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ENERGY

(Energy policy)

(Part 1)

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PART I

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Confidential Filing

Energy Policy. Meetings of the International Energy Agency (IEA). Discussion of World Oil Situation and Prices.

~~Power~~ ENERGY

PART I: May 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~8.5.79~~							
~~16.5.79~~							
~~29.5.79~~							
~~6.6.79~~							
~~11.6.79~~							

PART 2 begins:-

NJS to FCO 17.6.79

PART 1 ends:-

Dinner Mtg Note: PM/McFadyean 16.6.79

cc: Master Set of Records

Energy

MTs copy with PM's sidelinings filed above

NOTE OF A DISCUSSION OVER DINNER AT CHEQUERS ON SATURDAY, 16 JUNE 1979

Present:

Prime Minister
Mr. D. Thatcher
Foreign and Commonwealth Secretary
Secretary of State for Energy
Sir Frank McFadzean
Mr. C. Pocock
Mr. R. Hart
Mr. P. Baxendell
Mr. N. Sanders

* * * * * * * *

The discussion, which lasted for 3½ hours, ranged widely over the world oil scene. The following is a summary of the main points.

Developments in the price of oil

Mr. Hart said that the price of Saudi marker crude at 31 December 1978 had been $12.70/barrel. It had been intended that the price should rise by the end of 1979 to $14.55, but in the wake of the Iranian crisis that level had already been reached for Saudi oil, and the figure for some other producers was already higher. His latest information, based on conversations that day with Kuwait, was that Iraq and Kuwait were about to move to $18.50.

Mr. Baxendell said that OPEC would be meeting on 26 June. It was likely that there would be a convergence at that meeting to $18.50, and it was everywhere expected that the price would move to $20.00 on 1 July. $20.00 would mean an increase in OPEC's sales compared with $12.70 of $70 billion/year.

The Spot Market

Mr. Hart described the current state of the spot markets. He said that a year ago the product spot markets accounted for 1 mbd out of the free world's fuel consumption of 50 mbd. They had now shrunk to ½ mbd - a tiny proportion of total oil sales. A year ago the

/ spot crude

spot crude market had accounted for ½ mbd; now it was up to 2-2½ mbd, because some producers were themselves selling at spot prices. Iran, Iraq, Libya and Nigeria were examples.

Mr. Pocock pointed out that the disparity between official and spot prices meant that some individuals could become millionaires on the basis of a single tanker load of oil.

The Saudi position

Saudi Arabia had unused production capacity at present of some 1½ mbd. They were clearly the key in any attempt to force down spot prices by increasing supply, but Mr. Pocock said that although the Saudis understood the arguments that were being put to them privately by individual consumer nations, they were not prepared after Camp David to allow themselves to be seen to be the friends of the United States. Saudi-American relations were not improving quickly; no new American Ambassador had been appointed.

Passage deleted and closed, 40 years, under a FOI Exemption.

GWayland
29 September 2009

The American position

Mr. Hart gave some figures for current U.S. oil consumption. Their figures for the first and second quarters of 1979 had been 19.4 mbd (actual), and 17 mbd (estimated). The corresponding figures for 1978 had been 19.1 mbd and 17.2 mbd. So, inspite of 1977/78 being a colder winter in the U.S. than 1978/79, their overall consumption so far in 1979 was, in Shell's view, much the same as it had been in 1978. Shell expected that American consumption would be down in the third and fourth quarters of 1979. Overall for calender 1979 their original expectation had been an average consumption of 18½ mbd; now it was down to 17.87 mbd - a drop of some 3½%.

/ Mr. Hart

Mr. Hart said that he had no hope whatsoever of any sizeable increase in excise duty on gasoline in the U.S.A. The political pressures in the Congress against such an increase were too great, especially given that Congressmen had to be re-elected every two years. The President's programme was now the key thing. He also suggested that it might still be true that the U.S. used less energy per unit of GNP than some other developed countries.

Longer-term energy developments

Mr. Pocock said that the Mexican fields were between the North Sea and Kuwait in size: they might produce 5 mbd in ten years' time, but given the growth in the Mexican population, there would not be enough Mexican oil to make a difference.

The Prime Minister said that she thought that the CIA report on Soviet oil supplies had been too optimistic. Mr. Pocock said that the USSR was still exporting product so as to gain foreign exchange. Last winter the export rate had fallen from 1 mbd to ½ mbd, but he expected it to go up again. Simultaneously, however, Soviet satellites were being told to buy on the world market; so the overall flow was roughly in balance.

Mr. Baxendell said that Chinese production was very small and of low quality. In the longer-term they would need to consume their own production and they would not be another Saudi Arabia.

The Prime Minister said that all such discussions led her to the conclusion that nuclear energy was our only hope. She was concerned about the effects of Harrisburg, given her view that we would have to move to a PWR system. The Germans were asking for a study which might take a minimum of eighteen months.

Strasbourg

There was a lengthy discussion of how the Government might best respond to the proposals which would be put by the French at Strasbourg. These were principally:

/ (i)

(i) A three-year programme for import ceilings;

(ii) An agreement to prevent imports above the OPEC price;

(iii) New developments in cooperative international financing of exploration projects in developing countries.

Discussions about the possibility of flooding the spot market and about "transparency" were also anticipated.

Import ceilings

All of those present agreed that the proposals on import ceilings were impracticable, and over-simple. It would be impossible to monitor such a scheme completely; some consumers would simply evade the measure by, for example, bunkering ships and aircraft in other countries, and the scheme would not work because there were too many opportunities for too many individual consumers to get round it and too much money available to finance them in doing so. There was also the problem of defining the base line on which the reduction in imports would be calculated.

Our own position was a special one, because our domestic production was growing so fast. A voluntary import ceiling would therefore not affect us in the same way as other countries. But the idea was intrinsically a bad one.

Mr. Pocock pointed out that the French might argue that they had tried to limit their own imports by placing a money ceiling on them. In fact their limit had always been unrealistically high and had never been tested. The Prime Minister summed up their strategy as a dirigiste approach and a get round mentality.

Maximum import prices

The Shell representatives said that this proposal simply would not work. Too many loopholes - such as freight rates, credit terms and the details of buy-back arrangements - were available. The effect of such a measure would not be to establish

/ a ceiling

a ceiling, but to set a floor price. Everybody would bid up prices to the "ceiling" and the result would be worse than the starting position.

International financing arrangements

The Shell representatives offered some support for this proposal. They said that it might help in certain cases.

Flooding the spot market

The Prime Minister said that she would say that the spot crude price rise had been caused by producers choosing to funnel their oil through the spot market. It followed that measures to bring the spot price down would have to be on the supply side. Sir Frank McFadzean said that it was simply impossible to suppress the spot market, and Mr. Baxendell said that it certainly was not within the companies' power to do so. Mr. Hart pointed out that the U.S. had restrained companies from using the spot market in March and April 1979; when that policy had been reversed the spot price had risen by $10. It was a dangerous game to play. The Prime Minister said that in her view it was not possible to upset market forces except for a very short time.

Sir Frank McFadzean pointed out that the spot market was based on expectations and that an announcement of a change in policy would affect it well before any additional supplies reached it. Mr. Hart said that the spot product market had dropped by some $2 over the last week on rumours of increases in production.

Sir Frank McFadzean said that the Chairman of OPEC had told one of the Shell Managing Directors that Saudi Arabia were indeed intending to open up production of an extra 1½ mbd, but Exxon had said that they did not believe it. Everyone was in fact adopting a bargaining position.

/ Transparency

Transparency

Mr. Howell said that the French would respond well if we made encouraging noises about transparency. Mr. Hart explained that the plan was for oil companies and traders to report their transactions on the spot product market weekly to the EEC Governments. The theory lying behind the proposal was that this information would be available to OPEC as well and might filter through to those deciding policy in Iran. The Prime Minister said that given the relative sizes of the spot product and spot crude markets, this seemed an insignificant proposal.

Alternative proposals

The Prime Minister asked what positive alternatives she could put forward at Strasbourg and later at Tokyo. She asked whether it was in fact possible to reduce the import targets any further without inducing a real recession. Mr. Hart said that if the proposed economies were genuinely put into effect, supply and demand would be likely to come into balance during 1980. Any more elaborate mechanism might therefore come into force at exactly the wrong time. The Shell representatives argued that the most effective measure was demand restraint by price. This should be raised especially at Tokyo.

Mr. Pocock suggested that the Prime Minister should ask President Carter whether he could justify his claim that American restraint measures were already working. He suggested that the President should be invited to table detailed figures to back up that assertion.

Sir Frank McFadzean said that if prices were not put up by increases in excise duty, then the consumers would have to face price rises from the producers and the resources concerned would be transferred across the international exchanges.

The British position

The Foreign Secretary said that in 1973 the oil companies had told him, when it had been suggested to them that they ought to give preferential treatment to Britain, that they had

/ international

international contracts and would share their oil around the world. Sir Frank McFadzean said that that had not been the way in which he had then put the matter. The companies did have legal and moral obligations around the world, and if they made everyone else suffer while preserving Britain's consumption, then British ships and aircraft would not be bunkered abroad.

Mr. Baxendell said that the position had been transformed since 1973 by the production of North Sea oil. Their estimates were that in the first quarter of 1979 14% of North Sea production had beenshipped to the U.S.A. and 44% to Europe. 30% had been refined in the U.K. Much of the exports had been handled by BP who were swapping. BP were in fact supplying the British market at the same rate as they had in 1978, Esso were at approximately the same level, and Shell were higher.

The reason that there was a conspicuous shortage of oil products in Britain but not to the same extent in other Western European countries was that there had been a number of small suppliers in Britain who had bought on the Rotterdam spot market and had done very well for themselves. Now that the spot price had gone up, they had dropped out of the market altogether. In addition, middle-sized companies such as Petrofina and Total were putting less into Britain. Shell and Esso were refining all their North Sea crude in the U.K.

The Foreign Secretary asked what would happen if there were a 10% shortage in world supplies, and whether the companies would not in fact share the shortage around, even though the oil was British. Mr. Baxendell said that the Government was in a strong position to lean on the companies in several different ways, such as the issue of flaring consents and through their detailed regulatory powers on North Sea production. Sir Frank McFadzean said that the Government would indeed be able to ensure British supplies if they wished to do so.

/ Mr. Howell

Mr. Howell said that at present BP were enlarging their market share rapidly in place of the small importers and distributors. He said that BNOC would be making available from 1 July an extra 7½ million tons/year for British refiners. The Shell representatives said that they had spare refining capacity and would be greatly interested.

The Prime Minister asked about the implications of Article 34 of the Treaty of Rome for preferential treatment. Mr. Howell said that it would be a great deal easier to evade those provisions through BNOC than through the companies, who could more easily be taken to the European Court.

Coal and gas

Mr. Howell said that Britain was achieving a 5% saving on last year's energy consumption, but to a large measure by using extra coal. Mr. Pocock said that the level of coal imports ought to be increased. The Prime Minister said that we were already quietly importing all the coal it was physically possible to handle. There were constraints in the docks and in the railway system. Mr. Howell said that stocks of coal at power stations had levelled off this week for the first time. The Prime Minister said that we were giving priority in every way we could to getting coal on the ground at the power stations.

Mr. Pocock suggested that gas prices should be raised to an economic level. The Prime Minister said that she was not prepared to see further increases in gas prices. The retail price index would already be rising by 18% at the end of this year and she would not add to that.

MJS

17 June 1979

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File

10 DOWNING STREET

From the Private Secretary

16 June 1979

THE WEST'S BARGAINING POSITION IN NEGOTIATIONS
WITH OPEC ON PRODUCTION AND PRICES

Thank you for sending me, with your letter of 8 ~~June,~~ a note by FCO, Treasury and Department of Energy officials, on the bargaining positions of OPEC and the West in any future negotiations on oil production and prices.

The Prime Minister was grateful for this assessment, which she has read with care. The Prime Minister is content that the paper should form the basis of her briefing for the forthcoming European Council Meeting in Strasbourg on 23/24 June.

I am sending copies of this letter to Martin Hall (HM Treasury), Garth Waters (Ministry of Agriculture, Fisheries and Food), Andrew Duguid (Department of Industry), Bill Burroughs (Department of Energy) and Martin Vile (Cabinet Office).

B. G. CARTLEDGE

G.G.H. Walden, Esq.,
Foreign and Commonwealth Office.

Energy Policy Pt 1

Prime Minister

This is the paper on the supply position over the coming 12 months which we commissioned last week. Would you like to discuss this, and Mr Howell's paper (Flag B), at E Committee on Tuesday - trade union legislation is the only item at present?

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MR LANKESTER

cc: Mr Vile
Sir Kenneth Berrill
Mr Mountfield

SHORT-TERM SUPPLIES

I attach the inter-Departmental assessment of the options for energy supplies in the coming 12 months, for which you asked in your letter of 6 June to the Private Secretary to the Secretary of State for Energy. It concentrates, as you requested, on the short term and the options for action.

2. In putting it forward could I underline several points:-

(a) The effects of the Budget, and the general course of the economy, bring a new uncertainty into the equations. But to the extent that the economy does decline the easier, perversely, our energy supply problems become.

(b) The Department of Energy's assessment is that on present prospects we stand a reasonable chance of getting through the next year without serious energy shortages. But the risks are downside - both for coal and oil - and we have relatively little room for manoeuvre.

(c) On coal supply the key issues are going to be the closure of uneconomic pits, imports and the ability of the railways to move substantially increased amounts of coal to the power stations, including coal drawn from our present reasonably healthy pithead stocks. The size of our stocks of coal at power stations this autumn may depend critically on this factor.

(d) As a fallback at the power stations we have a useful ability to burn natural gas in place of coal. Up to 3 million tons of coal could be saved in this way but at a high cost to the CEGB because gas is of course a much more expensive fuel than coal.

(e) On oil the issues are going to be the attitude we adopt to stocks - should we draw them down further or rebuild them - and our ability to negotiate a discreet preference from the oil companies.

(f) Apart from the ongoing effects of higher energy prices and the continuing energy conservation campaign, we have little scope for achieving additional reductions in demand short of the introduction of a full-scale energy allocation system. Such scope as there is for mandatory restraint, short of full-scale rationing, largely affects petrol.

(g) It is worth noting that the solution of our problems this winter will not of itself lead to a more comfortable position in 1980-81. The problems then could be as bad or worse.

3. Finally, I would be grateful for your advice on whether the Prime Minister would wish this report to be discussed by Ministers collectively. If so, the appropriate forum might be (E(EA). My own view is that a collective discussion is not yet necessary. Individual action points which may require collective decision could be handled as they arise. Two - imports of coal for Scottish power stations and for the BSC - are already the subject of Ministerial correspondence. We could also, if this would be helpful, provide a draft letter which might underline the Prime Minister's concern that all necessary steps should be taken urgently to improve our ability to meet our energy requirements next winter.

P Le CHEMINANT

Cabinet Office
15 June 1979

ENERGY SUPPLIES 1979-80

NOTE BY OFFICIALS

Background

1. A letter dated 6 June from the Private Secretary to the Prime Minister to the Private Secretary to the Secretary of State for Energy records the Prime Minister's wish to have "an agreed factual appraisal of the energy supply prospect for the United Kingdom over the next 12 months focussing particularly on oil and coal; the scope for action; and a realistic display of the options". This report from a group of officials drawn from the Departments principally concerned fulfils that remit.

2. The Department of Energy estimate that fuel demand, taking account of the latest economic growth prospects outlined in the Budget, will remain at about the level or slightly below that of 1978-9 when total United Kingdom primary fuel consumption was 369 million tonnes of coal equivalent (mtce). A particularly cold or warm winter could produce differences of some 5 mtce. either way.

3. At this level of demand fuel supplies will be tight but should be just adequate provided there are no new disruptions. But there are considerable uncertainties and none of them are in our favour. The threat of disruption in the pits is ever present and even the achievement of the full 5 per cent reduction in oil demand which we are seeking will leave supply barely above prospective demand. We will thus be highly vulnerable to any further dislocation or shortfall in the international oil market that may develop over the next 12-18 months.

3. The position at the power stations and oil supply prospects generally are considered in more detail in the remainder of this report.

Power Station Coal

4. The Central Electricity Generating Board, which covers England and Wales, requires to use some 106 million tonnes of coal equivalent over the next 12 months if electricity supplies are to be maintained. 11 mtce of this will be provided by nuclear power stations, the cheapest source of supply, where available capacity will be used to the maximum possible extent. For the rest, there is flexibility for switching between coal and

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oil burn, particularly during the summer months when electricity demand is low and there is more spare plant in the system. The CEGB also have a limited capacity to burn additional gas in substitution for coal.

5. In present circumstances, with oil both expensive and scarce, the CEGB has already reduced its oil burn to the minimum practical level. During the next 12 months an oil saving of around 2 million tonnes, most of it arising during the summer months, is expected to be achieved in this way. The reduction in oil burn, which will provide a significant part of our contribution to the international oil saving effort, has led to a significant increase in the CEGB's demand for coal, and it is expecting to burn 80 million tonnes of coal this year, some 5 million tonnes more than last year, and the highest level ever.

6. The CEGB's programme, and in particular the planned high level of coal burn, clearly involves some risks. A hard winter and industrial disputes have run down coal stocks and even assuming record deliveries of coal to power stations can be achieved, the CEGB expect to go into next winter with under 16 million tonnes of coal in stock at power stations. This is some 2-3 million tonnes below the level they would ideally like to ensure a minimum of six weeks endurance in the event of any interruption of supplies. Nevertheless, the CEGB considers that provided there are no serious industrial relations problems and no other unforeseen factors arise which seriously affect the programme, they should be able to get through next winter. Looking further ahead, however, they are concerned that any significant shortfall, or another cold winter, could leave them in a very vulnerable position next year.

7. The picture for England and Wales does not, however, fully bring out the problems faced in Scotland, where both the electricity and coal supply systems are, for geographical reasons, largely autonomous. Power station and pithead coal stocks are much tighter, and NCB forecasts of output from the Scottish Area are not received with confidence by the Electricity Boards. There is no way in which power station stocks can be restored to the minimum level necessary (1.8 million tonnes) to offer security of supply in the coming winter, or in which the Scottish system can contribute now or in the remainder of the year to oil savings, without imports of upwards of 0.25 million tonnes of coal either from England or from abroad. The price quoted by NCB for coal

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from England is £5 per tonne above the Scottish price and there must be serious doubts whether, with the blockage of the East coast rail line until October, this quantity can be transported: on the other hand, SSEB has found ready availability of coal from abroad, at a price only £2 above that for Scottish coal. This import requirement is likely to be short-term only: nuclear and gas fired capacity planned to come into operation in the coming year will substantially ease the pressure on Scottish coal supplies thereafter.

8. The Northern Ireland situation is different again. Oil-fired stations account for 81 per cent of electricity generating capacity in the Province. While the Northern Ireland Electricity Service (NIES) is doing all it can to maximise coal burn without regard to normal merit order considerations, the service does not have the capacity open to power stations in Great Britain to switch from oil. The NIES oil requirement in a typical four week winter period is of the order of 125,000 tonnes although in abnormally severe winter conditions in the past the requirement has been as high as 185,000 tonnes a month. To date, the Service has been able to meet its aim of holding 30 days or so of oil in stock but is becoming concerned about its ability to maintain this position without some form of reassurance on oil supplies, although recourse to spot market purchases at high prices (which could disrupt the finely balanced finances of the NIES) has so far been avoided. The matter is being considered by the Department of Commerce for Northern Ireland in consultation with the Department of Energy.

9. The problem of providing enough coal to the Generating Boards both to build up stock and to maintain a high level of current consumption resolves into two questions: how can the necessary coal be obtained? And how can it be moved to the power stations?

10. There are four sources of supply:

a. Current deep-mined production. The NCB are aiming at 108 million tonnes in 1979-80. They see this as the upper limit for the year. Production is currently running below target. If the trend continued, output might be only 106 million tonnes.

b. Open-cast coal. Production for 1979-80 is forecast at 14 million tonnes. This figure might be increased by speeding up authorisations for sites, but the effect would be marginal - at most an additional 0.2 million tonnes could be expected in 1979-80.

c. Pithead stocks. The NCB are already planning to supply the CEGB 3 million tonnes from stock this year. A further 1 million tonnes of steam coal and 3 million tonnes of coking coal could in theory be made available from stock, but there would be severe transport difficulties in moving this coal and the use of coking coal at power stations would involve the NCB in accepting a reduction of about £7 per tonne on the coking coal price. There is a further possibility of diverting up to 0.4 million tonnes from intended exports, for which rail transport is planned, and the NCB are looking into this.

d. Imports. The CEGB are importing sone 2½ million tonnes of Australian coal (including 2 million just negotiated) under their existing contract. There may be scope for finding an additional ½ million tonnes on the spot or short-term contract market. The CEGB consider that, with a sustained effort, such purchases might be increased to 1½ million tonnes, allowing an import of some 4 million tonnes in total. In addition, the South of Scotland Electricity Board may import ¼-½ million tonnes.

11. At present, pits are being closed only when they approach exhaustion, so delaying closures now planned would not add substantially to coal supplies this year. One conclusion from the review of coal strategy which will be put to Ministers shortly will be the need for the NCB to take steps to reduce its financial losses. One of the questions to be considered will be that of accelerating the closure of uneconomic pits. This will need extremely careful handling if disruption of coal production is to be avoided and if the mining unions' traditional opposition to coal imports is not to be strengthened.

12. As to movement British Rail plan to meet CEGB's present requirement to move some 64 million tonnes of coal to power stations in 1979-80. This is about 5 million tonnes more than in 1978-79. It is at or close to the limit of the present railway capacity, which is limited by the number of locomotives, and by some staff shortages.

13. British Rail is giving priority to power station coal movements at the expense of other freight traffic; is making special efforts to catch up on locomotive maintenance; and is working closely with NCB and CEGB to make the best use of the available capacity by weekend working and in other ways. Deliveries so far are up to about the planned level. But continued efforts will be needed from the three industries, who will have to work together to make the most of the railway capacity eg by longer notice from the CEGB of the coal movements they require.

14. BR and CEGB are working on plans to expand the railway carrying capacity by up to 5 million tonnes, but this will take time and cannot affect the next 12 months. To find more capacity within the next 12 months, BR would have to cut other traffic including Inter-City services; the financial implications would be considerable and would need to be reflected in the price charged by BR for the additional coal movement. There may be some more limited opportunities (eg to supply Didcot by imported coal via South Wales) which the industries would need to examine together; they could not make a large difference.

15. Vehicles might be found to move 1 million tonnes or more of coal by road at a price which could be £1-2 per tonne above the rail cost. Port and ship capacity could probably be found for any movements that could go by coastwise shipping, but rail and road capacity would limit what could be carried from the ports. The net increase in movements by sea would be small.

Gas burn

16. Additional gas could be burned at the CEGB's 2 dual gas/coal fired stations. An extra 1 million tonnes of coal could be saved by burning gas at Hams Hall. Savings of up to an additional 2 million tonnes could be achieved at West Thurrock, but the coal displaced here could not easily be diverted elsewhere because of transport difficulties. If gas supplies were significantly increased to the CEGB, BGC would expect to be paid the full industrial oil related price. The additional cost to the CEGB of displacing 3 million tons of coal could be about £60 million.

Coking coal for the steel industry

17. The question of additional imports of coking coal by BSC, about which there is currently correspondence between the Secretary of State for Industry and the Secretary of State for Energy, is not germane to impriving fuel supplies this winter. The BSC contract is for an additional 550,000 tonnes a year, with deliveries beginning this financial year, but the NCB could supply substantially more than this to power stations from stocks (including coking coal stocks), if transport were available. The question could be more relevant to coal supplies, next year.

United Kingdom Oil Supplies

18. The International Energy Agency estimates world supply of oil to be about 3 per cent short of unrestrained requirements in 1979. It also expects a shortage - perhaps not on the same scale - to persist into 1980.

19. The supply of crude oil to the United Kingdom is expected to be broadly in line with the world picture. Supplies are currently at about last year's levels, while unrestrained demand would be about 3 per cent higher. However, the exceptional demand in the first quarter of 1979 due to the unusually cold weather caused stocks to be drawn shortly and the desire to rebuild stocks means that the shortfall against total demand (current use plus stock building) is about 5 per cent. This has produced localised shortages, which are being dealt with by the oil companies, with guidance from the Department of Energy.

20. The current world shortfall in supply stems originally from the troubles in Iran. But it may also be a first manifestation of the supply constraint on world oil which has been foreseen for some time. Supplies are likely to increase gradually in response to higher prices, but the world can no longer rely on extra oil being freely available to meet increments in demand. In the short run, the only way to bridge the gap is to reduce demand or to further run down stocks. There is some scope for action by Governments. Otherwise balance will be achieved by market forces with higher prices and lower economic activity. Within the United Kingdom, oil consumption is now being constrained by the switch to coal in power stations, the action being taken in the public sector, and reduced allocations by companies. The price increases already in prospect and the budget tax increases will add force to these constraints.

21. Possible international action to affect the world oil situation is being considered separately and is outside the scope of this paper. The possibilities for internal action to help overcome physical shortages in the United Kingdom are examined in the following paragraphs.

22. There are four ways of tackling oil shortages in the United Kingdom - leaning on the producers, running down stocks, putting more North Sea crude oil into our refineries, and increasing North Sea oil production.

23. Leaning on the Producers The major oil companies claim to be handling the world-wide crude oil shortage by allocating supplies equitably between countries. While we believe this to be broadly true we cannot be certain. In any event as an oil producing nation, we are better placed than most other consuming countries to put pressure on the oil companies to safeguard supplies to the United Kingdom on a discriminatory basis. The sale-back of royalty oil, sale of BNOC oil, and our controls over UKCS production all offer opportunities for this. The use of such leverage need not be contrary to our international commitments so long as the IEA emergency storage scheme has not been activated, and so long as we do not fall foul of the provisions of the Treaty of Rome relating to restraints on trade. Considerable discretion will obviously be needed however if international complaints are to be avoided.

At the same time we will need to ensure that additional supplies to us from the United Kingdom Continental Shelf do not simply displace supplies from elsewhere which would otherwise have come here and there are practical problems in monitoring such movements. Nevertheless, pressure is possible and is being applied.

24. Running down our stocks: current stocks of petroleum products and their crude oil equivalent in the United Kingdom are equivalent overall to about 78 days' use (on the EEC basis of calculation), though the level of stocks varies widely from product to product, gasoline being below the level of our international obligations. The minimum level of working stocks needed to maintain ~~the~~ distribution probably amount to about 55 days' supply and to the extent that we can secure North Sea oil production for use in the United Kingdom, we are better placed than other countries to take a risk on stocks. Even so, the great uncertainties about forward supply of crude oil make it prudent to build stocks further against next winter: a general stock rundown would leave OECD countries very vulnerable to blackmail on price. If we were nevertheless to cut into stocks further at this stage we would need to be sure that the oil companies did not adjust their worldwide supplies at our expense. In addition, plans are in hand, for both financial and oil supply reasons, to dispose of 450,000 tonnes of crude oil from the 1.1 million tonnes of crude oil and products in Her Majesty's Government's storage system.

25. Putting more North Sea crude oil into our refineries (either directly or, through swap arrangements, indirectly): In addition to exercising pressure on the oil companies we are already planning to take our North Sea royalties in crude oil rather than cash next year. This will give us supplies which could be put into our refineries. Equally we could make greater use of BNOC's equity and participation oil for the same purpose. The problem of ensuring that such diverted supplies represent a genuine net addition to total United Kingdom refinery throughput, remains.

26. Increasing North Sea production: extra supplies can be obtained from the North Sea in the short term at a price. That price largely relates to the extra gas which, for technical reasons, would need to be flared as the oil is produced. In the case of the Brent field, for example, it would be possible to produce an extra 6 million tonnes of oil if current flaring restrictions were lifted. The companies' plan for supplying their United Kingdom refineries already count on access to the full quantity and the Secretary of State for Energy is prepared to authorise a concession, up to 5 million tonnes, subject to satisfactory assurances from the companies on disposal of the oil which should entail securing about three quarters of this oil as a net addition to United Kingdom supply.

27. Underlying many of the steps which might be taken to increase oil supplies to the United Kingdom lie our international obligations to the EEC and the IEA. These are described in Annex A. There are also problems about the contractual liabilities of the oil companies. In present circumstances, this is a question of delicate balance. If our steps were too obvious, they could boomerang. Other countries could put pressure on the companies to allocate Middle East oil away from us, there could be dissention between consumer Governments and within the EEC accusations against us could hamper our efforts to secure the better budgetary deal. But, provided that we are discreet, we ought to be able significantly to improve our supply situation.

28. However, the introduction of any form of international allocation scheme would transform the situation, requiring the United Kingdom to transfer overseas any supply above the average level available internationally. The desirability of such action will be an issue at the Tokyo mummit. The IEA's existing emergency allocation system - to which we are legally committed - would in any case be triggered if world supplies fell short by 7 per cent.

29. If despite our best endeavours we nevertheless find ourselves facing shortages of oil, or particular oil products, there is a range of further restraint measures which the Government could take. These include weekend closures and restricted hours at filling stations, speed limits, restriction of space heating, the imposition of a general Government allocation scheme, and fullscale petrol rationing. These measures are described in detail in Annex B. Their implementation would require a declaration of "energy emergency" under Section 3 of the Energy Act 1976. There is little scope for further effective measures without this preliminary step. Nor is there much scope for reducing oil demand by measures to reduce electricity consumption. The only readily enforceable measure would be a ban on display lighting, from which the savings would be minimal.

CONCLUSION

On present plans and without further action, energy supplies to the United Kingdom over the next 12 months are likely to be adequate - but only just - to meet demand. There are however considerable risks. Not only are there uncertainties about supply - both of coal and oil - but the required extra movement of coal arising from the continued switch from oil to coal in power stations will place a considerable strain on the railways. Road transport can help marginally but it is by no means sure that all the required extra rail movement can be accommodated. Indigenous production of coal is unlikely to increase and may decline. There is scope for additional imports - perhaps up to 2 million tonnes - and a further 4 million tonnes or so is available from pithead stocks. The other possibility at power stations is to substitute natural gas for coal in those stations equipped to burn both. Up to 3 million tonnes of coal this winter could be saved in this way but the extra cost to the CEGB would be substantial.

The oil situation is more complex. It is possible to increase North Sea crude production and to divert, by various means, more oil to United Kingdom refineries. The extent to which these steps would lead to a net increase in oil supplies would depend on the arrangements which could be made with the oil companies. The implementation of a formal international oil-sharing scheme would restrict our ability to arrive at private arrangements with the oil companies (though the factors involved in a decision about such a scheme are wide-ranging and outside the scope of this paper.) On the other hand our oil stocks are still substantially above minimum working levels though with wide variations between particular products. It will be for decision in the light of developments whether we can afford to run down such stocks further, either alone or as part of an international arrangement, or should continue, as at present, an attempt to rebuild them.

Mandatory steps to curb energy demand short of a full scale allocation scheme would be unlikely to yield significant savings except perhaps of petrol and Derv. Our continued efforts at energy conservation and the effect of high energy prices will yield some benefit in terms of reduced demand but quantification is not possible.

