitals during the first week of November to present these ideas to the Europeans.

(iii) That subsequent to, and depending on the results of these meetings, a decision memorandum to the President be drawn up on whether or not an US/UK embargo on key compressor components and technology should be sought.

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ANNEX I - ECONOMICS OF THE SIBERIAN PIPELINE

The economics of the project are questionable:.

- Since 1978 the economic factors affecting East-West gas trade have changed dramatically. Overall energy growth rates are down and markets are soft. European gas demand fell last year by 4 percent. It appears that the rate of substitution of gas for oil has slowed. Official estimates of future gas demand have been revised downward and the market is likely to be weak for a considerable period of time.

- These fundamental changes in world energy markets raise serious questions as to whether the volume of gas contemplated for transmission through the pipeline can in fact find a market in Western Europe. While the Soviets may wish to set the FOB price as close as possible to the BTU equivalent of crude oil, in the current market and for the foreseeable future such a high price would almost certainly make it impossible for the gas to be competitive with other forms of energy in Western Europe.

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The pipeline project would make Europeans vulnerable to Soviet pressure

- The volume of Soviet gas as a percentage of total European energy consumption is not alone a sufficient indicator of economic and political vulnerability:
- Gas is a difficult fuel to replace on short notice. Unlike oil, there is no spot market. Gas trade requires large start-up infrastructure investments in pipelines or LNG facilities. Furthermore, it is much more expensive and technically challenging to hold large strategic stocks of gas as compared to oil. Certain regions will be heavily dependent on Soviet gas and might apply strong pressure on national governments to avoid actions that could result in an interruption. In the event of an interruption, Soviet gas could not be readily replaced unless there was excess capacity in other parts of the European energy grid.
- Residential and commercial consumers are particularly dependent on gas. A cut-off of Soviet gas would be onerous for these politically sensitive sectors. Thirty percent of gas for the pipeline is earmarked for residential use. Residential and commercial consumers are the least able to absorb an abrupt fuel supply interruption. Homeowners have limited capacity to switch easily to another fuel. Furthermore, gas prices would probably rise precipitously in the wake of a Soviet embargo and thus place a harsh financial burden on homeowners and commercial businesses.
- Technical or seasonal difficulties--perhaps complicated by the need to divert gas from export to domestic use to make up for reduced deliveries of Iranian gas--forced the Soviets to slow some gas shipments to the West last winter and spring. The probability of further technical or seasonal interruptions may increase as the Soviets try to ship more gas from outlying and more risky Siberian provinces to Western Europe.
- In the past, the Soviet Union has used energy exports as a political lever, interrupting supplies to Yugoslavia, Israel, and China, among others. Under some circumstances, the Soviets might elicit otherwise unobtainable economic and political concessions from their West European gas customers.
- Thus, West European vulnerability to Soviet gas leverage could be substantial. And it is not unreasonable to assume that the Soviets from time to time would see the dependence of Western Europe on Soviet gas as an opportunity to try to obtain political and/or economic benefits.

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ANNEX III - ENERGY ALTERNATIVES AVAILABLE TO EUROPE

European economic security and political interests could be better served by choosing non-Soviet alternatives.

- A major alternative may be oil itself. The oil market for the 1980s has undergone a significant change from that of the late 1970s when plans for gas imports were developed. Few predicted the magnitude of demand reduction in response to rising oil prices. Much of this is due to structural changes in our economies and societies, not simply reduced economic growth. In light of these circumstances there is a possibility that energy prices may be relatively stable during the 1980s.
- African gas is closer to our European allies than it is to us and can be an alternative to Soviet imports. There are substantial gas resources in Algeria, Nigeria, Cameroon and Qatar that could be available to our European allies and friends; this gas could replace part of the anticipated Siberian pipeline deliveries.
- Within Western Europe, Norway has the potential to become an increasingly important gas supplier to Continental Europe in the 1990s, although prospects for accelerated development in the 1980s are uncertain. The US and others could assist Norway with recycling some of its increased revenues into long term profitable sources, so as to minimize the adverse short term effects in their economy. It may also be possible to convince the Dutch to slow their phase-out of exports in light of reduced demand. This is largely a political question, and could be influenced by our views.
- Coal has more potential than any other resource for providing additional energy during the rest of this century and beyond. Rapid growth in the use of coal is critical to the successful transition to a more secure energy future. There are increasing indications that a "coal renaissance" is now underway and that the shift to increased coal use will gain momentum.

