


CONFIDENTIAL

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Begins: 16/2/82.
Ends: 27/5/82.

PO -CH /GH/0027



PART A

Chancellor's (Howe) Papers:

TAXATION OF NORTH SEA
OIL AND PERTROCHEMICALS

Disposal Directions: 25 Years

Phidjan

24/7/95.

PO -CH /GH/0027
PART A



FROM: M A JOHNS

DATE: 16 February 1982

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

16 February 1982

1. MR CRAWLEY *J. 16/ii/82*
2. CHANCELLOR OF THE EXCHEQUER

NORTH SEA TAXATION - UKOOA AND THE IFS

You will have seen Mr Middleton's note of 12 February about UKOOA's letter of the same date rejecting the IFS proposals. You may like to send a brief acknowledgement to UKOOA on the lines of the attached draft.

M A JOHNS

cc Ministers of State (Lords)
Mr French
Mr Middleton
Mr Battishill
Mr Robson
Mr Wicks

Mr Dalton
Mr Rogers
Mr Crawley
Mr Stephenson
Mr Whitear
Mr Johns
PS/IR

FROM: A M W BATTISHILL
17 February 1982

CHANCELLOR OF THE EXCHEQUER

PS/EST cc
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M&E mind
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to agree with this*

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (L)
Sir Douglas Wass
Mr Ryrie
Mr Burns
Mr Middleton
Mr Quinlan
Mr Burgner
Mr Dixon
Mr Kemp
Mr Griffiths
Mr Wicks
Mrs Boardman
Mr Ridley
Mr French

PS/Customs & Excise
Mr Freedman - C&E

HEAVY FUEL OIL DUTY

This note reports the results of further work by officials to try to identify ways of helping industry with its heavy fuel oil bill without risking the potentially enormous PSBR cost if the Frigg contract were thereby triggered. The conclusions are unfortunately far from encouraging and my recommendation (which is shared by Customs & Excise) is that the best course would again be to leave the duty (and the other rebated oil duties) unchanged in the Budget - and not revalorise it. This is what the Budget arithmetic so far assumes.

Background

2. Following the difficulties last year, you will remember that you asked the Secretary of State for Energy to make an assessment of the costs and benefits of re-negotiating the Frigg contract. Mr Lawson wrote to you in November advising that the price which would have to be paid to the Norwegians for a re-negotiation would greatly exceed any possible direct benefit to British industry. He concluded that:

"We should ... recognise that HFO duty must stay."

MEMORANDUM FOR THE SECRETARY OF DEFENSE
DATE: 12/15/50

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Mr. Tolson
 Mr. E. A. Tamm
 Mr. Clegg
 Mr. Glavin
 Mr. Ladd
 Mr. Nichols
 Mr. Rosen
 Mr. Tracy
 Mr. Carson
 Mr. Egan
 Mr. Gurnea
 Mr. Harbo
 Mr. Hendon
 Mr. Pennington
 Mr. Quinn
 Mr. Nease
 Mr. Gandy

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 Mr. Pennington
 Mr. Quinn
 Mr. Nease
 Mr. Gandy

NAVY BUREAU OFFICE

This report reports the results of further work by the Bureau
 to try to identify any of possible relations with the Navy
 but all still without identifying the specific persons.
 The only contacts were the Navy Department. The
 connections are not necessarily from connections and the
 connections (which is shared by Tolson & Rosen) is that
 the best source would be to have the Navy (and the
 other related all details) mentioned in the subject - and the
 results is that the Bureau will be able to do so.

Approved

Following the discussion last week, you will remember
 that you asked the Secretary of the Navy to take an
 account of the costs and benefits of re-organization of the
 Navy. Mr. Tolson asks you to have a similar
 that the price which would have to be paid to the Government
 for a re-organization would be the cost of possible direct
 costs to the Navy. He would like

"The thought ... regarding that was very great."

3. Before coming to a final conclusion you decided that officials should be asked to take one further look at the whole subject to see whether it might be possible to devise some form of selective relief to industry which could side-step the Frigg complication.

Further work

4. The report below summarises the work that has been done. As well as the Treasury and Customs, this has involved the Departments of Industry and Energy. Our conclusions are summarised in paragraphs 31 to 39.

Developments since last year

5. Compared with this time a year ago:

1/ (a) industry is using less fuel oil: consumption is now only half what it was three years ago;

(b) the level of the duty has fallen in real terms: the present £8 a tonne duty is only four-fifths of what it was in 1980;

(c) international comparisons remain difficult as ever: a year ago UK duty-inclusive prices were the second lowest in the EC; but now they are among the highest (because spot prices have fallen) - though there is some trend towards higher duty levels in the rest of the EC;

(d) the pressure from industry for some relief, though still with us, is much less vociferous - possibly because of a wider understanding of the Frigg complication.

(e) the direct cost of abolishing the duty has risen - from £195m to £230m in the first year and from £705m to £735m after four years (the BGC and NCB costs more than balancing the reduction in industrial consumption).

Possible schemes

6. Against this background, we have considered three possible schemes for giving selective relief suggested by the Department of Industry. In the light of the Attorney General's advice last year, these are designed to give relief to not more than 25 to 30 per cent of total fuel oil consumption in this country. Briefly, we have looked at three possible schemes of relief. These would be targeted respectively at:

(i) the three most oil-intensive industrial sectors - glass production, iron and steel and paper and board manufacture;

(ii) those enterprises using heavy fuel oil most intensively (in practice, those with an oil intensity above a specified threshold); and

(iii) the heavy fuel oil used in electricity generation.

7. None of these reliefs could be introduced quickly. In each case a number of legal and administrative problems would have to be overcome. Depending on the precise coverage, the cost of relief would range between some £10 and £30 million in a full year. Extra staff would be required: perhaps as many as 60 to 70 in the first year for either of the first two types of scheme.

8. As with any selective relief, there would be awkward borderline problems. These would ^{be} especially severe in the first two types of scheme, which would be seen by industry as having some of the flavour of the old SET. A relief confined to electricity generation would present fewer definitional and administrative difficulties. But, even if the benefit of lower electricity costs could be confined to industrial consumers (and we can see no way of ensuring this at present), it would be spread so thinly that it would be hard to present such a scheme as meeting the needs of the oil-consuming industries. Paradoxically, the greatest beneficiaries of a

scheme on these lines would not be companies reliant on heavy fuel oil but those using electrical power.

9. Overlaying the difficulties attaching to particular schemes lies the general shadow cast by the Frigg contract. We could not be sure that any of the schemes would be free from challenge by the Norwegians, or that a challenge could be successfully resisted. It would be extremely difficult for Ministers to say publicly why relief was being confined to less than a third of total consumption, and to find convincing reasons for resisting extension to other potential claimants.

Alternative course

10. The alternative to selective relief would be to repeat the course you followed last year and leave the rate of duty on fuel oil unchanged. Leaving the duty at 3½p a gallon would mean that the duty would have been reduced in real terms over a two year period by something like 20%. This is not, of course, without cost: not to revalorise the duty again would mean forgoing some £15 million extra revenue from fuel oil next year and a broadly similar sum in a full year through the cost of Frigg oil. But the benefits would be spread evenly across all consuming industries.

11. The Secretary of State for Industry, whilst he would no doubt be disappointed if this were the outcome, has recognised (in his letter of 10 February) the real practical difficulties in the way of introducing a selective relief.

Recommendation

12. It does not seem to me that the benefits from any of the schemes that we have looked at are sufficiently attractive to justify proceeding with them. Whilst European duty levels remain well ahead of ours, my recommendation would be to leave the duty level unchanged again this year. Customs & Excise would support this view. If you are content with this approach you might wish to write quickly to the Secretaries of State for Energy and Industry. We will provide a draft.

There are also those who say that the industry would be better off if it were nationalized.

In the industry the situation is not clear cut. Some say the industry should be nationalized, others say it should be left alone. It would be extremely difficult for the industry to say publicly that it is being nationalized. There is a lot of talk of nationalization, but it is not clear what is meant by that word.

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HEAVY FUEL OIL DUTY

Ministers asked officials to consider the possibilities for providing some form of selective relief to industry as an alternative to across-the-board action or renegotiating the Frigg contract as background to the 1982 Budget. This report has been prepared by officials from the Customs and Excise and the Departments of Energy and Industry under Treasury chairmanship.

1981 Budget

2. The implications of abolishing or halving the rate of the duty, or of providing some form of selective relief were examined in detail in a report submitted to Ministers before the last Budget. In the event, it was not felt to be possible to go beyond holding the rate on all rebated oils (including gas oil and Avtur) to the level of 3½p a gallon (or approximately £8 per tonne in the case of fuel oil) set in 1980.

3. In reaching this decision Ministers were particularly concerned with the high cost of any across-the-board reduction (in terms of both revenue foregone and cost penalties for the British Gas Corporation (BGC)) as compared with the amount of direct benefit which would accrue to industry. These costs would be particularly large in second and subsequent years, because of the effect of the existing terms of BGC's contract for purchasing North Sea gas from the Frigg field. Under these, the price falls as the duty rises; and increases as the duty falls.

4. The total direct PSBR costs were then estimated to be:

	<u>£m current prices</u>			
	i. in the case of <u>abolition</u>			
	1981-82	1982-83	1983-84	1984-85
Revenue lost ^{(1) (2)}	170	200	225	250
BGC (excl Frigg) ⁽¹⁾	20	45	50	55
Frigg contract	20	225	345	380
NCB/CEGB ⁽¹⁾	-15	15	20	20
Total	195	485	640	705

(1) Assuming re-valorisation to 1980 level

(2) Fuel oil only

£m current pricesii. in the case of reduction to £4 per tonne

	1981-82	1982-83	1983-84	1984-85
Revenue lost ⁽¹⁾⁽²⁾	100	115	125	140
BGC (excl Frigg) ⁽¹⁾	10	25	30	30
Frigg contract	10	75	115	125
NCB/CEGB ⁽¹⁾	-5	10	10	10
Total	115	225	280	305

(1) Assuming re-valorisation to 1980 level

(2) Fuel oil only (excluding gas oil, avtur)

5. They also took into account:

i. The uncertainty that any selective scheme of relief would escape penalty under the Frigg contract in the event of a challenge from the Norwegians being taken to arbitration; and

ii. The likelihood that any selective scheme would both involve complex problems of definition and administration and be difficult to present and defend against extension without endangering the prospects for successful future negotiations with the Norwegians about gas supplies.

6. The immediate effect of the decision was to allow the duty burden to fall in real terms by about 12% compared with where it stood immediately after the 1980 Budget. Increasing the duty on heavy fuel oil in line with inflation would have added an equivalent of £1-1.20 a tonne to the duty at that time or an estimated £15 million to the duty burden in 1981/82. Under the existing Frigg contracts it would also have reduced the price paid by BGC for Frigg purchases, with a resource saving of £5 million in 1981/82 rising to £15 million in 1982/83.

PROSPECTS FOR 1982/83

Burden on industry

7. General price movements since the 1981 Budget mean that at 3½p a gallon the duty now stands at about 20% or £2 a tonne lower in real terms than it did in 1980. If maintained at its current level for a further year this erosion in real terms could be expected to increase to about 27% or perhaps £3 a tonne by March 1983.

8. The real burden of the duty on industry, as a whole, measured as a proportion of manufacturing industry's selling price declined during 1981 from an average of 0.08% at the time of the pre-1981 Budget report to 0.05% currently. Within this overall figure, as Annex A shows, the position varies markedly between sectors. In certain manufacturing industries (notably glass, iron and steel, paper and board, chemicals and textiles) the importance of fuel oil as a proportion of selling price remains significantly higher. The change in the absolute burden on industry as a whole reflects not only the erosion of the real duty level, but also the continuing decline in consumption by all types of users illustrated in Annex B. Overall consumption of fuel oil during the first half of 1981 stood at some 53% of its level during the same period of 1979, the decline being most marked in the case of the Central Electricity Generating Board (CEGB) at 38%, as compared with the manufacturing sector (60%).

9. But much of UK industry's case for a reduction before the 1981 Budget rested on their comparative price and duty disadvantage in cash terms vis-a-vis EC oil users. The recent NEDC Energy Prices Task Force Report showed that, on 1 October last, the UK heavy fuel oil net of duty was within the range elsewhere in the EC, though the duty-inclusive price was (with the Dutch) at the top. Generally, the difference between UK and continental prices tends to close during the winter months when demand on the continent pushes up spot prices. But this year the influence of low spot prices in a slack market has held down continental prices and the disparity has widened. Annex C shows the current UK net of tax price as substantially above the continental average and the duty inclusive price as around 15% above it (12% above that in Germany and 16.5% above France). Although UK market prices are slowly being eroded by competition, there is no immediate prospect that the gap will be closed.

10. Moreover, as the figures in Annex C show, at £8 a tonne, the UK duty is till the highest in the Community with the exception of Ireland. There are some indications that in general the average duty level for the Community can be expected to rise over the longer term; more particularly:

i. The recent French decision to introduce a duty of about £4 per tonne on fuel oil; and

ii. The increasing interest on the part of the Commission and Germany in reducing exemptions and reliefs from oil duties, and in imposing a significant level of duty on fuel oil.

But progress in this area at Community level can be expected to be slow, and not greatly to influence duty and price differentials in 1982/83.

11. Some continuing pressure for relief can therefore be expected in 1982/83, particularly from those sectors with a higher than average oil intensity. What pressure there has been for relief during 1981/82 has been largely confined to these industries, with the major concern of energy intensive industries being directed towards the level of electricity prices.

Across-the-Board action

12. The direct PSBR costs of across-the-board action on the rate of the duty are now estimated to be:

i. in the case of abolition

	82/83	83/84	84/85	85/86
Revenue lost ^{(1) (2)}	150	160	180	200
BGC sales (excl Frigg) ⁽¹⁾	20	57	80	100
Frigg	50	275	325	375
NCB sales ⁽¹⁾	10	23	40	60
Total	230	515	625	735

ii. in the case of reduction to £4 per tonne

	82/83	83/84	84/85	85/86
Revenue lost ^{(1) (2)}	80	90	100	120
BGC sales (excl Frigg) ⁽¹⁾	10	32	40	50
Frigg	25	125	140	60
NCB sales ⁽¹⁾	5	13	20	30
Total	120	260	300	360

(1) Assuming re-valorisation to [1981] level

(2) Fuel oil only (excluding gas oil, avtur)

iii. in the case of not revalorisinga. to 1980 levels

	82/83	83/84	84/85	85/86
Revenue foregone: fuel oil	30	30	35	35
gas oil,	25	20	30	30
Avtur	5	5	5	5
BGC sales (excl Frigg)	10	10	15	20
Frigg	15	30	40	50
NCB sales	5	10	10	15
Total	90	115	135	155

b. to 1981 levels

	82/83	83/84	84/85	85/86
Revenue foregone: fuel oil	15	15	20	20
gas oil,	10	10	10	10
Avtur	5	5	5	5
BGC sales (excl Frigg)	5	7	10	15
Frigg	10	25	30	35
NCB sales	1	3	5	8
Total	46	65	80	93

13. The differences between these figures and those in paragraph 4 reflect not only the decline in fuel oil consumption, but the effects of movements in relative prices of alternative fuels. The combined effect has been to increase the significance of the costs to the NCB and BGC (including Frigg) as an element in the total PSBR costs of any across-the-board action.

Frigg

14. Following the 1981 Budget Ministers asked BGC to consider the prospects for re-negotiating their North Sea contracts so as to break the link between the level of the fuel oil duty and the price of Frigg gas. If successful, this would significantly reduce the costs of across-the-board action. But in practice, there seems no prospect achieving it without incurring off-setting disbenefits, given:

i. The pre-existing complaints from the gas producers that their return on investment is too low; and

ii. The increased Norwegian awareness following the 1981 Budget the impact of duty changes and of the UK's desire for change. This has been evidenced by their raising the question at Ministerial level and otherwise of whether HMG has in the past deliberately raised the duty to keep the Frigg price down.

