Collection: Bailey, Norman A.: Files
Folder Title: East-West Trade
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ID Doc Type	Document Description	No of Pages	Doc Date	Restrictions
86768 MEMO	CLARK TO SHULTZ ET AL RE POLAND AND PRESIDENT'S DECISION ON SANCTIONS EXTENSION	2	8/2/1982	B1
86769 MEMO	RENTSCHLER/BLAIR/NAU TO CLARK RE PIPELINE SANCTIONS DECISION	1	7/30/1982	B1
86770 REPORT	SAKHALIN PROJECT	1	8/2/1982	B1
86776 MEMO	FROM CLARK RE ECONOMIC SANCTIONS	1	8/7/1982	B1 B3
86771 MEMO	BAILEY TO CLARK RE SANCTIONS POLICY IN THE FUTURE	1	7/13/1982	B1
86772 MEMO	CLARK TO THE PRESIDENT RE SANCTIONS POLICY: NEXT STEPS	2	ND	B1
86773 MEMO	BAILEY TO CLARK RE LEGAL CONSIDERATIONS PRESENTED BY EXPORT CONTROLS	1	8/9/1982	B1
86774 PAPER	LEGAL CONSIDERATIONS PRESENTED BY EXPORT CONTROLS	6	ND	B1

The above documents were not referred for declassification review at time of processing

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ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions	
86775	MEMO	FROM RAYMOND RE SOVIET USE OF FORCED LABOR	1	8/11/1982	B1	B3

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

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86768	MEMO CLARK TO SHULTZ ET AL RE POLAND AND PRESIDENT'S DECISION ON SANCTIONS EXTENSION	2	8/2/1982	B1

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3

National Security Council
The White House

RECEIVED

Package # 5253

82 AUG 2 A10 : 28

No folder
you should probably
seen by Brenda
Reger prior to dispatch
She was over this
morning and said
that all outgoing
memos now have
to indicate classification
of each paragraph

URGENT

	HAS SEEN	ACTION

I–Information A–Action R–Retain D–Dispatch N–No further Action

DISTRIBUTION

cc: VP Meese Baker Deaver Other________

COMMENTS

PRES. PENCILED IN HIS
"O.K." ON TOP PAGE –
→ PLEASE SIGN
AT TAB I

Done
8-2-82

A

SECRET

THE WHITE HOUSE
WASHINGTON

July 31, 1982

Mr. President:

If the attached reaffirmation of your rationale for the sanctions decision meets your approval, I would like to sign it and have it distributed to the addressees by Monday.

Bill
Bill Clark

OK
RR

SECRET

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	ZUBER
Box Number	
5	36

ID	*Document Type* / *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86769	MEMO RENTSCHLER/BLAIR/NAU TO CLARK RE PIPELINE SANCTIONS DECISION	1	7/30/1982	B1

The above documents were not referred for declassification review at time of processing

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6

MEMORANDUM

NATIONAL SECURITY COUNCIL

August 2, 1982

E-W T

MEMORANDUM FOR KENNETH M. DUBERSTEIN

FROM: ROBERT M. KIMMITT Bob

SUBJECT: H.R. 6838 To Lift Polish Sanctions

Quite simply, this bill seeks to overrule the President on an important national security matter. Our view is that it should be strongly opposed at every level, including this week's Subcommittee session. Powell Moore tried to contact you Saturday to convey this same message.

Attachment

Incoming correspondence

cc: John Poindexter
Norman Bailey
Dick Pipes

THE WHITE HOUSE
WASHINGTON

DATE 7/30/82

TO: BOB KIMMITT

FROM: KEN DUBERSTEIN

For your information ____________

Call me ____________

Please handle ____________

Please follow-up ____________

Comments:

Guidance please on a quick turnaround time. If question, please call B. Oglesby (6620).

Many thanks

4

THE WHITE HOUSE

WASHINGTON

July 30, 1982

MEMORANDUM FOR KEN DUBERSTEIN

FROM: M. B. OGLESBY, JR.

