INFORMATION
650-X

SECRET (GDS)

February 9, 1973

MEMORANDUM FOR: GENERAL SCOWCROFT

FROM: HAROLD H. SAUNDERS

SUBJECT: Iran Oil

1. The attached memo [redacted] is probably the best account you will see on the Shah's attitude toward the oil negotiations. It is also useful because it gives a picture of exactly what an emissary would face if he approached the Shah on behalf of the President. 25X1

25X1 2. The second paper attached is a draft paper that I will be discussing with [redacted] on Monday. It is the paper that you asked for at the meeting of your working group just before you left. I hesitate to give you this draft because it will be a much more finished product after
25X1 I have [redacted] contributions. You can ignore it until I send you a finished draft Tuesday, but I thought you might want a chance to comment on the general approach before then. Unless I hear from you I shall just push ahead with the objective of having a finished draft to you Tuesday. That one will be turned into a vehicle for decision.

SECRET (GDS)

HHSaunders:tmt 2/9/73

Page Denied

Page Denied

No Objection to Declassification in Part 2012/11/09 : LOC-HAK-30-6-23-6

Page Denied

SECRET

February 9, 1973

U.S. INTERESTS IN IRANIAN OIL

On January 23, the Shah announced that the consortium of oil companies operating in Iran faces two choices for the future:

1. It can continue present operations until 1979, with some tax adjustments, after which it will enjoy no special privileges and receive no compensation.

2. It can turn over operations now to the Iranian national oil company, in return for which the companies will receive long-term purchasing contracts at discounted prices. The terms of compensation were not specified, but would presumably approximate those used in the Saudi participation agreement.

By making this announcement, the Shah has apparently foreclosed the option of continued operations of the consortium through 1994, with financial adjustments to match the terms reached in the Arab participation agreements. The USG and the companies will have to reach an early decision on whether to try to get the Shah to withdraw from his present position and return to negotiations on a financial package to meet Iran's demands within the framework of the consortium, or whether to press for modifications of the Shah's two options to make them less disruptive to US interests.

SECRET

A case can be made for confrontation with the Shah over his unilateral actions of January 23, whereby he threatened to break the contract with the consortium on flimsy pretexts. The consuming countries, after all, have substantial potential influence in Iran, and it is at least worth considering whether it might be possible through concerted action to force the Shah to back down. On balance, however, it would seem that the Shah will be adamant in sticking with his two alternatives. This is an important judgment to make before considering which of the two options is better in terms of US interests.

The analysis of US interests below is intended first to shed light on whether it is important for the US to try to persuade the Shah to back down and then, assuming that effort may not be worthwhile, to deal with the question of how the Shah's two options affect US interests. If we are not to try to force the Shah to retreat, the next question is whether the US should press for one of his two options. The Shah has made it clear that he prefers a long-term sales contract and will be quite angry if the companies refuse this alternative. The US companies have wavered, but some believe that continuing the status quo through 1979 will be more advantageous.

The key issues for the US are the following:

1. What is the US national interest in the operations of American oil companies as producers in Iran? This question is basic for two reasons: (1) If there were a way to modify the Shah's formula,

how much should the US Government invest in supporting it? If there is no way to modify the Shah's formula, does an analysis of our interests suggest that one of the Shah's options would serve our interests better than the other?

2. How do the Shah's two options each affect those interests and other oil interests in the region?

3. Should the USG take a position on which option should be accepted by the companies?

4. What action, if any, is required of the USG?

Our Interest in US Oil Company Operations as Producers in Iran

In their heyday, US oil companies were seen as guarantors of oil supply to the Western world, as well as profitable business investments abroad. Today, since the producer countries have increasingly gained power and sophistication, it is assumed that the companies have lost their role as independent counterweights to the governments in producing countries and have more and more been reduced to a technical role in production, exploration and distribution--principally the last two. It is increasingly felt that if the interests of consuming countries in reasonable prices and security of supply are to be protected, the responsibility will fall on the governments in consuming countries and not on the companies. The remaining interests of the USG in the operations of US companies in Iran can be reduced to four:

1. a general interest in protecting US enterprises abroad against confiscatory nationalization. In the case of oil companies, the principle of compensation at updated book value, recently worked out with Saudi Arabia, is at stake. The Saudis have served notice that accession to the Shah's demands could cause them to re-open their negotiations.

2. an interest in the repatriation of US profits from companies operating abroad, since this positively contributes to the balance of payments. From Iran, the positive contribution to the US balance of payments ledger in 1971 amounted to about $450 million. Some portion of this could be lost under either of the Shah's options.

3. the "echo-effect" that any actions against US companies in Iran might have in Saudi Arabia and elsewhere. The major issue is the effect on the participation agreements with the Arab states in the Gulf.

4. an interest in the technical contribution the companies can make through investment and management to efficiency in production and, more important, to aggressive exploration. This may be less a factor in Iran and Saudi Arabia than in other areas, but an interest in these activities generally would encourage support for the companies' rights.

The Effects of the Shah's Options on US Interests

The consequences of the Shah's two alternatives are discussed in relation to the major US interests identified above.

Option 1: Continue operations to 1979, then end special status.

Interest 1: Precedent of Confiscatory Nationalization

--No necessary short-term impact, provided that attention not focus on post-1979 arrangements. Time is gained to work on compensation formula after 1979.

--But Shah has announced that in 1979 he will take over without any compensation. Unless this can be modified, precedent could be very damaging elsewhere.

Interest 2: Balance of Payments and the Repatriation of Profits

[CIA is preparing detailed study that will be available February 13.]

