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RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER AND THE
PRESIDENT OF THE FRENCH REPUBLIC AT CHEQUERS AT 4.30 P.M. ON
FRIDAY 16 NOVEMBER 1973

Present: Prime Minister
Sir M. Palliser

M. Pompidou
M. Andronikof

The Prime Minister said that there were two other matters that he expected the forthcoming summit meeting would need to discuss and that it would be useful for the President and him to consider as well.

Oil Supplies. He wondered how the situation should now be handled in the light of the fact that France and Britain were at present receiving favourable treatment from the Arab producers. The British Government found it difficult to make a precise assessment of likely future developments and how far the Arabs would continue with their present restrictive policy. It was clear that the only satisfactory outcome would be the achievement of a peace settlement. It was therefore desirable to maintain pressure on the United States to seek to induce Israel to work for a sensible settlement. If this were not achieved they would all be faced with the problem of a progressive further reduction of supplies by the Arabs and further increases in oil prices, with inevitable consequences for the Community as a whole. They therefore needed an assessment of how France and Britain, as the two major countries involved, ought now to handle the matter.

President Pompidou said that, as regards the present situation, the Prime Minister was right in saying that the principal Arab producers were trying to grant France and Britain a more or less privileged status as compared with the United States, Japan or even other European countries. They were both under some pressure to intervene with the Arabs in favour of one or more

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Community countries. But in the present situation the French Government had serious reservations about any such action. This was not because he did not well understand the position of the Dutch and indeed of the Germans. But he felt that, as long as no progress had been made in peace negotiations, that any such action was more likely to result in their being attacked by the Arabs and treated by them in the same way as other countries than in agreement by the Arabs to restore the position in so far as the Dutch and Germans were concerned. The Prime Minister agreed.

President Pompidou said that the situation for a country like the Netherlands seemed likely to deteriorate very quickly. It would be legitimate for him to remind them that last May they had refused to consider a proposal by the French Government that stocks of oil should be built up in the Community. But there was little use in indulging in this kind of recrimination. The situation was what it was. In the longer term, however, there was no mistaking the seriousness of the problem they faced. A number of Arab producers, for example the Gulf Sheikhdoms, Kuwait and Abu Dhabi, had realised that it was against their interest to use up their reserves too soon and that, if they increased their prices, they could reduce their production and then benefit from their oil resources for a longer period. But the consequence of this was likely to be a more or less permanent limitation on oil supplies. On the other hand, it seemed likely that, for example, Iran, Iraq and possibly Saudi Arabia would take the view, given the extent of their resources that they could expand their output considerably and need not restrict supplies to consumers. But this left the problem of prices. Leaving out of account the fluctuations in the value of the dollar which naturally had an effect on this,

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there was the question of what policy the United States might pursue. If the United States succeeded in imposing a peace settlement, they would be enormously powerful in the Middle East. Trying to put himself in the shoes of the United States Government, he noted that they had long been irritated by the fact that European industry was getting its energy more cheaply than United States industry. This meant that, even on the most favourable hypothesis, the United States interest probably did not lie in lower prices; nor indeed did the interest of the big oil companies. They were increasingly little more than middlemen between the producers and the consumers. They were bound to favour the wider profit margins that would result from increased prices.

In this situation President Pompidou suggested that they needed some serious studies (he did not know whether the British Government had done this. Certain studies had been done in France but he would prefer them to be of a "really impartial nature"). These would be designed to establish the level of oil prices at which conventional sources of energy (and for the time being he was not concerned with nuclear energy) including in particular coal, whether European or American, could become truly competitive with oil. Equally, they should know the level that oil prices had to reach before the development of e.g. Tar Sands became competitive. This would enable them to assess the "cut off point" (without taking account of the use of oil simply as a weapon) i.e. the price level that oil would have to attain before it began to be in the Arab interest to keep it stable. During his return journey from China, he had called on the Shah of Iran in Tehran and had found him fully seized of this problem. If they could have some thorough-going

and objective studies made it might be possible to make at least some of the Arab producers stop and think about the problem. He emphasised that this of course only related to the problem of prices.

President Pompidou said that, secondly they needed to diversify their sources of oil supply. It would not of course be in the European interest to be too dependent on the Soviet Union for supplies of natural gas. But he thought that a certain proportion of Soviet gas might provide some degree of assurance, at least for the countries of continental Europe. The same was true in respect of both Iranian and Algerian natural gas. Algeria in particular was heavily populated and had great development needs. The Algerians would wish to limit the rate of depletion of their oil reserves. But, as their contracts with the United States had shown, the potential supply of natural gas from Algeria was enormous. Once things had settled down politically, Algeria could be a substantial supplier. This was equally true of sources in Europe, especially in the North Sea where problems arose that did not simply affect the European countries as a whole but had an impact on relations with other countries and indeed between France and Britain - as was also the case in respect of the Continental Shelf between Brittany and Cornwall. But all this related to the immediate or longer term and depended on the political situation and a peace settlement. This was why he thought that, whatever their personal feelings might be, they had no interest whatever in making difficulties for attempts by others, and especially by the United States, to restore peace.