15. Nevertheless, BGC has embarked on negotiations with Norsk Hydro, perhaps the key licensees. The latter are demanding full retrospective removal of the fuel oil duty element from the price formula while BGC are seeking to maintain prices at their present level. BGC think it might be possible to reach a compromise under which the price would be increased by 25-50% of the savings presently attributed to the fuel oil duty element. The negotiations are, however, temporarily in abeyance; BGC believe the Norwegians are waiting to see whether any change is made in the fuel oil duty in the Budget before resuming. Their reaction will be a complicating factor in considering the presentation of any Budget changes. At first sight, they would now seem more likely to challenge any attempt at selective relief than before the last Budget. But equally, it is clear that, in any event, the Sales Agreement cannot be altered in time for the fuel oil duty to be reduced across-the-board in the next Budget without adversely

affecting the price of Frigg gas, and the estimates given in paragraph 12 accordingly assume an unchanged contract.

Selective Relief

16. Against this background officials were asked to consider the possibility of some selective relief for particularly heavy industrial users-although the previous Minister of State to the Treasury (Commons) reported to the House last year that he recognised that there was unlikely to be a solution on these lines. In doing so we have been guided by the Attorney General's advice (a year ago) that a scheme of relief limited to about 30% of total consumption of heavy fuel oil might stand a "reasonable chance" in arbitration of resisting a Norwegian claim to apply the lower (relieved) rate of duty under the Frigg contract rather than the rate applying to the remaining 70% of use. To preserve a margin of safety we have accordingly looked at schemes which would relieve not more than 25% of HFO consumption from the full rate of duty.

17. The remainder of this report considers the 3 main possibilities which the Group identified:

Option 1: relief for oil intensive sectors

Option 2: relief for oil intensive enterprises

Option 3: relief for oil used in electricity generation

18. These are considered in turn below. But there are a few general practical points to be made at the outset:

i. All the schemes outlined are intended to extend relief to up to 25% of deliveries of fuel oil. This percentage would mean that oil relieved under the schemes would, together with oil used in horticulture etc which is already relieved, be less than the 30% identified by the Attorney General as the safe upper limit. It is important that this limit should not be breached, but even so there is no guarantee that any scheme will not be challenged by the Norwegians or what the outcome of any subsequent arbitration would be. These figures do not include

oil consumed duty-free by the oil industry itself, which would amount to up to 20% of total inland deliveries.

ii. All would require considerable additional preparatory work, including consultation with BGC and, in the case of Option 3 with the CEGB. Options 1 and 2 could probably not be implemented before 1 October, whilst it would be extremely difficult to find solutions for the practical and legal problems involved in Option 3 before 1 April, in time to affect the CEGB's 1982/83 price tariff for industrial users.

iii. None would be capable of providing relief for all manufacturing industry (which currently accounts for some 55% of total usage/ excluding refineries) or even all those which would regard themselves as having some claim to special relief, because of the need to keep below the 25% ceiling.

Option 1: Oil intensive sectors

19. Under this scheme, establishments whose major activity fell within selected minimum list headings (MLH) of the Standard Industrial Classification (SIC), where intensity of oil use is particularly high, would be eligible for relief. Oil intensity might be defined by the ratio (within a sector) of fuel oil delivered to either sales or net turnover of the sector as a whole. On either criterion, as Annex A shows the 3 most eligible sectors would be:

- Glass production
- Iron and steel production
- Paper and board manufacture

20. Together, these sectors accounted for about 14.7% of total fuel oil deliveries in the first half of 1981. The direct revenue cost of relief would be about £20 million/ in a full year. Relief would be provided by either repayment of duty or by authorisation to receive oil duty free. The latter would be administratively the simpler, as the need to check claims and make repayments would be avoided. The initial staff cost would be about 60-70. Between 15 and 20 would continue to be required

to control the use of the duty-free oil, while about 50 (gradually declining) would be needed in the early years to process applications and grant approvals for duty-free use. On-going control staff would be provided by Customs and Excise, but they have neither the available resources nor the expertise to cope with the question of determining eligibility.

21. The arguments in favour of a relief on these lines are:

i. It would concentrate relief on those sectors where fuel oil usage is proportionately highest, and which have been amongst the most vociferous in calling for relief;

ii. The use of relatively broad classifications to determine eligibility could avoid some administrative and presentational problems; and

iii. The proportion of total usage relieved would remain relatively identifiable and controllable within the 25% ceiling.

22. As against these:

i. The need to rely on broad classifications would mean that undertakings within the selected sectors would get relief for the whole of their heavy fuel oil consumption regardless of use (including, for example oil used for heating offices). The relief would thus be subject to the same type of anomaly as those which gave rise to much criticism of the Selective Employment Tax;

ii. It would not provide relief to certain industries within excluded sectors (eg man-made fibre, brick and chemical industries) which may in practice use fuel oil more intensively than some which would benefit from relief;

iii. Pressure for the relief to be extended could also be expected from those sectors with only slightly lower oil intensity (eg textiles) and it would be difficult to defend the border-lines chosen without public reference to the Frigg problem,

since revenue and administrative considerations would be insufficient to satisfy criticism at the margin;

iv. It would give rise to distortions of competition between rival sectors (eg glass and plastic bottles);

v. It would require complex administrative arrangements, which would involve substantial staff costs, especially in the first year. There would also be very real problems of classification. The VAT classifications would be unsuitable because it relies on self-classification and relates to legal units, which will often span several industries. The SIC which classifies individual establishments, suffers from the fact that it is based on self-classification and in some respects is several years out of date. Its use for taxation purposes for which it was never intended would invite a flood of applications for reclassification;

vi. It would conflict with energy conservation policies within individual sectors; and

vii. It could invite opposition from the European Commission on the grounds that, because it identifies particular undertakings and products, it was a selective operating subsidy under Article 92 of the Treaty of Rome.

23. Up to £9 million of the total £20 million relief in a full year under this scheme would go to the British Steel Corporation (BSC) and might therefore be off-set against its EFL. We have considered whether it would be possible to exclude BSC from the relief, with the intention of including another sector of private industry. This would however carry these problems, in addition to those noted in paragraph 22:

i. The possibility that any enacting legislation would be hybrid;

ii. Discrimination within the industry by eroding BSC's competitiveness further;

iii. The impossibility of proving that the rest of the iron and steel sector should still qualify for relief; and

iv. The lack of a clear-cut choice of an additional sector for relief, because of the comparable claims of the chemicals, textiles and miscellaneous categories.

For these reasons, we would not recommend the exclusion of BSC. If Ministers are attracted to a scheme on these lines, covering the iron and steel sectors, further consideration would need to be given to the treatment for EFL purposes of the benefit which BSC would derive.

Option 2: Oil intensive enterprises

24. This scheme would allow relief on all heavy fuel oil used in establishments (regardless of sector) with an oil intensity above a specified threshold, defined by the ratio of fuel oil purchases to net turnover within that establishment. Both purchases and turnover would be established by means of an auditor's certificate, on the model of many of the financial assistance schemes operated by the Department of Industry. Because eligibility for relief would be determined by the oil actually consumed, this scheme could operate only on a repayment basis. Administratively the repayment provisions could have many similarities to the fuel grant at present operated by the Department of Transport for stage carriage bus services. 60-70 additional staff would be needed in the first year but this should decline gradually to about 20 to 25. The direct revenue cost would be between £20 million and £30 million in a full year.

25. The arguments for a relief on these lines would be:

i. Relief would be directly targeted to those enterprises which most needed it rather than to sectors which might contain a wide variation between individual enterprises;

ii. It would consequently avoid some of the anomalies of a scheme linked to broad sectors.

26. As against this:

- i. There could be expected to be continuing pressure for extension of the relief, which could not be countered by an appeal to a broad-brush approach;
- ii. It would give rise to distortion within sectors, by penalising the energy-efficient and diminishing their competitive advantage in such a way as to impact on conservation policies;
- iii. It would not be easy to set a qualifying threshold at the correct level to ensure maximum relief for industry within a 25% ceiling;
- iv. It would involve a number of administrative and control problems, which would require a continuing need for significant staff costs. In particular, it would be possible for multi-establishment concerns to manipulate the scheme.

Option 3: Relief for electricity generation

27. This would provide relief for heavy fuel oil used in the generation of electricity for industrial use, including use by the electricity supply industry (ESI), private generators and combined heat and power systems. In the case of the CEGB, the need would be for the relief to be passed on in full in reduced electricity prices to all industrial consumers. For private generators and heat and power systems there would need to be a specified output level which would have to be exceeded before relief became available. The total direct revenue cost would be between £30-40 million in a full year and an additional 10 staff would be required on a continuing basis.

28. The arguments for a relief on these lines would be:
- i. Its benefit would be spread through industry in the form of reduced electricity costs;
 - ii. It might be easier to defend against extension without reference to Frigg by reference to industry's calls for reduced electricity costs;

iii. It would be the easiest to administer and control;

iv. It would be easy to identify the proportion of the total oil usage which was being relieved.

29. As against these:

i. It would be unlikely to satisfy the demands for relief from many of those who have complained most, and who would benefit more from direct relief of the fuel oil which they consume.

Paradoxically it would benefit firms relying on electricity for heating and power; and would do nothing directly for those who do not use fuel oil to generate electricity. At least some large users of fuel oil are unlikely to be also large electricity users, and these might reasonably object to industry in general benefitting from relief in this indirect way in what they would regard as at their expense;

ii. It is not clear whether the electricity supply industry would be able to pass on the benefits of this concession to industrial consumers alone. They may conclude that such action would contravene the industry's statutory obligation to give no undue preference to any group of customers;

iii. Practical problems could be involved in determining what proportion of fuel oil burnt is for industrial consumption and reflecting this properly in the tariff structure;

iv. These problems make it unlikely that solutions could be found in time to affect the ESI's tariffs for 1982/83 which are due to come into force on 1 April.

v. Even if these problems could be overcome, the consequent reduction in industrial electricity prices of around $\frac{1}{2}\%$ would soon be lost sight of by industrial users in the normal annual increase in electricity charges;

vi. Oil is at present a comparatively small element of electricity costs; ESI has capacity for four times its oil-burn in 1981. Any incentive to switch to oil could have consequences for its demand for coal. If it led to an increased consumption of oil by ESI, the 25% limit might be breached;

vii. Although relatively cheap to administer, staff costs could be greatly increased if relief had to be allowed to the smallest private generators; and

viii. Other proposals are being separately considered which would benefit intensive electricity users and which if implemented would dwarf any benefit which might result from this scheme.

30. Up to half the relief under this scheme would go to the ESI in the first instance, and could be criticised on those grounds by private industry. We have therefore considered also the possibility of limiting relief to oil used in private electricity generation and combined heat and power systems. This would have a direct revenue cost of £15 million but would still require 10 staff. It would also have the advantage of being well within the 25% ceiling. Against this would have to be set, in addition to arguments i. and vii above:

i. Any legislation might be hybrid;

ii. Distribution of relief would be fortuitous depending on a decision to generate electricity privately, rather than on any proven need for relief; and

iii. As a consequence relief would still be still further divorced from the calls for action on heavy fuel oil costs to industry in general.

For these reasons, we would not recommend the exclusion of the ESI.

CONCLUSIONS

31. The 1981 decision to maintain the existing duty level took into account the direct revenue and Frigg costs involved in any across-the-board action and the difficulties associated with any form of selective relief (paragraphs 2-6).

32. Since the 1981 Budget, the absolute burden of the duty on industry has fallen because:

i. The duty now stands at about 80% of its 1980 level in real terms; and

ii. Consumption is continuing to decline (paragraphs 7-8).

33. Over much of 1981-82, the UK duty-inclusive price of fuel oil has been towards the top of the EC range. But the UK duty level continues to be considerably higher than in most EC countries, and the duty-inclusive price is currently 15% higher than EC levels. There is no immediate prospect of these differentials narrowing. (Paragraphs 9-10).

34. Industry's main energy concern at present is electricity prices, but continued calls for action on fuel oil duty can be expected, particularly from energy intensive manufacturing sectors like glass, iron and steel, paper and board, textiles and chemicals. (Paragraph 11)

35. The estimated direct PSBR costs of across-the-board action (including maintaining the duty at its 1980 level) are now marginally higher than in 1981, despite some decrease in the direct revenue cost reflecting the fall in consumption. Non-revalorisation would maintain the duty burden at about 20% below its 1980 level in real terms (rising to 27% by end 1982-83) at a total direct revenue cost of £30 million (or £60 million including gas oil and Avtur) and an indirect Frigg cost of £15 million. (Paragraphs 12-13).

36. BGC's efforts to re-negotiate Frigg are unlikely to achieve early success; will continue to complicate the presentation of any Budget changes; and may result in increases in the price of Frigg gas (paragraphs 14-15).

37. The Attorney General advised after the last Budget that a selective scheme of relief which applied to up to 30% of total consumption might stand a reasonable chance of escaping penalty under Frigg is taken to arbitration (paragraph 16).

38. It might be possible to devise three main alternative schemes of selective relief within this criteria to provide relief for:

- i. Some of those sectors which have high oil intensity eg glass, iron and steel, paper and board (paragraphs 19-23); or
- ii. Those establishments which have the highest oil intensity, regardless of sector (paragraphs 24-26); or
- iii. Oil used in private and public electricity generation, with the understanding that the ESI's cost savings would be passed on solely to their industrial consumers (paragraphs 27-30).

The direct revenue cost of relief on these lines would vary between schemes but would be in the order of £10-30 million in a full year. (This would be additional to the costs of non-revalorisation of the duty as a whole in paragraph 12 if this were felt desirable.)

39. But none of these schemes:

- i. Could be certain of escaping Frigg penalties;
- ii. Would satisfy all claimants or be easily defended against extension without risks for the Frigg renegotiations;
- iii. Could be easily reconciled with EC taxation trends or the UK/EC energy objective of discouraging oil dependency; nor

iv. Could be implemented without considerable further work on the administrative and legal/legislative complexities and difficulties which would be involved. Relief for sectors or establishments could not be implemented before 1 October. The administrative and staff problems and costs would be least in the case of relief for electricity generation (5-10 staff as compared with 60-70); but the legal and legislative problems would be greatest, and would be difficult to solve in time for the relief to affect the new electricity tariffs for 1982 which will take effect from 1 April.