SUBJECT: Findley (R-Illinois) Bill: H.R. 6838 to Lift the Polish Sanctions Applied Last December

The Foreign Affairs Subcommittee on International Economic Policy and Trade will consider this bill next Wednesday. Tentatively, it will go to full Committee the following Tuesday.

Findley has both Frat-Allis and Caterpillar in his district and obviously needs to push this bill.

We need guidance as to the level of our effort to oppose this legislation in the House.

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86770	REPORT SAKHALIN PROJECT	1	8/2/1982	B1

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WS Journal 10
8/3/82
S-K'T.

Britain Orders 4 Firms to Defy U.S. Pipeline Ban

U.K. Move Affects Contracts With Value of $228 Million Related to Soviet Gas Line

By ROBERT L. MULLER And DAVID BRAND
Staff Reporters of THE WALL STREET JOURNAL

LONDON — The British government turned away from its long-standing support for the Reagan administration and followed other European nations in defying an American ban on supplying U.S.-licensed equipment for the Soviet natural-gas pipeline project.

The United Kingdom's trade secretary, Lord Cockfield, told the House of Lords that four companies in Britain, with contracts valued at a total of about $228 million for the proposed 3,600-mile pipeline will be prohibited from complying with the U.S. embargo. The pipeline, estimated to cost between $10 billion and $15 billion, is scheduled to supply 1.41 trillion cubic feet of gas annually to Western Europe by the mid-1980s.

Lord Cockfield said the embargo was "an attempt to interfere with existing contracts and is an unacceptable extension of American extraterritorial jurisdiction in a way which is repugnant in international law."

For other major international news, please see the stories about:
—Meeting between Reagan and Israeli foreign minister, page 2.
—Reagan's comments on continued martial law in Poland, page 2.

The Reagan administration made a low-key response to the British move. The State Department issued a statement saying it regrets "any action which weakens Western pressure on Polish authorities to relax significantly their martial-law measures." But the statement added the U.S. officials need time to study the British action before commenting further.

The four companies, one wholly British and three subsidiaries of American concerns, will be open to British penalties if they fail to honor the Soviet pipeline contracts "solely because of compliance with U.S. regulations," a government source said. The British concern is John Brown Engineering Ltd., a unit of John Brown PLC, the three others are Smith International (North Sea) Ltd., a unit of Smith International Inc., Newport Beach, Calif.; Baker Oil Tools (U.K.) Ltd., a unit of Baker International Corp., Orange, Calif., and AAF Ltd., a unit of Allis-Chalmers Corp., West Allis, Wis.

U.S. Companies Comment

In Milwaukee, an Allis-Chalmers spokesman said the transactions of its British-based AAF Ltd., which supplies John Brown with air filters for turbines used on the Soviet pipeline, aren't covered by the American ban. Allis-Chalmers plans to continue to supply the filters, and so won't be open to British penalties, the spokesman added.

In Orange, Calif., a spokesman for Baker International Corp. said he couldn't comment because he wasn't familiar with the details of the British decision. However, he stated that the Baker Oil Tools contract with the Soviet Union doesn't involve equipment intended to be part of the pipeline project.

In Newport Beach, Calif., a spokesman for Smith International said the company had previously ordered its English unit to comply with the U.S. embargo. Following the action by the British government, the spokesman said the two companies will be seeking legal advice on how to proceed. Smith International said its subsidiary's Soviet contract involves gas production equipment that isn't directly related to pipeline construction. "We think it's important to note that the embargo doesn't just apply to the pipeline. It applies to all oil equipment," the spokesman said.

Positions of Other Countries

The British action follows the recent tough stand on the U.S. embargo taken by France, Italy and West Germany. The French government has gone further than any other European country in actually ordering its companies to honor their pipeline contracts with the Soviet Union. The Italians have said that all signed agreements will be honored, although it has stopped short of ordering its companies to comply. And the West Germans, with the largest Soviet pipeline-related trade among the Europeans, has made clear its opposition to the U.S. sanctions.