ANNEX A

INTERNATIONAL COMMITMENTS

a. Demand Restraint

1. The IEA Governing Board agreed on 2 March that member countries would reduce their demand for oil on the world market by 2 mbd, or about 5 per cent of the pre-crisis estimate of consumption. The Energy Council of the EEC similarly agreed on 13 March to reduce EEC oil consumption in 1979 by 25 million tonnes to 500 million tonnes. The United Kingdom is party to both these agreements. The EEC commitment is the more onerous since -

a. it applies over 1979, and the first quarter had elapsed before any measures could be taken; and

b. it is a commitment to reduce consumption, not demand on world markets (which can be achieved, in part, by counting increased indigenous oil production).

b. International Allocation Arrangements

2. As party to the IEA, the United Kingdom is bound by the arrangements for allocation of oil supplies between countries should available supplies to the Group fall below 93 per cent of supplies in a base period (the latest 12 month period for which figures are available). The Group position is comfortably above this trigger point at present. If the system were activated, the United Kingdom might have a right to supply* other members - it is not possible to forecast the position in advance. Members would also be committed at least to imposing demand restraint of 7 per cent and to drawing down stocks before becoming entitled to any supply from other countries of the Group. A cut in demand of 7 per cent would probably require mandatory Government measures.

3. The IEA emergency system also has a "selective trigger" arrangement under which any member country can apply to the Governing Board for maintenance of 93 per cent of its base period supply if it is otherwise likely to fall short of this figure. Sweden has already made such an application. If granted, the United Kingdom's obligation to supply Sweden would be minimal - about 2,800 tonnes a month - but allocations to Sweden might trigger applications from other countries. The Swedish request has so far been refused.

* from other countries of the Group, or an obligation to supply

4. The United Kingdom has complementary obligations to restrain demand under an EEC scheme. This provides that during a period of oil supply difficulties member states will reduce consumption of petroleum products by a maximum of 10 per cent of normal consumption for a maximum of 2 months. After this period there will be variable reductions in member states depending on the ability of each to substitute for other types of fuel. The quantities of petroleum products saved as a result of this differentiated reduction in consumption will be shared out between member states. Basically, however, sharing is done through the IEA scheme.

ANNEX B

POSSIBLE OPTIONS FOR MANDATORY DEMAND RESTRAINT MEASURES

1. All the options set out here (apart from speed limits) would require the declaration of an energy emergency under section 3 of the Energy Act 1976. There is little scope for further effective measures without this preliminary.

2. Restriction of space heating. An Order could be made further restricting the internal temperatures in buildings (current maximum 20°C). This Order could not be enforced in relation to domestic heating (and only partially in commercial and industrial premises). It might be necessary simultaneously to lower the minimum heating standard. The Order would save all types of fuel, but in small quantities - perhaps 3 per cent of heating oil over the year and well under 1 per cent of electricity demand in the winter months.

Oil measures

3. Weekend closures of filling stations: Stations could be required to close on Sundays, or on Saturday afternoons and Sundays. This makes it more difficult for the pleasure motorist to be sure of supplies for long journeys. It might save some 2 per cent of petrol sales.

4. Restricted hours for filling stations: This works much as weekend closure does. People who really must have petrol will fit in with the reduced hours. The more restrictive the hours, the more people who can do without will stay away from filling stations. If the hours are very restrictive, there will be queueing problems and traffic obstruction; and it will be necessary to include special hours for "priority users"; and to introduce means of identification for such users. A scheme and draft Order exist.

This measure could save up to five per cent of petrol.

5. Speed Limits: Previous experience indicates that speed limits have only short term effect in petrol saving, although they may serve a useful purpose in bringing home the message of economy to the motorist.

6. Release oil companies from their contractual commitments. This would permit oil companies to discriminate between categories of customer under their allocation scheme and so provide a possible means of catering to priority consumers. It would also free companies to take on new customers in priority categories who are without supply. But it would leave the customers of one company as against another potentially worse off, depending on that company's supply position. It would implicitly involve Government acceptance of responsibility to provide for the priority categories, without providing the means. To date there is little evidence that this scheme is necessary.

7. Impose a General Government Allocation Scheme. This would entail setting a limit, in terms of a given percentage of consumption in a base period, in the quantities of oil products which a company could supply to each customer. The limit would be the same for every oil company or oil distributor. If the percentage were so set as to equate overall demand with supply, some companies would have a surplus of product over that which they were permitted to sell. The intention would be to direct surplus to companies whose total supplies were insufficient to make the full allocation to their customers. This system would involve invoking the mechanism of the Oil Industry Emergency Committee.

8. Transfers of surplus oil to deficit companies might be achieved voluntarily but it is more likely that transfers would have to be required by Government. This could mean imposition of price controls for transfers; and there would be a danger that companies with ample supply might divert their surplus overseas, worsening the overall United Kingdom position.

9. A two-tier structure might be needed, with the price difference being set by funding through an industry levy. The details of price control in this situation have not yet been worked out.

10. Petrol and Derv Rationing.

The allocation scheme described above would apply to petrol and derv, like other products. But the random pattern of purchase of these products would not permit the allocation system to ensure equitable supply. A rationing scheme might have to be superimposed. This would cover only petrol and, if necessary, derv. This rationing would take some three months to introduce, would directly require some 2,200 civil servants, and is estimated to cost £1½ million per month.

Electricity measures

11. Restriction on the level of lighting including a prohibition (apart from minimum safety requirements) on the lighting of unoccupied rooms, in offices, shops and places of recreation. It is estimated that this could contribute a saving of up to 1 per cent during the winter months (equivalent to ½ million tonnes of primary fuel).

12. Prohibition on the use of electricity for advertising or display purposes, including floodlighting of public buildings. The savings would be minimal at any time of the year, and any value would therefore be mainly presentational, eg to reinforce calls for voluntary savings at work and at home.

Other Fuels

13. Apart from the small savings which are possible on space heating, there is little scope for direct savings of coal or gas by mandatory measures, though they can be achieved indirectly by measures to reduce electricity demand.

Qa 04154

To: MR STOWE

From: SIR KENNETH BERRILL

Energy Supplies

1. In her weekend box the Prime Minister has two important papers on energy supplies. One is concerned with the United Kingdom domestic position and is an appraisal of oil and coal supply prospects for the UK over the next 12 months. The other discusses the international oil situation and the possibilities for further action by consumer countries: an issue which is certain to bulk very large at the Tokyo Summit and probably at Strasbourg too.

Flag A

Flag B

The UK Domestic Energy Scene 1979/80

2. The paper on the domestic position reveals an uncomfortable supply prospect. We should just about get through next winter without major electricity disruptions. But the sort of localised oil shortages already being experienced are likely to continue and could worsen. The risks are all downside and in the coming winter we will not enjoy the flexibility we have had in the past to cope with unforeseen disruptions of one sort or another.

?

3. There are a number of measures which the Prime Minister could ask responsible Ministers to undertake in order to bolster the position:

- maximum pressure should be applied to the oil companies to supply the United Kingdom market preferentially. (There is a lot which can be done without running foul of international obligations.)

- BNOC should be left in no doubt that its priority is towards ensuring that as much crude oil as possible is refined in the United Kingdom;

- the importance the Government attaches to moving the maximum amount of coal to power stations before next winter should be impressed to the utmost on British Rail;

- the CEGB and SSEB should be allowed to import as much coal as they can acquire and physically transport;

- the NCB need to be encouraged to release coking coal for use in power stations.

4. Even these steps cannot be adequate to meet all the potential problems. Energy supplies next winter will be highly vulnerable to industrial action and there is little we can do about it.

The International Energy Scene

5. The United Kingdom is much more likely than many of our partners to achieve effective demand restraint. Our slowing down of economic growth, and hence use of energy will exceed that of many of our major competitors. Added to that we have the flexibility to switch from oil to coal at power stations. So for us a 5 per cent reduction in oil demand should be well within reach.

6. Ideally we need an agreement in Strasbourg/Tokyo which binds our partners to achieving equally effective reductions in their energy consumption, but which does not deny us the ability to secure supplies sufficient to our own reduced needs. !

7. Thus, the CPRS believes our Tokyo/Strasbourg objectives should be:

- to obtain unequivocal commitment from those less well placed than ourselves to the achievement of demand reductions

- to make this commitment clear and watertight enough to demonstrate to OPEC the earnest intent of the consuming nations

- but to avoid getting locked into a formal oil allocation scheme which would inevitably deprive us of supplies we would otherwise have.

8. Of the proposals in circulation to restore order in the oil market, the following strike us as being appropriate:

- "an agreement to translate the demand and indigenous supply goals for 1979 into a specific and publicised set of import targets". (One of the proposals from Dr Schultze - Chairman of the US Council of Economic Advisers.) Publicised targets would be unlikely to embarrass us - the extra quantities of oil we might require to avoid shortages would be easily lost in the figures - but would put others under the spotlight, where they deserve to be

- exhortation on the oil companies to avoid trading on the spot market. In practice this would be unlikely to eliminate such trade but could reduce some of the pressure on prices and do us no harm.

9. On the other hand an oil allocation scheme, whether through import licences or formal/informal adaptations of the IEA scheme, should, in the CPRS view, be avoided. Import licences would require a whole new set of rules, eventually as intricate as the IEA system, but starting from scratch and taking time to build up. The IEA scheme itself was designed for a different set of circumstances (a short crisis interruption in supplies) and would need modification to deal with the present situation (a small shortage likely to last for perhaps a year). Over such a period there would be great scope for cheating and certain countries might only be prepared to join if they were confident of being able to cheat. The United Kingdom would be net providers of oil and the cheating would be partly at our expense.

10. So our interests are to oppose allocation schemes but to do so in a way which does not expose us to the charge that we do so because our own oil supply position is better than other industrial nations.

11. I am sending a copy of this minute to Sir John Hunt.

15 June 1979

KR

Prime Minister
I'm not sure whether you had a chance to read this paper - relevant to Strasbourg briefing.
R 18/6

PRIME MINISTER

THE INTERNATIONAL OIL SITUATION

Introduction and Summary

1. You will I understand be receiving tonight a report by officials on the UK's oil and other fuel supply prospects for the next twelve months. However, whatever we decide in the way of changes to increase our own security of supplies, especially through increased supplies of North Sea oil to the UK market, the dangers for us in the overall world oil shortage remains very great. In the first place, even if we used all our North Sea oil (and had the refinery capacity to handle it) we would still have to import a quarter of our oil needs in the current year.

In the second place, we will not be insulated from the deepened recession and trade disruption which a mishandled international response to the oil cutback would bring.

In the third place, while we want to use North Sea oil to cushion ourselves to some extent (more effectively than at present), once we have done that there is an obvious national interest in using our oil to strengthen Britain's international position, and to trade any surplus on world markets to do so.

Thus, although our position is different to that of some other oil-consuming nations, our strong interest in really effective international action remains.

2. Attached are factual annexes on the current world oil supply position, the international action already agreed and the various proposals which have been put forward internationally. Energy is of course likely to be the key area of discussion at the European Council in Strasbourg and the Tokyo Summit. It is essential that we have a well thought through position before then.

3. In summary, my own views are as follows:

(a) Effective implementation of the IEA and EEC decisions to reduce demand by 5% is essential to the solution of both the supply and the price problem. We should continue our own demand restraint measures (which compare well with those taken by others) and press others to be more effective.

(b) We should be ready to join in an international effort to persuade all important oil companies not to buy or sell for the time being on the spot market, whose high prices receive so much attention; and perhaps make veiled threats of possible further action enough to raise doubts in the minds of anyone who deals with it.

(c) In support of (b) we should work for an internationally agreed stockpiling policy designed both to ensure adequate stocks for next winter and to avoid pressure on the market from competitive stockbuilding. We should study further the possibility of governments actually releasing stocks so as to force down spot prices.

(d) On the supply side we should of course continue to do everything possible to increase our own energy production. But we should also do what we can by bilateral visits and discussions to encourage OPEC and other producers such as Mexico to increase production. We should continue to work for more formal international discussions with OPEC if they are willing to have them.

(e) We should be cautious about proposals for import ceilings - this could lead us into domestic allocation. But if this suggestion is strongly pressed by others we might be ready to agree that the existing IEA and EEC demand restraint commitments which apply to the group as a whole should be translated into specific undertakings by each country to hold imports at agreed levels provided that the choice of method for reducing imports is left to individual Governments.

(f) International allocation - doubtfully effective and highly interventionist - would be undesirable at this stage.

These points are discussed in more detail below.

DEMAND RESTRAINT

4. The figuring still suggests (see Annex A) that a fully effective implementation of the existing 5% IEA and EEC demand restraint commitment should be sufficient to bring supply and demand back into balance and ease the current price spiral. The UK is meeting its obligations and must continue to do so. Other countries, admittedly with fewer easy options like fuel switching, have not done so well. We must keep up the pressure on them at every opportunity, particularly at Tokyo. The threat of a world recession which the oil price spiral is bringing ever closer should provide a powerful stimulus to the laggards such as Italy and Germany to fall into line. We might also consider whether there is any way in which we could strengthen the existing IEA monitoring arrangements.

SPOT MARKETS

5. The French have proposed detailed regulation of the Rotterdam spot market in an attempt to reduce spot prices and therefore reduce the upward pressure on OPEC prices. This is unrealistic. If Rotterdam is suppressed other spot markets will spring up elsewhere and nothing will have been achieved. However there is no doubt that very high spot prices are a standing invitation to OPEC to either increase prices or divert supplies from the oil companies to the spot market. In the context of renewed efforts to implement the 5% commitment in full I think it would be helpful if the Summit and IEA countries could agree to persuade important oil companies not to buy or sell on the spot market. The oil companies might agree to a concerted effort of this kind without legal sanctions, although we would have to accept that, as well as lower spot prices the effect would be to reduce crude oil supplies to those countries concerned, at least to some extent.

STOCKPILING POLICY

6. Much of the current presure on oil supplies and prices comes from stockbuilding by oil companies and Governments. Some of this is absolutely essential preparation for next winter. Some of it however reflects general nervousness about future prospects and

the need to meet Government imposed minimum stockholding obligations. My view is that, although the oil supply situation is highly vulnerable, the risk of an oil price induced recession is such that we should be prepared to accept somewhat lower stocks than hitherto in order to keep prices down. Governments might even consider threatening that they might deliberately release oil from strategic stockpiles in order to flood the market. Any action on stocks would need to be undertaken by all countries and would have to be agreed within the IEA and EEC but Tokyo ought to give a strong lead.

DISCUSSIONS WITH OPEC AND OTHER OIL PRODUCERS

7. OPEC countries are of course aware that an oil price induced recession would not be to their benefit either. But we should make use of any bilateral discussions we have with them or with other oil producers who may have some influence, such as Mexico, to ram home the arguments. I will do all I can to develop quickly good contacts with the OPEC oil Ministers. I also agree with the proposition which has already been put to you that, while we may have little direct leverage with the OPEC countries, we should keep open the door in the Tokyo communique to producer/consumer discussions. If OPEC were prepared to have such discussions which is admittedly doubtful, they might find some of our arguments hard to refute. We need to consider very carefully what is the posture if IEA/EEC countries most likely to call for the same response from at least the more responsible Middle East oil producers. And whether we can hope to have any impact on the 26 June OPEC meeting or not. In any case what happens there must have a bearing on what conclusions are reached at the Summit.

The fact of the matter is that without some co-operation with oil producers we cannot solve the problems of price and the balance of supply and demand.

INTERNATIONAL ALLOCATION AND IMPORT CEILINGS

8. Voluntary implementation of the IEA's emergency oil sharing scheme or quantitative restrictions on imports, are concepts which are currently receiving some attention internationally (see Annex B) though it is by no means clear how far our partners will

wish to espouse them. The basic idea is that they would serve to reinforce demand restraint and remove the incentive to purchase at spot market prices, as the buyers might then find their oil allocated away from them at average prices. However the IEA allocation scheme is a complex one, and has never been tried in practice. There is real doubt whether it would really work, particularly if triggered voluntarily in a situation different from that for which it was intended, and with the various modifications which would have to be agreed. There is also a strong possibility that it would lead to oil being allocated away from the UK, and we should lose much of our flexibility to improve our own supply position. The most we should agree to is further study of the possibility of allocation if the situation should get worse, but the IEA scheme itself is not triggered.

9. Import controls might take the form of consumer governments using import licences to restrict their oil supplies to 95% of pre-crisis expectations. Alternatively they might take the form of a statement of intent by each government on oil import levels, which would match the 5% demand restraint commitment. Import licenses would involve considerable EEC complications although they might actually make it easier for us to get a better share of North Sea oil supplies. But this would also involve a new bureaucratic control and a big step towards domestic allocation. The milder variant of a statement of intent by each country on the import levels they would observe might work if backed up by an internationally agreed stance on stockbuilding which would discourage cheating.

SUMMARY

10. To summarise, our vital national interest lies in continuous steps to improve indigenous oil supplies to our market with efforts to strengthen international action. The latter should include concerted pressure to cut demand, moves to help defuse the spot market and

efforts to improve world supply through contacts with OPEC countries, possibly leading to full-scale producer/consumer discussions. It is not in our interest to be drawn, before we have to be, into international allocations scheme.

11. I am copying this minute to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary, other members of E Committee, and Sir John Hunt.

David Howell

D A R HOWELL
15 June 1979

ANNEX A

WORLD OIL SITUATION AND ITS ECONOMIC CONSEQUENCES

Oil Supply and Demand

1. The latest forecasts for non-communist world oil supply and demand are as follows:

	Million barrels/day (mbd)		
	1978	1979	1980
Non-communist world oil Consumption (ignoring the effects of demand restraint measures)	51.4	52.8	54.2
Non-OPEC oil supply	20.7	21.7	22.8
Demand for OPEC oil	30.7	31.7	31.4
OPEC supply	29.9	29.6	29.8
Stock draw to balance	0.8	1.5	1.6

Source: IEA/GB(79)19

Demand figures modified to exclude the effects of demand restraint measures.

2. The IEA figures assume Iranian production stabilising at about 3.5 mbd from the second quarter of this year onwards, and Saudi production at the Aramco ceiling level of 8.5 mbd. It is possible that Iranian production may be rather higher - though we would not expect it to go above 4 mbd. It is perhaps more likely that Iranian production will fluctuate considerable over the coming months with political developments inside the country.

3. The economic growth rate assumptions lying behind the IEA projections are 3½% for 1979 and 3% for 1980. As will appear from para 8 below, we would regard the assumption for 1980 as too optimistic. OECD oil consumption, and the shortfall in oil supplies in 1980, are therefore unlikely to be as great as the IEA figures suggest. But all this means in effect is that part of the oil deficit will be met by reduced economic growth.

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IEA & EEC Commitments

4. IEA Member Governments are committed to reduce their demand for oil on the world market by 5% (or 2 mbd). No time period for the fulfillment of this objective is laid down, though many IEA governments interpret it as something to be achieved by the end of 1979. The IEA Ministerial meeting in May agreed that extension of demand restraint into 1980 was inevitable. The EEC has an oil savings objective in a rather different form; Member States are committed to holding their collective 1979 oil consumption to 500 million tons, as opposed to the pre-crisis estimate of 525 million tons. There is some doubt however whether, in the absence of demand restraint measures, EEC consumption would have been as high as 525 million tons. The UK should be able to achieve the 5% oil savings target, through the substitution of coal for oil in electricity generation over the summer, a campaign of oil savings in the public sector, additional flaring in the North Sea (which allows increased oil production), and savings by the general public, particularly in response to higher petrol prices and the informal allocation schemes operated by the oil companies. However, the performance to date of IEA governments generally has been patchy. Effective savings by the US will be particularly important, as the US accounts for half of IEA total oil consumption, but our European partners also need to do more.

5. If the effect of demand restraint measures builds up gradually throughout the rest of this year, the 1979 shortfall may be reduced to 0.7 mbd. A 5% saving in oil throughout 1980 should eliminate the deficit next year, and allow a modest amount of stock rebuilding.

Prices

6. In the short term, the demand for oil is relatively unresponsive to price increases. The relatively small absolute shortfall in world oil supplies has therefore been reflected in substantial price movements.

7. The average official price of OPEC crude oil has risen by 32% since the end of last year. All OPEC producers except Saudi Arabia are charging premia on their oil sales, and we can expect that at the OPEC meeting on 26/27 June the Saudis will agree to raise their prices at least to around the average level now being charged by other OPEC producers.

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This would produce a 41% rise in average OPEC prices since the end of last year. Further price rises later in the year are possible, particularly if there are few signs of effective demand restraint by consumers by the beginning of this winter. Prices in the spot market have risen substantially, to over $40/barrel in some cases. The spot market accounts for only a few per cent of total crude oil sales, but it has a psychological effect on the price setting decisions of producers, as a barometer of the potential market value of crude oil. In some cases, producers have deliberately withdrawn oil from contract sales in order to sell it spot.

Economic Consequences

8. A further substantial rise in prices would have significant effects on the world economy. The Treasury's latest World Economic Prospects projection, which incorporated a price assumption (which is now probably too low) of $18 at the end of the year, showed world growth at 3.3% in 1979 and 2.6% in 1980. A large part of this slow-down is accounted for by slower US growth. OECD countries (excluding the UK, Australia and New Zealand) were estimated to move from a combined current account surplus of around $9 billion in 1978 to a current account deficit of $9 billion in 1979 and $11 billion in 1980. OPEC countries were estimated to have surpluses of $20 billion in 1979 and $24 billion in 1980 compared with a small deficit in 1978. In addition, rising oil prices will put severe strain on the payments balances of many oil-importing LDCs, and damage their development prospects by restricting their ability to import capital goods. The scale of the effect of oil price increases on the world economy will depend on the extent to which governments react to higher inflation and worse current account positions. Reactions which reduce growth are more likely the larger oil price increase. As a rough rule of thumb, a 10% increase in oil prices would:

(a) add $16 billion to OPEC revenues

(b) add $13 billion to the OECD oil bill and $3 billion to the non-OECD oil bill

(c) raise inflation by about ½% after a year though this could be somewhat higher if domestic energy prices were raised in time.

(d) reduce growth in the industrial world by about 0.4% after a year (this allows for some policy reaction by governments. With no such reactions and no confidence effects on savings and investments the effect could be 0.2%).

/4..

(e) increase the OECD current account deficit by about \$8 billion, of which \$3½ billion would fall to the US.

Effects on the UK Economy

9. The effects of an oil price increase on the UK economy are complicated by the fact that, assuming a floating exchange rate, the pound is likely to appreciate because the UK is thought to be relatively well placed to deal with a world oil shortage. The combined effect of a cut in world growth (para 8(d) above) and the loss of competitiveness due to a stronger pound would be to reduce our GNP. So long as we continue to give priority to keeping inflation under control, the Treasury estimates that each 10% increase in the oil price in 1979 might cut UK GNP by ½%-¾% in 1980, with an associated increase in unemployment. The effect on consumer prices in the UK of higher oil prices would not be large because the appreciation of the pound would offset the effect of the increase in the dollar price of oil.

DEPARTMENT OF ENERGY
15 June 1979

ANNEX B

POSSIBILITIES FOR FURTHER INTERNATIONAL ACTION

1. The existing oil demand restraint objectives of the IEA and EEC are described briefly in para 4 of Annex A. The major possibilities for further action by consumer governments are:

(a) activation of the IEA Emergency Allocation Scheme. It would be necessary to modify the scheme to allow for the fact that the normal 7% shortfall "trigger point" has not been reached. It might be possible to link the right to receive allocations under the scheme with the achievement of demand restraint objectives.

(b) The US have suggested, in the context of preparatory work for the Tokyo Summit, that an informal system of allocation between countries be instituted. If informal allocation did not work, the US would favour "more stringent measures".

(c) Physical limits might be set to oil imports. The US have suggested that each Summit country should set an oil import target for 1979, and a lower target for 1980 (to be reviewed quarterly). The French have suggested oil import targets for EEC Member States for the three years 1980-82.

(d) The present 5% demand restraint commitment could be specifically extended to cover 1980. The IEA Ministerial meeting in May agreed that this was inevitable. It might be possible to reformulate the objectives to make them more watertight eg by breaking them down into individual country objectives for oil consumption (or, alternatively, for oil imports - see (c) above).

/2..

(e) The EEC Commission have proposed that the possibility of a voluntary internal allocation system within EEC Member States be studies urgently, with a view to bringing it into effect before the end of 1979 if the situation does not improve. (This would build on the existing allocation schemes operated by oil companies in a number of Member States).

(f) Concerted pressure could be brought to bear on oil companies not to buy or sell oil or products in the spot market, or not to buy or sell above a given price, or not to buy marginal cargoes of crude or products in the spot market outside their normal trading pattern.

(g) The French have suggested that consumer countries should prohibit the import of crude or products at above OPEC government selling prices.

(h) The French have also suggested various measures to regulate the operation of the spot market, including the establishment of "posted prices". The EEC Commission have proposed that oil companies should be required to notify EEC governments of purchases of crude or products at above OPEC government selling prices.

(i) The existing obligations on oil companies to maintain stocks at or above a given level could be reviewed (in order to discourage oil companies from buying in the spot market solely in order to maintain emergency stocks). The possibility of releasing some emergency stocks onto the market could be studied. The US have suggested an undertaking by Summit countries not to buy for strategic stockpiles when this would place undue pressure on oil prices.

DEPARTMENT OF ENERGY

15 June 1979

MR. LANKESTER

cc: Sir Kenneth Berrill
Mr. Mountfield
Mr. Vile

INTERNATIONAL OIL ISSUES

We had intended to let you have, prior to the Prime Minister's meeting with Sir Frank McFadzean and others on Saturday, a check-list of the main extant suggestions for international action on the oil situation as background to the discussion. I understand, however, that Mr. Howell - who has been consulting Lord Carrington - is about to send the Prime Minister a comprehensive minute on the subject which will serve the same purpose. Sir Kenneth Berrill is also, I know, letting you have some points from the CPRS.

2. There are however a few additional points which I might usefully add:-

(a) Although the Prime Minister will be meeting Lord Carrington and Mr. Howell on Saturday and views will inevitably harden, there is a lot to be said for reserving final decisions until later. Sir John Hunt and Sir Michael Palliser are in Paris at a meeting of the Preparatory Group for the Tokyo Summit and Mr. Howell will be in Brussels on Monday for a meeting of the EEC ~~and its~~ Energy Council. Those concerned will therefore be able to report early next week on the latest thinking of our partners.

(b) If the Prime Minister wishes any further discussion on these international oil issues to be arranged, the briefing meeting for Strasbourg arranged for next Tuesday afternoon in preparation for the Strasbourg Summit provides one obvious opportunity. Another might be the meeting of E Committee already arranged for Tuesday morning (with Industrial Relations the only item on the agenda). Mr. Howell's minute is being copied to all members of E.

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(c) I am nor sure how far it is intended that discussion on Saturday night will range. But, apart from questions of international action, the oil company guests might well be asked for their opinion on:-

(i) The chances of the US putting its energy house in order.

(ii) The outcome of the OPEC price meeting in Geneva later in the month.

(iii) The impact of present oil prices on underlying demand.

(iv) Whether present attempts to rebuild stocks internationally represent self-inflicted wounds or are justified by the longer term outlook.

3. Finally, it is worth making the point that oil company views and assessments vary widely and are, naturally, coloured by the interests of the particular company concerned. The reactions of one company to any particular question affecting them should not necessarily be taken as representing the views of the industry as a whole.

P. Le CHEMINANT

Cabinet Office
15 June 1979

CONFIDENTIAL

CONFIDENTIAL

Energy - Policy

DS/

Original copied to/cc Prime Minister - March '79 Meeting with Mr. Garvin Chairman of Exxon.

10 DOWNING STREET

From the Private Secretary

15 June 1979

Dear Bill,

Mr. C.C. Garvin, the Chairman of the Exxon Corporation and Dr. A.W. Pearce, the Chairman of Esso Petroleum, called on the Prime Minister at 1730 hours on Wednesday, 13 June. The following is a summary of the main points which came up during their discussion.

Mr. Garvin first surveyed the world oil scene as he saw it. Twenty years ago the oil companies had been finding oil at a rate of 20 billion barrels per year but over the last ten years the rate of discovery had dropped to 14-15 billion barrels. World consumption was now running at 20 billion barrels per year, with the consequence that world reserves were being gradually depleted. Against a background in which the US appeared to be unwilling to accept that a world shortage existed, a major question was whether the rate of discovery could be increased to match the rate of consumption. Geologists tended to say that the prospects were reasonably good; but they were increasingly looking at deep sea areas where, while drilling was feasible, the oil industry did not yet have the necessary production technology. His own view was that the prospects for increasing the rate of discovery above the current level were not good. This would only change if it were possible to restart exploration work on a major scale in parts of the Middle East, such as Iraq, where there still seemed likely to be vast undiscovered reserves.

Turning to the question of the current shortfall in world supply, Mr. Garvin said that the 5% cut in consumption agreed under the IEA arrangements was not enough. He had told the US Administration that it was essential for the 5% reduction to be implemented, and he had suggested to them that President Carter should perhaps call for a further 5% cut to be agreed at the Tokyo Summit. In the absence of such further measures, the current shortfall would only be eliminated if Saudi Arabia could be persuaded to produce more. They were currently producing at the rate of about 8½ million barrels a day against a potential of 11-12 million barrels. The Saudis were not only producing less than they were able to, but they were also selling a larger proportion to LDCs which, because they did not have refinery capacity, were reselling on the spot market - and thereby causing greater difficulties still for the Western oil companies. The background to this appeared to be the disenchantment of the Saudi Royal Family with the US - both for

/their

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their failure to cut back oil consumption, and for the part which the Administration had played in bringing about the Israeli/ Egypt Peace Treaty. They were also concerned about their investments overseas and were therefore inclined to hold back the rate at which these were accumulating. Mr. Garvin said that, in his view, Sheikh Yamani was personally sympathetic to the needs of the Western economies; but he did not seem able to carry enough weight with the Royal Family. It would be very helpful if Western Governments could get closer to the Saudis to try to bring home to them the implications of their current policies. The Prime Minister agreed that steps must be taken to get closer to the Saudis, though Mr. Begin's general intransigence made this difficult and President Sadat had not helped with his recent remarks about King Khalid.

The Prime Minister asked whether the current shortage might give way to a surplus in a year or two's time, as it had done after 1974. Mr. Garvin replied that he thought this was unlikely because a repeat of the 1975 recession in the US and Europe was, in his view, improbable; and production in the Middle East was unlikely to pick up. For even if the Saudis could be persuaded to increase production, there was a risk that production in Iran would decline, and the political situation in Iraq made it unlikely that production there would increase.

The Prime Minister then asked Mr. Garvin for his views on alternative energy sources. Mr. Garvin said that 2.6 billion dollars had been invested in the Canadian tar sands project, and this was producing only 100,000 barrels of oil per day. The capital costs of converting coal into oil were likely to be even higher. The US Administration were providing substantial funds for research into solar energy, but it seemed unlikely there would be a real break-through on this front within the next 25 years. In the shortrun, therefore, oil - and by implication the OPEC countries - would continue to play a key role. But it was also essential for Western countries to push ahead with their nuclear programmes. The Harrisburg incident had put the US programme back several years, even though the official enquiry into the incident was likely to say that it was due entirely to operator faults.

The Prime Minister agreed that rapid progress must be made on the nuclear front. She had been very impressed by the French programme, and it was a matter for concern that that UK had fallen behind over the last five years.

I am sending copies of this letter to Martin Hall (HM Treasury), Martin Vile (Cabinet Office) and Paul Lever (FCO).

Yours ever,

Tim Lankester

Bill Burroughs, Esq.,
Department of Energy.

Extract from: PM/Andreotti talks.