President Pompidou said that as regards prices, it was possible that the increasing firmness of the dollar might induce

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a more reasonable attitude amongst the oil producers, even though, whenever the dollar rose, the price of oil also increased. But it might at least limit purely arbitrary price increases by the producers. In the long term, however, it was essential to disengage their economies and those of all European countries from this total dependence on oil as a source of energy. This meant that they should vigorously pursue the rapid development of nuclear power. Speaking quite frankly, it was true that in the short term France and Britain were in a better situation than other European countries, except in regard to price levels. It was in their interest and that of their partners that current restrictions should end. But they should already be seeking to prepare very rapidly for real European independence in the energy field. It was not possible for all of them individually to have their own independent resources and production. The solution therefore lay in a diversification of sources of energy whether geographically or technically. Speaking in purely national terms he had observed for a long time that the United Kingdom was in the most favourable position of any of the Nine because of its reserves of coal and the North Sea. But looking at it from a French and indeed a broader European point of view, he thought they needed a very active policy. They should not be afraid of having too much; the risk they ran was of having too little and of being dependent on others. They now had to ensure that they were no longer subject to pressure or even blackmail in this field. That at least was how the French Government intended to react. But he thought that this problem also required study, organisation and action at the European level. Summing up, President Pompidou said that a number of specific problems were linked with this general problem, including

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the search for peace in the Middle East; the monetary system; the development of sources of energy; the possibility of an economic crisis in Europe if restrictions on oil supplies continued; and, in the longer term, the prospect of commercial competition with the United States. This was a complex of interconnected problems, and each one had direct consequences on all the others.

The Prime Minister agreed that they should do nothing that might lose them their present preferential position without in practice enabling them to help those of their friends who were at present in a more difficult situation. The key to the matter lay in the political position of Europe in relation to the oil producing States. He had been interested by the President's description of his talk with the Shah. His impression was that the Shah did not wish to limit output. He wished to produce as much as he could, so as to have the necessary resources both for Iranian development and for arms purchases. But the Shah would identify himself completely with the Arab producers in any price increases.

The Prime Minister said that the following matter was causing him grave concern. The United States oil companies in particular had already cut back their supplies, with the result that other consumer countries such as Japan were receiving much less than they needed. Accordingly, these countries were showing increasing interest in offers of "participation": that was to say the purchase of oil direct from Arab governments and Iran. The Japanese and possibly also the Germans and the United States might be ready to pay much higher prices to ensure secure supplies on a participation basis. And this competitive bidding would entail further serious price increases.

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Hitherto, they had regarded Japan as the most likely to develop this process. But since the Japanese balance of payments was now weaker than it had been the risk might be greater with certain other countries. For example, the German balance of payments was strong and that of the United States was improving.

The Prime Minister said that, under the price arrangements established in Vienna, the Arabs had almost doubled the price of oil. They also argued that, if the price of participation oil went up, there should be a corresponding rise in the price of oil to the oil companies. Thus if Japan, the United States or Germany bought their oil direct and paid much higher prices the inevitable result would be increased prices to our companies: and this could place a much heavier burden on the French and British balance of payments.

The Prime Minister said that a practical problem that arose was whether they should seek to induce the countries concerned to agree only to pay a limited price for participation oil so as to avoid a general increase in prices. But in practice it was not clear to him how the necessary action in this field could be taken without the risk of provoking further retaliation from the oil producers. He thought that both the French and British Governments would prefer not to take the lead in this matter. But if they could not persuade someone else to do so, they risked being the victims of other countries out-bidding each other for participation oil.

The Prime Minister said that a third practical problem arose from the huge financial balances of the oil producing countries. If this money were allowed simply to move to and fro across the world it would gravely threaten unstable currencies, including, for example, a number of those within

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the Community. He wondered therefore whether it might not be possible for the Community to enter into some arrangement with the Arabs for the stabilisation of these balances, or whether they should propose some form of Community development projects for the oil producing countries which could help to mop up these balances. It was possible that France and Britain were in a better position to take a lead in regard to the financial balances and development projects because of their good relations with the Arabs. These practical problems could arise quite quickly. The United States companies were already talking openly of allocating oil supplies and as a result the demand for participation oil was bound to increase substantially. Indeed, there were signs that a number of countries were planning to increase their purchase of participation oil during the next few weeks.

