2690

DEPARTMENT OF STATE

BRIEFING MEMORANDUM

S/S

7319228

UNCLASSIFIED
~~CONFIDENTIAL~~

OCT 13 1973

To: E - Mr. William J. Casey

From: EB - Willis C. Armstrong WCA by JLK
S/PC - James S. Sutterlin JSS by. C.W.R.

SRG Meeting on International Petroleum Situation - Monday, October 15th at 10:00 a.m.

The purpose of this meeting, as we understand it, will be to review the current world petroleum situation, in light of the Middle East conflict, and to consider the implications for US short and long term petroleum strategies. A meeting has been arranged for Monday morning at 9:15 a.m., before the SRG, to brief you on the latest developments.

While oil developments will evidently be governed by political-military events in the days ahead, the Secretary may wish to use this meeting to explore some of the domestic elements of our petroleum policy as they bear on the international situation.

The Current Situation

Saudi Arabia currently produces oil at a rate of 8.5 million B/D; other Arab Persian Gulf producers, in excess of some 7 million B/D; Libya, 2.3 million B/D.

Thus, in total, the Arab world now contributes in excess of 18 million B/D (excluding Algeria), of which

UNCLASSIFIED
~~CONFIDENTIAL GDS~~

DDRS

some 10 B/D go to Europe, some 4 million B/D to Japan, and some 2.6 million B/D (directly or indirectly) to the US.

Europe's supplies have so far sustained roughly a 6% cut -- a loss of about 1.6 million B/D -- as a result of the closure of the Syrian terminal and reduced deliveries through the trans-Arabian pipe line (TAP).

Possible Arab Moves

Mr. Davies will brief you Monday morning on any new developments in Arab oil policy.

There are several basic questions the Arabs have to deal with in fashioning a strategy, should they decide on the attempt to use oil as a lever on US policy.

-- Whether to establish a specific linkage between US actions (e.g., resupply of the Israelis) and possible supply limitations, or to try, through more general threats of an interruption of supply, to pressure the US into modifying its policy.

-- How best to implement a cutback, i.e. whether to aim it directly against the US (export embargo), or more generally, against Western consumer countries (global production ceiling) to seek leverage via Europe and possibly Japan.

US vulnerability to even total cessation of all Arab oil supplies, direct and indirect, is still relatively limited at this time (see annex 1). The Arabs know this. Thus, the Yamani formula -- a ceiling on production, which could progressively be lowered -- has several advantages from the Arab point of view.

-- The prospect of progressively greater supply shortages will create strong political pressures in the West, particularly in Europe, in favor of a solution acceptable to the Arabs.

-- At the same time, such a scenario avoids a direct and overt move, singling out the US as its target, that would deeply antagonize the American public.

-- A limit on production has a degree of economic plausibility and justification since the Saudis (and most of the other Persian Gulf producers) do not in fact need these large oil revenues.

Thus, an export embargo directed specifically against the US would more likely be imposed in retaliation to specific US actions considered highly offensive by the Arabs, and would be only of limited effectiveness unless combined with export ceilings to other consumer countries.

Possible US Actions

There is a range of possible measures we might take in anticipation, or in the event of, a cut off. These measures would be useful in dealing with an embargo aimed against the US but only of limited value in dealing with global production cut backs. The timing of making such measures public would have to be very carefully considered in relation to possible Arab reaction.

Broadly, these measures are (in order of severity):

1. Domestic Steps (see also annex 2):

-- Convene the Foreign Petroleum Supply Committee, an industry advisory committee to the Secretary of Interior, to examine the supply situation;

-- Appeal by the President for voluntary measures to cut back consumption (e.g. appeal to the public to reduce thermostats, to increase the use of car pools, to reduce pleasure driving and consumption of electricity, etc.).

-- Steps to increase domestic supply (e.g. emergency production from Elks Hills naval petroleum reserve, surge production in Texas fields, etc.).

-- Mandatory measures to reduce consumption.

2. International Steps

-- Convene a meeting of the OECD High-Level Oil Committee to begin high-level consultations among Western consumer countries;

-- Seek the declaration of an emergency situation from the OECD;

-- Convene the International Industry Advisory Committee of the OECD to begin consultations on international emergency oil supply allocations; and/or

-- Complete rapidly the international oil sharing agreement now under discussion in the OECD.

Our overall posture should be to maintain a careful balance until Arab intentions clarify: on the one hand, new actions, such as the cabinet committee meeting convened by Governor Love, which signal increased determination to reduce US dependence on Middle East oil, will have a beneficial effect in strengthening our posture; conversely, any premature publicity of US steps that appear to assume specific Arab moves to trigger a scarcity of supply would evidently be undesirable.

Some Longer-Term Questions

In calling this meeting, we understand the Secretary may also be interested in exploring the question of how the present crisis bears on our longer-term international petroleum strategy, which has been the subject of NSSM 174.