Original: Italy June 79

15 June 79

~~The Prime Minister said that the British Government, too, was prepared to be very tough on inflation. Some exchange controls were being relaxed, in order to release UK investment to Europe. This was one way of gradually bringing the exchange rate down: money would be able to enter and leave the UK on more equal terms than before.~~

~~Signor Andreotti said that, when his Government had taken over, Italy's rate of inflation had stood at 23 per cent. The Government had got it down to 13.4 per cent and was determined to keep it there.~~

Energy

Signor Andreotti said that energy would be high on the Agenda at Strasbourg. Each member country of the Community had a different situation so far as energy was concerned: the UK had oil, the FRG coal, while Italy had nothing. It was essential to try to produce some concrete decisions at Strasbourg. It was no use simply declaring that energy consumption should be reduced by 5 per cent, and then leave it to member countries, with all their differences in resources, to carry out this prescription. It would be much better if the European Council could agree, for example, that all petrol stations in the EEC should be closed on Saturdays and Sundays. If all members were to subscribe to such a decision, it would be easier for each country to accept it. The problems of nuclear energy, as well, could be more easily tackled on a Community basis.

The Prime Minister said that she was not in favour of the weekend closing of petrol stations since this would discriminate against those who were obliged to work on Saturdays and Sundays. Each country would develop a different means of achieving the common objective. The Prime Minister said that she was more concerned by the nuclear energy issue: Europe would have to replace its coal and oil by nuclear power but there had been insufficient preparation of the public case

/for this.

for this. People had to be reminded that uranium was just as much God-given as the sun and the waves. If Europe could not be brought round to favour nuclear power, the whole economic future of the Community would be in jeopardy. Italy, like France, had taken some very far-sighted decisions. The Prime Minister and Signor Andreotti agreed that Chancellor Schmidt's proposals on nuclear safety were helpful and should be pursued.

The discussion ended at 1315.

BGC

15 June 1979

File

10 DOWNING STREET

From the Principal Private Secretary

15 June 1979

Talks with the Germans on Energy

Ken Stowe and I went to Bonn earlier this week so that I, as Ken's successor, could meet Jürgen Ruhfus and one or two other officials in Chancellor Schmidt's office. During our meeting we gave them an account of the Prime Minister's talks with President Giscard and we mentioned that, as part of the follow-up to the Prime Minister's visit, Sir Jack Rampton was getting in touch with his French opposite number to discuss energy matters as a prelude to the meeting of the European Council in Strasbourg on 21/22 June. We asked Ruhfus whether he would welcome similar contacts with Federal German officials, and he said that he thought that this was a good idea.

We have since consulted the Prime Minister, and she believes that there would be advantage if Sir Jack Rampton could have bilateral talks with the Germans on the lines of those he has already had with the French, even though there may not now be time for this to be done before the European Council. Unless your Secretary of State or the Foreign and Commonwealth Secretary sees any difficulty about this, I should be grateful if Sir Jack Rampton could now go ahead and approach the Germans.

I am sending a copy of this letter to George Walden (Foreign and Commonwealth Office) and Martin Vile (Cabinet Office).

CAW

W.J. Burroughs, Esq.,
Department of Energy.

Fire

Energy

10 DOWNING STREET

From the Private Secretary

13 June 1979

FUEL STOCKS AT POWER STATIONS

The Prime Minister has read your Secretary of State's minute of 11 June about coal imports for the South of Scotland Electricity Board. Subject to Mr. Howell's views, she agrees that the SSEB should be informed that the Government will not stand in the way of imports during the current year with the provisos set out in paragraph 5 of the minute.

I am sending a copy of this letter to the Private Secretaries to the Secretaries of State for Energy, Industry, Employment, the Chief Secretary, the Minister of Transport, and to Sir John Hunt.

T. P. LANKESTER

Kenneth MacKenzie, Esq.,
Scottish Office.

PRIME MINISTER

Talks with the Germans on Energy

When Mr. Stowe and I were in Bonn yesterday to meet one or two key officials in Chancellor Schmidt's office, the discussion turned to energy matters and we told them that, as a result of your talks with President Giscard, Sir Jack Rampton was now in touch with his French opposite number on energy problems. We asked the Germans whether they would welcome similar bilateral consultations, and they said that they would.

If you agree, I will ask the Secretary of State for Energy's office to arrange for Sir Jack Rampton to get in touch with his German opposite number as soon as possible.

Agreed [illegible]

[illegible]

12 June 1979

Original in Appts filing

cc: Mr. Wolfson
Mr. Stowe
Mr. Cartledge
~~Mr. Pattison~~
Miss Stephens

CONFIDENTIAL

Energy

NOTE FOR THE RECORD

The following is a summary of the main points which arose during the Prime Minister's lunch with Sir Frank MacFadzean at Chequers on Friday, 8 June.

Chairmanship of BNOC

The Prime Minister asked Sir Frank if he would be interested in the Chairmanship of BNOC. Sir Frank replied that he would have great difficulty in accepting this appointment. It would mean his having to give up his Directorship of Shell - and also - he thought - his Directorships in the insurance business. When pressed, however, he made it clear that there were no circumstances in which he would accept the job.

The Prime Minister asked Sir Frank for some suggestions for this appointment. He offered two names: Mr. Monty Pennell of BP, and Mr. Ashley Rayburn of Rolls Royce.

CPRS

The Prime Minister also asked Sir Frank if he would be interested in becoming the Head of the CPRS. Again, Sir Frank made it clear that he was not interested. He did, however, indicate that he would be interested in advising the Prime Minister on industrial and energy matters in some role or other. The Prime Minister said that she would consider the possibility of asking him to become a personal adviser, perhaps on a part-time basis.

Future of BNOC

The Prime Minister expressed her doubts about BNOC. Sir Frank said that he could see no reason whatever for having a nationalised oil company. In his view, there was nothing which BNOC could do which could not be achieved by other means. In particular, he questioned the value of the participation agreements which, supposedly, gave the UK greater security of oil supplies. In fact, BNOC had entered into contracts with foreign customers for much of

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/their

their participation oil. But even if they had not, in the absence of any refinery capacity, they were obliged to sell all of their participation oil back to the oil companies; and this meant that they had no effective control over the disposal of the refined oil.

The Oil Situation

Sir Frank said that the key to remedying the current oil shortage was Saudi Arabia. If they could only be persuaded to produce another million barrels per day, and unload this on the spot market, the current price spiral would immediately be eliminated. In his view, the Saudis did not sufficiently understand the implications of the current situation for the western economies and in turn for political stability in the world. This was not because they were basically unsympathetic, but because the west - in particular the Americans - had failed to maintain close enough contacts with them. The Prime Minister agreed that they appeared to be basically sympathetic, but pointed out that the Americans were in a weaker position vis a vis Saudi Arabia following the agreement between Egypt and Israel over Sinai. Nonetheless, it was indeed important for the west to establish closer contacts with the Saudis and persuade them of the consequences of their holding back supplies. There might well be a case for a European Head of Government to visit Riyadh after Strasbourg, and perhaps President Giscard would be the most appropriate.

Sir Frank also said that it was pointless to tell the oil companies to keep clear of the spot market. There would always be some secondary companies who would be willing to pay very high prices at the margin in a situation of shortage. The only way of getting the spot market price down was for the oil producers to increase their sales in this market significantly.

The Prime Minister went on to say that energy would be a key item on the agenda at Strasbourg, and she would value Sir Frank's advice on what the UK position should be. Sir Frank said that he would prepare a note on the current oil situation as he saw it, and he would be very glad to discuss this with the Prime Minister before she left for Strasbourg. He suggested that he might bring with him Messrs. Baxendale and Hart of Shell. The Prime Minister

/said

This is a copy. The original has been extracted and closed, 40 years.

said that she would try to arrange a private supper, to which she would also invite the Secretary of State for Energy.

Sale of Public Sector Assets

Sir Frank said that he was against selling off parts of nationalised industries. These would tend to be the more profitable ones and this would destroy management's morale; and there was always the prospect that they would be re-nationalised by a future Labour Government. In his view, the "BP solution" was a much better way forward.

As regards floating off shares in British Airways, he thought this was thoroughly feasible; but it would be a mistake to make too much haste. To do so would mean selling the shares at a discount to asset values because of relatively low current profitability; and this would be both politically and financially objectionable. Sales of BA shares should be made over a two to three year period.

British Aerospace

The Prime Minister asked Sir Frank about the Chairmanship of British Aerospace. Sir Frank replied that Lord Beswick would have to go. Lord Beswick was totally inadequate as a Chief Executive and the Americans who had negotiated the aircraft deals last year had told him that he (Lord Beswick) had been a hopeless negotiator. He carried no weight in the industry whatever.

The Bingham Report

Paragraph deleted and closed, 40 years, under a FOI Exemption.

AWayland
29 September 2009

CONFIDENTIAL

Paragraph deleted and closed, 60 years, under a FOI Exemption

Wayland
29 September 2009

The Prime Minister said that she saw nothing but disadvantage for the national interest if the involvement or otherwise of previous Governments were to become the subject of major controversy. Sir Frank said that he did not dissent from this, but he repeated that if the DPP were to proceed, he would have little option but to defend his colleagues. Even if the DPP did not prosecute, he doubted whether the issue of previous Governments' involvement would simply disappear.

TL.

12 June 1979

2pp

Y SWYDDFA GYMREIG
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Oddi wrth Ysgrifennydd Gwladol Cymru

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From The Secretary of State for Wales

R 12/6

The Rt Hon Nicholas Edwards MP

Dear David

12 June 1979

OIL SUPPLIES FOR FOOD PRODUCTION AND DISTRIBUTION

Although I have now seen your reply, I feel that I should nevertheless add my weight to Peter Walker's letter of 31 May, in which he warned that the arrangements for dealing with fuel shortages in the agriculture industry had begun to creak. I am afraid that in Wales they are beginning to show signs of breaking down altogether. We know of at least two fairly significant distributors who have been refused supplies. Admittedly in one case the firm involved was one that had no regular contract, preferring to make spot purchases at the best price obtainable. But a second case has now occurred involving a firm refused supplies by Total Oil with whom they had had a contractual relationship of some 10 years. In addition, Roger Thomas (Member for Carmarthen) has just written to me saying that the Farmers Co-operative at Carmarthen have been informed that their fuel supplies for the next three months will be reduced by 25% compared with the same period last year.

So far, these difficulties seem fairly localised, but it is very worrying that, at the very time when farmers' demand for fuel is reaching towards the high levels needed for the harvest, the industry is already suffering serious shortages. I therefore very much support Peter Walker's suggestion that you put the needs of agriculture to the oil companies in very firm terms.

/ I am sending copies of this letter to the recipients of yours.

Yours ever

Nick

The Rt Hon David Howell MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

VMS

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SWIP 3EB

Bill Burroughs Esq
Private Secretary to
The Secretary of State for Energy
Thames House South
LONDON
SW1

11 June 1979

Dear Bill

I attach supplementary Questions and Answers on points my Minister considers could come up during your Secretary of State's answers and statement today. It replaces the material sent to you on 8 June.

One Question and Answer is in square brackets, because the Government's final line will - I understand - depend on the outcome of the Home Secretary's meeting and of Cabinet tomorrow. But my Minister thinks that Mr Howell may need to refer to the need to maintain public confidence that London would not come to a stop in the even of a strike on the underground.

Yours

Genie

MRS E C FLANAGAN
Private Secretary

Copies of this letter go to Tony Battishill, Tim Lankester and Martin Vile.

ENERGY CONSERVATION: PQ BY MR NIGEL FORMAN FOR ORAL ANSWER ON 11 JUNE BY THE SECRETARY OF STATE FOR ENERGY

BRIEFING ON POSSIBLE TRANSPORT SUPPLEMENTARIES

Q. Will the Secretary of State take action to reduce speed limits in the interests of energy conservation?

A. In my view, and that of my Rt Hon Friend the Minister of Transport, there is not a case, in the present circumstances, for compulsory measures such as stricter speed limits. I hope every motorist will act sensibly to conserve fuel through reducing speed and more careful driving.

Q. What steps is the Secretary of State taking to ensure that bus and train services are not cut because of a shortage of fuel?

A. As I said in my statement on 7 June, I believe that it would be wrong, at the present levels of shortfall, to set up an elaborate official system of government allocation of supplies to priority users. My Department will continue to be ready to intervene with suppliers on specific problems. But like my Rt Hon Friend the Minister of Transport, I hope that operators will act so as to minimise inconvenience to the public.

Q. What steps is the Government taking to ensure that adequate fuel supplies are available for traffic in London in the event of a strike on London's underground.

A. I trust that good sense will prevail and that a crippling strike will not take place. If it does, the Government will announce in good time the measures it proposes and will also seek the co-operation of the public and employers.

/Q. Will there be enough fuel for buses and cars?

A. The Government recognise the need to maintain public confidence that fuel will be available for essential journeys. This is not yet the time to announce any specific measures./

HOUSE OF COMMONS

Mr John MacKay (Con - Argyll)

To ask the Minister of Transport, if he will make a statement on the future of vehicle excise duty.

Mr Norman Fowler

I shall be reviewing the whole operation of VED and, pending the result of this review, I shall not be proceeding with the consultations on the phasing of the change from VED to petrol tax initiated by the previous Government.

Friday 25 May 1979 for
Thursday 24 May 1979 (No 135)
Department of Transport

65/79/80
(55)

Graduated VED on cars

Background

1. Mr William Rodgers has suggested that there should be a temporary increase in VED on cars, graduated according to engine size. VED is currently £50 on all cars. The suggestion is not new, but has always been ruled out on the grounds that it would complicate the administration of VED and hence increase staff numbers.

2. Attached are

a) press cutting setting out Mr Rodgers' proposals

b) copy of PQ by Minister of Transport announcing review of VED.

Speaking Note

3. As my rt hon Friend, the Minister of Transport, has made clear we are going to review the whole operation of VED and, among other things, we will consider the possibility of a graduated scale for cars. However, account will need to be taken of the extra staff that would be required to administer this more complicated tax structure.

THE GUARDIAN
Monday June 11 1979

Rodgers attacks Cabinet on energy

By Michael White and Alec Hartley

Labour's former Transport Secretary, Mr William Rodgers, yesterday delivered a crushing attack on the Government's "deplorably casual approach" to the energy crisis and proposed a 10-point programme to cope with the short-term problems.

In a forceful assertion of the rights of public over private transport needs he demanded a guarantee of supplies for all public transport, the freezing of commuter fares this autumn (as he had planned as Secretary of State), higher road fund taxes for larger, "gas-guzzling" cars, and an immediate temporary speed limit for commercial vehicles designed to save fuel—including a 50 mph maximum for heavy lorries.

The shortage of fuel may force some ambulances in London off the road soon, and could force the closure of a number of hospitals. The Chevron Oil group, sole supplier of petrol to the London Ambulance Service's 900-plus fleet has cut supplies by nearly a third in the last two months.

The Greater London Council, which handles the South-west Thames Health Authority's supplies as well as its own, will meet Chevron representatives and Department of Energy officials today in an attempt to get an increase.

With two months' supply normally in hand for ambulances there is no shortage yet, but the health authority said that unless supplies were increased soon "we will have to consider reducing services."

London hospitals are having to pay £1.80 a gallon for extra heating oil — double the normal price — because Shell and Esso are failing to deliver enough. Mr Michael Wilkin, chief supplies officer for the South-west Thames authority, said there was a "very real danger" of hospitals closing soon.

Many Tory MPs want something done, despite the publicly-stated view of Mr David Howell, the Energy Secretary, that it is against the Cabinet's market philosophy to interfere.

Mr Rodgers, speaking in Pimlico, London, complained of "a vacuum of leadership." It is nonsense that a country rich in oil should be facing chaos and restrictions. Like Mr Callaghan and Labour's energy spokesman, Dr Dickson Mabon, he stopped short of demanding rationing at this stage.

Mr Callaghan will be in the Commons today to hear Mr Howell's statement, and if necessary to throw his weight behind Labour demands for action, which on the back benches already include calls for rationing.

Mr Rodgers's statement is the most comprehensive call yet for "short-term measures to conserve fuel and ensure that existing supplies are used to full advantage."

His proposals also include maximum prices to prevent "profiteering", particular control over supply and profits on motorways; a relaxation of restrictions on car-sharing (and advertising for passengers), and talks with local authorities "with a view to suspending the operation of all-day off-street parking facilities for private cars where public transport can cope."

Mr Rodgers's plan for a temporary increase in vehicle Excise duty (ranging from 50 per cent extra for 1500 cc cars to 100 per cent on 3½ litre-plus cars) is ironical in view of his successful campaign to get the Labour Government to pledge itself to abolish it.

But yesterday Mr Rodgers insisted that the decision of his successor, Mr Norman Fowler, to keep road tax should be overturned so that "motorists pay tax in accordance with the petrol they consume."

The Opposition has been quick to press the new Government on what it evidently [illegible] as an issue [illegible] free market philosophy [illegible] found wanting. Mr Callaghan took the initiative in seeking a statement today.

Rhoodie 'linked to Mobuto'

Continued from page one

Continued from page one

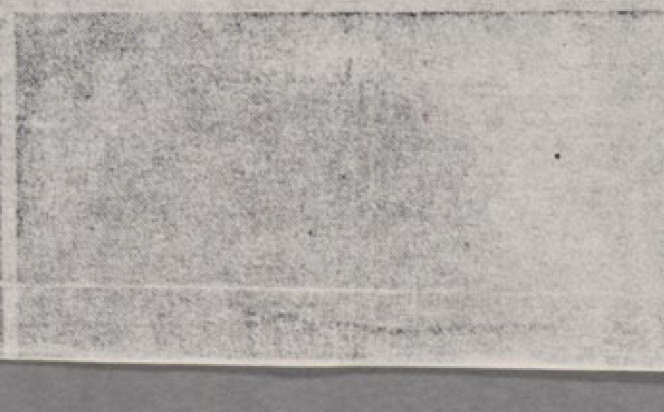
the Erasmus Commission, re- [illegible]

Right faults Left ...and vice versa

By Michael White, Parliamentary Correspondent

The tempo of Labour's general election post-mortem quickened yesterday when a [illegible] to ensure that Labour policies reflected "the real political aspirations" of the trade union rank and file.

Mr Mason's hawkish contribution to Labour's election [illegible]



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By our Parliam[illegible] Correspondent

Budget week [illegible] Deputy Sec[illegible] of the Exc[illegible] Howe [illegible] with the po[illegible] world co[illegible] the Chancello[illegible] Minister have disappoint[illegible] union leaders [illegible] give the inevit[illegible] industrial fric[illegible]

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SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

Prime Minister
Agree the proposal in para 5 on coal imports (subject to Mr. Howell's views)? It seems sensible.
TL 12/6

Agree our

Prime Minister

FUEL STOCKS AT POWER STATIONS

Flag A 1. In the light of the minute of 31 May from the Secretary of State for Energy about the need to increase coal stocks at CEGB power stations, you should be aware that the South of Scotland Electricity Board (SSEB) is in even worse position.

2. Largely as a result of coal production in Scotland last winter falling short of target, stocks at SSEB power stations are some 30% below the desired level at this time of year. SSEB has undertaken to purchase all the suitable coal which can be supplied by the Scottish Area of the National Coal Board in the current year, but this will be insufficient to ensure that the Board starts next winter with the required level of 9 weeks' stock. NCB has offered an additional 0.25m tonnes of coal from the North East of England. This is, however, to be considerably more expensive than Scottish coal - a crucial consideration from the Board's point of view since it will be seeking to keep to a minimum the tariff increases which will be necessitated by the forthcoming general increase in coal prices and our proposed cut in its cash limit - and there may well also be transportation difficulties as a result of the closure of the East Coast rail line.

3. In these circumstances SSEB is exploring the possibility of importing upwards of 0.25m tonnes of coal at a price comparable to that of Scottish coal. The Board has informed my officials of its intentions in this respect and is awaiting a Government response.

4. The damaged reactor at Hunterston B power station is expected to be back in full service in 1980 and the Scottish Boards will also begin to benefit in that year from the burning of gas in the North of Scotland Hydro-Electric Board's new station at Peterhead. It is unlikely, therefore, that the necessity to import coal will continue into next year.

5. Subject to the views of Department of Energy Ministers with whom this matter has been raised separately, my inclination would be to inform SSEB that we will not stand

in the way of imports during the current year, provided that we are consulted further by the Board before any contract extending beyond the current financial year is entered into or if imports during the current year seem likely to exceed 0.5m tonnes.

6. I am copying this minute to the Secretaries of State for Energy, Industry and Employment, the Chief Secretary, the Minister of Transport and Sir John Hunt.

G.Y.

Scottish Office
11 June 1979

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

House of Commons Hansard Columns 37-55	11/06/79 Oil Supplies

Signed BWayland Date 27 October 2009

PREM Records Team

MS

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01 211 6402

Nick Sanders Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON SW1

11 June 1979

Dear Nick

OIL SUPPLY SITUATION: ORAL STATEMENT 11 JUNE 1979

I attach for your information a copy of the oral statement on oil supplies my Secretary of State proposes to make in the House at 3.30 pm this afternoon.

I am copying this letter to the Private Secretaries to the Leader of the House of Commons, the Chief Whip and the Chief Press Secretary at Number 10 and Martin Vile (Cabinet Office).

Yours sincerely
Colin L. Ambrose

C.L. AMBROSE
PRIVATE SECRETARY

PRIME MINISTER

PA
(amended by PM) MJS

ORAL STATEMENT - OIL SUPPLY SITUATION

With permission Mr. Speaker I wish to make a statement about the oil supply situation.

Following disruption of oil supplies from Iran from the early part of the year a tight world oil situation has developed, with total supplies on present estimates likely to be well short of expected demand world-wide. The position in Iran could easily worsen again and the prospect from the other suppliers is at best fragile.

Against this background the UK position is as follows:

Supplies are currently coming into the UK market at about the same rate as this time last year. But demand is well up, we have had a cold winter and it is obviously vital now to rebuild stocks for the Autumn.

This means that actual supplies to UK consumers are on <u>average</u> about 5% below the increased levels on which people were counting.

However this does not give the full picture since the supply position stemming from Iran has affected different oil companies supplying the British market in very different ways. This has led to serious shortages for some particular customers and some particular regions, especially as the first effects work through.

The oil companies have been rationing their allocations to their customers and the Government has specifically requested asked the UK Petroleum Industry Association to achieve a more even and effective distribution overall and to ~~move swiftly to~~ meet specific difficulties as a matter of urgency where customers are threatened with real hardship. This is a new era of restricted oil supply and the oil companies large and small must adapt to it.

i.e. —

Contd/2.

At the same time the Government has taken steps to achieve an overall cut in demand of 5%, in line with our EEC and international obligations. It is both in our interest and in the world's interest to ease oil pressures by working with our trading partners to prevent a panic ~~destructive~~ scramble for oil.

Strong enough to convince Govt supporters?

I have made it clear that in the public sector measures must be taken to cut down by the 5% overall, consistent with the maintenance of essential services. In industry, in the home and on the roads we are looking for a cutback of at least 5% by all, so that the limited allocations will be distributed ~~bite~~ more evenly than if some consumers simply carry on as normal and leave others seriously short.

?

In all this the oil companies - both major and independent - plainly bear a heavy ~~have a key~~ responsibility. ~~But~~ The Government is also working closely with organisations throughout the country and industry to achieve the 5% and help people cope with higher prices which are the inevitable result of scarcity. I believe that this approach through nation-wide and voluntary co-operation is a good deal more effective than attempting to organise everything in detail from Whitehall.

Looking immediately ahead I am not satisfied with the arrangments I have found for supplies of oil into the UK market, particularly when we are a major oil producer. We certainly have to trade North Sea oil internationally and with commercial skill to live and to invest. But we must get the balance right.

Are the refineries short?

I am also considering taking royalties in kind which may help UK refineries and suppliers meet their customers' needs.

How soon?

But even with these measures on the supply side, energy conservation must now be given a permanent and central place in our policy and I shall be proposing more measures on this front.

Contd/3.

As for rationing, or Government organised priorities for whole categories, with of course tighter cuts for those not in the preferred categories, I believe that at present levels of shortfall this would lead at once to far more rigidity and unfairness, quite apart from the cost to the taxpayer and the economy of the necessary paraphernalia. Nor would it produce a drop more oil.

If the world situation deteriorates sharply again we may be forced to pay that price, ~~and we would anyway be likely to move into emergency sharing arrangements with our trade partners to head off serious world trade disruption.~~

But in the present conditions the most sensible way forward is through steps to improve supplies in the UK market combined with ~~effective demand restraint~~ economical use by everyone, and – ~~(which will have to be practised by everyone as part of a permanent, long term adjustment to high cost energy from which the UK cannot be insulated.~~

I shall, of course, seek to keep the House fully informed of the situation in the coming weeks.

11th June 1979.

file

bc Mr. James

289

10 DOWNING STREET

From the Private Secretary

11 June 1979

I have shown the Prime Minister your letter of 8 June and the attached draft Press Statement advising motorists to conserve fuel.

The Prime Minister does not think it would be wise to put out such a Statement, which - in her view - would tend to irritate many motorists and would not save much fuel.

I am sending a copy of this letter to Bill Burroughs (Department of Energy).

T. P. LANKESTER

Mrs. E. C. Flanagan,
Department of Transport.

CONFIDENTIAL

VLB.

cc D/N D/Tpt
DOE FCO
D/M SO
D/I WO
D/T CO

10 DOWNING STREET

From the Private Secretary 11 June 1979

The Prime Minister has considered the Chancellor of the Exchequer's minute of 8 June in which he proposed that the previous Government's commitment to produce an annual report on the use of North Sea oil should be allowed to lapse. The Prime Minister has noted the points in the Chancellor's minute and agrees that it would be better not to produce an annual report.

I am sending copies of this minute to the Secretaries of State for Energy, the Environment, Employment, Industry, Trade and Transport, the Foreign Secretary, the Secretaries of State for Scotland and Wales, and to Sir John Hunt.

T. P. LANKESTER

A. M. W..Battishill, Esq.,
H.M. Treasury.

CONFIDENTIAL

VLB

CONFIDENTIAL

Prime Minister

Agree para 4 - i.e. drop the annual report?

(I always thought this was a phoney exercise - the important thing is to ~~use~~ properly use all our resources, not just N. Sea resources. They are [illegible]).

TL 6/6

Cc Mr Wolfson
Mr Hoskyns

Agreed on!

The set of Treasury figures just published are sufficient annual report for this year. The rest will come out in P.Q.'s and debates.

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

You will remember that last year our predecessors published a White Paper entitled "The Challenge of North Sea Oil" (Cmnd 7143) which described the benefits which North Sea oil and gas had already brought to the economy and discussed the way in which the additional revenue flowing from the North Sea would be used to further the Government's objectives.

2. In the White Paper the last Administration also undertook to present an annual progress report to Parliament, giving details of the Government take from the North Sea and indicating how the resources of the North Sea were being deployed to the nation's longer-term advantage. The first report in the series, covering the financial year 1978-79, was to have been published this summer and we now need to decide whether we want to produce a similar document ourselves.

3. My own view is that this would be a mistake. Unlike our predecessors, we do not accept that it is a proper function of Government to attempt to define a set of objectives towards which our North Sea resources should be directed. Our own progress report would therefore necessarily be confined to a general discussion of the economic benefits to be derived from North Sea oil. Moreover, I fear that we could find it embarrassing to produce an annual report in the period before our own economic policies bear fruit. In practice, I suspect

/that the

CONFIDENTIAL

that the publication of the report might simply serve to highlight a number of difficult policy issues which we should prefer not to expose publicly.

4. Subject to your own views and those of the colleagues to whom I am copying this minute, I would therefore propose that we regard the commitment to the production of an annual report on the use of North Sea oil as having lapsed with the change of Government. If this is agreed, there may be advantage in announcing this in low key in due course - perhaps in reply to an arranged Parliamentary question.

5. I am, however, well aware of the immense public interest in quantifying the economic benefits we derive from the North Sea and in the whole range of statistics associated with North Sea oil production. My officials are currently considering with others the form in which estimates of Government take from the North Sea should be presented publicly and we shall, as in the past, continue to publish detailed articles on the contribution which our North Sea resources are making to the overall development of the economy.

6. I am copying this minute to the Secretaries of State for Energy, the Environment, Employment, Industry, Trade, and Transport, the Foreign Secretary, the Secretaries of State for Scotland and Wales, and to Sir John Hunt.

G.H.

(G.H.)
8 June, 1979

RESTRICTED

1

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

cc Mr James

Prime Minister
It would be silly to put this out over the weekend. We can reconsider next week. Agree?
TL
8/6

Ken Stowe Esq CB
Principal Private Secretary to
the Prime Minister
10 Downing Street
LONDON
SW1

8 June 1979

It would really irritate me if that sort of advice were put out!
MT.

Dear Ken

I understand that your Press Office and the Department of Energy both take the view that it would be advisable if no further Government advice were issued to motorists this weekend about the need to save fuel.

However, circumstances could change, and a statement might be needed after all. My Minister thought it would be useful if he had a short statement ready if required. He had prepared the attached draft advice, which draws on and elaborates Mr Howell's statement earlier this week. He would be prepared to authorise its issue at any time if the Prime Minister thought that it would be helpful.

I am sending a copy of this letter to Bill Burroughs.

Yours
Genie

MRS E C FLANAGAN
Private Secretary

RESTRICTED

RESTRICTED

DRAFT PRESS STATEMENT:

MINISTER ADVISES MOTORISTS TO CONSERVE FUEL

In a message to motorists today Mr Fowler said:

"The Government has called for consumers to cut their consumption of oil by at least 5%. I appeal to all motorists to contribute their share to this target. Road transport accounts for nearly 30% of total energy consumption of oil products in the UK - well over half of which is used by private cars. The scope for saving is very substantial if all car users carried out some simple economies. For each motorist there would be only a tiny effect on his own mobility, but in total this could make a big contribution to out energy saving target."

Mr Fowler had the following advice for motorists:

"Think twice about getting your car out, especially when your journey is short or when you can take a bus or train instead. If you do need to travel by car and especially if you are a commuter, then whenever possible share it with others.

Drive more carefully and be more gentle with the brake and the accelerator. In particular drive more slowly. The average family car uses 36% more fuel at 70 mph than at 50 mph.

Make sure your car is properly maintained according to the manufacturer's instructions. It has been estimated that, if the engines of all cars were properly tuned, up to 5% of the fuel used could be saved.

Fill up with petrol only when you need to. Drivers who insist on a full tank at all times cause shortages and long delays and frustration at service stations. If all drivers applied these rules for themselves, there would be substantial savings in our consumption of oil, as well as enough fuel for everyone.

NOTE FOR EDITORS

The Minister in his statement encouraged people to make more use of public transport and car sharing. Both are good ways of making better use of fuel for transport. Since the 1978 Transport Act private motorists have been able to carry in their cars up to 7 passengers at separate fares.

Insurance arrangements are not a ban to giving lifts, or accepting a contribution to the cost. Vehicles must still be properly insured. The motor conference clarified the position last year in the following terms.

> "The receipt of contributions as part of a car-sharing arrangement for social or other similar purposes in respect of the carriage of passengers on a journey in a vehicle insured under a private car policy will not be regarded as constituting the carriage of passengers for hire or reward (or the use of the vehicle for hiring) provided that:

a. the vehicle is not constructed or adapted to carry more than seven passengers (excluding the Driver);

b. the passengers are not being carried in the course of a business of carrying passengers;

c. the total contributions received for the journey concerned do not involve an element of profit.

