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The Director of Central Intelligence

Washington, D.C. 20505

9 July 1981

MEMORANDUM FOR: The President
The Vice President
Secretary of State
Secretary of the Treasury
Secretary of Defense
Secretary of Commerce
Secretary of Energy
Director, Office of Management and Budget
United States Trade Representative
Assistant to the President for National Security Affairs
Chairman, Joint Chiefs of Staff

FROM: William J. Casey

SUBJECT: Siberian Pipeline

The attached has been prepared for your information in connection with the NSC meeting this afternoon.

William J. Casey

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CIA MEMORANDUM ON SIBERIAN PIPELINE

The United States should attempt to dissuade the Europeans from consummating the agreement. At a minimum, the Allies should delay decision pending a joint study of their energy security in the changing economic and political environment of the 1980s. These are the basic arguments that can be made:

-- The pipeline will improve future Soviet economic growth and facilitate a military buildup which the West (especially the US) will have to counter. (Tab A) This probably will be the most compelling argument to the Europeans.

-- It would replace their current hard currency earnings from oil which seem likely to dry up during the second half of the 1980s. The Siberian pipeline would thus prevent a reduction of the hard currency they have to spend from the current level of $24 billion to $12 billion and enhance the Soviet ability to extend their influence over other countries.

-- The Soviet gas will cover less than 3 percent of European energy requirements and is not needed to cover increases in European energy demand. Demand projections are being lowered greatly because of energy conservation and alternative, often cheaper supplies of gas and other energy sources will be available. The argument that the pipeline would increase the security and the price of energy supply by diversifying sources and reducing dependence on the insecure Persian Gulf is weak.

-- The $4 billion of annual Western exports for the pipeline would add less than 1/2 of 1 percent to the foreign trade of the Alliance. To the extent that these increments to Western energy and trade enable the Soviets to maintain or increase their military capability, the United States, carrying 54 percent of the COCOM defense burden, would bear the brunt of responding.

-- The $16 billion European investment would be better spent on alternative schemes to ensure Allied energy security. Some combination of American and Australian coal, Norwegian and British gas from the North Sea, and Western capability to produce synthetic gas can satisfy the Western European needs which the Siberian pipeline is intended to meet. (Tab B)

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Tab A

Impact of the Pipeline Project on The Soviet Military Effort

-- Soviets have increased defense spending in real terms at an average annual rate of 4-5 percent since late 1950s; military now consumes 12-14 percent of GNP.

-- Economic growth is slowing and could drop to 2 percent or less by mid-decade. As a result, USSR will have increasing difficulty in maintaining pace of defense buildup. Military share of GNP could be a point or two higher in 1985 and three or four points higher in 1990 if past trends continue. More important, military could take as much as three-fourths of annual increment to GNP by end of the decade. (Figures A-1, A-2)

-- Although the pipeline project would not eliminate economic problems (it would at best add a few tenths of a point to GNP growth), it could ease the strain considerably in key sectors and thus facilitate the military effort.

  -- Hard currency earnings from the project could maintain the Soviets' import capacity in the face of declining oil revenues. This would permit them to continue to import large amounts of Western machinery and equipment. (Table A-1)

  -- Technology transfer associated with the project will benefit domestic gas production--the key to meeting Soviet energy demands in the 1980s. It would enable the Soviets to purchase Western Arctic-design extraction and processing equipment, large-diameter pipe and compressors--items which the USSR cannot match in quality nor produce in the quantities required.

  -- These aspects of the project will aid the military effort in two ways: some imported equipment financed by gas sales will likely be used in military systems; other imports will be directed to civilian uses, reducing pressure on the defense industries to switch to non-military products.

-- Collapse of the pipeline deal could significantly increase Soviet long range economic problems and the difficulty of maintaining the current pace of their military programs.

  -- Hard currency earnings could fall by $10 billion or more by 1990, requiring major cuts in purchases of energy and of Western goods that cushion the defense effort.

  -- Defense-related industries such as electronics, chemicals and machine-building could be especially hurt, because they use much of the machinery and equipment imports.

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-- Even without the 9,600 kilometers from Siberian gas fields to Western Europe, their five-year plan calls for them to build 15,000 kilometers of gas pipeline to meet their own energy needs. For them to produce in the USSR the equipment needed for these pipelines and domestic energy production, given likely trends in production of naval ships, ground force weapons, and aircraft engines, the Soviets would be forced to divert investment from other sectors and cope with important additional costs, delays, and stringencies. These could substantially increase the Soviets' overall economic problems and impose significant costs and difficulties in maintaining the pace of their military buildup.

These factors could induce the Soviets to at least reduce the growth of military spending (if not cut it in absolute terms).

