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SENIOR INTERDEPARTMENTAL GROUP--INTERNATIONAL ECONOMIC POLICY

September 16, 1982

TIME AND PLACE: 4:30 p.m., Room 305, OEOB

SUBJECT: Poland-related Sanctions

PARTICIPANTS:

Treasury
Secretary Regan (Chairman)
Marc Leland

State
Secretary Shultz
James Buckley

Defense
Secretary Weinberger
Fred Ikle

Agriculture
Secretary Block

Commerce
Secretary Baldrige
Lionel Olmer

Justice
Jonathan Rose

CIA
William J. Casey
Maurice Ernst

Office of Vice President
Donald Gregg
Admiral Daniel Murphy

USTR
Ambassador Brock

CEA
Geoffrey Carliner

OMB
David Stockman

White House
Robert C. McFarlane

OPD
Roger Porter

NSC
Norman Bailey
Roger Robinson
Dennis Blair

Minutes

Secretary Regan opened the meeting. He stated that the objective of the meeting was to agree on a package of sanctions which the U.S. Government would be willing to exchange for the sanctions currently in place against the Soviet Union in response to the events in Poland. He also stated that the problem of including Japan in any agreement should be addressed. The meeting was then turned over to Secretary Shultz.

Secretary Shultz stated that we need to review our overall objectives toward the USSR and establish where we are now. He referred to the President's four point decision in response to his memorandum of

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August 24. He noted that the final point of that set of decisions was a charge to prepare the U.S. position for the time that the European allies proposed discussions on the sanctions issue. He then briefly reviewed the history and status of the arrangements for talks with the European allies affected by the extraterritorial application of the sanctions. Originally the British had proposed talks on the issues and Secretary Shultz had accepted the proposal. After negotiations among the European countries themselves and a British request that the U.S. call a meeting, which the Secretary refused, the plans for a meeting had been suspended. The Secretary said that there would be the opportunity to discuss these issues during the bilateral meetings on the margins of the UN General Assembly, but a definite meeting had not been scheduled. He stated that in this setting it did not seem wise to work out a detailed negotiating package or set of guidelines since any meeting would simply be used to feel the Europeans out.

The Secretary then proceeded to outline his understanding of the President's policy on East-West trade. First, the President was realistic about the behavior of the Soviet Union -- military buildup, the use of chemical weapons, Central America, Horn of Africa, Kampuchea, the invasion of Afghanistan and, finally, the suppression in Poland were both objectionable in themselves and examples of underlying Soviet behavior. To deal with the Soviets, the U.S. needed strength -- military strength, based on an adequate military budget -- and the capacity to use it if necessary. By the same token, the U.S. needed economic strength and the capacity to bring it to bear. The President was willing to negotiate with the USSR in areas of mutual advantage, for example in arms reductions, and in economic areas such as the sale of grain. However, in all negotiations, it was necessary to negotiate from strength and the U.S. objective was to limit Soviet options -- military, economic and ideological. Once the Soviets understood that their options were limited, they would have the incentive to change their behavior. If this occurred, the U.S. would be willing to discuss a constructive relationship.

Thus, although the primary dimension of U.S. strength in dealing with the Soviet Union is military, it is in a political setting. This means that the political dimension of alliances such as NATO is important, and the "whole thing relates together." The problem is that many European countries do not have the "stand in there" attitude of the Reagan administration.

The economic dimension of national strength is an adjunct to military strength. The Secretary then proceeded to summarize a paper on East-West trade which he had written before assuming his current office. Trade is by its nature mutually advantageous, although not equally advantageous. Because of its ability to buy and sell as a single unit, the Soviet Union has been able to gain advantages which are out of proportion to its overall economic strength compared to the West. A good example has been grain sales, and it is for this reason that Secretary Shultz has favored long-term agreements in this area. Furthermore, trade involves the transfer of "ideas," and in East-West trade, the ideas flow (with the exception of grain) from West to East. Despite its economic superiority, the West today finds that trade has given advantages to the East: the U.S. farmers are dependent on Soviet markets, and Western bankers find themselves dependent on their East European debtors. The long-term challenge is to alter these relationships, so that the advantages of East-West trade swing to the West.

