



OIL

PS
 PS/MR RENTON
 PS/PUS
 MR BRAITHEWAITE
 MR GOODALL
 MR O'NEILL
 MR J THOMAS
 MR DC THOMAS
 MR EGERTON
 HD/EnSSD
 HD/WAD
 HD/ERD
 HD/ECONOMIC ADVISERS
 HD/MCAD
 HD/MED
 HD/SEAD
 HD/NENAD

RESIDENT-CLERK

PS/NO 10 DOWNING STREET

MR CE HENDERSON, HD/012 DU, Room 1445

MR HIGSON

MR FREEMANTEL

MISS PENNY BOYS

PS/ S of S FOR ENERGY

MR B URWIN

~~MR B LAVELLE~~

~~MR S ROBSON~~

~~MISS H B GUNB~~

~~MS P IDRAFX~~

MR B MARTIN, Rm 7116

MISS LACKEY (WEG)

MR D FORD (CT5)

DEPT OF ENERGY

THAMES HOUSE SOUTH

HM TREASURY MR WICKS

MR LEAHY

DTI

(Victoria St)

~~MR GAVIN HARRISON~~ ODA

IMMEDIATE

TO WASHINGTON

GR 1200

CONFIDENTIAL

FM JEDDA 180730Z JUL 85

TO IMMEDIATE F.C.O.

TELEGRAM NUMBER 436 OF 18TH JULY 1985.

INFO PRIORITY RIYADH, DOHA, ABU DHABI, DUBAI, BAHRAIN, MUSCAT, KUWAIT, BAGHDAD, ALGIERS, TEHRAN, MEXICO CITY, QUITO, CARACAS, LAGOS, JAKARTA, CAIRO, OSLO, WASHINGTON.

ADVANCE COPY

MY TELNO 431 (NOT TO ALL) : SAUDI OIL POLICY

SUMMARY

1. YAMANI FORECASTS FAILURE AT THE FORTHCOMING OPEC MEETING, LEADING TO AN ABANDONMENT OF QUOTAS AND THE EFFECTIVE BREAK-UP OF OPEC FOR THE TIME BEING. HE EXPECTS A GRADUAL, BUT POSSIBLY DRAMATIC, INCREASE IN PRODUCTION BY SEVERAL PRODUCERS, INCLUDING SAUDI ARABIA, LEADING TO A SHARP DROP IN OIL PRICES.

DETAIL

2. H CALLED ON THE SAUDI OIL MINISTER IN TAIF ON 17 JULY. SHAIKH YAMANI WAS STILL RECOVERING FROM THE VIRUS WHICH PREVENTED HIM FROM PARTICIPATING IN THE VIENNA OPEC MEETING EARLIER THIS MONTH, AND HAD SOME DIFFICULTY WITH HIS VOICE. HE NEVERTHELESS SPOKE FOR ABOUT HALF AN HOUR.

3. YAMANI SAID THAT HE WOULD BE LEAVING FOR THE EXECUTIVE COMMITTEE MEETING IN GENEVA ON 20 JULY, BUT THAT HE SAW NO PROSPECT OF ANY SATISFACTORY OUTCOME TO THE OPEC MEETING ITSELF. THE INEVITABLE RESULT WOULD BE ABANDONMENT OF OPEC QUOTAS

PROSPECT OF ANY SATISFACTORY OUTCOME TO THE OPEC MEETING ITSELF. THE INEVITABLE RESULT WOULD BE ABANDONMENT OF OPEC QUOTAS, LEADING SOONER OR LATER TO A SIGNIFICANT FALL IN PRICES. SAUDI ARABIA HAD THE CAPACITY TO INCREASE HER OUTPUT TO 9 MBD, OR EVEN MORE, WHICH WOULD LEAD TO A DROP IN OIL PRICES AS LITTLE AS DOLLARS 10. HE DID NOT EXPECT THIS TO HAPPEN IMMEDIATELY, BUT A GRADUAL MOVE IN THAT DIRECTION WAS, IN HIS VIEW, UNAVOIDABLE.

4. HE ASKED HIM WHETHER ANY OF THE PROPOSALS WHICH THE PRESS HAD REPORTED FROM THE VIENNA MEETING (YOUR TELNO 306 WERE LIKELY TO SUCCEED. HE DOUBTED WHETHER ANY OF THEM WOULD BE EFFECTIVE. THE IRAQIS HAD PUT FORWARD THEIR DEMANDS FOR AN INCREASE IN THEIR OWN QUOTA, BUT NO MEMBER OF OPEC WAS PREPARED TO GIVE UP EVEN ONE BARREL OF OIL TO HELP IRAQ. THE IRAQIS WERE CLEARLY DETERMINED TO INCREASE PRODUCTION ANYWAY, AND THEIR PIPELINES THROUGH TURKEY AND SAUDI ARABIA WOULD LEAD TO QUITE A SIGNIFICANT INCREASE. HE ASKED ABOUT THE PROSPECTS FOR THE YANBU PIPELINE. YAMANI REPLIED THAT IT SHOULD BE READY BY THE END OF THE YEAR, WITH AN INITIAL THROUGHPUT OF ABOUT 200,000 BD, RISING TO 500,000 BD NEXT YEAR. BOTH THE SAUDIS AND KUWAITIS WOULD OF COURSE STOP EXPORTING OIL ON IRAQ'S BEHALF (IE 180,000 BD FROM SAUDI ARABIA AND 123,000 FROM KUWAIT). BUT THE IRAQIS WOULD STILL BE WELL OVER THEIR QUOTA.