<u>Note</u>

If in any doubt whether a car-sharing arrangement is covered by the terms of a private car policy, the policy holders concerned should make an enquiry to their motor insurers.

The private motorist can advertise lifts in his church, work place and club (and their periodicals). But under the present law he cannot advertise to the general public unless the local authorities and traffic commissioners are satisfied that it is a "social car shceme" i.e. for welfare purposes.

1

Prime Minister

This is the study for which you asked after seeing Mr. Roy Jenkins. It is not very encouraging but I fear that it is realistic. Do you agree that it should form the basis of the relevant European Council brief? Bryan 12/6

Yes ....

Foreign and Commonwealth Office

London SW1A 2AH

8 June 1979

Dear Bryan,

The Bargaining Position of OPEC and the West in Future Negotiation on Production and Prices

In your letter of 21 May you asked for advice on how a study could be initiated on the bargaining position of the West, and the EEC in particular, vis-a-vis OPEC in any forthcoming negotiation on oil prices and supply. I sent you an interim reply on 4 June in which I said that officials were preparing a note on the subject.

I now attach a note which has been discussed and agreed with officials at the Department of Energy, Treasury, MAFF and the Departments of Trade and Industry.

I am sending copies of this letter and enclosure to the recipients of my letter of 4 June.

Yours ever

George

(G G H Walden)

Bryan Cartledge Esq
10 Downing Street

NOTE BY FCO, DEPARTMENT OF ENERGY AND TREASURY OFFICIALS

THE BARGAINING POSITIONS OF OPEC AND THE WEST IN ANY FUTURE NEGOTIATIONS ON OIL PRODUCTION AND PRICES

1. The paper in annex seeks to assess the respective bargaining positions of OPEC and the West in any future dialogue on oil production and prices. It concludes that the cards which the West hold are not strong enough to allow them to confront OPEC effectively with demands on price and production levels. In present tight market conditions such an approach would be particularly unrealistic. There is a real risk of OPEC reacting to any approach which they regard as hostile by cutting back production and further increasing prices. That is a risk we cannot afford to take.

2. The paper also concludes, however, that there is a basis and a need for a more constructive discussion with OPEC countries of issues of mutual interest. This would enable the consumers to put across the notion of the interdependence of OPEC and Western economies and to gain acceptance for the need to avoid sudden and sharp increases in the price of oil which are in the interest of neither the West nor OPEC nor other developing countries. We would however have to be careful to avoid such a discussion degenerating, as did the CIEC conference of 1976-7, into yet another North-South confrontation.

3. The paper has also considered the question of a possible trade-off between food and oil. It concludes that EEC food exports to OPEC countries (and western food exports in general) are not a strong bargaining counter. Although EEC food exports to OPEC countries and western food exports generally are substantial, OPEC countries are already getting the majority of their food imports from non-Western countries and could find andpay for supplies from elsewhere if Western supplies were withheld.

THE BARGAINING POSITIONS OF OPEC AND THE WEST IN ANY FUTURE NEGOTIATION ON PRODUCTION AND PRICES

OPEC BARGAINING POSITION

1. OPEC's strength depends largely (though not wholly) on the state of the oil market. From 1977 to the end of 1978 demand was less than OPEC countries were willing to produce. Saudi Arabia was producing well below her self-imposed production ceiling and had excess capacity of nearly 3 mbd. Stocks were high. The nonimal price of oil was steady throughout the period and the real price was falling. The producers' position was therefore relatively weak although the OPEC cartel held together thanks to Saudi willingness to throttle back production. Events in Iran have transformed the market. Last winter Iranian exports (which had been over 5 mbd) were stopped completely. This was only partly offset by increased production in other OPEC countries. As Iranian exports resumed (now 3 mbd) the other producers in several cases reduced production to earlier levels. Demand (including demand for re-building depleted stocks) now exceeds supply by about 1.5-2 mbd. There is no evidence that the OPEC producers with excess capacity (Saudi Arabia, Kuwait, and the Emirates) are willing, as they were last winter, to increase production sufficiently to ease the market. In the aftermath of the Iranian revolution and the Israel/Egypt peace treaty, the Saudis in particular are concerned to adopt a less exposed line in OPEC on production and prices.

2. The implication of this is that unless and until effective demand restraint measures are implemented by the consumers the market will remain tight; and OPEC countries will not find it difficult to increase prices more or less at will. Already OPEC government selling prices have risen by over 30% this year to an average price for Middle East oil of about 17 dollars a barrel, and further increases are likely to be decided at the OPEC

/Ministerial

Ministerial meeting on 26 June. Prices in the admittedly marginal (3-5% of the total) spot market have more than doubled to over 35 dollars a barrel over the same period. In present and prospective market conditions therefore, OPEC's bargaining position is strong: indeed, given market pressures, it is difficult for individual OPEC countries to exercise a moderating influence even if they wanted to.

[A] 3. The prospects up to 1985 were examined by an interdepartmental group of officials, whose report the Prime Minister has already seen. Briefly, the report suggests that, in the absence of any surprises between now and 1985, supply and demand might broadly be in balance by the latter date. The uncertainties are very great, however, and we could be in for a bumpy ride; it is more likely than not that political and domestic economic factors in OPEC countries, "accidents" on the supply side, and shortcomings in the industrialised world's plans to restrain demand for oil effectively and to increase the production of nuclear and other alternative forms of power, will all lead to a tighter market and to a further increase in the real price of oil. A good deal will depend on the rate of world economic growth. If this is very low the pressures on oil prices will be less but the implications for unemployment, investment and adjustment will be serious. In any event, the real oil price will increase substantially by the end of the century.

Bargaining strength of the West

4. The West's strongest bargaining card has been its strategic and military support for some of the producers especially in the Gulf. But following the Iranian revolution and the signature of the peace treaty between Egypt and Israel this card is no longer so strong. Other possible bargaining counters for the West are:

(a) The industrialised world supplies much of the technology, skilled labour, manufactured goods and services without which

/OPEC

OPEC countries could not develop their economies. This is an important factor which could be stressed in any negotiation. It underlines the theme of interdependence. But it is not a real bargaining counter. The consumers need to export to OPEC to offset their growing trade deficits; it would damage them to refuse to do so; and OPEC countries could always turn to the East for technical expertise and technology they could not supply themselves.

(b) The industrialised countries possess the technology needed to exploit producers' oil and gas reserves to the full. It would be self-defeating, however, not to assist in the development of the OPEC countries' energy resources when we clearly need them. Threatening to play this card could moreover merely accelerate the existing tendency among the producers to recruit and pay for the skills and technology they required on the open market. Some countries like Iraq, are already largely self-sufficient and able to reach their desired levels of production without substantial outside help. Other producers might turn to the Soviet Union, which could partially offset a withdrawal of Western technology. The West could, however, offer to work with OPEC to instal the technology they now need to exploit their gas reserves to the full and to reduce gas flaring.

(c) The industrialised countries could offer the improved access to their markets that OPEC seeks. In the short term this seems to be one of the consumers' strongest cards. But greater OPEC access to Western markets would have adverse implications for some sectors of our economies (in particular refining and petrochemicals) and will need to be traded for tangible concessions on oil production and prices. And any attempt to deny access could lead to the producers withholding supplies of crude oil.

/(d)

(d) The industrialised countries possess the financial markets through which the producers can invest their surplus oil revenues. But, while it is true that OPEC will want to protect their investments and therefore have a direct interest in the West's economic strength, the higher oil prices they are currently obtaining more than offset the losses on their dollar investments;

(e) The West is OPEC's main supplier of defence equipment and military training. To threaten to withhold defence sales would however be very confrontational and probably counter productive. In any case not all OPEC members depend on the West for arms (eg Libya, Algeria and Iraq). Such a threat would therefore only have limited application and could open some areas to the USSR.

(f) The EEC and the US are together considerable exporters of food stuffs. In 1976, the most recent year for which figures are readily available, OPEC countries imported food from:

$ million

EEC	USA	Eastern bloc	ldc's	Rest of World	Total
1611	1236	467	2072	934	6320

These figures show that OPEC countries have fairly diversified sources of food supply; and they have been diversifying further by channelling large sums in recent years into the development of food supplies in ldc's such as the Sudan. In 1976 the EEC and US together supplied some 45% of OPEC needsIf these exports were stopped, OPEC countries would undoubtedly experience reductions in local availability for some items. They would, however,be able to find and pay for alternative supplies from elsewhere. We conclude that any

/attempt

attempt to put pressure on OPEC by threatening to withhold food would fail, and would invite retaliation. Moreover, the EEC would be deprived of valuable outlets for some food stuffs which tend to be produced in surplus.

5. The consumers' bargaining position could improve if conditions in the oil market changed. The root of the present problem is the West's propensity to consume energy. Unless we can reduce consumption we are never going to be in a strong position vis-a-vis OPEC countries. The industrialised countries could and should cut their demand for OPEC oil (along the lines of recently agreed IEA and EEC demand restraint measures) and develop alternative energy sources. But these changes will not in the foreseeable future alter the fundamental balance between the two groups of countries. In present circumstances, the consumers are in a particularly weak position. If they wish to open discussions with OPEC, they will therefore need to adopt a cooperative rather than a confrontational approach. To confront OPEC with demands on oil prices and production levels would get nowhere. And the market is now such that the producers can and are quite likely to respond to any approach which they regarded as hostile by cutting back production. The consequent price increases would more than offset any loss of OPEC revenues from the reduction in the volume of sales.

6. But if the consumers are in no position to confront OPEC, their hand is not so weak as to rule out entering into a carefully managed discussion of issues of mutual interest in a cooperative spirit. The consumers will need to speak to all the major OPEC producers, not just to the Gulf producers and Saudi Arabia, whose ability to influence OPEC in moderate directions has been weakened by the events of the past six months. Whether or not more direct discussion of OPEC production levels, such as the French seem to be suggesting with their idea of a annual review of forecast production and consumption levels, will prove feasible will need

/further

further study. The themes which could be developed are:

(i) the economies of OPEC and the West are increasingly interdependent. There is a close interrelationship between crude oil prices, production and demand levels on the one hand and economic growth, inflation and the export price of manufactured goods on the other;

(ii) sudden and excessive oil price increases damage Western economies, and both OPEC and the West would suffer from any resulting recession. Inflation does not just damage the West but OPEC as well, by increasing export prices for manufactured goods and by eroding real oil prices and the value of OPEC financial assets;

(iii) large and sharp rises in the real oil price are likely to be followed by a fall in demand and a slack market. This sort of see-saw and the corresponding fluctuations in oil revenues are likely to be against OPEC's economic interests as well as those of the West. It is in the interest of both sides to avoid violent and unpredictable fluctuations in the oil price, though not all OPEC producers (or all Western consumers) yet accept this argument or its implications;

(iv) if the West is damaged economically, it will also be weakened strategically leaving us less able to protect the Saudi and Gulf regimes (para 4(e) above);

(v) if OPEC were seen to be deliberately raising oil prices and as a result causing world depression, OPEC countries could well find themselves politically isolated not only from the West but from the rest of the developing world.

7. The influence of the oil importing developing countries could be an important factor in any negotiation; and it could work either for us or against us. The producers have shown

/themselves

themselves to be very sensitive to criticism from the developing world of their price policies, and their failure to take account of other developing countries' interest. The recent UNCTAD conference at Manila has shown this clearly. So far the poorer LDC's have shown little inclination to break with their OPEC allies. It would suit us in some ways if the LDC's were to open their own dialogue with OPEC, but we have to accept that for different reasons neither the LDC's nor the producers will agree to the industrialised consumers extricating themselves from such a dialogue. There are signs that OPEC are trying to consolidate their position with the LDC's by resuscitating the link between oil prices and the range of North/South issues of concern to the LDC's which some OPEC countries tried to establish at the time of the CIEC (1976-7). If we ever got to a position where OPEC collectively linked North/South concessions with the supply of oil this would be very damaging. The West needs to do all it can to avoid this outcome, which could lead both to unacceptable demands for concessions on trade, aid and technology transfer and to a sterile discussion on the subjects of importance to us, by showing practical sympathy for the plight of the oil importing developing countries by helping their own development of their energy resources and by convincing them that they stand to gain as much as the industrialised world from increased international cooperation on energy issues.

8. The question of possible contacts with OPEC is likely to feature prominently both at the European Council in Strasbourg and at the Tokyo Summit. If the Prime Minister broadly agrees with the line set out in this paper, it could form the basis for briefing on the subject for both these meetings. The West needs to research and coordinate its approach. Some work has been done on defining the West's objectives in any contacts, but no conclusions have yet been drawn. The European Council should

/perhaps

perhaps give impetus to work within the EEC, already under way in preparation for the proposed meeting on 28 June between Yamani and M. Giraud (for the French Presidency). The Summit could give an impetus to work within the IEA (of which France is not, however, a member).

11 JUN 1979

PRIME MINISTER

Oil Supplies: Possible Statement

I passed on to Mr. Callaghan's office your decision about his request for a statement on oil supplies.

Subsequently his office have come back to say that, despite the fact that Mr. Howell will be answering Questions on Monday, he still thinks that there ought to be a comprehensive statement on the same day. I have consulted the Chancellor of the Duchy, who is very strongly of the view that backbench concern is sufficient to justify a statement. Ian Gow agrees. The Chief Whip is also worried about backbenchers' feelings on the matter.

Yes mt.

In the light of this, are you prepared to agree that Mr. Howell should make a statement? If he does, then Monday is a much better day than Tuesday (Budget Day) or Wednesday (when there will be a social security statement). Although Mr. Callaghan is not pressing very hard on the matter, there would be every likelihood of an early PNQ if no statement was forthcoming.

Given all of this, shall we have a statement by Mr. Howell on Monday after all?

Yes mt.

MJS

7 JUNE 1979.

PA

PRIME MINISTER

Oil Supplies: Possible Statement

I passed on to Mr. Callaghan's office your decision about his request for a statement on oil supplies.

Subsequently his office have come back to say that, despite the fact that Mr. Howell will be answering Questions on Monday, he still thinks that there ought to be a comprehensive statement on the same day. I have consulted the Chancellor of the Duchy, who is very strongly of the view that backbench concern is sufficient to justify a statement. Ian Gow agrees. The Chief Whip is also worried about backbenchers' feelings on the matter.

In the light of this, are you prepared to agree that Mr. Howell should make a statement? If he does, then Monday is a much better day than Tuesday (Budget Day) or Wednesday (when there will be a social security statement). Although Mr. Callaghan is not pressing very hard on the matter, there would be every likelihood of an early PNQ if no statement was forthcoming.

Given all of this, shall we have a statement by Mr. Howell on Monday after all?

MS

7 June 1979

DSG.

10 DOWNING STREET

From the Private Secretary

7 June 1979

Dear Bill,

This is to confirm that the Prime Minister is content with the draft statement which your Secretary of State intends to make to the Press today on the current energy situation. (This was sent over under cover of his minute of 6 June).

I am sending copies of this letter to the Private Secretaries to the Lord President, the Chancellor of the Exchequer, the Home Secretary, the Foreign and Commonwealth Secretary, the Secretaries of State for Education and Science, Industry, the Environment, Northern Ireland Office, Scottish Office, Welsh Office, to the Paymaster General, the Secretaries of State for Defence, Employment, Health and Social Services, Agriculture, Fisheries and Food, the Minister of Transport, and also to Martin Vile (Cabinet Office).

Yours ever,

Tim L.

Bill Burroughs, Esq.,
Department of Energy.

JS

1

PRIME MINISTER

THE WEST'S BARGAINING POSITION VIS-A-VIS OPEC

You will see from the attached FCO letter 4.6.79, and its enclosure, that a good deal of work is already in hand on the study which you asked to be made of the bargaining position of the main oil-consuming countries vis-a-vis the oil producers. You may like to glance at the paper on the medium-term prospect for the world energy market over the weekend.

I have the impression from the FCO letter, however, that the work is going ahead at a fairly leisurely pace. Would you like me to make it clear to all concerned that you will wish to be in a position to put forward specific proposals on the substance of a Western bargaining position at the Economic Summit in Tokyo?

[illegible]

7 June 1979

This just isn't what we are wanting. There is virtually no assessment of other bargaining counters available to us. This is just a leisurely dissertation on the demand/supply position on oil assuming nothing unusual happens.

MT

cc Press Office

PRIME MINISTER

I am intending to make a statement to the press tomorrow on the current energy situation, the need for a national effort to cut oil consumption by at least 5% and also on my approach to energy conservation longer term. A copy is attached and is also being sent to Christopher Soames, Geoffrey Howe, William Whitelaw, Peter Carrington, Mark Carlisle, Keith Joseph, Michael Heseltine, Humphrey Atkins, George Younger, Nicholas Edwards, Angus Maude, Francis Pym, Jim Prior, Patrick Jenkin, Peter Walker and Norman Fowler, and also to Sir John Hunt.

DH.

Secretary of State for Energy,

6 June 1979.

ENERGY SAVING IS A "MUST"

EVERYONE SHOULD CUT OIL CONSUMPTION BY AT LEAST 5%

ENERGY SECRETARY

Britain's consumers were today asked to cut their oil consumption immediately by at least 5%. Mr David Howell, Secretary of State for Energy, said that substantial energy and particularly oil savings were needed now and in the longer term.

"This is an area where we can no longer afford to soft pedal" he added.

In his statement Mr Howell said:

"The shortage of oil which besets the world is serious, certainly uncomfortable and very worrying. Unless consumers world-wide reduce their demand the shortfall in world oil supplies this year is expected to be 1.5 million barrels per day (mbd) - roughly 3% of total supplies.

Our own position in Britain is this:

1) In the UK the oil companies estimate that over the first half of this year we are likely to have nearly the same volume of oil supplies as last year. But this has to be set against increased demand of nearly 7% during the first quarter, largely because of the cold weather last winter. All in all demand for 1979 may now be 2 - 3% up on last year, and with our stocks in a heavily depleted state.

2) In these circumstances of scarcity prices inevitably are rising rapidly, creating problems for all of us.

3) It follows from this that:

(a) all of us must use less oil; and

(b) the Government's task must be to help consumers to adapt to a new and continuing era of expensive energy from which none of us can escape.

4) To cut oil demand we must economise and conserve. This is perfectly possible for us to do. And the oil problem is manageable if we do, provided everyone of us, averaged out over the country as a whole, cuts our use of oil and its products by at least 5%.

I recognise that some consumers and some suppliers face more serious constraints. But the oil companies would find it easier to help them if every other consumer reduced his demand by the required 5%.

5) The problem will not go away. It is not a passing phase but a permanent challenge. Nor does North Sea oil offer an escape route for Britain. Production is, of course, building up in the North Sea. That build up represents increased resources for Britain which to some extent cushion us from the worst effects of the world shortfall. But it does not mean that we can isolate ourselves from the world.

Why? Because we have to trade in different qualities of oil to meet our needs: we have international obligations. And along with our industrial partners we have undertaken to use less oil so that the supply problem is solved in an orderly way without a self-defeating scramble.

We are also an integral part of the world trading community and rely, perhaps to a greater extent than anyone else, on trade for our standard of living. If we are to thrive others must thrive, too.

Against this background I set to work immediately on my appointment as Secretary of State for Energy to examine the adequacy of our national energy conservation policies.

I am concerned with two aspects:

- the short term, to meet the needs of the immediate situation; and

- the longer term, because oil saving is not just a temporary imperative.

As Secretary of State I shall be taking a direct and continuing interest in issues of energy conservation and the more economical use of energy. Mr Moore, the Parliamentary Under Secretary will of course continue in charge of day to day departmental work on energy conservation questions.

This is an area of energy policy which we can no longer afford to soft pedal. Unless we and our trading partners can handle the tight situation in an orderly way, there will be unnecessary hardship for those in this country and throughout the world who can least afford to bear it.

It is also clear that the Government and public sector must give a sensible and firm lead on conservation. To ensure that such a lead is forthcoming I have secured Ministerial backing in every major Department for oil and energy saving. Each Minister concerned is reviewing the progress made so far in Government Departments and agencies, local authorities and nationalised industries. They will monitor progress and I will report regularly on what is being achieved and what more needs to be done to improve the efficient use of energy in the public sector.

However, if significant savings are to be achieved industry and commerce must also make further economies - not at the expense of production but by using energy much more efficiently. This will help firms to offset the impact of ever higher energy costs.

At the present levels of shortfall I believe it would be wrong to saddle our country with an elaborate official system of government allocation of supplies. By close collaboration between the Department of Energy and the oil suppliers we should be able to adapt to the tight new situation. The Department will continue to be ready to intervene with suppliers on specific problems of short supply and difficulty.

Meanwhile I have been in touch with the CBI and the Association of British Chambers of Commerce. They have agreed to ask every chairman or managing director to institute new oil and energy economy measures in their own organisation. I am also briefing the TUC's Fuel and Power Committee on the position to enlist the help of employees in securing economies.

At the same time I am arranging to publicise more intensively the availability of advice, especially to the small to medium sized firm, through my Department's Energy Quick Advice Service and the Energy Survey Scheme. These services provide consultant's advice to help firms introduce measures which can have an immediate impact on energy consumption and also build up continuing and cumulative energy - and cost-saving.

Many opportunities remain for short-term cost effective investment in oil and general energy conservation. This is invariably low risk investment with a quick pay back and investment which, carried out now, could materially help firms this coming winter.

I am in continuous touch with the fuel industries, including the oil companies. I am asking them to intensify their efforts to inform their customers on how to get the most out of the energy they use.

I am also examining how we might extend and speed up the flow of information on good oil and energy saving practice to firms and organisations through, for example, my Department's newspaper "Energy Management". We must bring into play every means of disseminating good energy practice.

To reinforce energy managers - the real experts on energy saving on the shop and office floor - I am calling together the chairmen of their 62 groups up and down the country to give them a personal briefing on the current position and take their advice on what more can be done.

On transport side I am having discussions with the Road Haulage Association, the Motor Agents Association and the AA/RAC. Here I want to ensure that their expert practical advice is made readily available to their members and the motorist generally.

For the domestic consumer my Department and the Department of the Environment make available a number of advisory leaflets. I would however particularly draw attention to the Homes Insulation Scheme which offers grants to those whose houses are uninsulated. With my colleagues, I also intend to examine progress on the insulation of public sector dwellings.

Action by everyone at home, at work and behind the wheel is essential. So too is action by those organisations best placed to advise their own particular sectors of the economy.

I am now also examining how our longer term energy conservation policies might be reinforced and whether the current balance between pricing, information, advice, research and demonstration, incentives and legal compulsion is right. In the light of our national progress I shall take further steps as, and if, required.

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
211 6402

Prime Minister
For information. Mr Howell touched on this this afternoon.
TL 6/6

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries
and Food
Whitehall Place
London SW1A 2HH

6 June 1979

Dear Peter

Flag A

Thank you for your letter of 31 May about the supply of fuel to farmers, fishermen, food processors and distributors during the current oil shortage. I agree that during the last few days of May supply arrangements were under great strain. On the other hand, while many of your clients suffered real anxiety, none to our knowledge actually closed down an essential service for lack of oil - even where the supplier was Esso, who had to deal with the additional problem of a strike by their tanker drivers at the Avonmouth terminal. My basic approach is that at the current level of national supply, which is not drastically below demand, responsibility can and should rest on the oil companies to cater equitably for consumers' needs to the extent possible yet on a basis which is sensitive to clear priority needs. It is true that there are legal difficulties about companies openly giving preference to one class of consumer as against another, but recent events have shown that they will go quite a long way to seek to avert serious waste (such as farmers pouring milk away), or failure of essential services. The companies have every motivation to avoid the Government intervention which they know must threaten if they leave vital producers without adequate supplies.

The point you raise about price involves very difficult issues of international control of the excessive demand on oil markets which has driven prices up so much this year. Consumers in the UK cannot be shielded from the consequent increase in product prices; and in cases where there is a heavy (direct or indirect) dependence on the spot market, these increases may be severe. I shall be alert to any evidence of the sort of profiteering which can characterise a situation of short supply; but price controls which fail to reflect the actual movement in international markets will simply result in worsening problems of supply. Ireland is a recent case in point.

I am sending copies of this letter to the recipients of yours.

Yours ever

David

D A R Howell

Energy

PRIME MINISTER

Energy: Your Meeting with Mr. Howell

You may wish to refresh your memory of your discussions with President Giscard about energy and I attach the relevant part of my record (which the Secretary of State of Energy will already have seen).

The main point is to decide how to take up President Giscard's suggestion of urgent bilateral consultations on energy matters in advance of the Strasbourg European Council. Lord Carrington recommends that we should react postively and quickly to this suggestion, either by Mr. Howell getting in touch direct with the French Minister of Industry (who is responsible for Energy), M. Giraud: or by senior officials having an urgent preliminary meeting to prepare the ground for a more substantial meeting between Ministers. You may wish to ask Mr. Howell for his own views on handling this.

You should also know that the Germans, when Lord Carrington mentioned to them M. Barre's separate suggestion for trilateral (UK/France/FRG) energy consultations, expressed the view that they did not favour this since it would create the impression of a European "directory" on energy but preferred to deal with the subject through normal Community channels.

This certainly should not, however, hold up our bilateral consultations with the French.

Bryan

(1) [illegible] at official level

6 June 1979

At 1215 the Prime Minister and President Giscard were joined by:

M. Raymond Barre

The Foreign and Commonwealth Secretary

Mr. G. G. Walden

M. Robin

* * * * * *

Energy and the Tokyo Summit

President Giscard summarised the subjects which he and the Prime Minister had already covered during their tete-a-tete discussion and said that the Prime Minister had suggested that, with Lord Carrington and M. Barre, they should discuss the forthcoming Economic Summit in Tokyo and the problem of energy, before moving on to wider international issues.

The Prime Minister said that energy was expected to be the main item on the agenda of the Tokyo Summit. The problem was how the leading energy users could persuade the leading energy producers not to raise their prices still further and thereby cause a world recession. Western objectives were thus quite clear but the methods by which they might be achieved were very unclear. Specific ideas were needed. The problem was common to many Western countries, although France had moved further along the road to a solution than any other country in Europe, through her nuclear programme. The UK, for her part, had found only a temporary solution in her North Sea oil. President Giscard asked how temporary a solution this was. The Prime Minister said that it would last for 15 to 20 years. President Giscard commented that this was a help. The Prime Minister went on to say that the alternatives facing some countries were either to go all out for nuclear power, or, if they were unwilling to do this, to accept a significant reduction in their standard of living.

The Prime Minister said that she had never attended an Economic Summit but she had studied their communiques closely: they were always the same. Meanwhile, the world's economic problems continued;

/ and so

and so did the communiques. President Giscard agreed and said that, although discussions at Economic Summits had become academic, the first such meeting, at Rambouillet, had produced useful results in the form of a stabilisation of exchange rates. Unfortunately, however, participation in the Summits had then been enlarged: their communiques were now just words. President Giscard agreed with the Prime Minister that the next Economic Summit should concentrate on energy. He thought that it should, despite everything, be possible to achieve some useful results. He would like to suggest what these might be.

Firstly, President Giscard said, the Summit could demonstrate a real determination on the part of the major energy users to reduce their consumption. France, for her part, would lower temperatures in public buildings and impose a ceiling on the amount of oil consumed by power stations. These measures could be discussed at the European Council meeting in Strasbourg.

Secondly, it was a fact that the operation of the spot market in oil produced unacceptable results. The international oil companies should be asked to keep out of the spot market during, in the first instance, the month of June. Chancellor Schmidt, in a recent discussion with M. Barre, had agreed that this measure should be taken in order to produce a moderating effect on prices. It was a fact that every Gulf ruler had the latest spot market price on his desk first thing every morning.

Thirdly, agreement should be reached on an annual approach by the major users to the major producers in order to assess whether the savings planned by the users during the coming year, as well as the production levels planned by the producers, would be sufficient and in phase with each other.

Fourthly, the Summit participants should discuss a programme for exploiting alternative sources of energy. This was mainly a problem for the Europeans, since the Americans and Canadians were already making progress in this field. President Giscard added,

/ in

in parentheses, that he had just received a report from M. Francois-Poncet, who was in Washington, to the effect that press reports about the U.S. Administration's decision to subsidise oil imports were too pessimistic: President Carter was in fact working on the introduction of quite drastic conservation measures, on a possible approach to the oil producers and on steps to stabilise the spot market in oil - precisely those measures which he was himself advocating. President Giscard said that he thought that the American approach seemed quite constructive.

Lord Carrington commented that it was essential to formulate, during the European Council meeting in Strasbourg, a European approach to the Tokyo Summit. The Prime Minister said that, ever since the Yom Kippur war, the West had managed to absorb substantial increases in the price of oil, to the extent that it would soon be economic to extract oil from the tar sands and shale - this would require a price of $40 per barrel. A situation had been created a year ago in which the West had once again found itself with a surplus of oil but this situation would not be repeated because of events in Iran.

Describing the French nuclear power programme, President Giscard commented that an anti-nuclear demonstration in Loraine on the previous day had attracted only 500 participants. France was currently building ten new nuclear plants: he thought that if the Government continued to give a strong, clear line, there would not be a great deal of public opposition. It would be helpful if both France and the UK were to take a strong and positive line on nuclear power in Strasbourg. The Federal German Government found itself in difficulties on nuclear power, largely because of the constitutional powers of the länder. Germany still had no reprocessing plant.

President Giscard went on to say that he fully shared the Prime Minister's view that the objective should be to arrive at practical conclusions, first in Strasbourg and subsequently in Tokyo. The Prime Minister said that the British Government was at present pursuing a policy of requiring power stations in the UK to substitute coal for oil: if continued, however, this policy could affect the UK's capacity to build up coal stocks, which

/ would

would be needed against the possibility of further trouble from the miners during the coming winter. The Government might, therefore, have to reconsider.

President Giscard asked who in the British Government would be responsible for preparing the UK position on energy at the European Council in Strasbourg. The Prime Minister said that she thought she would. Lord Carrington asked whether President Giscard was suggesting that it would be useful to have bilateral consultations on energy in advance of the European Council and President Giscard confirmed that he was. It was agreed that bilateral consultations would be arranged, at the highest practicable level, as a matter of urgency.

SUBJECT

cc: Master Set of Records

NOTE FOR THE RECORD

The Prime Minister held a meeting with the Secretary of State for Energy at 1400 hours on Wednesday 6 June 1979. The following are the main points which were discussed.

This item copied to Appts.

Chairmanship of BNOC

Mr. Howell said that Lord Kearton intended to resign as from 30 June, though he had asked him to stand ready to stay on for a few weeks after that until the Government's ideas on the future of BNOC were a little clearer. The Prime Minister said that, in her view, Sir Frank MacFadzean would be an ideal successor. He had resigned from British Airways for personal reasons, not because of ill health; and he was very keen to take on a new executive responsibility. Irrespective of the future structure and activities of BNOC, he would be an excellent choice. If necessary, he would have no objection to presiding over the running down of BNOC. If Mr. Howell regarded him as an acceptable choice, she thought the sooner he took over the better.

Mr. Howell replied that he would be extremely happy for Sir Frank to be appointed. The Prime Minister said that she would accordingly sound him out on the possibility.