The attached executive summary of NSSM 174 (annex 3) explores two general longer term strategies for dealing with the international oil problem:

-- A strategy of multilateral cooperation among consumer countries to improve the terms and enhance the security of oil supplies;

-- A strategy under which we would seek to enlist the national self-interest of key producer countries such as Saudi Arabia in bilateral arrangements designed to enhance security of supply for the US.

The case for such a fundamental reexamination of US oil policy -- in the past we have left the management of international oil relations to the companies on grounds that we did not wish to politicize commercial relationships -- is that the traditional company-government negotiating process has been breaking down; as the world has moved into a period of scarcity and the financial strength of the producer governments has progressively increased, the basic asymmetry of the traditional bargaining process under which private companies must deal with sovereign governments, having a unilateral power to legislate terms, has been revealed. Also, oil relations are seen by the Arabs increasingly in political as well as economic terms. A different strategy, implying an increased governmental role in oil relations, could not, of course, change the basic economic fact of a sellers market in petroleum. The issue is whether such alternative strategies, by bringing to bear the moral authority and political weight of the US and other governments, would be useful in giving greater stability to international oil relations than they have had in the recent past.

In operational terms, the form such alternative strategies would have to take, consistent with US public policy toward private enterprise, would be that of rather general government-to-government understandings at a very high political level concerning production levels, criteria and ground rules for setting oil prices, and perhaps other modalities of the concession arrangements. Within such a broad and general framework, the companies would continue their traditional role.

There is a serious question, however, whether such an arrangement would remain viable for very long. The world-wide scarcity of crude oil is likely to increase for some years, putting pressure on the price structure. This will manifest itself in offers by private companies, short of oil, of ever higher prices for participation crude, i.e. the share of crude oil production owned by the producer governments as a result of their equity position in the producing operations.

To curb competitive bidding by companies supplying the US domestic market, the government would probably have to control imports through an import allocation scheme and perhaps institute price controls. To curb international competition by other consumer countries scrambling for additional oil supplies, the framework agreement would have to be multilateralized to encompass other consumers and limit pressure on the terms of the US bilateral arrangements. Under conditions of continuing scarcity, such a multi-party arrangement might ultimately entail a global oil allocation scheme.

If the Administration were to decide on the bilateral approach -- and, indeed, the political climate were to permit this --, an understanding with Saudi Arabia, for example, as part of some kind of broader, more general Middle East settlement, could presumably be handled in a manner that protects the interests of other consumers. In fact, such a move would presumably trigger action by other consumers to associate themselves with such an understanding (the US could then seek to obtain closer consumer cooperation and coordination as a quid-pro-quo). On the other hand, assuming such an arrangement were negotiable under the appropriate political conditions, it might well be seen in Arab eyes as establishing an explicit linkage between oil and politics -- a linkage which might make it more difficult for the Saudis to remain aloof in a future Middle East conflict, even recognizing that their current posture is dictated at least as much by political as by economic considerations.

As regards multilateral consumer cooperation, the most promising area is that of defensive measures, such as an oil sharing arrangement and coordinated stockpiling. As the US remains considerably less dependent on imported oil than other major consumers, there is a presumption that sharing arrangements benefit other consumers more than the US. It is difficult to conceive, however, that other consumers would not take very strong measures to compel the international companies to provide them with a reasonable share of the available world oil supply, for example, through the diversion of overseas oil that would normally be destined for US markets, if there were no equitable sharing arrangement. Conversely, such an arrangement would benefit the US more than other consumers if an oil boycott were directed against the US -- although, by establishing a linkage to other consumers, it would tend to push Arab perceptions in the direction of global limitations, which would cause more severe world-wide supply shortages than supply curtailments aimed at the US.

Attachments:

Annex 1 - Current US Vulnerability
Annex 2 - Conservation Actions
~~Annex 3 - Oil Supply Arrangements: NSSM 174~~

C.W.R.

Drafted: S/PC:CWRuser:gtm
x22026:10/13/73

Annex 1

Current US Vulnerability

We currently import about 1.7 million barrels per day of Arabian crude oil and refined products that come from Arab countries through refineries in the Caribbean and Europe (10 percent total oil consumption). We also receive about 400 thousand barrels per day from Canada that might be cut off in an Arab boycott.[1/] Finally, projections are that we will need an additional 600 thousand barrels per day from Arab sources this winter. As shown below, this creates a total vulnerability of about 2.7 million barrels per day or about 15 percent total oil consumption.

Petroleum Imports from Arab Sources
(October 1, 1973)

	000's of Barrels Per Day	Percent Oil Consumptio
Crude Direct to U. S.	1,100	
Refined Products Received Through		
Europe	260	
Caribbean	330	
TOTAL to U. S.	1,690	(10%)
Vulnerable Imports from Canada	390	
TOTAL Current Vulnerability	2,080	(12%)
Additional Winter Needs	600	
TOTAL Projected Vulnerability	2,680	(15%)

Saudi Arabia supplies the majority of these Arab imports with Kuwait and Libya production also significant. European and Japanese dependence on Arab oil is far greater than the U. S. with Arab oil accounting for 75 percent and 50 percent of European and Japanese total oil consumption.

