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WHITE HOUSE STAFFING MEMORANDUM

DATE: July 12, 1982 ACTION/CONCURRENCE/COMMENT DUE BY: [redacted]

SUBJECT: Issue Paper re U.S.-Soviet Long-Term Grain Agreement to be
[redacted]

	ACTION	FYI
VICE PRESIDENT	☐	☐
MEESE	✓	☐
BAKER	✓	☐
DEAVER	✓	☐
STOCKMAN	☐	☐
CLARK	✓	☐
DARMAN	☐P	✓SS
DOLE	✓	
DUBERSTEIN	✓	☐
FIELDING	☐	☐
FULLER	☐	☐

	ACTION	FYI
GERGEN	✓	☐
HARPER	✓	☐
JAMES	☐	☐
JENKINS	☐	☐
MURPHY	✓	☐
ROLLINS	✓	☐
WILLIAMSON	✓	☐
WEIDENBAUM	☐	☐
BRADY/SPEAKES	✓	☐
ROGERS	☐	☐
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Remarks: Please provide any comments you may have on this issue paper by close of business Tuesday. This paper was circulated previously, in advance of the 6/28 CCFA meeting which was postponed.

Thank you.

Richard G. Darman
Assistant to the President
(x2702)

Response:

ISSUE PAPER
U.S.-U.S.S.R. GRAIN AGREEMENT

ISSUE:

The current U.S.-U.S.S.R long-term grain agreement will expire on September 30, 1982. The Administration needs to decide whether it wants a formal arrangement (and, if so, what kind of formal arrangement) to govern U.S.-U.S.S.R. grain trade after September 30.

BACKGROUND:

U.S.-U.S.S.R. Grain Trade Prior to 1975. An unfavorable climate, poor soil, backward technology, and an extremely inefficient agricultural system make periodic crop failures in the Soviet Union a virtual certainty. As a result, the Soviets have, during the last twenty years, imported increasing amounts of grain to accommodate their domestic needs.

The U.S. first sold grain to the Soviet Union in 1963, when a poor crop compelled the Soviets to import 10.4 million metric tons (mmt) of grain, including 1.8 mmt from the U.S and 8 mmt from Canada. The Soviets bought no more U.S. grain during the the 1960s.

Conditions in the early 1970s rekindled Soviet interest in American grain. The U.S. and the U.S.S.R. consciously moved toward detente. The Soviets committed themselves to upgrading their diet, and the U.S. had ample supplies of grain to export.

In 1971, the Soviet Union purchased 3 mmt of U.S. feed grains principally to help increase their livestock and poultry production.

In 1972, the Soviets offset a significant reduction in their grain crop by entering the U.S. market and buying, over a two to three month period, 19 mmt of U.S. grain, including one-fourth of the total U.S. wheat crop. The Soviets made their purchases quietly and early, before prices adjusted to the sudden increase in demand. The Soviets also were able to capitalize on USDA's wheat export subsidy program and a credit arrangement just negotiated with the U.S. These circumstances, as well as the domestic market disruption caused by the massive grain purchases, led critics to label the U.S. sales as the "great Soviet grain robbery."

The U.S.-U.S.S.R. Grain Agreement. The summer of 1975 brought new reports of a looming Soviet crop failure. These reports, coupled with the desire to avoid a repeat of the 1972 scenario, prompted the Ford Administration to suspend grain sales to the Soviet Union until an arrangement could be worked out that would prevent Soviet disruption of U.S. domestic markets and guarantee U.S. farmers a reasonable share of the Soviet market.

The ensuing negotiations with the Soviet Union produced an agreement with the following provisions:

- The Soviets agreed to purchase 6 mmt of U.S. wheat and corn, in approximately equal proportions, during each of the five years covered by the agreement;
- The Soviets could purchase up to 2 mmt more of U.S. grain during any year without consultations with the U.S.;
- The U.S. agreed not to embargo exports of up to 8 mmt of grain to the Soviet Union;
- The Soviets were required to consult with the U.S. (to determine a higher supply level) before buying more than 8 mmt of grain in any given year; however, such sales in excess of 8 mmt were not covered by the safeguard against embargoes.
- There was an escape clause for the U.S. in the event of a major U.S. crop shortfall;
- Soviet purchases were to be made at prevailing market prices and in accordance with normal commercial terms.