Oil Situation

Mr. Howell said that the current oil shortage was certainly serious. On current price levels, demand exceeded supply by about 7 per cent. On the other hand, supply in the current quarter was about the same as it had been in the same quarter last year. The shortages were so far manifesting themselves mainly at the petrol pump, though lower fuel deliveries were likely to reduce British Rail's services next week, and the farming community were complaining about shortages of diesel fuel. The Department of Energy were coming under great pressure, as were energy departments in all other Western countries, to intervene in the market and allocate supplies. But he was very much against giving in to such pressure unless the shortages got significantly worse. There was some scope for leaning on the oil companies to allocate their supplies as between different types of customer. However, they had their own legal obligations not to discriminate; and in any case, it would be counter-productive to try to take over the allocation of supplies from the companies.

/This would

This would mean more bureaucracy, it would make the Government subject to all kinds of competing pressures, and there was no evidence - at present shortages levels - that allocations would be any more equitable than they were at present. In addition, once the Government started to intervene, full scale rationing would probably follow very quickly. The oil companies would be quite relieved to have their responsibilities for allocating existing supplies taken away from them; but this must be resisted if at all possible.

On the other hand, the problems faced in some areas could not be denied. In particular Texaco were very short. They had taken risks by concentrating on the spot market last year and the other oil companies were not disposed to help them out. They were quite dominant in the west country, Norfolk and the border country; and it was in these areas that the worst petrol shortages were being experienced.

Amongst the other companies, BP, Shell and Esso were fairly well placed for supplies; and this explained why the petrol situation was not as bad as in some other Western countries. BNOC had blundered badly last year by committing themselves to long term contracts with foreign customers - more so than had the private oil companies. But they were now doing all they could to get themselves out of these contracts.

The Prime Minister said that she generally agreed with Mr. Howell in his reluctance to move to allocation by Government as long as the situation does not get significantly worse. It was better to rely on the market mechanism together with Government measures to conserve energy. The Prime Minister then reported that President Giscard had said to her yesterday that it was important for the oil companies to keep clear of the spot market; otherwise they would be playing into the hands of OPEC.
Mr. Howell pointed out that his predecessor had written to the oil companies advising them not to operate in the spot market; and he believed they were going along with this.

/Mr. Howell

Mr. Howell went on to say that he intended to put out a statement the following day explaining the realities of the current situation, including the Government's general position on allocation, etc. The Prime Minister said that he should try to get over the following points:

i. UK supply is no lower than this time last year.

ii. In view of the world situation, and the higher UK demand, prices are bound to be higher.

iii. Consequently, it is essential that everyone should economise.

iv. The private sector should, and would, economise in response to market signals.

v. The public sector was taking the necessary measures on oil demand restraint.

vi. Government allocation and rationing would be pointless at the present juncture, and would only involve a massive bureaucracy.

(After the meeting Mr. Howell agreed to send over a draft of a statement this evening.)

In addition to his statement, the Prime Minister said that Mr. Howell should let all Ministers have speaking notes - and these should be sent through the Paymaster General.

The Future of BNOC

Mr. Howell said that it would have been better if BNOC had never been set up. But it was now a reality and it could not be dismantled overnight. There were certain parts of it whichshould definitely be dismantled - for example it was too big in its upstream operations: but it was necessary to be cautious in going about the dismantlement process. There were two reasons for this:

/ first,

first, BNOC was so large that to move too quickly might be upsetting to the UK oil market; secondly, BNOC appeared to offer the UK some security of supply, and this factor could not be lightly dismissed at the present time. The Chancellor had asked him to find £300 million or so from the sale of BNOC assets this year; he would try to find this, but he could not absolutely guarantee it.

The Prime Minister said that she agreed that we could not move too precipitately. However, she did not see how BNOC could possibly remain in its present form; it must certainly be slimmed down at the very least. As for the method of disposal of BNOC's assets, Lord Carrington was keen that there should be sales to the French and the Germans. However, she was very opposed to any such move.

Energy and the European Council

The Prime Minister said that President Giscard had said that it would be useful to have bilateral consultations on energy in advance of the European Council. She thought such consultations should be arranged as a matter of urgency. Mr. Howell said that he would be very happy for consultations to take place; but there was a problem as to which officials in his department could be spared for this. They were very heavily pressed at the moment on account of the BNOC review and the oil supply situation. The Prime Minister then asked who in other departments could help. I suggested that Mr. le Cheminant (Cabinet Office) could play a useful role and the Prime Minister and Mr. Howell agreed. It was left that this possibility should be pursued at official level.

TL

6 June 1979

Copy: Mr. Cartledge

CONFIDENTIAL

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Original filed France (Visit) May '79

10 DOWNING STREET

From the Private Secretary 6 June 1979

Dear Bill,

<u>The Prime Minister's visit to Paris on 5 June : Energy</u>

As you know, your Secretary of State is calling on the Prime Minister this afternoon and I think it would be helpful to him to have an account of the Prime Minister's discussion with President Giscard in Paris yesterday on energy matters. I therefore enclose, for his personal information, a copy of the relevant extract from my note of the Prime Minister's talks. I should be grateful if you would ensure that any subsequent distribution of this record is strictly limited and confined to those senior officials directly concerned with the topics discussed.

For enclosure see BGC to PM of 6/6/79

Following her talks with President Giscard in Paris, the Prime Minister visited the Eurodif uranium enrichment plant which is nearing completion at Tricastin, near Pierrelatte in southern France. The Prime Minister was given a thorough and effective briefing on the plant by M. Pecqueur, the Administrator-General of the Commissariat à l'Energie Atomique, during her flight down to Tricastin and she was, I think, very impressed by everything which she saw there. It might be helpful to Mr. Howell to glance at the enclosed hand-out on Eurodif which we were given, in case the Prime Minister mentions her visit to the plant.

I am sending copies of this letter, without enclosures, to George Walden (Foreign and Commonwealth Office) and Martin Vile (Cabinet Office).

Yours sincerely,

Bryan Cartledge.

Bill Burroughs, Esq.,
Department of Energy.

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10 DOWNING STREET

cc FCO PGO
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SO

From the Private Secretary

6 June 1979

Dear Bill,

Your Secretary of State called on the Prime Minister at 1400 hours today to discuss various energy matters. The following is a summary of the main points which they discussed. I am writing to you separately about the chairmanship of BNOC.

Oil Situation

Mr. Howell said that the current oil shortage was certainly serious. On current price levels, demand exceeded supply by about 7 per cent. On the other hand, supply in the current quarter was about the same as it had been in the same quarter last year. The shortages were so far manifesting themselves mainly at the petrol pump, though lower fuel deliveries were likely to reduce British Rail's services next week, and the farming community were complaining about shortages of diesel fuel. The Department of Energy were coming under great pressure, as were energy departments in all other Western countries, to intervene in the market and allocate supplies. But he was very much against giving in to such pressure unless the shortages got significantly worse. There was some scope for leaning on the oil companies to allocate their supplies as between different types of customer, but they were under a legal obligation not to discriminate, so that there was a limit to how much pressure could be brought to bear.

Mr. Howell went on to say that it would be counter-productive to try to take over the allocation of supplies from the companies. This would mean more bureaucracy, it would make the Government subject to all kinds of competing pressures, and there was no evidence - at present shortages levels - that allocations would be any more equitable than they were at present. In addition, once the Government started to intervene, full-scale rationing would probably follow very quickly. The oil companies would be quite relieved to have their responsibilities for allocating existing supplies taken away from them; but this must be resisted if at all possible.

/On the other hand,

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On the other hand, the problems faced in some areas could not be denied. In particular Texaco were very short. They had taken risks by concentrating on the spot market last year and the other oil companies were not disposed to help them out. They were quite dominant in the West Country, Norfolk and the border country; and it was in these areas that the worst petrol shortages were being experienced.

Amongst the other companies, BP, Shell and Esso were fairly well-placed for supplies; and this explained why the petrol situation was not as bad as in some other Western countries. BNOC had blundered badly last year by committing themselves to long-term contracts with foreign customers - more so than had the private oil companies. But they were now doing all they could to get themselves out of these contracts.

The Prime Minister said that she generally agreed with Mr. Howell in his reluctance to move to allocation by Government as long as the situation did not get significantly worse. It was better to rely on the market mechanism together with Government measures to conserve energy. The Prime Minister then reported that President Giscard had said to her at their talks the previous day that it was important for the oil companies to keep clear of the spot market; otherwise they would be playing into the hands of OPEC. Mr. Howell pointed out that his predecessor had written to the oil companies advising them not to operate in the spot market; and he believed they were going along with this.

Mr. Howell went on to say that he intended to put out a statement the following day explaining the realities of the current situation and the Government's position on allocation, etc. The Prime Minister said that he should try to get over the following points:

(i) UK supply is no lower than this time last year;

(ii) in view of the world situation, and the higher UK demand, prices are bound to be higher: consequently, it is essential that everyone should economise;

(iii) the private sector should, and would, economise in response to market signals;

(iv) the public sector was taking the necessary measures on oil demand restraint;

(v) Government allocation and rationing would be pointless at the present juncture, and would only involve a massive bureaucracy.

In addition to his statement, the Prime Minister said that Mr. Howell should let all Ministers have speaking notes - and these should be transmitted through the Paymaster General.

/ The Future of BNOC

The Future of BNOC

Mr. Howell said that it might perhaps have been better if BNOC had never been set up. But it was now a reality and it could not be dismantled overnight. There were certain parts of it which should definitely be dismantled - for example, it was too big in its upstream operations: but it was necessary to be cautious in going about the dismantlement process. There were two reasons for this: first, BNOC was so large that to move too quickly might be upsetting to the UK oil market when the situation was currently so fragile; secondly, BNOC offered some security of supply, and this factor could not be lightly dismissed at the present time. The Chancellor had asked him to find £300 million or so from the sale of BNOC assets this year; he would try to find this, but he could not absolutely guarantee it.

The Prime Minister agreed that it would be wrong to move too precipitately. However, she was opposed to BNOC remaining in its present form; and it must certainly be slimmed down at the very least.

European Council

The Prime Minister said that President Giscard had said that it would be useful to have bilateral consultations on energy in advance of the European Council. She thought such consultations should be arranged as a matter of urgency. Mr. Howell said that he would be very happy for consultations to take place.

We were subsequently informed that Mr. Howell would like Sir Jack Rampton to take the lead at official level for the UK side and I understand that arrangements are being made for him to have talks with his French opposite number early next week. I have mentioned this to the Prime Minister, and she is content.

I am sending copies of this letter to Paul Lever (Foreign and Commonwealth Office), Tony Battishill (HM Treasury), Kenneth MacKenzie (Scottish Office) and Martin Vile (Cabinet Office), and also to Richard Prescott (Paymaster General's Office).

Yours ever,

Tim Lankester.

W. Burroughs, Esq.,
Department of Energy.

re HS. Energy

c Cabinet + others.

10 DOWNING STREET

From the Private Secretary

6/F15-6-79

6 June 1979

Dear Bill.

Energy

The Prime Minister was grateful for your Secretary of State's minute of 25 May about oil supplies and his minute of 31 May about fuel stocks at power stations. She has also seen a copy of his letter of 31 May to the Lord President about oil demand restraint, and also the Minister of Agriculture's letter of 31 May about oil supplies for food production and distribution. In addition, she is aware of the reductions in British Rail services which will be starting from next Monday on account of the cut in fuel deliveries,,and she understands that the Ministers most closely concerned are considering the question of coking coal imports for BSC.

Having considered these papers, and having noted that the current position is in several respects far from satisfactory, the Prime Minister believes that there is an urgent need for an agreed factual appraisal of the energy supply prospect for the UK over the next 12 months focussing particularly on oil and coal; the scope for action; and a realistic display of the options. Since a number of Departments have an interest in this, the Prime Minister has asked that such an appraisal should be prepared by an inter-departmental working group under Cabinet Office chairmanship. The following Departments,should be represented on this group: Energy, Trade, Industry, Scotland, Transport, the FCO and the Treasury. The CPRS will also be represented. The Prime Minister would like the Group's report to be completed by Friday 15 June.

I am sending copies of this letter to the Private Secretaries to the members of Cabinet including the Minister of Transport, Gerry Spence (Central Policy Review Staff) and Martin Vile (Cabinet Office).

Yours ever.

Tim Lankester.

W.J. Burroughs, Esq
Department of Energy

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10 DOWNING STREET

From the Private Secretary

SIR KENNETH BERRILL
CENTRAL POLICY REVIEW STAFF

The Prime Minister was grateful for your minute of 1 June, and for your further minute of 5 June, on oil supplies. In the event, as you will see, the Prime Minister has decided to set up a Cabinet Office chaired Group to look at the energy supply prospect over the next twelve months, and no doubt most of the points which you raised in these minutes and in the draft letter which you provided will be taken up by the Group.

I am sending a copy of this minute to Martin Vile (Cabinet Office).

T P LANKESTER

6 June 1979

PRIME MINISTER

MEETING WITH THE SECRETARY OF STATE FOR ENERGY

I understand you wish to discuss with Mr. Howell the possible role which Sir Frank McFadzean might play in reorganising BNOC. No doubt you will want to ask Mr. Howell what are his own ideas for BNOC's future development.

I understand that Department of Energy officials have now produced a draft paper which considers a number of options for BNOC ranging from abolition through to maintaining the status quo. Mr. Howell will be discussing this with his junior Ministers tomorrow morning before seeing you. I understand they are very divided on what should be done: Mr. Lamont favours something close to abolition, whereas Mr. Gray is for maintaining the status quo.

BNOC's activities fall under three main heads:

(i) Its share in the existing North Sea fields which is valued at between £600m and £900 m. These shares are all, with the exception of the Viking field, well under 50 per cent. They were taken over from NCB and from Burmah.

(ii) Its 51 per cent share of the Fifth and Sixth round licences.

(iii) Its trading in "participation" oil. BNOC now has access to 51 per cent of all oil from the North Sea.

As regards (i), Mr. Howell has been asked by the Chancellor to sell off approximately £300m of assets this year to help the PSBR. He has, I believe, accepted this in principle; and he is now working on the modalities.

One of the "middle" options which his Department are looking at is to sell off all of the North Sea assets, including the 51 per cent share in the Fifth and Sixth licensing rounds, but to

/ continue

continue the participation agreements. Whether it is worth continuing with the participation agreements rests heavily on one's assessment of how much real security of supply they offer to the UK. Sir Kenneth Berrill in his note at Flag A suggests that the participation arrangements do, if properly exploited, offer a good deal of security.

Another option would be to continue with the participation agreements, and keep at least some of the North Sea assets which should bring in a lot of revenue over the years and enable the Government to be more knowledgeable of the goings-on of the oil companies than if it got out altogether; but to jettison the shares in the latest licensing rounds, which are likely to involve very heavy capital expenditure before they produce any revenue.

TL

5 June 1979

AM seen

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To: MR LANKESTER

From: SIR KENNETH BERRILL

Oil Supplies

TPM 1. On 31 May I minuted Mr Stowe on the subject of oil supplies to the United Kingdom economy over the coming winter. You told me that the Prime Minister had raised two questions:

(i) What leverage could the UK Government exert on the private multinational oil companies?

(ii) What powers did BNOC possess over oil supplies and what would be involved in BNOC exerting those powers?

In what follows I shall attempt to answer those two questions. I regret that the answers must of necessity go into some detail.

HMG Leverage over Multinational Oil Companies

2. Relations between Governments and oil companies have much in common with a game of poker - and this is especially so when supplies are short and all countries are struggling for favourable treatment. The pressure cannot be too overt or the EEC Commission will step in (as they already have on the UK claim that we have the power to require that oil from the UK Continental Shelf be first landed in the UK). The French Government is particularly adept at this game of poker and they make full use of their State controlled company ELF/Aquitaine. We in the UK have not done badly. All the participation agreements were negotiated 'voluntarily' and though the Commission may argue, the oil companies have not protested against our 'landing requirements' nor our 'expectation' that oil companies will not commit substantial quantities of North Sea crude more than 2 years ahead.

3. The fact is that a UK Government, if it has the political will, can exert considerable discreet pressure on an oil company because it can influence that company's operations in the North Sea. The powers cover the issue of future exploration licences, the granting of development consents, approval of production levels, the extent of gas flaring, etc. The Department of Energy could, if it were so instructed, take a very long time examining the enormous amount of technical detail which a company has to supply to it and just be very slow in coming to conclusions. For these companies, time is money.

4. The consultation arrangements under the Participation Agreements provide readily available fora for the Government discreetly to make its wishes known and for the companies to respond. The companies could, if they so wish, exert a preference for the UK without fear of effective detection and recrimination by our partners. There is no doubt that the French will be leaning heavily on them at this moment and that it will be extremely difficult for us to prove discrimination in favour of France.

BNOC's control over oil supplies

5. UK oil demand is currently near 2m. barrels per day (approaching 100m. tons a year). The attached table gives the forecast for BNOC's access to oil over the next 18 months. The figures are complicated (and would be reduced if parts of BNOC were sold off). The complications are, in a way, helpful, in that they make it difficult for outside observers (including the Commission) to monitor just what is going on. But the general picture is of (a) a doubling of BNOC access to crude oil over the period; and (b) the ratio of 'BNOC oil' to UK total consumption rising to around 40 per cent by end 1980. This oil is not all freely in BNOC hands.
Other features of BNOC's oil availability are as follows –
(a) The bottom line of the table shows the 'sale back' agreement to Shell, Esso, Mobil and Texaco. At the end of 1980 this sale back oil will be 14 per cent of UK consumption. This oil is all safely 'UK use'. BNOC is obliged

to sell this oil to the four companies provided they use both the BNOC oil and their own 49 per cent share of the oilfields in question to help supply the UK market.

(b) Most of the remaining BNOC crude is sold to companies on forward contracts. BNOC has no refining capacity and has to make forward arrangements to dispose of it. The current distribution is 35 per cent to the UK and 65 per cent abroad (35 per cent Europe and 25 per cent North America). Some of the forward contracts expire this month, and some in September, but the bulk are till December and BNOC would need to give 3 months notice if it did not intend to renew. BNOC has, however, put a 'force majeure' clause in all its contracts which explicitly gives the Secretary of State for Energy the power to require immediate cancellation. Given the present supply position the exercise by the Secretary of State of such a requirement would be likely to excite international protest. But BNOC is confident that such a step would not be necessary. If the Government told BNOC to ensure that the great bulk of 'BNOC oil' was retained in Britain (or at least an equivalent amount of lower quality crudes required for our own refinery balance) this could be achieved. In anticipation of this, BNOC has taken some steps in its contractual negotiations - for example, telling companies that their BNOC sales contracts may not be renewed if equivalent volumes are not available to the UK and by biasing its contracts policy towards UK subsidiaries of multinational oil companies where the UK's powers of leverage are potentially greater.

6. I repeat, the relationship of Governments to multinational oil companies is very much a poker game. It is a game where most of the action takes place discreetly and is incapable of external monitoring. Some of our neighbours, especially the French, are experts at it. With North Sea oil, BNOC, the participation agreements, etc., we go into this poker game with very strong cards - even if we may not be very experienced players. Given North Sea oil, UK public opinion will expect to see adequate treatment of the UK market. This can be achieved but the Department of Energy and BNOC would need to know what is expected of them.

7. I am sending a copy of this minute to Sir John Hunt.

5 June 1979

BNOC'S ACCESS TO CRUDE OIL

1979 & 1980 (Est)

(~~million~~ thousand barrels per day)

must be ~~[illegible]~~

R

	1979			1980			
	II	III	IV	I	II	III	IV
UK Continental Shelf (UKCS)							
Equity[1]	56	70	81	88	93	97	104
Participation[2]	225	235	240	262	307	300	290
Other purchases[3]	71	88	83	65	75	75	63
Royalty[4]		58	58	[165][5]	[165]	[165]	[165]
Sub-Total	352	451	462	580	640	637	622
Non-UKCS[6]	109	152	152	190	185	206	199
TOTAL	461	603	614	770	825	843	821
Saleback to Shell/Esso/Mobil/Texaco	150	168	178	218	250	258	278

1. Either through transfer from NCB or through purchase, eg from Burmah, BNOC holds a straight equity interest in some North Sea oilfields.
2. Oil received under the 51% participation policy
3. BNOC has agreed to purchase the oil of a number of companies, usually small ones, who do not wish to retain it themselves, eg. Charterhouse, Ultramar and Burmah.
4. HMG has the right to take its 12½% royalty in cash or in oil. As an experiment it is taking it in kind from some fields until the end of 1979.
5. Assumed take for the year 1980 and shown net, ie. the amount incremental to the non-royalty case.
6. Under its participation agreement with BP BNOC keeps 12% of its participation oil and sells back the remaining 39% to BP, which in exchange supplies BNOC with an equivalent amount in value from elsewhere (normally heavier Middle East crudes).

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Prime Minister

You were dissatisfied with Ken Berrill's draft minute on fuel supplies. He has answered your queries (Flag A). But I think a Cabinet Office chaired group to look at all this, as suggested below by John Hunt, is much better. It should focus mainly on coal and oil. Agree?

cc Mr Wolfson
Mr Hoskyns

Ref. A09715

PRIME MINISTER

Fuel Supplies

You have had a minute from the Secretary of State for Energy (dated 31st May) about fuel stocks at power stations, in which he points to the danger of the power stations entering next winter with inadequate coal stocks (with all that implies for the NUM) and to the limitations (notably but not exclusively transport limitations) of putting the situation right. I understand that the Minister of Transport is likely to minute you shortly explaining the problems which the railways face in handling extra tonnages of coal (shortages of diesel fuel, a high "outage" of diesel engines reflecting industrial disputes which have held back the maintenance programme and a shortage of trucks and of guards for goods trains). There is also correspondence between Ministers (which you will not have seen) on the question of importing coking coal for the British Steel Corporation. And of course lying behind all this is the shortage of oil and the need, both in our own interests and to meet our international obligations, to reduce our use of oil next winter to meet the 5 per cent IEA/EEC target.

2. In short, Mr. Howell's minute reveals the tip of a fairly large iceberg and where, to mix metaphors, Departmental interests do not altogether coincide. I suggest that there is an urgent need for an agreed factual appraisal of the energy, and particularly coal/ supply situation over the next 12 months, the scope for action and a realistic display of the options. As a number of Departments are concerned (Energy because of its general responsibilities, Industry as representing the main industrial consumers including the BSC, Trade because of the import aspects, Scotland because of its responsibilities for electricity supply in that country and its political concern with North Sea oil, Transport because of the physical ability to move coal - and perhaps to import it - is emerging as a major potential bottleneck, the FCO because of the international implications and the Treasury because of financial aspects), the simplest course would be for the Cabinet Office to convene an interdepartmental working group charged with producing the kind of report I have outlined. If you agree, and because time presses, we could ask them to report within ten days or a fortnight.

and oil?

Yes please and quickly - we shall need to know before Strasbourg.

JOHN HUNT

5th June, 1979

SAVING TELEGRAM

2

Prime Minister

You asked what was being done to make the Saudis aware of the consequences of oil price rises.

Miss Francis
cc copy w comps to Mr Castledge
to 10 Downing St

Clayden 11/6

BY BAG - PRIORITY

FM JEDDA

CONFIDENTIAL

TO FCO TEL NO 2 SAVING OF 4 JUNE 1979

REPEATED FOR INFORMATION: DEPT OF ENERGY

12/6

FCO PASS BY TELEGRAPH TO FOLLOWING POSTS:

TEHRAN, MEXICO CITY, ABU DHABI, BAGHDAD,

KUWAIT, CARACAS, QATAR, ALGIERS, LAGOS

SAVING TO:

MUSCAT, BAHRAIN, OSLO, WAHSINGTON, UKDEL OECD,

PARIS, UKDEL, BRUSSELS BONN, TOKYO

FROM PARSONS IN RIYADH

SAUDI OIL POLICY

1. I had a detailed discussion today with Hisham Nazer, Saudi Planning Minister, (Yamani is apparently unwell), which has produced interesting insights into the current Saudi thinking over moves to restore a measure of order into the oil supply and price situation. Nazer's views can I believe be taken as fairly typical of the Saudi establishment, particularly given his responsibility for securing from future oil revenues the amount Saudi Arabia requires to finance her fast-increasing budget (he said that the 1979 target for oil revenue is $35,000m).

2. I set out to Nazer our concern, shared with our Western partners, and, I believed, by Saudi Arabia, to avoid the present near anarchy in oil pricing going further. We recognised that the descrepancy between supply and demand was bound to produce upward pressure on prices, but it was necessary to find a means to regulate this. Although ourselves a substantial producer, the economic effects of sudden price adjustment caused problems for us, just as they did for other producers. Did the Saudis believe it would help if we and perhaps our European

/partners

partners were to take some particular action before the next OPEC meeting which might help Saudi Arabia and others who shared her concern to urge restraint on the price front? We also were giving serious thought to whether it would not help to work for further dialogue either between major producers and consumers, or between OPEC and non-OPEC producers. Did the Saudis think this would help?

3. Nazer made it clear that Saudi Arabia was worried at the way things were going. Saudi Arabia was already trying to restrain prices by charging about $6 less per barrel than other producers who had imposed surcharges. But it was galling to see this profit go straight into the oil companies pockets. He implied they would be reconsidering whether this tactic was worth it. Moreover unlike the mid-70s, Saudi Arabia was no longer building up a surplus from oil exports, nor did she aim to. Like Algeria, Iran or Iraq she needed every penny she could get for her development programme. In 1978, for the first time, she had been obliged to dip into reserves to finance expenditure. So Saudi Arabia now had an interest in seeing prices rise, although in an orderly fashion. The West should recognise this.

4. Moreover it was unacceptable to OPEC producers that the industrialised and third worlds should be so profligate in consumption. He went on and on about Saudi Arabia taking the blame for the lack of refinery capacity which was the real cause of California's shortage. I got him to accept that we in Europe were now starting to take economies seriously, and that the US government was trying to inculcate restraint. But he clearly saw the US behaviour as thoroughly unhelpful. There was no point in talking about dialogues or urging price moderation on producers until the consumers demonstrably put their house in order. He

/went

went on to infer a distinction among non OPEC producers between the Mexicans on the one hand, and ourselves and the Norwegians. Saudi Arabia saw merit in talking to the former about ways to regulate the market, but he was less than enthusiastic about opening discussions with such as we. For the Saudis our interests seem to be incontrovertibly with the consumers.

5. He also gave an explanation of the rationale behind Saudi Arabia's reluctance to join in any form of dialogue. She would, as always, be the object of unjust accusation by both her OPEC partners and the consumers. The former saw the Saudis as soft on the consumers; the latter thought Saudi Arabia had all the remedies in her power, which she did not. She could not raise production substantially without massive new investment ($16,000m) which might or might not prove to be economically recoverable. She was capable of sustaining, with her present installations, a production level of 11 mbd but she did not want to go that high. In effect he was saying she was no longer to be seen as swing producer.

6. So Saudi Arabia would steer clear of such dialogues, while doing what she could to counsel moderation in OPEC. She was not optimistic of getting restraint in the short term. We should be urging the Iranians to produce more, rather than tackling the Saudis. Munro said we had discussed with the Iranians. The Iranian Vice Minister of Finance had told him in Tehran this week that Iran saw the force of making price increases in (an) orderly manner. But it was doubtful if the government had the authority to apply this. He had also been told Iran's current production was at its technical limit of 4.7 mbd. We had to accept that Iran was unlikely for some while to go higher; indeed disturbances could reduce output again.

/7.

7. I asked if he saw value in my tackling other Gulf producers next week, such as Zaid and Khalifa bin Hamad. He doubted this would have any effect. They were not significant producers. But he accepted that restraint on their part could have psychological benefit.

8. All in all a fairly discouraging outlook. The Saudis seem likely to work for moderation in price increases and perhaps to raise production slightly to this end. If so, this is some comfort. But they are feeling persecuted, and have convinced themselves of Western profligacy. Other political issues, eg Arab/Israel do not necessarily harden what is already a fairly tough position towards the consumers. Nor are they sure how to handle their OPEC partners. From this brief contact I conclude that, although Western countries should lose no opportunity to express similar concern in talking to the Saudis and others, we will not have any real impact on them until we can produce convincing evidence that we are serious about conservation.

WILTON

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SIR A DUFF
SIR A PARSONS
MR BUTLER
MR J MOBERLY

ADDITIONAL DISTRIBUTION
OIL

Foreign and Commonwealth Office

London SW1A 2AH

4 June 1979

Dear Bryan,

Call on the Prime Minister by the President of the European Commission on 21 May, 1979

In your letter of 21 May you asked for advice on how a study could be initiated on the bargaining position of the West, and of the EEC in particular, vis-a-vis OPEC in any forthcoming negotiations on oil prices and supplies.

Officials are preparing a note on this subject, which I shall then forward to you and to the Private Secretaries of other departments concerned. If the Prime Minister and her colleagues agree with the note's conclusions, they could be reflected in the briefing on producer/consumer contacts both for the European Council meeting at Strasbourg and for the Tokyo Summit.

The Prime Minister may meanwhile like to know that officials have over the past three months been doing some preliminary work considering the basis for producer/consumer contacts and the objectives which the West in general, and the UK in particular, should set themselves. We have so far concentrated on:

(a) studying the medium term outlook for the world energy market, with special emphasis on oil production and prices. I attach a paper, which was prepared by the FCO, Treasury, Bank of England and Department of Energy officials, and which has been submitted to Ministers concerned in these Departments;

(b) seeking the views of our main partners on medium term prospects, and making sure they are aware of our thinking. We passed an earlier version of the paper - written before the Iranian revolution - to the Americans, French and Germans, and we have now instructed our posts in these countries to hand over a suitably bowdlerised version of the present paper;

(c) defining the objectives of the developed consumer countries in any dialogue with OPEC. Some preliminary work has taken place within the IEA and EEC, and work will continue. The note by officials will set out our present conclusions;

/(d)

B G Cartledge Esq
10 Downing Street

(d) trying to define OPEC producers' objectives, which will probably continue to be to resist negotiations on energy alone (and especially on oil prices), to seek a wider agenda covering trade and aid issues, as during the CIEC negotiations, and generally to blame consumers for the world's energy difficulties.

The Americans have hitherto taken the lead and traded heavily on their special relationship with Saudi Arabia. But this relationship is not what it was. As regards producer/consumer contacts, some of our partners are in favour, others are pessimistic about the West's bargaining position; the Americans have been very negative though there are signs of change. The producers may not agree to any talks except on their own high terms, though there are differences of view between them which we might be able to exploit.

Before any contacts, let alone negotiations take place, therefore, it will be vital to concert the West's bargaining position. Once we have done our homework, we could press for coordinated Western (and Community) research on our bargaining position in negotiations. But the timing and tactics will need further consideration.

We have made enquiries about the CIA paper of 1976 and will send you a copy as soon as it can be located.

I am sending a copy of this letter to the recipients of yours and also to the Private Secretary of the Chancellor of the Exchequer in view of the fact that the Treasury have been closely involved in the work on this subject and chaired the interdepartmental group that produced the paper I have enclosed.

Yours ever

Paul

(P Lever)

- 4 JUN 1979

A

THE MEDIUM TERM PROSPECT FOR THE WORLD ENERGY MARKET: OIL PRICES, OPEC SURPLUSES AND THE WORLD ECONOMY.

Summary

This is a report by a group of officials from the Treasury, the Bank of England, the Department of Energy and the FCO under Treasury chairmanship. It begins by describing the very uncertain outlook for the oil market in the period immediately ahead (paragraphs 11 to 14). It then examines the prospect for 1985, which was chosen as a focus for convenience. Although we do not think it possible to forecast future developments so far ahead with confidence, the exercise is useful in that it illustrates reasonably precisely the factors that are likely to determine the price of oil and the consequences for the world economy. The uncertainties are very important. (Paragraphs 15 and 16.)

