



SECRETARY OF STATE FOR ENERGY
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Michael Alexander
Private Secretary to the
Prime Minister
10 Downing Street
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20 December 1979

Dear Michael,

GOVERNMENT DEALS WITH OPEC

Thank you for your letter of 17 December concerning the IEA Ministerial Meeting. My Secretary of State has acted on the Prime Minister's suggestion that informal discussions be held with the oil companies concerning Government deals with OPEC countries in time for the meeting of Ministers on 21 December.

I attach a paper for discussion at this meeting, reporting the outcome of contacts with BNOC, BP and Shell and indicating the direction in which my Secretary of State intends to proceed, subject to the agreement of colleagues.

I am sending a copy of this letter and attachment to the recipients of yours.

Yours ever,

W J Burroughs
Private Secretary

Jill

AT NO. 10

GOVERNMENT to GOVERNMENT OIL PURCHASES

Note by the Secretary of State for Energy

In my note on the Implications of Changes in the World Oil Market, which was circulated by my Private Secretary's letter of 5th December, I recommended that officials should evaluate the scope for and relative merits of establishing direct purchasing arrangements with OPEC governments through BNOC, specially created subsidiaries of BP or Shell, or major UK industrial oil consumers. Exploratory discussions have been held between my officials, BP Shell and BNOC. We need to form some preliminary views on the merits of these possible approaches to guide me in my forthcoming visit to the Middle East (Kuwait, Saudi Arabia (and Iraq)).

2. BP and Shell share basic reservations about the OPEC producers' interest in encouraging government to government arrangements. They doubt that the producers' motivation is genuinely antipathic towards the multi-nationals (who offer some attractions as technically and financially reliable customers when supply exceeds demand), believing rather that their basic objective is simply to divert more oil to the spot market. The companies draw attention to the obvious increased vulnerability of government customers to OPEC political pressure. They are anxious about government competition with the major oil companies for access to supplies simply aggravating supply disruptions and pressure on prices. Nonetheless, both companies ultimately took a pragmatic attitude, accepting that in present circumstances there may be some countries in which governments can gain access to much needed oil supplies which are likely to be denied to the traditional multi-national customers.

BP's attitude

3. BP's initial reservations were stronger than those of Shell because they see the UK as already being relatively advantaged in terms of secure oil supply, particularly following the recent dedication of BP's UK production to UK needs. In these circumstances they questioned the need for HMG to join the rush of governments seeking direct supply from OPEC. They themselves, however, have already given some encouragement to their affiliates in Europe to seek direct supply on their own behalf. If HMG were to move into this area, BP would hope to be directly associated with the initiative and to have access to any oil secured for the benefit of their international business. However, having accepted that the imminent net self-sufficiency of the UK does not amount to security of supply for all the oil requirements of the UK, BP do accept that HMG might be able to gain access to oil to which BP cannot hope to have access and which would then be dedicated to the UK. For example, BP have no real expectations in Saudi Arabia, nor do they expect to be able to improve on the reduced supply they have been offered in Iraq in 1980. On the other hand, they would regard any government intervention at this stage in Kuwait as potentially damaging. What they seek is a commitment to close consultation case by case with HMG to try to ensure that there is no additional loss to BP through the appearance on the scene of HMG (or its agent). Should HMG secure oil of this kind, BP seek the opportunity to use their facilities (transport and refining) to the maximum extent compatible with HMG's basic purpose.

Shell's attitude

4. Shell's attitude to the practical aspects of a possible initiative by HMG is to warn against the danger of paying prices too far in excess of the Government Selling Price (GSP). On the basis that world supply is currently actually in excess of real demand, they expect to be able to close their supply gap in 1980, albeit in part at spot prices. Their prime interest in HMG's potential role is in possible access to crude at a better price. They have a deficit on their UK requirement and would be prepared

Contd/3

to take an additional supply from HMG on terms which give some fall-back insurance through their international supply company if this new supply were suddenly terminated. Shell share BP's assessment of the lack of prospects for them in Saudi Arabia. However they would regard any government initiative in Iraq or Kuwait as premature. Shell, like BP, would gladly offer its facilities as agent to HMG in the event of HMG securing additional supplies.

BNOC position

5. BNOC have already held some conversations with the Kuwaitis with a view to a small scale crude oil exchange that would give the UK a net volume advantage (say 1.3 barrels of heavy for 1.0 of light) and claim they have the blessing in principle of the Kuwaiti Minister for Oil. They also have invitations, but only in general terms, to visit Saudi Arabia, Qatar and Abu Dhabi. BNOC take the view that they should be principal rather than agent in any direct dealings with OPEC governments for the supply of crude, accepting that they should dispose of it to UK refiners. They offer the services of the Corporation as a participant from the outset in any discussions with OPEC governments.

Assessment

6. My assessment is that the OPEC move away from the multi-nationals has substance and cannot be ignored. Though the UK has a clear advantage over its EEC neighbours, we remain heavily dependent on the efforts of the multi-nationals for the imported half of our supply. Even during the period of net UK self-sufficiency we shall be unable to count on about 1/5th of our crude requirement (even on an exchange basis) since volumes of UKCS crude of that order belong to companies without refining interests in the UK. Government to government deals may be the only way in which sufficient crude can be obtained for our refineries at term prices (or something near that). Despite the danger of adding impetus to undesirable market changes I judge that our security of supply could be increased by government to government dealing with OPEC.

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7. OPEC may well prove more willing in practice to deal with HMG than with Shell or BP, even though OPEC professes reluctance to deal with traders, even national oil companies, who have no refining interests. This assessment does not need to be resolved now, but it is clear from the assessment of Shell and BP that there are already some OPEC producers who might repay government to government overtures.

8. At this stage we need go no further than test the reaction of OPEC governments to dealing with HMG or a company acting on its behalf. I believe that any associated financial risks, whether our agent is BNOC or a private company, could be off-loaded on to the ultimate recipients of the oil. Refining companies should be willing to pay that price in the interests of securing their supplies at something close to term prices.

9. I propose to use my visit to the Middle East in January to take soundings of the position and the strength of the OPEC move away from the multi-nationals. The line I will take will depend upon the circumstances in each country, accepting the general need for caution in our approach at this stage. It is clear that in Kuwait I shall need to exercise special caution given the interests of BP and Shell. In Saudi Arabia there seems to be scope for more robust enquiry. [Should one of my team visit Iraq, he will need to take a middle course, bearing in mind BP's lack of further expectations there and the uncertainty of Shell's position]. I am arranging up to the minute briefing from the two private sector companies. I propose to warn BNOC to take no further initiative in the Middle East until after my return.