The original documents are located in Box 8, folder: “Soviet Oil Negotiations” of the Frank Zarb Papers at the Gerald R. Ford Presidential Library.

Frank G Zarb

JAN

Pls Put with FEA files

we must go together

~~SECRET~~

~~CONFIDENTIAL~~

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

October 10, 1975

MEMORANDUM FOR FRANK G. ZARB
MELVIN CONANT

FROM: Joseph C. Bell
Assistant General Counsel for International, Conservation and Resource Development Programs

SUBJECT: Soviet Oil Negotiations

1. Summary

After nine days of negotiations, we reached accord on a long-term grain agreement and a general letter of intent to enter into an oil agreement, except for the key element of price. Pursuant to instructions, the U.S. delegation insisted on a Soviet commitment to a 15 percent discount. This the Soviets adamantly refused. The letter of intent and proposed U.S. side letter on price are attached as Annexes A and B. The negotiations are briefly reviewed in Annex C.

For reasons set out below, I would strongly urge the acceptance of the oil letter of intent without the price clause so that both the grain agreement and the oil letter can be initiated and approved simultaneously. This would provide the maximum obtainable political advantage for the U.S.

Unless I underestimate our grain leverage, I do not believe that the Soviets will offer a price significantly below that necessary to facilitate the actual export of oil. Continued pressure will not only be unavailing, but also will be detrimental to future political and economic relations. (Of course, there may be a "political" deal of which I am not aware, but the quid pro quo would have to be very substantial.)

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2. Price Discount

Patolichev, Minister of Foreign Trade, and Kuzmin, Deputy Minister, in all discussions in which I have been involved, have strongly rejected the notion of any price discount. They have said that any discount:

- Was inconsistent with their basic principle to trade at world market prices.
- Would damage their relations with consumer and producing governments.
- Was unnecessary as they could sell the oil to other parties.
- Was "political," "offensive," and inconsistent with treatment of the Soviet Union as an equal.

The Russians are particularly sensitive about any language which does not provide parity or mutuality in treatment of the U.S. and the U.S.S.R. As such, they found it completely inconsistent for us to ask for a discount on oil while we were not only not providing a discount on grain, but were also asking for a long-term grain agreement with a unilateral U.S. right to terminate. Although they are, of course, skilled negotiators capable of dissembling, I feel that was a matter of strong genuine concern to them.

Although in earlier private discussions with Robinson, Patolichev had spoken of an "attractive" price, it now seems clear that, absent the strongest leverage from grain, no substantial price discount can be expected. That does not rule out a "favorable" price within the range which world prices might encompass. But a bald discount, as Washington has requested, appears quite unacceptable.

3. Letter of Intent

The existing draft letter of intent should be signed, recognizing that the question of pricing is being postponed. Politically we probably would get as much or more benefit from "continuing" talks as represented by the letter of intent as we do from a final agreement, which will be subject to partisan criticism. By signing simultaneously with the grain agreement, we provide the implicit link which Congress and others demand without formally coupling the two (meeting the Soviet concern in this regard).

Even if the letter of intent leads only to an umbrella agreement under which private purchases are made, the agreement is in our interest. As set out in my earlier cable, such an agreement would still have the following advantages.

A. Security of supply. Although Soviet oil may not be more secure than OPEC oil, total security is increased by diversifying sources. In fact, the Soviets could probably be expected to continue deliveries in another embargo. Soviet deliveries in Europe apparently continued during the last embargo, and any cut-off, especially in the context of a government to government agreement, would allow the U.S. to take retaliatory action in grain or other areas. Moreover, the Soviets have apparently generally carried out their foreign trade obligations recognizing their long-run interest in having access to those Western resources, especially technology, which they need.

B. OPEC dependency. To the extent that Soviet deliveries come from a reduction in Soviet or Eastern European demand, dependency on OPEC is further reduced. In this respect the Soviet deliveries are fully equivalent to domestic conservation efforts.

C. OPEC pricing. Even deliveries at commercial prices can have an impact on OPEC pricing. One of the more difficult problems for OPEC has been the establishment of proper differentials for transport and quality. For instance, the Algerians and the Iraqis differ on the proper Mediterranian price by about 75 cents per barrel. Notably OPEC chose not to try to deal with pricing differentials in its September meeting.

Soviet sales may put further pressure on these differentials which we may be able to increase in negotiations. (Potential success here, unfortunately, has been somewhat prejudiced by Washington's insistence on a straight discount.)

D. Maritime arrangements. Any agreement should provide some utilization of U.S. ships hauling grain to the Soviet Union on the backhaul to the U.S. This will provide extra employment, attractive to the unions, and could result in a reduction of subsidy.

E. Option. It should be noted carefully that the letter of intent represents an option. The Soviets would offer the oil for sale, but we are not now committed to buy. This itself has substantial value.

4. Grain Leverage

Such an agreement will, of course, not satisfy all the loose expectations of matching petro-power with agri-power. In fact, the amount of leverage which the United States has from the grain sales is probably exaggerated. There are other sources of grain, and at some cost of rearranging supply networks, it is possible for foreign grain to move to the U.S.S.R. and U.S. grain to move to those markets which would otherwise have taken foreign grain. The Soviet Union obviously would like to have access to the U.S. market, the largest source of export grain, but our power is hardly unlimited and our position is nowhere comparable to that of OPEC in oil.

