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EXECUTIVE SECRE .RIAT

ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
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SUSPENSE 18 Mar 86
Date

Remarks
To 5: Please provide DCI feedback of discussion with Robinson.

STAT

Executive Secretary
3 Mar 86
Date

3637 (10-81)

DIRECTOR OF CENTRAL INTELLIGENCE

Executive Registry
86- 0879

3 March 1986

MEMORANDUM FOR: D/SOVA/DI

FROM: DCI

SUBJECT: Analysis of Soviet Cash Flows

Doug:

STAT

Give [redacted] a call and discuss this with him. Tell him you are calling at my suggestion.

William J. Casey

ROUTING AND RECORD SHEET

SUBJECT: (Optional)

Analysis of Soviet Cash Flows

FROM:	EXTENSION	NO.
D/SOVA 4E58 Hdqs.		DATE 27 FEB 1986

TO: (Officer designation, room number, and building)	DATE RECEIVED	DATE FORWARDED	OFFICER'S INITIALS	COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.)
1. DDI Registry	27 Feb 86		✓	
2. Chairman, NIC	28 Feb			
3. Exec. Registry DDCI (copy)	28 FEB 1986			
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The New York Tim

Copyright © 1986 The New York Times NEW YORK, SUNDAY, FEBRUARY 16, 1986 +

The New York Times/Jim Wilson

amin L. Hooks, executive director, left, annual meeting of National Association ple. In his address on the state of the or- eadership. Page 28.

ggests Decision
aft Was 'Flawed'

ssociated Press

"There are an awful lot of people involved in the countdown process who are involved in the investigation into the Challenger explosion."

Mr. Reagan, in naming the 13-member commission on Feb. 3, asked for a report from the panel within 120 days.

Consultation With Members

Mr. Weinberg, the commission spokesman, said it had been Mr. Rogers's decision, in consultation with other panel members, to request that NASA exclude from investigative teams those involved in the decision to launch the shuttle.

A knowledgeable source, speaking on condition of anonymity, said that ban would apply to various people who were involved in the "checks along the road" that led to the final decision to go ahead with the launching from the Ken-

Continued on Page 32, Column 4

RUSSIANS SOUGHT U.S. BANKS TO GAIN HIGH-TECH SECRETS

Plan to Buy Institutions in 70's Was Foiled — Gaps Seen in Investment Statutes

By MARTIN TOLCHIN
Special to The New York Times

WASHINGTON, Feb. 15 — The Soviet Union secretly tried to acquire three banks in northern California and an interest in a fourth to gain access to advanced American technology, United States intelligence and military officials say.

The attempt, which was foiled by United States intelligence agents in the mid-1970's, was part of what American officials have described as a broad Soviet effort to acquire Western technology for military and commercial purposes.

United States officials and private lawyers familiar with the case said Soviet agents wove a pattern of international intrigue using disguised principals and large sums of money that traveled a circuitous route.

C.I.A. Agent Saw Pattern

The scheme failed when an agent of the Central Intelligence Agency noticed a peculiar lending pattern by the Singapore branch of a Soviet bank. The case attracted little attention in the United States, and officials and lawyers familiar with it provided details that have not been previously disclosed.

American intelligence, military and banking officials, along with some members of Congress, said the scheme raised questions about whether banking statutes, even those that have been strengthened since then, are adequate to cope with a threat to national security.

If the Soviet Union had managed to take over a bank, the officials said, it could have learned about the confidential finances of American high-technology companies, perhaps enabling it to put pressure on executives and companies or even take one over.

Takeover Plan Was Legal

The plan, which did not violate any laws, was aborted after a $1.8 million down payment was made on the banks: the Peninsula National Bank in Burlingame, the First National Bank of Fresno, and the Tahoe National Bank