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ANNEX IV - US CONTRIBUTION TO WESTERN EUROPE AND OVERALL
WESTERN ENERGY SECURITY

- The United States has taken and will continue to implement a number of steps which will increase the availability of oil as well as gas on the world market. We have already decontrolled oil prices in an effort to encourage domestic production and reduce wasteful use. Moves are also being taken to increase leasing of federal land including the Outer Continental Shelf in order to help stimulate heretofore locked-in domestic energy wealth.
- The Administration is currently reviewing proposals for accelerated gas price deregulation. But, even if the deregulation process cannot be accelerated, price controls on most domestic gas will be removed by the time that the Siberian pipeline is completed. Accelerated gas price deregulation will help stimulate domestic production and enable the US to decrease its need for oil and gas imports.
- As gas price deregulation proceeds, gas use will become more efficient and supplies more plentiful. To the extent the US will still require imported gas, market forces will favor imports from Canada and Mexico and possibly other Western Hemisphere sources rather than long-haul liquified natural gas (LNG). Even under our current competitive fuels test for the price of gas imports, long-haul LNG will have difficulty finding a place in the US market.
- The Administration has announced its commitment to the development of nuclear power in the US and has stressed that the US will reestablish itself as a reliable partner in the international nuclear energy arena. Many of our allies and friends in Europe will welcome the reentry of the US into a position of leadership in the international nuclear community. Several European countries are concerned about problems related to the back-end of the nuclear fuel cycle, specifically reprocessing and waste management. Our more positive position on reprocessing and expanded nuclear cooperation, particularly in the back-end of the fuel cycle, could help to mitigate some of the problems associated with the accelerated development of West European nuclear power.

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ANNEX V - Embargo of Compressors and Related Technology

A means to possibly delay construction of the pipeline would be a US embargo of compressors and related technology. The supply of turbines may be a critical chokepoint for the West Siberian pipeline project. The Soviets have ordered some \$2 billion worth of turbine compressors for the project from Western European companies who are partial licensees of G.E. gas turbine technology. Current plans call for General Electric (U.S.) to supply the European companies with \$175 million in critical turbine technology. GE and Rolls Royce control directly, or indirectly by means of licenses, all Western technology for the production of turbines that could be used on the pipeline. A French company, Alstrom-Atlantique, is the only full G.E. licensee of gas turbine technology, but does not now produce the type of rotor that G.E.'s partial licensees in Europe have ordered from the American company. Under the terms of the Export Administration Act, the President could place either national security or foreign policy export controls on this equipment and technology.

The US faces four options with regard to an embargo:

(i) No embargo. This would mean a continuation of present policy, as the US does not currently control the export of turbines or compressors nor their components and technology. This option would allow the construction of the pipeline to go forward as expected and US industry, in particular GE, would benefit. The perception that this would implicitly signal US approval is somewhat muted by the fact that no US company is a direct supplier. Other high Administration priorities in European dealings could continue to be judged on their own merit (as opposed to being possibly affected if an embargo option is chosen).

(ii) US unilateral embargo. This would signal the Europeans of the seriousness of US intentions. It would also deny the Soviet Union the best product; the GE turbine is known to them -- it is already in use and it fits their needs. If denied the GE product, the Soviet Union would likely purchase the more expensive UK Rolls Royce turbine: it is similar to the US technology, although it has not been tested in the Soviet Union. We recently learned that the British EGCD (their EXIM equivalent) is prepared to finance Rolls Royce -- thus the British Government appears ready to support such a sale. There is an added Soviet bonus to buying the Rolls Royce unit, since it is an aeroderivative engine several generations more advanced than the G.E. product.