2. The working groups estimate for 1985 (subject to all the caveats stressed in the previous section) produces the result that available OPEC oil supply will exceed, by a very small margin, the demand for it. If this estimate were borne out by events, market factors would point to no, or only a small, increase in the real oil price over its present level in the second quarter of 1979 - though the nominal oil price could be expected to continue to rise broadly in line with the increase in the price of manufactures - say at somewhere between 5 and 10 per cent a year. (Paragraphs 17 to 19.)

3. The most important assumption - an inherently unlikely, though necessary, one - is that no surprises will occur before 1985. Judging by recent experience, however, we are in for a bumpy ride. The path and timing of that journey are impossible to predict with any certainty, for a variety of reasons. The first major set of uncertainties concerns the path of the real oil price: different paths can have markedly different effects on the world economy and yet arrive at the same price in 1985. Secondly, various uncertainties surround the 1985 world energy balance. The demand for OPEC oil depends on, among other factors, the extent to which one form of energy can be substituted for another, the success or otherwise of conservation measures (especially in the United States), the rate at which nuclear energy develops and the net balance of Communist energy trade with the rest of the world. The supply of OPEC oil also poses difficult

problems. Saudi capacity may rise faster than the modest rate anticipated. Conversely, several OPEC members might very well produce less than the shares allocated to them. The later development might, however, elicit increased production and conservation elsewhere. With all these uncertainties in view, most commentators at the moment would probably regard the estimate as pitching pressures on the real oil price too low. Spare capacity - such as existed a year ago - is highly unlikely to recur before 1985. (Paragraphs 20 to 25.)

4. Price decisions by OPEC will not necessarily follow the market, although in general the closer demand is to available supply the easier will OPEC find it to make price increases stick. But rather than following the market OPEC may be successful, for economic as well as political reasons, in limiting its members' production so as to keep prices high; if demand were very weak the economic reasons could become pressing. Whatever the state of the market the Saudis may be less willing than in the past to vary their production so as to keep prices lower than other OPEC members would desire. Iran is likely to be more intent on securing price increases than the Shah was in recent years; but the shaky new regime is unlikely to exercise the same influence as the Shah did. If Saudi and Iranian influence wanes, Iraq's influence in OPEC can be expected to increase. Iraq may become less hawkish, though her behaviour is difficult to predict. The general conclusion is that political factors are likely to push up the real price of oil before 1985. (Paragraphs 26 to 32.)

5. Whether or not the real oil price rises before 1985, a substantially increased real oil price seems certain by the end of the century. (Paragraph 33.)

6. If the real oil price remained at or a little above its present level the overall OPEC surplus would probably disappear or even become a deficit in the early 1980's. The Saudi surplus would disappear. Some OPEC countries would remain in surplus, and others would be able to finance deficits. Even if there were an increase in the real oil price between now and 1985, provided it was reasonably small and gradual, we would expect only a modest OPEC surplus to which the world economy could adjust without serious disruption - even though growth rates might continue to be disappointing by comparison with those of the post-war period up to 1973. Much more serious difficulties would arise if the oil price increases were sharp and irregular. (Paragraphs 34 to 38.)

7. Despite North Sea oil, the United Kingdom's interests are similar to those of the OECD countries. Like them, we would be likely to suffer from the inflationary and depressive effects of sudden sharp increases in the real oil price. (Paragraphs 39 and 40.)

8. Annex A gives details of the estimate of demand for OPEC oil in 1985.

9. Annex B gives details of the estimates for supply.

10. Annex C describes in more detail the factors likely to influence the behaviour of the three big OPEC states: Saudi Arabia, Iran and Iraq.

Introduction

11. In the years ahead, the availability and cost of energy supplies will be increasingly crucial influences on the world economy. The world oil market has changed dramatically in the past year. In early 1978, OPEC was producing at a rate of 29 million barrels of oil per day (mbpd) of which Iran contributed about $5\frac{1}{2}$ mbpd. Saudi Arabia had spare capacity of about 3 mbpd, stocks were high and the North Slope of Alaska and the North Sea were adding to the world's productive capacity at a faster rate than the increase in demand. As a result, the nominal oil price had been stable since the beginning of 1977 and the real oil price was declining. The Iranian revolution brought with it a transformation in the oil market. Iranian production was greatly reduced in the last quarter of the year and exports ceased altogether early in 1979. Today, even though Iranian exports have been resumed (at a much reduced level), the market remains very tight. Stocks have been run down and, even though current supply comes close to meeting current demand, there is no longer a safety margin of spare capacity.

12. The outlook for the next couple of years is very uncertain. The possibilities range from a reasonably satisfactory to a highly dangerous state of affairs. Thus, one possibility is that:-

(i) The conservation measures agreed by countries in the International Energy Agency (IEA) will be really effective, saving about 2 mbpd and offsetting the effects of the Iranian shortfall.

(ii) Iranian production will gradually creep up to 4 mbpd.

(iii) If Iranian production fails to achieve that level, Saudi Arabia will once more be willing to allow Aramco to produce more than the $8\frac{1}{2}$ mbpd ceiling (as in the winter of 1978-79).

(iv) Other OPEC producers, including Iraq, will also produce more than they did in 1978.

The combined effect of these assumptions could produce a surplus in the oil market (though probably not a large one, and probably not until 1980), with a corresponding stability in contract prices and, possibly after a time, a fall in spot prices to a level below the OPEC official price.

13. But it is also possible that each of these things will go wrong. Thus:-

(i) The IEA conservation exercise may not prevent demand expanding.

(ii) Iranian production may be disrupted by renewed unrest.

(iii) Despite (ii) Saudi Arabia might insist on sticking to their $8\frac{1}{2}$ mbpd ceiling.

(iv) The other OPEC producers might also cut back production.

The result of these alternative assumptions in combination would, almost certainly, be further sharp increases in prices and serious disruption of OECD industries in the winter of 1979-80. We should have a second major energy crisis on our hands.

14. The most likely outcome lies between these extremes. Our best estimate is that the market will remain tight, and that the price of oil will increase in the course of the next few years at least in line with the prices of OECD manufactures. This increase may not be a steady one, but we hope that serious disruption of industry will be avoided.

Purpose of this report

15. Under regular departmental arrangements reports are produced from time to time on the current situation:-

(i) by the Department of Energy on the world oil position

(ii) by the FCO on political developments

(iii) by the Treasury and the Bank of England on the implications of events in the oil market and in OPEC for the world economy.

These three departments and the Bank felt that it might be helpful for the Ministers chiefly concerned to see a paper which attempted to step back from the current position and consider the outlook for the oil markets and the world economy in the medium and longer term. The year 1985 has been chosen as a focus, for convenience. The next section of this paper sets out a series of calculations of the demand for OPEC oil and the supply of OPEC oil in 1985 on some plausible assumptions about events between now and then, but including the assumption that nothing very surprising will happen to change the picture. We believe it to be worthwhile to make such detailed calculations, not because we believe that we can forecast the future so far ahead with any confidence at all, but in order to illustrate in a fairly precise manner the factors that determine the demand for and the supply of oil, the resulting oil price and the consequences for the world and the UK economies.

16. Recent events have illustrated the basic unreality of working on "surprise-free" assumptions about the Middle East, the uncertainty that must surround any forecast of the world energy market and the future price of oil and how quickly our expectations about the medium term can alter. In the mid-1970s some people were prophesying that the rise in real oil prices begun in 1973 and 1974 would continue during the 1970's and 1980's with potentially catastrophic results for the world economy. In fact by mid-1978 (as Table 1 shows) the real oil price was 14% below the peak it reached in 1973-4 and our assessment then was that by 1985 world oil supplies would still exceed demand by a reasonable margin, that any upward pressure on prices was more likely to come from OPEC countries' desires for extra revenues than from market forces and that Saudi Arabia would remain a strong moderating force. We were not alone in this judgement; a series of weighty studies produced during 1978 suggested that substantial pressure on the real price of oil was perhaps unlikely before the early 1990's. By early 1979, following the Iranian revolution, the view of many forecasters in the oil companies and elsewhere had changed again: it had begun to seem that the substantial rise in real oil prices confidently expected by the end of the century had already begun, and would certainly not be delayed until the 1990's as had been the general expectation only a few months earlier. Thus the temptation to extrapolate the current situation into the far-distant future is almost irresistible; and readers of this report must bear that point in mind.

CONFIDENTIAL

TA[illegible] 1 : INDICES OF THE PRICE OF OIL: 1973(1) = 100[2]

Year	$ Price	Index of $ Price	The Real Price[1]	Year	$ Price	Index of $ Price	Index of Real Price[1]
1960	1.50	71.1	101.5	1970	1.30	61.6	75.6
1961	1.45	68.7	97.1	1971	1.65	78.2	90.3
1962	1.42	67.3	95.3	1972	1.90	90	95.3
1963	1.40	66.4	93.4	1973	2.70	128	116.7
1964	1.33	63.0	87.4	1974	9.76	462.6	346.1
1965	1.33	63.0	86.0	1975	10.72	508.1	337.6
1966	1.33	63.0	84.4	1976	11.51	545.5	360.5
1967	1.33	63.0	83.8	1977	12.60	596.9	364
1968	1.30	61.6	82.2	1978	12.70	601.9	320.6
1969	1.28	60.7	78.2				
1973(1)	2.11	100	100	1977(1)	12.49	591.9	371.1
(2)	2.41	114.2	106.8	(2)	12.49	591.9	367.6
(3)	2.77	131.3	113.6	(3)	12.70	601.9	363.6
(4)	3.51	166.4	143.2	(4)	12.70	601.9	353.9
1974(1)	9.22	437	366.7	1978(1)	12.70	601.9	336
(2)	9.63	456.4	343.3	(2)	12.70	601.9	330.5
(3)	9.82	465.4	337.5	(3)	12.70	601.9	314.9
(4)	10.38	491.9	340.4	(4)	12.70	601.9	303.0
1975(1)	10.46	495.7	321	1979(1)	13.80	654.0	326.0
(2)	10.46	495.7	319.3	(2)	15.83	750.2	355.0
(3)	10.46	495.7	337.3				
(4)	11.51	545.5	375.4				
1976(1)	11.51	545.5	371.1				
(2)	11.51	545.5	369.1				
(3)	11.51	545.5	357.1				
(4)	11.51	545.5	345.9				

[1] The $ Oil Price Deflated by the $ price of OECD manufactures exports.

[2] Saudi Arabia Ras Tanura - Light Marker Crude. In 1977 Q1 and Q2 and in 1979 Q1 and Q2 an allowance is made for the fact that OPEC members other than Saudi Arabia (and UAE in 1977) were selling at higher prices. The Saudi price was $12.09 in the first two quarters of 1977 and $13.34 in 1979 Q1 and $14.54 in 1979 Q2. No account is taken of periods when some discounts were being offered.

The oil market in the mid-1980's: a "surprise-free" estimate.

17. Table 2 below illustrates what the demand for OPEC oil might be in 1985 at the present real price. The table assumes that OPEC oil is the marginal source of world energy: demand for OPEC oil is therefore calculated as a residual, after other economically viable sources of energy have been used to the full.

TABLE 2: DEMAND FOR OPEC OIL

	Million barrels per day (mbpd) of oil equivalent	
	1977	1985
Developed countries		
Energy demand	75.2	94.7
Energy supply	47.6	61.6
Net imports	27.6	33.1
Developed countries outside OPEC (including Mexico)		
Energy demand	11.2	17.3
Energy supply	7.9	16.1
Net imports	3.3	1.2
Communist Countries (including China)		
Net imports (exports)	(1.7)	0.2
OPEC Countries		
Energy demand	3.6	5.2
Non-oil energy supply	1.6	4.7
Net demand for oil	2.0	0.5
Required OPEC oil production	31.2	35.0

The key assumption is that growth in the OECD countries over the period 1978-85 averages 3.6% a year. This and other underlying assumptions are described at greater length in Annex A.

18. The relevant entries in Table 2 for non-OPEC supply assume that oil production in Mexico will have risen by 1985 to 4 mbpd from its present level of 1.5 mbpd, and in China to perhaps 3.7 mbpd from 1.8 mbpd in 1977. Table 3 below summarises our estimates of the available supplies of oil from OPEC countries in 1985:-

TABLE 3: OPEC SUSTAINABLE PRODUCTION CAPACITY AND LIKELY AVAILABLE SUPPLY[a]

million barrels per day

	1978		1985		
	Installed capacity	Production[b]	Installed capacity	Maximum sustainable	Probable willing production
Gulf area[c]	28.4	20.3	29.8	26.8	24.6
Rest of OPEC[d]	10.8	9.0	11.6	10.6	10.6
Total	39.2	29.3	41.4	37.4	35.2

Notes

(a) Oil and natural gas liquids

(b) Average of first three quarters

(c) Saudi Arabia, Iran, Iraq, Kuwait, UAE, Qatar

(d) Algeria, Nigeria, Libya, Gabon, Venezuela, Ecuador, Indonesia.

Annex B gives a more detailed division of these figures by country, although any such split must be very speculative. There is a major uncertainty, of course, about Iran, affecting both continuity of supply and the nature of the regime in power in 1985. The figures allow for a more conservationist regime than the Shah's, but assume that the Iranian government in 1985 will both want and be able to produce at around 4½ mbpd.

19. It can be seen that the estimate of likely available OPEC supply in 1985 in Table 3 (35.2 mbpd) just exceeds the estimate in Table 2 of likely demand (35.0 mbpd). If this were borne out, market factors would point to no, or only a small, increase in the real oil price over the present level - though the nominal price could be expected to continue to rise broadly in line with the increase in the price of manufactures say at somewhere between 5 and 10 per cent a year. However, it should be recognised that this apparent balance in the market is being achieved at a relatively slow rate of growth for the industrial countries. If the latter succeeded in growing 0.5 per cent a year faster than projected over the period 1978-85 (optimistic but not impossible), demand could exceed supply by something of the order of 2½ mbpd. This gap would have to be closed by an increase in the real price, once the possibilities for increasing non-OPEC production and reducing demand had been exhausted. Equally, of course, growth could well turn out to be lower than assumed, and in that case weak demand would lead to downward pressure on the real oil price.

What could go wrong?

20. The estimates summarized above assume relatively steady economic growth between now and 1985, a matching steady expansion of OPEC production to meet the growing demand and oil prices that are adjusted regularly to keep pace with inflation, but no more. The scenario on which these estimates are based contains no accidents or surprises and, for that reason, seems inherently unlikely. The chances must be that in future, as in the past, we will have a bumpy ride. But, of course, we are not able to predict in any systematic way the size and timing of the bumps.

21. One set of uncertainties relates to the path the oil price will take between now and the mid-1980s. There could be temporary shortages resulting from supply disruptions of the kind we have seen in Iran. This could produce periods in which real prices rose sharply. For example, the rises in the second quarter of 1979 could be followed by further steep increases later in the year. These could cause a severe check in world economic growth, and, as a result, a lower demand for OPEC oil, a slack oil market and, perhaps, a period of stable nominal prices and falling real prices. Such a succession of rises and falls in the real oil price might even be repeated more than once between now and 1985. For each 1 per cent by which GDP in 1985 fell short of our assumption, demand for OPEC oil in that year might be ½ mbpd less. By 1985 the oil market might be back in balance, and the real price could be back at today's level; but, as a consequence of the bumpy price path, world economic activity and both demand and supply of oil might be noticeably lower than the levels assumed in paragraphs 17 and 18.

22. Other uncertainties relate more directly to the calculated 1985 balance. In addition to the overall level of economic activity (see paragraph 19), the estimat[ed] demand for OPEC oil would be affected by factors such as the following:-

(a) Our calculation estimates demand for OPEC oil as a residual. The fact that energy is available in some form outside the OPEC countries, or is available within OPEC countries as gas rather than oil, does not necessarily mean that it will be taken up immediately in preference to OPEC oil. The figures underlying our calculation imply a very substantial shift in the period up to 1985 towards coal and natural gas (some of the latter exported by OPEC countries), and this may not prove possible to achiev[e] in time, particularly with no rise in the real price of oil. BP consider that this factor could result in a demand for OPEC oil as much as 2½ mbpd higher than the estimate in Table 2.

(b) Conservation could turn out to be either more or less effective than hoped. Table 2 includes estimates for the US which take into account only those measures in operation in September 1978. The complete and successful implementation of the US National Energy Act could reduce demand for OPEC oil in 1985 by 1.5 mbpd below the figure in Table 2. The consequence of a substantial degree of failure by the US to achieve President Carter's energy conservation objectives is rather more difficult to quantify; our best guess is that it could add 0.5 mbpd to the figure in Table 2 for demand for OPEC oil in 1985. If all the IEA members decided to make their present temporary demand restraint measures permanent, and if these were fully effective, the demand for OPEC oil would be 2 mbpd lower.

(c) The Harrisburg accident could result in a major setback to investment in new nuclear capacity throughout the Western world. This may have the effect of reducing available nuclear capacity in 1985 (and increasing the demand for OPEC oil) if existing nuclear power stations are closed down or projects under construction are delayed. The main effect of Harrisburg is more likely however to be on new nuclear projects, which will not greatly affect the energy balance in 1985, but could have an important effect later in the 1980s and in the 1990s. In 1985 demand for OPEC oil might be increased by up to 1 mbpd.

(d) While the volume of Communist energy trade is expected to increase steadily, forecasts of the net energy position of the Communist countries in 1985 vary greatly. The figure might be almost anywhere between 1 mbpd net <u>imports</u> and 1 mbpd net <u>exports</u>.

23. There are also uncertainties about OPEC countries' ability and willingness to supply. On the one hand, our forecast of OPEC capacity assumes only a relatively modest increase in Saudi capacity. It is still possible that, perhaps as a result of American urging, this could turn out to be a pessimistic assessment. The Saudis may allow a higher level of investment in new capacity than expected, thus increasing willing OPEC production by possibly as much as a further 2 mbpd.

24. On the other hand, willing OPEC supply could easily be less than we have assumed. OPEC countries may become increasingly concerned to conserve supplies for later in the century when real oil prices could be expected to begin to rise

sharply. On quite plausible assumptions about the willingness or ability of the Gulf States to produce, or about political stability in other OPEC countries such as Nigeria and Libya, available OPEC supply could be reduced in 1985 - or in some year before then - by as much as 4 mbpd. But, if so, the resulting sharp increase in prices might in turn bring forward a higher level of world oil production and greater conservation in consuming countries, with a subsequent period of slack oil demand and declining real prices. To take a less extreme case, there is also the possibility that OPEC members will successfully combine to manipulate production levels so as to create continuous mild upwards pressure on the real oil price.

25. In short, a world without surprises is unlikely and the chances that the estimate discussed above will be proved wrong are correspondingly high. The uncertainties operate in both directions; but most commentators at the moment would be more likely to expect market pressures on the oil price to prove to be greater than our estimate suggests, either in 1985, or sometime before then. At no time between now and 1985 is the world likely to have a margin of spare capacity as large as that which in 1978/79 helped us to cope with the consequences of the Iranian revolution.

<u>The OPEC Cartel: political and economic factors</u>

26. So much for the market situation in and before 1985 and its possible direct implications for the oil price. Price decisions by OPEC will not, however, automatically follow the market. Even though OPEC prices are at present in some disarray as members move independently to exploit the tight market, the organisation has shown in the past that it can set higher prices and make them stick even when market pressures would not support an increase. One reason why the cartel has worked so well up to now lies in Saudi Arabia's willingness, hitherto, to act as "swing producer" - that is to maintain a production capacity much higher than is normally required and to accept the larger part of any variations in demand resulting from the workings of the oil market. As a result OPEC members have only had to agree a price, not a supply. For Saudi Arabia this has involved both accepting reductions (as in 1977 and the early part of 1978) and also allowing production to increase (as has happened since Iranian supplies were disrupted). For the future, there are indications that OPEC members may be more willing than in the past to co-operate in restraining production as a way of maintaining pressure on the price; and that the Saudis may be less willing to act as the "swing producer".

27. The existence of OPEC does not mean that market conditions are irrelevant to the price of oil. In general, the closer demand is to available supply, the easier will OPEC find it to make price increases stick. But the perverse case is also possible: if demand were very slack, many OPEC countries - including some who up to now have been thought of as permanent surplus or "low absorber" countries - could find themselves in dire need of revenue and the organisation could gain the necessary sense of unity to ration production and impose a price rise. Not, perhaps, a likely scenario; but a possible one.

28. Political and economic developments within OPEC countries will thus not only condition individual members' production levels and hence the level of supply in the market; they will also influence OPEC decisions on prices more directly. Annex C describes some of the relevant political and economic prospects up to 1985 for the three main OPEC producers - Saudi Arabia, Iran and Iraq. Attitudes and aspirations in other OPEC countries (see paragraph 34 below) will also be important, but we would expect these three countries to hold the key to OPEC pricing deciions insofar as they are not determined by market forces.

29. In the past, as noted above, Saudi Arabia has had a special influence on the oil price, and has played a crucial moderating role, because of her willingness and ability to act as "swing producer". But the Saudi regime's self-confidence has been reduced by events in Iran, and there are now reasons for doubting whether they will ever want to occupy that position again. Concern to preserve US support in an unstable environment, and about the effects of a world economic recession on the value of their financial assets are likely to continue to influence their policies; but such factors may in future to be outweighed by:-

(i) Increased concern about security of the present regime and disenchantment with the ability and willingness of the US to guarantee it.

(ii) A consequent concern to adopt a less exposed position in the Arab world on oil prices, greater sensitivity to the case for slower depletion of Saudi oil reserves and a reluctance to undertake the massive investment in new capacity that would put them back into an exposed position as "swing producer".

(iii) The need for more revenue to finance Saudi development plans. Our calculations suggest that very early in the 1980's pressure to raise either prices or production will be making itself felt if Saudi Arabia is to avoid being forced into unacceptably low growth of government spending and imports. In the light of (i) and (ii) price rises seem the more likely choice.

30. Events in Iran are exceptionally hard to predict. But despite the likely economic retrenchment and hence reduced need for oil revenues, we must expect Iran to join the price-hawks within OPEC, seeking the highest possible income from the much reduced level of production that she is likely to be able or to want to maintain. On the other hand, the new rulers of Iran are unlikely to have the prestige or firm control that enabled the Shah to exercise a crucial influence in OPEC in the early 1970s.

31. With Iran and Saudi Arabia less dominant, Iraq, as third largest OPEC producer, could be increasingly important. Iraq certainly has the potential to add considerably to OPEC supply in the mid-80s; whether she will pursue the policies necessary to do so is uncertain. There have been recent indications that the Iraqis may have decided to be more co-operative with Western governments and oil companies; But we cannot be sure. Iraq is likely to remain somewhat unpredictable, and her policies impenetrable. It is clear however that Iraq would be able, should she wish, to reduce production in the future without encountering a financial constraint.

32. Most of the factors discussed in this section - and others mentioned in Annex C - imply that rises in real oil prices between now and 1985 are more likely than is suggested by the analysis in paragraphs 17 - 19 of prospective developments in the market. With instability in the Middle East likely to persist, and the chances that the supply/demand equation may be approximately in balance, political factors may play an enhanced role in OPEC decisions.

The longer term

33. Even if there were no rise in the real oil price by 1985, it is as certain as anything can be that the real price will rise very substantially by the end of the century as a result of pressures in the market - even allowing for future technological change. If the real price does rise before 1985, it may be partly because coming shortages (as reflected in producers' conservation policies) have cast their shadow forward. If the real price does not rise before 1985, then the nominal price increases in the late 1980s or 1990s will be that much sharper.

OPEC Surpluses and the World Economy

34. As noted above, the impact of oil prices on the world economy depends not only on the level of real oil prices in 1985 but also on the path oil prices take. If, as depicted in the estimate in paragraphs 17-19 above, the real oil price stayed at or a little above its present level, the OPEC current account surplus would probably disappear and could even become a deficit. With oil production expected to increase by only 20% over 7 years, real export earnings would on this assumption increase by less than 3% a year unless OPEC countries were more successful than we would expect in developing other sources of export revenue such as manufactures or gas, or prepared to cut their imports back to a greater extent than seems likely. As explained in Annex C, the Saudi current account surplus could disappear in the early 1980s, even with a gradual deceleration of imports; and the overall balance, after taking account of capital flows and official transfers, could turn negative somewhat earlier. As also explained in Annex C, Iran might be in rough current account balance by 1985. Iraq (see paragraph 31) should be in surplus: but, if she had to would presumably cut back on oil production rather than invest surpluses in the international capital markets. The smaller Gulf states might continue to run surpluses, but they could be lower than these countries would ideally want in order to satisfy their objective to provide for future generations after the oil has run out by the creation of suitably large portfolios of overseas investments. Other important OPEC developing countries (for example Nigeria, Algeria and Venezuela) might be able to finance slightly faster growth in imports by capital inflows.

35. Even if there were moderate steady increases in the real price of oil, we would expect OPEC's collective current account surplus to remain small as the OPEC economies adjusted their import plans in line with more buoyant revenues. On the basis of past experience, the international financial system should be capable of recycling these surpluses. Our forecast of the current account surplus of OPEC in 1979 has recently been revised upwards to about $20 billion. In real terms this is much lower than it was in each year from 1974 to 1977 inclusive.

36. Just as the OPEC economies can adjust to a steady increase in the real oil price, so too can the economies of the consuming countries. Output would be likely to be sustained by the rising demand for imports by OPEC. Similarly, the current accounts of consumer countries need not deteriorate - higher exports could offset the higher oil bill, though some exporting countries might do better than others. The increase in the real oil price would represent a loss of real income which the populations of the consuming countries would have to be willing to accept if they wanted to avoid setting off an inflationary spiral. Assuming only a small OPEC surplus, the loss in real income would represent only a small part of the annual increment in real output so that a positive growth in real wages would still be possible and there would be a reasonable chance that the loss would be willingly accepted. For these reasons we would expect the world economy to adjust reasonably smoothly to a moderate steady increase in the real price of oil - even though the growth rates achieved might continue to be disappointing by comparison with those of the post-war period up to 1973.

37. More serious difficulties for consumer economies would arise if the oil price increases were sharp and irregular. The producer countries would be unable to raise imports fast enough to keep up with the increase in their oil revenues and large current account surpluses would result. It was argued in 1974 that the deflationary effect of the higher oil price could be offset and that, if this were done by cutting taxes, the inflationary impact could be offset too. In practice a smooth adjustment was not achieved. The inflationary spiral was only checked in the end by economic retrenchment, notably in the UK, Italy, France and many of the smaller OECD countries.

38. Thus experience indicates that the ability of the authorities to cope with a sharp rise in the real price of oil is rather limited and that such increases are likely to produce both a contraction in demand and an increase in inflation. Despite this, representatives of US government departments have argued, in bilatera[l] discussions with us, that periodic, sharp rises are to be preferred to a steady increase on the grounds that the shocks generated by the former would lead to more substantial progress on conservation and development of alternative energy supplies. We doubt the validity of this argument and note that it has taken the United States over 5 years since the massive price increase in 1973-74 to implement significant policy changes (and, even now, there are some doubts

about their effectiveness). In any case, more conservation is unlikely to offset the serious consequences of sharp increases in price for the world economy explained above.

~~Implications for the UK~~

39. During the period in the 1980s in which the UK is self-sufficient in oil, or a net exporter, the UK will be better insulated from such implications for the world economy than most other developed countries. While we are net exporters the oil account of the balance of payments will gain from higher oil prices. But this gain will be offset at least in part by the inflationary effects of an oil price rise, and the effects of a depressed world economy on our other industries. In any case the UK will be a net exporter for a relatively short time and when, in the late 1980s or 1990s, we are once again net importers we shall have to depend more on our manufacturing industries. Thus on balance the UK's economic interests lie much more with the rest of OECD than with OPEC.

40. Uncertainties about the path that the oil price will take to the mid-1980s and the level that it will reach when we get there, are just as important for policy as any central estimate. In the short and medium-term the most important risk is that price increases or supply shortages may occur sooner than 1985 - as a result of accidents or otherwise. The implications of such a course of events would be severe for the UK as well as for the world economy in general. Our policies - both international and domestic - should therefore be designed to do what we can to reduce this risk and to insure against it at an acceptable cost.

HM Treasury
14 May 1979

ANNEX A

DEMAND FOR OPEC OIL

The forecasts for 1985 in Table 2 rely on a large number of assumptions.

Developed countries' energy demand

2. The demand for energy in developed countries is related to the level of economic activity (GNP). Other things being equal an increase of 1% in the GNP of OECD countries is expected to result in an increase in their demand for energy of 0.925%. It is also necessary to take account of the remaining effects of price changes in the past. Since demand for energy seems rather insensitive to changes in its price this does not alter the calculations very greatly. Assuming that governments are successful in raising domestic oil and energy prices to international prices, and that conservation policies are adopted that are economic in the sense that they cost less than the value of the energy they save, we assume that these factors will in combination produce an energy coefficient of 0.82 (rather than 0.925) up to 1985.

3. As to the prospects for growth over 1979 and 1980, growth in the major OECD countries is projected to average around 3%, which is expected to result in an increase in unemployment. Work in OECD's WP2 has highlighted the difficulty of raising growth sufficiently to take up some of the slack in the industrial economies without a further rise in inflation. We have therefore assumed that between 1980 and 1985, taking one year with another, the best that will be achieved is growth in line with productive potential. This is estimated at 3.8% a year for OECD compared with a rate of around 5% achieved before 1973. Following two years of relatively low growth up to 1980, this gives an average between 1978 and 1985 of 3.6%.

Developed countries' energy supply

4. Developed countries' energy production is projected to increase slightly faster than internal demand, meeting two thirds of requirements in 1985. Given the high priority developed countries attach to minimising dependence on oil imports, we would expect their production to be fairly insensitive to a reduced level of economic activity. But the long development periods associated with major energy schemes make it unlikely that there would be a significant expansion of production above the level shown in table 2 if faster economic growth were achieved.

5. The expected 30% increase in supply by 1985 depends on three main factors: achievement of the scheduled expansion of North Sea oil production; an increase of more than a third in coal production, mainly for electricity generation - three-quarters of this increase being in N America; and the achievement of existing nuclear power programmes without slippage. Nuclear power would then contribute 7.3 mbpd of oil equivalent supply in 1985, compared to 2.3 mbpd in 1977.

Energy demand in developing countries outside OPEC

6. Present annual consumption of commercial energy in these countries is about 2 barrels of oil equivalent per head, in contrast to 34 in developed countries. Consumption should rise rapidly as development takes place, as a result of industrialisation, urban growth, less use of non-commercial energy sources, and increased domestic and transport use.

7. Therefore, we expect energy demand growth to be more rapid than economic growth - 1.3% for every 1% increase in GNP. In table 2 it is also assumed that average GNP in these countries will increase by 4.7%, a third faster than for OECD. Even so, in 1985 this group's total energy demand will be only one-fifth that of developed countries.

Energy supply in developing countries outside OPEC

8. We expect energy supply in this group to more than double by 1985, as the majority of countries increase local production as fast as possible to limit imports and maximise economic growth. The energy demand/supply balances of the 90 or so countries involved will vary widely, however: India and S Korea produce nearly 80% of the group's coal, and will continue to do so. In 1985, five countries - Argentina, Brazil, Egypt, India and Mexico - may produce about 70% of the group's oil production, with Mexico alone producing 40% of the total. Thus, even though the group's net demand for OPEC oil is expected to fall to only 1.2 mbpd in 1985, most countries will continue to be net oil importers.