5. Soviet-U.S. Relations

Our demand for a discount was clearly deeply resented by the Soviets as an attempt to use unwarranted political pressure. A basic decision is required whether we want to normalize trade and commercial relations or not. I assume from the Trade Agreement that the Administration does want to normalize these relations. If so, then we should deal with the Soviets as other commercial partners with whom we have ongoing relationships and should not, as we are currently, attempt severe pressure to obtain from them economic concessions which cannot be considered to be mutually beneficial.

6. Negotiating Tactics

Washington's insistence that Robinson press for a discount after the Soviets had clearly rejected any such declaration (confidential or otherwise), undermined Robinson's authority. In the future, Patolichev will be far less likely to play out his hand knowing that after his negotiations are complete, Washington will take a second bite.

7. Future Negotiations

If we are going to continue to press a hard line, I would suggest altering the form of our negotiations. First we could go back to my original formulation which builds up the Soviet price by (1) calculating a U.S. delivered price and then (2) netting back to an f.o.b. Soviet price. This would be consistent with paragraph 4 of the proposed letter of intent which calls for some deliveries to the U.S. By working with these freight rates, one can, in fact, obtain some benefit for the U.S. without in theory departing from a world price.

Secondly, we should give consideration to focusing any benefits solely on sales made to the U.S. Government. This would avoid very difficult problems in picking up rents which might otherwise accrue to the oil companies. If the Soviets are inclined to give at all, it would certainly be much easier for them to do so on sales to the U.S. Government in which all the terms are subject to negotiation and a discount could be more readily hidden.

cc: John Hill
Robert E. Montgomery, Jr.

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ANNEX A

Moscow, U.S.S.R.

His Excellency
N. S. Patolichev
Minister of Foreign Trade
Moscow, U.S.S.R.

DECLASSIFIED
E.O. 12958, Sec. 3.5
State Dept. Guidelines
By W Hos, NARA, Date 11/24/00

Dear Mr. Minister:

This is to confirm the understanding arising out of our discussions October 2-7 that our two Governments intend, within 30 days, to conclude an Agreement concerning the purchase and shipment of Soviet oil. This Agreement will provide for the following:

1) The Government of the Union of Soviet Socialist Republics will, for a period of five years, offer for sale annually 10 million metric tons of crude oil and petroleum products.

2) The Government of the United States may purchase the crude oil and petroleum products for its own use or, by the agreement of the Parties, the purchase of crude oil and petroleum products may be made by United States' firms.

3) About 70 percent of the total quantity offered for sale will be crude oil. The remainder may be petroleum products, in particular diesel oil and naphtha.

4) Some portion of the crude oil or petroleum products will be shipped to the United States, partly in tankers used to transport grain from the United States to the Soviet Union.

5) Some portion of the crude oil or petroleum products may be delivered to Europe or other agreed marketing areas.

6) Prices for crude oil and petroleum products will be mutually agreed at a level which will assure the interests of both the Government of the United States and the Government of the Union of Soviet Socialist Republics.

In addition it is further understood that both Governments will work for the extension and expansion of the cooperative efforts already underway in the field of energy. Such efforts will be particularly directed towards the fuller application of the technological capability of both countries in increasing energy output from existing sources and in developing new sources of energy.

Sincerely yours,

Charles W. Robinson
Under Secretary of State
for Economic Affairs

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ANNEX B

Moscow, U.S.S.R.

His Excellency
N. S. Patolichev
Minister of Foreign Trade
Moscow, U.S.S.R.

Dear Mr. Minister:

It is understood that the price of crude oil and petroleum products purchased and sold pursuant to the Agreement which our two Governments are to enter into shall be established on the basis of world prices. To take account of transportation and other factors, including the need for such crude oil to be competitive in United States markets, it is agreed that the price of similar quality Soviet oil, f.o.b. Novorossisk, shall be 15 percent less than the f.o.b. market price, Ras Tanura, of 34 degree Arabian Light crude oil. Petroleum products shall be priced at the competitive equivalent of the price of crude oil. Unless otherwise agreed by the Parties, all other terms and conditions shall be in accord with normal commercial practices.

Sincerely yours,

Charles W. Robinson
Under Secretary of State
for Economic Affairs

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ANNEX C

I assume you were kept informed through the State Department of the progress of negotiations. In summary, there were essentially four stages.

(1) In meetings of September 30 and October 2, the Soviets made clear (a) their unwillingness to enter into a final oil agreement at this time, and (b) their refusal to consider any price discount, but Robinson managed to push them towards the notion of signing a letter of intent to enter into a future agreement.

(2) In a meeting of October 4, Robinson presented them with our draft letter of intent, based upon the earlier discussions.

(3) On October 6, the Soviets presented a counter draft. The major change was in Article 6 (price). We countered with a new version of Article 6 which I drafted designed as part of a negotiating strategy to end up with at a minimum a simple clause "prices to be mutually agreed." In a meeting the evening of October 6 between Kuzmin and myself, our counter draft was discussed. Kuzmin probed whether our draft implied a "discount." I replied that the word "discount" was not very useful, but that the price had to be such as to make the arrangement attractive to the U.S. After considerable discussion, he produced a second Soviet draft which was very similar to a variant we had considered putting forth ourselves. This is the clause now embodied in the proposed Article 6. We were wrapping up the grain agreement that night, and the Soviets obviously wanted to finish with the oil letter as well.

(4) On October 7, pursuant to instructions, we presented the demand for a confidential side letter providing a price discount. The draft attempted to cloak the discount in language acceptable to the Soviets, e.g., the reference to world prices and the attempt to make the discount appear to be a transport adjustment. The Soviet reaction, once the letter was understood, was an unequivocal no.