After martial law was imposed in Poland last December, the U.S. embargoed all U.S. exports of oil and gas equipment and technology to the Soviet Union. On June 18, President Reagan broadened the American restrictions to ban U.S. companies' foreign subsidiaries and European companies manufacturing under U.S. license from supplying equipment to the Soviets.

Sir John Mayhew-Sanders, chairman of John Brown PLC, noted yesterday that the company's $182 million contract to supply 21 gas turbines for the Soviet pipeline "is a legally binding contract entered into three months before President Reagan entered his order last December." As a result of the British government action, he said, the first six turbines will be delivered to the Soviets at the end of August.

The other 15, Sir John said, "require more components which we would normally get from the U.S." However, he said, it would be possible for the company to obtain these components from "other places." He wouldn't elaborate other than to say, "I think we will deliver the other 15." John Brown has been receiving the components from General Electric Co. As "a manufacturing associate" of the U.S. concern and not as a licensee, Sir John added.

U.K. Company Isn't Pleased

John Brown, however, is "not pleased" with the British government action because the company fears that it could appear to be defying U.S. regulations and "appear to quarrel with U.S political intentions," said Sir John. Urging U.S understanding of the company's dilemma, he declared, "We aren't some dishonest cowboy company."

British government sources last night were describing the action as "a double negative", in that the four companies are forced to disobey the U.S. embargo but at the same

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86776	MEMO FROM CLARK RE ECONOMIC SANCTIONS	1	8/7/1982	B1 B3

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(7)

THE WHITE HOUSE
WASHINGTON

7/29

Judge,

If you didn't verbally task Casey yesterday, then it is not OBE. It will provide good reference material in the future especially since George Shultz may not agree with the effectiveness of sanctions.

② 7/29 WC
Did you discuss w/ Casey

14

259

National Security Council
The White House

Package # 4788
REP
TAG

RECEIVED

82 JUL 14 A10:56

	SEQUENCE TO	HAS SEEN	ACTION
John Poindexter	1	J	
Bud McFarlane	2	M	
Jacque Hill	3	J	
Judge Clark	4	C	A
John Poindexter			
Staff Secretary			
Sit Room			
JACQUE	5	Done	A

I–Information A–Action R–Retain D–Dispatch N–No further Action

DISTRIBUTION

cc: VP Meese Baker Deaver Other__________

COMMENTS

7/28
① JP:
assume we discussed
at Wed. (7/28) 5 pm mtg.

7/29 John
② Jim - Dis OBE'd?

Cmz

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86771	MEMO BAILEY TO CLARK RE SANCTIONS POLICY IN THE FUTURE	1	7/13/1982	B1

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86772	MEMO CLARK TO THE PRESIDENT RE SANCTIONS POLICY: NEXT STEPS	2	ND	B1

Bailey 18

SC/S PROFILE ~~CONFIDENTIAL~~ ID 8205559

UNCLASSIFIED UPON REMOVAL OF CLASSIFIED ENCLOSURE(S) amf 3/8/10

RECEIVED 09 AUG 82 17

TO CLARK FROM BAILEY DOCDATE 09 AUG 82

E-W T-

KEYWORDS: SANCTIONS EXPORT CONTROLS

USSR LEGAL ISSUES

SUBJECT: UNGER - ROBINSON PAPER RE LEGAL CONSIDERATIONS PRESENTED BY SOVIET PIPELINE EXPORT CONTROLS

ACTION: FOR INFORMATION DUE: STATUS IX FILES

FOR ACTION	FOR CONCURRENCE	FOR INFO
CLARK		ROBINSON
		NAU
		PIPES
		RENTSCHLER

COMMENTS

REF# LOG NSCIFID (N /)

ACTION OFFICER (S)	ASSIGNED	ACTION REQUIRED	DUE	COPIES TO
	8/12	Noted by Poindexter w/comment		
Kimmitt	8/12	For comment	8/13	NB

DISPATCH W/ATTCH FILE (C)

19

299

National Security Council
The White House

Package # 5557

82 AUG 9 P 8: 02

	SEQUENCE TO	HAS SEEN	ACTION
John Poindexter			
Bud McFarlane			
Jacque Hill			
Judge Clark			
John Poindexter	1	P	
Staff Secretary			
Sit Room			
KIMMITT	2		A

I-Information A-Action R-Retain D-Dispatch N-No further Action

DISTRIBUTION

cc: VP Meese Baker Deaver Other

COMMENTS

Any comment?

