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Central Intelligence Agency
Washington, D.C. 20505

DCI/DDCI Executive Staff

13 June 1986

16 JUN 1986

NOTE FOR: Mr. Casey

SUBJECT: Meeting with Secretary of Interior, 16 June 1986

[redacted] and two of his oil experts, [redacted] will join you for your meeting with Secretary Hodel on Monday at 1300. Afterward, Dave will take the Secretary off to a conference room for a more detailed briefing. 25X1 25X1

Attached you will find a short memo from [redacted] outlining Hodel's interests and some talking points on the world oil situation. 25X1

[redacted] 25X1

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12 JUN 1986

MEMORANDUM FOR: Director of Central Intelligence

FROM: [redacted] 25X1
Director of Global Issues

SUBJECT: Background Information for 16 June Meeting with Secretary Hodel

1. Action: None. This memorandum transmits an agenda for the Secretary of the Interior's visit to Headquarters on 16 June and background information on the world oil market situation to prepare you for your meeting with Secretary Hodel.

2. Issues to be Discussed: Interior informs us that Secretary Hodel wants to spend up to two hours being briefed on the CIA world oil supply and demand outlook and price projections. His increased interest in this topic is the result of pressure from the Hill and oil producing interests to do something to encourage outer continental shelf leasing and US exploration activity in an environment of falling oil prices. We believe that underlying market conditions remain weak. Consequently, oil prices are likely to be volatile over the summer months unless OPEC can reach a new production-sharing agreement at its 25 June meeting in Yugoslavia. The probability that the organization will reach an agreement is increasing. Even without an agreement, prices will likely rise toward yearend with the onset of winter. Over the long-run, oil consumers will become increasingly dependent on OPEC as lower prices stimulate consumption and slow development of non-OPEC oil.

3. After your meeting with Secretary Hodel, OGI will provide a detailed briefing on these issues, as well as a demonstration of our computer work on oil facility modelling.

[redacted] 25X1

All portions classified SECRET NOFORN.

[redacted] 25X1

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Background for 16 June DCI Meeting with Secretary Donald Hodel on the World Oil Market Outlook

Oil Market Background

- o The current oil market situation--characterized by low prices and high production--came about as a result of higher oil prices in the 1970s. Oil consumption fell dramatically in response to conservation and substitution away from oil, non-OPEC supplies increased, and oil inventories fell.

- o This year's oil price collapse, however, was touched off by OPEC.

  - oo Saudi Arabia's decision late last year to abandon its role as swing oil supplier and move to aggressively recapture market share sent oil prices plummeting. Prices are now about 50 percent below 1985 levels.

  - oo Saudi production doubled between September and December 1985 as a result of Riyadh's switch to a market related pricing scheme--so-called netback prices which guarantee refiners a healthy profit margin.

  - oo Although no other producer was willing to cut production to make room for higher Saudi output, competitive forces and marketing problems lowered oil production in several non-OPEC countries, like Mexico and Egypt. High cost producers, like the US, Canada, and Australia, squeezed by lower prices, also suffered involuntary production cuts.

Near-Term Outlook

- o Falling oil prices will have a limited impact on short-term oil consumption.

  - oo According to our estimates, consumption in the first quarter of 1986 was slightly higher than in the same period of 1985, due mainly to increased gasoline consumption in the US.

All portions classified SECRET NOFORN.

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- oo We project that consumption over the rest of 1986 will average 1-2 percent higher than 1985 levels. Although demand has been even higher in both the US and Europe during the past month or two, a large part of the increase is probably the result of higher than expected stock-building.

- oo Because oil consumption varies seasonally, demand in the summer will be lower than in the first quarter. Consequently, we expect this seasonal decline in demand to keep downward pressure on prices during the next several months, unless producers agree on a workable method to cut production.

o OPEC will meet on 25 June in Brioni, Yugoslavia to try to hammer out a new production ceiling and a way to allocate that quota among its members.

- oo If members agree to a production level that is approximately 1-2 million barrels per day (b/d) below current output of 18 million b/d, the market would balance. Under these circumstances, we would expect prices to stabilize this summer and then begin rising, perhaps reaching $17-20 per barrel by the end of the year.

- oo Although progress toward a new accord is being made, a consensus has not yet been reached. Without an agreement, we expect prices to remain volatile throughout the summer, with some upward price movement when seasonal factors increase demand in the fall.

o OPEC producers have actively sought non-OPEC assistance in restraining production. To date, Angola, Egypt, Mexico, Malaysia, Oman, Brunei, the Soviet Union, and China have all indicated a willingness to cooperate with OPEC, but are unlikely to reduce their own sales without solid evidence that OPEC has established a realistic quota and that members are adhering to it.

- oo Norway, in what would be a major policy-turnaround, has also said it would consider ways to aid OPEC efforts to firm prices. A meeting is being scheduled between Norway's new energy minister and representatives from OPEC.

- oo Despite these promises, we doubt that countries whose production has already dropped well below last year's levels because of marketing and pricing problems will make further cutbacks. Others would probably make only token reductions.

Long-Term Outlook

- o Low oil prices will have a major impact on the long-term oil market, raising demand, slowing supply development, and hastening a return to a tight market situation.

  - oo We expect high cost non-OPEC supply--from the US, Canada, Norway and the UK, for example--to decline over the longer-term.

  - oo Although OPEC available oil production capacity has declined by over 25 percent from peak levels achieved in the 1970s, the organization still has ample surplus production capacity and low cost oil reserves. Indeed, the combination of lower non-OPEC supply and higher demand could raise the demand for OPEC oil by about 7 million b/d by 1990.

- o The net result will be increased dependence by the US and other OECD countries on imported oil, particularly from OPEC countries.

SECRET NOFORN

Executive Registry
86- [redacted] 2731

12 JUN 1986

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25X1

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All portions classified SECRET NOFORN.

SECRET NOFORN

Agenda for the
Honorable Donald Hodel
Secretary of the Interior
16 June 1986

Time	
1400-1430	Meeting with the DCI
1430-1530	World Oil Market Briefing

I. World Oil Supply
- o OPEC/Saudi Production Offensive
- o Non-OPEC Supply

II. World Oil Demand
- o Impact of Falling Prices

III. Short Run Price Outlook

IV. World Oil Productive Capacity
- o Impact of Iran-Iraq War
- o Persian Gulf Pipelines
- o Impact of Declining Prices

V. The Future of OPEC

1530-1545	Facility Modelling Demonstration

25X1

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SUBJECT: Background Information for 16 June Meeting
with Secretary Hodel

OGI/SRD [redacted] (11 June 1986) 25X1

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