Continued on Page 36, Column 1

MARCOS IS DECL
AQUINO SAYS 'I
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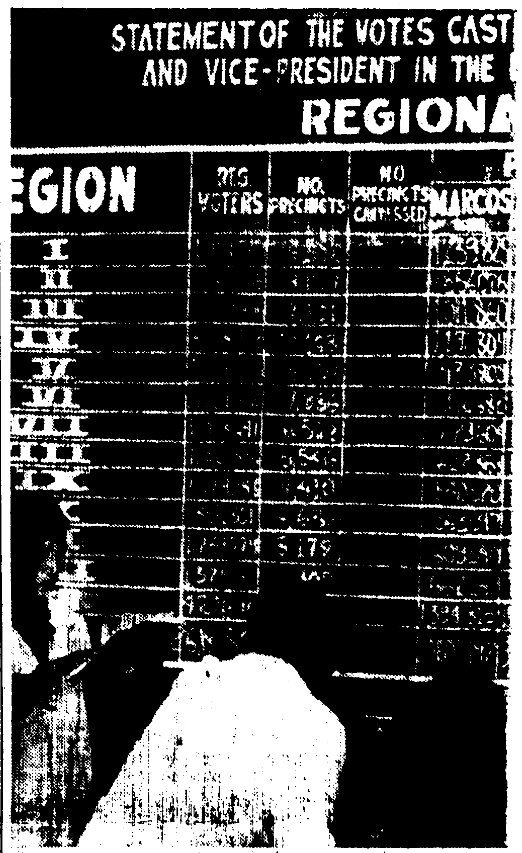

National Assembly members examining final presidenti

President, in Shift, Faults N For Election Fraud in Phi

By LESLIE H. GELB
Special to The New York Times

WASHINGTON, Feb. 15 — President Reagan, in a shift of emphasis, today directly blamed President Ferdinand E. Marcos's party for widespread fraud and violence in the recent Philippine presidential election.

In a statement issued by the White House in California, Mr. Reagan said that while American observers' final reports on the Philippine election are

that "evidence ke fraud by Marcos ba reports, the oppo church."

High-ranking Adm cials in Washington statement reflected sion by the Reagan look beyond the elect said the Administrati ome accomm

Soviet Attempt to Buy U.S. Banks Seen as Effort to Gain Western Secrets

Continued From Page 1

in South Lake Tahoe. In addition, the Soviet Union sought partial interest in the Camino California bank in San Francisco. Peninsula National had made numerous loans to high-technology companies and, along with the other banks, counted employees and executives of high-technology companies among its clients.

"I always viewed it as a deliberate penetration by the K.G.B. of the American banking system," said Bartholomew Lee, a San Francisco lawyer involved in a civil case resulting the effort.

Senator Daniel Patrick Moynihan, Democrat of New York, an intelligence specialist, was one of the few on Capitol Hill in the late 1970's aware of the Soviet effort. "It's a new form of industrial espionage," he said. "It doesn't involve people stealing blueprints; they own the blueprints."

M. Melnikuv, deputy trade representative at the Soviet Embassy here, said he was not familiar with the takeover attempt. "I never heard this story, and I don't know anyone who has," he said. "Our relations in the financial field in the United States are practically nonexistent."

Similarly, officials of the Moscow Norodny Bank, which financed the attempt to buy interests in the banks, have insisted that its loans were strictly business transactions.

Foreign Investment Problems

To intelligence, military and banking officials, and some members of Congress, the Soviet scheme underscored one of the problems in a society that welcomes foreign investment, in which the highest bidder can acquire institutions that have access to sensitive information. They said the incident also highlighted the difficulty of learning the true principals in some financial transactions and of tracking money whose source has been under layers of transactions.

"There is sometimes a real conflict between free trade and national security," said Richard N. Perle, Assistant Secretary of Defense for international security policy. "It seems to me in our national security interests not to give the Soviets any leverage."

Mr. Perle also noted the problems of ...sed ownership and said the laws ...l be strengthened to provide in...tion on the true nature of these ...ctions. "It seems to me that at ...ry least we ought to have a con...g audit of what is being acquired ...y whom," he said. "We ought to ...ehind the immediate purchaser, ...tisfy ourselves that we know who ...really dealing with."

'Not a Private Affair'

...ator Moynihan said: "The owner...f banks is not a private affair. If ...ave to go two or three layers into ...stem to find out what's happen...) two or three layers into the sys-

...ks can be a important source of ...ble intelligence, said Representa...harles E. Schumer, a New York ...crat who is a member of the ...ng Committee. "If you wanted to ...t about any aspect of American ...ry, one of the most effective and ...ely cheap ways to do it is to get ...a bank," he said. "They give un...ly foreign powers a window into ...they ought not to see."

