Soviet Natural Gas Deals With Western Europe

In recent months the USSR has concluded arrangements for the construction of natural gas pipelines to Western Europe. This article describes the background and the features of the projects, which are shaping up into a multinational East-West joint venture of unprecedented magnitude and duration.

Moscow's conclusion of a 20-year agreement on natural gas sales with Italy in December, following the earlier completion of negotiations for a similar arrangement with West Germany, marks an important Soviet breakthrough into the Western natural gas market after several years of intermittent discussions. Austria in 1968 had signed a 23-year agreement, and France is actively considering the purchase of Soviet natural gas in the late seventies. The arrangements concluded or proposed all involve the supply by the Western partner of large diameter pipe and equipment on credit which is to be repaid from the proceeds of natural gas sales.

Soviet-Italian Agreement

On December 10 the Italian State Petroleum Agency Ente Nazionale Idrocarburi (ENI) signed an agreement to purchase 100 billion cubic meters of Soviet natural gas over a 20-year period. The gas will be transported via a 231-mile pipeline to be constructed by an Italian-Austrian-Soviet consortium from the existing Bratislava (Czechoslovakia) terminal across Austria to Tarvisio in Northeastern Italy. Deliveries are scheduled to begin in 1973, eventually reaching a peak of 6 billion cubic meters per annum. The USSR agreed to initial purchases on credit of $200 million worth of pipe, compressors, and other equipment, with additional orders to be placed later. Total value of exchanges under the agreement, according to an ENI press release, would amount to $3 billion.

Although a natural gas-pipeline agreement had been under discussion off and on for five years, there had been no indication of any serious negotiations since spring 1968 when agreement was reported imminent. What has been made public of the particulars of the Soviet-Italian agreement, which was signed for the USSR by Deputy Foreign Trade Minister N. G. Osipov and by Eugenio Cefis for ENI, leaves many questions unanswered. While the speedy conclusion of an agreement indicates that it must follow closely the arrangements worked out previously, the over-all magnitude of the agreement, and of Soviet gas deliveries in particular, is larger than anticipated.

The unit price of the gas has not been disclosed, but it appears to be at the lower end of the $11 to $15 per cubic meter range under discussion in earlier negotiations. The amount of the Italian loan presumably will be equivalent to the Soviet order for pipe and equipment, but its terms are still unconfirmed and may not yet have been finally agreed. Indications are that the credit will have a maturity of about seven years and bear interest at a rate of 5.5%. Although a Soviet broadcast stated that the Italian pipe would have a diameter of 1.42 meters (56 inches), Italy at present is not known to have the capability for producing pipe of such large diameter so that in fact deliveries--which are to begin this year--may consist of smaller pipe at first.

Soviet-FRG Agreement Imminent

Negotiations between representatives of the USSR and West German industry, underway since a meeting in late April 1969 at the Hanover Fair between the German

Minister of Negotiations Schiller and Soviet Foreign Trade Minister Patolichev, were concluded in late November. The 20-year agreement, expected to be signed this month, will provide for deliveries beginning 1973 and reaching a peak of 3 billion cubic meters per year by 1978/79. (The Soviets initially had asked for a West German commitment for 5 billion cubic meters per year.) The unit price agreed is in the vicinity of $12.00 per 1,000 cubic meters, which would result in a considerably lower price than that of Dutch gas, even when the cost of adapting Soviet gas to the lower caloric standard of the FRG is taken into account. Distribution will be handled by Ruhrgas A. G. with delivery confined initially to Bavaria.

The proceeds from the gas over an as yet undetermined period are to be used to finance Soviet purchases of large-diameter (56 inch) West German pipe--a figure of 1.3 million tons has been mentioned and a total value in the $330-$410 million range. Pipe deliveries are to begin this year and will be financed by a West German bank consortium, with the interest expected by West German officials to be 6.5 %--i.e., below presently prevailing rates in the FRG.

The FRG is under no economic pressure to procure gas from the USSR, since proven West German natural gas reserves are substantial and a continuing flow of Dutch gas has been secured under a 25-year arrangement. However, political considerations, mainly a desire to improve the climate of relations with the USSR through expanded economic ties and its presumed beneficial effect on German relations with East Europeans, are an important factor; such considerations may be even more compelling under the new West German Government than they were under the Grand Coalition.

