

SUBJECT  
cc Master.



file JKR ARF 9  
cc John Ledwood

10 DOWNING STREET

From the Private Secretary

16 January 1985

pa

BNOC AND OIL PRICES

The Prime Minister held a meeting today to discuss BNOC and oil prices. Present were the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, and your Secretary of State.

The Secretary of State for Energy reported on his meeting with Shaikh Yamani. The latter had been suspicious of the UK's intentions and had referred to a "Treasury" study which was supposed to show that a price of \$25 per barrel would be in Britain's interest. (The Chancellor pointed out that this was probably a reference to a study by independent economists using the Treasury model.) Shaikh Yamani said the United States also favoured a price of \$25 but, in his view, had not adequately considered how a controlled reduction could be achieved. Once the price began to fall, it could move substantially; it was not until the price fell below \$20 that there would be any significant increase in demand. Shaikh Yamani claimed that a significantly lower oil price would damage the US banking system which had made substantially energy-related loans.

Shaikh Yamani thought the oil price would strengthen in the short term. Rather than the 15-16 mbd which was expected, OPEC's production in the next quarter would be around 14 mbd. This, combined with colder weather and the low level of stocks, would help the price up. Shaikh Yamani repeated his argument that the United Kingdom, while sharing an interest with Saudi Arabia in price stability, had made no sacrifice in the form of reduced production.

The Secretary of State for Energy said he explained to Shaikh Yamani why there could be no cuts in production proposed by HMG. Controls of gas flaring had only a limited impact. The Government had, however, incurred costs from allowing BNOC to maintain its selling prices. He had also explained why BNOC no longer had any significant influence on oil prices.

SECRET

Shaikh Yamani had argued that any attempt by BNOC to cut its prices would immediately be matched by the Nigerians who felt strongly that the UK was trying to undercut them and take their markets. In discussion it was agreed that talks with the Nigerians to explain the UK's position would be helpful and that the Secretary of State for Energy should arrange a meeting with the Nigerian Oil Minister as soon as possible. Shaikh Yamani had volunteered to help arrange this.

The discussion then turned to the price BNOC should set for January. The Secretary of State for Energy said BNOC would have to set a price in the last week of the month. If, as he expected, there was some strengthening of the market in the next two weeks, BNOC could set a price close to that ruling at the end of the month, and perhaps also extend this price through February. To relate BNOC's price to the average which had ruled during the month rather than the higher price ruling at the end of the month would, in his view, have a serious effect on the market.

The Chancellor said that, if BNOC maintained its existing price, the net cost to the PSBR for January could be £3½ million. Even in net terms, the losses were significant. Uncertainty over BNOC's pricing policy was an influence in the disturbed state of the foreign exchange markets and he hoped, therefore, that BNOC's pricing policy could be resolved quickly. Although OPEC were making a great effort to defend the price of \$29 per barrel, they failed to acknowledge that, as a consequence of the increase in the dollar, the real price of oil had risen for all countries other than the United States.

Summing up the discussion, the Prime Minister said the group should meet again in the last week in January to consider the price BNOC should set for that month. The Secretary of State for Energy should contact the Nigerian Minister for Oil as soon as possible. Meanwhile, BNOC should seek, as far as possible, to disengage from participation contracts.

I am copying this letter to Len Appleyard (Foreign and Commonwealth Office and Rachel Lomax (HM Treasury). I would be grateful if it could be shown only to those who strictly need to know of its contents.

*Yours sincerely*  
*Andrew Turnbull*

(ANDREW TURNBULL)

Michael Reidy, Esq.,  
Department of Energy.