...lerick R. Dahl, associate direc... the Federal Reserve Board's ...n of Banking Supervision and

The New York Times

Representative Charles Schumer said he believes banks offer intelligence-gathering potential to "unfriendly foreign powers."

Regulation, said: "We're really in a public dilemma. We've always had a tradition in this country that anyone could start a bank, with the proviso that he had some money and was reputable. Then you come to the question of undesirables getting in. You try to keep them out, but it's easier said than done."

The Soviet attempt may not be an isolated one. Amos Dawe, a Singapore businessman who served as the Russians' major intermediary in the bank scheme, told Federal officials that the Soviet Union had succeeded in carrying out similar acquisitions in other parts of the country, but he declined to specify where or when, his lawyers said.

Mr. Perle agreed. "If the Moscow Norodny bank attempted to acquire banks in Silicon Valley, you can be sure that they made other efforts elsewhere," he said.

Plan to Buy Banks: Hiding Money's Source

A detailed account of the Soviet scheme was pieced together from interviews with intelligence and military officials, private lawyers familiar with the case, court records and a statement by Mr. Dawe.

According to court records, the Moscow Norodny bank's Singapore branch used Mr. Dawe to acquire the three California banks and used another intermediary, Y. T. Chou, a business associate of Mr. Dawe's, to acquire a half interest in the Camino California bank in San Francisco.

The scheme was aborted by United States intelligence officials, who released the story to an Asian financial newsletter. Mr. Dawe has acknowledged through his lawyers his role as an intermediary. Efforts to reach Mr. Chou, who is believed to be living in southeast Asia, were unavailing.

Moscow Norodny selected the banks to be acquired, and supervised their acquisition, according to Mr. Dawe's statements.

Ephraim Margolin, one of Mr. Dawe's attorneys in San Francisco, said of his client, "There is no doubt in my mind that he was working for the Russians."

Cliff Palefsky, another of Mr. Dawe's San Francisco attorneys, said his client hoped to make money on the deal. But he added: "There's no question that he was reporting to the Russians. It was Mr. Dawe's belief that the Soviets were interested in gaining some access to computer technology."

Mr. Dawe, now 51 years old, rose from postal clerk to become one of the richest men in Southeast Asia. He was the principal owner of the Mosbert Group, a holding company with interests in hotels, real estate, plantations, finance companies, and other properties. The Mosbert Group controlled some 200 companies with $160 million in assets in southeast Asia.

Singapore to San Francisco

According to papers filed in Federal District Court in San Francisco, Mr. Dawe obtained a $50 million line of credit in late 1974 from the Moscow Norodny bank's Singapore branch for the purpose of purchasing several banks in northern California.

The first installment of funds to Mr. Dawe, $3 million, traveled a circuitous route from Moscow Norodny in Singapore to the Pacific Atlantic Bank in Panama, to the Commerce Union Bank in Nashville, Tenn., and, finally, by letters of credit, to Mr. Dawe in San Francisco.

In a brief interview with the British Broadcasting Corporation in 1983, Mr. Dawe recalled that Moscow Norodny had sent him to San Francisco to study various banks.

Upon his return to Singapore, Mr. Dawe said in the interview, he was surprised by how much Moscow Norodny already knew about the American banks. "I have details, they have already more details," Mr. Dawe said. "They have more details than I could imagine. They have done their homework. They have all the details of all the banks in the big area."

Mr. Dawe negotiated the sale of the Fresno, Tahoe and Burlingame banks, which were owned by the Central Bank of California.

"We had no reason to suspect that he was not the principal," Robert L. Haggen, the bank's vice president and counsel, said in an interview. "He was a very wealthy man with operations all over the world."

Court records reveal that Mr. Dawe purchased the Burlingame bank in December 1974, for $3.05 million, placed $300,050 in an escrow account and financed the remainder through a letter of credit issued by the Commerce Union Bank of Nashville.

Mr. Dawe purchased the Fresno and Tahoe banks in June 1975, for $7.9 million. He placed $808,300 in escrow and paid an installment of $685,266 in October 1975. He also put the stock in the Fresno and Tahoe banks up as collateral for the sale.

