RR7.79

Prime Minister [2]

DRN

27/1

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

22 January 1986

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

Dear Secretary of State

OIL PRICES

Thank you for your letter of 22 January.

I share your general assessment of the position in the oil market. Despite the inevitable difficulties caused by the sharp fall in the oil price, I entirely agree that we should stick to our longstanding policy of non-intervention in UKCS production levels. As you say, any change in policy could create misunderstandings both with OPEC and with OECD countries. On top of that, any cutback in UKCS production is likely to be very costly indeed to the Exchequer. It is also likely to damage the confidence of oil companies in the UKCS and so reduce future exploration and development activity. The plain fact is that we are in a far stronger position to take a sharply lower oil price in our stride than most other oil-exporting nations.

In view of this I trust that, in any contacts with oil producers, our determination to stand by our present policy will be made clear.

I am copying to the Prime Minister, Geoffrey Howe, Leon Brittan and Sir Robert Armstrong.

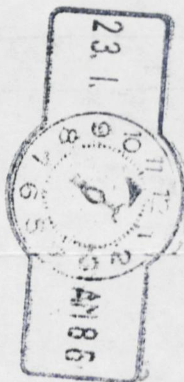
Yours sincerely

pp NIGEL LAWSON

(approved by the Chancellor and signed in his absence)

GNERGY PT2

Oil Prices



SECRET

26

Prime Minister 2

DRN 22/1

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

The Rt Hon Nigel Lawson MP Esq
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1

22 January 1986

Dear Nigel

OIL PRICES

You will no doubt have seen that the price of North Sea oil for delivery in April has gone below $20 and was some $19.40 at 4 pm on 21 January. I felt I should draw this to the attention of colleagues, since $20 has become for many a psychological barrier.

As I said in my minute to the Prime Minister of 11 December, there is a surplus of production over demand, which could reach some 2 to 4 million barrels a day by the second quarter of this year. The price of North Sea oil for prompt delivery has fallen from almost $31 ~~million~~ at the end of last November, through $26 in the Christmas period, to $20.50 now.

12 DEC Attached

It is, of course, impossible to forecast how oil prices will move in the period ahead. Dr Hammer recently expressed a generally optimistic view to the Prime Minister. On the other hand, Peter Holmes of Shell has recently said that his private view is that oil prices could well fall to $15 before the middle of the year. With the removal of OPEC support, there is no obvious higher level at which the slide might be expected to stop.

The OPEC Committee on market share, set up at the last OPEC Conference, is due to meet in the first week of February. It is unlikely to agree any effective action, and may only pave the way for an emergency full Conference. Meanwhile, the Saudis are sticking to their aim of increasing production and are reliably reported to be producing nearly 5 million barrels a day, some 650,000 bpd above their quota and 3 mbpd above their production level last summer. Financially they are clearly better off at this level of production at current prices than they were in the summer, when they were only producing some 2 mbpd at a price of about $25 a barrel. It therefore seems likely that the market will become even

SECRET

SECRET

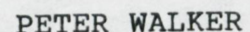
more nervous towards the end of this month, and that the Saudis have persuaded themselves that a further slide in the oil price is the only effective way of putting pressure on OPEC and non-OPEC producers alike.

As you know, demand reacts fairly slowly to lower prices and so it is probable that only renewed restrain by OPEC will really stabilise the oil price in the short term. It is hard to see whether and when such restraint will occur; but a lower oil price will put considerable pressure on oil dependent economies, particularly OPEC members and those with little room to increase production.

In short, I do not think we should be too optimistic about the prospect for oil prices, and you will obviously be considering the implications for both the domestic and international economies.

I should add that we continue to receive a series of unsolicited proposals, which would involve us in a greater or lesser degree of intervention. At one extreme, Dr Al Chalabi, the acting Secretary-General of OPEC argued at a recent Ditchley Conference for full-blooded co-operation between OPEC and non-OPEC producers, while Peter Holmes has himself on occasion argued that it was in HMG's enlightened self-interest to adopt royalty banking, at least in the summer. The theme of all these suggestions has been that we should try to help OPEC save face by some gesture, after which the Saudis would be prepared to re-establish OPEC discipline. Since the New Year we have received more specific suggestions; for instance, our Ambassador in Abu Dhabi has reported that Dr Otaiba has suggested that we should say that UKCS production would not exceed its current level (but production is likely to be 2% higher in 1986); while Dr Parra, the London representative of the Venezuelan State Oil Company, has suggested that we should be prepared to state publicly that the production will fall in the summer (which regularly happens in any case as a result of maintenance work). Any such steps would be inconsistent with our market stance on oil prices and could in any case give rise to misunderstandings both with OPEC and our OECD partners.

I am copying this letter to the Prime Minister, Geoffrey Howe, Leon Brittan and Sir Robert Armstrong.



PETER WALKER

SECRET

ENERGY P12

Oil Prices