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Prime Minister

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PRIME MINISTER

VISIT TO THE MIDDLE EAST
4-11 JANUARY 1980

I had a most useful visit to Kuwait, Saudi Arabia and Iraq in the week 4-11 January. In the course of this visit I had full discussions with oil and other Ministers and was received by the Emir of Kuwait, the King and Crown Prince of Saudi Arabia and the Deputy Prime Minister of Iraq.

Events in Afghanistan and Iran have clearly frightened the Governments of all these countries. Amongst other things, they saw recent Soviet actions as a possible prelude to moves to gain control of Middle East oil. Kuwait and Saudi Arabia explicitly said that only a firm stand by the West could prevent further intrusions by the Soviet Union. Generally, the oil producers in the Middle East have become much more aware of the extent to which they depend on the continued stability of the West. Their fear of the Soviet Union is not, however, matched by an equal willingness to stand up and be counted in the international fora of the world.

All the oil ministers I talked to were of the view that there would be a temporary surplus of oil supplies over demand during 1980. Views on the size and duration of this surplus varied: Sheik Yamani taking the most optimistic line in estimating that there was a current surplus of 3 million barrels per day. All the Ministers expressed the hope that this surplus would lead to an easing of oil prices and to their greater stability (though there was at least some doubt about the whole-hearted support of Kuwait).

There was, however, no agreement on the extent to which, and how soon, this surplus might lead to an easing of prices. The general nervousness amongst consumers could well lead to continued stockpiling beyond the current already high levels. Furthermore, buyers might still take contracted supplies at high prices to retain the goodwill of suppliers. I emphasised to Sheik Yamani, in particular, that an additional problem was the maldistribution of supplies - the fact that the Aramco Partners were getting more than adequate supplies meant that other companies, notably BP and Shell, were forced to pay higher prices for other supplies (e.g. from Iran).

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The Saudi Arabians said that they did not see themselves maintaining their production at 9.5 m.b.d. indefinitely but at least implied that they were not intending to cut back until some easing of prices had taken place. The Kuwaitis stressed their determination to reduce production at an early date to 1.5 m.b.d. but I am left with the impression that they will not in practice do so if it is likely to lead to increased instability of prices. The Iraqis gave no indication that they were likely to reduce oil production in the foreseeable future.

There was general agreement that there would be increased use of Government-to-Government oil deals. Iraq in particular wanted to see almost all oil moved through such channels so that their political strategy could be enforced. Kuwait, though taking a much less political view saw no reversal of the trend as likely though she accepted that greater use of this route was inefficient and likely to lead to higher prices and higher stock-piles.

I explained our potential interest as a Government in direct oil deals and received sufficient encouragement to make me think that there will be opportunities for us. Iraq spoke of possible trading deals particularly when the market had become more stable; Kuwait were ready to renew discussions with BNOC and Saudi Arabia took note of our potential interest. We must watch for and take any openings which occur.

Kuwait and Saudi Arabia in particular took up the question of North Sea oil pricing. The line was taken that the UK should not be taking its lead from such "revolutionary" governments as Algeria and Libya. By doing so we would be used as justification for more moderate producers to bring their prices into line with the extremists. I explained to them, as also to Iraq, that the UK did not set prices. BNOC was required under its participation agreements to pay market prices for the oil it bought. Since North Sea was directly comparable to that of

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African producers we had therefore no escape from following the lead of such countries.

Other points were:

i) Kuwait was finding it extremely difficult to invest its revenues. It wanted opportunities to make low risk high return investments overseas of a kind which it was very difficult to find. The obvious conclusion was that it was better advised to reduce production and keep its oil in the ground.

ii) The Kuwaitis stressed that additional taxes by industrial countries on oil encouraged oil producing countries to put up prices however illogical this might seem to us. (Yamani made the same point on previous occasions).

Finally a special word about Iraq. We appeared to be much more welcome than we expected. This socialist police state seems to be cautiously opening its doors wider to the West. Apart from the possibility of oil deals they showed considerable interest in a continuing dialogue with us and in the possibility of a Seminar on oil and particularly gas questions which it was left to us to pursue further in the first instance.

I am copying this to Chancellor of the Exchequer, the Foreign Secretary, the Secretaries of State for Industry and Trade, and Sir Robert Armstrong.

DH.

Secretary of State for Energy
16 January 1980