OPEC's energy demand

9. In the case of Iran we have assumed nil growth in energy demand, consistent with Annexes B and C.

10. For the remaining twelve countries we expect that the growth of energy consumption should tend to slow down as they become more industrialised and

real incomes rise; this would be consistent with the experience of developed countries. Nonetheless, while the energy coefficient for OPEC may be lower than that for the rest of the developing world, it is still expected to be greater than 1.0: in table 2 it has been assumed that the coefficient is just under 1.2. Coupled with rapid economic growth of about 7% pa, this leads to the demand for energy nearly doubling by 1985.

OPEC non-oil energy supply

11. OPEC countries possess about 60% of the non-communist world's known natural gas reserves. Much of this gas is associated with oil and they are produced together, but until recently most of this gas has been flared, because its domestic use has been expensive and export unprofitable, because of the investment required. For example, in 1977 OPEC gas production was 4.6 mbpd, of which 2.4 mbpd was flared. With declining oil reserves, OPEC countries are placing increasing priority on gas utilisation, and we expect production nearly to treble by 1985.

Communist countries energy balance

12. At present communist countries are small net exporters of gas and oil: from the USSR to W Europe, and from China to Japan. This balance is estimated to change over the next ten years, with net imports of 0.2 mbpd in 1985. The USSR's current exports are primarily aimed at earning foreign currency, though she imports some gas, especially from Iran. China, which has in the past largely depended on coal, is rapidly expanding its oil and gas productive capacity, and is estimated to export 0.7-0.8 Mbpd of oil in 1985, partly to finance purchase of foreign technology. It is unlikely that the growth in energy demand in the USSR and Eastern European Comecom States will be matched by increasing domestic supply: coal and gas production will increase, but USSR oil production (97% of the bloc's oil production) is estimated to level off after 1980, as existing oil fields run down and there are delays in opening up new sources of supply, which are adequate in terms of reserves, but difficult to exploit for technical and geographic reasons. The E European communist countries are estimated to be net energy importers of about 1 mbpd in 1985.

ANNEX B

SUPPLY OF OPEC OIL

The detailed country by country estimates underlying Table 3 are as follows:

OPEC SUSTAINABLE PRODUCTION CAPACITY AND LIKELY AVAILABLE SUPPLY* mbpd

	1978		1985		
	Installed capacity	Production**	Installed capacity	Maximum sustainable supply	Willing production
Saudi Arabia***	11.8	7.7	13.0	11.5	10.5
Iran	7.0	5.7	5.0	4.7	4.4
Iraq	3.2	2.5	4.8	4.3	4.3
Kuwait***	3.3	2.0	3.0	2.7	2.5
UAE	2.4	2.0	3.2	2.9	2.2
Qatar	0.7	0.5	0.8	0.7	0.7
Algeria	1.2	1.2	1.4	1.3	1.3
Nigeria	2.4	1.8	2.6	2.4	2.4
Libya	2.5	1.9	2.8	2.5	2.5
Gabon	0.3	0.2	0.3	0.3	0.3
Venezuela	2.4	2.1	2.4	2.2	2.2
Ecuador	0.3	0.2	0.3	0.3	0.3
Indonesia	1.8	1.7	1.8	1.6	1.6
	39.2****	29.3****	41.4	37.4	35.2

* Oil and natural gas liquids

** Average of first three quarters

*** Figures for Saudi Arabia and Kuwait include their respective shares of production in the neutral zone.

**** Numbers do not add up due to rounding

These estimates for individual countries must by their nature be extremely uncertain, and undue weight should not be attached to them. We have set them out country by country partly to show the relative importance of different countries, and partly so that comparisons can be made with projections made by others. Most of the figures are similar to those included in an IEA forecast first circulated at the end of 1978 (see IEA/SLT(79)8). The two main exceptions are as follows:

a. The estimate for Saudi Arabia is lower. The Saudis are still saying in official discussions (for example recently with the IMF) that they intend to increase their sustainable production capacity to $11\frac{1}{2}$ - 12 mbpd. But the recently published report of the US Senate Foreign Relations Committee on the future of Saudi Arabian oil production provides detailed evidence to the effect that Aramco have been asked to work on the basis of a sustainable production figure of only 10.8 mbpd in 1983 and 11.2 mbpd in 1987 (these figures exclude production of natural gas liquids and in the Neutral Zone). The estimate also takes account of the political factors discussed in paragraph 29.

b. For Iran, we have assumed that with the change of regime the investment required to maintain 1978 capacity in 1985 will not be made; and that any regime in power will be more conservationist than the Shah's. The figure of 4.4 mbpd (of which 3.7 mbpd would be for export) would, we think, be sufficient to meet Iran's likely 1985 foreign exchange needs at today's real oil prices, and on certain assumptions might also be sufficient to meet her needs for government revenue.

ANNEX C

OPEC: POLITICAL AND ECONOMIC PROSPECTS TO 1985

This Annex concentrates in turn on the three largest OPEC producers, Saudi Arabia, Iran and Iraq. This is not to say that developmentsin other OPEC countries, such asAlgeria, Venezuela or Kuwait may not be important. But we would expect the three main producers to hold the key to likely OPEC attitudes up to 1985.

Saudi Arabia

2. The kingdom's importance has if anything been accentuated by the Iranian revolution, but her willingness to produce to the limit for an inadequate reward (and for friends who appear unreliable and insatiable) may be reduced. The Saudi regime's self confidence has been shaken by the events in Iran. On the other hand the regime is very different fromthe Shah's in Iran and should be more secure. The pace of development in Saudi Arabia has been slower, and, although the large number of immigrant workers is a potential weakness, it allows the Saudis to enjoy the fruits of development without the social strains so evident in Iran.

3. Politically, Saudi Arabia's behaviour in OPEC may continue to be motivated to some extent by:

i. An enhanced desire to preserve American support in an increasingly unstable environment.

ii. A continued desire to prevent grave damage to the world economy, to the dollar and hence to Saudi investment abroad. (But the importance of this argument to Saudi Arabia's true interests should not be overestimated: the higher income stream from a 10% rise in oil prices would be sufficient within a year to compensate the Saudis financially for around a 7% capital loss on their investments, without allowing for the continuing financial benefits of a higher price in later years.)

4. But we would expect these considerations to be outweighed by:

a. Disenchantment with the willingness and ability of the United States to guarantee the security of the regime.

b. A wish to keep closer to other Arab nations in the wake of the Egypt/Israel peace treaty.

c. A reluctance therefore to take as exposed a position in OPEC as hitherto.

5. Even before the Iran crisis, it was apparent that the Saudis felt they were entering a period of consolidation. Earlier physical constraints on development have eased, but the authorities are anxious not to return to the high inflation rates of 1975-76. In addition, they are concerned that development should proceed in an orderly manner and that modernisation should not go too fast. Hitherto shortages of manpower have been overcome by the recruitment of foreign workers; but anxiety over the social and security implications of this policy has led to tighter controls on immigration. This new attitude suggests that labour shortages could re-emerge and act as a brake on development in the years ahead. The budgetary constraints which began to make themselves felt in 1978 may have eased temporarily with the increase in production arising from events in Iran. But the latest transfer of SR 6.7 billion from state reserves to the budget account, and the news that the Saudis may now be contemplating borrowing suggest that some deceleration in the growth of government expenditure lies ahead.

6. Although the Saudis do not consider that an Iranian-style backlash could happen to them, they have been reminded that very-rapid development imposes strains on society and disturbs traditional and religious values. On the other hand, events in Iran could stimulate the Saudis to increase their defence spending.

7. There are therefore a number of considerations that on balance point to a gradual deceleration of government spending, particularly on development. Even so, we would not expect this deceleration to be sufficient to prevent financial strains emerging in Saudi Arabia in the early 1980s.

8. The April 1979 oil price increases, coming on top of the higher Saudi production which followed the initial Iranian crisis has, we calculate, largely eliminated the forecast budget deficit for 1978-79, and would allow a 10% increase in expenditure in 1979-80 with a balanced budget. The corresponding balance of payments calculations now point to a comfortable current account in 1979; but, even assuming a gradual deceleration in the growth of imports, this would disappear in 1980-81 (assuming that there is a constant real price for oil and no great increase in production). Despite the likely deceleration in the rate of Saudi economic development, therefore, pressure to raise oil prices (or possibly to increase production) would be making itself felt very early in the 1980s. Against the political background described in paragraphs 2 - 4 above, these economic needs are likely to be an important determinant of Saudi attitudes.

Iran

9. The identity and policies of the future rulers of Iran are still unknown - the present set-up seems unlikely to last for long. But whoever comprises the Iranian government we expect considerable economic retrenchment and a more austere, and less development-minded, regime than the Shah's. On the other hand Iran has been a "high absorber" partly because it has a population of 35m, and it will not cease entirely to be so just because military expenditure and prestige projects are pruned. The underlying motive for the Shah's drive to modernise Iran remains: by the end of the century, even with greater conservation, Iranian oil supplies will be running out, and new industries will be needed to take oil's place. Moreover, the new government will need to respond to the demands of the population for consumer goods and improved social services. Defence spending will slacken markedly but other public expenditure may not.

10. Politically, Iran's ability to produce oil regularly up to the 3½ - 4 mbpd targets that have been stated for the immediate future could continue to be restricted by:-

i. Industrial action. The strikes, which were so effective in bringing down the Shah, may be revived for other political ends, or simply for higher wages.

ii. Indecisive government policy. The signs are that Iran is in for a long period of weak central government, with the danger in the background of a military coup, or a left-wing takeover, or even civil war.

iii. Reluctance to use foreign expertise.

iv. International and internal tension. The Iran/Iraqi understanding which has held since 1975 could be at risk, with the possibility of tension on the border and of Iraqi subversion in the oil producing province of Khuzestan.

11. How far will Iran's economic needs determine her attitude to oil production, and to the oil price? As noted above it is clear that the regime's policies involve a substantially lower level of imports and government spending than obtained under the Shah. Turning this into figures for 1979, let alone 1985, is a highly speculative exercise. For 1979 a possible starting point would be a 35% volume reduction in imports over 1978 (embracing a 70% cut in military expenditure, 40% in transport and 30% in most other categories). It should be borne in mind that during the first quarter imports were almost non-existent. A possible oil production profile (based on what now seems might be technically feasible) would produce an average of 2.9 mbpd in 1979 (exports of 2.2. mbpd). If the average Iranian oil price this year were $16.5 per barrel (Iran clearly intends to put her prices at the top end of the range for medium/heavy Gulf crudes), then Iran might have to run down reserves by about $4 billion to a level of around $6.5 billion (equivalent to 5½ months' imports) during the year. All the elements in this equation are reasonably plausible, and indeed could give Iran a little margin in hand (higher output and/or a higher price could finance higher imports and/or less rundown in reserves).

12. As to subsequent years, a possible scenario might be a small rise in import volume in 1980 (as major projects are wound up but demand for food and essential commodities remains firm) followed by further small increases in subsequent years as the rigours of an Islamic republic are gradually relaxed. Even so, given the size of the contraction in 1979, import volumes in 1985 might be around the level in 1978. Even with no increase in the real oil price beyond the 1979 level the oil production needed to finance such a level of imports in 1985 might be of the order of 4 mbpd, a level that should present no technical difficulty.

13. Looking at the oil production requirement from the budgetary point of view, however, it seems that a higher level of oil revenues could well be needed to sustain government expenditure especially during the early period of high domestic

spending to get the economy under way again. Even after allowing for a degree of deficit financing and a devaluation of the rial - both of which would, of course, lead to severe inflationary pressures - it looks, at least initially, as if a higher level of oil production might be needed to meet budgetary pressures than would be required to keep the balance of payments looking reasonably healthy. The figure of 4.4 mbpd for 1985 included in the table in Annex B is intended to allow for these factors.

14. It may well be that the need for oil income will not, over the next few years, be the main determinant of Iran's economic and financial policies, but we must in any case expect Iran to join the OPEC price-hawks, seeking the highest possible income from the lowest level of production. Such a policy would reflect the need to conserve oil reserves for future generations, combined with an unwillingness to see Iran as having any responsibility for economic and financial stability in the West. However, the rulers of Iran will be without the prestige or firm central control which enabled the Shah to exercise strong influence in OPEC for large price rises in 1973 and for moderation in the late 1970s. It is too early to judge the effect of these factors on OPEC politics.

Iraq

15. The Iraqi government has not officially released details of oil revenues, production or exports since 1972. Estimated production together with Iraq's productive capacity since 1975 are as follows:

Year	Production (mbpd)	Capacity (mbpd)
1976	2.18	2.8
1977	2.27	3.1
1978	2.6 ?	3.2?

Iraq's proven oil reserves, at 34 billion barrels, are exceeded among OPEC countries only by those of Saudi Arabia (135 billion barrels) and Iran (55 billion barrels). Total reserves are thought to be much larger, probably second only to Saudi Arabia.

16. The current (1976-80) Development Plan envisages capacity increasing to 4 mbpd by 1980. This is a target which was scaled down last year from the higher level of 6.5 mbpd originally proposed. Most of the investment necessary to reach this target is already under way. With its ample reserves there are thought to be no

physical constraints on Iraq further increasing its productive capacity to 5.0 mbpd by 1985 (as envisaged in Annex B).

17. Nor are there thought to be any technical or administrative constraints on Iraq's ability to expand capacity to this extent. The Iraqi economy is almost entirely centrally planned (the private sector accounts for only 5% of the total) and, since the takeover of the oil industry by the Iraqi National Oil Company (INOC) in December 1975 was completed, the role of foreign oil companies has been very limited. Nevertheless, Western private companies remain in Iraq, providing expertise through service contracts; and the Soviet Union has provided, and continues to provide, extensive technical assistance. Nationalisation does not appear to have adversely affected the rate of development of capacity since 1975.

18. The detectable policy governing Iraqi oil production is to maximise revenues. Iraq has traditionally been among the most vociferous hawks within OPEC, pressing for substantial price increases; but when it has suited her, she has been prepared to discount the price of her oil compared with the light marker crude to expand production. The regime has also used its control over access to the Iraqi market for Western goods to induce oil importers (eg West Germany in 1978) to increase their take from Iraq by threatening to boycott their manufactured goods.

19. It is unlikely that increasing revenues will result in substantial increases in imports. The Development Plan 1976-80 aims to achieve an annual growth rate of GNP of 16.6% with per capita income growth of 13.3% p.a. and industrial sector growth of 17.8%. But the centrally planned nature of the economy and the very tight import licensing arrangements mean that the authorities will have the ability to sit on any excessive import rises. The regime has shown its ability to do this when imports in 1976 showed a fall of 18% on the previous year, compared with a rise in oil exports of around 11%.

20. If the Iraqis were to produce to near maximum capacity they would, given the low import growth, accumulate substantial financial assets. There is some doubt they they will wish to do so, given their distrust of those centres, including international institutions, where such assets could be held. Fresh aid to the frontline Arab states was pledged at the Baghdad Conference in October 1978, but flows have been spasmodic in the past and are liable to sudden interruption for political reasons. Iraq is associated with other Arab aid-giving organisations

such as AFESD. Iraq may spend more on armaments - mainly obtained hitherto from the Soviet Union, but now increasingly from France and other Western suppliers. The tentative conclusion is that she is more likely to limit her production if that (or price increases) threatened to increase her financial assets substantially beyond present levels. This could fit conveniently with an OPEC policy of keeping the market fairly tight to keep pressure on the price.

21. The Iraq regime is likely to come under increasing pressure from the Kurds, the Shia community and the Iraqi Communist party during 1979. It may therefore need further military equipment, and possibly more consumer goods from abroad. Kurdish insurgency could threaten production in the Kurdish fields, but in the past the Iraqi Army has been able to keep the oil flowing.

22. The impenetrability of Iraqi politics makes it difficult to make more than a tentative forecast of Iraq's oil exports by 1985. Suggestions by the Iraqis about the need for closer consumer/producer relations, some evidence that they are concerned about the prospect for political stability in the Gulf region and a greater willingness to co-operate with Western oil companies are all encouraging recent developments. Too great reliance should not be placed on these signs, but they suggest that the Iraqis may be more willing than hitherto to co-operate by helping to meet reasonable world energy demand.

cc Mr Hoskyns
Mr Wolfson

CONFIDENTIAL

Prime Minister
I think Energy are being too complacent about oil supplies. Their note (Flag B) on coal stocks suggests they are doing the right things to replenish the ~~power~~ power stations.

Are you content for me to write to Energy as per the draft at C?

No. Am not happy about that draft. Two points arise

(Mr Walker's letter at Flag D is also relevant)

Qa04131

To: MR STOWE

From: SIR KENNETH BERRILL

OIL SUPPLY

Flag A

1. The Secretary of State for Energy's minute to the Prime Minister of 25 May on Oil Supply perhaps understates the problems inherent in the current oil supply situation, which could well become much more acute next winter. I therefore attach a draft minute raising a number of points, which, if the Prime Minister agrees, you may wish to include in a reply to the Department of Energy.

I have slightly adapted

TL 1/6

(1) What "leverage" has HMG on the companies?
(2) What are BNOC's powers and what is likely involved in practice in a situation of shortage? Could you ask Sir K.B.

MT.

2. There is no obvious reason why the OPEC oil producers should turn up the taps to meet the current shortfall in supplies. Nor is it likely that IEA members collectively will be able easily to achieve their objective of a 5 per cent reduction in oil demand, let alone a further reduction beyond that. Few other IEA members enjoy even our own limited flexibility to switch from oil to coalburn at power stations or to increase indigenous oil production by, for example, relaxing gas flaring controls. The shortages are not likely to disappear in the short term; they could become much more severe.

3. The Government will find it politically very awkward if just at the time we are reaching oil self-sufficiency we have not used the leverage we have over the oil companies and the direct access to oil which we have through BNOC to ensure adequate oil for our own needs(after having fulfilled our IEA and EEC obligations). Judging by past experience, eg in 1973, and current straws in the wind this is not likely to happen automatically. The international oil companies are likely to wish to apply a policy of equality of misery amongst

.../...

CONFIDENTIAL

all countries and disregard the fact that the UK is now a major producer. But the prospect of future licencing rounds and other factors give us a powerful weapon for ensuring our needs are given priority. In this context it would be prudent to ensure that the study commissioned by the Prime Minister on BNOC looks carefully into BNOC's role in securing oil supplies in tight situations.

assuming BNOC has a future
TL

4. The companies may also have more room to give priority to certain classes of customer, eg farmers, industry, hospitals, than they admit.

5. I am sending a copy of this minute to Sir John Hunt.

KB

1 June 1979

Att

At Flag E is a letter from Mr Howell asking Departments how they intend to save oil. This is welcome, and I have mentioned this in the draft letter.

TL

Prime Minister
The table attached shows coal stocks at the power stations are very low, and that stocks at the pits are too high.
TL 1/6

PRIME MINISTER

FUEL STOCKS AT POWER STATIONS

Power station coal stocks fell more sharply than usual last winter and greater use of coal in place of oil this summer will restrict the normal summer stock build. Even if the programme for record levels of coal movements to power stations this summer is achieved, the CEGB expect to go into next winter with under 16 m. tonnes at power stations - some 3 m. tonnes below last year's level, and to end the winter with only 10 m. tonnes - some 4 to 5 m. tonnes below the level of recent years. I accordingly propose to discuss with the CEGB and the NCB the scope for increasing coal stocks.

The CEGB cannot save coal by increasing oil burn because oil supplies are very tight. Moreover, the reduced oil burn and increased coal consumption this year provides most of our contribution to the international oil saving programme. Clearly however if the CEGB can lay their hands on some extra oil for stock they should do so.

The main possibilities for rebuilding power station coal stocks appear to be:-

- increased coal imports. Some 2½ m. tonnes of Australian coal will be imported this year in any case. Railway capacity may limit any additional quantity to about 1 m. tonnes, though we believe that with a sustained effort this could be increased to 2 m. tonnes of additional imports;

- increased gas burn. An extra 1 m. tonnes or more of coal can be saved in this way; beyond this savings of up to an additional 2 m. tonnes could be achieved at West Thurrock - but the coal displaced could not at present easily be diverted elsewhere because railway capacity is already stretched by the existing coal delivery programme. Nevertheless this possibility will be kept in reserve;

- use of coking coal. Perhaps up to 2 m. tonnes might be used but, again, the main constraint is likely to be existing pressure on the coal handling and transportation system.

I intend to discuss with the NCB and the CEGB what really is the maximum achievable with each of these measures, but together they may enable us to secure a substantial improvement in stock levels.

The coal industry will be very sensitive to proposals for extra imports. We must therefore be very careful about the presentation of any action that may be taken. The chief points are:

a) Action to build up coal stocks before the winter should be presented as a natural consequence of the world oil crisis and thus in accordance with our international commitments made in March to reduce oil consumption.

b) We shall need to reassure the coal industry by stressing the short term nature of the measures, while publicly acknowledging the vital long term role of coal.

c) Sympathetic treatment now of the dispute between BSC and the NCB on coking imports would be crucial in this context.

I am sending copies of this minute to the Secretary of State for Industry, the Secretary of State for Employment, the Secretary of State for Scotland, the Chief Secretary, the Minister of Transport and Sir John Hunt.

DH

Secretary of State for Energy,
31 May 1979.

A

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

The Rt Hon David Howell MP
Department of Energy
Thames House South
Millbank
London SW1

31 May 1979

OIL SUPPLIES FOR FOOD PRODUCTION AND DISTRIBUTION

I am naturally very concerned about the prospects of maintaining supplies of fuel to farmers, fishermen, food processors and distributors whilst the oil shortage lasts.

Your Department and mine have been operating arrangements under which food producers (including, of course, the farmers and fishermen) and food distributors, who have difficulty in getting enough fuel, send the details to our officials who then approach the oil companies on their behalf.

There have been signs during the last two weeks that when under pressure these arrangements certainly begin to creak. We have had examples of farm co-operatives being devoid of their supplies at a peak time of usage . Last weekend milk tanker operators were in a situation where they were about to leave milk on farms which would have to have been poured away and it was only at the last moment we were able to scrape together enough to keep these particular lorries going.

In 1973/4 you will know that the then Government gave a very high priority to food production and distribution and, I must confess, that my own experience at that time was that the oil companies could not be relied upon to put the national interest before the chance of making bigger profits, and for them to give the priorities the national interest demanded a great deal of prodding was required.

I am very concerned that at a time such as harvesting, and in the case of the fishermen at peak periods for fishing, either the supplies will not be available or supplies will be offered at a very high premium on normal prices. If this is so the effect on food production and distribution could be serious.

I hope/...

I hope, therefore, you will be prepared to put it to the oil companies that they must allocate their reduced supplies in such a way as to assure food producers and distributors that they will receive the fuel that they need at normal market prices. I think they should also be warned that a failure to do this would bring an understandable public demand for both price fixing and compulsory allocation.

I am sending copies of this letter to the Prime Minister, the Chancellor of the Exchquer, the Secretaries of State for Scotland, Wales and Northern Ireland and the Secretary of State for Industry.

PETER WALKER

cc Mr. Wolfson
Mr. Hoskyns
Mr. Pattison

Energy

JS

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

MR. VILE
CABINET OFFICE

I attach a note on the points which the Prime Minister made when she visited the Department of Energy on 18 May. The note was prepared by the Department of Energy, though I insisted on several drafting changes. It is being circulated only to Senior Officials in the Department of Energy and to you, because the Prime Minister specifically said that she did not want any minuting.

T. P. LANKESTER

31 May 1979

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
TEL: 01 211 6402

TP Lankester Esq
Private Secretary to the
Prime Minister
10 Downing Street

31 May 1979

Dear Tim,

As promised, and with apologies for delay, I enclose three copies of a record of the points made by the Prime Minister in discussions here on Friday 18 May.

Yours sincerely,

John Arnott

John Arnott
Private Secretary

PRINCIPAL POINTS MADE BY THE PRIME MINISTER ON HER VISIT TO THE DEPARTMENT OF ENERGY: 18 MAY 1979

Oil

The Prime Minister expressed the view that cuts in consumption incurred through or on behalf of international agencies could not be top priorities for the UK. It was much more important to maintain adequate supplies of fuel to keep industry going. She was very concerned that a blanket figure of 5% could not take sufficient account of the circumstances of individual countries.

Turning to the North Sea she enquired about the causes of the decline in oil exploration activity. As to the right balance of incentive and complusion for future policy, she felt that there was a real risk that excessive regulations regardless of coutervailing incentives would have a damaging effect on confidence.

Coal

The Prime Minister asked what could be done about the £300 million loss which the NCB expected to make this year. She recalled that Government's relations with the NCB for so long as she could remember, had largely consisted of a succession of write-offs. She asked how much a pit had to be losing before it could be closed, and expressed confidence that many miners would be happy to accept closure providing that they were given generous terms of redundancy. The Rhondda was cited as an area where extensive pit closures had not prevented advances in economic prosperity. She had great difficulty in seeing the money which, over the years, the Government had put into the coal industry as any kind of serious investment proposition; the likelihood of a return remained remote. Over the time in which she had knowledge of the industry, again, it had invariably been promised that a few more years of investment would see the industry into the black; but the improvement had yet to appear. She therefore questioned the wisdom of the massive investment programme which the NCB were currently embarked on. Moreover, on environmental grounds, she was unhappy with the proposed Belvoir development.

. Electricity

On fuel stocks for the coming winter generally, she noted that should there by any difficulties in supply we would have need of maximum reserves and flexibility. As a contribution to this we should have more dual-fired power stations. If the winter should be a difficult one, it would be absurd not to have taken every possible step towards securing alternative supplies. The decision of the previous Government to burn an additional 2 million tons of coal at the power stations this summer would make us more vulnerable to coal shortages. She suggested that the CEGB should consider imports on a significant scale in order to increase stocks, though she appreciated that the attitude of the NUM could not be ignored.

The Prime Minister said that she had never been able to see the case for further re-organisation. She was against it because it tended to absorb energy which could otherwise be applied to the real tasks of the industry. The change which was needed was to inject some competition into the field. She recalled that the Conservative Party had suggested many years ago a structure of regional power boards, rather than a centralised industry, and remarked that she felt it would be highly beneficial if the consumer could have the option of buying surplus electricity from any producer - such as a local manufacturer - who might happen to have excess production, rather than being tied to a national monopoly. In preference to a re-organisation of the industry, she would like to see fairly small changes to open it up to competition. She wondered whether it would be possible to add something to this end to the Competition Bill which is being prepared by the Trade Secretary at the moment. (The Secretary of State undertook to look into this).

She asked why the industry had decided to move from 500 mw to 660 mw sets. It seemed that teething problems with the 500 mw sets had only recently been overcome: would it not have been better for the CEGB to persevere with these sets rather than take risks with still larger ones? She also expressed surprise that more attention had not been given to the relatively high losses in electricity production.

Nuclear

The Prime Minister said that she believed that we would only come close to solving our problems in energy supply when we had a substantial contribution to overall supply from nuclear power. She was confident that UK engineers would not cut corners in a way which could expose us to incidents of the kind which had taken place at Three Mile Island. She noted with regret that the French programme in fast reactors had overtaken our early lead in the field. She noted that the Government was committed to a major public enquiry on the CDFR but would like to see the project move ahead as fast as possible within that constraint. She noted the desirability of ensuring that all engineering problems were fully worked out before relevant construction work commenced, as had not been the case in the first AGR programme.

She felt that all of those concerned should be making great efforts to present nuclear power to the public in a positive light. She commended a lecture in which Sir John Hill had remarked that a critical analysis of the use of coal as a fuel, had it been performed before the exploitation of coal became common-place, would certainly have condemned such a dangerous and messy power source. If we were to have adequate supplies of energy for the future this re-assurance by the Government of the need for, and fundamental acceptability of, nuclear power was essential.

On nuclear waste, she remarked that she had been concerned by the volume of material which had to be dealt with. She hoped that some more efficient way of dealing with these large volumes could be found.

Gas

The Prime Minister hoped that the price of gas would not be increased for reasons of energy policy alone. She noted that the new Government had inherited a great many inflationary pressures which would have to be allowed to work their way through the system. She would not wish to see unnecessary additions to these.

BNOC

The Prime Minister made clear that she saw no value in having another commercial oil company. She noted that BNOC's existing contracts and commitments - which would have to be respected - imposed restraints on a radical restructuring of BNOC. She saw no advantage of introducing a private equity interest to BNOC, making it more like BP, and would prefer to dismember it. The equity interests could be sold off, subject to any fettering required to retain an appropriate UK share in the UKCS or to retain Government control. She was not convinced that having oil in the hands of BNOC put the Government in any stronger position in evading EEC restrictions than would obtain in the absence of BNOC.

International Negotiations

The Prime Minister said that the UK should take a tough line in international negotiations on energy issues. It was essential that the national interest should be protected.

31.5.79

Cabinet / Cabinet Committee Document

The following document, which was enclosed on this file, has been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES.

Reference: CC(79) 4th Conclusions, Minute 8

Date: 31 May 1979

Signed AWayland Date 27 October 2009

PREM Records Team

From Sir Kenneth Berrill KCB

29.v.79

Mr Lankester.

Fuel Stocks

Does the Prime Minister see the attached? It illustrates vividly a point we made in the CPRS brief for her visit to the Department of Energy. Stocks of coal at the pit head are high, stocks downstream are low. The graph presents a worrying picture of where we might be at the onset of the next winter. Needs careful watching – & action.

KB.

CONFIDENTIAL

Energy

VL6

cc HO
FCO
HMT
D/I
LPO
D/M
MAFF
D/T
CST
CO

10 DOWNING STREET

From the Private Secretary

29 May 1979

International Energy Agency

The Prime Minister has seen and taken note of the Secretary of State for Energy's minute of 25 May, summarising the outcome of the I.E.A. Ministerial Meeting which he chaired on 21/22 May. The Prime Minister was glad to have Mr. Howell's account of this meeting.

I am sending copies of this letter to the Private Secretaries to other members of E Committee and to Martin Vile (Cabinet Office).

B. G. CARTLEDGE

W. Burroughs, Esq.,
Department of Energy.

CONFIDENTIAL

2

Prime Minister

To note.

cc Mr Wolfson
cc Mr Hoskyns

PRIME MINISTER

OIL SUPPLY

Despite the resumption of oil exports from Iran at about two-thirds of the previous level, world oil supply is currently running about 4% below the level of normal demand. Moreover, normal channels of supply are being by-passed to a growing extent by producers, thereby increasing uncertainties about future supply and hence demand by companies for any marginal quantities available on the open market. The inevitable result has been swiftly rising prices: term prices for crude oil are now 25% - 50% up on prices at the end of last year and spot prices for crude and most products have doubled.

Over the first 6 months of this year, the major companies operating in the UK expect their access to crude and product supplies to run less than 1% below last year's levels. Unconstrained demand this year has, however, been up 5% - 6% on last year (first quarter figures). Stocks were drawn down in the first quarter to meet this demand; and the prudent need to rebuild stocks, with an eye particularly to next winter, is increasing the gap between demand and supply now. As a result almost all major oil companies operating in the UK are restricting supplies into the market, at best at 100% of last year's level and in some cases down to 80%.

In short, the overall shortfall in UK supply is in line with the general world situation, ie. it is serious, but not critical. Effective demand constraint to the full extent of the 5% to which Member States of the International Energy Agency are committed would reduce the gap between world supply and demand to negligible proportions. But the supply position of individual countries and companies is uneven. In the UK, this is reflected

Contd/2.

in the more severe allocation cuts being imposed by some companies. It is this uneven effect which is giving rise to most concern and demands for further Government intervention from both sides of the House.