--Company profits through 1979 will continue on present basis. No short-term balance of payments loss anticipated.

--But, after 1979, if US companies lose favored position in Iran, balance of payments contribution from Iran oil operations will decline.

--In view of uncertainties over future prices, however, it will be difficult to estimate b.o.p. effects precisely.

Interest 3: Effect in Saudi Arabia

--Little short term impact, provided post-1979 arrangements not stressed.

--But after 1979, if no modifications, prospects of disrupting participation agreements. If, however, participation agreements are proceeding normally in 1979, Saudis may wish to cultivate reputation for responsibility, in contrast to unreliable Iran.

Interest 4: Technical Contribution of US companies

--Reduced US company role in Iran and little new investment as 1979 takeover approaches.

--But possibility of working into agreement a formula for amortizing any new investment between now and 1979.

Option 2: Long-term Sales Contract at Discounted Prices.

Interest 1: Precedent of Confiscatory Nationalization

--Serious problem if terms are bad.

--But Shah has indicated he will follow same formula as used in Saudi Arabia.

Interest 2: Balance of Payments and Repatriation of Profits

--Will depend on price advantage under long-term contracts. May be less favorable in short run and better in long run.

--Major b.o.p. effect will come from world price of oil. Some argue that national oil companies will find it difficult to drive prices up, and may in fact lower them. If true, net advantage insofar as US is importer of oil.

Interest 3: Effect in Saudi Arabia

--Possibly disruptive to participation agreements if presented by Shah as victory for his leadership and wave of future.

--But Saudis less able to take over now; interested in reputation for reliability; and more likely to renegotiate for earnings increases than for entirely new agreement.

Interest 4: Technical Contribution of US Companies

--Less involvement in Iran, with possible effects elsewhere.

--But prospects for contract work with Iranian national oil company and in other producing countries if companies retain capabilities and incentives.

Comment: With respect to each of these four interests, US companies will be seriously weighing pros and cons in their responses to the Shah. US national interests do not diverge significantly from those of the companies and thus we will want to include their judgment of costs and benefits in reaching our own conclusions.

The US Position on the Shah's Two Options

If the US can do nothing to get the Shah to back down from his January 23 ultimatum, we have several choices. We can take no action apart from general support of the companies in whatever choice they make. Or we can try to influence the companies and subsequently our European allies to accept one or the other of the options. Finally, and perhaps most usefully, we can press for modifications in the options which will make any choice minimally disruptive of our oil interests elsewhere. A basic question is whether the USG has any interest in which option is chosen apart from the preferences of the US companies. The companies themselves will be assessing the impact of the options on future earnings and will want to avoid upsetting the participation agreements in Saudi Arabia. To this extent company and US interests coincide. A choice will ultimately rest on the comparative advantages of the two options.

Advantages of Option 1 (Status quo to 1979)

--Less disruptive in short-run.

--Buys time to work for modifications after 1979, so that final option might include both compensation and future sales contract.

--Participation agreements less likely to be affected.

Advantages of Option 2 (Sales Contract now)

--Shah, Europeans and some US companies may prefer this option. If so, US can avoid confrontations by supporting this choice.

--If sales contract respected, some prospects for long-run stable supply and somewhat lower prices.

--Compensation likely to be paid on updated book value.

What US Actions Are Appropriate?

We are already in close touch with the US companies. The range of actions open to us falls into two broad categories--approaches to the governments of the other major consuming countries (British, Dutch, French--perhaps Japanese, Italians, Germans) and approaches to the Shah. The possible elements of approach are outlined below.

Approaches to Consumers. The following are the kinds of approaches that could be made to the governments of the consuming countries:

--The minimum approach would be to talk with the UK, Netherlands and French governments once we have decided on a position towards the Shah's proposals. The purpose would be to gain support for a concerted approach on the next round in the negotiations.

--In addition, an argument has been made for forming a closer association among the governments of the consuming countries. Not enough time is available now to do this in any elaborate way. The proposal at this stage would be to approach the main DAC governments (UK, Dutch, French, Italians, Germans, Japanese) urging them to take the following line with the Shah: "It is essential to the orderly flow of investments in the world that there be stability in agreements reached. If agreements are reached and then unilaterally abrogated, this will have a serious effect on the flow of future investment." The implication would be left that the substantial credits Iran will be seeking in these countries will be in jeopardy. This line would, of course, be a step toward confrontation between the consuming and the producing governments, although the objective would be to handle the approach so as to leave the Shah an honorable course. Those who make this proposal feel the approach would have to be from the President.

Approaches to the Shah. It is possible to think of approaches to the Shah on two planes:

--There could be a broad discussion of US-Iranian relations, interests and strategies. The range of topics to be discussed would include Soviet objectives in the Middle East; the threats to stability in the Persian Gulf and Indian Ocean regions; the potential for intra-regional cooperation (Iran, Saudi Arabia, Jordan, Egypt, even Israel); the degree of Saudi-Iranian cooperation possible; the role of the US in Saudi Arabia, the Gulf, Iran, the Indian Ocean; the importance of reciprocity in US-Iranian relations. The discussion could lead toward, but stop short of, the consequences for the US position in the Gulf if the participation agreements collapse.

--Although the Shah will not regard oil as an appropriate subject for the USG to address, there is the possibility of a USG approach related to whatever response the companies make to the Shah's proposals. The choice is among these elements:

--Specific backing for the companies' proposal.

--General expression of preference for one of the Shah's two options or some modifications of them.

--A more generalized discussion of the general principles that need to be preserved.