16 February 1982

JANUARY - JUNE 1981

MLH in
SIC (1968)

		<u>Sales</u> (£million)	<u>Deliveries of</u> <u>fuel oil</u> (k tonnes)	<u>Oil intensity</u> (tonnes per £m of sales)
463	Glass	527.1	214.3	407
311-312	Iron & Steel ..	(2000)*	612.5	306
481-484	Paper & Board ..	2368.7	360.4	152
271-279	Chemicals	8629.9	976.3	113
411-429	Textiles	3005.0	336.5	112
492-499	Miscellaneous ..	1807.5	198.3	110
464	Cement	294.2	25.5	87
431-433	Leather	285.1	20.2	71
211-240	Food, drink & tobacco	10938.1	663.8	61
491	Rubber	1024.6	51.4	50
461&469	Bricks etc	1414.1	62.3	44
321-323	Non-ferrous metals	1689.3	74.9	44
331-399	Metal using industries ...	26068.3	648.9	25
441-450	Clothing & footwear	1826.3	40.3	22
313	Iron castings ..	(500)*	9.8	20
462	Pottery	320.7	5.0	16
485-489	Printing & publishing	3330.2	36.2	11
471-479	Timber, furniture etc .	2382.8	23.3	10
TOTAL	MANUFACTURING INDUSTRY	68411.9	4360.2	64

* DoI estimates

CONSUMPTION OF FUEL OIL & GAS OIL

JANUARY-JUNE

	GAS OIL					FUEL OIL				
	1984 cons- umption	% total cons- umption	1979 cons- umption	% total cons- umption	1984 cons- umption as % of 1979 consumption	1984 cons- umption	% total cons- umption	1979 cons- umption	% total cons- umption	1984 consumption as % of 1979 consumption
MANUFACTURING	1291.1	22.3	1833.6	23.2	70	4360.2	54.2	7306.8	47.8	60
ELECTRICITY	47.8	0.8	225.1	2.9	21	2189.3	27.2	5734.1	37.5	38
RAILWAYS	385.4	6.7	415.5	5.3	93	15.0	0.2	27.9	0.2	34
TOTAL PUBLIC UTILITIES	447.4	7.7	673.7	8.5	66	2205.6	27.4	5820.7	38.1	37
AGRICULTURE & FORESTRY	363.3	6.3	572.1	7.2	64	116.2	1.4	211.2	1.4	35
FISHERIES	101.6	1.8	168.3	2.1	60	0.1	0.001	5.2	0.03	2
MISCELLANEOUS NON-MANUFACTURING INDUSTRIES	887.3	15.3	1075.7	13.6	83	222.3	2.8	370.5	2.4	40
TOTAL NON-MANUFACT- URING INDUSTRIES	1715.4	27.6	2214.1	28.0	77	365.8	4.5	636.7	4.2	57
CENTRAL HEATING	2203.7	38.1	3107.8	39.4	71	977.8	12.1	1292.2	8.5	76
TOTAL DELIVERIES	5798.1	100	7897.1	100	73	8051.4	100	15283.8	100	53

2. CONSUMPTION OF FUEL OIL & GAS OIL

January - June

	GAS OIL		FUEL OIL	
	1981	1979	1981	1979
Iron & Steel: Steel	98.2	154.6	612.5	1,341.4
: Iron Castings	18.0	30.3	9.8	18.4
Nonferrous metals	42.6	66.8	74.9	109.9
Metal using industries	385.3	610.4	648.9	1,074.6
Pottery	1.9	4.3	5.0	6.6
Glass	9.6	12.1	214.3	280.0
Cement	8.9	11.1	25.5	50.0
Bricks	96.3	118.3	62.3	159.7
Food, drinks & tobacco	172.1	228.9	663.8	962.4
Chemicals - Soap & detergent	1.4	2.0	40.1	67.7
- Plastics & synthetic rubber	25.6	27.7	78.8	150.6
- Other (inc Petrol Chemicals)	97.0	131.2	857.4	1,324.6
Textiles, leather etc	57.3	86.8	397.0	575.2
Paper-making	15.9	29.5	360.4	608.8
Printing	18.1	29.6	36.2	53.1
Other Manufacturing:				
- Timber	22.5	35.6	23.3	37.0
- Rubber Goods	7.8	9.8	51.4	66.1
- Miscellaneous	212.5	244.6	198.3	320.7
TOTAL MANUFACTURING INDUSTRY (excluding public utilities)	1291.1	1,833.6	4360.2	7,306.8
Gas-making	3.9	10.9	1.1	57.3
Electricity Generation	47.8	225.1	2189.3	5,734.1
Railways	385.4	406.2	15.0	27.9
TOTAL PUBLIC UTILITIES	447.4	673.7	2205.6	5,820.7
Agriculture & Forestry	363.3	572.1	116.2	211.1
Fisheries	101.6	168.3	0.1	5.2
Oil exploration & production	187.6	183.7	17.8	26.7
Other Marine	175.6	214.3	9.4	23.2
Other	887.3	1,075.7	222.3	370.5
TOTAL NON-MANUFACTURING INDUSTRY	1715.4	2,214.1	365.8	636.7
TOTAL CENTRAL HEATING	2203.7	3,107.8	977.8	1,292.8
PETROLEUM INDUSTRY'S OWN USE	85.3	67.9	138.5	227.4
TOTAL DELIVERIES	5798.1	7,897.1	8051.4	15,233.8

COMPARATIVE PRICE AND TAX LEVELS

A. FUEL OIL PRICES: 12 JANUARY 1981

£/tonne

	Tax Exclusive Price	Duty	Duty-inclusive price ¹ to business users
Belgium	97.46	-	97.5
Denmark	102.83	28.11 ²	130.9 ²
Germany	92.76	3.16	95.9
France	92.35	0.07	92.4
Ireland	102.78	12.53	115.3
Italy	87.54	0.44	88.0
Netherlands	95.62	2.92	98.5
UK	84.3	8.00	92.3

B. FUEL OIL PRICES: 8 FEBRUARY 1982

£/tonne

	Tax Exclusive Price	Duty	Duty-inclusive price ¹ to business users
Belgium	99.7	-	99.7
Denmark	109.2	28.6 ²	137.8 ²
Germany	104	3.4	107.4
France	99.1	4.1	103.2
Greece	96.3	?	96.3 (+?)
Ireland	120.9	8.2	129.1
Italy	97.2	0.4	97.6
Netherlands	106.9	2.1	109.0
UK	112.2	8.0	120.2

¹ Represents final price to VAT-registered users, ie excludes VAT; and

² Duty in Denmark (rebated to VAT-registered traders and hence effectively nil to industrial users)

Exchange rate: £1 = \$1.8615 (1982) £1 = \$2.4021 (1981)

Source: EC report-back telex

P. Do you still
have vps?
18/2

CONFIDENTIAL

FROM: C D HARRISON
18 February 1982



C
Decision is just taken at yesterday's
meeting. Letter to S/S's Ind +
Energy informing them herewith.
M

PS/CHANCELLOR (MR JENKINS)

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Minister of State (L)
- Sir Douglas Wass
- Mr Ryrie
- Mr Burns
- Mr Middleton
- Mr Quinlan
- Mr Battishill
- Mr Burgner
- Mr Dixon
- Mr Kemp
- ~~Mr Griffiths~~
- ~~Mr Wicks~~
- Mrs Boardman
- Mr Ridley
- Mr French
- PS/Customs & Excise

*Mc hair @ \$10
of A.B.'s submission
for no more
in year*

HEAVY FUEL OIL DUTY

You asked for the Economic Secretary's views on Mr Battishill's submission of 17 February.

The Economic Secretary has commented that it is greatly to be regretted that the Government's hands are tied by the Frigg contract. Otherwise, there would be a good case for reducing the heavy fuel oil duty. But in the circumstances, he agrees with Mr Battishill that the most preferable option is to leave the duty level unchanged again this year.

CDH
C D HARRISON
Private Secretary

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

22 February 1982

The Rt. Hon. Nigel Lawson, MP
Secretary of State for Energy
Department of Energy

cc PS/CST
PS/FST
PS/EST
PS/MST(L)
Sir D Wass
Mr Rynie
Mr Burns
Mr Middleton
Mr Quinlan
Mr Battishill
Mr Burgner
Mr Dixon
Mr Kemp
Mr Ridley
Mr French
PS/C&E
Mr Harrison

Nigel

HFO DUTY AND THE FRIGG CONTRACT

You will recall that, in response to your letter of 12 November last, I suggested that before we came to a firm conclusion about the future of the heavy fuel oil duty officials should be asked to take one further look at the whole subject to see whether it might be possible to devise some form of selective relief to industry which could sidestep the Frigg complication.

I have now studied the report prepared by my officials in association with yours and Patrick Jenkin's. I am grateful for the effort that has been put into this, and in particular to the Department of Industry for the work they have done in identifying a range of options for giving selective relief from the duty.

In spite of the ingenuity of these schemes, however, I am not persuaded that the industrial and political benefits from going down this road are commensurate with the risks to which we should be exposed if we were challenged by the Norwegians.

In all the circumstances, I have concluded that the best course is to do as I did last year, and leave the duty unchanged in the Budget.

I am copying this letter to Patrick Jenkin.

Geoffrey Howe

GEOFFREY HOWE

2
A. 1



SECRETARY OF STATE FOR ENERGY

THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

01 211 6402

prop ✓ *Plamp 1/3*

CHEQUEQUE
8 MAR 1982

- Ps/cek*
- gr*
- fr*
- ET*
- MITL*
- Sir D. J. A.*
- N. B. J. A.*
- W. P. J. A.*
- W. M. J. A.*
- W. J. A.*
- W. A. J. A.*
- 8 March 1982*
- W. J. A.*
- W. J. A.*
- W. J. A.*
- W. J. A.*
- W. J. A.*

BUDGET-CONFIDENTIAL

The Rt Hon Geoffrey Howe QC MP
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Dear Chancellor,

HFO DUTY AND THE FRIGG CONTRACT

Thank you for your letter of 22 February.

I agree that the best course is to let the duty stay as it is.

I am copying this letter to Patrick Jenkin.

*Yours sincerely,
Nigel Lawson*

NIGEL LAWSON

(Approved by the Secretary of State and signed in his absence)



C.
As with you on Jth

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

3 March 1982

1. MR CRAWLEY *ji - 3/iii.*
2. MR DALTON *AWD 3/3*
3. CHANCELLOR OF THE EXCHEQUER

C.
CST
comment on
timing below

PRT AND PETROCHEMICAL FEEDSTOCKS

1. In the light of Monday's meeting I attach a draft reply to the Secretary of State for Industry's letter of 23 February. The Chief Secretary and the Minister of State (Lords) also have outstanding correspondence from ICI and the Economic Secretary from BP. We will provide draft letters to go out to these companies once there is agreement to set up a study. We assume Ministers will want to write to them immediately after the Budget if possible.

✓

Do you agree
- at the mtg
we said
Tey, IR, Do I,
DEnergy

2. We have suggested that the group should include Scottish Office representation since the Secretary of State has expressed such strong concern about the future of Grangemouth and was also in the lead on the discussions last summer on the Mossmorran cracker. We have also suggested that it should take as its target date for reporting early May since we understand BP aim to take a final decision on Grangemouth towards the end of May.

3. We have agreed the attached draft with Treasury officials.

M.A. Johns

M A JOHNS

- cc
- Chief Secretary
 - Financial Secretary
 - Economic Secretary
 - Minister of State (Lords)
 - Sir Douglas Wass
 - Mr Ryrie
 - Mr Middleton
 - Mr Dixon
 - Mr Battishill
 - Mr Wicks
 - Mr Robson

- Sir Lawrence Airey
- Mr Dalton
- Mr Rogers
- Mr Crawley
- Mr Stephenson
- Mr Whitear
- Mr Johns
- PS/IR

CONFIDENTIAL

FROM: T F MATHEWS
DATE: 3 March 1982



C.

PRINCIPAL PRIVATE SECRETARY

- cc Financial Secretary
- Economic Secretary
- Minister of State (Lords)
- Mr Ryrie
- Mr Middleton
- Mr Dixon
- Mr Wicks
- Mr Robson
- Mr Chivers
- Mr Dalton)
- Mr Crawley) INLAND
- Mr Johns) REVENUE

✓
Early from below

PS/Inland Revenue

TAXATION AND THE PETRO-CHEMICAL INDUSTRY

The record of the Chancellor's meeting on 1 March records (paragraph 5) that the inter-departmental study "should aim to report by June so that its findings would be available for the Committee stage of the Finance Bill." I have discussed this with the Chief Secretary who agrees that the study must be completed by end-May at the very latest to allow reasonable time for decisions, and the drafting of amendments for the Committee Stage, which we must have completed by the end of June. I guess that the relevant Clauses of the Bill are likely to come somewhere between $\frac{2}{3}$ and $\frac{3}{4}$ of the way through the Bill. As you know, it is likely to be a pretty long Bill again this year, and we are aiming to make an early start so as to avoid the "House of Lords problem" experienced last year.

2. The Chief Secretary has also noted that, from ICI's point of view, a decision in the summer, if helpful, would be fine because Mossmorran is not starting until 1984-85. But BP would like a decision sooner.

TM

T F MATHEWS
3 March 1982

CONFIDENTIAL



A column of faint, illegible text on the left side of the page, possibly a list or index.

A horizontal line of faint text, likely a section header or title.

A large block of faint, illegible text in the middle of the page, possibly a main body of text or a long list.

A block of faint, illegible text at the bottom of the page, possibly a conclusion or a signature area.

Y S YDDFA GYMREIG

GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Linell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru



WELSH OFFICE

GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)

From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

CONFIDENTIAL

RECEIVED	
REC.	5 MAR 1982
ACTION	CST
DATE	
BY	

4th March 1982

BP CHEMICALS AND ICI

I should like to express my strong support for the proposal made by Patrick Jenkin in his letter of 23 February to you that two studies should be undertaken of the economic justification and technical feasibility of measures to support petrochemical activities in the United Kingdom - with particular reference to BP Chemicals and ICI. My special concern is with the former company. Its Baglan Bay and Barry plants provide about 1,700 jobs in a Special Development Area and about 1,000 in a Development Area respectively. I have seen for myself the very positive steps taken by the company in recent years to come to terms with the massive increases in feedstock and energy costs and believe that they have both the will and the inherent capacity to return to profitability. But whether they can do this without some measure of support or some exceptional arrangements (in regard to energy costs in the case of Baglan Bay) I do not know.

The two South Wales plants of BP Chemicals are a closely integrated operation linked also with BP's Llandarcy refinery. The essential feedstock is naphtha and thus they will not directly benefit from any more favourable tax arrangements on ethane that might be introduced. But BP Chemicals' ability to sustain the (presently loss making) South Wales plants must to some extent depend on their overall financial situation and I would therefore be sympathetically disposed towards any realistic and defensible measures that would underpin their Grangemouth operation. Hence my support for the two studies proposed by Patrick Jenkin.

I would hope that the first of these would cover the question of energy costs and possible means of reducing them - at least in respect of Baglan Bay. Energy costs there now represent 28% of the total; but BP

/Chemicals

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury
Parliament Street
LONDON



Chemicals argue that the existence of their own 118MW power station on site but with the capability of almost instantaneous cutting into or out of the national grid puts them in a very special position - they maintain that when the CEGB finds it necessary to switch in a power station to meet demand it ought immediately to go to full load with BP then taking the excess generation off the grid at marginal prices. Such an arrangement it is claimed would result in some expensive fuel oil now burned at the BP Chemicals' power station being replaced by marginal coal. I do not know how Nigel Lawson views this argument nor how the intended operation of Dinorwic power station bears on it. The technical aspects in any event are not the heart of the matter: what is critical is that BP Chemicals regard energy costs as one of the two keys to the viability of their South Wales plants (the other is volume of production - and this is determined by market demand). The company are hoping for some relief from our legislation to break the British Gas Corporation monopsony and some assessment of the value of this would need in any event to be made as part of the first study proposed by Patrick Jenkin. But I would, as I say, very much hope that the question of energy costs as a whole and of possible specific measures to reduce them would also be covered.

/ I am copying this to Patrick Jenkin, George Younger, Nigel Lawson and Robin Ibbs.

John

Nigel

Also at back is
letter from SoS Wales
As drafted the
letter wd not be
sent to the Welsh



C.
letter (mainly Scots?)
to issue? I/R feel that
Scots must be
involved.
JKR
also below 4/3

PS/CHANCELLOR OF THE EXCHEQUER

- cc Financial Secretary
- Economic Secretary
- Minister of State (L)
- Sir Douglas Wass
- Mr Ryrie
- Mr Middleton
- Mr Dixon
- Mr Battishill
- Mr Wicks
- Mr Robson

JKR

My recollection is the same:

but given

- ① The fact that all this
was not for below the
surface in my No. 10 talks
with both Sir
Waterhouse's letter
- ② Need to spend (only
many times necessary)
- ③

- Sir Lawrence Airey)
- Mr Dalton)
- Mr Rogers)
- Mr Crawley) I/R
- Mr Stephenson)
- Mr Whitear)
- Mr Johns)
- PS/IR)

PRT AND PETROCHEMICAL FEEDSTOCKS

The Chief Secretary has seen Mr Johns' submission of 3 March, covering a draft letter to Mr Jenkin, and recommending that the study group should include Scottish Office representation. The Chief Secretary thought that it was agreed at the Chancellor's meeting on this subject that there was not going to be a Scottish Office representative?

attached below

See my comment I agree.

JKR
4/3

had it not be better (clearly quid pro quo in long run) (that's what)
to include the 2 regional Secs. @ this stage
O, should we not ask ourselves, why is not
outlined?

18

T F MATHEWS
4 March 1982

fp

Perhaps better to win at, at "decision",
in this form than in letter @ G at the time
how. Does CSO agree?

CONFIDENTIAL



FROM : P A MICHAEL

DATE : 5 MARCH 1982

PS/CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir Douglas Wass
Mr Ryrie
Mr Middleton
Mr Dixon
Mr Battishill
Mr Wicks
Mr Robson
PS/IR

PRT AND PETROCHEMICAL FEEDSTOCKS

The Minister of State (Lords) has seen Mr Mathews' minute to you of 4 March recording the Chief Secretary's recollection that it was agreed at the Chancellor's meeting that there was not going to be a Scottish Office representative on the study group.

The Minister has asked me to say that his own clear recollection is the same as that of the Chief Secretary.

