10 DOWNING STREET

Prime Minister

This accords with Dr Hammer's view.

It also points to action to keep energy prices up in the UK through taxation – we already have a poor record on efficient use of energy.

DRW
31/1

MR NORGROVE

31 January 1986

IMPACT OF LOWER OIL PRICES ON UK OIL AND GAS DEVELOPMENT

In recent years investment in the development of our oil and gas resources has represented roughly 25% of total UK industrial investment. The UK content of the expenditure has been over 70%, generating many thousands of jobs. With oil prices less than $20 per barrel, should we now brace ourselves for a hiatus of exploration and development activity? My guess is no.

The oil industry has polarised into two cultures. The buyers and traders on the downstream side of the industry have become very short term in their outlook, living on their wits in response to the hour-by-hour movement of oil prices. By contrast, those on the upstream side of the industry are preoccupied with the outlook for energy prices in the 1990s, when the oil and gas fields currently being planned and developed will come into production. Today's oil prices make them nervous, but they take comfort in the underlying trends.

Three-quarters of the non-communist world's known oil reserves are in OPEC countries - dominantly Saudi Arabia, Iraq, Iran, and Kuwait. Yet the rate of non-OPEC production is currently twice that of OPEC. Each year the world consumes the equivalent of the original North Sea oil reserves, but today there are no newly-found provinces like the North Sea ready to be developed. Non-OPEC production is set to decline before long - the more so if oil prices remain low in the short term. It seems inevitable that the OPEC countries will be back in the driving seat some time in the 1990s; the only question is when.

Against that background, let me be more specific as regards UK oil and gas activity:

- The existing oil fields will continue to produce because marginal operating costs are generally less than $5 per barrel, and in any event the facilities must be maintained.

- The producing gas fields are dedicated to BGC under long-term contracts; in any case, the contract prices for the gas are largely uninfluenced by oil prices.

- The oil and gas fields already under development will be brought into production as planned; for those approaching completion, there is a compelling case to press ahead and start generating cash; for those not long started, the hope is that oil prices will be higher when the fields come into production in a few years time.

- For development projects currently being planned, the key question is oil prices in the 1990s, ie the picture outlined above. As regards new gas development projects, BGC needs the gas so there is a sellers' market.

At heart upstream oil men are optimists. Moreover, when the going is tough they would rather be investing in the UK North Sea than most other places. I don't believe we shall see much slackening of momentum, either of exploration or development.

JOHN WYBREW