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(iii) UK/US embargo. This option could have the effect of delaying delivery of compressor components for up to two years--the time needed for the French firm to produce a similar product. There is question how a delay in the components will affect the overall schedule of the pipeline completion.* Compressors can be added rather late during construction and, therefore, gas flow might not be delayed significantly. UK Defense Minister Nott told Secretary Weinberger in August that the idea of UK participation in an equipment embargo is a "non-starter" and would be "politically disastrous" for the Atlantic Alliance because of German sensitivities over the project.

(iv) UK/US/French embargo. This option would have the most effect in delaying the pipeline. The Soviets would have to substitute two to three times as many of their compressors for the higher quality Western alternatives, if the Soviets could indeed increase production to that level. As noted above, there would be possibly serious problems in obtaining the British and French support for such action. While G.E.'s full licensee in France is technically bound by contract to honor US export control regulations, the US has no means to enforce this regulation outside of its borders. Enforcement would require French Government assistance and the French are unlikely to stop a project in which they have an important energy stake. Neither the French nor the British have domestic legal mechanisms to control trade that has not been designated as strategic (i.e., trade which has direct military application) by COCOM. COCOM, which operates on a consensus basis, does not currently control equipment and technology in the energy area, and a US proposal in COCOM to institute an embargo would face German (and perhaps other) opposition.

Since neither the British nor French have legislation with which to control non-strategic exports, a possible US alternative strategy with these countries is to ask them not to extend official credits for substitute sales to the USSR. All existing equipment orders for the pipeline, with the exception of GE sales of rotors to its European manufacturing associates, are slated to receive official credits. If Rolls Royce and Alsthom-Atlantique were forced to offer market financing for their substitute products, their attractiveness as suppliers would be diminished. However, as rotors constitute only about 10% of the total value of turbine and compressor sales for the pipeline, the Soviets might pay the price to ensure that the pipeline moves forward.

*This issue is being carefully considered at this time and more information should be available shortly.

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If we choose to pursue one of the embargo options, a convincing strategy will have to be developed to counter the likely European view that this is a means to punish them for their decision to proceed with the pipeline. The US should stress that this is not the case: it is our sincere view that the embargo would serve an important Western security objective. Because such action might delay construction of the pipeline, the Europeans may reassess the economic viability of the pipeline, which in the view of the US has not been given sufficient attention in light of recent and expected world energy markets.

The decision to embargo is likely to affect other areas of European-US relations. It may also drive a wedge between the allies which would benefit the Soviet Union. The pros and cons of this action will have to be given careful consideration alongside other high Administration priorities.

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ANNEX VI - LIKELY EUROPEAN REACTION TO US CONCERNS AND PRESENTATION

The Europeans are likely to reply that:

- Projected levels of European dependence on Soviet gas are low. Dependence on Soviet energy will be 5 percent or less of total energy consumption in all countries except Austria. The Europeans conclude, therefore, that the Soviets would not gain any real leverage as a result of this pipeline.
- Their use of Soviet gas is a necessary part of their strategy to reduce their oil consumption and to diversify their sources of energy. Soviet gas imports, by reducing their dependence on fuels from the Middle East, would, on balance, improve their overall energy security.
- The Soviet Union, unlike Middle Eastern suppliers, has never in the past shut off energy shipments to West European countries for political reasons.
- The only immediate alternatives to increased Soviet gas imports would be increased dependence on oil and gas from the least reliable Middle Eastern suppliers.
- They have scaled-down the project and are contemplating a safety net based on:
 - The flexibility of indigenous European gas production;
 - Their ability to substitute other fuels (oil or coal) for gas used in electric power plants and industry;
 - Significantly expanded stored gas reserves; and
 - The integration of European national gas grids.
- The US approach does not meet one of the major reasons for proceeding with the project--the creation of employment and contracts for the European companies, particularly in the currently depressed steel industry.

ATT to NFAC #6748-8T
23 October 1981

MEMORANDUM

SUBJECT: Impact of US Export Licensing Decisions on Completion of the Yamal Pipeline

1. Newly acquired information strongly indicates that US refusal to license key compressor components for the Yamal pipeline would not delay completion of that project. Previous estimates of delays of about two years in acquiring denied components from European suppliers appear to be correct; nevertheless, even with such a delay the compressors would be available soon enough to complete the pipeline about on schedule.