PHM
P A MICHAEL
Private Secretary

CONFIDENTIAL



EXCHE	
REC.	8 MAR 1982
ACTION	Mr. Johns ^{19/3} IR
COPIES	CSJ FSJ EST MST L Sir A Warr

Pup

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Mr Pyne
Mr Middleton
Mr Bathurst
Mr Wick
Mr Robson
PS/IR

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Whitehall
LONDON SW1

8 March 1982

Dear Geoffrey,

PROBLEMS OF THE PETRO CHEMICAL SECTOR: ICI AND BP CHEMICALS

Patrick Jenkin has copied to me his letter of 23 February about the problems facing the UK petro chemical industry and in particular ICI and BP Chemicals.

I share Patrick's concern. Whilst the industry has possibly to some extent brought the problems on itself through, for example, and over-estimation of market growth there is no doubt that a major contraction by either BP or ICI would be a serious blow and one which would be difficult to explain away against the background of North Sea oil and gas; an area which, albeit for sound market reasons, looks increasingly unlikely to provide anything like the new developments which have long been prophesised.

Solutions are certainly not immediately apparent. The views of individual companies tend to vary according to their own requirements and market position. Tax adjustments too are not without their problems in terms of where one draws the line on feed stock, how it is to be confined to UK based operations etc. Nevertheless, I think a study or studies such as those proposed could provide a very useful overview of the industry and the help needed and I would certainly wish my officials to be associated with it.

I am copying this letter to Patrick Jenkin, Nigel Lawson, Nicholas Edwards and Robin Ibbs.

Yours sincerely,

Cuniffe



FROM: T F MATHEWS
DATE; 9 March 1982

MISS RUTTER

C.
letter still outstanding.
Do you wish to accept this
compromise including Scots
but excluding Welsh. IR's

- cc PS/FST preferred option.
- PS/EST N Wicks view is
- PS/MST (L) that we do,
- Sir D Wass regrettably,
- Mr Ryrie probably have to
- Mr Middleton have the Scots
- Mr Dixon Grangemonth,
- Mr Battishill
- Mr Wicks but that the
- Mr Robson Welsh Secretary is
- PS/IR fears are much more
- general + there is
- no case for including
- him.

JKR 10/13

PRT AND PETROCHEMICAL FEEDSTOCKS

The Chief Secretary has seen your minute of 8 March recording the Chancellor's feeling that it would be better to include the Scots in the working group. While the Chief Secretary would prefer to leave them out, he can see the case for taking the Scots aboard and will go along with it so long as we do not hesitate to register disagreement with them whenever necessary. But he thinks that the Welsh Office's involvement is more difficult to justify, and he has noted that the Welsh Secretary's letter of 4 March opens up much wider questions about energy policy and pricing generally.

2. In short, the Chief Secretary is prepared to go along with the inclusion of the Scots, but he does not think it desirable or necessary to include the Welsh as well.

*But the Welsh view
is very similar -
I am bound to give
(equally probably do a
substantive case?)
Wa (S) minute?
Is the any way of doing things
the way on "archive"?*

TM

T F MATHEWS

FROM: T F MATHEWS
DATE: 11 March 1982



→ MISS RUTTER

C.

N. Wicks suggested that we could make the invitation to the CPRS firmer on grounds of bolstering the sound.

JKR
12/3

PRT AND PETRO-CHEMICAL FEEDSTOCKS

The Chief Secretary has seen your minute of 11 March. He does not wish to stand out for the exclusion of the Welsh, so he is prepared to let them in too.

2. The Chief Secretary cannot think of a ready answer to the Chancellor's question about strengthening the non-regional forces on the Working Group. The Group will of course have a Treasury Chairman, and there will also be a Treasury representative who can be briefed to resist unreasonable demands, and to reserve the Treasury position if necessary.

TM

T F MATHEWS
11 March 1982

Pps with you

H. money

15/3



CABINET OFFICE

Central Policy Review Staff

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 05858

From: J. R. Ibbs

CONFIDENTIAL

ppp

CH/EXCHEQUER	
REC.	15 MAR 1982
ACTION	Mr Johns IR ⁽¹⁷⁾ / ₃
COPES TO	CST
	FST
	EST
	MST L

Sir D Warr

Mr Payne

12 March 1982

Mr Middleton

Mr Baffinbill

Mr Wickle

Mr Robson

PS/IR

Dear Secretary of State,

Problems of the Petrochemical Sector

Your letter of 23 February to the Chancellor set out the serious problems facing the petrochemical sector particularly as seen by ICI and BP Chemicals. Given the importance of this sector for our manufacturing base, I agree there is a need for a study of policy alternatives on feedstock costs.

You express the hope that the CPRS could undertake this study. As you know, our resources are fully stretched at the moment and I regret we could not take the lead with the deadline for completion in May. We would, however, be glad to contribute to the work.

I am sending a copy of this letter to the Chancellor, the Secretaries of State for Energy, Scotland and Wales, and to Sir Robert Armstrong.

Yours sincerely,

J R Ibbs

The Rt Hon Patrick Jenkin MP
Department of Industry
ASHDOWN HOUSE
S W 1

CONFIDENTIAL



SECRETARY OF STATE FOR ENERGY
 THAMES HOUSE SOUTH
 MILLBANK LONDON SW1P 4QJ
 01-211 6402

purp.
 C.
 Crossed with your
 letter.
 JKR
 16/3

Rt Hon Sir Geoffrey Howe QC MP
 Chancellor of the Exchequer
 Treasury Chambers
 Parliament Street
 London SW1

EXCHEQUER	
16 MAR 1982	
ACTION	Mr Johns IR 16/3
CRIS TO	CST
	FST
	EST
	MST L

16 March 1982

Mr Wickes
 Mr Robinson
 PS/IR

PROBLEMS OF THE PETROCHEMICAL SECTOR: ICI AND BP CHEMICALS

Sir D Wass

Mr Pyrie

I have seen Patrick Jenkin's letter to you of 23rd February and the subsequent correspondence from George Younger and Nicholas Edwards.

Mr Middleton

Mr Balfourhill

Paragraph 10 of Patrick's letter assumes that the "Mossmorran amendment" would confer a competitive advantage on those to whom it could be applied. But, as was made clear in the announcement of the Government's intention to legislate, it would merely put long-term inter-affiliate deals in ethane for petrochemical use on to a similar basis, so far as possible, to comparable arm's-length deals.

The extension proposed by Patrick would cover mixed NGL streams such as that supplied to the Mossmorran fractionator. There is a substantial risk that it would thereby bring LPGs and even condensate within the scope of the Mossmorran amendment. That would cause me concern since the price of those forms of petroleum is normally determined by periodic renegotiation rather than according to a long-term formula.

I note that in logic the "Mossmorran amendment" should be applied to methane and to gases used as fuel as much as to those used as feed-stock. However, I agree that more study of the implications would be needed before making that logical extension. Until it is completed, it would, I think, be dangerous to extend the proposed amendment beyond the restricted application announced in the autumn.

I should like my officials to be associated with any such study. If a wider study such as Patrick suggests in paragraph 8(a) of his letter is put in hand, I would also wish them to be associated with



that study. But I am bound to say that I would not readily welcome fiscal distortion of the kind Patrick is suggesting.

On the energy side, I doubt whether there is much mileage in BP Chemicals' suggestion about switching their station into and out of the grid. As Nicholas Edwards says, this is a technical matter and one which BP should take up with the CEGB. It would in any case be better to exclude electricity from Patrick's proposed study since it will be the subject of another study you yourself proposed on prices to industry generally.

I am sending copies of this letter to Patrick Jenkin, George Younger, Nicholas Edwards and Robin Ibbs.

*Yours ever
Nigel*

NIGEL LAWSON



EXCHEQUER

DATE	24 MAR 1982
ACTION	Mr Johns IR 24/3
COPIES TO	CST
	FST

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

Sir D Wall
Mr Payne
Mr Middleton
Mr Bathkhill
Mr Dixon
Mr Wick
Mr Robson

23 March 1982

Dear Geoffrey, Sir

PROBLEMS OF THE PETROCHEMICAL SECTOR

Thank you for copying to me your letter of 16 March to Patrick Jenkin.

I note that you are proposing a comprehensive study into the problem of the petrochemical industry and possible solutions; that pending the outcome of the study you propose to confine the "Mossmorran amendment" to ethane; and that, for the time being, you suggest that BP and ICI should simply be informed that we are giving further thought to the problems of the industry and hope to provide a response by early summer.

I am in agreement with the line you propose and my officials will be contacting Mr Dixon to confirm the Scottish Office interest in participating in the proposed Working Group.

I am copying this letter to the recipients of yours.

Yours ever,
Cromie.

C. puf



Secretary of State for Industry

EXCHEQUER	
23 MAR 1982	
TO	Mr Johns IR 24/3
	CST
	FST
	EST
	MST L
	Mr D Wass

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

23 March 1982

Private Secretary to the
Chancellor of the Exchequer
Treasury
London SW1

Mr. Pyne
Mr. Middleton
Mr. Battisill
Mr. Dixon
Mr. Wick

Mr. Robson
P3/112

Dear Private Secretary,

PROBLEMS OF THE PETROCHEMICAL SECTOR

My Secretary of State has asked me to thank you for the Chancellor's letter of 16 March which he saw before departing for the United States.

2 He welcomes the Chancellor having agreed to his proposal for a study of this sector and, in view of the current pressures on the CPRS, is content for the study to be carried out by an inter-departmental group of officials under Treasury leadership. DOI officials will be contacting Mr Dixon direct about arrangements.

3 My Secretary of State is also in agreement with the proposed terms of reference subject to the following general comments. He agrees strongly that the study should be completed in time to allow for any decisions taken as a result of it to be incorporated in the Finance Bill. This points inevitably to limiting its scope as far as possible. Nevertheless, it will in his view be necessary to ensure that it does not concentrate exclusively on ethane. All relevant factors will need to be taken into account including, for example, the feed-stock opportunities offered by other North Sea materials - such as mixed streams, LPGs, and naphtha derived from North Sea crude. Moreover, given the integrated nature of the industry, particularly at ICI's site on Teeside, the study will be bound to look not only at the position of the ethylene derivatives but also to take account of the aromatics side. He accepts that the "Mossmorran Amendment" should be restricted to its present formulation pending the outcome of the study.

4 Finally, he agrees that there should be no general announcement that this study is taking place - although it may be difficult to avoid it becoming knowledge particularly if we are faced with questions in the House. However, as the Chancellor



2.

recognises, ICI and BP do clearly need to be told that further work is in hand both because of the representations they have made to Ministers, but also because of the possibility that officials may need further information from them in the course of the study.

5 I am copying this letter to the Private Secretaries of the Secretaries of State for Energy, Scotland and Wales, and to Mr Ibbs.

Yours sincerely,
Caroline Varley

CAROLINE VARLEY
Private Secretary

C
Useful analysis - but if the end we have to wait & see
what's right? Did you see page 7 of speech on 6/8? Study
a right decision!

I did!

MJ

243

FROM: N L Wicks
DATE: 24 March 1982

CHANCELLOR OF THE EXCHEQUER cc

Chief Secretary
Financial Secretary
Economic Secretary
MST(L)

*Thank you. My feel is
that a long-term
of the oil market will
show a low oil
differential - + the N. Sea, 'high
cost, is likely to be
unworkable*

Sir D Wass Mr Burgner
Mr Ryrie Mr Battishill
Mr Middleton Mr Barber
Mr Byatt Mr Ridley

"THE ENERGY INDUSTRIES IN SCOTLAND"

You asked for a short assessment of this speech by Mr Raisman,
Chairman of Shell UK.

2. Mr Raisman's theme is that North Sea development stands at a
crossroads. We would agree. On oil, the first initial development
stage is over, some fields are already running down, and the pace
of development needs to pick up if oil production in the late 80s
and in the 90s is to be sustained. The particular issue on oil is
whether the next two or three years will see an increase in develop-
ment despite weak oil prices and, the companies would argue, the
tax regime. On gas, development has been in the doldrums after the
expansion of the late 60s and early 70s. The particular issue here
is whether the Oil and Gas (Enterprise) Bill and the abolition of
the monopoly will unlock further development. Mr Raisman argues
that permission to export gas will be an important incentive here.

3. Underlying Mr Raisman's analysis is the unargued assumption
that there should now be a steady expansion of North Sea
developments throughout the rest of the decade. It is easy to see
why this should be in the interest of the oil companies and their
equipment suppliers. And it is certainly one of the Government's
planning objectives.

4. Mr Raisman eschews both threats of non co-operation by the oil
industry and prognostication, but makes a plea for the industry to
be relieved of "avoidable uncertainty". His analysis suggests
that the oil companies face three uncertainties. The first is the
world oil price, which is beyond both Shell and HMG's control. The
second is depletion policy. He implies here that production cuts

on existing fields would impede development of future fields since the reduction of revenues from existing fields would impede development of new ones. Mr Raisman believes it unlikely that this Government will impose production cuts. Third, is North Sea tax. Mr Raisman made his speech before the Budget and so far as I know, Shell have not published any reaction to it.

5. Not surprisingly, Mr Raisman equates "the national interest" in the North Sea with interests of the oil companies and their equipment suppliers. What is good for Shell is good for the UK. Certainly the companies know more about their own particular parts of the North Sea than Whitehall does and theirs is the equity risk. But against that, we can be certain that Shell and BP do not run their operations to optimise benefits to the UK. Their criterion for decision making will, quite rightly, be corporate self-interest. There is little recognition in Mr Raisman's analysis that the Government has a legitimate interest in a business where both oil production and price is dominated by other governments' decisions, downstream operations are dominated by a handful of multi-national companies and the UK's North Sea oil is a once and for all resource.

6. Mr Raisman's analysis prompts two obvious questions for Government. First, in the light of the latest expectations on oil price, will the present combination of Government depletion and tax policies secure the desired increase in the level of development? Hitherto our assessment has been that the policies will meet this objective and nothing that the oil companies have said since the Budget alters that view. Second, what would be the consequences if the Government miscalculated the companies' reactions to the tax regime and the new development failed to occur? We argued in the December review of the North Sea fiscal regime that the Department of Energy's preference to delay some developments during the 1980s provided some safety net against the worst effects of any misjudgement as to the industry's taxable capacity or its approach to future developments in the North Sea. We will be reviewing this conclusion in the report on "possible fallback positions" which you have asked for by the end of next month.

7. A straw in the wind about future development may be provided by the reaction of the boards of BNOC, Shell and Esso when they consider in the next month or so the detailed development proposals for the Clyde oilfield. BNOC has every incentive to agree since it will be their only new development. Shell and Esso's views are much more uncertain. It is possible that Shell and Esso may refuse to put up the cash for the development, either because they genuinely doubt its business prospects or as a way of putting pressure on the Government on tax.

N.L.W.

N L WICKS

Week end by
PWP

FROM: N L Wicks
DATE: 25 March 1982

→ CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
MST(L)
Sir D Wass Mr Burgner
Mr Ryrie Mr Battishill
Mr Middleton Mr Barber
Mr Byatt Mr Ridley

THE VIEWS OF MR RAISMAN OF SHELL ON THE NORTH SEA TAX

I spoke too soon when I said in my minute of 24 March on Mr Raisman's article on "The Energy Industries in Scotland" that Shell had not published any reaction to the North Sea tax proposals in the Budget. At yesterday's press conference on Shell's profits, Mr Raisman attacked the Budget proposals. I attach the relevant extract from the Financial Times.

I saw
We shall
need to
address all this,
in the round,
fairly soon

N.L.W.
N L WICKS

Shell UK attacks N. Sea oil tax

BY RAY DAFTER, ENERGY EDITOR

SHELL UK, whose net profits fell 58 per cent to £158m last year, yesterday warned that the Government's North Sea oil taxation policies were ruining Britain's chances of remaining self-sufficient in oil into the 1990s.

Mr John Raisman, chairman and chief executive, said the company's tax bill — up from £95m in 1980 to £502m last year — was one of the main reasons for the drop in profits. The company had also been hit by the economic recession, a further decline in oil demand, the fall in the value of the pound against the dollar and losses in its chemicals operations.

The results were "disappointing," he said.

Shell UK, one of the market leaders in the UK oil products sector had a turnover of £5.2bn last year compared with £4.2bn in 1980, when its net profit was £373m. Its pre-tax operating profit rose from £614m in 1980 to £887m.

When the results were recalculated on a current cost accounting basis, however, Shell UK was seen to have made a loss of £65m last year as against a profit of £166m in 1980.

