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Perry Craddock.

01 211 6402

Mrs Rachel Lomax
Private Secretary to
The Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 2AG

27 January 1986

Dear Rachel,

OIL PRICES

Officials in the Department have been approached by Anthony Towell, Chairman of Challenger International (a small UK publicly quoted oil company), who was formerly with Shell, at the request of Mr Oscar Wyatt to pass some information to the Secretary of State and the Chancellor. I understand that Mr Wyatt is Chairman of Coastal Corporation (a large US company) as well as a director of Challenger International. Mr Wyatt claims to be a close friend of President Reagan, and also says he knows the Chancellor, whom he tried to telephone direct.

Mr Wyatt wanted Ministers to know that he had just been told by a senior official in the US Government that the King of Saudi Arabia had said two days ago that unless the North Sea producers were willing to concert their policies with OPEC, he was intending to get really rough with Britain and Norway. The King had sought advice from his officials as to what punitive action Saudi Arabia could take against the UK in particular. He had raised the possibility of cancelling the Tornado contract and imposing tariffs on UK exports to Saudi Arabia.

Mr Towell was referred to the Department by Sylvan Robinson, who is head of Shell's worldwide trading activities and who has been leading for Shell in the Tornado negotiations. We do not know Mr Wyatt. I would therefore be most grateful for any light you or the FCO could throw on him.

I am sending copies of this letter to David Norgrove (No 10), Len Appleyard (FCO), John Mogg (DTI) and Richard Mottram (MOD).

Yours,
Geoff

G S DART
Private Secretary

010

30

Foreign and Commonwealth Office

London SW1A 2AH

31 January 1986

Dear Geoff,

WITH DN Oil Prices

Thank you for sending me a copy of your letter of 27 January to Rachel Lomax.

Ever since the initial Formal Understanding for the purchase of Tornado was signed last September we have been on the lookout for signs that the Saudis might link the purchase of these aircraft to our willingness to accommodate Saudi concerns over oil. Although the Saudis have had several opportunities to make this linkage, they have never done so. It was not raised, for example, when Sir Geoffrey Howe called on the King and the Foreign Minister earlier this month; and Shaikh Yamani's attitude to a meeting with Mr Walker suggests that the Saudis are in fact more critical of us in public than in private, an argument our Ambassador elaborated on in his telno 81 of 27 January.

The Tornado deal itself appears to be making satisfactory progress. It is noticeable that the oil deal was signed with Shaikh Yamani on 26 January - ie after the King is alleged to have stated his intention to get tough with the UK.

Against that background we do not believe that Mr Wyatt's warning should cause too much alarm. We should certainly not be complacent about the Saudi attitude, which could harden towards us if prices continue to fall sharply. Our Embassy in Riyadh will watch for any sign of such a change in Saudi thinking. But as far as Tornado is concerned, the Foreign Secretary believes we should keep a steady nerve.

Mr Wyatt is known to us as a prominent businessman. We have no information on how close he is to President Reagan or on his reliability as an interlocutor, but we are making enquiries through our Consulate-General in Houston.

/I

I am copying this letter to David Norgrove (No 10), John Mogg (DTI), Richard Mottram (MOD) and Rachel Lomax (Treasury).

Yours ever,

Robson Culshaw

(R N Culshaw)
Private Secretary

Geoff Dart Esq
PS/Dept of Energy

010

CC BO

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

G S Dart Esq
Private Secretary to the
Secretary of State for Energy

28 JANUARY 1986

Dear Geoff,

OIL PRICES

Thank you for your letter of 27 January.

The Chancellor does not recall ever meeting Mr Oscar Wyatt.

Even assuming Mr Wyatt's information is correct, the Chancellor remains of the view that the Government should hold to its longstanding policy of non-intervention in UKCS production levels.

I am copying this letter to David Norgrove (No 10), Len Appleyard (FCO), John Mogg (DTI) and Richard Mottram (MOD).

Yours ever

Rachel

RACHEL LOMAX
Principal Private Sectetary

28. I. PM 86

Prime Minister 2

I imagine that stories like this may sooner or later begin to reach the newspapers.