By definition, any trade with the Soviet Union gives some advantage to the Soviet Union, and thereby increases Soviet military capability. However, this administration has not adopted a "no trade" policy. The allies are firmly in favor of East-West trade. The question is to set the limits on this trade, to question individual transactions as to whether substitutes are available, whether there are military applications of the items traded, and to evaluate each transaction. A second set of criteria to apply to limiting trade with the USSR is whether it can be used for "tactical maneuver" in putting pressure on the behavior of the Soviet Union. In general, the Secretary believed, short-term trade measures have little effect on Soviet behavior. Policies needed to be sustained to have effect. The current sanctions, for example, the Secretary believes, should be maintained or, if replaced, replaced with sustainable measures. A third consideration is cooperation with allies. Almost any trade measure in East-West trade is more effective if implemented by all the Western countries.

As the officer charged by the President with preparing for talks with the Europeans on possible replacement measures for the current sanctions, Secretary Shultz was looking for a set of measures that would have clarity, would affect the Soviet Union, could be sustained, and would have broad Western support. There had been a number of suggestions within the SIG, several of which had already been discussed with the allies. Now the United States had shown a depth of determination which had not been clear earlier, and it might be better able to reach agreement with the allies. The Secretary noted that, contrary to certain press reports, the U.S. Government was not looking for a way to drop the sanctions. If an acceptable alternative package could not be worked out, we would "stick with what we have."

The Secretary then reviewed the elements which could be included in an alternative sanctions package. The first was credit, which the Secretary considered "our best tool." It was difficult for any government to argue that it made sense to give the Soviet Union subsidized credit. Some progress had been made with the allies before Versailles. The remaining work was to gain agreement or down payments and set up a monitoring body. This was essential because of the possibilities of manipulation of the price of equipment and credit terms, i.e. hidden subsidies.

The second area was affirming and expanding COCOM. Like credits, COCOM was an area in which it was relatively easy to gain agreement in principle, but difficult to agree on specific implementing measures.

The third area was sanctions on the export of oil and gas technology. In this area, it would be difficult to secure allied agreement, even though the United States was the dominant supplier. It might be necessary to "play hardball" with the European countries, refusing them this technology for non-Soviet sales if they did not go along with embargoing sales to the Soviet Union. With carefully chosen items, this area might be suitable for an agreement.

The fourth area was alternative energy sources. This area was also "susceptible" to agreement in principle, but difficult in implementation. Algeria, for example, had proved itself an unreliable supplier. However, the Secretary felt that the Norwegian/Dutch arrangements might be worked out, and this alternative source brought on line before the 1990s. Another problem was Soviet pricing policies, which would undercut Norwegian and Dutch prices.

The Europeans would place grain sales on the agenda. The U.S. must maintain the position of no subsidies for grain sales, and keep these sales as an example of why we should not adopt a "no trade" position.

Concluding his summary, Secretary Shultz noted that in the various agency papers there were detailed discussions in each of these areas. He reiterated his belief that it did not make sense to formulate a detailed U.S. position. For example, in discussions it might turn out that the Europeans were willing to offer more attractive propositions. However, it was important to maintain the principle that any alternative set of sanctions must be at least as effective in punishing the Soviet Union as the current sanctions, and must be more broadly supported, to include Europe and Japan. In the meantime, we should not underestimate the power of the temporary denial orders of the Commerce Department. They are wreaking a great deal of havoc, both with European companies and with our own. They also demonstrate the depth of our determination, which is valuable in any negotiation. The President has made his preference clear, and it is up to his "agents" to carry them out.

Secretary Weinberger stated that the President's objective was to improve the situation in Poland by punishing the Soviet Union using the tool of the pipeline sanctions. Any alternative measures to be adopted should not set back those objectives, yet should assist in limiting the damage to alliance relations. Germany promised to be a special problem, since it is so strongly committed to trade with the Soviet Union. Concerning credit restraint, Secretary Weinberger had never been impressed by shortening maturity dates. It was important to arrange credit restraints so that they restricted hard currency available to the Soviet Union. In the area of alternative energy sources, it was important to bring other sources on stream before the 1990s -- the MidEast and our own Alaskan fields were possibilities. France, for example, is only importing Soviet gas as a backup fuel, and could be worked on in this area. The U.S. could ask for a limitation to the deliveries from the first strand of the pipeline, as it should have three years ago. If there is to be a meeting between the United States and the Europeans, there should be clear instructions to the U.S. side. If other attractive possibilities arose, the instructions could be adjusted. However, clear instructions were in many ways an advantage. The current U.S. sanctions should not be underestimated in their effect, and should not be exchanged for something else lightly.