1/ Although Canada now could not transfer oil from the Western provinces (that export to the U. S.) to the East (which import Arab oil), political forces might force a cutback of exports if an Arab cutoff occurred.

SECRET

The only cutoff that has been reported in the crisis so far has been about 1.6 million barrels per day of oil destined for Europe disrupted by the war -- about 15 percent of European oil consumption. If this continues, European exports to the U. S. of refined products would unquestionably be terminated. This would result in a cutoff of about 260 thousand barrels per day -- about equal to a cutoff of Libyan oil. Both contingencies would be serious and require many of the same actions needed to meet a total Arab cutoff.

Impact of a Cutoff

About three or four weeks of imports are currently waterborne in transit to the U. S. Thus, if a cutoff of oil happened today, actual shortages would not effect the U. S. immediately.

In addition, the oil companies currently hold about 900 million barrels of oil stocks of which about 420 would be available1/ as buffer stocks. Ideally, these stocks would provide a 210 to 250 day supply even if a total Arab cutoff occurred providing time to implement other measures outlined below.

However, to be useful these stocks would have to be efficiently distribute and this would require implementing a full-scale mandatory allocation program. This would be the first priority if a cutoff occurred.

While taking advantage of the time provided by the stocks in transit and those held by the companies, we would implement some or all of the actions described below to cut back on demand and enhance supply.

1/ The remainder are needed to keep refineries in operation (400 million barrels) and to meet normal seasonal variations (120 million barrels).

SECRET

Conservation Actions

Conservation actions fall into two categories:

-- voluntary programs with large potential impact on demand but questionable chances for success especially over the long term; and,

-- mandatory programs such as tax programs and regulatory measures which would be efficient but carry their own political problem.

Voluntary programs include measures such as:

-- Public appeals for reducing heating thermostats below the national average of 74 degrees.

-- Increased use of car pools for commuting, reduced pleasure driving and reduced electricity and gas consumption.

-- Encouraging greater industrial efficiency in the use of energy.

Potential savings are great because these measures would be focused on economic areas of high energy consumption. For example, if only about 30 percent effective, a voluntary program could cut demand by almost 600 thousand barrels per day potentially covering about 30 percent of a potential Arab cutoff.

Mandatory conservation measures include:

-- Reducing commercial aircraft flights so that airlines increase their passanger loading from the current 50 to 70 percent. (Requires Civil Aeronautics Board cooperation.)

-- Reducing speed limits to 50 mph wherever possible and pressing for more frequent engine tune ups using State inspection mechanisms.

Potential savings from these sources are about 410 million barrels per day or 20 percent of the maximum potential shortfall.[1/]

We also investigated several tax alternatives and other economic measures as part of a full-scale emergency program:

1/ Not counting the 600,000 barrels per day that may be needed for winter needs.

-- ask Congress for an emergency tax on gasoline to discourage gas consumption for pleasure driving;

-- a tax on heating fuel to encourage switching towards non-petroleum fuels, particularly coal.

The unattractiveness of these tax measures could be somewhat reduced by allowing an income tax rebate proportioned to the energy tax.

In addition, several non-tax economic alternatives are being investigated. For example, pressures could be brought on the Cost of Living Council to allow the price of heating oil to rise to meet recent increases in the international price of oil -- a move to increase production and refining.

Since many of these measures would encourage the increased use of coal, a critical aspect of this program would be to get a relaxation of air pollution standards -- a step requiring cooperation at the State level.

Although firm projection of impact of these measures are not now available, early estimates are that about 500 thousand barrels a day could ultimately be saved -- about 25 percent of the total shortfall.

Taken together, both voluntary and mandatory conservation measures could provide relief sufficient to cover about 75 percent of the potential shortfall,1/ the greatest potential for short term relief when combined with the mandatory allocation program.

Measures to Increase Domestic Supply

Although not adequate in themselves to compensate for an Arab cutoff, some relief could be gained through increased domestic production. Like the conservation measures, some political log jams would have to be dislodged at both the State and national level. In particular:

-- actuate emergency production from the Elk Hills naval petroleum reserves (requires Congressional approval);

-- surge emergency from Texas fields to greater than efficient rates -- requires approval of the Texas government.

Potential production of about 300 thousand barrels per day or 15 percent of the total potential Arab cutoff is estimated from these sources.

Like the conservation measures, a key consideration in implementing these measures would be mobilizing for the President the necessary political support to overcome the vested interests and bureaucratic resistance which have already slowed progress on the President's energy program.

1/ Not counting the 600,000 barrels per day that may be needed for winter needs.