DHN 31/1

29

Jp.0120

Mr Norgrove

c: Mr Powell (with attachments)

Oil Prices

Geoff Dart's letter attached.

It is also worth noting that Sheikh Yamani signed the Tornado oil contract the day after the King is said to have made these remarks. However, the Saudis do face a very difficult balance of payments outlook over the next few years and they will be looking for substantial savings on their imports. The Tornado deal may be at risk on this account. We shall be looking at the Saudi economic outlook and their policy options in more detail in a forthcoming assessment.

PERCY CRADOCK

31 January 1986

29 January 1986

I checked the position on oil exports following our conversation at lunch on Monday.

<u>Net</u> oil exports are 8 percent of total UK exports. <u>Gross</u> oil exports are 15 percent of total exports.

(DAVID NORGROVE)

Sir David Wolfson

8 Douro Place, W8

BR/4

DN Hay
Stan.

FROM: MRS R LOMAX

DATE: 28 JANUARY 1986

MR VERNON

1 - Nigel - pl
Copy to David
Norgrove - No10

2 - pup

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Byatt
Mr Cassell Mr Lavelle
Mr Monck
Mr Evans
Mr Fitchew
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Robson
Miss O'Mara

OIL SUBJECT BRIEF

The Chancellor was grateful for the revised version of this subject brief, attached to your minute of the 28 January. On defensive 5, he has commented that while the facts are no doubt correct, we do not want to appear as spokesman for the oil companies.

RL

RACHEL LOMAX

29. I. AM 36

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

TF

MR NORGROVE – No 10.

David,

We spoke – for your own use. Some good material here.

Philip Ws.

28/1

14-25

FROM: K VERNON
DATE: 28 JANUARY 1986

1. ~~MISS O'MARA~~ MOM 28/1

2. CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Byatt
Mr Cassell
Mr Lavelle
Mr Monck
Mr Evans
Mr Fitchew
Mr Monger
Mr Scholar
Mr Culpin
Mr Kelly
Mr Mowl
Mr Robson
Mr Haache
Ms Leahy
Mr Pickering
HE/17

OIL SUBJECT BRIEF

I attach a revised version of this subject brief reflecting your comments contained in paragraph 4 of Mrs Lomax's minute of 27 January to Mr Broadbent. Specifically -

(a) a new defensive point 5 explaining why petrol prices have fallen by much less than crude prices

(b) Defensive point 8 makes the point more forcibly that we will not join OPEC.

(c) Defensive point 2 refers to FSBR forecast rather than the Autumn Statement.

(d) Factual 1 makes the point that the Autumn Statement assumption on oil prices was in line with the then prevailing oil price.

MOM

for K VERNON

273/011

North Sea Oil Brief

Factual

1. **Prices**: per barrel of North Sea crude for immediate delivery:

		$	£
average	1979	20.6	9.7
	1980	34.7	14.9
	1981	37.3	18.4
	1982	32.9	18.8
	1983	29.3	19.3
	1984	28.8	21.3
	1985	27.6	21.5
	March 1985	28.0	24.9
	November 1985	29.7	20.6
2 January 1986		25.8	17.7
22 January 1986		20.0	14.3

North Sea oil prices in $ terms currently about 20 per cent below forecast for 1986 which underlay Autumn Statement.

(IF PRESSED: Forecast underlying AS assumed $25 barrel for 1986, in line with then prevailing forward price, compared with current price of about $20. Also assumed $/£ exchange rate broadly unchanged at its October/November level. Current $/£ exchange rate is slightly below October/November 1985 level. See Defensive 1.)

Oil price in 1974 just under $10. Real world price, taking 1980 as 100, now 72 - lowest since 1979 - compared with 58 in 1974.

2. **Tax revenues**:

1984-85 - about £12 billion
- about 9 per cent of total revenues

1985-86 - about £11½ billion
- about 8½ per cent of total revenues
- largely determined by prices up to end 1985 so little affected by latest fall

1986-87 - estimate will be published at Budget time (but see also Defensive 2.)