2. Well informed officials from four US pipeline companies and engineering firms, in discussions with CIA analysts, unanimously expressed the following views:

(1) If the US government refuses to license exports of key US-produced components for the GE compressor now planned to be used in the Yamal pipeline, the Soviets will quickly turn to the Rolls Royce RB211 as a substitute, with little degradation of results.

(2) They could also contract to have the embargoed components produced in Europe, even though this might take four years or so compared with less than two if these were obtained from GE. This would give the Soviets an option both for this and subsequent pipeline projects.

(3) The compressors or major compressor components could be installed in the last stages of the pipeline construction process. Since it would take at least four to five years to build the pipeline, the availability of compressors need not be a cause of delay.

(4) Delays of one to two years in construction time are in any event likely, not because of unavailability of compressors, but because of difficulties with weather, terrain, and inexperienced construction labor.

3. This information suggests that the US lacks the instruments necessary to delay completion of the pipeline through unilateral action.

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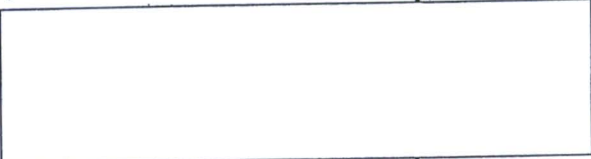
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BY KML NARA DATE 9/25/12

We may complicate the construction problem, but probably nothing more. We know of no evidence supporting a contrary view.

4. A more detailed analysis will be available on Monday, 26 October.



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Background

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to assist Norway with recycling revenues into profitable long term sources of income so that its domestic economy is not adversely affected. The US could also discourage imports of long haul LNG to U.S. markets (for example, by applying a prohibitive import fee and/or a comparative fuel price test) and thereby induce some producers to reconsider their pricing decisions. European gas consumers would clearly benefit from such action. (Annex 4 goes into more detail on possible US action.)

(5) In the event that the pipeline proceeds, means must be found and put in place to reduce European vulnerability. The best defense against a politically motivated cut-off is to have convincing emergency precautions in place that can be readily activated. Some of these precautions would include larger oil and gas stocks, shut-in gas reserves in European fields which could be used in a gas emergency, and more dual-fired capacity among large industrial users and electrical power plants--so that oil and coal could be substituted in the event of a disruption of the gas supply. There are several means to "internalize" the security costs (e.g., a gas import security fee) which could be used to finance security initiatives such as those described above. Such suggestions to the Europeans must be accompanied with convincing arguments for the need and preliminary assessments of the costs of these security measures. (Annex 2 has a fuller discussion of European vulnerability.)

(6) If it wished the US could try to delay construction of the pipeline by seeking a joint US/UK embargo of key compressor components and technology for the project. Current plans for the pipeline call for west European compressor component manufacturers to procure compressor turbine rotors and drive shafts from General Electric. Only Rolls Royce now produces a turbine which is not based on U.S. technology and Rolls Royce is now prepared to deliver these key components. If we can obtain and effectively enforce a US-UK embargo of turbines to run the pipeline compressors, we may be able to delay the delivery of key components for up to two years. By that time a French licensee of G.E. technology could retool to produce a similiar product. On the other hand, it is doubtful that the UK would go along with such an equipment embargo. (British Defense Minister Nott's reaction to Secretary Weinberger was very negative.) The US could also consider unilateral action. Such action would not be as effective as a joint US-UK embargo, but it would signal the seriousness of US concerns over the pipeline. U.S. companies would lose sales; GE, for example, would lose some \$175 million in sales and release a new competitor on world markets. Any other actions we might take are not likely to have the same impact in establishing the seriousness of our intentions.

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However, unilateral action is likely to meet with sharp European criticism and may weaken allied cooperation on other high Administration priorities. The motivation for such action will have to be clearly explained and understood because there could be charges that the US is unilaterally imposing its viewpoint on the Western alliance. If we choose to discuss the embargo option with the Europeans it will be necessary to develop a convincing argument to counter the likely European response that this is a move to punish Europe for going through with the deal. We should emphasize that such action is a worthwhile security measure and in long term Western security interests. Because such action could delay construction, it would give Europe more time to reassess the economic viability of the pipeline in light of recent and expected world energy markets. (See Annex V)

Recommendations

(i) That the objectives and means outlined in this paper be cleared by members of the SIG on East-West Economic relations and, shortly thereafter, by a Cabinet level group (probably NSC).

