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10 DOWNING STREET

From the Private Secretary

18 June 1979

17.6.79

Earlier today I sent you a short summary of the discussion at dinner at Chequers on 16 June. The Prime Minister has asked that the Foreign Secretary and the Secretary of State for Energy should also have, for their personal use only, a copy of the detailed record of that occasion. One is attached: the Prime Minister has asked that it should not be circulated on anything but the most restricted basis.

I am copying this letter and its enclosure to Bill Burroughs in the Department of Energy. I should be grateful if he could proceed in the same way.

N. J. SANDERS

Paul Lever, Esq.,
Foreign and Commonwealth Office.

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10 DOWNING STREET

From the Private Secretary

17 June 1979

The Prime Minister entertained the Foreign Secretary, the Secretary of State for Energy, Sir Frank McFadzean and Mr. Pocock, Mr. Hart and Mr. Baxendell (all from Shell) to dinner at Chequers on Saturday 16 June. The following is a short summary of the main points raised.

On the price of oil, the Shell representatives anticipated early moves by Iraq and Kuwait to \$18.50; and that the OPEC meeting on 26 June would lead to a general price rise to \$20 from 1 July. They ascribed the current high prices on the spot crude market to the funnelling of supplies through them from some producers, including Iran, Iraq, Libya and Nigeria.

They gave some of their own estimates of the current level of U.S. oil consumption. In 1978 actual consumption in the USA in the first two quarters had been 19.1 mbd and 17.2 mbd respectively. Corresponding figures for 1979 were 19.4 mbd (actual) and 17 mbd (estimated). So, in Shell's view, American consumption so far this year was overall at much the same level as it had been in 1978 despite a more favourable winter this year.

In discussion of the possibility of suppressing the effects of the spot market, the Shell representatives said that the only producer capable of providing enough oil to do so was Saudi Arabia; and that the Saudis understood the economic arguments which had been put to them for doing so, but were not prepared after Camp David to allow themselves to be seen to be the friends of the United States. In their view progress in improving Saudi-American relations was still slow.

Much of the discussion was devoted to the line which the Government might take in response to the proposals expected to be put by the French at Strasbourg. These were:

(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.

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On the first, all of those present regarded the proposals on import ceilings as impracticable. There were too many opportunities for too many individual consumers with too much money at their disposal to evade any such measures.

Mr. Pocock pointed out that the French might argue that they had tried to limit their imports by placing an overall money ceiling on them. In fact their limit had always been unrealistically high, and had never been tested.

Furthermore, a scheme of import ceilings would be impossible to monitor completely and raised the problem of definition of the base line on which the reduction would be calculated.

On maximum import prices, the Shell representatives took the view that the proposal simply would not work. In the first place, the "ceiling" price would rapidly become a floor price; what was more, there was a multiplicity of potential loopholes - such as freight rates, credit terms and detailed buy-back arrangements - by which the controls could be circumvented.

The Shell representatives were more attracted to the third proposal, of international financing arrangements.

Mr. Howell said that the French would respond well if we made encouraging noises about transparency. The Prime Minister distinguished between the spot product and the spot crude markets, and said that since the transparency plan would apply only to the spot product market, it did not seem to her to offer a significant way forward.

The Prime Minister asked, given the general doubts about the French proposals, what positive alternatives she could put forward at Strasbourg and 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, the combination of slow down in economic activity and the reductions in consumption would bring supply and demand 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, and suggested that this should be raised especially at Tokyo. Sir Frank McFadzean said that if prices were not put up by increases in excise duty, then consumers would have to face price rises from the producers and the resources concerned would be transferred across the international exchanges.

Mr. Hart said, however, that he had no hope of any sizeable increase in excise duty on gasoline in the USA. Such a proposal was political anathema to the Americans. The President's programme was now the key thing.

/ Mr. Pocock

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

The discussion turned finally to the outlook for Britain. The Foreign Secretary asked what the attitude of the companies would be if a general reduction of, say, 10% had to be made. Mr. Baxendell said that since 1973 the position had been transformed by North Sea oil. The Government would be in a strong position to lean on the oil companies producing in the North Sea. The weapons at the Government's disposal included flaring consents and 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, but it would be a difficult political decision.

The Shell representatives said that the reason for the present shortage of oil products in Britain while other Western European nations did not seem to be suffering in the same way was that a number of small suppliers in Britain had been relying on the Rotterdam spot market, and had now been forced out of business completely. Furthermore, certain middle-sized companies were putting less oil into Britain. Shell and Esso were refining all their North Sea crude in the UK. BP were supplying the British market at the same rate as they had in 1978, Esso were at approximately the same level and Shell were higher.

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

I am sending copies of this letter to Bill Burroughs (Department of Energy), Martin Hall (HM Treasury) and Martin Vile (Cabinet Office).

NJS

J. S. Wall, Esq.,
Foreign and Commonwealth Office.