Mr Raisman regretted recent Budget measures had not eased the North Sea tax burden. The introduction of a new Advanced Petroleum Revenue Tax penalised the early cash flow from new fields and inhibited the exploitation of further offshore reservoirs, he said.

He urged the Government to reconsider the taxation system, warning that UK oil self-sufficiency — achieved for the first time last year — might not be sustained into the next decade. There were enough oil reserves to stay self-sufficient into the next century, given the right investment climate.

Shell and its offshore partner Esso expect to produce more than 500,000 barrels of oil a day from the North Sea this year, about a quarter of the total output. Mr Raisman

warned that taxes might force Shell to defer one or more development projects.

Projects under review included the Tern field and three or four medium-sized discoveries — each of 100m to 150m barrels of recoverable reserves — in the central and northern parts of the North Sea.

Shell was using all its North Sea oil in its refining operations, which ended last year marginally profitable on an historic cost analysis. On a current cost accounting basis the downstream oil refining and marketing business made a £40m loss, he said.

Shell is leading an industry movement to raise petrol prices in urban areas by 5p a gallon to about 160p although according to Mr Raisman it is uncertain whether Shell can make the new prices stick in the depressed market.

Mr Desmond Watkins, managing director of Shell UK Oil — the marketing and refining arm

Continued on Back Page

Cycle not maintained

CONTENTS

Continued from Page 1

Shell

of the group — said current cost losses would have been much more severe last year but for strenuous cost-cutting exercises. In recent years staff had been reduced from 12,000 to 9,000.

Shell's chemicals business made an operating loss — on an historic basis — of about £45m last year compared with a deficit of £66m in 1980. Mr Keith Walley, managing director of Shell Chemicals, said that 1981 had been a "damned difficult year." The poor results of the base chemicals and plastics businesses had swamped the other operations — such as agricultural and speciality chemicals — which had fared better.

Shell UK attacks N. Sea oil tax

BY THE EDITOR, LONDON

Handwritten note:
The article is a...
summary of the...
debate on the...
oil tax.

Shell UK has launched a vigorous campaign against the proposed new oil tax in the North Sea. The company's chief executive, Sir John Blyth, has written a letter to the Chancellor of the Exchequer, Mr. James Callaghan, expressing his strong opposition to the measure.

Mr. Blyth's letter states that the proposed tax would be a "retrogressive" one, which would mean that the rich would pay a higher rate of tax than the poor. He also claims that the tax would be a "burden" on the industry, which would lead to a loss of jobs and a decline in production.

Shell UK has also launched a public relations campaign, in which it has been attacking the tax in the press and on television. The company has been accused of "misleading" the public and of "obscuring" the facts.

The proposed tax is a 10% levy on the value of oil produced in the North Sea. It is expected to raise £1.5 billion for the Treasury each year. The Government has defended the tax as a necessary measure to reduce the budget deficit.

However, the oil industry and other groups have argued that the tax would be a "disaster" for the industry. They claim that it would lead to a loss of 100,000 jobs and a decline in production of 10%.

The Government has said that it is prepared to consider any reasonable proposals for reducing the tax. However, it has also said that it is not prepared to "give in" to the industry's demands.

The debate on the oil tax is expected to continue for some time. It is one of the most controversial issues of the day.

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Continuation Page 1 Shell

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The debate on the oil tax is expected to continue for some time. It is one of the most controversial issues of the day.

UK Offshore Operators Association Limited

192 Sloane Street
London SW1X 9QX
(Registered Office)

C/PEM (or) will, I think, be advising you to have UKOOA in for a chat MST(R) will be briefed to mention this in the course of the debate in the COW, if you agree (see (b) below)

Jul 23/4
Telephone: 01-235 0292

22 April 1982

The Rt Hon Sir Geoffrey Howe QC MP
The Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

EXCHEQUER
23 APR 1982
Pst/In
MST(R)
Mr MOORE
Mr FRANK
Mr LIGGS

Dear

Chancellor,

The UK Continental Shelf Tax Regime

In the proposals we sent to you last October, we expressed the industry's concern about the severe deterioration in the attractiveness of North Sea developments caused by the 1981 Finance Act. Existing fields showed a significant overall reduction in their profitability and new projects were seriously impaired. The proposals we put forward then, with unanimous industry support, were designed to retain a reasonable return for industry and aid new developments, including small fields. At the same time they recognised the immediate concern to maintain the overall tax yield at a level significantly higher than that produced by the pre-1981 regime.

Having completed a thorough study of your 1982 Budget proposals, we wish to advise you of our assessment of their effects on UKCS activities. We consider it important that we do this now, particularly in view of recent Government statements to the effect that the continuing level of exploration activity on the UKCS is an indication that future offshore activity will not be adversely affected by the current tax regime.

As we have stated in the past, that is a mistaken view. The vital criterion is not the level of exploration activity - itself still too low - but the start of actual development projects; the present lack of these is only too evident. In our view both the present high rate of tax and the lack of incentives for development of small fields are important contributory factors to this state of affairs.

We are particularly disappointed that the greater part of UKOOA's submission of last October has been ignored. That submission had been very carefully prepared and set forth realistic proposals.

We wish therefore, to urge you to consider again the following points:

1. The current tax regime fails to recognise that future offshore activities will be characterised by the development of small fields

While one or more large fields may be found, the industry's expectation is that future activities offshore of the UK will be dependent upon the development of small fields and, with the new techniques evolving, on the development of expensive and deep-water fields. The current tax regime fails to recognise this fact and there is

widespread concern within the industry that offshore UK hydrocarbon resources will not as a consequence be developed. It is clear and very regrettable that the UKCS has become much less attractive relative to other offshore areas of the world as a result of adverse changes in the tax regime, culminating in the last two Budgets.

2. The level of taxation is excessive

- (i) The average tax burden of about 85%, and the marginal tax rate still of about 90% are excessive, and impose too heavy a burden on a high-risk industry.
- (ii) The cash flows of the existing producing fields have been substantially reduced, particularly by the 1981 Budget, when there is an urgent need for funds to conclude committed projects as well as, we would hope, for re-investment in the UKCS.
- (iii) The oil industry welcomes the abolition of SPD, as requested. It is nevertheless very disappointed in the overall 1982 Budget proposals, which failed to reduce the penal tax burden imposed on the oil industry by the drastic changes in the 1981 Budget. Indeed, the 1982 Budget proposes to increase PRT yet again and permanently to advance payment of PRT, thereby worsening the industry's cash flow position and the economics of small fields.

3. The current level of exploration activity is still too low

The foregoing contribute to the current level of exploration drilling activity, which although showing improvement in 1981, is still very much lower than in the mid-70s. It is still far too low bearing in mind what could be extensive opportunities provided by the total UKCS area, only approximately 12% of which is currently licensed for drilling. We are discovering far fewer reserves than we are consuming; new reserves being found are only between one-third and a half of current annual consumption.

4. The excessive level of taxation has already reduced, and will increasingly reduce, UKCS development activities

- (i) Unless the tax regime is very much improved, UKCS activities will decrease further. This will entail the erosion of UK expertise and technology. Work for supporting companies in the construction and manufacturing industries is already decreasing with an adverse effect on UK employment. As an example, there are no platform orders forecast at all for the Northern North Sea for 1982. The platform contractors, the module fabricators and British shipyards have already expressed their concern at the situation.
- (ii) The run down of British offshore services and manufacturing capacity and development expertise, now at a highly sophisticated level, is particularly regrettable as it will be extremely difficult to reverse the trend.

5. The offshore taxation regime provides no incentives for the development of small future fields

- (i) It is important to stress that the average size of the first 26 fields currently producing or under development is over 400m barrels. The next 11 potentially commercial fields identified by UKOOA at the beginning of 1981 average around 100m barrels. The average size of another 37 fields referred to in the Review of Marginal Fields of January 1981 undertaken jointly by Government and UKOOA is only around 60m barrels. We have not as yet been able to take into account discoveries made in 1981.

- (ii) Before the 1981 Budget all the 11 potentially commercial fields mentioned above were considered commercially viable. Now after the 1981 and 1982 Budgets, only two or three of these fields are still certainly so considered, and the remainder are under review and are doubtful starters. This lack of development of reserves is most alarming, particularly bearing in mind that the last development consent issued was for the Hutton field in 1980.
- (iii) The 37 'marginal' fields mentioned above were regarded as being in that category even before the 1981 Budget so that now their development will have become even more doubtful.
- (iv) The failure of the tax regime to provide incentives for both incremental investments and the development of small fields is deplored. It must be reiterated that UK production in the future will have to rely almost exclusively on these smaller fields.

6. Long lead times give urgency to the need for timely tax changes

It is important that the tax regime is corrected as soon as possible in view of:-

- (i) the long lead time from the issue of licences to production from any discoveries, which is now over ten years, and will become longer in the deeper-water frontier areas;
- (ii) the rapid decline in production from the 26 fields producing or now being developed, which will occur well within this ten-year period.

In summary, we would like to stress our two major objections to the present UKCS tax regime:-

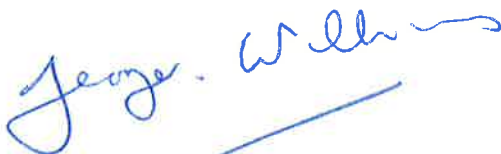
- (i) The total Government take is too high even for the current producing fields, and has reduced cash flow to leave too little for future development.
- (ii) It offers no new incentives for the development of the smaller fields which will be the 'bread and butter' of the UKCS from now on.

We are currently finalising a report setting out specific comments on the 1982 Budget proposals which will be forwarded to Government in the very near future. The report will make specific proposals for amendments in the 1982 Finance Bill, and will also propose that joint Government/industry discussions be resumed to solve the longer-term problems of incentives for future development.

We are available for a meeting with you, and the Secretary of State for Energy, to whom I am sending a copy of this letter, if you consider this would be useful, to discuss the concern we have expressed in this letter.

Finally, with regard to publicity, as you know we made a short Press Release following the Budget. It is now our intention to make a fuller Press Release expressing the views outlined in this letter in the course of next week.

Yours sincerely



G Williams



FROM: M A JOHNS *pps pa.*

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE *mpf*

26 April 1982

1. MR GREEN *9/8/26/4*
2. CHANCELLOR OF THE EXCHEQUER

NORTH SEA FISCAL REGIME: UKOOA LETTER

1. UKOOA have now written to you to express their concern at the Budget proposals on oil taxation. Their principal point (set out in several different ways) is that the burden of tax is too high, particularly on small fields and that as a result development will suffer. There are no new facts or arguments in their letter; an evaluation will be provided in our fall back report which we hope to have with Ministers soon.
2. UKOOA say they are available for a meeting with you and the Secretary of State for Energy if this would be useful. We would think that such a meeting would be desirable as early as it can be fitted in so that Ministers can demonstrate that they are still interested in a dialogue with the industry and to discover the likely lines of the industry's attack. I attach a draft to this effect.
3. UKOOA also promise a more detailed report making specific proposals for amendments to the 1982 Bill. We do not think it is necessary to hold up a meeting with Ministers until this is available; it can probably be better handled by discussions (if any are necessary) at official level.

M.A. Johns
M A JOHNS

cc	Ministers of State (Revenue)	Mr Green
	Mr Middleton	Mr Rogers
	Mr French	Mr Crawley
	Mr Moore	Mr Stephenson
	Mr Wicks	Mr Whitear
	Mr Robson	Mr Johns
		PS/IR

p. type ✓ 22/4

G Williams Esq
UK Offshore Operators Association Limited
192 Sloane Street
LONDON
SW1Z 9QX

THE UK CONTINENTAL SHELF TAX REGIME

Thank you for your letter of 22 April; I have noted your Association's concern about our tax proposals. We did not introduce them without a great deal of thought and study about the likely effect on development, and we are well seized of the likely importance of small fields in the future - fields which should be well protected from tax by the PRT and APRT oil allowances.

I, and the Secretary of State for Energy, would, however, be very happy to see your Association if you would think it helpful to elaborate on the points in your letter. My ^{office} ~~secretary~~ will be in touch to arrange a convenient date.

Appendix A

1000

1000

U.S. DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT
1970
BOSTON, MASS.

GENERAL INSTRUCTIONS FOR THE USER

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UK Offshore Operators Association Limited

192 Sloane Street
London SW1X 9QX
(Registered Office)

Telephone: 01-235 0292

4 May 1982

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

Dear

Chancellor,

The UK Continental Shelf Tax Regime

As promised in my letter to you of 22 April 1982, we are today forwarding to Government, through Mr Peter Middleton of the Treasury, a UKOOA Discussion Paper commenting on the 1982 Budget proposals.

We believe that Government should urgently address the two fundamental taxation problems - namely that Government take is far too high, and that incentives are needed for new investments, in both existing and new fields. As already outlined to you, the maximum hydrocarbon recovery from existing fields and the timely development of new reserves are threatened. The future of the offshore supplies industry and its existence as a major industrial growth area is also at risk.

We recommend **FIRSTLY** that, as a practical measure to relieve the immediate tax burdens on the oil industry, changes should be made in the 1982 Finance Bill in respect of the following:

1. Rate of PRT. There should be no increase in the rate of PRT to 75%.
2. Advance Petroleum Revenue Tax. UKOOA still recommends very strongly that APRT should be phased out as quickly as possible; however, whilst APRT continues in its present form and at its present level, we suggest it is essential that, with immediate effect, APRT should be treated as a normal cost, which would allow it as a deduction for Corporation Tax and in the calculation of PRT pay-back (as with SPD).

In either case, measures should also be introduced, as suggested in UKOOA's 1981 Tax Submission, to ensure that fields of low profitability, which do not incur substantial mainstream PRT, are not burdened with unwarranted APRT for unduly long periods, and that any amounts paid will be reimbursed in a reasonable time.

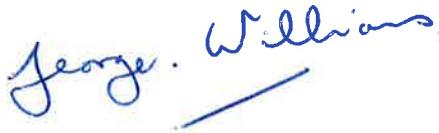
3. Timing of Payments. The "smoothing" of PRT (including APRT) should be on the basis of spreading payments evenly, both in advance of and later than the present due date, ie not entirely an acceleration, as proposed.



We recommend SECONDLY that, as the above will by no means eliminate all the problems of the present tax regime, long term fiscal considerations affecting both existing and future fields should be subject to an intensive examination by a joint Government/UKOOA Study Group, such as that set up in 1979. It is suggested that this Group should be asked to report before the end of 1982, with recommendations for desirable changes to the UKCS fiscal system to be considered for introduction in the 1983 Budget.

I am again sending a copy of this letter to the Secretary of State for Energy.

Yours sincerely

A handwritten signature in blue ink that reads "George Williams". The signature is written in a cursive style and is positioned above a horizontal line.

G Williams

BRINDEX

The Association of British Independent Oil Exploration Companies

CH/EXCHEQUER	
REC.	- 4 MAY 1982
ACTION	PSIR 6/5
COPIES TO	MST R
	Sir D West
	Mr Byrne
	Mr Quinlan

Please reply to:

G. W. Searle,
Chairman, BRINDEX,
c/o London & Scottish Marine Oil PLC,
Bastion House, 140 London Wall,
London EC2Y 5DN
Tel: 01-600 8021

4th May 1982.

The Rt. Hon. ~~Sir~~ Geoffrey Howe, QC., MP.,
The Chancellor of the Exchequer,
Treasury Chambers, ~~Mr~~ Middleton
Parliament Street,
London SW1P 3AG.

Dear Chancellor,

I am writing as Chairman of The Association of British Independent Oil Exploration Companies to express our disappointment that none of the proposals put forward in our submission of September 1981 has, except for the abolition of Supplementary Petroleum Duty (SPD), been brought into the provisions of the 1982 Finance Bill.

Brindex believes that it is becoming clearer day by day that the high level of oil taxation coupled with many adverse factors in its assessment and collection, are having their inevitably discouraging effect on companies in the UK oil sector, on new developments and on employment in the service industries.

The abolition of SPD is welcomed but the form of Advance Petroleum Revenue Tax (APRT) is such that it would become an additional financial burden in cases where fields are not profitable enough to pay full PRT. Appendix B of the Brindex submission of September last, while accepting the need for APRT, suggested a form which would avoid it becoming onerous on new and marginal fields.

The tax problems of marginal fields, satellite accumulations and incremental investments still remain, as also does the need for incentives to maximise recovery and to avoid premature closure of fields.

