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From the Private Secretary

2 March 1982

The Saudi Minister of Planning, Sheikh Hisham Nazer, called on the Prime Minister at 0945 hours this morning. He was accompanied by the Saudi Ambassador, the Director-General of Planning, Mr. Karim, and the Assistant Director-General of the Royal Commission for Jubail and Yanbu, Mr. Mubarak.

Sheikh Hisham said that the third development plan was going well. The previous plan had improved the country's basic infrastructure; the ports were no longer congested and construction of the road network was well advanced. The real problem was now the scarcity of trained manpower. Improvements in training and education were however long term objectives. Meanwhile, the development of basic industries at Jubail and Yanbu was well under way. The steel mill and fertiliser plant would both be operational next year. The next decade's output from the fertiliser plant had already been sold.

The discussion then turned to the state of the oil market. Sheikh Hisham said that Saudi production was now running at 8.5 million barrels per day, having fallen from the level of 10.5 mbd at the height of the Iran/Iraq war. The market had behaved very unpredictably over the last few years. It had moved from severe shortage to severe glut, with consequent swings in prices. Sheikh Hisham said that he thought that the high levels of demand in 1979/80 had not been solely for consumption. There had been a great deal of stockpiling. This stockpiled oil was now coming on to the market, partly because of the very high interest rates prevailing in world financial markets. The severe recession also reduced demand, and high oil prices had encouraged economy. He felt it was now important to balance supply and demand, and so to stabilise prices. In the long term, however, he felt that there would always be "an energy crisis". The present levels of unemployment prevailing in Western economies showed how much latent demand for energy there was. Demand from the third world could also be expected to grow. He did not feel that alternative sources of energy, or conservation, would supplant the fossil fuels, even in the medium term. New technologies could increase recovery from oil fields from 30% to 70%, and there were still good long term prospects for oil producers.

/ Sheikh Hisham

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Sheikh Hisham then asked about the state of the UK economy. In reply, the Prime Minister said that the Government's policies were designed to improve the competitiveness of British industry. This was a long-standing problem, but she felt there were signs of success. Productivity in British industry was now at record levels and the increase in unit labour costs last year had been among the lowest in all the Western economies. The first effect of tackling such problems was always to increase unemployment as waste and inefficiency was eliminated. The main burden of reducing unemployment fell on industry, and the Government had a programme to help small businesses start up; but because of the recession this had not been as immediately successful as had been hoped. The Prime Minister said she did not like to criticise the policies of the US Administration in public, but the key to ending the recession was largely in the hands of the Americans. She recognised that reducing inflation must be President Reagan's top priority, but she was concerned about the size of the US deficit. President Reagan would have to take a decision on whether to finance this deficit through borrowing at higher interest rates or by increasing taxes, and for electoral reasons he would have to take this decision by June. The Prime Minister acknowledged that President Reagan was strongly opposed to any increase in taxes, especially in the run up to the mid-term elections in November; but high interest rates would be just as damaging, both domestically and world-wide. She added that there were now few oil surpluses to help finance the US deficit; some OPEC countries were already net borrowers on the financial markets.

Finally, the Prime Minister asked Sheikh Hisham to give her best wishes to King Khalid; and for his part, Sheikh Hisham said that he was glad there were such good bilateral and trading relations between the UK and Saudi Arabia. The meeting ended at 1015 hours.

I am sending a copy of this letter to Francis Richards (Foreign and Commonwealth Office).

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