21st July, 1967

CABINET

THE OIL SUPPLY SITUATION

Memorandum by the Minister of Power

Supplies

The supply position is improving slightly. In general, it remains a tanker problem but this is being eased somewhat by the growth of exports from Libya and the Levant pipelines. There are signs that Libya is increasing the number of countries (other than the United States and United Kingdom) to which it permits exports; Iraq has confined exports to certain countries in Southern Europe. This means that Southern Europe, including France - which throughout has drawn supplies from Algeria - will immediately be better off than Northern Europe, including ourselves. The main oil companies through their supply programmes are adjusting for this as fast as possible; though tanker rerouting imposes delay, the rearranged pattern of supply is now settling down.

2. For the United Kingdom itself, the Arab ban remains in being, and with Nigerian oil exports stopped, supplies are being programmed to us from Venezuela, the United States of America, and Iran, where production has been stepped up to the limit. Of our three main suppliers, accounting for three-quarters of our imports, BP are relying on Iran; Shell on Iran and Venezuela; and Esso on Venezuela and the United States of America. I shall keep in close touch with the companies to see that the United Kingdom gets at least its fair share of deliveries. So far it is satisfactory that they have been able to arrange this despite the ban on United Kingdom and United States destinations. On exports, I am discussing with the oil companies how best to strike a balance between our immediate needs (to keep oil here and to import products from overseas refineries) and our long-term interest in keeping export outlets. The industry will be increasing product imports; some useful amounts, I hope, will be drawn from Italian refineries running Libyan crude but this will have to be done discreetly and perhaps indirectly, to avoid risk of Libyan counteraction. The Russians have again refused to supply us.

United Kingdom Stocks

3. The improved supply prospect was reflected in the estimate of stocks as at end-September which I circulated earlier this week (C(67) 134). I shall have revised estimates in time to report them orally to my colleagues when we meet. The end-September forecast, although 5 million tons or nearly a third below normal, is not critical, and since
some smaller companies have not yet received programmes from their foreign parent companies, it is, if anything, a cautious estimate. We must bear in mind also that in addition the Government holds in stock about five days' supply against just such an emergency as the present.

**Particular Products**

4. I attach in an annex the stock position product by product. These are companies' stocks, and they reveal no immediate cause for anxiety except over naphtha and fuel oil. The naphtha position is very serious. In the Western world there is an absolute shortage at the present time. Naftamondial, the Zurich oil traders, have had their proposal to supply Russian naphtha via Rotterdam turned down by the Russians. The first reaction from Rumania has been that there is probably nothing available for the rest of this year (but we still await their considered advice). United Kingdom refiners are maximising their production but nevertheless the oil industry may shortly have to cut its customers in the United Kingdom by an average of 20 per cent. Consultations are being pressed ahead with our two main consumers (the Gas Boards and the petrochemical industry) on the use of alternative fuels and how best to apportion the short supplies of naphtha.

5. Fuel oil stocks still give some grounds for concern in view of the much greater demand expected in the winter, when stocks are normally run down. The industry is planning to draw extra supplies from the Western Hemisphere, and this should shortly be reflected in the forward stock position.

**Prices**

6. I have had no application for a further price increase, though we know that not all companies were fully covered by the recent increase. Overall, the price increases on the Continent have been of the same order as here but with considerable variations e.g. a good deal higher in Western Germany and much lower in France and Italy. I shall need to keep a close watch on the price situation to ensure that our domestic prices are right in relation to the companies' costs in the United Kingdom and to price levels in Europe which could, if they rose steeply, tend to draw off supplies from the United Kingdom market.

**The Immediate Future**

7. Hitherto the oil industry has been concentrating on the immediate and critical task of rerouting supplies to get oil flowing in the maximum possible quantities to this country, and the supply and stocks forecast made by my Oil Industry Emergency Committee have been related to the current quarter (end-September). This is a short period, especially with the approach of winter, on which to base decisions on petrol rationing or the restriction of industrial oil consumption. I have therefore asked the OIEC to provide by the end of this month its best estimates of the position at the end of the year.
8. Officials of the Departments concerned have examined the balance of payments costs. Their present estimate is that if the dislocations last for six months, i.e., till the end of November, the additional cost to the United Kingdom balance of payments would be about £85 million, of which some £15 million would fall in 1968. The largest item in these costs is the charter of tankers (almost wholly foreign-owned) at very high rates, but the purchase of some high-cost oil in the Western Hemisphere is also allowed for. The estimate takes account of the effects for the business of British oil companies overseas, where Shell hope to recover the extra cost of supplies and perhaps even do better, while BP are likely to fall short by £10 million or so of recovering costs. My officials are keeping these estimates under continuous review as the situation develops and are consulting with other Departments and with the industry on measures which might minimise these balance of payments' costs.

9. I also arranged for officials to consider whether even if supplies prove adequate, rationing and other restrictions of consumption might nevertheless be desirable on balance of payments' grounds. They estimate that in the period September (the earliest the restrictions could be introduced) to November, about £15 million might be saved on oil account by the restrictions mentioned in paragraphs 10 and 11, and about £25 million by more severe cuts, especially on industrial fuels. On the other hand, the effect of the cuts on industry in general, while incapable of close calculation, could easily be so great as to result, through a fall in exports, in a net loss to the balance of payments. Thus restrictions are not recommended on balance of payments grounds.

Restriction of Consumption

10. This is the position against which we have to judge whether immediate action is required to introduce measures to ration motor fuel or restrict industrial oil consumption.

Planning for petrol rationing is far advanced and the scheme could be launched from the end of this month. Before rationing becomes effective a six-week period is required for the issue of ration books and for dealing with applications for supplementary allowances. Rationing could not therefore become effective before mid-September, and only then if we announce immediately that the final preparatory steps are to be taken and coupons issued. If we did this it would not of course commit us to ration in mid-September, though it would be widely assumed that this was the intention.