It is not clear how much Mr. Chou, who was also backed by Moscow Norodny, paid for the half interest in Camino California in October 1975.

'One Smart C.I.A. Guy:' The Plan Falls Apart

United States officials said that an American intelligence officer with a banking background based in Singapore learned of the transactions. "It was one smart C.I.A. guy who noticed a peculiar lending pattern," Mr. Perle said. "It didn't smell right."

American intelligence officers then disclosed the purchases to Raymond Sacklyn, publisher of a Hong Kong financial newsletter, Target, according to United States officials. Mr. Sacklyn refused to identify the source of the article.

The bank deal collapsed upon publication of the article. Moscow Norodny withdrew its funds, leaving Mr. Dawe financially vulnerable.

Mr. Haggen said Central bank foreclosed on its collateral and acquired the stock to the three banks.

In July 1977, Mr. Dawe was indicted by a Federal grand jury in San Francisco on charges of improper transfer of funds in connection with his purchase of the three banks as well as the use of collateral that was previously pledged to other creditors.

In addition, a tangle of lawsuits ensued as the Soviet bank tried to get back its money from Mr. Dawe after the bank purchases were scuttled.

"The Russians wanted him," Mr. Palefsky said. "Through the Moscow Norodny bank, they were able to get him indicted in Hong Kong."

Hong Kong Extradition

Mr. Dawe, who was fighting extradition to Hong Kong on the fraud charges, returned to San Francisco from Taiwan to face the United States charges. "Amos came to the United States voluntarily, with certain promises by the Government," Mr. Margolin, another of his attorneys, said. "They promised that if he stood trial, he would be protected and not extradited. The promises were not kept."

Federal prosecutors denied that any such deal had been made, although Mr. Dawe had cooperated with the C.I.A. The United States charges were dismissed in February 1979, at the request of the Justice Department, and he was subsequently extradited to Hong Kong. Robert Mueller, an assistant United States attorney who prosecuted the case, would not comment on whether charges had been dismissed at the request of the C.I.A.

In Hong Kong, Mr. Dawe was ultimately convicted of fraud in connection with the bank scheme. He began serving a five-year prison sentence in 1984.

"A number of different people have told us that there is a basis for suspicion that Hong Kong is really doing the bidding of somebody else, perhaps knowingly, perhaps not, the bidding of the Soviet Union," Mr. Margolin told a Federal judge at Mr. Dawe's extradition hearing in 1979.

William Dorward, Commissioner for Hong Kong and its senior representative in the United States, responded through a spokesman, "It is so bizarre that I could not even begin to comment."

Mr. Chou sold his interest in the Camino California bank to Jack Johansen, the president. Mr. Chou is now living in southeast Asia, Mr. Johansen said.

Federal Banking Laws: New Measures Proposed

Intelligence and military officials say the Soviet effort fit into a broader scheme referred to last September by Defense Secretary Caspar W. Weinberger.

"By their own estimate," Mr. Weinberger said, "more than 5,000 Soviet military research projects each year are benefiting significantly from Western-acquired technology."

Although the Federal banking laws were toughened in 1978, as a result of several cases of domestic fraud, intelligence, military and banking officials contend that they remain inadequate to block the kind of takeover attempted by Moscow Norodny bank.

There is no law, for example, prohibiting the Russians from acquiring United States banks, and intelligence officials believe that there are inadequate efforts to discover the true principals of some bank transactions.

"As long as we have an inadequate

The New York Times

Amos Dawe, a Singapore businessman, negotiated the purchase of three California banks for a branch of Moscow Norodny Bank.

statutory base, we're going to be vulnerable," Mr. Perle said.

Steven J. Weiss, Deputy Comptroller of the Currency, said that under Federal laws, "it's tightened up a great deal, but there are still some problems."

Mr. Weiss noted that his agency had 60 days to approve or reject a proposed bank sale. Such sales can be rejected on three grounds: if the purchaser fails to provide the necessary information, lacks financial capability or is judged to lack integrity or competence.

"That's where we get a lot of murky stuff," Mr. Weiss said. "We have a standard procedure of checking with the C.I.A., F.B.I. and Interpol. Those checks frequently produce nothing." At best, he said, they produce gut reactions or information that cannot provide the basis for rejecting a sale.