(ii) That a high level State-led team visit Bonn, Paris, Rome and other selected capitals during the first week of November to present these ideas to the Europeans.

(iii) That subsequent to, and depending on the results of these meetings, a decision memorandum to the President be drawn up on whether or not an US/UK embargo on key compressor components and technology should be sought.

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ANNEX I - ECONOMICS OF THE SIBERIAN PIPELINE

The economics of the project are questionable:

- Since 1978 the economic factors affecting East-West gas trade have changed dramatically. Overall energy growth rates are down and markets are soft. European gas demand fell last year by 4 percent. It appears that the rate of substitution of gas for oil has slowed. Official estimates of future gas demand have been revised downward and the market is likely to be weak for a considerable period of time.

- These fundamental changes in world energy markets raise serious questions as to whether the volume of gas contemplated for transmission through the pipeline can in fact find a market in Western Europe. While the Soviets may wish to set the FOB price as close as possible to the BTU equivalent of crude oil, in the current market and for the foreseeable future such a high price would almost certainly make it impossible for the gas to be competitive with other forms of energy in Western Europe.

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The pipeline project would make Europeans vulnerable to Soviet pressure.

- The volume of Soviet gas as a percentage of total European energy consumption is not alone a sufficient indicator of economic and political vulnerability:
 - Gas is a difficult fuel to replace on short notice. Unlike oil, there is no spot market. Gas trade requires large start-up infrastructure investments in pipelines or LNG facilities. Furthermore, it is much more expensive and technically challenging to hold large strategic stocks of gas as compared to oil. Certain regions will be heavily dependent on Soviet gas and might apply strong pressure on national governments to avoid actions that could result in an interruption. In the event of an interruption, Soviet gas could not be readily replaced unless there was excess capacity in other parts of the European energy grid.
 - Residential and commercial consumers are particularly dependent on gas. A cut-off of Soviet gas would be onerous for these politically sensitive sectors. Thirty percent of gas for the pipeline is earmarked for residential use. Residential and commercial consumers are the least able to absorb an abrupt fuel supply interruption. Homeowners have limited capacity to switch easily to another fuel. Furthermore, gas prices would probably rise precipitously in the wake of a Soviet embargo and thus place a harsh financial burden on homeowners and commercial businesses.
- Technical or seasonal difficulties--perhaps complicated by the need to divert gas from export to domestic use to make up for reduced deliveries of Iranian gas--forced the Soviets to slow some gas shipments to the West last winter and spring. The probability of further technical or seasonal interruptions may increase as the Soviets try to ship more gas from outlying and more risky Siberian provinces to Western Europe.
- In the past, the Soviet Union has used energy exports as a political lever, interrupting supplies to Yugoslavia, Israel, and China, among others. Under some circumstances, the Soviets might elicit otherwise unobtainable economic and political concessions from their West European gas customers.
- Thus, West European vulnerability to Soviet gas leverage could be substantial. And it is not unreasonable to assume that the Soviets from time to time would see the dependence of Western Europe on Soviet gas as an opportunity to try to obtain political and/or economic benefits.

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ANNEX III - ENERGY ALTERNATIVES AVAILABLE TO EUROPE

European economic security and political interests could be better served by choosing non-Soviet alternatives.

- A major alternative may be oil itself. The oil market for the 1980s has undergone a significant change from that of the late 1970s when plans for gas imports were developed. Few predicted the magnitude of demand reduction in response to rising oil prices. Much of this is due to structural changes in our economies and societies, not simply reduced economic growth. In light of these circumstances there is a possibility that energy prices may be relatively stable during the 1980s.
- African gas is closer to our European allies than it is to us and can be an alternative to Soviet imports. There are substantial gas resources in Algeria, Nigeria, Cameroon and Qatar that could be available to our European allies and friends; this gas could replace part of the anticipated Siberian pipeline deliveries.
- Within Western Europe, Norway has the potential to become an increasingly important gas supplier to Continental Europe in the 1990s, although prospects for accelerated development in the 1980s are uncertain. The US and others could assist Norway with recycling some of its increased revenues into long term profitable sources, so as to minimize the adverse short term effects in their economy. It may also be possible to convince the Dutch to slow their phase-out of exports in light of reduced demand. This is largely a political question, and could be influenced by our views.
- Coal has more potential than any other resource for providing additional energy during the rest of this century and beyond. Rapid growth in the use of coal is critical to the successful transition to a more secure energy future. There are increasing indications that a "coal renaissance" is now underway and that the shift to increased coal use will gain momentum.