Many of these are difficult matters and it is important that discussions may continue in order to resolve them. Other matters relating, for example, to APRT can be put forward in the form of proposals for specific amendments to the 1982 Finance Bill.

We have noted and fully support the press release made by UKOOA on 27th April and we are aware that UKOOA are finalising a report setting out specific comments on the 1982 Budget proposals.

continued.....

The Rt. Hon. Sir Geoffrey Howe, QC., MP.

4th May 1982.

The purpose of this letter is to support and reinforce the views of UKOOA set out in their press release and to express the disappointment of the Members of Brindex on the negative reaction to their submission of last September.

Yours sincerely

Geoffrey Searle

G.W. Searle.

From: P E MIDDLETON
4 May 1982

1. Minister of State (R) cc PS/Inland Revenue
2. Chancellor of the Exchequer *Ja* Mr Moore
Mr French
Mr Wicks *J*

NORTH SEA FISCAL REGIME: LETTER FROM UKOOA

1. Miss Rutter's minute of 26 April suggested - in the context of the recent UKOOA letter - that the debate was becoming bogged down. So why not take a fresh view either by arranging a seminar or a 2 man consultancy team to assess the merits to date?
2. Perhaps I could briefly review progress.
3. The objective has been to secure a reasonably stable tax regime so far as structure is concerned. This was the nub of your Budget presentation. We may have to tinker at the edges with the arrangements set out in the Budget. But no-one - neither ourselves nor the industry - wants a further review of the whole structure of taxation. This could only hold up development in the North Sea.
4. The main source of dispute is simply one about whether the oil companies are paying too much tax or not - and whether the level of taxation is having an undesirable effect on development. This is a very difficult issue. The fall in the oil price just before the Budget made field economics worse. But on our view they were still within the margin of sensitivity within which the structure of tax rates had been analysed. However you commissioned us to take a further look, in the interdepartmental group, at possible fall back options. This work should be available very shortly now - it was promised for the middle of the month. It will enable Ministers to decide whether there are measures they wish to take within the tax structure set out at Budget time to relieve the oil companies of tax. Any legislative changes would need to be decided by the end of May.
5. As far as presentation is concerned, Ministers decided that the right tactics were to avoid debate. To that end we have adopted a very low key approach. It was decided to hold the Inland Revenue background note in reserve and to deal with the issue of

North Sea tax in very general terms at Budget time. These tactics have succeeded quite well. The debate in Committee of the Whole House was quiet as the MST(R)'s minute of 27 April shows. And the Minister was able to take the opportunity to start to deploy our case in a little more detail. The UKOOA letter to you, when released to the press, received very little attention. In presentational terms things have gone easier than we might have supposed.

6. There is however a very real problem in deciding what to believe and what not to believe about the issue of substance. This depends in part on the level of development we actually want to see in the North Sea in the next few years and the relationship of that to the more distant future. I doubt whether a seminar or an enquiry would help very much in this assessment - and it would certainly be very time consuming and difficult for anyone not already deeply immersed in the subject. It would also be very difficult not to reopen issues of structure which we believe are closed. It would certainly involve a change in the way in which the presentation has been organised - unless it was a purely internal assessment, in which case its value would be very limited.

7. Neither the Department of Energy, nor Inland Revenue, nor Treasury officials think there would be much to be gained from another enquiry. Instead I would recommend the following:

- a. Ask the Minister of State who has come new to the subject to give you his personal assessment of the merits of the case. In doing this he could take account of:
- b. a substantial piece of work from officials on fall back positions. This will provide an opportunity for both assessing whether the level of tax is excessive and whether any steps should be taken to alleviate it; and
- c. Further discussion with UKOOA. The UKOOA letter was disappointing. It reflects the fact that they can only agree on one thing: general reductions in taxation. Structural changes simply benefit some at the expense of others. However, I have spoken at some length to Mr Williams. UKOOA will be coming up with a number of specific proposals within the structure of tax set out in the Budget. If we now reply to

UKOOA inviting them to see us sometime within the next 10 days or so, Ministers will have a first hand opportunity to assess the strength of their arguments.

d. Separately see BP. This has already been arranged by the FST. The reason for this is that so much of the present tax yield comes from BP that we do not want to put them at any special disadvantage.

8. I think that we have proceeded in any orderly way. Decisions on tax can be taken in time to make changes in the Finance Bill if required. They can also reflect the other aspects of work on oil set out in my minute of 19 March, all of which were intended to be ready by the middle of this month. Two have already been submitted: Mr Wood to the Financial Secretary on Oil Pricing in Weak Market Conditions and Mr Byatt's note of 30 April on Oil Market Prospects to 1985. The tax work is the third and a further note on fiscal and monetary options will complete the picture. When the separate components are all done, I will let you have a short note bringing together the present state of thinking on the North Sea in all its aspects.

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(long with
put in w/e
box)

fp
FA Clark
P E MIDDLETON



FROM: SUE TYRRELL

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

17 May 1982

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P. m. in to
yr letter to
Under Assoc
letter >

PS/CHANCELLOR OF THE EXCHEQUER

NORTH SEA FISCAL REGIME: BRINDEX LETTER OF 4 MAY 1982

1. Following UKOOA's letters of 22 April and 4 May, which you will have seen, Brindex have now also written to the Chancellor expressing their disappointment with the Budget proposals and associating themselves with UKOOA's criticisms.
2. Unlike UKOOA, Brindex have not asked for a meeting and therefore a brief acknowledgement of their letter only is required. I attach a draft reply.

SUE TYRRELL

cc Mr Crawley
Mr Johns
Mr Sudan
PS/IR

G W Searle Esq
Chairman
Brindex
London & Scottish Marine Oil plc
Bastian House
140 London Wall
LONDON EC2Y 5DN

1/15
pl type

Thank you for your letter of 4 May concerning our proposals in this year's Finance Bill for changes to the North Sea tax regime. While I have noted your Associations disappointment, I should stress that these proposals were put forward only after a thorough consideration of their likely effects on both present and future developments.

changes suggested
by IR.

I also note your support for the press release recently issued by UKOOA criticising the Budget proposals. ^{You people} You may like to know that the Secretary of State and I shall be meeting ^{them} ~~you~~ UKOOA in the near future, and I can assure ~~you~~ that we will take careful note of their suggestions.

GEOFFREY HOWE



FROM: M A JOHNS

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE
21 May 1982

- John 21/5/82*
1. MR CRAWLEY
 2. CHANCELLOR OF THE EXCHEQUER

Wed 26
BRIEFING FOR MEETING WITH UKOOA ON ~~TUESDAY~~ 25 MAY

UKOOA's letters of 22 April and 4 May and Discussion Paper of 4 May.

1. UKOOA are coming to discuss two letters they have sent on the North Sea Fiscal Regime. The first, of 22 April was a general criticism concentrating on two points - that the level of tax is too high and that it fails to give sufficient encouragement to the development of small fields. The second, of 4 May backed this up with more detailed analysis, proposed some immediate specific changes in the Budget proposals, and suggested a joint Government/UKOOA review of the fiscal regime with a view to more wide-ranging changes in the 1983 Finance Bill. Our detailed reactions to the points covered by UKOOA's representations are set out in the report of the Steering Group on the North Sea Fiscal Regime (and the Working Party report attached to it) sent to Ministers on 14 May, supplemented by our note (APRT-repayment and cutoff) of 17 May to the Minister of State (R). The Minister of State (R) has minuted you (his note of 17 May) giving his preliminary views. We understand that an internal meeting may be arranged shortly to discuss further. If this is held before you see UKOOA (which seems advisable) this brief is of course subject to any conclusions that may emerge.

cc Chief Secretary
Financial Secretary
Minister of State (Revenue)
Mr Middleton
Mr Moore
Mr Wicks
Mr Robson
Mr Dorken - D/En

Mr Green
Mr Rogers
Mr Crawley
Mr Stephenson
Mr Whitear
Mr Johns
PS/IR

LEVEL OF TAXATION

2. UKOOA make a number of points on level of taxation:

- a. On existing fields Government take will average 85 per cent, post tax rate of return for companies is 13.1 per cent (real) after allowing for exploration costs and the profit investment ratio 0.6, which they regard as a totally inadequate reward for risk taking. We would welcome the chance at official level to discuss the basis of these figures. On our view (based on our post Budget analysis), the average rate of return would be a few percentage points higher than this (18 per cent excluding exploration costs covering a range from breakeven to 30 per cent), but on either basis the returns would generally seem reasonable both to remunerate past investment and attract new investment.
- b. Future fields will in their view be even more unattractive: figures are given for a possible small field of the future and a gas condensate field, both of which actually suffer as a result of the Budget. We are surprised at these conclusions - we accept gas condensate fields can be difficult to develop but would not expect the Budget proposals to worsen their economics; our own figures would suggest a typical small field (like the fields in the UKOOA/Government marginal fields review study) to be much more profitable than UKOOA's model field even on conservative assumptions on future oil prices. We would welcome the opportunity to discuss economic assumptions with UKOOA.
- c. UKOOA say that incremental investments are still uneconomic - UKOOA now accept that rates of return can be high (the position for incremental projects has been improved as a result of the Budget proposals) but argue that since the absolute amount of profit is low they are still unattractive because of the large initial funds and the commitment of skilled manpower.

The first part of the report is devoted to a description of the general situation in the country. It is found that the country is a large one, with a population of about 100 million. The climate is generally warm, and the soil is fertile. The principal occupations are agriculture and stock raising. The principal products are sugar, cotton, and rice. The principal cities are Havana, Santiago, and Pinar del Rio. The principal languages are Spanish and English. The principal religions are Catholicism and Protestantism. The principal forms of government are monarchy and republic. The principal forms of society are feudalism and capitalism. The principal forms of industry are agriculture and stock raising. The principal forms of commerce are trade and industry. The principal forms of art are music and painting. The principal forms of science are mathematics and physics. The principal forms of literature are poetry and prose. The principal forms of education are primary and secondary. The principal forms of health are medicine and surgery. The principal forms of law are civil and criminal. The principal forms of religion are Catholicism and Protestantism. The principal forms of government are monarchy and republic. The principal forms of society are feudalism and capitalism. The principal forms of industry are agriculture and stock raising. The principal forms of commerce are trade and industry. The principal forms of art are music and painting. The principal forms of science are mathematics and physics. The principal forms of literature are poetry and prose. The principal forms of education are primary and secondary. The principal forms of health are medicine and surgery. The principal forms of law are civil and criminal.



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As the initial funds only have to be found for a very brief period (until tax relief is given 6 months later) we find this argument unconvincing; on constraints of skilled manpower, we would need more evidence to show these would seriously inhibit highly profitable investments.

- d. UKOOA point out that while the marginal rate of tax has generally fallen, it has actually risen in some cases. This is true only for fields which pay PRT but not APRT - these are profitable and pretty uncommon (since they earn profits enough to pay PRT on little production). Small less profitable fields will tend to be ones which pay no PRT.

Effect of tax on development

3. UKOOA are likely to point to publicised deferments or cancellations - Shell/Esso's recent decision not to proceed with Tern is a case in point. The announcement made by the companies however made it clear that tax was not the only factor - uncertainty on oil prices and technical problems were also mentioned. More generally the industry have not demonstrated in any particular case that taxation has been the major factor in a decision not to proceed. Department of Energy data indicates that in every known case to date, other factors, such as technical problems, and the state of the oil market had a greater effect on the decision than the tax regime. Discretionary royalty repayments are of course available if the Secretary of State for Energy feels them to be appropriate to the individual case.

Line to take

4. The balance between the companies' need for a fair return on investment and the Government's right to a share in an irreplaceable national resource is a delicate one. It is the Government's view that the Budget proposals achieve the correct balance and that no further reduction in Government take is justified. This was arrived at after very full analysis of existing and likely future fields, including all the (not very numerous) cases where companies came before the Budget to present figures to the Revenue. The new figures presented

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by UKOOA in their letter of 4 May deserve closer study and, are in some respects surprising and it would be sensible, whatever happens about a wider review, for officials to discuss with UKOOA the underlying assumptions. Where companies are aware of individual fields where development is endangered by the burden of the fiscal regime, it is open to them to ask the Department of Energy to consider the possibility of royalty refunds.

UKOOA'S PROPOSALS OF 4 MAY

5. UKOOA make seven specific proposals in their discussion paper and these are discussed in detail in the Steering Group and Working Party Reports submitted to Ministers on 14 May. A summary of the arguments contained there follows.

i. PRT rate to remain at 70 per cent

6. This proposal would reduce the overall burden of taxation in the North Sea without helping the less profitable fields which pay little or no PRT anyway. It is therefore ineffective in improving the profitability of the most deserving fields. It is also very costly - failure to increase PRT to 75 per cent would cost £650m in the money of the day from 1983/84 - 1986/87.

ii. Phasing out APRT

7. Phasing out APRT by 1986 would cost £470m between 1983/84 and 1986/87 (UKOOA originally proposed phase-out by 1985) without significantly improving the field profitability. This would clearly be of some assistance to less profitable fields producing more than the APRT allowance, but on our figures not a great deal of APRT would be paid by small fields if prices were very low. [In the \$25 constant price scenario the fields in the Marginal Fields Review would increase their IRRs by an average of only 1.4 percentage points.] A phase out after the first generation of fields have reached payback in the mid-1980s would involve a commitment to action many years off in circumstances one cannot now predict and it is open to question how much

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FOR
USE

reliance UKOOA would place on a pledge which would not take effect before well into the next Parliament. Finally, though we anticipate that future fields will be small, it is not impossible that a larger profitable field may be discovered, in which case the loss of flexibility which APRT represents would be regretted.

iii. APRT to be allowed as a deduction for Corporation Tax

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FOR USE

8. While APRT continues, UKOOA argue that it should be allowable, as was SPD, as a deduction for Corporation Tax. [The arguments on this proposal are finely balanced and the Steering Group is divided on this issue.] Ministers will not therefore want to dismiss the option but could point out the difficulties. Firstly, the cost is large (some £340m to 1986/87) and while some of the benefit would go to fields of the sort UKOOA are concerned about, not all would and there might be more cost-effective ways of achieving much the same result (ie not for quotation earlier repayment of stranded APRT). Secondly, it is not clear in principle that a payment which is an advance of a later liability should be allowed as a deduction from profits before the eventual liability occurs—an argument which could be relevant in the double tax credit contract.

??

iv. APRT to be included in calculating Payback

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FOR
USE

9. Under the Budget proposals APRT unlike SPD is not included in the computation of payback and this is criticised by UKOOA on the grounds that APRT is a cash flow cost like SPD and should therefore be included. Although the effect on field profitability would be small, the cost too is fairly small (£50m to 1986/87). [The Steering Group Report recommends this as a worthwhile concession should Ministers feel that small-cost concessions are required.] Ministers could say that they understood the case in logic for this concession although there were oddities and potential circularities in including the amount of tax paid in computing the amount of the same tax due. Moreover, while the cost was not large, it did not seem directed at the point where the shoe pinched most - fields reaching payback

already benefit considerably from the change from SPD to APRT.

v. Earlier repayment of stranded APRT

10. UKOOA argue that excess APRT not set off against PRT should be repaid before the end of field life. Repayment of excess APRT after ^{say} five years would have negligible cost and would benefit the less profitable fields most.

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FOR USE

[The Steering Group recommend this concession on its own merits, irrespective of political considerations.]

Ministers could say they are considering this sympathetically, although there are practical problems to be got over.

UKOOA also suggested that liability to further APRT should be cut-off in some circumstances after a period of time. They could be asked to elaborate on this, but Ministers will not wish to give any commitment.

vi. More 'neutral' arrangements for Smoothing

11. The smoothing arrangements are criticised by UKOOA for their effect on cash flows in the short-term - BP particularly are concerned on this point. UKOOA argues for a smoothing arrangement that is neutral in its effect on cash flows in that the spreading of PRT would be achieved without any acceleration to take. This would be very costly - some £410m in 1983/84 and £740m to 1986/87.