President Pompidou said that a number of oil producing countries, including Iran, were increasingly desirous of negotiating direct agreements, either on a State-to-State basis or on a State-to-company basis. But such agreements with the companies would no longer perpetuate the traditional relationship under which oil was simply sold like any other raw material. The attitude of the producers depended in some measure on the level of their economic development. Some of them were concerned to obtain investment in their own countries, others were interested in investing themselves in the consumer countries, especially in Europe. The Iranians had both possibilities in mind. They sought investment in Iran but they also wished to be involved in the working of the oil market not simply in the production of oil, but also in the refining and even in the distribution process within the consumer countries.

President Pompidou said that it was no secret, since the Shah told everyone about it, that the Iranians were already in

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discussion with Italy about such an agreement, though the form of it seemed a little vague: and he believed that they were discussing the idea as well with the Germans. The Prime Minister asked whether this was with the intention of owning a refinery in Italy or in Germany. President Pompidou confirmed this. He continued that, on the question of the financial balances they should not forget the possibility of these being used to threaten the deployment of another kind of "oil weapon". The monetary organisation of Europe should therefore be such as to make it possible for capital movements outside the Community to be properly controlled. During a visit to Germany in 1970 for the bilateral exchanges under the Franco/German Treaty, he had discussed this with Herr Schiller. But the latter had been so dogmatic in his rejection of anything which smacked of dirigisme, that he had refused even to contemplate such an idea. The President had pointed out to the Federal Chancellor that even at that time the amount of capital in Arab hands was quite enough to disorganise the European monetary system and their currencies, unless they were able to fix or control the movement of capital in and out of their countries. And the position was much more acute now.

The Prime Minister asked whether the President thought that we had any means of action or power to prevent the oil producers from a further rapid increase in their prices: or had this simply to be accepted as inevitable. President Pompidou said that in the present situation and in the short term they might try to deploy a certain degree of diplomatic or political influence designed to show the Arabs that their prices policy and their reduction in supplies, though allegedly caused by the Middle Eastern war and the fall in the value of the dollar, in fact

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had a much more damaging effect on the European countries, including those whom the Arabs called their friends, than on anyone else. But to speak absolutely frankly - and leaving aside what he had already said about the need for diversification - he believed that all the industrial countries, including Japan, Germany, France and Britain should recognise that as long as they encouraged the growth of industrial production at rates of around 6 - 7 - 10 per cent per annum, they would all remain wholly dependent on oil supplies. They must be ready to return to more modest rates of growth (though he would certainly not wish to say this to his electors). The Japanese Prime Minister had told him that 8½ per cent represented the minimum possible rate of annual growth for Japan. Mr. Tanaka had not said if this was the minimum from the point of view of production, consumption or employment, etc.: but whatever it was, it put Japan at the mercy of their energy suppliers and implied that they were ready to pay virtually any price.

The Prime Minister said that he had omitted to mention the studies, to the need for which President Pompidou had referred. The British Government had done a considerable number of such studies and would gladly exchange information about them with the French Government. Indeed the reason why they had maintained coal production in Britain at a higher level than seemed justified at current comparative price levels was because they had calculated that by 1976 it would become competitive in terms of price. But in fact developments in the oil sector would mean that this would happen a good deal sooner. They had studied a considerable number of comparable price levels including those related to, e.g. oil-bearing shale and nuclear power. President Pompidou said that the French had also made certain studies. He was

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grateful to the Prime Minister for his offer and would welcome an exchange on the lines proposed. It would be useful not only to see whether their two Governments agreed but also whether they saw the same opportunities developing.

The Prime Minister said that they had had an interesting day of talks. On the following morning they might perhaps discuss matters connected with the European Community, including progress in carrying out the programme laid down at the previous year's Summit meeting, as well as subjects which might come up at the forthcoming Copenhagen Summit.

The Prime Minister said that he was delighted that they would be able the following day to witness the signature by the Foreign Secretary and M. Jobert of the Channel Tunnel agreement. M. Pompidou said that this was indeed an important agreement. Hitherto, virtually the sole link between the Continent and Britain had been called "Heath". Now they were to have another link.

The Prime Minister said that he had been dining the previous evening with Lord Harcourt who was the leader of the British syndicate and whom President Pompidou would meet the following day. Lord Harcourt had told him that it had taken him thirteen years' work to achieve this result and that the construction of the tunnel had first been proposed in 1867. The Prime Minister had agreed that this was a long time, but had reminded Lord Harcourt that the first committee to discuss the introduction of decimal currency had been set up in 1842, and the currency had not been introduced until four years previously.

The meeting ended at 7.10 p.m.