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ID	*Document Type* / *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
86773	MEMO BAILEY TO CLARK RE LEGAL CONSIDERATIONS PRESENTED BY EXPORT CONTROLS	1	8/9/1982	B1

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86774	PAPER LEGAL CONSIDERATIONS PRESENTED BY EXPORT CONTROLS	6	ND	B1

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E-W T/A

Soviet Gas: The Price of Secrecy

By Fred S. Hoffman

The West fell with notable speed from the apparent harmony at the Versailles summit to the abyss of discord over the Yamal gas pipeline project. French Foreign Minister Cheysson's prognosis of a "divorce" within the alliance offers little cause for cheer about the future of the unity that has protected Western security since World War II. The causes of Western discord are wider and deeper than the dispute over the Yamal project, but the West is unlikely to resolve the broader differences without finding a way out of the pipeline impasse.

Despite subsequent events, elements of the Versailles communique suggested some "rules of the game." The seven signatories agreed to "pursue a prudent and diversified economic approach to the U.S.S.R. and Eastern Europe consistent with our political and security interests." Unfortunately President Mitterrand's bland assertion that each country is "sovereignly responsible for deciding what is prudent" immediately contradicted the statement's recognition of a common interest in economic relations with the East, in turn eliciting the unilateral extension of U.S. sanctions against the Yamal project.

To reconstruct an alliance policy, we need a strong reaffirmation of a common interest in economic policy toward the East. In pursuit of this interest, the summit seven should also reaffirm the Versailles agreement to "... exchange information in the OECD on all aspects of our economic, commercial and financial relations with the Soviet Union and Eastern Europe." These exchanges are especially needed to deal with the pervasive problem of subsidies, which is deeply rooted in the domestic politics of each of the seven nations.

Lenin's prediction that capitalists would sell the rope to hang them fails to do justice to the irony of the current controversy about Western economic relations with the Soviet Bloc. The West isn't simply selling the rope; it's giving away quite a bit of it through subsidies and Western countries are competing for the privilege to do so. But surely refusing to subsidize our avowed adversaries falls short of the "economic warfare" from which our allies recoil.

A Taxpayer-Subsidized Risk

Since the onset of detente, Western gifts have been a major feature of East-West trade. These gifts have taken the form of government-subsidized credit at concessionary rates: guarantees that absorb on behalf of Western taxpayers the risk premium associated with Western export credits; and government bailouts for large firms heavily involved in East-West trade and credit. Government guarantees (explicit or implicit) have perverse effects that are hard to estimate precisely. Apart from their effects on credit terms, they weaken the incentives of Western commercial negotiators to drive a hard bargain with their Soviet counterparts over the terms of agreements that distribute the risks of losses. Moreover, by placing governments at risk with respect to recovery of credits, guarantees push the familiar economic dependence of creditors on major debtors into a political dependence.

These guaranteed ventures attract Western firms the way nectar attracts bees; the taste adds to special-interest pressures on Western governments to expand East-West trade whatever the overall economic effect on the country involved, let alone the strategic and political effects on the West.

The larger and riskier the project, the more serious the effects can be. And the current Yamal pipeline project is very large and very risky. The risks include construction cost overruns for the pipeline; slower, more costly or smaller natural gas reserve development than expected; and lower than expected prices for alternatives to Siberian natural gas.

The as yet unpublished details of the agreements with the Soviet Union are what will determine the division of benefits and risks among the participants. They include the security and repayment schedule for Western credits, specifically whether the repayments are dependent on "pipeline earnings"; how such earnings are defined; and the agreements governing the price and purchase amounts for the natural gas exported to the West, especially the existence of a floor price. Only fragmentary, unconfirmed information has been available on these matters.