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- The United States has taken and will continue to implement a number of steps which will increase the availability of oil as well as gas on the world market. We have already decontrolled oil prices in an effort to encourage domestic production and reduce wasteful use. Moves are also being taken to increase leasing of federal land including the Outer Continental Shelf in order to help stimulate heretofore locked-in domestic energy wealth.
- The Administration is currently reviewing proposals for accelerated gas price deregulation. But, even if the deregulation process cannot be accelerated, price controls on most domestic gas will be removed by the time that the Siberian pipeline is completed. Accelerated gas price deregulation will help stimulate domestic production and enable the US to decrease its need for oil and gas imports.
- As gas price deregulation proceeds, gas use will become more efficient and supplies more plentiful. To the extent the US will still require imported gas, market forces will favor imports from Canada and Mexico and possibly other Western Hemisphere sources rather than long-haul liquified natural gas (LNG). Even under our current competitive fuels test for the price of gas imports, long-haul LNG will have difficulty finding a place in the US market.
- The Administration has announced its commitment to the development of nuclear power in the US and has stressed that the US will reestablish itself as a reliable partner in the international nuclear energy arena. Many of our allies and friends in Europe will welcome the reentry of the US into a position of leadership in the international nuclear community. Several European countries are concerned about problems related to the back-end of the nuclear fuel cycle, specifically reprocessing and waste management. Our more positive position on reprocessing and expanded nuclear cooperation, particularly in the back-end of the fuel cycle, could help to mitigate some of the problems associated with the accelerated development of west European nuclear power.

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A means to possibly delay construction of the pipeline would be a US embargo of compressors and related technology. The supply of turbines may be a critical chokepoint for the West Siberian pipeline project. The Soviets have ordered some \$2 billion worth of turbine compressors for the project from Western European companies who are partial licensees of G.E. gas turbine technology. Current plans call for General Electric (U.S.) to supply the European companies with \$175 million in critical turbine technology. GE and Rolls Royce control directly, or indirectly by means of licenses, all Western technology for the production of turbines that could be used on the pipeline. A French company, Alstrom-Atlantique, is the only full G.E. licensee of gas turbine technology, but does not now produce the type of rotor that G.E.'s partial licensees in Europe have ordered from the American company. Under the terms of the Export Administration Act, the President could place either national security or foreign policy export controls on this equipment and technology.

The US faces four options with regard to an embargo:

(i) No embargo. This would mean a continuation of present policy, as the US does not currently control the export of turbines or compressors nor their components and technology. This option would allow the construction of the pipeline to go forward as expected and US industry, in particular GE, would benefit. The perception that this would implicitly signal US approval is somewhat muted by the fact that no US company is a direct supplier. Other high Administration priorities in European dealings could continue to be judged on their own merit (as opposed to being possibly affected if an embargo option is chosen).

(ii) US unilateral embargo. This would signal the Europeans of the seriousness of US intentions. It would also deny the Soviet Union the best product; the GE turbine is known to them -- it is already in use and it fits their needs. If denied the GE product, the Soviet Union would likely purchase the more expensive UK Rolls Royce turbine: it is similar to the US technology, although it has not been tested in the Soviet Union. We recently learned that the British EGCD (their EXIM equivalent) is prepared to finance Rolls Royce -- thus the British Government appears ready to support such a sale. There is an added Soviet bonus to buying the Rolls Royce unit, since it is an aeroderivative engine several generations more advanced than the G.E. product.