5. YAMANI ADDED THAT, HISTORICALLY, OPEC HAD ALLOWED IRAN AND IRAQ A JOINT QUOTA BETWEEN THEM. ALTHOUGH IRANIAN EXPORTS WERE STILL AFFECTED BY CUTBACKS IN THE SHUTTLE SERVICE TO SIRRI, THE IRANIANS WERE NO LONGER BEHAVING AS REASONABLY AS THEY HAD, AND WERE ALSO NOW PRODUCING OVER THEIR QUOTA. ON POLITICAL GROUNDS, THEY WERE ALSO STRENUOUSLY OPPOSING AN INCREASE IN IRAQ'S QUOTA.

6. YAMANI SAID THAT THE ALGERIANS HAD REVIVED AN OLD PROPOSAL AT VIENNA THAT AN OPEC MIX OF 2 TO 3 MBDXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

6. YAMANI SAID THAT THE ALGERIANS HAD REVIVED AN OLD PROPOSAL AT VIENNA THAT AN OPEC MIX OF 2 .59 3 MBD SHOULD BE SOLD ON THE SPOT MARKET AT A DOLLAR BELOW NORTH SEA PRICES. THE ALGERIAN MINISTER OF OIL HAD EVEN TOLD ONE OPEC COLLEAGUE AT VIENNA THAT ALGERIA WAS DETERMINED TO GO FOR A PRICE WAR, WHICH HE FOUND ASTONISHING.

7. HE ASKED WHETHER THERE WAS ANY PROPOSAL TO CHANGE THE SAUDI MIX BETWEEN HEAVY AND LIGHT CRUDE. YAMANI SAID THAT SOME ADJUSTMENT IN THE PRICE OF HEAVY CRUDE MIGHT BE POSSIBLE, BUT OPEC HAD NOW PASSED THE POINT WHEN CHANGES OF THIS SORT WERE ADEQUATE TO DEAL WITH THE PROBLEM. HE ASKED WHETHER HE WAS TALKING ABOUT THE BREAK-UP OF OPEC? YAMANI REPLIED THAT HE WAS, AT LEAST FOR THE TIME BEING. SAUDI ARABIA WOULD CONTINUE TO CO-OPERATE WITH HER OPEC PARTNERS, BUT SHE HAD DECIDED THAT SHE COULD NO LONGER BEAR THE BURDEN ALONE. IT SADDENED HIM THAT OTHER OPEC PRODUCERS WERE NOT PREPARED TO CO-OPERATE. HE ADDED,

COULD NO LONGER BEAR THE BURDEN ALONE. IT SADDENED HIM THAT OTHER OPEC PRODUCERS WERE NOT PREPARED TO CO-OPERATE. HE ADDED, WITH A SMILE, THAT THE SAME WENT FOR NON-OPEC PRODUCERS.

8. I ASKED YAMANI ABOUT THE ORIGIN OF THE STORY THAT THE AMERICANS HAD BEEN NOTIFIED THAT SAUDI ARABIA WOULD START PRODUCING AT 9 MBD. YAMANI SAID THAT IT APPARENTLY AROSE FROM SOMETHING WHICH THE UNITED STATES ENERGY SECRETARY HAD SAID TO THE NEW YORK TIMES AND THE WALL STREET JOURNAL IN PARIS, AND THAT HE HAD HIMSELF "HAD TO PUT OUT A DENIAL THAT WHAT THE SECRETARY HAD SAID HAD ANY BASIS OF TRUTH". HE COULD NEVERTHELESS TELL ME "AS A FRIEND" THAT HE EXPECTED THIS TO HAPPEN. WHEN I ASKED WHETHER SAUDI ARABIA WOULD STILL KEEP TO ITS QUOTA OF 4.35 MBD, HE REPLIED "THERE WILL BE NO QUOTAS NOW".

