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JR VB

cc Master Set
Energy Jan 1980
North Sea Oil Prices.

10 DOWNING STREET

From the Private Secretary

6 February 1980

Dear Bill,

OIL PRICES

As you know, the Prime Minister held a meeting here this morning to discuss the prices of Iranian and UKCS oil. In addition to the Secretary of State for Energy, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and Sir Robert Armstrong attended the meeting.

Iranian Prices

The Secretary of State for Energy said that the Iranians had increased the price of their oil by $2.50 per barrel. This was broadly in line with other increases. Despite the fact that some of the pressure had been taken off the spot market, this seemed to be having no effect on term or Government fixed prices. The dominant factor was customer nervousness about access. The contract agreed with the Iranian authorities early in the year on a price of $30 had given the Iranians freedom to renegotiate the price every month. If BP and Shell were to reject the latest Iranian increase, they would in effect be breaking that contract.

Mr. Howell said that Shell and BP would be the principal immediate sufferers if they did not purchase Iranian oil. The French and the Germans would suffer in the longer term since much of BP's oil went to Germany and of Shell's to France. In the short-term, however, it was easy for the French, e.g. M. Giraud, to adopt a relaxed attitude. Even the Germans were being somewhat ambivalent. Count Lambsdorff had told the Americans that he favoured concerted action towards Iran while taking with Mr. Howell the line that he would prefer to let market forces operate. As for the Americans, their oil companies were buying oil at higher prices throughout the Middle East. This was the wrong point in the oil price spiral for Britain to be asked to make a stand.

The Prime Minister asked whether there was any possibility of getting oil from Saudi Arabia or ARAMCO to make up for any short-fall in the supply from Iran. Mr. Howell said that he had raised this point with both the Saudi Government and with Mr. Duncan but had got nowhere. Shaikh Yamani's unwillingness to give the UK a share of Saudi production probably reflected both the peculiarities of the ARAMCO arrangements in Saudi Arabia and generalised nervousness about American reactions.

/The Secretary of State

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The Secretary of State for Trade said that he thought it important to bear in mind our broader relations with Iran. Eventually the situation in that country would improve and commercial activities might open up for us there. If we distanced ourselves from Iran now, the effect on our future prospects would be unhelpful. This might apply the more strongly if a deal was done with ARAMCO. The Foreign and Commonwealth Secretary said that the same argument applied to our political relations with Iran: once the hostages were released there might be an important role for the European Governments in Iran. We should not be pushed into action now which might prejudice our chances of exploiting that future opportunity.

Summing up the discussion, the Prime Minister said that it was agreed that we should go ahead with the Iranians on the basis of the new price demand. But the Secretary of State for Energy should also get in touch with the Americans and others to try to arrange for a concerted policy on holding off from the purchase of Iranian oil in the months immediately ahead in the hope that market forces would operate. Contacts with ARAMCO as a possible source of alternative supply should also be pursued. Finally, it was agreed that if there were to be joint resistance in future to demands by "the OPEC hawks" the Iranians should not be regarded as a result of today's decision as a special case who would be excluded from the operation of such a policy.

UKCS Prices

The Secretary of State for Energy said that the price of Libyan, Nigerian and Algerian crudes had now risen to $34 or over, and it was no longer possible for BNOC to hold their prices at $30. There were two options - either to force BNOC's price to arbitration, or to allow BNOC themselves to settle a price at not more than $34. His own initial instinct had been to go for arbitration, but he now felt that on balance it would be better to allow BNOC to negotiate the price. If expert valuers were brought in, the price was likely to go even higher. Furthermore, the arbitration arrangements differed as between the various companies with which BNOC had contracts; different results would therefore almost certainly emerge, and this would cause confusion.

The Prime Minister said that BNOC had done well to hold the current price of $29.75 and she was concerned about the implications for the RPI of allowing UKCS prices to go up now. She wondered whether, were it not for the Treaty of Rome, it would be possible to have differential prices for North Sea crude - with world prices for exports and a lower price for crude entering the UK market.

Mr. Howell said that a differential price system would either require physical controls on the movement of oil, or subsidies from the Government on oil sold in the UK. Although the continued hiking of prices by OPEC was deplorable, any attempt by the UK to move away from market determined prices would be contrary to the Government's whole philosophy - and in any case this could not be done within the EEC rules. The Chancellor added that even if we were able to hold down UKCS prices, product prices would still move in line with the market. From a revenue point of view, it was better if UKCS prices went up as well.

/The Prime Minister

The Prime Minister then raised the question of from which date the new BNOC price should be operative. She hoped that on this occasion there would be no back-dating - particularly since the Nigerians appeared only to have moved their prices on 4 February. Mr. Howell explained that BNOC had notified their customers on 1 February that the price would go up from that date, and they had done this only in response to the price increases announced by Algeria, Libya and Kuwait at the end of January. If the BNOC price increase was back-dated to 1 February, as he proposed, it could still be presented as being in response to the market. The Foreign and Commonwealth Secretary expressed the hope that use of the word 'premium' in relation to the price could be avoided.

Summing up a brief discussion, the Prime Minister said that Ministers were agreed that BNOC should be authorised to negotiate a price of not more than $34 on the lines suggested in paragraph 12b of Mr. Howell's minute of 5 February; they were also agreed that the price increase should be back-dated to 1 February but that it should be made quite clear that the decision to raise prices had been taken after the other producers had already moved.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), John Wiggins (H.M. Treasury), Stuart Hampson (Department of Trade) and to David Wright (Cabinet Office).

Yours ever

Michael Alexander

W. J. Burroughs, Esq.,
Department of Energy.