-- They would not necessarily result in a reduction in Soviet military capabilities. Soviet defense spending is now so high (Table A-3) that with reduced growth (or indeed with no growth at all) substantial modernization of the armed forces as a whole would continue.

-- They could, however, require the Soviets to curtail or stretch out selected weapon programs and perhaps make them more forthcoming in arms control negotiations.

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Tab B

The Impact of the Pipeline on Western Europe

Although construction of the proposed pipeline would have a substantial impact on the Soviet economy and military potential, it would have little effect on Western Europe's economies but would make Western Europe somewhat more vulnerable to Soviet political pressure.

Specifically, purchases of Soviet gas through the pipeline:

-- Would not be needed to cover increased energy demand;

-- Would add to the problem, not to the solution, of energy supply security.

-- Would probably be an expensive source of energy.

1. Will the Soviet gas be needed?

(a) Projections of European energy demand are being substantially lowered.

-- Between 1978, when the pipeline plans were first seriously discussed, and this year, IEA's projections of West European energy demand in 1990 were lowered by almost 4 million b/d. (See attached table).

-- IEA projection of total industrial nation energy demand was lowered by 16 million b/d.

-- The amount of Soviet gas to be imported through the proposed pipeline -- .5 to .8 million b/d equivalent is only about one eighth to one fifth as large as the reduction in projected European energy demand.

-- This may not be the end of the story; demand projections may continue to be lowered as information on the strength of market reactions to higher oil prices pours in.

(b) Many projections of European demand for natural gas also are being lowered.

-- During the past 2 years, Shell, Phillips, and BP have lowered their 1990 forecasts by about the volume of the projected Soviet deliveries.

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(c) Alternative energy sources are available;

-- Recent and likely future U.S. withdrawals from LNG deals with Algeria and Nigeria will make available more LNG from these sources to Western Europe than is now projected in European plans. Indeed, Western Europe is the only alternative market for this gas. The amount of additional gas made available to Europe is about 2.3 billion cubic feet per day, or 50-75 percent of the additional Soviet gas. US needs can be met from domestic, Canadian, and Mexican sources.

-- After 1990, more than enough Norwegian gas can be developed to offset the Soviet gas. A single gas structure, discovered and explored during the past 3 years, could produce at least two-thirds of the proposed Soviet deliveries by the early to mid-1990s.

-- US coal supply will be ample to meet increases in European coal demand substantially larger than now planned. The necessary adjustments in European energy policies would not be particularly difficult. European investments in US coal infrastructure--for example, in building a large port capable of handling very large coal carriers--would make the coal cheaper. Loss of Soviet gas could be offset by some 40-60 million tons of coal imports, an increase of about one-third in current projections of West European coal imports.

2. <u>Would the pipeline enhance or weaken European energy security?</u>

(a) The European argument that the pipeline would increase the security of energy supply by diversifying sources and reducing dependence on the insecure Persian Gulf is weak, if not totally invalid.

-- Even if Soviet gas supplies were secure, they would not provide insurance against the contingencies of interruptions of Persian Gulf oil, because--

(1) Soviet gas would substitute for only a small part (less than 10 percent) of Persian Gulf supplies and;

(2) The supply of Soviet gas could not be expanded if the Persian Gulf or other foreign supplies were interrupted.

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(b) Supplies of Soviet gas are themselves not reliable; they are subject to both technical and political risks.

-- The technical risks result from severe climatic conditions in the USSR and the near absence of spare Soviet pipeline capacity and gas storage; periodically the Soviets make large cuts in their exports to Western Europe to meet priority domestic needs (this point is well known to the Europeans).

-- Although in most likely circumstances Moscow would be loath to use its gas as a blunt weapon to pressure Western Europe, because it needs the gas revenue badly, it would be able to exert subtle political pressure.

-- Vulnerability to Soviet pressure would increase despite the fact that increases in imports of Soviet gas would about offset declines in imports of Soviet oil. For most of Western Europe, Soviet oil is a marginal and variable source of energy, for which alternatives can be quickly found. Soviet gas, however, would become part of the base load of European energy supply because of the high investment costs required.

(c) Although other sources of gas too are subject to technical and political risks, in a number of cases, these risks will probably decline;

-- Specifically, Algeria and Nigeria both will become highly dependent on a steady flow of gas revenues to cover their expenditures.

3. Is Soviet gas a source of cheap energy?

(a) Soviet gas, if priced at approximate parity with crude oil, is not cheap. US and Australian coal are substantially cheaper.

(b) If, as we believe, oil markets continue to be soft for several years, the bargaining position of gas importers will become stronger and stronger. Consequently, patient buyers are likely to get better terms.

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