"There have been cases where the proposal stinks, but we don't have the statutory grounds to turn them down," Mr. Weiss said.

Banking Timidity Charged

But a 1984 report by the House Committee on Government Operations accused the banking agencies of timidity. "Even when confronted with evidence of prior misconduct or questionable integrity, the agencies rarely deny change of control applications," the report said.

Representative Fernand J. St Germain, the Rhode Island Democrat who is chairman of the House Banking Committee, noted the problems of ascertaining the principals of some transactions. "There are many subterfuges used to disguise ownership," he said.

But he said that many of these problems could be solved by strict enforcement of existing laws. "The controller's office is wearing blinders," Mr. St Germain said.

The problem of money laundering has led the Reagan Administration and members of Congress to introduce legislation to make the process a crime.

But some believe that there is no defense against a determined, well-financed effort. "If you're willing to spend enough time, money and effort, you can get away with anything," said Quentin Breen, another of Mr. Dawe's San Francisco lawyers.

"When you live in an open society, you have to accept the consequences," Mr. Breen continued. "The question is, can we afford to continue to be an open society?"

DO NOT FORGET THE NEEDIEST!

~~SECRET~~

Executive Registry
86- 0711

20 February 1986

MEMORANDUM FOR: Chairman, National Intelligence Council

FROM: Director of Central Intelligence

SUBJECT: Analysis of Soviet Cash Flow

1. The front page story in Sunday's Times on Soviet attempts to acquire US banks for use in technology acquisition, together with the attached speech by Roger Robinson suggesting that Soviet banks are managed to use their deposits and interbank relationships in a manner which substantially enhances the currency available to the Soviet Union, prompts me to ask for an analysis of this whole
25X1 question. The timeliness of such an analysis is further built up by [redacted] memorandum highlighting the currency difficulties the Soviets are now experiencing. I attach a copy of that memorandum.

25X1 2. I understand that [redacted] of OGI are working problems in this area and I would like them or anyone who might be appropriate
25X1 to get together with [redacted] get his further ideas, and see what information needs to be pulled together to fully evaluate this phenomenon. It will almost certainly become an issue when Senator Garn, as I understand he is contemplating, pushes a somewhat revised form of his proposed legislation authorizing greater Presidential control over international interactions with Soviet Bloc and associated countries.

William J. Casey

25X1 [redacted]

~~SECRET~~

The Security Triad of East-West Economic Relations: Technology Transfer, Energy Trade, and Financial Flows

Presented by

Roger W. Robinson, Jr., President of RWR, Inc.
and former Senior Director for International
Economic Affairs at the National Security
Council (1982-1985)

before the

Heritage Foundation
on February 11, 1986

February 11, 1986

The Security Triad of East-West Economic Relations: Technology Transfer, Energy Trade, and Financial Flows

Presented by
Roger W. Robinson, Jr.

I am delighted to have another opportunity to speak before the Heritage Foundation on the subject of the security dimensions of East-West economic and commercial relations in the post-Geneva period. I would also like to convey special thanks to those at Heritage who are dedicating their time and energy to this crucial family of national security issues.

I think it would surprise most people were they to step back and assess how many of the more publicized issues and challenges which the United States faces in the world today are directly or indirectly underpinned by the East-West economic and financial equation. I make this assertion because, like most endeavors in the human condition--whether it be at the individual, state, or national level--the proverbial "bottom-line" of the ability to get things done rests upon economics and particularly finance.

Having said that, I must confess that after a dozen years of active involvement in this policy area, I continue to be somewhat troubled by the lack of a more common understanding in the Western Alliance concerning the key elements of the strategic or security side of East-West economic and commercial relations. I have long referred to what I believe to be the three most important components of strategic trade with the East as the "Triad." They are: 1) the illegal acquisition by the Soviet Bloc of militarily-relevant Western technology;

2) Western energy security--specifically, the ongoing Soviet strategy to dominate Western Europe's natural gas markets; and 3) untied and non-transparent Western financial flows to the Warsaw Pact countries. These components of the Triad are, in my view, the principal avenues of the West's windfall contributions to Soviet military-related innovation, the USSR's hard currency earnings structure, and the Soviet Union's ability to maintain and expand its costly global commitments.