The U.S.-U.S.S.R. grain agreement eased the way for major expansion of U.S. grain trade with the Soviets. Moreover, the agreement created more consistency in sales of American grain to the Soviets, thus avoiding the uncertainty which had plagued the U.S. market before 1975.

	Total USSR Grain Imports (mmt)	US Grain Exports to USSR (mmt)	US Share of Total USSR Grain Imports (%)
FY 1973	22.5	14.1	63
FY 1974	5.7	4.5	79
FY 1975	7.7	3.2	42
FY 1976	25.6	14.9	58
FY 1977	8.4	6.1	73
FY 1978	22.5	14.6	65
FY 1979	19.6	15.3	78
FY 1980	27.0	8.3	31
FY 1981	38.8	9.5	24
FY 1982 (projected)	45.0	17.8	40

The Soviet Grain Embargo of 1980. On January 4, 1980, in response to the Soviet military invasion of Afghanistan, President Carter cancelled contracts for the sale of 13.5 mmt of U.S. corn and wheat to the Soviet Union. The U.S. also denied the Soviets access to an additional 3.5 mmt of grain which had been offered to but not yet purchased by the Soviets. Finally, shipments of soybeans, broilers, and some other agricultural products were halted.

The Soviets were able to minimize the effects of the embargo by drawing down their grain stocks and by increasing grain, soybean, rice, flour, and meat imports from non-U.S. origins, primarily Argentina, Canada, Australia, and the European Economic Community (EEC).

The Soviets have since entered into new long-term purchasing agreements with Argentina, Brazil, Canada, Hungary, and Thailand in an attempt to diversify their sources of supply and reduce the threat of future embargoes.

In April 1981, President Reagan lifted the Soviet grain embargo. This was followed by an agreement in August to extend the expiring U.S.-U.S.S.R. grain accord for an additional year, through September 30, 1982. In October 1981, the U.S. offered the Soviets an additional 15 mmt of grain, raising to 23 mmt the amount of U.S. grain available to the Soviets during fiscal year 1982. To date, the Soviets have purchased a total of 13.9 mmt of U.S. wheat and corn.

U.S. Sanctions Against the Soviets in Aftermath of the Polish Declaration of Martial Law. Discussions concerning negotiation of a new U.S.-U.S.S.R. long-term grain agreement were under way within the Administration when the Polish government declared a state of martial law in December 1981. When the Soviet Union failed to respond to U.S. urgings to help restore basic human rights in Poland, the President announced a number of sanctions against the Soviets, including postponement of negotiations on a new grain agreement.

DISCUSSION:

Soviet Interest in a New Long-Term Grain Agreement. Soviet grain production has declined sharply during the past three years, after more than a decade of steady growth. Following a record crop of 237 mmt in 1978, the harvest fell to 179 mmt in 1979, 189 mmt in 1980, and reportedly to 158 mmt in 1981, nearly one-third below target. To avoid massive shortages, the Soviets have imported more than 100 mmt of grain since June 1979. During the marketing year ending this June, Moscow is expected to import a record 45 mmt of wheat and coarse grain. Moreover, last year's crop shortfall was not confined to grain. The output of sugar beets, sunflowers, and potatoes was among the worst of the past two decades.

Soviet hard-currency outlays this year for all agricultural commodities -- including grain, other feedstuffs, meat, sugar, and vegetable oil -- will probably reach some $12 billion, up about $1 billion from last year, and a sharp increase from the roughly $8 billion spent in 1980. Altogether, food imports now account for roughly 40 percent of total Soviet hard-currency purchases.

Even with a strong recovery in domestic grain production, Moscow will continue to import large amounts of grain. Current estimates indicate that the Soviets probably will import 41 mmt of wheat and coarse grains during the next marketing year (July 1982-June 1983). The ultimate level of Soviet grain imports during the next marketing year will depend on:

- o The size of the 1982 Soviet grain crop. USDA recently reduced its projection for the 1982 Soviet grain crop from 200 to 185 mmt;

- o Hard-currency constraints. Increasing Soviet hard currency constraints or a decision by Western bankers to curtail short-term credits could hamper Moscow's import intentions;

- o U.S.-U.S.S.R. trading relations;

- o The extent to which the Soviets will allow increased dependence on imported grains; and

- o Soviet port capacity. Currently Soviet grain import capacity is 45-50 mmt per year.