A full exchange of information about the Yamal pipeline, as agreed to at Versailles, could clarify the economics of the case for Western citizens and their quarreling governments.

If Soviet obligations to repay depend on Western gas purchases—that is, the pipeline's "earnings"—the rules for dividing such earnings among Western and Soviet pipeline partners take on critical importance. The amount of the earnings and the effect on Western energy supplies will depend on the price and volumes involved in the gas purchase agreements. While these are secret, published estimates indicate that the price agreements include both a formula for escalation of the price based on a weighted average of crude oil and product prices, and a floor price that is estimated at about $5.50 per million BTU in 1984. This figure is well above current prices for natural gas in Western Europe. If the floor price is indexed to the general price level beyond 1984, it may remain above prevailing market prices for gas.

In the event that energy markets continue soft through the remainder of this decade, the floor price would determine the marketability of Siberian gas, whether such gas will have to be subsidized to be sold, whether there will be any pipeline "earnings," and the pace of repayment of the credits. Moreover if the floor price results in a long-term commitment by the West Europeans to take planned pipeline output at, say, $1 per million BTU higher than market prices over the first 10 years of the contract, the cost to Western economies (and subsidy to the Soviet Union) would have a 1982 present value of more than $5 billion, discounted at 15% per year.

Because of the project's secrecy, only the Soviet Union appears to be in a position to assess the risks and benefits of the project as a whole. All details are known to the Soviet Union, a party to all the agreements. But secrecy implies that something is supposed to be hidden from someone. If secrecy arises from commercial rivalry among Western firms and governments competing to supply pipe and equipment for the project, it clearly helps the Soviets to play Western competitors against each other. Moreover, without knowledge of the agreements reached by other participating firms and governments, Western participants can't estimate their own risks reliably.

Right Thing for Wrong Reason

Secrecy also conceals the details of the agreements from groups within the West whose interests are at risk and who are not parties to any of the agreements. These groups include alternative suppliers of natural gas; energy users who may face higher energy prices if a floor price agreement keeps the purchase price for Siberian gas above market prices, or if the long-term purchase commitment for gas aborts development of alternative energy supplies; and taxpayers who will have to make good on guarantees in the event that payback anticipations are not realized.

It may be that the details of the agreements support the contention that the project confers important economic benefits on the West. Secrecy, however, inevitably feeds suspicions that it is instead a large, juicy plum for the Soviet Union resulting from Western pursuit of detente, jobs and benefits for politically powerful domestic interests. The full exchange of information, as agreed to at the Versailles summit, could at least clarify the economics of the case both for the citizens of the West and for their quarreling governments. Moreover by putting Western negotiators on a more even footing with their Soviet counterparts, it might also improve the terms for the West.

Western governments are chafing under the burden of a defense establishment forced on all of them by the military threat from the Soviet Union. At such a time, it is surely unconscionable for Western countries to engage in pork-barrel projects that subsidize trade with their adversaries as a matter of sovereign right requiring only superficial explanation to their allies. Such a posture invites further unilateral acts which may bring us a good deal closer to the divorce of which France's Mr. Cheysson has spoken.

For its part, the U.S. needs to adopt a clearer and steadier policy and rationale. It may be better to do the right thing for the wrong reason than not to do it at all. If the Yamal project is economically marginal or harmful to the West, an economic boon to the Soviets and a threat to Western firmness in dealing with them, it may be better to oppose it as a reprisal for Poland than to acquiesce in it. But if Western participation in the Yamal project is a bad idea, it was bad before the Polish repression. And if the Polish government rescinded martial law tomorrow, it would still be a bad idea.

By withholding U.S. technology as a sanction against Polish repression, the U.S. has confused the long- and short-term problems of relations with the Soviets. In alliance matters, it is more than a matter of esthetics to try to do the right thing for the right reason. It often means the difference between an effective policy and one that is primarily an irritant.

