Will Europe help stabilize Soviet energy output?

by William Engdahl

One likely outcome of the Group of Seven Western economic summit talks with Soviet leader Mikhail Gorbachov in London July 17 could be a major effort by particularly Western European governments and companies to assist in the development and upgrading of Soviet oil and gas capacities, according to informed European petroleum industry sources.

During the preparations for the G-7 visit by Gorbachov, Moscow sent the Western governments a detailed list of proposed areas of possible joint cooperation in energy development. These include the Yamal region, West Siberia, the Caspian Sea, and the remote Barents Sea, believed to contain enormous natural gas reserves in an extremely desolate and difficult area. The Soviets also held out the prospect of cooperation in upgrading the inadequate petroleum refining capacities in the U.S.S.R., especially near urban areas where gasoline shortages are chronic.

While Gorbachov was in London, government representatives from all European members of the Conference on Security and Cooperation in Europe (CSCE) met in Brussels to discuss a proposal being advocated by Dutch Prime Minister Ruud Lubbers to draft what he has termed a "European Energy Charter." According to a spokesman of the Brussels-based Center for European Policy Studies involved in the preliminary talks around Lubbers's plan, the initiative is seen as part of the creation of a "common economic space" for Eastern and Western Europe, and to create the framework for significant Western European investment in exploitation of the vast Soviet oil and gas reserves for European needs.

'A European energy community'

In his initial proposal for such a common European energy strategy, Lubbers likened it to the significance after World War II of the European Coal and Steel Community in the rebuilding of Europe. "The creation now of an energy community could make an important contribution towards preventing new walls from dividing our continent," he stated, as well as "preventing us from becoming too heavily dependent on other parts of the world for our energy." There is widespread conviction in the wake of Washington's Persian Gulf war, that Europe, at present, is de facto "hostage" to American blackmail for its future oil supplies from the Gulf. Presently, a majority of West European energy comes from the Gulf.

Lubbers pointed to the enormous untapped oil, gas, and coal resources of especially the U.S.S.R., and contrasted this to their "desperate need of capital and technology," which would come largely from Western Europe in exchange for Soviet energy supplies.

Energy at center of Soviet economic crisis

The energy problem is at the center of the current breakdown crisis of the Soviet economy, and its resolution is being increasingly recognized in Western Europe as the key to beginning the reconstruction of that economy. In the 1970s, Soviet planners made what proved to be a fatal economic blunder. In the wake of the 1974 Western oil shock, which saw oil prices rise 400% within weeks, the U.S.S.R. decided to compensate for its backward agricultural sector by becoming the world's largest buyer of Western grain. The grain imports, mostly from the United States, were to be financed by exports of Soviet oil and gas.

As a consequence, no serious efforts have been made to modernize Soviet agriculture and food distribution over the past 15 years, as imported grain continued to come in. Instead, all spare resources that had not been dedicated to the substantial Soviet military modernization during that time were dedicated to earning the maximum from exploiting the West's high energy prices, by expanding oil and gas production.

By the mid-1980s, oil and gas counted for some 60-75% of all Soviet hard-currency export earnings. The Soviets had made their economy, ironically, hostage to the vagaries of Anglo-American oil control. Then in 1986, largely in order to help a flagging economy in the United States, Saudi Arabia flooded the world market with cheap oil, and prices plunged in a matter of weeks to below $9 per barrel from highs of $26-30 only months earlier. The Soviet hard-currency earnings were devastated just as Gorbachov's economic reform was to have started.

As Western dollar earnings collapsed after 1986, desperately needed investment for modernizing the aging oil fields of Siberia and elsewhere was not to be had. Already by the mid-1980s, the largest Soviet oil fields were showing signs of a serious drop in output. To maximize oil sales during the boom years, Soviet planners had pursued an unwise policy of pumping wells far beyond advisable limits, often destroying future reserves in the process. In addition, with the notable exception of the Western-built gas pipeline infrastructure built by Germany's Mannesmann company during the early 1980s, the Soviet-made steel pipe and welding quality used in transporting natural gas inside the Soviet Union, thrown together under pressure of fulfilling the "Five-Year Plan," was of such an inferior quality that countless explosions and breakdowns have disrupted supply in recent months.