The Soviets could obtain most, if not all, of next marketing year's grain import requirements from exporters other than the United States. Some 10 mmt of wheat and coarse grains from Argentina, Canada, Hungary, Thailand, and Brazil are guaranteed to the U.S.S.R. under long-term agreements negotiated following the U.S. grain embargo in 1980. These and other exporting countries have either made commitments or are making plans to sell the Soviets an additional 19.1 mmt of wheat and coarse grains during July 1982-June 1983. Excluding the exportable supplies of U.S. grain, there will exist on the world market 62.2 mmt of wheat and coarse grains from which the Soviets could satisfy their remaining estimated import requirements of 12 mmt.

Wheat and Coarse Grain Exports
July 1982 - June 1983
(mmt)

Exporting Country	Projected Exports to all Destinations	LTA Commitments to USSR	Current Projected Sales to USSR in Excess of LTA Commitments	Balance for other Destinations or Further Sales of to USSR
Canada	24.3	4.5	5.5	14.3
Australia	15.6	*	3.0	12.6
Argentina	17.2	4.0	6.5	6.7
EC	19.5	*	2.5	17.0
Thailand	3.2	0.5	-	2.7
Brazil	0.5	0.5	-	-
Other Western Countries (excluding U.S.)	8.7	*	1.0	7.7
Eastern Europe	2.2	0.5	0.6	1.2
Total Exports (excluding US and USSR)	91.2	10.0	19.1	62.2

* no LTA with USSR

In a May 24 speech announcing the U.S.S.R.'s food program for the 1980s, Soviet President Leonid Brezhnev made specifically mentioned the need to reduce Soviet imports of foodstuffs from "capitalist countries," presumably meaning the United States.

In the same speech, Brezhnev announced a planned increase in the mean annual production of grain to 250-255 mmt for the 12th Five-Year-Plan period (1986-1990) (as compared to the actual annual average of 205 mmt during the 10th Five-Year-Plan period (1976-1980); for meat -- a planned increase in mean annual production to 20-20.5 mmt (as compared to the actual annual average of 14.8 mmt during the 10th Five-Year-Plan period); and for milk -- a planned increase in mean annual production to 104-106 mmt (as compared to the actual annual average of 92.7 mmt during the 10th Five-Year-Plan period). The history of Soviet grain production suggests that such production goals would be extremely difficult to attain if the Soviets did reduce grain imports from capitalist countries, particularly the United States.

U.S. Foreign Policy Considerations. The U.S. is pursuing, and encouraging its allies to pursue, a general policy of economic restraint with the U.S.S.R., based upon fair burden sharing in the West. A government-to-government agreement, especially one perceived as newly-negotiated, that promotes grain exports, would be regarded as an exception to that policy, just as official guarantees on grains sales, even under the present grain agreement, constitute an exception to the foreign policy flexibility the President enjoys on other elements of U.S.-U.S.S.R. trade.

More specifically, negotiations with the Soviets would signal an end to one of the President's measures against the U.S.S.R. in response to the Poland crisis, undercutting the general package of Poland-related sanctions, and imply that the situation there has improved and that the U.S. is prepared to adopt a "business-as-usual" stance. The Soviets could be expected to promote this interpretation vigorously. In the absence of real changes in Poland, this would undermine U.S. credibility on burden sharing and U.S. efforts to induce its allies to exercise restraint in credit and trade arrangements with the U.S.S.R.

U.S. Domestic Considerations. The U.S. farm sector is experiencing serious economic hardships due to over-abundant grain supplies, high interest rates, and a cost/price squeeze. Pressure is being applied on the Administration to provide various forms of relief for farmers, including paid land diversions, export subsidies, and increased food assistance.

All of these programs entail substantial budget outlays and lead to increased government interference in agriculture. The negotiation of a new long-term U.S.-U.S.S.R. grain agreement that guarantees a larger share of the Soviet market for U.S. farmers is virtually the only cost-free, market-oriented step the Administration can take to help the farm community. It
is a step that would also demonstrate the Administration's commitment to the central feature of its farm policy -- increasing agricultural exports -- as announced in the President's agriculture speech on March 22.