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REVIEW & OUTLOOK

Pipeline Basics

The great pipeline debate between the U.S. and Europe isn't about natural gas at all. It's about subsidizing the Soviets in a vast capital project they couldn't otherwise afford.

Both sides must acknowledge that this is the basic issue before there can be any hope of resolving the conflict. What is needed from the Europeans is greater candor, both about the deal and about their reasons for entering into it. The benefits to European equipment-supply industries—clearly a major reason they have pursued this project—simply do not override the economic risks, not to mention the aid the project offers to a country that squanders its resources on a never-ending expansion of military might.

Some Europeans still insist they're not really subsidizing the pipeline. It's true, they say, that German bankers just returned from Leningrad having signed away $1.1 billion in credits at a measly 7.8%. This is below market rates and well below the 12.5% minimum Mr. Reagan sought at Versailles as a guarantee against subsidies. But they argue they'll be paying bargain prices for the gas and getting high prices for the European steel and equipment used to build the pipeline. They're clearly wrong on the first claim and we're dubious about the second.

Europeans may have been led to believe they'd get cheap gas but the Germans and French have agreed to buy the gas for prices starting at $4.75 to $5 per million BTUs, rising to a $5.70 minimum in 1984. Just last February the French signed a deal with Algeria agreeing on $4.65 as the market rate. As a political favor to its former territory, France paid the Algerians an extra 55 cents as a "development aid bonus." Instead of 55 cents as the bonus, the Russians are getting low interest rates and the prospects of billions in much-needed hard currency.

Mr. Reagan's embargo on the U.S. technology needed to build large turbines makes it doubtful that the Russians can deliver even at the price they're demanding. If they are forced to use smaller, less-powerful turbines to pump the gas through the 42-inch pipe, it is doubtful they can achieve sufficient pressure to supply the large quantities they are promising. Their unit costs will rise, and hence their ability to repay loans will diminish, unless they can renegotiate their contracts. Uncertainties among some Europeans, the Belgians and Spanish in particular, over price and delivery prospects are having an impact on the deal. The Russians, we're told, still haven't found buyers for about half the gas they had originally planned to deliver to Western Europe.

What about the second claim, that the Russians are paying more than the market rate for pipe and equipment? Don't bet on it. There will be a minimum of $5 billion (and the Russians may later ask for more) in eight-year credits. The initial credits have carried interest well below European market rates. Any way you figure it, the forgone interest by European banks adds up to a lot of money, far more than seems likely to be recovered with higher price tags on pipe and compressors. As Mr. Hoffman observes nearby, the fact that no one is revealing these price tags gives good cause for such suspicions.

The deal could get worse. The Russians are said to be planning to take about 85% of the Siberian gas that moves through the pipeline for their own use, to replace oil supplies that seem likely to dwindle in the years ahead. If future pipeline throughput falls short of expectations, no one can be sure whether the Russians would put a greater priority on their own needs or on earning foreign exchange by shipping to Western Europe. Although the Germans claim they will always have back-up supplies in the event of a Soviet cutoff, a shortfall in shipments would still be an embarrassment to Western creditors and to Ruhrgas, the German distributor.

The potential for Western creditors and distributors to be sucked into additional take-it-or-leave-it prices or financing can be assessed by estimating what a project of this size would cost if it were built in the West. The Alaskan natural gas pipeline, which has never gotten beyond the talk stage, was shelved last May when the latest estimates showed it would cost $43 billion and that the gas would have to sell for $15 to make the project economic.

Can the Russians build a pipeline of about the same volume and length for one-quarter of the construction cost? Even if you assume a very low value on the gas at the wellhead, on the labor that will be needed for the project and on the other domestic resources that will go into it—that is, even if you assume that the only true costs are what the Russians have to buy in the West—the answer is doubtful. For one thing, Russian construction, while cheap, is not very efficient.

There are clearly plenty of questions. The West European leaders who have entered into this deal are asking their people to accept it on faith. Mr. Reagan, to his credit, has refused to follow that course. He is most likely doing the Europeans a big favor.

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