

Memorandum by Lord Mills on oil supplies (London, 30 September 1958)

Caption: On 30 September 1958, prior to the next Cabinet meeting, Lord Mills, British Minister of Power, issues a memorandum on oil supplies in which he examines the question of the increase of oil stocks in the United Kingdom in the light of the recent events in the Middle East. The memorandum highlights the measures to be taken by the United Kingdom to cope with a sudden interruption in or cessation of the country's oil supplies from the Middle East.

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CABINET

OIL SUPPLIES

MEMORANDUM BY THE MINISTER OF POWER

As an insurance against the sudden disruption of this country's oil supplies, the oil companies agreed earlier this year to hold substantially higher stocks in the United Kingdom than before the Suez crisis. Further, approval in principle was given to the extension of the Ministry of Power's underground Potash Brine (P.B.) storage by 1 million tons from a capacity of 1.2 million tons to 2.2 million tons. As will be seen from Appendix A to this paper, the arrangements made with the oil companies have resulted in their stocks being increased to approximately 14 weeks' supply. Recent events in the Middle East suggest that we should examine urgently whether any further insurance against an interruption of imported oil supplies should be undertaken, and if so, in what manner.

2. There is always the danger of interruption or cessation of our oil supplies from the Middle East. The table at Appendix B (which was prepared in the course of a Joint Anglo-American Study) demonstrates the effect on Europe's oil supplies of various possible situations in the Middle East. It will be seen that the cessation of imports from all Middle East producers except Iran would reduce Europe's oil supplies to less than half of normal if no additional oil was imported from the Western hemisphere. At best the supplies could be raised to three-quarters of normal if (a) an extra 50 million tons annually were imported from the West at a dollar cost of \$1,000 millions (75 per cent. falling on the United Kingdom) and (b) India and the other Eastern consumers accepted some reduction in their Iranian supplies. If they declined to accept a cut Europe might not do better than two-thirds of normal.

3. Our present civil stocks would enable us to limit restrictions on consumption to an overall 10 per cent. cut for a period of 8 months if external supplies reached 75 per cent. of normal and 5 months if the external supplies were no more than 66 $\frac{2}{3}$ per cent. If our stock level could be raised by 1 month's normal supply either these periods of grace could be extended to 15 months and 9 months respectively, or the rate of the dollar drain could be reduced.

4. Government owned stocks of oil total over 2 million tons but these were acquired for defence reasons and we could not rely on much of them being available for civil purposes in the type of crisis we may have to face. The oil companies are unlikely to add further to their own stocks as they are generally of the opinion that in reaching the present stock level they have already gone further than their commercial needs. The capital cost of the present improvement in commercial stocks compared with pre-Suez levels is of the order of £60 millions.

5. The substantial advantages of adding a month's supply to our stockpile suggest that we should consider seriously the provision of Government funds for this purpose. As indicated in paragraph 3 we should be able to face the interruption of Middle East oil supply for nearly twice as long without serious dislocation of the economy. In addition oil acquired before a crisis can be bought for sterling at normal prices as against a higher price in dollars during a crisis, and the risk of a trading loss is negligible.

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6. In a crisis it is to be expected that Europe's oil supplies would be pooled and shared as they were during the Suez incident. It has been agreed that countries which create a special reserve stock should derive the full benefit from it, but there is a risk that if we raised our own stock level much above that of Europe generally we should not be able to avoid entirely some sharing of the excess. Although sharing would of course reduce the periods of grace mentioned in paragraph 3, I am sure that the balance of advantage would still lie with adding to our stockpile. The following paragraphs consider possible methods of securing additional stocks amounting to 1 month's inland consumption which in 1959 would total about $2\frac{1}{2}$ million tons.

Filling of Empty Government Storage Tanks

7. One way in which a material addition to our stocks can be achieved quickly is to fill available Government storage with oil (mainly with refined products, as most of the storage is technically unsuitable for crude oil). About $\frac{1}{2}$ million tons capacity, mainly buried tanks (owned by the Service Departments as well as the Ministry of Power), is available for filling during the current financial year. A further $\frac{1}{4}$ million tons is expected to become available thereafter, although this figure is subject to adjustment in the light of the changing defence requirements of the Service Departments. I propose that my Department should be authorised, subject to discussion of a detailed programme with the Treasury and the Service Departments, to purchase and store $\frac{1}{2}$ million tons of oil (mainly refined products) as soon as practicable, and a further $\frac{1}{4}$ million tons as storage becomes available. The cost of the full programme would be about £10 millions, and maintenance and turnover of the stocks would amount to some £225,000 a year. About £7 millions of the capital cost would fall in the current financial year, and a Supplementary Estimate would be necessary. For the reasons given in paragraph 16 below, I consider that the Government should be prepared to meet the cost of these measures.