While companies are operating their own allocation schemes, they must treat all their customers equitably, or risk legal action. This inhibits them from giving priority to any particular classes of consumer (though there has been some informal response to the need to cater, for example, for the late spring sowing needs of farmers). It is open to us to invoke powers under the Energy Act 1976 to relieve companies of their contractual obligations and establish priority needs. But such a system cannot work successfully without re-allocation of supply also between companies. To mount the full-scale Government directed oil allocation scheme (the counterpart to which would be petrol rationing) would be a major Government intervention which I do not recommend. There is reason to suppose, for example, that such a Government directed system might divert away from the UK part of the supply which might otherwise have come here. The major oil companies, with whom we have discussed the situation, do not recommend Government intervention on the supply side.

What is needed is demonstrable commitment to demand saving, with the public sector giving a strong lead. Action on this is in hand and I will make further recommendations as necessary. This effort must form part of a coherent long term programme for oil conservation and optimising our use of our indigenous oil.

Colleagues are likely to find it necessary to comment on the oil supply situation this week-end. I suggest they speak to the points in the attached note.

I am sending copies to this minute to Cabinet colleagues including the Minister for Transport and to Sir John Hunt.

David Howell

Secretary of State for Energy,
25 May 1979.

THE UK OIL SUPPLY SITUATION

SPEAKING NOTES FOR MINISTERS

1. What is the UK oil supply situation?

Supplies to the UK in the first six months of this year are expected to be at much the same level as in the first six months of last year. But due to the hard winter, demand this year has been running at about 5-6% more than last year and this has left us with low stocks which need to be rebuilt before next winter. If the full demand were to be met, we would need extra supply, and this extra oil is simply not available.

We have a serious oil problem, but not a crisis. This is happening all over the world.

2. What should people do about the shortage?

Everyone must cut back on their consumption of oil. We need to save at least 5% of what we had planned to use this year. The country has joined its partners in the International Energy Agency and in the EEC in a commitment to make these savings; it is vitally important that they are achieved. If they are not, prices will continue to rise and many people will go short of oil.

For its part, the Government is cutting back on the consumption of oil in the public sector and in the use of oil for electricity generation. Everyone else, whether in industry, commerce, or as a motorist, must contribute. This may mean cutting back on some services so that essential services can be maintained.

3. What is being done to share out supplies?

In order to make available supplies go round as fairly as possible, and in order to rebuild their stocks, the oil industry is operating an allocation system. Consumers should adapt themselves to their allocation and put it to the best effect; all unnecessary uses of oil should be cut out.

4. Why is the effect on consumers uneven?

Some suppliers have been harder hit by the world supply shortage than others. This means that their customers may be getting less than others. If everyone cuts back these problems should be reduced to a minimum and be within the capacity of the industry to solve. The industry itself has not suggested Government intervention on the supply side.

5. What is the Government doing about it?

The Government is committed to effective demand constraint, which is the way to bring supply and demand back into balance. Plans for rationing exist but their introduction would not produce any more oil. No other country has found it necessary to take this step. The Secretary of State for Energy has made it clear he expects all parts of the public sector to account to him for achievement of 5% demand constraint.

6. Why are we not protected by the North Sea Oil?

The maintenance of normal trade patterns with our trading partners is as much in our interest as it is in theirs. This is an international problem, which needs an international solution. In any case, to get the right balance of products, and to operate the refineries in an economic manner, we need to import oil which is cheaper than our own North Sea oil.

7. Can BNOC help to direct supplies our way?

BNOC has been asked to help our refiners as much as they can; but the Corporation must, of course, honour its commitments to our trading partners.

8. Will we have to share UK oil with others if the situation gets worse?

If the oil sharing arrangements in the International Energy Agency are introduced, we might have an obligation to make a contribution to others, or a right to a supply from them. That is the essence of the commitment into which all parties to the International Energy program entered.

Department of Energy (OP(H))

25 May 1979

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Prime Minister
For information.
BGA
23/5

PRIME MINISTER

INTERNATIONAL ENERGY AGENCY -
MINISTERIAL MEETING 21/22 MAY.

As energy will bulk large at the Tokyo Summit you may like to know the outcome of the IEA Ministerial meeting which I chaired. The main points were:-

a) Agreement that the world oil situation is very tight and that this situation is likely to continue into 1980. Particular concern about the large and rapid increase in crude oil and product prices. Ministers reaffirmed the need for effective implementation of the already agreed reduction of 5% in oil demand and recognised that measures to reduce demand will also be necessary for 1980. It is left to Member States to decide on appropriate measures including pricing policies, strengthened voluntary programmes or mandatory action if necessary. I made it clear that we did not favour the last.

b) Complete agreement - even from a country like Austria - that the world cannot do without nuclear power. To achieve the necessary nuclear programmes everything possible must be done nationally and internationally to overcome safety, waste disposal and non-proliferation problems and to inform the public of the results of this work.

c) Ministers adopted principles for IEA action on coal designed to increase both production and consumption very substantially. This is mainly a question of bringing the big coal producers like the USA and the big energy importers like Japan together. But the

196

Contd/2.

UK will benefit from effective action which reduces pressure on limited oil resources.

I am sending copies of this minute to the members of E committee and to Sir John Hunt.

David Howell

Secretary of State for Energy,

25 May 1979.

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CONFIDENTIAL

FILE

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Energy

Copied to:
Euro Pol: Jenkins
May 79.

10 DOWNING STREET

From the Private Secretary

B/F ~~30.5.79~~

21 May 1979

B.F. 11/6

Dear Paul,

Call on the Prime Minister by the President of the European Commission on 21 May 1979

The President of the European Commission, Mr. Roy Jenkins, called on the Prime Minister at No. 10 today at 12 noon. Mr. Jenkins was accompanied by Mr. Tickell; Mr. Michael Franklin (Cabinet Office) was present.

I enclose a copy of my note of the Prime Minister's discussion with Mr. Jenkins. I should be grateful if you would ensure that it is given the restricted distribution appropriate to Prime Ministerial records.

You will note the Prime Minister's reference to the need for co-ordinated research on the bargaining position of the West, and of the EEC in particular, vis-a-vis OPEC in any forthcoming negotiations on oil prices and supplies. I should be grateful for advice on how such a study might be initiated, either nationally or within the Community framework. I should also be grateful if the CIA paper produced in 1976, to which Mr. Tickell referred, could be identified and a copy sent to me for the Prime Minister's information.

I am sending copies of this letter and enclosure to Garth Waters (Ministry of Agriculture, Fisheries and Food), Andrew Duguid (Department of Industry), Bill Burroughs (Department of Energy) and Martin Vile (Cabinet Office).

Yours ever,

Bryan Cartledge.

Paul Lever, Esq.,
Foreign and Commonwealth Office.

gn.

CONFIDENTIAL

Top copy on Energy, May 1979
(PM's visit to D. Energy)

Energy 1979

PRIME MINISTER

I attach notes setting out the main issues, with an indication of their possible timetable, on which I expect early collective discussion will be necessary. You may wish to have a brief discussion on some of these when you visit the Department on Friday.

I am sending copies of the note to Geoffrey Howe, Keith Joseph, Lord Carrington, Michael Heseltine, John Nott, Jim Prior, George Younger, Nicholas Edwards and Sir John Hunt.

DH.

Secretary of State for Energy
16 May 1979

CONFIDENTIAL

INTERNATIONAL OIL SHORTAGE

As a result of the Iran crisis the world oil situation is extremely tight. There were little or no oil exports from Iran between Christmas 1978 and the beginning of March 1979. Iranian output has since recovered but is unlikely to exceed about two thirds of its pre-crisis level - a shortfall of 2 m. barrels per day or about 6% of internationally traded oil. Some OPEC countries which had increased output while there were no Iranian exports are now cutting back to pre-crisis levels. Local shortages are beginning to appear and more serious ones can be expected next winter.

2. The member countries of the IEA at the beginning of March committed themselves to reduce demand for oil on world markets by 5% by an unspecified date. The European Council at its March meeting agreed that the Community should reduce oil consumption by 25 m. tonnes or just under 5% in 1979. Some progress has been made: but the decisions are slow to take effect and it is not clear that the full reductions will be achieved. The question of continuing demand restraints into 1980 will arise in the coming months.

3. The UK has been partly insulated from the pressures by North Sea oil, but export commitments cannot be redirected into the UK except in a full emergency, when our obligations under international oil-sharing arrangements (IEA, EEC) would come into effect. Supplies this quarter are expected to be about 2½% below demand at present prices. Most companies are now allocating supplies to regular and contract customers at or below last year's level and declining to take on new business. Customers without contracted supplies are finding it hard to get enough at prices they are at present prepared to pay. The CEGB at the request of the Government is reducing oil consumption in the six summer months by 1½ to 2 mill. tonnes and a vigorous oil saving campaign was launched by our predecessors throughout the public sector. But further measures including fiscal ones may well be needed.

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4. The most serious result of the Iran crisis is that it has enabled OPEC countries to increase prices substantially. After taking account of the premia which most OPEC countries except Saudi Arabia are charging, prices at the end of April were nearly 25% higher than at the end of 1978, though in real terms only restored to 1974 levels. Since then Iran has increased prices by a further 60 cents a barrel or 3.6%. This may produce a ratchet effect and make it difficult for Saudi Arabia to hold her prices at levels lower than those of the other OPEC producers. The OPEC increases have not yet been fully reflected in the UK partly because of the strength of sterling. But further retail price increases are inevitable. Petrol prices must be expected to rise by 4p to 5p over the next few months even with no change in fuel tax.

5. Policy hitherto in both the IEA and EEC has been to try and tackle this situation by encouraging a better balance between supply and demand through demand restraint. But a number of countries are now urging the introduction of formal allocation systems or of new measures to influence prices through Government action. The UK has been cautious about these suggestions. (We doubt whether they are either practical or in our interests given our North Sea oil).

6. It has to be remembered that, though in 1980 we may produce the equivalent in tons of our domestic oil needs, we have to export a lot of our light sulphur free oil and import other producers' heavy oil to meet our product needs.

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REVIEW OF BNOC

A quick review of BNOC has been set in hand with the aim of putting recommendations to Ministers in June. The review will cover all the Corporation's activities: how far each of them is essential to secure the national interest: and the compatibility of such activities with a commercial operation. Urgent consideration is being given to a new financial structure/ separate from the National Oil Account (which will require legislation), and the removal of BNOC's special position on assignment of licences. The Corporation should certainly be made subject to PRT (Petroleum Revenue Tax), a change which the Chancellor could embody in the Finance Bill together with any changes in PRT that might be agreed.

2. The review of BNOC will include the future of their participation agreements with oil companies. It will also cover possible changes in the financial structure to permit private ownership and mixed finance and/or the outright disposal of assets to private buyers.

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COAL STRATEGY AND NCB FINANCES

We expect to submit in mid-June papers on policy for the coal industry, and on the financial position of the National Coal Board, which is likely to require legislation in the late autumn.

2. The changed outlook and steep price increase for oil in 1973/74 transformed the future prospects for coal and led to the adoption of a substantial programme of investment - some £500 million a year - designed to reverse the industry's previous decline. Current energy forecasts confirm the longer-term need for a larger, more efficient coal industry at which the investment programme is aimed, but suggest the possibility of exportable surpluses in the medium term. Substantial cost increases, aggravated by losses from keeping in production old and uneconomic collieries and the burden of unfructified investment costs, have eroded coal's competitive advantage. The NCB's current five year plan forecasts large losses and heavy reliance - some £375 million in 79/80 after a second coal price increase in the summer - on public expenditure throughout the period with substantial claims on the contingency reserve. No

3. A review of the industry's present planning objectives and its financial position is in hand. Decisions will then be needed on general coal strategy on measures to set the industry on the road of financial viability the future financial regime of the NCB and statutory powers of grant aid to the industry, and the handling of a number of specific problems, such as the heavily loss-making coalfields. These include South Wales, on which there is a published report which the previous Secretary of State prepared in conjunction with the Board and the mining unions, under the tripartite consultative arrangements set up by the previous Administration. The future of these arrangements also needs to be considered.

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ORGANISATION OF THE ELECTRICITY SUPPLY INDUSTRY

The last Government prepared a Bill to set up a new Electricity Corporation in place of the Electricity Council, the CEGB and the 12 Area Electricity Boards in England and Wales, and to provide for the internal structure of the industry below the main board of the Corporation to be determined in future by secondary legislation. The Bill was published but not introduced; it was however the subject of "pre-legislative hearings" by the Select Committee on Nationalised Industries last year which highlighted a number of controversial features of the proposals, but endorsed the general framework and argued the need for early legislation.

2. Decisions are required on whether or not to proceed with the reorganisation of the industry and, if so, whether on a centralised or devolved basis. A report on this including the legislative implications will be submitted as soon as possible.

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PROSPECTS FOR THE TURBO-GENERATOR INDUSTRY

An early report will be submitted on the prospects and scope for early rationalisation of the two turbine manufacturers.

2. Related to this question is the allocation by the Central Electricity Generating Board and the South of Scotland Electricity Board of the orders for the turbo-generators for the two AGR power stations at Heysham and Torness which the previous Government approved. Design contracts, which will in practice determine the ultimate destination of the manufacturing orders, are due to be placed soon and the Generating Boards are expected to consult the Government before notifying the manufacturers of their intentions. Other Departments will need to be consulted. Collective discussions by Ministers may be necessary.

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ORGANISATION OF THE NUCLEAR INDUSTRY

The present structure of the nuclear industry, based on the National Nuclear Corporation (NNC) and its operating subsidiary the Nuclear Power Company (NPC), was devised in 1973 and intended to operate as a partnership between Government and General Electric Company (GEC). The arrangement has not worked satisfactorily, and changes have been under discussion for the last 15 months. There is a consensus that GEC should cease their supervisory management of NPC, that the present two-tier structure (NNC and NPC) should be replaced by one single Company directly responsible for all its activities and that the NPC's management should be strengthened. Other more fundamental proposals about NPC's long-term role, structure and membership have been raised but left unresolved. There is an urgent need to end the uncertainties and settle on a sensible structure which will meet present and future needs. There will be early discussions with the parties mainly concerned with the aim of bringing forward proposals for limited interim changes to resolve the immediate uncertainties before the Summer Recess.

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THE ROLE OF NUCLEAR POWER

Ministers will need to give careful consideration to their attitude towards nuclear power. The recent incident at Harrisburg in the United States has prompted widespread concern about nuclear safety. However, the general safety record is good and at present there seems little prospect of our being able to satisfy, without a significant nuclear contribution, our future energy requirements, particularly as oil and gas supplies become scarcer and increasingly expensive. It will be important therefore to maintain and develop our nuclear option. But public confidence will need to be strengthened in the safety of nuclear operations.

2. Nuclear, in particular safety aspects, and general energy policy will be reviewed to arrive at a considered and balanced view. A number of specific issues will arise for decision in the coming months, though it is not possible at this stage to say whether or when they may call for collective consideration. They include policy on the further development of the fast reactor, possibly under international collaborative arrangements, and related issues; the choice of licensor for work on a PWR design for possible introduction in this country; expanded arrangements for assessing the safety and security of civil nuclear power, possibly - again - international arrangements and our position relative to various questions which arise on Euratom and the competence of the Community.

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NATIONALISED ENERGY INDUSTRIES PRICING AND FINANCIAL TARGETS

Proposals to increase domestic prices for gas and electricity by 8 - 9%, and to increase service charges in the gas industry, are being considered by the Price Commission. The proposals (together with increases in non-domestic prices, which have gone ahead) were put forward by the industries to enable them to achieve their financial targets for 1979/80 (6½% on turnover, after interest, for gas; 10% on net assets before interest for electricity (England and Wales). The Price Commission reports are due in June.

2. Ministerial decisions to overrule the findings of the Price Commission and to allow the price increases to go through may be necessary to allow the industries to achieve their financial targets, and to operate within their cash limits; there may need to be a second electricity price increase later this year because of rising costs (see paragraph 4 below) and lost revenue from the current delay to price increases.

scope for increased efficiency? TL

3. Industrial coal prices were increased in March by 9%; domestic prices are to go up in the autumn. The NCB's cash limit set for 1979/80 assumed a further industrial coal price increase this summer. The Board now estimate that the additional revenue required is £133m. requiring an average increase of about 6%. The most likely date would be 1st July. If Ministers wish to intervene a decision would be needed by early June.

4. A further coal price increase would need to be passed on in higher electricity prices. The consequential increase would be about 2 - 3%, if there were no other factors involved, but may need to be higher (see paragraph 2 above).

5. Decisions will also be needed in the summer in the nationalised industries' financing and investment review on measures to eliminate the nationalised energy industries' bids

for additional public expenditure in the years 1980/81 - 1983/84 as a result of their forecasts of higher external financing requirements. This could involve higher prices for gas and electricity, colliery closures and reductions in investment programmes. Decisions on gas and electricity prices will need to be reflected in the setting of medium-term financial objectives for the gas and electricity industries, from 1980/81 onwards, which will determine the industries' future price levels. Energy policy, public expenditure and counter-inflation will be relevant considerations.

CONFIDENTIAL

Power file

i. ~~Caption~~ – can you pls. arrange x

2. CF

3. B.F. T.L. ~~18~~ May

8/5

10 DOWNING STREET

From the Private Secretary

8 May 1979

The Prime Minister has given some preliminary consideration to the various energy issues which the new Administration will have to tackle. She would be grateful if your Secretary of State, in consultation with interested colleagues, would let her have an early note setting out the main issues which will have to be dealt with and also setting out a timetable for bringing them forward for collective consideration. The Prime Minister has herself picked out two issues on which she would like reviews to be got underway as soon as possible: firstly, she would like to have a review from your Department and the Department of Industry on the prospects, and scope for early rationalisation, of the two turbine manufacturers; secondly, she has asked for an urgent review of BNOC and its possible future role. Linked to the question of BNOC is the future of the existing participation agreements with the private oil companies, and the Prime Minister has asked for advice in due course on what the Government attitude should be to them - taking into account the point that there appears to be some doubt about their legal validity.

See Prime Minister May 79: Visit to DoEn.

As I have already mentioned to you, the Prime Minister would like to pay a visit to your Department before Parliament rises for the recess; we will be in touch with you to arrange a suitable time and date.

I am sending copies of this letter to Tony Battishill (Treasury), Andrew Duguid (Department of Industry), Tom Harris (Department of Trade), Paul Lever (Foreign and Commonwealth Office), Eric Sorensen (Department of Environment), Ian Fair (Department of Employment), Kenneth MacKenzie (Scottish Office), George Craig (Welsh Office) and Martin Vile (Cabinet Office).

T. P. LANKESTER

Bill Burroughs, Esq.,
Department of Energy.

CONFIDENTIAL

b.c.: Mr. Stowe
Mr. Wolfson
Mr. Ridley
Mr. Ryder

File

Power

10 DOWNING STREET

From the Private Secretary

MR. VILE

CABINET OFFICE

ENERGY ISSUES

The Prime Minister has now considered Sir John Hunt's minute of 4 May on the above subject. She has made the following comments:

(i) Under the heading of Oil Consumption, she has commented: "We must try to keep coal stocks at a high level. For 1979/80 that is more important than cutting oil consumption".

(ii) The Prime Minister agrees that we must make every effort to close uneconomic pits.

(iii) On fast breeder reactors, the Prime Minister has commented: "We are committed to an inquiry first. I hope it can be started soon".

(iv) Under the heading of Electricity, the Prime Minister would like an early review from the Departments of Industry and Energy on the prospects, and scope for early rationalisation, of GEC and NEI (Parsons).

(v) The Prime Minister agrees that we need an early review of BNOC. She has also noted that there appears to be some doubt about the legal validity of the existing participation agreements. She has questioned whether this is really so.

(vi) On energy prices, she has commented that there should be no increase in gas prices (she made a similar comment on the Budget brief). In response to the statement in the brief that "both the coal and electricity industries will argue that they currently suffer unfair competition in their domestic sales from gas" the Prime Minister has commented: "Then let them improve their own efficiency". She has also commented on the electricity industry as follows: "There must be great potential for increased efficiency and competition in the electricity industry. Also improved research on the inefficient conversion factor and transmission losses".

The Prime Minister has noted Sir John Hunt's conclusions on these various issues, and I will be asking - on the Prime Minister's behalf - for a note from the Secretary of State for Energy setting

/ out

out a full list of the main issues that need to be tackled, together with a timetable for bringing them forward. The Prime Minister proposes to visit the Department before Parliament rises for the Recess.

T. P. LANKESTER

8 May 1979

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Ref. A09465

PRIME MINISTER

Energy Issues

The free world uses about 7,000 million tonnes of coal equivalent of energy a year. About 50 per cent of this is oil, about 20 per cent coal, about 20 per cent natural gas, about 7 per cent hydroelectric power and about 3 per cent nuclear. Most of the non-oil energy is consumed near the point of production. Oil is the balancing fuel. About 45 per cent of the free world's oil is produced in the Middle East and 90 per cent of this enters international trade.

2. With the exception of the United Kingdom, Norway and Canada, the industrialised Western countries are all heavily dependent on imported oil to maintain their economies. The USA imports 40 per cent of its supplies and takes nearly 20 per cent of the oil moving in international trade - mostly from the Middle East. The EEC countries import something over half of their combined energy requirements, again mostly oil and mostly from the Middle East. Japan imports 90 per cent of her energy - once again mostly as oil and mostly from the Middle East.

3. The United Kingdom has an especially favoured position among Western nations in terms of energy supply. By next year we should be producing as much energy as we consume - though because our oil is mostly valuable high-quality crude, and two-thirds of our requirements can be met adequately by cheaper low-quality crude, we will remain substantial international traders in energy.

4. The heavy dependence of the Western industrialised countries on Middle East has become a point of danger. The price-fixing activities of the OPEC cartel have imposed very heavy burdens on the Western economies and have threatened the stability of the world financial system. The vulnerability of the West to interruptions in oil supply has been underlined by recent events in Iran. But Iran provided only about 10 per cent of the world's oil consumption. Saudi Arabia produces nearly twice as much.

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5. Against this background energy issues loom large on any Government's agenda. Internationally we are joined, through our membership of the International Energy Agency, in a joint effort with the industrialised West to cut oil consumption. Nationally we are seeking to save energy and need to devote a substantial effort to the production of our own energy supplies.

6. As three (coal, gas and electricity) of our energy industries are in national ownership and the fourth (oil) has a considerable public stake (BNOC plus the Government's share in BP and the necessary Government involvement in the regulation, licensing, taxation and control of the North Sea) a good many energy issues inevitably come to the Government for decision. The Department of Energy is of course in the lead in these matters but other Departments, notably, but not exclusively, the Treasury, the Foreign and Commonwealth Office and the Scottish Office have a locus, and a high proportion of the necessary decisions require to be taken by Ministers collectively. The following paragraphs describe briefly the main issues which you and your colleagues may face on energy matters over the coming months.

Issues

7. Oil consumption: In order to achieve the target 5 per cent reduction in oil consumption to which we have committed ourselves in the IEA and to accommodate to a rather similar EEC decision, we have now embarked upon the policy of increasing the burning of coal in power stations through the summer months. But our ability to continue the effort next winter is in doubt, partly because the hard winter has run down our coal stocks and partly because of uncertainties about coal production - and transport capacity - next winter. You will want to satisfy yourself that continued increased coal burn can be accommodated at a reasonable cost and without reducing coal stocks to a dangerous level (and thus affecting the Government's bargaining position with the miners). Among other matters this raises the difficult question of coal imports. An early situation report is needed from the Department of Energy.

We must try to keep coal stocks at a high level. For 1979-80 this is more important than cutting oil consumption this.

8. Coal: Linked with this is the dreadful financial position of the National Coal Board (NCB), with a prospective loss of around £300 million in 1979-80. To keep within the cash limits will probably require either cutting back heavily on investment or closing uneconomic pits, together with a substantial further increase in coal prices in the autumn (perhaps to levels which affect the NCB's ability to keep its market share). In simple economic terms the choice is clear, but pit closures will not be easy. Imported coal is substantially cheaper than that of our marginal pits and you will wish to consider what place imports should have in our economy. A particularly important case is fuel for the steel industry as further imports of coking coal have recently been the subject of licensing controls. These fundamental questions will arise naturally over the next few months when the Government come to consider the long-term coal policy review on which officials are now working.

9. Nuclear energy: We are at present committed to building two new advanced gas-cooled reactors (AGRs) and to proceeding with design and development work on a pressurised water reactor (PWR). The organisation of the nuclear construction industry is in disarray. There is a general wish to change the structure of the National Nuclear Corporation, ownership of which is currently vested partly in the public and partly in the private sectors and in which GEC have the management contract. GEC were strong protagonists for the PWR and since the decision was taken to go ahead with additional AGRs, they have indicated their wish to pull out of the business. The uncertain future of the industry has led to the loss of key staff and continuing low morale. You will need therefore to consider quite quickly what needs to be done to prevent the industry drifting further and to remove uncertainties about its future. Decisions are also needed fairly soon on our policy towards Fast Breeder Reactors (FBRs). In particular a decision is needed on whether we should go ahead with a first commercial FBR and, if so, whether it should be built on the basis of international collaboration. This is likely to be a difficult decision not least because of the great

We are committed
to an enquiry first -
I hope it can be started
soon. MT

uncertainties of what will necessarily be a very expensive project. There are those who would advocate not proceeding with an FBR at all, relying on thermal reactors (AGRs or PWRs) until such time in the 21st century when fusion may provide virtually unlimited low-cost energy. But either route involves a highly risky gamble. Department of Energy are in the lead and you will want early proposals from them over the whole nuclear field.

10. Interest relief grants: Interest relief grants under the Industry Act have been used for some years as a means of stimulating the United Kingdom offshore supplies industry. They are currently under attack from the EEC as a distortion of competition and there are growing doubts in Whitehall whether they still represent value for money. There is a strong possibility that the EEC Commission will initiate legal proceedings against us over these grants and a very early review of their effectiveness will be needed.

11. Taxation of North Sea Oil: Your Party is now committed to making the changes in Petroleum Revenue tax proposed by the previous Government. As world oil prices rise the possibility of extracting yet further Government revenue from the North Sea will present itself. This is a matter for the Chancellor of the Exchequer in the first instance, but you will want to keep the possibility in the back of your mind.

12. British Gas Corporation profits: The British Gas Corporation is highly profitable, partly because it enjoys some very favourable supply contracts from the earlier North Sea fields and partly because its prices to the industrial consumer are related to the price of oil and rise with it. As a result the Corporation is actively and massively repaying its debts to the Government. You will want to consider whether there is a case for clawing back some of this profit in a more direct way. This, too, is primarily a matter for the Chancellor but again you will want to bear the possibility in mind.

13. North Sea Oil and Gas Depletion policy: So far the exploitation of oil and gas from the North Sea has been on the basis of maximum exploitation for maximum short-term benefit to the economy. The time may however be approaching when we need to assess anew the balance between short-term gains and the possible longer-term advantages of spinning out our reserves. No

immediate decisions are needed because the sixth licensing round has just been completed and there is a legacy of past promises to those holding earlier licences. Nevertheless future decisions on licensing and to an extent production from existing finds require to be based on a view of the most nationally advantageous profile of future production. The Department of Energy keep these matters under regular review and you might care to ask for a paper to come forward later in the year.

14. Electricity: Decisions in the nergy sector are characterised by long lead times, none more so in electricity generation where power stations have to be ordered 7-10 years ahead of forecast need. Past decisions mean that we have a good deal of apparently spare capacity in hand or on order. Current demand on the power plant industry is therefore low and it is desperately short of work. It is difficult to believe that the two turbine manufacturers - GEC and NEI(Parsons) - can both stay in the business and early rationalisation may be inevitable. There are substantial regional employment implications and you may wish to commission an early review from the Departments of Industry and Energy as a basis for later decisions.

Yes please pls.

Yes please, all

15. The Role of the BNOC: BNOC is at present a producer and trader in oil, adviser to the Government on oil matters and an important instrument in carrying out the previous Government's participation policies. You will want an early review here so that the future course of the BNOC can be charted in ways acceptable to you. Linked with this is the future of the existing "participation" agreements with the private oil companies. Views about their real importance vary and there is some doubt about their legal validity. The Department of Energy should be asked for advice.

urgent pls

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16. BP: The Government is the major shareholder in BP and its relations with that company are of prime importance. You will want to consider whether the Government prefers to reduce its shareholding (remembering that 17 per cent of the Company's shares are held by the Bank of England as a result of the Burmah rescue operation and their ownership is currently a matter of legal dispute).

17. Disposal of North Sea Oil: The previous Government erected three non-statutory guidelines for the disposal of oil from the North Sea. These guidelines covered the proportion of North Sea oil which it was felt desirable to refine in the United Kingdom; the maximum length of contracts for the sale of North Sea oil; and the restriction of North Sea oil imports to member countries of the EEC and the IEA. The issues are complex and link with foreign policy, not only through the IEA and the EEC but also through the recurring questions of the possible supply of oil to Israel and South Africa. You will want an opportunity to confirm, alter or abandon the guidelines.

18. Energy Conservation: The Iranian situation showed clearly how vulnerable was the world in general and the West in particular to even a marginal and temporary interruption in oil supplies and it jolted the IEA countries to make further immediate efforts towards energy savings. By international standards our present policies are reasonably good, but there is no doubt that more can be done. A number of proposals are in preparation by officials. As some involve extra Government spending you will want to take decisions in time for them to be reflected in the public expenditure review.

19. Energy Prices: Soundly-based energy prices are the key to energy conservation, to the financial health of the energy industries and to the Government's tax take or expenditures on energy supply. Oil prices are set externally by the world market and you presumably would not wish to seek to hold down our domestic oil prices artificially. The price of coal and natural gas follow oil prices (not always very closely) and there is no national economic advantage to be gained by seeking to interfere in this process. Electricity prices follow from the costs of the primary fuels used and the very heavy capital costs incurred in providing new generating capacity. Given the strength of the OPEC cartel it is likely that energy prices will in any case tend to rise in the long run faster than prices in general. More immediately a substantial increase in coal prices seems inevitable in the autumn which will have a consequential effect on electricity prices. In the normal course of business both of these decisions would come to Ministers for endorsement.

There are however two underlying energy price issues which you may also care to have examined. The first relates to gas prices where those for domestic supplies, unlike industrial sales, are currently below the oil-related price. Should they be increased in the interests of conservation? Both the coal and electricity industries will argue that they currently suffer unfair competition in their domestic sales from gas. The other issue relates to current cost accounting. The BGC's accounting practices already come close to full CCA depreciation. But the depreciation practices of both the NCB and the Electricity Supply authorities fall well short of this. The effects of full CCA depreciation could be particularly dramatic for electricity. You may think that Ministers should be presented with the arithmetic so that they can take a conscious decision on the issue.

No

They will then improve their own efficiency

Conclusions

20. The energy sector will present your Administration with a series of challenging and complex problems of great national significance. It would be well worth while asking the new Secretary of State for Energy, in consultation with interested colleagues, to let you have quickly a full list of the main issues that need to be tackled together with a considered timetable for bringing them forward for collective consideration.

I will visit the departments before we ask for their views MT.

John 4/5

John Hunt

There must be great potential for increased efficiency and competition in the Electricity industry. Also improved research on the inefficient conversion factors + transmission costs. MT.

END

Filmed at the National Archives (TNA) in London

February 2010