For example, hasn't it struck most Western policy-makers as odd that the Soviet Union, which has a total annual hard currency income of only about $35 billion from all sources (including arms sales), can sustain a global empire which can directly rival the United States? More specifically, how does the USSR support such a vast array of third country commitments -- many of which must be hard currency financed -- with annual earnings equivalent to only about 15% of total U.S. corporate profits in 1984 or about one third of Exxon's annual revenues for that same year? These are central questions which I believe call for more thorough examination. Although the brevity of my remarks today will not permit a detailed attempt to answer these questions, I might at least offer a framework to advance the search.

In the area of finance, I have often been curious why I've never come across a security-oriented cash flow analysis of the USSR -- a page divided down the middle with "sources" of hard currency on the left side -- for example, oil and gas exports and the sales of arms, gold, diamonds etc.--and "uses" of hard currency on the right side--such as imports from the West, technology theft, underwriting Cuba and other client states, KGB/GRU operations etc. My own guess is that a detailed security cash flow analysis of this kind would show a formidable annual hard currency short-fall that presumably has to be financed through Western borrowings. Declining Soviet oil production and plummeting prices for both oil and gas -- composing approximately two-thirds of the USSR's total annual hard currency earnings structure -- should result in an even more active Soviet presence on the world credit markets than the roughly $3 billion in new credits attracted in 1985. The fact is that the level of Soviet indebtedness remained largely unchanged during the period 1979-1984 despite the fact that the USSR's hard currency needs apparently grew significantly. I believe this discrepency can be, at least in part, explained by substantial Soviet reliance on a rather hidden borrowing source in the Eurocurrency market.

This less visible borrowing activity takes place in the vast and amorphous interbank market where the Soviet Union has been a major player for many years. The interbank market is formed by the established practice among the world's banks of depositing cash with one another to facilitate the efficient flow of funds and to earn extra income on excess cash. The London Interbank Offering Rate (LIBOR) serves as the benchmark rate at which these deposits are offered to prime potential borrowers and usually floats at roughly 1% below the U.S. prime rate.

The six Soviet-owned banks located in the West, along with their branches, have been major beneficiaries of this global flow of interbank funds. The largest Soviet-owned banks in the West include Banque Commerciale pour l'Europe du Nord or Eurobank in Paris, Moscow Narodney Bank, London (which often serves as the coordinating point for other Soviet banking institutions in the West), and Ost-West Handlesbank in Frankfurt. Other 100% Soviet-owned banking institutions are located in Luxembourg, Zurich, Vienna, Singapore and Beirut. The Soviets go to some lengths to obscure their complete ownership of these institutions. For example, these banks are incorporated under the laws of the countries in which they are domiciled, have foreign nationals in management positions, have what appear to be a diverse group of shareholders, and even maintain representative offices in Moscow similar to Western banks.

These Soviet banks engage in other banking activities outside the interbank market and even place some of their own deposits with major western banks. This does not, however, offset the enormous advantage to the Soviets of having access to a large amount of hard currency at an interest rate which is below the U.S. prime rate and which can be used at their sole discretion. Access to these western deposits also permits the Soviets to avoid more expensive and visible forms of western financing. Afterall, why should the USSR arrange letters of credit, bankers acceptances, or go more often to the syndicated loan market when they can tap a largely invisible pool of western deposits for years at a time at interest rates below U.S. prime?

It is very difficult to estimate the precise amount of such western funds on deposit with the Soviet Bank for Foreign Trade, the State Bank of the USSR, and Soviet-owned banks in the West. Nevertheless, as the Soviets maintain correspondent banking relations with virtually every sizeable banking institution in the world, a ballpark estimate of the aggregate amount of western deposits with Soviet-owned banks in West would be roughly $5 billion. I would estimate that several billion dollars more in western deposits have been attracted directly by the Soviet Bank for Foreign Trade and the State Bank of the USSR. East European banks also enjoy the same favorable access to this untied, low-cost financing source. Although these deposits must eventually be repaid, similar to loans, they still represent a major reservoir of cheap money. I think that it would be very illuminating for the Administration and Congress to get a better handle on the Soviet Union's use of this kind of oversized, non-transparent reserve checking account for the funding of its global activities.