Lack of energy investment

Further adding to the chaos has been the desperation of Moscow to reduce its out-of-control inflation by cutting the state budget. This has meant further cuts in urgently needed oil and gas infrastructure. The budget for 1990 called for a cut of 40% for investment into the state energy sector.

One area in which this came to light was during the emergency mobilization last fall to harvest the unusually large grain crop. Much of the harvest rotted in the fields for want of gasoline or diesel fuel for trucks and tractors. Refining capacity in the U.S.S.R. is desperately inadequate.

All of this has come to a conjuncture at which, for the first time since World War II, total annual production of coal, gas, and oil declined in the Soviet Union. Soviet oil production last year, according to official statistics, was the lowest since 1978, and some Russian officials have warned that the fall in output is accelerating such that the U.S.S.R. could be a net importer of oil by 1995.

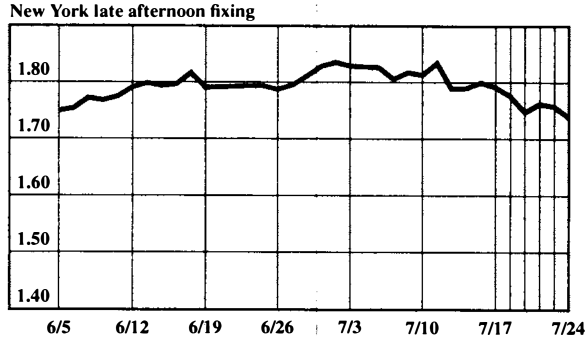
Already this past March, as the Gulf war was coming to its conclusion, German Foreign Minister Hans-Dietrich Genscher, in Moscow for talks with Soviet Foreign Minister Aleksandr Bessmertnykh, offered to help re-equip and modernize the Soviet oil sector with German technology, in return for secure supplies of oil and gas. He stated that Germany was "prepared to use our potential in order to increase Soviet energy supplies. We could use the energy exported, and we could modernize the related equipment."

According to London-based oil industry sources, at this point there is about to be a stampede of West European companies into the Soviet oil and gas sector, as soon as nagging problems of bureaucratic lines of authority between Moscow, various republics, and local authorities are ironed out. "The London G-7 talks certainly helped," stated a spokesman for the Geneva Petroconsultants. "The Soviets now recognize what the obstacles are to serious Western investment and seem to be moving to remedy them." As soon as this is clear, industry reports are that there will be significant investment activity especially from French, Italian, and Finnish companies.

Currency Rates

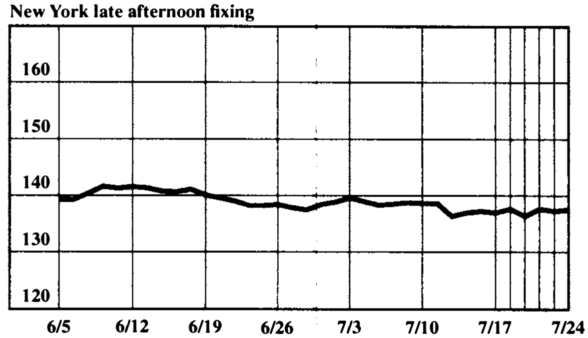
The dollar in deutschemarks

New York late afternoon fixing



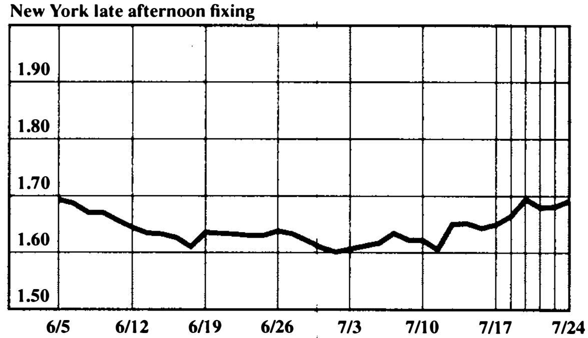
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing