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CCNO NBPM AT 3/8

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

3 August 1984

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Dear Secretary of State,

WORLD OIL MARKET

Thank you for your letter of 30 July.

I agree that unless the present market weakness is short-lived it will be very difficult to hold BNOC's prices for long. We would, I believe, need to weigh carefully the likely costs of trying to do so. In particular the potential longer-term consequences of the possible "inducements" to BNOC's customers you mention in your letter will require close consideration. It would, also, seriously compromise the policy we have pursued if we were to take measures on production or oil supply to try to influence prices. I am sure you will have these considerations very much in mind when putting forward any proposals.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe, Norman Tebbit and Sir Robert Armstrong.

Yours sincerely

David Peretz

NIGEL LAWSON
[Approved by the Chancellor, and signed in his absence]

ENERGY: OIL PRICES: PT2

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SECRET COPY NO. 9 OF 12 COPIES

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From the Minister for Trade

WBBm

The Rt Hon Peter Walker MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1

10 August 1984

Dear Peter.

WORLD OIL MARKET

I have seen a copy of your letter of 30 July to Nigel Lawson, and Nigel's reply of 3 August.

I am not entirely convinced that there would be a net cost to the country if oil prices were to fall, although I recognise of course that a sharp and sudden reduction might have disruptive effects in the short term.

I do however fully share your concern that if a fall were to take place the UK should not be seen to be in the lead. If a fall is inevitable, we clearly should do everything we reasonably can to avoid damaging our trading relations with OPEC producers and our investments in these countries. Nigeria in particular could be very unforgiving - even to the point of retaliatory action against our commercial interests - if they thought that the UK had had a hand in bringing about lower oil prices. Given ECGD's exposure in the market, this is a risk we should take care to avoid.

I am copying this letter to the recipients of yours.

Yours,

Paul

PAUL CHANNON

SECRET

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CNO

Prime Minister (2)

To note. Pity we did not get rid of BNOC which is now losing money and dragging HMG into the forefront of the oil market

AT 31/7

SECRETARY OF STATE FOR ENERGY

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

30? July 1984

Dear Nigel

MS

WORLD OIL MARKET

The consequences of OPEC's excess production in May and June are now hitting the oil market hard. Spot prices of North Sea oil are about $3 below BNOC's term prices. There have been some, so far, minor cuts in US posted prices. The USSR has cut its prices by $1.45 a barrel.

BNOC lost 60,000 b/d of its term custom earlier in July and is now selling on the spot market 340,000 b/d out of its total freely disposable avails of 870,000 b/d. At that rate, it is losing $1.2 m per day. Many of its remaining customers have threatened to start the phase out process from 1 August. Not surprisingly, Douglas Croham and Ian Goskirk came to see me on Thursday to propose a reduction in BNOC's term prices of $3 per barrel.

We continue to believe that the current surplus of crude oil on the market is temporary, and that spot prices should strengthen as seasonal demand increases next quarter providing OPEC members stick to their production ceilings. Prices will only harden when the market perceives that supply has been brought down into line with demand. In such a situation a price cut by BNOC would merely lead the market down without much likelihood that it could be restored as the market stengthened. Indeed, even at lower prices, BNOC may be unable to retain many of those term sales which are at risk.

If a price cut does become inevitable, it is important that we should be seen to have followed, not led other producer countries. The cuts in posted prices so far have not been of enough weight to convince OPEC that a cut in BNOC prices would be following the market.

I have accordingly asked BNOC not to propose any reduction in prices. Yamani has contacted me, and has asked for a private meeting tomorrow at my house. This I have agreed to do. I intend to impress upon him the seriousness of the situation and the need for Saudi Arabia to fulfil its role as swing producer and to cut its production, which has been high in recent months. I and my officials are offering every encouragement to BNOC's remaining term customers to continue to purchase from BNOC at current prices. It may be necessary to offer some inducement to obtain these results (about which my officials will consult yours).

The costs of such inducements will be very much less than the costs to the country of a fall in oil prices.

There remains a serious risk that a price cut will become unavoidable. I shall keep you in touch with the situation.

My officials have already been in touch with yours about the financial implications of BNOC maintaining its present prices.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe, Norman Tebbit and Sir Robert Armstrong.

Peter

PETER WALKER