Returning for a moment to the first leg of the strategic trade Triad -- the Soviet acquisition of militarily-sensitive technology -- we can take satisfaction in knowing that this problem is far better understood today than ever before. The President instructed the bureaucracy early in his first term to redouble its efforts to stem the flow of strategic technology to the Warsaw Pact countries. This past fall the Department of Defense, in coordination with the CIA, released an unclassified White Paper which made a valiant effort to quantify, where possible, the magnitude of our technology losses. The paper sought to identify the estimated savings achieved by the Soviet military research and development establishment as well the direct costs incurred by U.S. taxpayers to defend against these Western-sponsored advances in Soviet military strength. Whether or not one accepts the estimates in the Department of Defense White Paper, most informed observers would have to concede that U.S. taxpayers are penalized to the tune of billions of dollars annually.

Concerning the second leg of the Triad -- Western energy security, and specifically the carefully crafted Soviet gameplan to dominate the natural gas markets of Western Europe -- again, the President demonstrated what will be judged by history to be impressive vision and courage when he urged his allied counterparts, at the Ottawa Summit in July, 1981, to limit their level of dependency on Soviet gas supplies. Subsequent to the Ottawa meetings, he dispatched two high level U.S. delegations to Europe (the first one in the fall of 1981 and the second in early 1982) to persuade the allies to identify and develop secure, indigenous natural gas reserves (particularly the Troll gas field in Norway) and to halt the extension of subsidized credits to the Soviet Bloc for energy development and other purposes. The declaration of Martial Law in Poland in December, 1981 added urgency to these undertakings, since the Alliance needed to send a unified signal that continued repression in Poland would not be cost-free.

The President immediately decided to implement economic sanctions aginst the USSR by embargoing U.S. origin oil and gas equipment destined for the Soviet energy industry. In June, 1982, with no movement toward reconciliation in Poland and insufficient allied unity on a response to this situation, the President extended these sanctions to include U.S. subsidiaries and licensees located abroad. This decision temporarily crippled progress in the construction of the USSR's major gas export pipeline. Intensive allied consultations were then undertaken at the Ministerial level with a view toward achieving the President's goal of forging a durable allied consensus on the security dimensions of East-West trade.

The positive outcome of these Ministrial deliberations led the President to decide in November, 1982 to lift the oil and gas equipment sanctions <u>but only after</u> the allies had agreed to undertake urgent work programs in the key strategic trade areas, including enhanced Western energy security, which were to be completed by the Williamsburg Summit in May, 1983. Progress was swift in coming. The practice of offering subsidized credits was eliminated by an understanding achieved within the OECD. An agreement signed by some 25 nations in the International Energy Agency in May, 1983 also represented a major accomplishment for the Administration. The language of that agreement effectively deprives the USSR of major European participation in construction of the anticipated second strand of the Siberian gas pipeline which is presently underway or will be imminently. If abided by, this agreement will not only block Soviet domination of Western Europe's gas markets but will also deny the USSR between $5-$10 billion in annual projected hard curency earnings from the second strand in the mid to late 1990's and beyond.

I think it is important to emphasize that the mission of the Poland-related sanctions was not, as was so often reported in the world press, to block the first strand of the Siberian gas pipeline project. The Administration was aware that the first pipeline was a fait accompli. The Administration's extension of the Poland-related sanctions represented a last-resort, tactical decision by the President to penalize Soviet repression in Poland and to forge a new consensus within the Alliance on the security aspects of East-West economic relations. All of the security-minded objectives which the President outlined to his counterparts in Ottawa in 1981 were achieved.

Policy Prescriptions

I would like to use the remainder of this talk to offer some specific policy recommendations which address each of the three legs of the strategic trade Triad.

First, on technology transfer, I recommend the continuation of the effort to quantify the impact on the West of what these losses mean to our long-term security, to our taxpayers, and our intensive efforts to reduce the U.S. budget deficit. The potential Gramm-Rudman trigger mandating reductions in our own defense expenditures adds urgency to this task. The infrastructure of Cocom must be substantially bolstered from its woefully inadequate present status and an expanded array of incentives and disincentives should be brought to the table by the U.S. in negotiations with the allies and neutral countries in an effort to finally subordinate commercial benefit to our common security. The U.S. should also continuously develop new methods designed to assist the tracking and identification of stolen technology so that would-be diverters will operate in an uncertain environment.