11. Restrictions on industrial oil consumption would be handled by the oil industry under my instructions. The scheme would be to reduce deliveries to industry by a given amount—probably 10 per cent initially. Before it could be introduced there are two further stages of planning to be undertaken, first, completion of the central planning, which will take another two weeks and will proceed in any event; and second, the preparation of detailed delivery schedules by the oil industry, which would take about four weeks. This scheme also could not be introduced before early or mid-September.
12. On the basis of the supply and stock position and the industry's forecasts to end-September I do not think it is necessary to go ahead at once with the issue of ration books in preparation for rationing petrol from mid-September. Stocks of petrol at the end of September are estimated at only 2 \( \frac{1}{2} \) weeks below normal and, if rationing were introduced, the savings from the cuts envisaged would amount to a reduction of no more than 4 per cent or thereabouts in total sales of oil products. With demand declining in the winter months there might even be a risk that a surplus of petrol would arise resulting in a cut back in refinery runs and a reduction in the supply of other very important products including naphtha.

13. On industrial fuel, the central planning by the oil industry for restriction of consumption should certainly be completed, and I can then review early in August whether the supply situation makes it necessary to proceed with the detailed scheduling of deliveries in preparation for restrictions.

Future Uncertainties

14. The broad rule of thumb is that some shortages are liable to occur when overall stocks get down to 7 or 8 weeks supply. I have asked for the industry's specific advice on minimum stock levels so that I can judge the need for restrictions with greater precision. But there are of course unpredictable factors to be taken into account such as the possibility of a very bad winter and of further deterioration in the overseas supply position.

15. On the latter possibility, this is more a matter for the Foreign Secretary. An extreme case would be if Arab oil exports would again cease altogether, as they did for a short period in June. A less extreme case would be the reclosure of the Levant pipelines and of the Libyan export terminals. Syria has a record of capricious behaviour, and in Libya although the Government is increasingly in control of the situation the workers are subject to Egyptian and Algerian influence. If this did happen, the consequent tanker shortage would reduce supplies to Western Europe as a whole severely. Supplies, moreover, would be lost while tankers were being rerouted. Altogether, if these sources were lost for, say, a month, a stockdraft of 10 to 14 days' supplies might be needed to help meet normal demand. If Nigerian oil were to begin flowing again in the last quarter of this year, the position would of course be very much improved.

Conclusion

16. The general supply and stock situation has improved slightly in the last week or so. The exception to this is naphtha, on which urgent discussions are taking place with the oil, gas and petrochemical industries. I am quite clear that on present information there is no need to decide now to introduce either petrol rationing or restriction of industrial oil consumption; nor do I think it necessary to start the issue of ration books so as to be able to introduce rationing by mid-September. However, the situation remains precarious, and we shall need to review it again as soon as we have the oil industry's forecast of the position at the end of the year. If it shows a deteriorating trend it may be necessary to take the final steps in preparation for restricting consumption. I will report to the Prime Minister on the situation early in August when I have the companies' end year forecasts.
17. As to the balance of payments aspects of the problem, the danger of damage to industrial production from restricting supplies would seem to outweigh the savings on foreign exchange expenditure on oil supplies. I do not therefore think that we should introduce rationing on this account, since it might do more harm than good. We shall however have to consider very carefully what guidance to give to the oil industry on its restocking problems so as to strike the balance between security of supply and further strain on the balance of payments. Officials are working on this.

18. I invite my colleagues to agree that I should proceed on these lines.

R. W. M.

Ministry of Power, S. W. 1.

20th July, 1967
## COMPANY STOCKS \(^{(c)}\), including yield from crude \(^{(d)}\), in the UK

<table>
<thead>
<tr>
<th></th>
<th>Position at 2nd July</th>
<th>Position at 10th July</th>
<th>Estimated Position at 31st July</th>
<th>Estimated Position at 31st August</th>
<th>Estimated Position at 30th September</th>
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<tbody>
<tr>
<td></td>
<td>Product Total m. tons</td>
<td>Total Weeks(^{(a)})</td>
<td>Product Total m. tons</td>
<td>Total Weeks(^{(a)})</td>
<td>Product Total m. tons</td>
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<td><strong>Gasolines</strong></td>
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<td>Motor spirit</td>
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<td>1.3</td>
<td>2.1</td>
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<td>Naphtha</td>
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<td>0.7</td>
<td>0.5</td>
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<tr>
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<td>0.1</td>
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<td>0.9</td>
<td>1.3</td>
<td>0.9</td>
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<td>1.7</td>
<td>2.9</td>
<td>1.7</td>
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<td>2.9</td>
<td>5.1</td>
<td>2.9</td>
</tr>
<tr>
<td>Other</td>
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<td>0.8</td>
<td>0.5</td>
<td>0.8</td>
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</tr>
<tr>
<td><strong>Total stocks</strong></td>
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<td>12.9</td>
<td>7.9</td>
<td>13.2</td>
<td>7.9</td>
</tr>
</tbody>
</table>

\(^{(a)}\) Product stocks exclude an allowance for exports and bunkers of a million tons.

\(^{(b)}\) Normal end-September weeks\(^{(a)}\) supply forward.

\(^{(c)}\) Includes yield from crude.

\(^{(d)}\) Normal end-September weeks\(^{(a)}\) supply forward.

**Note:** In addition, the Government holds peacetime emergency stocks of 1.1 million tons in the form of gas oil (0.6 million tons); fuel oil (0.2 million tons); and very low grade motor spirit (0.3 million tons).