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FOR
USE

[BP have proposed a more modest alternative to deal with the problems of transition. This entails spreading the lump sum otherwise due on 1 September 1983 (not 1 March 1983 as originally stated in paragraph 18 of the Steering Group Report) backwards through the second half of 1983/84. This has an interest cost of only £20m and achieves a smoother pattern of receipts. Although this concession is not aimed at helping the small future field, it will alleviate BP's immediate cash flow problems, and in view of this and the modest cost, the concession is recommended by the Steering Group. Ministers will not wish to mention this specific option but could say that they had taken into account the acceleration of payment in setting the

level of tax and would regard UKOOA's proposals as unacceptably costly. They did, however, recognise there would be transitional problems - they had deferred smoothing until mid-1983 for this reason but would be interested to know (without commitment) whether UKOOA would see any merit in additional help for a further short transitional period.

vii. Government/UKOOA Study Group

12. UKOOA propose a joint review of the fiscal regime with a view to legislation in the 1983 Budget. Three areas are mentioned for review; the overall level of take, the problem of satellite fields and incremental investment, and the problems of marginal fields. The first of these would not be a productive area of joint discussion - it is a central Budgetary decision which must rest with Ministers and whatever the level of take, the industry is bound to argue for a reduction. There is scope for limited discussion on incremental investment and the problems of marginal fields. As UKOOA's criticisms of the Budget proposals in respect of marginal fields have focussed on hypothetical rather than specific cases, discussion on this aspect of the regime may prove useful. It would be wrong to imply, however, that such discussion could aim to produce agreed recommendations for legislation in 1983. Ministers could suggest to UKOOA that attempts to produce agreed recommendations across the whole fiscal regime would be unproductive but offer talks specifically on marginal fields and incremental investments to explore the problems (but not attempt agreed recommendations). But first they could invite UKOOA to comment on how far a continuing review would cause further uncertainty, how this fits with the industry's and your own objective of greater stability in the tax regime, and whether it would not be better to settle on a system now, even a disagreed one, rather than continue to seek the chimera of complete agreement and leave everyone wondering what would be changed next.

M. A. Johns
M A JOHNS

FROM: M A JOHNS



THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE
25 May 1982

1. MR CRAWLEY *June 25/6/82*
2. CHANCELLOR OF THE EXCHEQUER

BRIEFING FOR MEETING WITH UKOOA

1. The briefing of 21 May does not need to be modified in the light of yesterday's meeting on the Fallback Options. You asked, however, for additional points on which it might prove useful to seek further clarification from UKOOA. You might wish to use some, or all, of the following questions to probe UKOOA's position.

Deferments

2. How important is the effect of tax on deferment decisions, eg Tern? In the case of that project Shell/Esso also cited technical problems and the state of the oil market as contributory factors in the decision. Are UKOOA saying Tern would have gone ahead under more favourable tax conditions such as those represented by their proposals of 4 May?

What level of investment would follow from implementation of 4 May proposals?

3. Would UKOOA expect all the 11 potentially commercial and the 37 marginal fields referred to to become economic? If not what proportion would be economic or alternatively how costly would it be to make them so?

cc Chief Secretary
Financial Secretary
Minister of State (Revenue)
Mr Middleton
Mr Moore
Mr Wicks
Mr Robson

Mr Green
Mr Rogers
Mr Crawley
Mr Stephenson
Mr Whitear
Mr Johns
PS/IR

Do UKOOA still regard the fields of the Marginal Fields Review as representative of future fields?

4. If so, have they tested their economics under the new regime? If not, why are they no longer representative? One model field is quoted as representative of small future fields - we would appreciate detailed figures on this.

5. UKOOA are unhappy about the position of incremental investment, but the Inland Revenue drew attention to definitional problems with their pre-Budget proposal for special relief for satellite fields. (How do you define a satellite?) Do they have any new ideas to lay on the table?

6. How do UKOOA propose to protect low-profitability fields from the burden of 'stranded' APRT for long periods? ((2 ii c) of their discussion paper).

Do they have any specific ideas to put forward?

7. The question of Royalty refunds was raised in UKOOA's original Pre-Budget proposals, but not in their discussion document of 4 May. Does this represent a change of mind or a lower priority for this item?

8. UKOOA's proposals are costly. Given this, what are their priorities for their various proposals?

9. UKOOA place great importance on the need for a stable North Sea Regime yet want a through overhaul of the system. Which is of greater importance; stability or a constant review?

M. A. Johns

M A JOHNS

From: Mr M D Whitear
25 May 1982



THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

1. MR CRAWLEY *June 25/4/82*
2. CHANCELLOR OF THE EXCHEQUER

MEETING WITH UKOOA ON 26 MAY

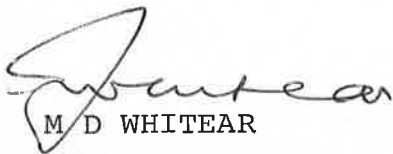
1. We have already provided briefing for this meeting (Mr Johns' note of 21 May), but there is one supplementary point which may arise. Since UKOOA wrote to Mr Middleton on 4 May, a consultative document has been issued on the subject of "PRT: expenditure relief and receipts from oil and gas related assets".
2. The objectives of the proposals set out in the paper were outlined in Mr Wakeham's announcement on 7 May (copy attached)*. UKOOA are unlikely to make an issue of the matter at tomorrow's meeting, and Mr Wakeham's announcement, supplemented by the following points, should provide enough material for you to handle any points which arise.
3. UKOOA may say that the proposals are onerous and provide a further period of uncertainty; or argue that they will disrupt existing arrangements. You may wish to make use of the following:

cc. Chief Secretary
Financial Secretary
Minister of State (Revenue)
Mr Middleton
Mr Moore
Mr Wicks
Mr Robson
Mr Dorken - D/En

Mr Green
Mr Rogers
Mr Crawley
Mr Stephenson
Mr Whitear
Mr Johns
PS/IR

*top copy only

- (a) If the existing rules were to be applied to developments now under consideration (new fields which rely on existing pipelines and terminals; floating production facilities which may be used for developing fields successively), relief allowed to the owner for the initial cost might be restricted and/or allowed over a period; the new proposals provide a more sensible and predictable pattern of relief and should therefore encourage developments of this kind.
- (b) The existing rules may themselves create uncertainty (because, at the time an owner incurs expenditure, he may have little idea what will be allowed in the way of relief, or when it will be allowed). Ministers are, however, conscious of the need to avoid further uncertainty in the period before the legislation is published: hence the firmness of the proposals in the document.
- (c) The industry has known for some time that tax changes in this area were in prospect; the detailed treatment of future receipts under existing agreements is one of the areas on which the document invites representation.
- (d) Ministers want to give industry a proper chance to comment on the complex technical issues in the paper: there would have been no time for this before legislation in the current Bill. The document explains in detail why legislation next year will have to come into effect as from publication: briefly to avoid uncertainty for the industry, and the risk of major forestalling for the Exchequer.


M D WHITEAR

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COMMERCIAL IN CONFIDENCE

From : P V DIXON
Date : 25 May 1982

CHANCELLOR OF THE EXCHEQUER

cc - As list attached.

WORKING GROUP ON PETROCHEMICALS

I now attach the report of the interdepartmental group, of which I have been Chairman, considering the prospects for the petrochemical industry in the UK and whether anything should be done to improve them.

2. The genesis of this was the "Mossmorran amendment" concerning the computation of taxable profits in respect of ethane produced in the North Sea and destined for petrochemical use. BP Chemicals and ICI had argued that this conferred an unfair competitive advantage on Shell/Esso and that this and various other problems should be acted upon in order to prevent a progressive decline of the UK's petrochemical industry.

3. The attached report concentrates on the supply, cost and taxation of feedstocks, in particular those used in the production of ethylene; and includes discussion of BP's and ICI's arguments on these topics. These are at the centre of the representations which have been made. We have not thought it appropriate in the time to consider all the other problems, for instance concerning synthetic alcohols, electricity prices, heavy fuel oil duty etc which raise wider issues not confined to petrochemicals.

4. While the Group's work has been proceeding, BP Chemicals and ICI have reached agreement on restructuring proposals, involving some closures and some exchange of plant. The result, if they are implemented, will be specialisation by BP in polyethylene and by ICI in PVC. The conversion of BP's Grangemouth cracker to use ethane rather than naphtha would be an integral part of this. The proposals fall within the merger control provisions of the Fair Trading Act and the two companies are currently seeking informal guidance from the Office of Fair Trading on whether they are likely to be the subject of a mergers reference.

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COMMERCIAL : IN CONFIDENCE

5. In considering action in response to the representations which have been made, it is necessary to have some view about objectives. We have not been able to find any arguments which could reliably be used to justify any particular size of petrochemical industry as an objective of policy. We have presumed that in this, as in other industries, Ministers would wish the scale and pattern of production to be determined by the working of the market in a "policy-neutral" environment. ✓

6. The chief recommendation of the Group is for an extension of the "Mossmorran amendment". The existing Clause 119 of the Finance Bill provides for North Sea ethane intended for petrochemical use, when transferred between affiliates, to be valued for tax purposes not according to the price which each period's deliveries would fetch if sold in separate contracts (the present law), but on a formula intended to reflect the sort of medium term pricing arrangement which would be agreed in a continuing arm's length deal. Neither the Clause itself, nor its extension, should carry any cost in terms of revenue foregone; but it provides greater certainty as regards raw material costs to those dependent on obtaining feedstock from affiliates. The recommendation is that the Clause be extended beyond ethane for petrochemical use to include mixed streams consisting largely of ethane and methane. This would be justifiable in terms of fiscal equity, and would also encourage BP Chemicals to convert their existing ethylene cracker at Grangemouth, so underpinning the future of that site. The Group also recommends that the provision be extended to cover ethane for non-petrochemical use, and methane when used as either a feedstock or a fuel. It would thus cover the full range of those lighter gaseous materials which, being difficult to transport except by pipeline, are likely to be sold only on a long-term basis. It would thus be tidier and more defensible in terms of taxation policy.

7. There are several measures concerning trade policy which the Group suggest should be pursued in consultation with the European Community as opportunity offers: anti-dumping, countervailing duties, possible changes in the GSP (or freezing of quotas), and further encouragement to the US and Canada to adopt more realistic pricing. These may not amount to much in practice, but further efforts could be worthwhile.

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8. The extension of the "Mossmorran amendment" to mixed streams will cover BP's Forties dry gas and meet their claim that this is essential if the conversion of Grangemouth is to go ahead. The Group do not have any proposals which would directly help ICI. On the other hand, the Group do not believe the extension of Clause 119 to methane and mixed streams should harm ICI. ICI earlier expressed some fear that it would: however, if they are to get full benefit from the restructuring, they need BP to be able to convert Grangemouth to ethane, which in turn depends on the proposed extension. They already have the benefit of a long-term low price contract for methane, and should not suffer competitively if the tax rules are changed to allow integrated companies to get the same certainty. ICI cannot be relied on to drop their public opposition to the whole concept of Clause 119. However, we believe the extension of the clause to all gases where arm's length deals would normally adopt a long-term pricing formula approach, and to fuel use as well as petrochemicals use, should make it easier for Ministers to meet criticisms that it is a specially tailor-made concession for the Mossmorran project. (Although Clause 119, as it stands, is in general terms and is in fact likely to be of some benefit to BP as well as Shell/Esso, it is likely to prove more difficult to counter criticism convincingly from BP and ICI if the clause is not extended).

9. The Department of Industry believe that, with restructuring, the position of both BP Chemicals and ICI would be strengthened. ICI, with heavy dependence on PVC, could, however, remain exposed, and it is the view of the Group that the position as a whole should be looked at again before the end of the year in the light of progress with the restructuring proposals and other developments, notably the forthcoming CPRS report on industrial electricity prices (since electricity is a major component of chlorine, one of the main constituents of PVC), and progress in eliminating spare capacity and restructuring the industry on the Continent. Such a study would also provide an opportunity to look more closely at the fundamental economics of the petrochemicals sector and at the extent to which other sectors are dependent on it; for present purposes, the Group notes that:

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(a) the bulk of the ethane coming ashore in quantities sufficient to be fractionated (separated from other gases) will in practice be going into petrochemical use - this is some answer to those who have argued that the UK may fail to realize the advantages, in relation to petrochemicals, which the North Sea is regarded as giving us;

(b) naphtha will remain the predominant feedstock for ethylene in Western Europe; ICI's Wilton 6 cracker, which will remain, is efficient and versatile and should have a future in competition with other naphtha-based plant.

10. The timing of any action resulting from this report will depend primarily on the progress of the Committee stage of the Finance Bill. Although it would be possible to amend Clause 119 on Report, it would be preferable to do it in Committee. Decisions need to be taken in time to get instructions to Parliamentary Counsel to enable amendments to be put down before the Clause is reached, probably shortly after Whitsun.

11. Finally, it is necessary to stress the sensitivity of the material in this report, especially the BP/ICI restructuring proposals; if news of these were to leak prematurely, it is possible that they would be abandoned; this could leave ICI in particular very exposed. Copies should not be passed on more than necessary.

12. Thus, in drawing the report to the attention of his colleagues, the Chancellor may wish to stress the need for urgent decisions and confidentiality. Subject to Ministers accepting the Group's recommendations, he may also wish to invite the Secretary of State for Industry, who received the representations from ICI and BP Chemicals, to see those companies shortly before the Government's Amendment to the Finance Bill is tabled, to tell them in confidence of the decisions that have since been taken (though it might be wise not to refer to any further review for fear of exciting false expectations).

13. This submission is being copied for information to members of the Working Group. I am grateful to Mr Andren, its Secretary, for much of the work done.

PD

CIRCULATION LIST

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Mr Ryrie
Mr Quinlan
Mr Christie
Mr Lovell
Mr Burgner
Mr Moore
Mr Robson
Mr Wicks
Mr Gordon
Mr Hartley
Mr Andren
Mr Ridley

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*e/2 sets for you to approve
from Crawley a letter to
SoSEn of the PM on the
changes agreed (or not
agreed at the mtg).
From Wicks a draft to
G Williams to be sent to the
SoSEn for approval*

From: J M Crawley
26 May 1982

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

CHANCELLOR OF THE EXCHEQUER *MST(R) approves.*

*JKR
27/5*

NORTH SEA FISCAL REGIME

1. Two points were left open following the meeting with UKOOA this morning and the subsequent discussion with the Secretary of State for Energy.
2. The first was whether or not to concede the immediate CT deduction of APRT. We understand that, in subsequent discussion with the Minister of State (Revenue), the conclusion was that this should probably not be conceded at least at this stage. *
3. The second was whether repayments of APRT after 5 years should be in a lump sum or staged. At present we estimate that repayments involved would be about £100m in 1988 on a lump sum basis, as compared with £30m if staged. The repayments could however be significantly more (perhaps up to £300m. on a lump sum basis) if prices turned out to be well below our central case (and less if prices were higher). The fields involved would however all be relatively unprofitable ones. We understand that the Minister of State favours lump sum repayment.

Chief Secretary
Financial Secretary
Minister of State (Revenue)
Mr Middleton
Mr Moore
Mr Wicks

Sir Lawrence Airey
Mr Green
Mr Rogers
Mr Crawley
Mr Stephenson
Mr Whitear
Mr Johns
PS/IR

4. We attach a draft letter for you to send to Mr Lawson on the basis that you would wish to concede lump sum repayment but not the CT deduction. We also attach on the same basis a draft minute to the Prime Minister. (You said at an earlier meeting that you would wish to let her know your decisions in this area). We suggest that this should be cleared in draft form with Mr Lawson, and the draft letter to Mr Lawson deals with this.

5. It should be noted that we have put in a marker at para 9 of the draft note to the Prime Minister on a possible extension of the clause on ethane valuation (the 'Mossmorran' clause). Mr Dixon's interdepartmental group have just reported to Ministers on this, but no decisions have yet been taken. I do not think it is necessary to hold up the note to No. 10 for this reason.

6. Lastly you may wish to note that the costs of the package given at para 6 of the draft note to the Prime Minister is made up as follows:-

82/3	£35m	(the concession to Sir William Clark's point).
83/4	£20m	(additional PSBR interest cost on 'smoothing' concession).
84/5	-	
85/6	£10m]	(APRT for 'payback').
86/7	<u>£40m]</u>	
	<u>£105m</u>	

= X% or concession: 0.3%

The APRT repayment concession will not cost anything till 1988. Nor can APRT cut off have any cost till then.