In the area of western energy security -- The Administration should send an early signal to the allies that despite the fall in demand for Soviet gas, we will insist that the May, 1983 International Energy Agency agreement be strictly observed, particularly when the Soviets begin to contact Rhurgas, Gaz de France and others for below-market second strand gas deliveries during a future period of increased demand. In addition, the positive direction of the current negotiations for the accelerated development of the Norwegian Troll gas field, as a substitute for Soviet gas, should be politically reinforced at the highest levels. The Administration should also do whatever it can to defuse the dangers inherent in West Berlin becoming 100% dependent on Soviet gas stemming from an agreement signed in 1982 and the likelihood that Turkey will become approximately 95% dependent on Soviet gas if current negotiations with the USSR come to fruition. Also, allied willingness to provide the West's most sophisticated oil and gas equipment and technology to the USSR and actively assist in the extraction, processing, and transmission of Soviet energy resources should be, in some way, factored into allied efforts to increase emigration from the USSR and achieve equal and verifiable reductions in nuclear weapons. The other elements of the Triad should likewise be considered in this context.

Finally, the Congress, in close coordination with the Administration, can play an important role by focusing on the practice of untied or so-called balance of payments lending to potential adversaries and reaching a clearer understanding of the amounts and Soviet use of interbank deposits. Certain principals or guidelines should also be considered for voluntary adoption by the Western banking community. Specifically, each loan to a potential adversary should have an identified and verifiable purpose -- be it an equipment purchase, a specific project (with loan drawdowns calibrated to project expenditures) or a short-term commodity transaction such as grain. Every loan should have a maturity that is strictly matched against the duration of the underlying transaction. For example, a grain transaction should be financed with a maximum loan maturity of 180 days rather than 3 years which would otherwise de facto provide the Soviets with 2 1/2 years of cash for their discretionary use. Finally, U.S. banks should aggregate their interbank deposit exposure to all Soviet-owned entites and periodically report these aggregate exposures to U.S. bank regulators, if they are not already doing so. The same practices should be applied to East-European entities. In this connection, I am not arguing for the discontinuation of interbank activity with the USSR -- only that specific information be developed on the amounts and the proper use and maturity of such deposits.

As these proposed principals to govern financial flows to potential adversaries are prudent from a commercial as well as security perspective, they will hopefully not present major problems for the Western banking community. The Administration should, in turn, urge our allies to adopt a similar approach. To take an extreme example, how would we feel about even $10 million in untied Western cash being made available to Colonel Kaddafi for his sole discretionary use? This particular issue brings to mind the sound advice offered by John Le Carre in his novel "The Honorable Schoolboy" which is embodied in the three simple words "follow the money."

In conclusion, there don't have to be any "losers" in the policy recommendations being proposed in this paper. Legitimate, non-strategic trade can go forward and expand; the U.S. can continue to streamline and expedite its export licensing procedures and trim the Cocom list, where indicated, to ensure enhanced U.S. export competitiveness; Western loans can continue to support specific trade transactions and projects; and hopefully incentives for greater Soviet geopolitical cooperation can be created through expanded East-West economic and commercial relations. Nevertheless, we simply cannot avert our eyes from those economic and financial practices which are deleterious to our long-term security interests; nor can we side-step the need to develop a more comprehensive picture of how the Soviet Union funds itself and its global activities.

I would hope that the U.S. security community, the Heritage Foundation, and other like-minded organizations will dedicate more resources and talented people to undertake further analyses of these issues. I would also recommend that consideration be given to the establishment, through legislation, of an Assistant Secretary of Defense for International Economic Security specifically to deal with the critical security aspects of trade and energy relations, and global finance. If properly structured, such a new position need not interfere or overlap with existing positions or functions which are, for example, responsible for the complex issue of technology transfer.

Finally, it is imperative that we successfully come to terms with the enormous Western contribution to the economic and financial vitality of the Soviet Union and its client states and formulate sensible policies accordingly.