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Energy

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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

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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.

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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:

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(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