3. Contribution of oil to the economy in 1985:

- 5-6 per cent of UK national income
- net oil exports 8 per cent of total UK exports (15½ per cent gross)
- 6 per cent of world oil production
- under ½ per cent of total UK employment
- 5 per cent of UK capital investment

4. Contribution to GDP growth

North Sea oil has contributed under ½ per cent a year to the average growth rate of economy of about 3 per cent a year during current upswing [1981H1-to date]. It contributed about 1 per cent a year in the upswing of 1975-79.
[NB has contributed ½ per cent a year since 1979, compared with annual growth of 1¼ per cent.]

Positive

1. Use made of North Sea revenue

(i) Overseas debt of public sector accumulated in 1970s reduced;

(ii) Revenues help reduce Government borrowing as a share of GDP and so help bring inflation down. Lower inflation good for investment. Domestic fixed investment across whole economy expected to beat record levels in 1985;

(iii) Build-up in net overseas assets to estimated £73½ billion end-1984, post-1945 record. Overseas assets will provide continuing foreign exchange income in future, as oil production declines.

2. Better off with North Sea oil

At today's prices, cost of extracting it below cost of buying oil on world market. And Government shares in profits of North Sea.

3. Beneficial effects of lower oil prices

Consumers and industry will benefit from lower oil prices. And lower prices will encourage higher world trade and output, with lower world inflation. The overall effects on both output and inflation in the UK are expected to be broadly neutral - if anything, slightly beneficial.

4. Effects of oil price falls on RPI?

Since May petrol prices at the pump have fallen by about 12p a gallon, or about 5 per cent. (A 10 per cent fall in pump prices reduces the level of the RPI directly by about ½ per cent, other benefits from lower energy prices.) [See Defensive 5.]

Defensive

1. Effect of lower prices on Autumn Statement 1985-86 revenue forecast

Oil price falls come too late in financial year to have much effect on 1985-86 revenues.

2. Effect on 1986-87 revenues of price fall

FSBR forecast North Sea revenues of £11½ billion in 1986-87. For latest estimate wait for Budget. $1 fall in oil price, other things being equal, equivalent to £500 million reduction in oil revenues. [NB oil price and exchange rate assumptions underlying FSBR forecast never made explicit.] But –

- consumers and industry would benefit from lower oil prices;
- lower prices would permit higher world trade and output, with lower world inflation

3. **Ready reckoner**

Suggests that other factors remaining unchanged, particularly the exchange rate, a fall in the oil price of $1 a barrel will lead to a reduction in revenues of £½ billion in 1986-87.

4. **Effect of lower prices on PSBR**

No decisions yet taken on appropriate level of PSBR for 1986-87. Government will persist with fiscal and monetary policies aimed at controlling inflation.

5. **Oil prices down over 30 per cent but fall of only 5 per cent in petrol prices since May 1985 implies dramatic improvement in oil company margins**

Why defend the oil companies?

Margins have improved in short term but petrol prices react to changes in crude prices only after a lag. They will not therefore reflect most recent fall in crude prices. Also, crude oil represents under half pump price of petrol, so would expect a much smaller change in petrol prices.

6. **Effect of oil price falls on exchange rate**

Markets naturally disturbed by recent large falls in oil prices. But actual relationship complex and uncertain.

7. **Effect on North Sea activity**

Oil prices would have to fall very far - well into single figures - for there to be any significant effect on production from existing fields. Exploration and development depend on price expectations, often looking very far ahead, and most analysts expect real oil prices to rise in the 1990s.

8. **Government curbs on North Sea production if oil prices start falling?**

UK continues to maintain freest oil province in world: decisions on how much to produce are made not by Government but by oil companies. We can take lower oil prices in our stride - some OPEC members, heavily dependent on oil exports, will suffer much more. There is no way in which UK will become country member of OPEC.

9. **GDP growth since 1979 simply reflects higher oil output**

In upswing - 1981H1 to 1985H1 - oil has accounted for less than ½ per cent of annual growth of around 3 per cent (contributed around 1 per cent in previous recovery).

G Haache, EA2 (Ext 3871)