On the purely economic side, long-term employment of Ruhr large-diameter pipe mills are not to be overlooked, as well as the desirability from the German point of view of providing some price competition for Dutch gas and German gas producers. Finally, for Bavaria, whose economic officials were the first to negotitate with Soviet representatives and which would be the first area to receive Soviet gas, price considerations are important since the transportation costs from the Dutch border would make Groningen gas considerably more expensive than the presently envisaged Soviet price.

As far as any danger of dependence on Soviet supplies is concerned, German officials have pointed out that at the level currently contemplated, Soviet gas would represent less than 10% of total FRG gas consumption in the second half of the 1970's. Furthermore, the selection of Ruhrgas A. G. as the agent for the sale of Soviet gas was partly motivated by the fact that this company has a large distribution network which would put it in a good position to provide gas from other sources in the event of a disruption in the supply of Soviet gas.

In a related development, the German Thyssen Iron and Steel Group announced last spring that their pipe manufacturing works had concluded an agreement with the USSR to jointly construct a pilot plant near Moscow for the manufacture of pipes 2.5 meters (99 inches) in diameter for the transport of natural gas. The contract followed 18 months of closely held Soviet-West German negotiations. Described as a "preliminary step" by German officials, the present contract is valued at about $20 million but is expected eventually to generate contracts for large-scale joint production worth over $200 million.

The 2.5-meter pipe is destined for parts of the projected "Northern Lights" gas pipeline from the West Siberian arctic gas fields to central and North-West European Russia. First indications of a Soviet program from the development of such large-diameter pipe--at present the largest pipe in regular production in the USSR or anywhere else is 1.42 meters (56 inches)--came about two years ago, but experimental production so far has apparently not produced entirely satisfactory results.

Franco-Soviet Discussions

Discussions conducted last September in Paris between delegations headed by Soviet Deputy Foreign Trade Minister N.G. Osipov and Jean Chapelle, Director of Foreign Economic relations in the French Ministry for Economics and Finance, produced agreement in principle on a gas pipeline arrangement of the type negotiated with Italy and West Germany. A Soviet announcement on

October 1 stated that France would supply pipe and equipment on credit to the Soviet natural gas industry, to be repaid by receipts from the sale of natural gas from the USSR in the second half of the seventies.

According to press reports originating mainly in West Germany, the Franco-Soviet understanding would envisage Soviet purchases of large-diameter pipe valued at $180-200 million, while deliveries of gas would not exceed 2.5 billion cubic meters per year.

Reasons for Soviet Drive

The growth of output of natural gas in the USSR in the past two years has been sluggish. As a result, the original goals for 1970 and for 1975 had to be revised downward. In 1969 natural gas extraction amounted to about 180 billion cubic meters, and the target for 1975 presently envisaged is 280-300 billion cubic meters.

The Soviet drive to line up customers in the West may seem surprising at a time when the Soviet natural gas extraction has been lagging, as has pipeline construction, and no significant acceleration in the Soviet fuels production appears likely within the next few years. Moreover, the USSR is committed to supply large amounts of natural gas to Eastern Europe, possibly as much as 10 billion cubic meters by the mid-seventies.

Since USSR gas reserves appear to be ample, however, it was probably this poor performance which spurred the Soviet drive in order to secure equipment and technological know-how the lack of which have been responsible in large measure for the sluggish performance of the natural gas industry.

Apart from the immediate Soviet objective of obtaining on credit, with as little hard currency expenditure as possible, needed equipment, the arrangements Moscow is now endeavoring to complete are designed to lay the foundations for future substantial foreign exchange earnings once the Western equipment has been amortized. By the mid-seventies, when the Soviet gas deliveries to Western Europe are to commence, the level of USSR gas imports from Afghanistan (which began in 1967) and Iran (scheduled to start this year) should be approaching the 14 billion cubic meter mark, which would more than offset the outflow. These imports, furthermore, are much cheaper than Soviet gas and entail no hard-currency expenditure.

Outlook

In view of the preliminary nature of the understanding with France, only a tentative estimate of the overall dimensions of the Soviet natural gas pipeline project can be hazarded. At this time the USSR appears well on its way to obtaining long-term commitments for West European gas purchases--from Austria, West Germany, France and Italy--totaling 11-13 billion cubic meters per year by the late seventies.

In the process Moscow may be able to line up credits of around $800-900 million for the purpose of importing upward of 2.5 million tons of large diameter pipe--leaving aside whatever purchases of "super pipe" may result from the Soviet-West German development effort--and other related equipment. This would constitute a multinational, East-West venture of unprecedented magnitude and duration involving terms far more generous than the customary Western credit arrangements repayable in hard currency.

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