8. It is possible that in the longer term the Service Departments may find further storage, and certain of their stocks, surplus to defence requirements. If the Committee approves my proposals in the above paragraph, I shall invite the Service Ministers to agree that before any surplus stocks and installations are offered for commercial disposal my Department should be consulted to examine whether the storage and oil involved would be suitable for use as a civil reserve.

Development of P.B. Capacity

9. A detailed scheme for the extension of P.B. capacity by 1 million tons already approved is almost ready, and it should be possible to start development soon. A small part of the new capacity should begin to become available next year, but the bulk of it will not be completed until the second and subsequent years.

10. No decision has yet been taken about the filling of the new capacity. The cost would be about £8½ millions if crude oil was stored, or up to £15 millions if refined products were selected (as they would be if defence considerations prevailed). I consider that we should take steps to fill the new P.B. capacity as it becomes available, and I propose in paragraph 17 that preliminary discussions should be held with the oil companies about the financing of the required stocks.

Other Possible Methods

11. The above measure would increase our stocks by $1\frac{3}{4}$ million tons, but to provide a full month's extra stock we should require a further $\frac{3}{4}$ million tons. It would be possible to increase P.B. storage in the area of the present scheme, beyond the extra 1 million tons approved, by a further 1 million or even 2 million tons of capacity at a cost within £2 a ton. This is the cheapest method of storage we know, but it might be up to 5 years before such extensions could be completely filled.

12. An alternative possibility would be to build surface tanks of conventional type. Assuming suitable sites are not already in Government ownership (and so far as is known they are not), the construction of surface tanks of $\frac{3}{4}$ million tons capacity would take about $2\frac{1}{2}$ years, of which nearly 18 months might be needed to acquire the land by negotiation (it is very doubtful whether compulsory powers could properly be used for this purpose), and rather more than a year for construction and filling. The cost of construction might be £6 millions and of filling with crude oil £6½ millions. It is doubtful whether the time saved would justify us in proceeding with this, as against the considerably cheaper P.B. storage.

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13. A much speedier alternative—though I do not know whether it would be possible—would be an arrangement with the oil companies to build Government storage on their land, preferably adjacent to the refineries where the crude oil would be processed. Under such an arrangement (which would need to ensure that the companies did not reduce their own storage plans as a consequence) the time needed for completion of the new tanks might be reduced to about 18 months, and this acceleration might be sufficiently important to warrant the higher cost of this type of storage as against P.B.

14. Another possible method of increasing our oil stocks quickly would be to use surplus tankers as floating storage. If this were done on a substantial scale, *e.g.*, to store 1 million tons of oil for which about 60 tankers would be needed, any present surplus of suitable British tankers would be fully absorbed and a considerable number of foreign ships might have to be chartered. I am advised that charterings on this scale might have a sharp impact on the tanker freight market, and that there are also technical difficulties in the way of using tankers for storage. In addition the maintenance for storage purposes of tankers which would otherwise be scrapped might tend to deter some companies from ordering new tonnage, with a consequent weakening of one form of insurance against a Middle East crisis.

15. At the present time the most promising method is the construction of Government tankage on oil industry land and I would like to have my colleagues' agreement to exploring this possibility with the industry. There may well be other feasible methods of constructing new storage, and I have set up a Committee under Sir Solly Zuckerman to report to me on the relative advantages of all the possibilities in this field, but I do not think the action I suggest in this paper ought to await this Committee's report—which would involve delay of six months or more.

Finance

16. In considering how the measures proposed in this paper should be financed, it is clear that the industry will be most reluctant to accept any burden in addition to that which they are already carrying by virtue of their increased commercial stocks. They would submit, with justification in my view, that before they were asked to make further stock provision, the Government should make some contribution from the Exchequer towards the measures proposed; so far the Government has paid nothing, but has received substantial revenue from the running down of Services' stocks from their higher pre-Suez levels. It is for this reason that I have proposed that the cost of filling the empty Government storage should fall on the Exchequer. If this Government expenditure is approved, I would feel able to sound the industry on what would be the largest contribution they could be induced to make towards the cost of filling the new P.B. capacity and constructing and filling the new proposed surface storage. I cannot predict the outcome of such consultation, but I suspect that the oil companies may feel that they could not add further to their expenditure on storage without a special increase in the prices of their products for the purpose and that this would only be practicable if the Government were to accept responsibility for it.

Summary

17. I invite my colleagues:—

- (a) to agree in principle that the addition as soon as possible of another month's supply to our oil stockpile is most desirable;
- (b) as steps towards achieving this end:—
 - (i) to approve the purchase of $\frac{1}{2}$ million tons of oil (mainly refined products) by the Ministry of Power at an estimated cost of £7 millions, for storage in empty Government tanks under a detailed programme to be worked out with the Service Departments and the Treasury;
 - (ii) to agree that a further $\frac{1}{4}$ million tons of Government storage which is expected to become available should be similarly filled at an estimated cost of £3 millions—if need be at Government expense;

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- (iii) to agree in principle that as and when it becomes available the 1 million tons of new P.B. storage should be filled with oil and that a further $\frac{3}{4}$ million tons of storage (probably conventional tankage) should be constructed and filled as soon as practicable;
- (iv) to authorise me to consult with the oil companies about the additional stocking programme and ascertain from them what contribution they would be prepared to make to its cost and on what terms.