9. I ASKED WHETHER OTHER OPEC MEMBERS HAD COMPARABLE CAPACITY TO INCREASE PRODUCTION. HE REPLIED THAT BOTH IRAC AND KUWAIT COULD INCREASE THEIR PRODUCTION LEVELS, AS COULD NIGERIA. VENEZUELA AND ECUADOR WERE ALSO VERY EXPENSIVE PRODUCERS, WHO WOULD BE VERY READY TO INCREASE THEIR PRODUCTION IF POSSIBLE. IN REPLY TO MY QUESTION, HE SAID THAT HE DID NOT THINK THAT THE KUWAITIS WERE CONCERNED ABOUT DEPLETION.

10. I ASKED FOR HIS ASSESSMENT OF THE EFFECTS OF LOW PRICES ON THE THIRD WORLD, COMMENTING THAT THE MAJOR OIL-PRODUCING DEBTORS WERE LIKELY TO SUFFER PARTICULARLY BADLY. HE AGREED THAT THE EFFECT COULD BE DRAMATIC, AS INDEED IT WOULD BE ON THE WHOLE INDUSTRIALISED WORLD. IT COULD QUICKLY LEAD TO A BANKING CRISIS IN THE UNITED STATES. BUT PRESENT SITUATION COULD SIMPLY NOT CONTINUE. I ASKED WHETHER HE EXPECTED A DEMAND FOR 9 MBD OR MORE. YAMANI REPLIED THAT STOCKS WERE AT PRESENT DANGEROUSLY LOW, AND THAT MANY COMPANIES WOULD BE READY TO BUY AT LOWER PRICES FOR THEIR STOCKS. WHEN I ASKED ABOUT THE EFFECT ON SAUDI FINANCIAL RESOURCES, YAMANI ADMITTED THAT THE ADVANTAGES OF QUADRUPLING PRODUCTION AT A THIRD THE PRICE WERE LIMITED; BUT THERE WOULD NEVERTHELESS BE SOME IMPROVEMENT.

11. I ASKED WHETHER THERE WAS REALLY NO HOPE THAT SOME MECHANISM COULD BE DEvised TO STOP OTHER OPEC MEMBERS ~~Z'GABATBEC'AGREEDMANIVSLEDAT~~ THAT THE EXECUTIVE COUNCIL SHOULD KEEP AN EYE ON FRINGE DEALS, AND IT HAD BEEN AGREED THAT INDIVIDUAL MEMBERS SHOULD REPORT TO THE EXECUTIVE COUNCIL. BUT HE DOUBTED WHETHER THEY WOULD, OR WHETHER THE MECHANISM WOULD BE EFFECTIVE.

12. IN CONCLUSION, YAMANI SAID THAT HE HAD NO DOUBT THAT THE FIRST REACTION OF SOME PEOPLE TO OPEC'S COLLAPSE WOULD BE PLEASURE, BUT THAT ON REFLECTION MOST PEOPLE WOULD BE SAD AT THE PROSPECT. I SAID THAT I WAS SURE THERE WOULD BE NO REJOICING IN THE BRITISH GOVERNMENT, PARTICULARLY IF THE COLLAPSE OF OPEC LED TO A DRAMATIC FALL IN PRICES ON THE LINES HE HAD SUGGESTED. YAMANI REPEATED THAT THIS NEED NOT NECESSARILY HAPPEN QUICKLY, BUT HE WAS SURE THAT IT WOULD HAPPEN NEVERTHELESS. WHEN I COMMENTED THAT THIS MUST

NOT NECESSARILY HAPPEN QUICKLY, BUT HE WAS SURE THAT IT WOULD HAPPEN NEVERTHELESS. WHEN I COMMENTED THAT THIS MUST BE ONE OF THE MOST DIFFICULT POINTS IN HIS LONG CAREER, YAMANI REPLIED THAT THINGS BECAME MUCH LESS DIFFICULT ONCE ONE HAD STOPPED FIGHTING.

13. COMMENT: THERE WAS NO DOUBT AN ELEMENT OF FLESH-CREEPING IN WHAT YAMANI HAD TO SAY, ALTHOUGH (WITH THE ONE EXCEPTION OF HIS REFERENCE TO NON-OPEC MEMBERS IN PARA 7 ABOVE) HE NOTICEABLY REFRAINED FROM ANY RECRIMINATION OVER HMG'S POLICIES OR PRODUCTION LEVELS. THE EXTRAORDINARY CONFLICTS AND CONTRADICTIONS IN SAUDI PRESS TREATMENT OVER THE PAST WEEK OR SO (MY TUR) NO DOUBT REFLECT AN INTERNAL DEBATE HERE. BUT YAMANI CERTAINLY LEFT ME WITH THE IMPRESSION THAT HE IS RESIGNED TO AT LEAST THE TEMPORARY BREAK-UP OF OPEC AS AN EFFECTIVE BODY.

WRIGHT

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"CHEATING". YAMANI SAID THAT IT HAD BEEN AGREED IN VIENNA
THAT THE ETC