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(iii) UK/US embargo. This option could have the effect of delaying delivery of compressor components for up to two years--the time needed for the French firm to produce a similar product. There is question how a delay in the components will affect the overall schedule of the pipeline completion.* Compressors can be added rather late during construction and, therefore, gas flow might not be delayed significantly. UK Defense Minister Nott told Secretary Weinberger in August that the idea of UK participation in an equipment embargo is a "non-starter" and would be "politically disastrous" for the Atlantic Alliance because of German sensitivities over the project.

(iv) UK/US/French embargo. This option would have the most effect in delaying the pipeline. The Soviets would have to substitute two to three times as many of their compressors for the higher quality Western alternatives, if the Soviets could indeed increase production to that level. As noted above, there would be possibly serious problems in obtaining the British and French support for such action. While G.E.'s full licensee in France is technically bound by contract to honor US export control regulations, the US has no means to enforce this regulation outside of its borders. Enforcement would require French Government assistance and the French are unlikely to stop a project in which they have an important energy stake. Neither the French nor the British have domestic legal mechanisms to control trade that has not been designated as strategic (i.e., trade which has direct military application) by COCOM. COCOM, which operates on a consensus basis, does not currently control equipment and technology in the energy area, and a US proposal in COCOM to institute an embargo would face German (and perhaps other) opposition.

Since neither the British nor French have legislation with which to control non-strategic exports, a possible US alternative strategy with these countries is to ask them not to extend official credits for substitute sales to the USSR. All existing equipment orders for the pipeline, with the exception of GE sales of rotors to its European manufacturing associates, are slated to receive official credits. If Rolls Royce and Alsthom-Atlantique were forced to offer market financing for their substitute products, their attractiveness as suppliers would be diminished. However, as rotors constitute only about 10% of the total value of turbine and compressor sales for the pipeline, the Soviets might pay the price to ensure that the pipeline moves forward.

*This issue is being carefully considered at this time and more information should be available shortly.

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If we choose to pursue one of the embargo options, a convincing strategy will have to be developed to counter the likely European view that this is a means to punish them for their decision to proceed with the pipeline. The US should stress that this is not the case: it is our sincere view that the embargo would serve an important Western security objective. Because such action might delay construction of the pipeline, the Europeans may reassess the economic viability of the pipeline, which in the view of the US has not been given sufficient attention in light of recent and expected world energy markets.

The decision to embargo is likely to affect other areas of European-US relations. It may also drive a wedge between the allies which would benefit the Soviet Union. The pros and cons of this action will have to be given careful consideration alongside other high Administration priorities.

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ANNEX VI - LIKELY EUROPEAN REACTION TO US CONCERNS AND
PRESENTATION

The Europeans are likely to reply that:

- Projected levels of European dependence on Soviet gas are low. Dependence on Soviet energy will be 5 percent or less of total energy consumption in all countries except Austria. The Europeans conclude, therefore, that the Soviets would not gain any real leverage as a result of this pipeline.
- Their use of Soviet gas is a necessary part of their strategy to reduce their oil consumption and to diversify their sources of energy. Soviet gas imports, by reducing their dependence on fuels from the Middle East, would, on balance, improve their overall energy security.
- The Soviet Union, unlike Middle Eastern suppliers, has never in the past shut off energy shipments to West European countries for political reasons.
- The only immediate alternatives to increased Soviet gas imports would be increased dependence on oil and gas from the least reliable Middle Eastern suppliers.
- They have scaled-down the project and are contemplating a safety net based on:
 - The flexibility of indigenous European gas production;
 - Their ability to substitute other fuels (oil or coal) for gas used in electric power plants and industry;
 - Significantly expanded stored gas reserves; and
 - The integration of European national gas grids.
- The US approach does not meet one of the major reasons for proceeding with the project--the creation of employment and contracts for the European companies, particularly in the currently depressed steel industry.

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Drafted: E:WFMartin:jvm:10/22/81

Clearances:

- EUR:JScanlan
- EUR/SOV:HHamilton
- EUR/RPE:DMiller
- EUR/CE:JDBindenagle
- S/P:DLoft
- T:MMarks
- EB/IEP:ALarson

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BY KML NARA DATE 4/7/2011

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