M.

Ministry of Power, S.W. 1,
30th September, 1958.

APPENDIX A

UNITED KINGDOM OIL STOCKS

I.—Commercial Stocks⁽¹⁾

	Storage Capacity	Average Stocks	Available for inland consumption	Average monthly consumption (inland)
		(²)	(²)	
1956 (pre-Suez)	11.9	6.8	4.9 (11½ weeks)	1.8
1957 (June)	13.5	8.4	6.6 (14½ weeks)	1.9
1958 (estimated)	15.4	9.4	7.6 (15 weeks)	2.1
1959 (estimated)	16.4	9.9	8.1 (14½ weeks)	2.4

(¹) Stocks cover refined products and estimated yield of refined products from crude stocks.

(²) Because of the need to allow a margin for day-to-day receipts and disposals, the diversity of grades and seasonal fluctuations in trade, average stocks in commercial storage cannot normally exceed about 60 per cent. of total storage capacity.

(³) Including working stocks but excluding stocks held for exports and bunkers.

II.—Government Reserves (January 1958)⁽⁴⁾

Admiralty (naval oil fuels)	...	...	...	1.6
War Office (motor fuels)	...	...	...	0.1
Air Ministry (aviation fuels)	...	...	...	0.3
Ministry of Power (mainly motor fuels)	...	...	...	0.4
				2.4
U.S.A.F. (aviation fuels)	0.4
				2.8

(⁴) Excluding Government military reserves held overseas.

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APPENDIX B

OIL SUPPLIES IN EUROPE IN A PRODUCTION CRISIS

	1958		1960		1965	
	No extra from the West	50 million tons per annum extra from the West	No extra from the West	50 million tons per annum extra from the West	No extra from the West	50 million tons per annum extra from the West
<i>Case 1</i> (No Middle East oil)						
Percentage of supplies maintainable	20-25	50-55	23	48	26	46
Period of grace afforded by stocks:—						
(i) 2 months' stocks ...	1½-2 months	1½-2 months	1½ months	1½-2 months	1½ months	1½-2 months
(ii) 3 months' stocks ...	3 months	4 months	3 months	3½-4 months	3 months	3-4 months
(iii) 4 months' stocks ...	4-5 months	7 months	4-5 months	6 months	4-5 months	6 months
<i>Case 2</i> (Iran only)						
Percentage of supplies maintainable	40-45	70-75	46	71	52	72
Period of grace afforded by stocks:—						
(i) 2 months' stocks ...	2 months	2 months	2 months	2 months	2 months	2 months
(ii) 3 months' stocks ...	4 months	8 months	4 months	6 months	4 months	6 months
(iii) 4 months' stocks ...	6 months	15 months	6 months	11-12 months	6-7 months	12 months
<i>Case 3</i> (Iran and Kuwait)						
Percentage of supplies maintainable	70-75	95-100	80	100	64	76
Period of grace afforded by stocks:—						
(i) 2 months' stocks ...	3 months	Indefinitely	2-3 months	Indefinitely	2 months	3 months
(ii) 3 months' stocks ...	10 months	Indefinitely	12 months	Indefinitely	6 months	10 months
(iii) 4 months' stocks ...	17 months	Indefinitely	22 months	Indefinitely	10 months	17 months
<i>Case 4</i> (Iran and Saudi Arabia)						
Percentage of supplies maintainable	65-70	95-100	71	96	64	76
Period of grace afforded by stocks:—						
(i) 2 months' stocks ...	3 months	Indefinitely	2 months	Indefinitely	2 months	2-3 months
(ii) 3 months' stocks ...	8 months	Indefinitely	6 months	Indefinitely	5-6 months	9 months
(iii) 4 months' stocks ...	13 months	Indefinitely	11 months	Indefinitely	9 months	16-17 months

MAIN ASSUMPTIONS

- (1) Consumption will be restricted by 5 per cent. during the first three months and by 10 per cent. thereafter.
- (2) A minimum of one month's stock must be maintained to ensure uninterrupted distribution.
- (3) There will be a larger surplus of tankers in 1960 than in 1958 but tankers will be in balance in 1965. In Cases 3 and 4 supplies will therefore be limited by tanker availability in 1965.
- (4) Extra supplies from the West will be mobilised at a rate which permits deliveries to Europe at the rate of an extra 50 million tons a year from the beginning of the third month after an emergency.
- (5) The Middle East exports available in Cases 2-4 will be distributed during the emergency in accordance with the normal pattern of overall Middle East exports, *i.e.*, three-quarters to west of Suez and quarter to east of Suez.