8/c MASTER CONFIDENTIAL Prime Minister HL

SUBJECT

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HMT

10 DOWNING STREET

From the Private Secretary

9 September 1982

Dear Jeremy,

Mr. Garvin, the Chairman of Exxon, accompanied by Mr. Forster, the Chairman of Esso Petroleum, called on the Prime Minister on 8 September.

Mr. Garvin said that world oil demand had fallen by 5% in 1980 and again in 1981. It had already fallen a further 4% during 1982. Exxon had had to revise their projections of world demand down substantially. They did not believe that the demand for total energy in the free world would grow at more than 1% per annum. They were waiting for oil stocks to reach their minimum level, but this had not happened yet. Each time they seemed to be nearing the minimum there was a further drop in demand. OPEC was currently producing around 18-19 million barrels a day (mbd); during the winter this might go up to 22-23 mbd. On their projections demand would be around the same level in 1990. If Iraq and Iran came back into production they would bring with them a further 7-8 mbd capacity. Who in OPEC would move over?

Mr. Garvin continued that he believed it vital to develop oil resources outside the Middle East. They did not believe that OPEC would break up, whatever difficulties the cartel faced, because they had a common goal.

The Prime Minister commented that the oil market was not a free market, and that the two price increases had put the West into turmoil. The need for companies to re-equip in the face of greatly increased energy costs was one of the major causes of the high level of unemployment. She did not foresee a sharp take-off from the current recession; rather, a gradual growth.

Mr. Garvin said that the depressed state of the oil market in the years to come was bound to have an adverse effect on oil producer governments' revenues. Last year's UK Budget had made great inroads into the oil companies' cash flow. That, together with the decline in oil prices, was causing them to postpone marginal development in the North Sea. The Prime Minister said that, following the Chancellor's announcement on 9 June this year, we now had a secure and stable fiscal regime for the future. She enumerated the principal changes which the Chancellor had

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announced. Mr. Garvin and Mr. Forster said that one would need a microscope to see the benefits that this would bring the oil companies. Their marginal tax rate had been reduced from 90.5% to 90%. Circumstances had changed dramatically since the earlier measures by the Chancellor, and in their view the changes announced in June did not go far enough to take account of the changed circumstances.

Mr. Garvin went on to discuss natural gas. Companies would be bringing out much more gas from the North Sea if they could obtain a market price for the output, as in the oil market. The Prime Minister said she hoped Mr. Garvin was making the same point in the United States. Mr. Garvin acknowledged that the United States had misused a valuable natural resource over many years, but said that President Reagan had told him that he was committed to taking action. Mr. Garvin believed that, notwithstanding the delay in 1983, the President would do as he had said. The Prime Minister described the political difficulties which the Government had experienced in raising the price of gas. Mr. Garvin said that their bench-mark was the price which the Norwegians charged North-European consumers - 26 pence a therm. The British Gas Corporation were tough negotiators; that was fine, but short-sighted in the long term. By 1986-7 it would be necessary to find new sources of gas, and for that there must be a consistent market-based principle in the price paid to producers.

The discussion concluded with an exchange of views about the prospects for the United States economy.

I am sending a copy of this letter to Francis Richards (Foreign and Commonwealth Office) and Peter Jenkins (H.M. Treasury).

Yours sincerely,

Michael Scholar

Jeremy Clayton, Esq.,
Department of Energy.