J M Crawley
J M CRAWLEY

DRAFT LETTER TO SECRETARY OF STATE FOR ENERGY

NORTH SEA FISCAL REGIME

We discussed the options following our meeting with UKOOA [today/yesterday]. We agreed that the tax concessions recommended by the Steering Group should be made, viz earlier repayment of APRT (after 5 years), allowing APRT for payback, and a transitional easement of 'smoothing' for the second half of 1983. But we agreed that no announcement on royalty refunds should be made pending the further work you have put in hand.

We also agreed to adopt the proposal made in the Revenue note of 17 May, viz a cut off of further field liability to APRT 5 years after first payment of APRT.

Two points were left open. The first was whether to allow APRT as a CT deduction immediately on payment (rather than at set off). We have to balance the presentational advantages of this against its substantial cost (and the slight additional risk on creditability). I did not feel that UKOOA made any strong case to suggest that this concession was a major priority for them. There may also be advantage in keeping at least something up our sleeve. I have concluded that we should not concede the CT deduction at this stage.

?
in case we
come under
pressure
next year,

The other point was whether any APRT repayment after 5 years should be in a lump sum or staged. Staged repayments would avoid the risk of rather lumpy future repayments, particularly in 1988 when repayment would first arise. But on balance I have concluded that we should go for the lump sum repayment which you yourself favoured.

I also mentioned that we had it in mind to concede two years retrospection for the relief given by clause 121 of the Finance Bill (which deals with certain anomalies arising on ring fence corporation tax). This is a point on which UKOITC has

pressed us, and would meet an amendment put down for Committee Stage by Sir William Clark.

We ~~have~~ ^{are} cleared ^{ing} separately my response to UKOOA on the joint review proposed by them and the further discussions which we ourselves are prepared to agree to.

I hope you can agree that this constitutes a reasonable package. I am considering with John Wakeham ^{how} [what steps] we ^{can ensure} [should take to make sure] that ^{the} concessions taken as a whole make a proper impact.

In view of the Prime Minister's earlier interest, I would like to send her a short note setting out what we have agreed. I attach a draft and would be glad to know as soon as possible whether you are content that I should minute her on these lines.

DRAFT NOTE TO PRIME MINISTER

NORTH SEA FISCAL REGIME

1. Since the Budget I have been carrying out a further review, in close consultation with the Secretary of State for Energy, of my proposals for changes in the North Sea Fiscal Regime (on which I minuted you on 26 February, and on which your Private Secretary reported your comments in his letter of 1 March), ~~the main of your earlier letter is that I thought~~

2. The review has taken into account both the uncertain current state of the oil markets, the representations of the industry on the regime generally and my Budget proposals in particular, and your own concern that the regime might be too onerous and inhibit desirable exploration and development. *I thought it right to let you feel you saw conclusions.*

3. ~~The main conclusions are that both Nigel Lawson and I believe that an adequate level of development can be achieved without further substantial tax changes and that any costly general relaxation of the regime would not be justified.~~ Although the oil market has hardened somewhat since the Budget there is of course still considerable uncertainty about the future of oil prices in both the short and long term. But the profitability of both existing fields and likely future fields has again been analysed in the light of our latest information and economic assumptions. The results still look generally attractive and robust to a wide range of oil price scenarios (including a fall as steep and steeper than any that has yet occurred).

is not likely to be sensitive to the kind of

that we could possibly make

what is likely to

4. It is true that there has been recent publicity given to company decisions to defer particular projects (including a formal announcement by Shell/Esso on the Tern field). But the companies admit, or our own evidence suggests, that other

Handwritten section header in the upper middle part of the page.

Paragraph 1: The first paragraph of the main text, containing several lines of faint, mostly illegible handwriting.

Paragraph 2: The second paragraph of the main text, continuing the faint handwriting.

Handwritten note in red ink: "Handwritten note in red ink"

Paragraph 3: The third paragraph of the main text, with a red arrow pointing from the right margin towards the text.

Handwritten note in red ink: "Handwritten note in red ink"

Handwritten note in red ink: "Handwritten note in red ink"

Paragraph 4: The fourth paragraph of the main text, located at the bottom of the page.

factors - such as uncertainty on oil prices or technical problems - have been factors as or more important than ^{tax} ~~tax~~ ^{regimes}. The Department of Energy is actively discussing with the companies concerned a number of projects which are expected to proceed before long. Tax concessions sufficient to produce a marked change in the pace of development would have to be very large indeed. Current depletion policy requires an adequate flow of new development (this is also desirable for the offshore supplies industry), but - given that existing developments already ensure self sufficiency to 1990 - does not point to a much accelerated rate of development.

5. There are however a number of concessions - none of them very costly - which we believe it would be right to make. They are mainly designed to meet ^{the} criticisms of my Budget proposals which I think have some force, in particular the industry's concern as to the effect on marginal, less profitable, fields of the new advance petroleum revenue tax (APRT) - which is to be introduced from the beginning of next year when the Supplementary Petroleum Duty lapses. ~~In addition a 'package'~~ ^{by the industry} of concessions on these lines should be seen ^{as a conciliatory} gesture, ~~to the industry.~~ ¶ The concessions I propose are:-

- (a) APRT to be repaid after 5 years (rather than at end of field life) if it has not by then been set off against ordinary PRT.
- (b) No further liability to APRT for a field once 5 years have elapsed since first APRT payment.
- (c) APRT to be allowed as a deduction in computing "payback" for PRT (so slightly prolonging availability of certain reliefs in some circumstances).

(d) A transitional provision to ease the effects of my proposals for 'smoothing' payments of PRT: this will ease cash flow problems for companies (BP in particular) in second half of 1983.

(e) Accepting an amendment put down by Sir William Clark for Finance Bill Standing Committee to make one of the technical relieving clauses (which cures an anomaly in ring fence corporation tax) retrospective for two years. The industry (including Shell and ICI) has pressed for this.

6. The overall cost of these concessions would be ~~£35m in 1982/83, £20m in 1983/84 and a total of £105m over the period up to 1986/87.~~ Repayments of APRT would not arise before 1988, and the cost (perhaps around £100m in that year) will depend on oil prices between now and then.

7. We have also agreed to continue discussions at a working level with the industry ^{to explore their} on their concerns on incremental investment and marginal fields. ^{This will allow us to have a closer} ~~I see this as an opportunity~~ ^{to make out} to probe further the analytical basis for some of their assertions, but I hope ^{at} to convince them that stability on the basis of the latest structural proposals is preferable to any further review of the tax structure as a whole.

8. I propose ^{to make these} ~~that the~~ changes outlined at para 5 above should be made by way of ^{at} Committee Stage amendment. ~~[We are also considering whether at that stage to extend the scope of the special provisions for the valuation of ethane for petrochemical purposes.]~~ ^{will aim} I shall wish to ensure that the proposed changes are announced as a package so that their overall effect is not lost. Although the individual components may seem relatively small, the whole package should go a long way to meeting some of the industry's main

✓
I did not include
here
VLR
2/5

1. The purpose of this document is to provide information regarding the activities of the [redacted] in the [redacted] area. This information is being provided to you for your information and is not to be disseminated outside of your organization.

2. The [redacted] has been identified as a [redacted] and is currently operating in the [redacted] area. It is believed that the [redacted] is involved in [redacted] activities and is a potential threat to the [redacted] area.

~~3. The [redacted] is currently operating in the [redacted] area and is believed to be involved in [redacted] activities. It is believed that the [redacted] is a potential threat to the [redacted] area.~~

4. It is recommended that you remain vigilant and report any suspicious activities to the appropriate authorities. The [redacted] is a potential threat to the [redacted] area and should be monitored closely.

5. This information is being provided to you for your information and is not to be disseminated outside of your organization. If you have any questions or concerns, please contact the [redacted] at [redacted].

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concerns. It should also be helpful in relation to future development of smaller less profitable fields.

9. In view of your earlier interest I thought you would like to know how I and the Secretary of State for Energy have agreed to proceed.

10. I am copying this to Nigel Lawson.

I spoke to Mr Williams after the meeting. He understood the basis of the proposed discussions - but cannot speak for his colleagues. He would welcome a letter which we have drafted the Press Office

FROM: N L Wicks
DATE: 26 May 1982

1. MR MIDDLETON

EM 26/5

cc Chief Secretary
Financial Secretary
Economic Secretary
MST(R) Mr Ridley
MST(C) Mr Harris
Mr Ryrie
Mr Moore PS/IR
Mr Burgner Mr Crawley } IR
Mr Wood Mr Johns }

2. CHANCELLOR OF THE EXCHEQUER

NORTH SEA TAX

We agreed subsequent to this morning's meeting that it would be desirable for you to send a short letter to UKOOA about the proposed discussions. This would serve to ensure that UKOOA could not claim to have got your agreement to their own proposal for a joint review as it stood, and would also ensure that the discussions themselves could be sensibly contained.

2. I attach a draft prepared in consultation with Messrs Crawley and Johns. It has been cleared in broad terms by the Department of Energy, but they have asked that Mr Lawson should be given the opportunity to comment. I suggest that if you are content, your Private Secretary should send the draft letter attached to Mr Lawson's Private Secretary.

3. Mr Crawley will be putting up a separate note shortly with a draft letter for you to send to the Secretary of State seeking his agreement of a note to be sent to No 10. (You will remember that at last week's discussion you indicated that you would wish to send a note to the Prime Minister on the decisions taken).

N.L.W.

N L WICKS

563/5

DRAFT LETTER FOR THE CHANCELLOR OF THE EXCHEQUER TO SEND TO
George Williams, UKOOA

I am grateful to you and your colleagues for the discussion [~~this morning~~] about your letter and paper of 4 May. I am considering the particular points that you put to me on the Finance Bill proposals, but I now write about your proposal for a joint study group.

2. In your letter you suggested that there should be a joint Government/UKOOA study group to examine all aspects of taxation and royalty with regard to overall Government take, and levels of take on incremental investments and new smaller fields. You envisaged that the group should make recommendations for changes considered desirable in the UKCS fiscal system for introduction in the 1983 Budget.

3. As I explained, I do not think that it would be realistic to undertake such a wide ranging joint review in the expectation of reaching agreed conclusions. Nevertheless, ~~I suggested that~~ it would be helpful to continue detailed discussions between officials and UKOOA - on a similar basis to the discussions which took place last Winter - on specific issues, in particular incremental investment and future fields. The aim of the discussions would be to examine, so far as possible on the basis of detailed information on particular cases, assumptions and analysis relevant to such matters as cost and production profiles, post-tax profitability and cash flow.

4. Perhaps you could be in touch with John Crawley
(438 7739) about the discussions.

Julian Wood
PS/ SoS Energy

DRAFT LETTER FOR PS/CHANCELLOR TO SEND TO
PS/Secretary of State, Energy

UKOOA ~~today's~~ ^{last Wednesday's}

Following ~~this morning's~~ meeting with UKOOA, the Chancellor thinks it would be desirable for him to write a short letter to UKOOA to clarify what was agreed on further discussions. This would ensure that the discussions could be reasonably contained, and would also ensure that UKOOA could not claim that their proposal for a joint study review had been accepted as it stands.

2. The Chancellor would be glad to know if Mr Lawson agrees that he should write as in the attached draft.
3. Please could I have a reply very quickly. The Chancellor would like to write ~~today~~ as soon as possible.

JWR

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PPS/PA



FROM : THE ASSISTANT PRIVATE SECRETARY

DATE : 26 May 1982

PS CHANCELLOR

- cc PS Chief Secretary
- PS Financial Secretary
- PS Economic Secretary
- PS Minister of State (C)
- Sir Douglas Wass
- Mr Ryrie
- Mr Quinlan
- Mr Christie
- Mr Lovell
- Mr Burgner
- Mr D J L Moore
- Mr P V Dixon
- Mr Robson
- Mr Wicks
- Mr Gordon
- Mr Hartley
- Mr Andren
- Mr Ridley
- PS Inland Revenue

WORKING GROUP ON PETROCHEMICALS

The Minister of State (Revenue) has seen the Group's report circulated by Mr Dixon with his minute of 25 May.

The position that would be created by the existing Clause 119 is clearly not defensible since it would impose a separate and different regime for ethane. On that basis the Minister agrees with the recommended extension of the Clause to cover all lighter gaseous materials which, being difficult to transport, are likely only to be sold on a long term basis. This is more logical and, as the paper says, is more defensible in terms of tax policy.

However, ICI are likely to be unhappy with this and press us further. The difficulty is that their proposals are

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objectionable in principle in that they seem to require quite artificial changes in the PRT regime which would be plainly transparent. The Group also advise that ICI's proposals would bring into the tax regime an artificial valuation for feedstocks at the heavier end where a normal commercial market with frequent price renegotiations already exists.

The Minister is by no means against helping ICI, but he feels we must find a better way of doing it. If we come under pressure he suggests we rely on the further study proposed by the Group which could try and come up with an acceptable solution. But he would not propose volunteering this unless absolutely necessary.

Clearly we have considerable interest in the BP Chemicals/ICI restructuring proposals on which the Office of Fair Trading's informal guidance has been sought by the companies. He wonders whether the Secretary of State for Trade's influence in this matter can be engaged?



J C MILNER

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3155 CST ✓ 7 June 3pm Treas

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P
has ind go? No

3700 MST (R) X
880 IST X
342 EST X
4785 Ryrie X
4663 Dixon P.V. ✓
5203 → minute X
5806 Wicks X



FROM: MISS J M SWIFT
DATE: 26 May 1982

PRINCIPAL PRIVATE SECRETARY

4030 ✓ Moore (or Kisson) X 4056
1R { Crawley X
Johns X
Green (if he wishes) 6760
6108 Ridley X

- cc. Financial Secretary
- Economic Secretary
- Minister of State (C)
- Minister of State (R)
- Sir Douglas Wass
- Mr Ryrie
- Mr Quinlan
- Mr Christie
- Mr Dixon
- Mr Lovell
- Mr Burgner
- Mr Moore
- Mr Robson
- Mr Wicks
- Mr Gordon
- Mr Hartley
- Mr Andren
- Mr Ridley
- Mr Harris

WORKING GROUP ON PETROCHEMICALS

The Chief Secretary has seen Mr Dixon's minute of 25 May to the Chancellor and the report of the inter-departmental group on prospects for the Petrochemical Industry in the UK.

2. The Chief Secretary suggests that Ministers should meet to discuss this paper. The Chief Secretary has been approached privately by ICI on restructuring.

MISS J M SWIFT
26 May 1982

CONFIDENTIAL



FROM: C D HARRISON
27 May 1982

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass
Mr Ryrie
Mr Quinlan
Mr Christie
Mr Lovell
Mr Burgner
Mr J L Moore
Mr P V Dixon
Mr Robson
Mr Wicks
Mr Gordon
Mr Hartley
Mr Andren
Mr Ridley
PS/Inland Revenue

WORKING GROUP ON PETROCHEMICALS : MOSSMORRAN CLAUSE

The Economic Secretary has seen the record of the Chancellor's morning meeting on 26 May, which he could not attend because he was visiting the VAT Central Unit at Southend. He has also seen the comments of the Minister of State (Revenue)

on the report by the Working Group on Petrochemicals, recorded in his Assistant Private Secretary's minute of 26 May.

2. The Economic Secretary does not agree with the Chief Secretary about the unimportance of "tax logic". He strongly feels that the Working Group's proposals would render Clause 119 far less indefensible than it would otherwise have been.

CDH

C D HARRISON
Private Secretary

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*Papers passed to
you at 11am today
RUT.*



FROM: T F MATHEWS
DATE: 27 May 1982

PRINCIPAL PRIVATE SECRETARY

cc. PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass
Mr Ryrie
Mr Quinlan
Mr Christie
Mr Lovell
Mr Burgner
Mr D J L Moore
Mr P V Dixon
Mr Robson
Mr Wicks
Mr Gordon
Mr Hartley
Mr Andren
Mr Ridley
PS/Inland Revenue

WORKING GROUP ON PETROCHEMICALS

The Chief Secretary has the following comments on the MST(R)s comments recorded in Jim Milner's minute of 26 May.

2. He does not favour the extension of the Clause to cover all lighter gaseous materials which are likely only to be sold on a long-term basis. He thinks it is better to be less "logical" than to rub the salt in ICI's wounds, as we have no proposals that would actually help them.

3. He does favour engaging the Secretary of State for Trade's influence in the matter of BP and ICI restructuring proposals.

TM

T F MATHEWS
27 May 1982

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