Secretary Baldrige stated that what was needed was a fundamental policy on East-West trade, particularly in the oil and gas area. This policy should be constructed independent of Poland. In addition, in taking sanctions against the Soviet Union, it is important that the burdens be shared within the alliance. It is important to win in this dispute, now that it has been joined, and the U.S. position would be stronger if we were supported by our allies.

Secretary Baldrige went on to several near-term decisions which needed to be made concerning our current policies: First, the "unintended effects" of our temporary denial orders. Dresser France supplies equipment to Brazil, Western oil companies in the North Sea, and even Australia. Our orders are holding up supplies to these projects outside of the Soviet Union. Second, "hardship" cases: a German subsidiary of the Cameron Iron Works of Houston, Texas stands to lose a $100M contract signed in March 1982 of low-technology oil and gas equipment to the Soviet Union. Third, "legal" problems which involve closing loopholes in the denial orders. For example, the thirteen subsidiaries of Creusot-Loire now have to be included in the temporary denial order making this our "most shakey" legal case. The U.S. could sustain a reversal in this instance which could hurt us. Secretary Bladrige stated that a system was needed for reviewing the problems in these three categories. He pointed out that the primary objective of the current policies were not to harm U.S. companies, and to do so risked losing U.S. support for the policies. In this connection, he stated there should be a way to make exceptions as we are doing ourselves damage.

Director Casey stated that an Intelligence Estimate was in final stages of preparation which would give in some detail the military effects of East-West trade. Director Casey stated that he believed that the restriction of the transfer of high technology to the Soviet Union was perhaps the most important measure the West could take, followed by the restriction of militarily relevant oil and gas technology, and finally, future pipelines to Western Europe which generate substantial hard currency. In reply to a question from Secretary Shultz, Director Casey said that he agreed with the categories of measures against the Soviet Union which had been discussed, but that we needed to look carefully at the priority of those categories based on their effect on the Soviet Union, and to consider whether they could be negotiated with the allies.

Secretary Regan then proposed four items as a result of the meeting:

-- First, that Secretary Shultz hold discussions with the allies as he had suggested, under only the broad instructions that an alternative package should cause "equal pain to the Soviet Union to what we are now inflicting." At the completion of those talks, if there had been no European offer, the SIG would reevaluate the situation.

-- Second, that the Secretary of Commerce would be authorized to make exceptions for those features of the denial orders which were damaging U.S. companies, but not the Soviet Union.

-- Third, that the CIA proceed quickly with the Intelligence Estimate.

-- Fourth, that in public, all members of the SIG-IEP would continue the current stance: that the U.S. is prepared to listen to any allied proposals for alternative sanctions against the Soviet Union, and that the U.S. has a clear idea of where it is going. If questioned closely about the status of consultations with the Europeans, all members would refer the questions to Secretary Shultz.

-- Finally, that these four points would be put in a paper for the NSC.

Ambassador Brock pointed out that in dealings with the Soviet Union, it was possible to make real progress if the agreements and their implementation were kept out of the limelight. The same was true for agreements with the Europeans.

The discussion then turned to several immediate cases before the Commerce Department for exceptions to the current temporary denial orders. First, the Cameron Iron Works, the German subsidiary of which had signed a contract in March with the Soviet Union for oil and gas equipment which was not for use on the Yamal pipeline. The deal had been caught by the June extension of the December sanctions.

Secretary Regan pointed out that the SIG-IEP could not sit "like a Supreme Court" rendering judgment on individual cases. It was necessary to give general guidance to Commerce and allow the Secretary to make the individual decisions. Secretary Baldrige said that he had the authority to grant exceptions to the orders

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on the basis of hardship, but that for exceptions on the basis of "unintended effects" he needed higher authority. He said that in general the U.S. sanctions and denial orders were a tough policy that had caused a great deal of economic damage both in Europe and the United States; what was needed now was sensible decisions to ameliorate them.

Secretary Weinberger stated that if we granted exceptions to U.S. companies, it would cause an uproar in Europe greater than that caused by the grain sales agreement extension. Secretary Shultz stated that the criteria should be to distinguish between American and European companies. If harm were being caused to European companies, then this would induce them to pressure their governments to change their positions; if the damage were being caused to U.S. companies, then an exception should be made. Secretary Baldrige stated that he now had all the guidance he needed to make his decisions on the hardship cases.

Secretary Baldrige then raised the "unintended effects" category. Hewlett Packard and several other computer companies had service contracts with Dresser France on office computers which had been sold to Dresser France. An exception was needed to allow Hewlett Packard and the other companies to repair these computers. There was general approval in the SIG that these exceptions should be made.

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