Consumers and longshoremen have an interest in maintaining a trading arrangement with the Soviet Union that minimizes domestic market disruption. Erratic purchasing behavior on the part of a large foreign customer can cause wide swings in domestic prices and the over-all inflation rate. Unrestricted access to the U.S. grain market could provide the Soviets with an opportunity to frustrate the Administration's economic recovery efforts.

OPTIONS:

1. Allow the existing U.S.-U.S.S.R. grain agreement to expire without providing for any formal agricultural trading arrangement between the two countries after September 30, 1982.

Advantages:

- Would be consistent with the President's policy of postponing negotiations on a new long-term grain agreement with the Soviets until there were improvements in the Polish situation.

- Could be presented as the Administration's attempt to reduce governmental intervention in the international marketing of U.S. agricultural products.

Disadvantages:

- Would give the Soviets unrestricted access to the U.S. grain market and could lead to disruption of the U.S. grain market if the Soviets were to resume their erratic purchasing behavior of the early 1970s.

- Farmers would view lack of an agreement as harming their prospects for maximizing their share of grain sales to the Soviet Union, and this would be perceived as undermining the President's commitment to help increase agricultural exports.

- Could lead to lowest level of U.S. grain exports under any of the options, and thus increase federal outlays for agricultural price support and production control programs.

2. Extend the existing U.S.-U.S.S.R. grain agreement for one year.

Advantages:

- Would maintain a formal trading arrangement that would assure U.S. farmers of some access to the Soviet market and insulate domestic users from increased Soviet disruption of U.S. markets.

- Would continue the status quo, thereby blunting the charge that the U.S. was making a concession to the Soviets in the absence of an improvement in the Polish situation.

- Would allow for a more positive trade atmosphere with the Soviets than there would be in the absence of an agreement, and thus would leave open the possibility of entering into negotiations on a new long-term grain agreement subsequent to an improvement in the Polish situation.

Disadvantages:

- Would be perceived by U.S. farmers as preventing them from maximizing their share of grain sales to the Soviet Union and thus undermine the President's commitment to help increase farm exports.

- Could be perceived as a weakening of U.S. sanctions imposed against the Soviets as a result of the Polish situation.

- Could undermine ongoing U.S. efforts to enlist the support of its allies in restricting government credits to the Soviet bloc.

3. Extend for two or more years the existing U.S.-U.S.S.R. grain agreement amended to provide higher minimum purchase requirements.

Advantages:

- o Would insulate domestic users from possible Soviet disruption of U.S. markets.

- o Would provide U.S. farmers with a larger share of grain sales to the Soviet Union and thus demonstrate the President's commitment to increasing agricultural exports.

- o Could promote U.S. foreign policy objective by increasing Soviet dependency on grain imports from the U.S.

Disadvantages:

- o Would signal U.S. retreat from sanctions imposed in response to the Polish situation and could undercut efforts to secure changes in the policies of the Jaruzelski regime.

- o Would undermine ongoing U.S. efforts to enlist the support of its allies in restricting government credits to the Soviet bloc.

- o Would provide the Soviets much greater opportunity to press for stronger supply guarantee provisions.

4. Negotiate a totally new long-term U.S.-U.S.S.R grain agreement.

Such an agreement might include four basic features:

1. A minimum purchase level for the grains covered under the agreement. The minimum purchase level would be adjusted each year on the basis of a two-year moving average of actual Soviet grain purchases.

2. A "prior consultation level" -- expressed as a percentage above the minimum purchase level -- beyond which the annual Soviet purchases could no go, without prior consultation with the U.S.

3. A "conversion factor" which would permit the Soviets to buy value-added products and apply such products' equivalent quantity in raw commodity terms against the minimum puchase level.

4. A provision that any decision on supply availability above the prior consultation level would require commitments on both sides to purchase/sell specific amounts.

Advantages:

- o Would develop a trading relationship more compatible with the private U.S. grain marketing system and the Administration's market-oriented philosophy.

- o Would assure U.S. farmers a reasonable share of the Soviet market, based on actual levels of grain trade.

Disadvantages:

- o Would signal U.S. retreat from sanctions imposed in response to the Polish situation, and could undercut efforts to secure changes in the policies of the Jaruzelski regime.

- o Would require protracted negotiations that could extend beyond the expiration of the current agreement.